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# U.S. Department of Education's Compliance With Improper Payment Reporting Requirements for Fiscal Year 2014

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## FINAL AUDIT REPORT



**ED-OIG/A03P0003**  
**May 2015**

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Our mission is to promote the efficiency, effectiveness, and integrity of the Department's programs and operations.



U.S. Department of Education  
Office of Inspector General  
Washington, D.C.

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## **NOTICE**

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

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**UNITED STATES DEPARTMENT OF EDUCATION**  
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES

May 15, 2015

**Memorandum**

**TO:** Thomas P. Skelly  
Delegated the Authority to Perform the Functions and Duties  
of the Chief Financial Officer  
Office of Chief Financial Officer  
Lead Action Official

James W. Runcie  
Chief Operating Officer  
Federal Student Aid

**FROM:** Patrick J. Howard /s/  
Assistant Inspector General for Audit

**SUBJECT:** Final Audit Report  
“U.S. Department of Education’s Compliance with Improper Payment Reporting  
Requirements for Fiscal Year 2014”  
Control Number ED-OIG/A03P0003

Attached is the subject final audit report that covers the results of our review of the Department’s compliance with improper payment reporting requirements from October 1, 2013, through September 30, 2014. We conducted our review at Federal Student Aid’s offices in Washington, D.C. An electronic copy has been provided to your audit liaison officers. We received your comments partially concurring with the findings and recommendations.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department’s Audit Accountability and Resolution Tracking System (AARTS). The Department’s policy requires that you develop a final corrective action plan for our review in the automated system within 30 calendar days of the issuance of this report. The corrective action plan should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after 6 months from the date of issuance.

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We appreciate the cooperation given us during this review. If you have any questions, please call Bernard Tadley at (215) 656-6279.

Enclosure

cc: John Hurt, Chief Financial Officer, FSA

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## EXECUTIVE SUMMARY

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The Improper Payments Information Act of 2002 (Public Law 107-300), as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) (Public Law 111-204) and the Improper Payments Elimination and Recovery Improvement Act of 2012 (Public Law 112-248), requires Federal agencies to reduce improper payments and to report annually on their efforts. IPERA requires the Inspector General to review the agency's reporting in its Agency Financial Report (AFR) and accompanying materials, and to determine whether the agency has met six compliance requirements. On October 20, 2014, the Office of Management and Budget (OMB) issued OMB Circular A-123, Appendix C, "Requirements for Effective Estimation and Remediation of Improper Payments," which provides agencies with guidance on implementing these laws and on requirements for the Inspector General's review of the agency's improper payment reporting.

The objectives of our audit were to (1) determine whether the U.S. Department of Education (Department) complied with IPERA; (2) evaluate the accuracy and completeness of the Department's improper payments reporting; (3) evaluate the Department's performance in reducing and recapturing improper payments; and (4) for the Federal Pell Grant (Pell) high-priority program, (a) evaluate the quality of the Department's improper payment estimate and methodology, (b) evaluate the Department's assessment of the level of risk associated with the program, and (c) review the oversight or financial controls described by the Department to identify and prevent improper payments.

We found that the Department did not comply with IPERA because it reported an improper payment rate that did not meet its reduction target for the William D. Ford Federal Direct Loan (Direct Loan) program. The Department established a fiscal year (FY) 2014 reduction target of 1.03 percent for the Direct Loan program and reported that the estimated improper payment rate was 1.50 percent for FY 2014. Because the reported estimated improper payment rate for FY 2014 was higher than the reduction target for FY 2014, the Department failed to meet one of IPERA's six compliance requirements. The Department complied with the other five requirements.

We found that the Department's reported improper payment estimates and estimation methodologies in its FY 2014 AFR and accompanying materials for both the Pell and Direct Loan programs were inaccurate, incomplete and unreliable. Therefore, the Department could not accurately evaluate its performance in reducing improper payments for the Pell and Direct Loan programs. Furthermore, we could not conclude that the Department actually met its reduction target for the Pell program. We did not identify issues with the Federal Family Education Loan program's improper payment estimate. We found that the Department recaptured greater amounts of improper payments in FY 2014 than in FY 2013. For the Pell high-priority program, the Department adequately assessed improper payment risks and described an adequate level of oversight to identify and prevent improper payments.

We found that the Department's improper payment estimates for the Pell and Direct Loan programs were not accurate and deviated from the OMB-approved methodologies in effect at the

time the Department's AFR was issued on November 14, 2014. The Department received initial approval from the Controller of OMB for its FY 2014 estimation methodologies on September 17, 2014, and again on November 6, 2014. On November 14, 2014, the Department issued its AFR and accompanying materials. On March 17, 2015, after the close of our fieldwork and four months after reporting its improper payment estimates in the AFR, the Department submitted to OMB a request to change the approved methodologies. The Controller of OMB retroactively approved the methodology changes on April 3, 2015. The methodologies deviated from the approved methodologies at the time the AFR was issued, in the following ways.

- Under the OMB-approved methodologies in effect at the time the AFR was issued, the improper payment estimates were to be calculated, in part, on a school-count-based ratio estimate. However, the Department actually used a dollar-based ratio estimate for the Pell and Direct Loan programs. We concluded that the Department changed its estimation methodologies after learning that the improper payment estimates using the methodologies in effect at the time the AFR was issued were higher than the previous year's estimates. After the close of our fieldwork, the Department submitted to OMB a request to use a dollar-based ratio estimate; OMB approved this request on April 3, 2015.
- In the OMB-approved methodologies for the Pell and Direct Loan programs, the Department proposed that all final program review reports available from the FY 2013 program review schedule of 311 program reviews would be included in the calculation of the FY 2014 improper payment rates for the Pell and Direct Loan programs. However, at the time the improper payment rates were calculated, about 69 percent of these program reviews had not been started, had not reached at least the draft program review report stage, were not applicable to the Pell or Direct Loan programs, or would not identify improper payments. We raised a similar issue in our prior audit of the Department's compliance with IPERA for FY 2013, where we found that the results of 69 percent of anticipated program reviews were not included in the calculation of the Direct Loan program's improper payment rate for FY 2013.
- The OMB-approved methodologies for the Pell and Direct programs listed three strata, based on the reason a program review is initiated. However, the Department used only two strata in its calculations.

Previously, we found that estimation methodologies based on program reviews were flawed because they excluded other sources of improper payments. While the Department's current methodology is approved by OMB, our concern that improper payment estimates may be understated by using program reviews as the sole source of information to estimate improper payments continues to exist.

In addition, the Department's supporting documentation for its reported improper payment estimates for the Pell and Direct Loan programs contained data transcription errors, data integrity errors, and significant formula errors and omissions. Lastly, the Department's AFR and its "FY 2014 Improper Payment Estimation Methodologies" were incomplete. The Department did not provide statistical sampling details for the Pell program and did not report amounts of improper payments associated with each category of root cause.

To correct the findings identified, we recommend that the Chief Financial Officer (CFO) for the Department, in conjunction with the Chief Operating Officer (COO) for Federal Student Aid (FSA), require the CFO for FSA to:

- Analyze the program review reports that identified improper payments for root causes and evaluate FSA's existing corrective actions to determine whether additional corrective actions can be implemented, intensified, or expanded to reduce or prevent improper payments in any program that fails to meet its reduction target.
- Prepare and submit the required remediation plans to Congress and OMB within 90 days of the issuance of this report.
- Recalculate the FY 2014 improper payment estimates for the Direct Loan and Pell programs in accordance with OMB-approved methodologies and correcting for all the data, calculation, and estimation methodology errors.
- Publish the FY 2014 recalculated improper payment rates, notify OMB and Congress of any changes, and explain the basis for the revisions in the FY 2015 AFR.
- Ensure that the results of an adequate number and percentage of program reviews are used in the calculation of the FY 2015 improper payment estimates.
- Ensure that all improper payments are included in the calculation of the improper payment estimates.
- Maintain adequate documentation of the sampling and estimation approaches used.
- In its annual reporting on improper payments, (1) provide sufficient details as to the samples used in calculating the estimated improper payment rates and (2) include the error amounts when reporting on the root causes of improper payments.
- Revise the estimation methodologies to include improper payments that are not identified in program reviews, such as those improper payments associated with recipients who do not use the IRS Data Retrieval Tool, who provide inaccurate self-reported income on the FAFSA, and who are not selected for income verification.

In response to the draft audit results, in its written comments, the Department concurred with our finding that it failed to comply with IPERA because it did not meet the reduction target for the Direct Loan program and with our finding that it needs to improve the completeness of its improper payment reporting. However, in its written comments, the Department partially concurred with our finding that it needs to improve the accuracy, completeness, and quality of its improper payment estimates and estimation methodologies. The Department concurred with all of the initial recommendations. We added a recommendation to this final report, after receiving the Department's written comments, for it to revise the estimation methodologies to include improper payments that are not identified in program reviews. In discussions with the Department subsequent to its written comments, it did not concur with this recommendation. We summarized the Department's comments at the end of each finding. We included the full text of the Department's written response as Enclosure 2 to this report. In response to the Department's comments, we made minor changes to the report, including specifying the dates that OMB approved changes to the previously approved estimation methodologies and acknowledging that program reviews identify both overpayments and underpayments.



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## BACKGROUND

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

The Improper Payments Elimination and Recovery Act of 2010 (Public Law 111-204) (IPERA) requires each agency, in accordance with guidance prescribed by the Office of Management and Budget (OMB), to periodically review all programs and activities that the agency administers and identify all programs and activities that may be susceptible to significant improper payments. Significant improper payments are defined as gross annual improper payments (the total amount of overpayments plus underpayments) in the program exceeding (1) both 1.5 percent of program outlays and \$10 million of all program or activity payments made during the fiscal year reported or (2) \$100 million (regardless of the improper payment percentage of total program outlays). For each program and activity identified as susceptible to significant improper payments, the agency must produce a statistically valid estimate, or an estimate that is otherwise appropriate using a methodology that OMB approved, of the improper payments made by each program and activity and include those estimates in the accompanying materials to the agency's annual financial reports. The Department identified the Pell and Direct Loan programs as susceptible to significant improper payments. The Department assessed the Federal Family Education Loan (FFEL) program as low risk (not susceptible to significant improper payments) in fiscal year (FY) 2014 and, consistent with OMB guidance, will seek to formally change the risk categorization of the FFEL program and remove the requirement for future annual reporting of improper payment estimates for the FFEL program.

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

- published a Performance and Accountability Report or Agency Financial Report (AFR) for the most recent fiscal year and posted that report and any accompanying materials OMB required on the agency Web site;
- conducted a program-specific risk assessment for each program or activity that conforms with IPERA (if required);
- published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessments (if required);
- published programmatic corrective action plans in the Performance and Accountability Report or AFR (if required);
- published and is meeting annual reduction targets for each program assessed to be at risk and measured for improper payments; and
- reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the Performance and Accountability Report or AFR.

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

The OMB guidance also provides that, as part of the Inspector General's review of the agency's compliance with IPERA, the Inspector General should also evaluate the accuracy and completeness of the agency's reporting and performance in reducing and recapturing improper payments.

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

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

### **Change in the Improper Payment Estimation Methodology for the Pell Program**

In prior fiscal years, the Department's methodology for estimating improper payments in the Pell program was based on the Free Application for Federal Student Aid (FAFSA)/Internal Revenue Service (IRS) Data Statistical Study. The FAFSA/IRS Data Statistical Study used tax return and FAFSA data for a sample of students and parents to calculate an improper payment rate based on recalculated Pell awards where income figures reported on the tax return did not match those reported on the FAFSA. The FAFSA/IRS Data Statistical Study showed that a percentage of recipients received the wrong Pell awards based on an expected family contribution (EFC) derived from incorrect income data on the FAFSA. The FAFSA/IRS Data Statistical Study focused equally on Pell overpayments and underpayments. Previously, the Department found that the inaccuracy of self-reported income on the FAFSA was the most significant root cause of improper payments in the Pell program.

The FY 2014 improper payment estimates for the Pell and Direct Loan programs were based on the results of program reviews of schools performed by Federal Student Aid (FSA). Program reviews primarily identify overpayments that need to be returned to the Department rather than underpayments. Furthermore, unlike the FAFSA/IRS Data Statistical Study, program reviews cannot identify inaccurate self-reported income on the FAFSA as a significant cause of improper

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

payments for applicants who do not use the IRS Data Retrieval Tool and are not selected for income verification.

### **OMB's Approval of the Department's FY 2014 Estimation Methodologies**

The Department received initial approval from the Controller of OMB for its FY 2014 estimation methodologies on September 17, 2014 (September 2014 OMB-approved methodologies). On November 6, 2014, the Department requested and received OMB approval to change the estimation methodologies for the Pell and Direct Loan programs to include draft program review reports, in addition to final program review reports, in its calculations. On November 14, 2014, the Department issued its AFR and accompanying materials. On March 17, 2015, after the close of our fieldwork and four months after reporting its improper payment estimates in the AFR, the Department submitted to OMB a request to change the approved methodologies that included the use of a dollar-based ratio estimate rather than a school-based ratio estimate. The Controller of OMB retroactively approved the methodology changes on April 3, 2015 (April 2015 OMB-approved methodologies).

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## AUDIT RESULTS

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We found that the Department did not comply with IPERA because it reported an improper payment rate for the Direct Loan program that did not meet the FY 2014 reduction target. The Department met the remaining five compliance requirements. Under IPERA, if the Department does not meet one or more of the six compliance requirements, then it is not compliant with IPERA. We found that the Department's improper payment estimates, estimation methodologies, and reporting in its AFR for both the Pell and Direct Loan programs were inaccurate and incomplete. The Department's improper payment estimates for the Pell and Direct Loan programs deviated from the September 2014 OMB-approved methodologies. We did not identify issues with the FFEL program improper payment estimate. We were unable to evaluate the Department's performance in reducing improper payments because of the inaccurate and incomplete improper payment estimates and estimation methodologies. However, the Department recaptured greater amounts of improper payments in FY 2014. For the Pell high-priority program, the Department adequately assessed improper payment risks and described an adequate level of oversight to identify and prevent improper payments.

The Department met five of the six compliance requirements of IPERA, as described in the following.

**1. Published an Agency Financial Report**

The Department complied with the requirement to publish an AFR. Under Section 3(a)(3)(A) of IPERA, an agency is required to publish on its Web site its AFR and any accompanying materials that OMB guidance requires. The Department published its AFR and accompanying materials, "Improper Payments Reporting Details," on November 14, 2014.

**2. Conducted a Risk Assessment**

The Department complied with the requirement to conduct a risk assessment. Under Section 3(a)(3)(B) of IPERA, if required, an agency must conduct a program-specific risk assessment of all programs and activities to determine which ones are susceptible to significant improper payments. IPERA and OMB guidance require that such risk assessments be performed at least once every 3 years. In FY 2014, the Department performed risk assessments for all FSA managed programs and the Department's administrative payments (salary, locality pay, travel, purchase card, and transit benefits). In FY 2013, the Department performed risk assessments for all non-FSA grant programs and contract payments.

**3. Published Improper Payment Estimates**

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

payment rate for Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended (Title I).<sup>2</sup>

**4. Published a Report on Actions to Reduce Improper Payments**

The Department complied with the requirement to report on its actions to reduce improper payments in the Pell, Direct Loan, and FFEL programs. Under Section 3(a)(3)(D) of IPERA, an agency is required to report its actions to reduce improper payments for programs it deemed susceptible to significant improper payments. The Department also reported on its efforts to recapture improper payments from all its programs, including that it worked with grantees and Title IV of the Higher Education Act of 1965, as amended (Title IV)<sup>3</sup> program participants to resolve and recover amounts it identified in its compliance audits of program participants and program reviews. We found that the Department succeeded in recapturing greater amounts of improper payments in FY 2014 than in FY 2013. On October 30, 2014, the Department submitted to OMB its FY 2014 Report on IPERA Payment Recapture Audits.

**5. Reported Improper Payment Rate of Less Than 10 Percent**

The Department complied with the requirement to report improper payment rates of less than 10 percent. Under Section 3(a)(3)(F) of IPERA, an agency is required to report estimated improper payment rates of less than 10 percent for each program identified as being susceptible to significant improper payments for which an improper payment estimate is published. OMB guidance further specifies that these rates should be gross improper payment rates comprising both overpayments and underpayments. The Department reported estimated improper payment rates of 2.16 percent for the Pell program, 1.50 percent for the Direct Loan program, and 0.00 percent for the FFEL program. These estimated improper payment rates were significantly below the 10-percent threshold.

**FINDING NO. 1 – The Department Failed to Comply with IPERA Because it Did Not Meet the Reduction Target for the Direct Loan Program**

The Department did not comply with IPERA because it reported an improper payment rate for the Direct Loan program that did not meet the FY 2014 reduction target. For the other two Department programs susceptible to significant improper payments (Pell and FFEL), the Department reported that it met the FY 2014 reduction target. However, we could not conclude that it met the reduction target for the Pell program because of problems with the Department's methodology and numerous data errors, as detailed in Finding 2.

Under Section 3(a)(3)(E) of IPERA, an agency is required to report, and meet, improper payment reduction targets when a program was identified as susceptible to significant improper payments.

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<sup>2</sup> The Department was not required to report on the Title I program under IPERA, because it was not identified as a program susceptible to significant improper payments. Because the Department did not identify the Title I program as susceptible to significant improper payments, we did not perform additional work related to the accuracy and completeness of the Department's estimation methodology for this program.

<sup>3</sup> Title IV programs include the Pell, Direct Loan, FFEL, and other student financial assistance programs that are administered by FSA.

To meet a reduction target, the improper payment rate for a program in the current year must fall within plus or minus 0.1 percentage points of the reduction target set in the previous year's AFR. In its AFR, the Department reported FY 2014 reduction targets and improper payments as detailed in Table 1.

**Table 1. FY 2014 Reduction Targets and Reported Improper Payment Rates**

Program	FY 2014 Reduction Target	FY 2014 Reported Improper Payment Rate	Reduction Target Reported as Met
Direct Loan Program	1.03%	1.50%	No
Pell Program	2.26%	2.16%	Yes
FFEL Program <sup>1</sup>	0.00%	0.00%	Yes

<sup>1</sup>The Department reported for FY 2014 an improper payment rate of 0.001 percent for the FFEL program.

In its FY 2013 AFR, the Department reported for the Direct Loan program a reduction target of 1.03 percent for FY 2014. However, in its FY 2014 AFR, the Department reported an improper payment rate of 1.50 percent. The Department also reported that the amounts of estimated improper payments for the Direct Loan program increased from \$1.056 billion in FY 2013 to \$1.532 billion in FY 2014. The Department reported that the root causes of the improper payments included documentation and administrative errors and verification errors. These errors include incorrect awards based on EFC,<sup>4</sup> incorrect processing of student data, student account data changes not applied or processed correctly, student ineligibility for a Direct Loan, and incorrectly determining the amount of Title IV funds that a student earned when a student withdraws. Errors associated with Direct Loan consolidations include incorrect processing of a loan verification certificate, the processing of duplicate loan verification certificates, a loan not intended for consolidation being processed, and incorrect information submitted on the loan verification certificate and processed.

Under Section 3(c)(1) of IPERA and OMB Circular A-123, if the Inspector General determines that an agency is not in compliance with IPERA for one fiscal year, the agency must submit a remediation plan to Congress and OMB within 90 days of the Inspector General's determination describing the actions that the agency will take to come into compliance. The remediation plan must also include measureable milestones, designate a senior official accountable for bringing the agency into compliance, and establish an accountability mechanism, such as a performance agreement.

**Recommendations**

We recommend that the Chief Financial Officer (CFO) for the Department, in conjunction with the Chief Operating Officer (COO) for FSA, require the CFO for FSA to—

- 1.1 Analyze the program review reports that identified improper payments for root causes and evaluate FSA's existing corrective actions to determine whether additional corrective actions can be implemented, intensified, or expanded to reduce or prevent improper payments in any program that fails to meet its reduction target.

<sup>4</sup> The EFC errors include (1) lack of supporting EFC documentation, (2) incomplete or inaccurate EFC information, and (3) inaccurate calculation of the EFC amount.

- 1.2 Prepare and submit the required remediation plan to Congress and OMB within 90 days of the issuance of this report.

### **Department Comments**

The Department concurred with the finding and recommendations.

## **FINDING NO. 2 – The Department Needs to Improve the Accuracy, Completeness, and Quality of its Improper Payment Estimates and Estimation Methodologies**

We found that the Department’s improper payment estimates and estimation methodologies in its FY 2014 AFR for both the Pell and Direct Loan programs were inaccurate, incomplete, and unreliable. Therefore, the Department could not accurately evaluate its performance in reducing improper payments for the Pell and Direct Loan programs. Furthermore, we could not conclude that the Department actually met its reduction target for the Pell program. We did not identify issues with the FFEL program’s improper payment estimate.

Under IPERA and OMB Circular A-123, Appendix C, agencies are required to prepare a statistically valid estimate of improper payments or an estimate that is otherwise appropriate using an alternative methodology that OMB approves. For FY 2014, rather than preparing a statistically valid estimate, the Department proposed preparing its improper payment estimates for the Pell, Direct Loan, and FFEL programs using alternative methodologies. The Controller of OMB approved the alternative methodologies on September 17, 2014. Additionally, under OMB Circular A-123, Appendix C, agencies are responsible for maintaining documentation for the alternative sampling and estimation approaches used.

### **Improper Payment Estimate Methodologies for Pell and Direct Loan Programs**

The Department based the improper payment estimates for the Pell and Direct Loan programs, in part, on program reviews that FSA conducted. The improper payment estimate for the Pell program was based on the results of 98 program reviews of schools that FSA Program Compliance—School Eligibility Service Group conducted. The group conducted these program reviews during FY 2013 and based the testing on payments made for the 2011-2012 award year. This methodology differed from the methodology FSA used in prior fiscal years, which was based on the FAFSA/IRS Data Statistical Study. That study used tax return and FAFSA data for a sample of students and parents to calculate an improper payment rate based on recalculated Pell awards where income figures reported on the tax return did not match those reported on the FAFSA.

The improper payment estimate for the Direct Loan program was based on three components. The first component consisted of the results of 96 program reviews of schools that the School Eligibility Service Group conducted. The second component consisted of testing a sample of 120 Direct Loan consolidations (from a universe of 553,663) to determine which were

considered to be improper payments.<sup>5</sup> The third component consisted of testing a sample of 120 Direct Loan refund payments (from a universe of 288,030) to determine which were considered to be improper payments. The samples for the second and third component were drawn from payments made from July 2013 through June 2014. The Department then combined the estimated improper payments for all three components to estimate an overall improper payment rate for the Direct Loan program.

We have raised concerns about the Department using the results of program reviews to estimate improper payments in prior audit reports.<sup>6</sup> Previously, we found that estimation methodologies based on program reviews were flawed because they excluded other sources of improper payments, such as the results of the FAFSA/IRS Data Statistical Study, which focused on inaccurate self-reported income on the FAFSA. The Office of Inspector General (OIG) had recommended that the methodologies consider this source of improper payments. Also, improper payment estimates based on the results of program reviews are susceptible to changes in the composition of schools selected for a program review.<sup>7</sup> For example, from one year to the next; FSA may change the selection of schools for program reviews focusing on compliance areas that may identify improper payments or would not result in improper payments.<sup>8</sup> While the Department's current methodology is approved by OMB, our concern that improper payment estimates may be understated by using program reviews as the sole source of information to estimate improper payments continues to exist. For example, program reviews do not identify improper payments associated with recipients who do not use the IRS Data Retrieval Tool, who provide inaccurate self-reported income on the FAFSA, and who are not selected for income verification.<sup>9</sup>

In prior fiscal years, when the Department based its improper payment estimates solely on the FAFSA/IRS Data Statistical Study, the Department identified the inaccuracy of self-reported income on the FAFSA as the most significant root cause of Pell program improper payments. In the FY 2014 AFR, the Department did not specify the most significant root cause of Pell program improper payments. However, in the Department's FY 2014 analysis of the causes of Pell program improper payments, the two leading causes for improper payments were identified as schools failing to complete verification of information reported on a student's FAFSA (about 35 percent of improper payments) and Pell funds disbursed to students attending an ineligible school (about 33 percent of improper payments). Neither of these causes are directly associated with students who submit inaccurate self-reported income on the FAFSA. Furthermore, the Department did not identify inaccurate self-reported income on the FAFSA as a unique root cause of improper payments in the FY 2014 AFR.

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<sup>5</sup> The Direct Loan consolidations include both overpayments and underpayments. The sampled payments were tested to determine which were actual improper payments.

<sup>6</sup> "U.S. Department of Education's Compliance with Executive Order 13520, 'Reducing Improper Payments' for Fiscal Year 2012 and 2013" (A03N0004) and "U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2012" (A03N0001).

<sup>7</sup> FSA identifies schools for program reviews based on risk-based compliance initiatives and management mandates, referrals or complaints, comprehensive compliance reviews, self-reported violations, and Compliance Assurance Reviews of schools assessed as low-risk. These five areas can trigger the need for a program review at a school.

<sup>8</sup> For example, program reviews on compliance with performance data reporting requirements would not identify improper payments.

<sup>9</sup> The IRS Data Retrieval Tool enables financial aid applicants to transfer certain income and tax information from an IRS Web site directly to their online FAFSA.



### **Improper Payment Estimate Methodologies for Pell and Direct Loan Programs Deviated From Methodologies That OMB Approved**

The Department's improper payment estimates for the Pell and Direct Loan programs were not accurate and deviated from the September 2014 OMB-approved methodologies in three ways. One, the Department used a dollar-based ratio estimate instead of the approved school-count-based ratio estimate. Two, it used fewer program reviews in its estimates than it proposed. Three, the Department did not classify program reviews into the approved categories.

#### *Use of Dollar-Based Ratio Estimate Rather Than School-Count-Based Ratio Estimate*

Both the September 2014 OMB-approved methodologies (school-count-based ratio estimate) and the executed methodologies (dollar-based ratio estimate) used two steps to estimate total improper payment dollars. The second step is where the two methods deviated. For both methods, the first step was to calculate a ratio estimated total for each school with a program review using the school's ratio of improper payments to total disbursements for the sampled students, multiplied by the total disbursements at the school. Under the September 2014 OMB-approved methodologies, the improper payment estimates were to be calculated, in part, on a school-count-based ratio estimate. The school-count-based ratio estimate weighted the program review schools' estimated total improper payments by the count of schools with program reviews to total schools. However, in the calculations, the Department actually used a dollar-based ratio estimate for the Pell and Direct Loan programs. The dollar-based ratio estimate weighted the program review schools' estimated total improper payments by the dollars disbursed at the schools with program reviews to total dollars disbursed for all schools. As a result of using a different ratio estimator, the improper payment rates are significantly different (see Table 2).

We concluded that the Department changed its estimation methodologies from the September 2014 OMB-approved methodologies after learning that the estimates using these OMB-approved methodologies were higher than the previous year's estimates. FSA's Supervisor, Systems Accountant stated that the Department's contractor initially calculated improper payment estimates using the September 2014 OMB-approved methodologies, but the Department decided to change the methodologies after learning that the resulting initial improper payment estimates were not reasonable and did not meet expectations given that similar data was used to calculate the FY 2013 and FY 2014 rates. We interpreted this to mean the Department expected that using similar data from one year to the next should yield similar results. The Department consulted with its contractor and decided to change the methodologies by using the dollar-based ratio estimate, instead of the school-count-based ratio estimate, to calculate the improper payment estimates. Using the dollar-based methodologies, the Department's reported improper payment estimates for FY 2014 were closer to the improper payment estimates for FY 2013. For example, the Pell program reported improper payment estimates were 2.16 percent for FY 2014 and 2.26 percent for FY 2013. The Direct Loan program reported improper payment estimates were 1.50 percent for FY 2014 and 1.03 percent for FY 2013. On March 17, 2015, after the close of our fieldwork, and four months after reporting its improper payment estimates in the AFR, the Department submitted to OMB a request to change the approved methodologies that included the use of a dollar-based ratio estimator. The Controller of OMB approved the changes on April 3, 2015.

As shown in Table 2, improper payment rates calculated using the September 2014 OMB-approved methodologies were significantly higher than those calculated using the Department’s revised methodologies.

**Table 2. Reported and Recalculated FY 2014 Improper Payment Rates (Dollars in Millions)**

<b>Program</b>	<b>Improper Payment Rate Using Department’s Revised Methodology, Dollar-Based<sup>1</sup></b>	<b>Improper Payment Dollars Using Department’s Revised Methodology, Dollar-Based</b>	<b>Improper Payment Rate Using September 2014 OMB-Approved Methodology, School-Count-Based<sup>2</sup></b>	<b>Improper Payment Dollars Using September 2014 OMB-Approved Methodology, School-Count-Based</b>
Pell	2.16 percent	\$682	4.28 percent	\$1,351
Direct Loan	1.50 percent	\$1,532	2.64 percent	\$2,697

<sup>1</sup> The Department’s revised methodology, dollar-based data come from the Department’s FY 2014 AFR.  
<sup>2</sup> The September 2014 OMB-approved methodology, school-count-based data come from the OIG recalculation using the approved weighting. These rates and dollar amounts do not account for other data errors reported in this finding. Due to the complexity of the other data errors noted, we did not perform recalculations to account for all of these errors.

*Use of Fewer Program Reviews Than Proposed*

The Department’s methodologies for calculating the FY 2014 improper payment rates deviated in another way from the methodologies OMB approved. In the OMB-approved methodologies for the Pell and Direct Loan programs, the Department proposed that it would include all final program review results (such as findings with improper payments) available from the FY 2013 program review schedule of 311 program reviews in the calculation of the FY 2014 improper payment rates for the Pell and Direct Loan programs. However, when the Department calculated the improper payment rate, about 69 percent of the 311 program reviews of schools specified in the proposal submitted to OMB had not been started, had not reached at least the draft program review report stage, were not applicable to the Pell or Direct Loan programs, or would not identify improper payments (for example, campus crime reviews).<sup>10</sup> As a result, the actual number of final program review reports available to perform the calculation was significantly smaller than expected for both the Pell and Direct Loan programs (79 each). The Department was concerned about the small number of final program review reports, so it received approval from OMB to increase the number by including draft program review reports in its calculations. Thus, the Department used 98 Pell and 96 Direct Loan program review reports, which were either draft or final program review reports at the time of the calculation, to estimate the improper payment rates.

<sup>10</sup> In its methodology submitted to OMB, the Department anticipated using 311 program reviews for the Pell program and 311 program reviews for the Direct Loan program. The Department only used 98 Pell program reviews and 96 Direct Loan program reviews in its calculation of the improper payment estimates. Therefore, for the Pell program, 213 program reviews (311 minus 98), or about 68 percent were not included in the improper payment rate calculation. For the Direct Loan program, 215 program reviews (311 minus 96), or about 69 percent were not included.

The OIG raised this issue in its audit of the Department's compliance with IPERA for FY 2013. In that audit, we found that the Department did not include results of 69 percent of anticipated program reviews in its calculation of the Direct Loan program's improper payment rate for FY 2013 because the reports had not yet been issued or the program reviews did not test for improper payments. In response to the finding and our recommendation, the Department stated that it had modified its FY 2014 estimation methodologies to expand the pool of available program reviews for use in its estimate. However, the Department's FY 2014 methodology still excluded about 69 percent of program reviews when calculating the FY 2014 estimate.

#### *Use of Fewer Strata Than Proposed*

The Department varied its approach from the September 2014 OMB-approved methodology by not classifying program reviews into the approved categories (strata). The September 2014 OMB-approved methodology listed three strata, based on the reason a program review is initiated, as (1) compliance initiatives, (2) Compliance Assurance Reviews, and (3) Comprehensive Compliance Review, referrals, complaints, and self-reported violations. The Department used two strata (compliance initiatives and Compliance Assurance Reviews) rather than three strata in its calculations. The Department's contractor stated that it used only two strata for the improper payment estimates because none of the program reviews used to calculate the improper payment estimate fell into the third stratum. We found that 40 Pell program reviews and 37 Direct Loan program reviews used to calculate the improper payment estimates should have been grouped into the third stratum. By not including the third stratum, the estimates were not calculated using the September 2014 OMB-approved methodology.

#### **Improper Payment Estimate Methodology for FFEL Program**

We did not identify issues with the FFEL program's improper payment estimate. The improper payment estimate for the FFEL program was based on the results of program reviews of 9 lender/servicers (from a universe of 24) and 14 guaranty agencies (from a universe of 34) performed by FSA Program Compliance—Financial Institution Oversight Service. These program reviews focused on special allowance payments and interest payments to lenders and reinsurance claim payments to guaranty agencies under the FFEL program. For the FFEL program, the Department used an entity-count-based ratio estimate rather than a dollar-based ratio estimate. The entities were lenders/servicers and guaranty agencies. In the proposal it submitted to OMB, the Department proposed using 22 program reviews of lenders/servicers and guaranty agencies in its improper payment estimate, and it used 23 program reviews in its calculations.

#### **Improper Payment Estimate Methodologies for Pell and Direct Loan Were Inaccurate**

The Department's estimates had numerous errors and inaccuracies, as described in the following sections.<sup>11</sup>

#### *Exclusion of Improper Payments Identified in a Program Review*

The Department did not properly calculate its estimates because it incorrectly excluded improper payments identified in one program review. The program review of one school found that the school disbursed Pell and Direct Loan funds to students enrolled in an ineligible program. Funds disbursed to students in an ineligible program should be classified as improper payments. However, the Department did not include the Pell funds (\$30,074) and unsubsidized Direct Loan

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<sup>11</sup> The OIG provided the Department with detailed information about each error.

funds (\$3,010) disbursed to these students in the improper payment calculations for the Pell and Direct Loan programs. As a result, the improper payment rates for the Pell and Direct Loan programs are incorrect and understated. However, the Department correctly included subsidized Direct Loan funds (\$8,462) disbursed to these students in the improper payment calculation for the Direct Loan program.

#### *Data Transcription Errors and Data Integrity Errors*

The Department's supporting documentation for its reported improper payment estimates contained both data transcription errors and data integrity errors. The Department created extrapolation spreadsheets from the program review results and used the spreadsheets to calculate the improper payment estimates. However, the extrapolation spreadsheets contained numerous errors, including the following:

- incorrect student counts for one school included in the calculation of the Direct Loan program's improper payment estimate (\$46.3 million was reported as disbursed to 78 students, for an average Direct Loan amount of more than \$593,000, which was more than 28 times greater than the maximum loan limit for that award year);<sup>12</sup>
- incorrect disbursement amounts for students sampled at another school included in the calculation of the Direct Loan program's improper payment estimate;<sup>13</sup>
- incorrect total disbursement amounts for three schools included in the calculation of the Pell program's improper payment estimate;<sup>14</sup>
- incorrect stratum assignments for two schools in the two strata used in the estimate;<sup>15</sup>
- duplicate entries for three schools in the calculation of the Direct Loan program's improper payment estimate; and
- incorrect cell references for one school included in the calculation of the Pell program's improper payment estimate.<sup>16</sup>

These errors indicate that the data, based on the results of program reviews, used to estimate the improper payment rates for the Direct Loan and Pell programs are not reliable. Therefore, the reported improper payment estimates are not accurate.

In addition, three key calculations in the Pell and Direct Loan extrapolation spreadsheets contained statistical formulas without any citations to statistical references or disclosed formulas. Specifically, the calculations had neither a formula description nor a citation for the (1) estimator for total improper payment dollars across all schools, (2) variance of estimated total improper payments at each program review school, and (3) variance for estimated total improper payments

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<sup>12</sup> For the 2011–2012 award year annual loan limits ranged from \$5,500 to \$20,500.

<sup>13</sup> At one school, a disbursement amount was incorrectly listed as \$25,774, when it should have been \$31,684.

<sup>14</sup> For two schools, source documents contained differing disbursement amounts for Pell. For the first school, the documents stated both \$12,366,866 and \$22,228,770, and for the second school, the documents stated both \$721,170 and \$21,400,932. At the third school, improper payments for multiple award years (\$86,715) were included in the Pell estimate, when only one award year (\$39,352) should have been included.

<sup>15</sup> One school was listed in the incorrect stratum for the calculation of the Pell program estimate, and another school was listed in an incorrect stratum for both the Pell and Direct Loan program estimates.

<sup>16</sup> For one school, the extrapolation spreadsheet used to calculate the improper payment estimate had incorrect formulas with errors that precluded the spreadsheet from calculating the school's ratio of improper payments to disbursements for sampled students, the school's estimated total improper payments, and the variance of the school's estimated total improper payments.

across all schools. In these spreadsheets, the Department cites a statistical textbook reference<sup>17</sup> but does not include a reference to a page or formula number for those three calculations. When we inquired about the specific formula references from the cited text for those calculations, the Department's contractor indicated that some of the statistical formulas were from a different text.<sup>18</sup> However, we found that the calculation the Department used was not the same as the formula in the cited reference. The Department's documentation should include appropriate citations and disclose formula for calculations performed so that the approach is transparent and can be validated.

#### *Errors and Incomplete Information in the Department's Formulas*

The Department's improper payment estimation methodologies for the Pell and Direct Loan programs were both incorrect and incomplete. The Department's estimation methodologies it submitted to OMB for approval contained significant formula errors and omissions. Specifically, we found the following.

- The variance formula used in the Department's calculations to estimate the improper payment rates for the Pell and Direct Loan programs understated the confidence limits and gave a false sense of precision. The formula omitted a square (for example,  $X^2$ ) in the second stage formula (for students selected), and completely omitted the first stage variance formula (for schools selected) along with a description of the first stage formula. For the Direct Loan program, the confidence limits for the reported estimate ranged between 2.02 percent and 2.30 percent. For the Pell program, the confidence limits for the reported estimate ranged between 1.32 percent and 1.67 percent.
- The Direct Loan program's estimation methodology initially submitted to OMB contained no probability-proportion to size formulas for the loan consolidation and refund activities; therefore, we were unable to assess that portion of the methodology.
- The Direct Loan program's estimation methodology submitted to OMB contained no description of the weighting for the three sources of improper payment information (program reviews, loan consolidation activity, and loan refund activity) used to calculate the improper payment estimate.
- The estimator formula proposed in the Department's calculations to estimate the improper payment rates for the Pell and Direct Loan programs erroneously contained a multiplication sign where the correct formula should have contained a division sign. The Department used the correct sign in its actual calculations.

As a result, the Department reported unreliable improper payment estimates and did not accurately and completely measure improper payments for the Pell and Direct Loan programs.

#### **Recommendations**

We recommend that the CFO for the Department, in conjunction with the COO for FSA, require the CFO for FSA to—

- 2.1 Recalculate the FY 2014 improper payment estimates for the Direct Loan and Pell programs in accordance with OMB-approved methodologies and correcting for all the data, calculation, and estimation methodology errors.

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<sup>17</sup> William G. Cochran. *Sampling Techniques* (New York: John Wiley & Sons Inc., 1977, third edition).

<sup>18</sup> Carl-Erik Sarndal, Bengt Swensson, and Jan Wretman. *Model Assisted Survey Sampling* (New York: Springer-Verlag, 1992, corrected fourth printing 1997).

- 2.2 Publish the FY 2014 recalculated improper payment rates, notify OMB and Congress of any changes, and explain the basis for the revisions in the FY 2015 AFR.
- 2.3 Prepare and submit the required remediation plans to Congress and OMB if the FY 2014 improper payment estimate for the Pell program recalculated under Recommendation 2.1 does not meet the improper payment reduction target.
- 2.4 Use the results of an adequate number and percentage of program reviews in the calculation of the FY 2015 improper payment estimates.
- 2.5 Include all improper payments in the calculation of the improper payment estimates.
- 2.6 Maintain adequate documentation of the sampling and estimation approaches used, including appropriate citations to statistical formulas.
- 2.7 Revise the estimation methodologies to include improper payments that are not identified in program reviews, such as those improper payments associated with recipients who do not use the IRS Data Retrieval Tool, who provide inaccurate self-reported income on the FAFSA, and who are not selected for income verification.

### **Department Comments**

The Department partially concurred with the finding and concurred with the initial recommendations. The Department did not concur with recommendation 2.7. As discussed below, the Department disagreed with statements and conclusions contained in the report.

### **1. Change in Estimation Methodologies for Pell and Direct Loan Programs**

#### **Department Comments**

The Department stated that the OIG's conclusion that "...the Department changed its estimation methodologies from the September 2014 OMB-approved methodologies after learning that the estimates using these OMB-approved methodologies were higher than the previous year's estimates..." is an inaccurate representation of its actions.

The Department stated that it changed the methodology not because the estimate was higher but because of inaccuracies in the estimate which made the estimate an unreliable method. The Department stated that the initial improper payment rate calculation results (using school-count ratio estimates) were not reasonable, did not meet expectations, and were potentially unreliable. The Department stated that to correct for bias in its initial calculations, it used dollar-weighted ratio estimates to provide a less biased weighting to extrapolate the improper payment amount. The Department changed the methodologies and did not obtain OMB approval of these changes until April 2015. The Department recalculated the improper payment rates based on the April 2015 OMB-approved methodologies and made the other corrections noted in its response to our draft report. The Department's revised improper payment rates for FY 2014 are 1.46 percent for the Direct Loan Program and 2.21 percent for the Pell Program.<sup>19</sup>

#### **OIG Response**

We interpreted the Department's response to mean the Department expected that using similar data from FY 2013 to FY 2014 should yield similar results. Initial calculations did not. We

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<sup>19</sup> We did not perform any work related to the Department's revised calculations.

based our conclusion on the fact that the estimates derived from the September 2014 OMB-approved methodologies were significantly higher than the estimates calculated and reported by the Department for FY 2013 and FY 2014. We also based our conclusion on the fact that the Department decided to change the methodologies after it knew of the initial improper payment rate calculation results.

Furthermore, neither the Department nor its contractor provided documentation to support their basis for the change in estimation methodologies for the Pell and Direct Loan programs. The Department's contractor stated that the FY 2014 methodologies were revised to use a dollar-weighted ratio estimate to correct for bias in the initial estimates. The contractor stated that it had performed a correlation analysis (to confirm a relationship between a school's total disbursements and the school's estimated improper payment amount), which could demonstrate the suitability of a dollar-weighted ratio estimate. However, the contractor stated that it had not maintained documentation of the analysis. Additionally, the Department did not disclose this change in methodology to OMB prior to the issuance of the AFR. On November 6, 2014, 8 days before the issuance of the AFR, OMB asked if the Department had changed the overall approach in the alternative methodology. The Department responded that, except for including draft program review reports in its calculations, "[t]he overall approach, for the alternative methodology has not changed . . ." However, the Department had revised the methodologies to use a dollar-based weighted ratio estimate in its calculations. After the end of our fieldwork (February 26, 2015), on March 17, 2015, the Department requested approval from OMB to revise the methodology and the Controller of OMB approved the revised methodology on April 3, 2015.

Although the Department provided recalculated FY 2014 improper payment estimates for the Pell and Direct Loan programs in its response, FSA did not provide supporting documentation and we did not perform any work related to these revised calculations.

## **2. Estimation Methodologies Based on Program Review Results**

### **Department Comment**

The Department disagreed with the following OIG conclusions from the draft audit results. "The FY 2014 improper payment estimates for the Pell and Direct Loan programs were based on the results of program reviews of schools performed by FSA. Program reviews primarily focus on overpayments that need to be returned to the Department rather than underpayments. Furthermore, program reviews are unlikely to identify inaccurate self-reported income on the FAFSA as a significant cause of improper payments."

The Department stated that program reviews test for payments made for an incorrect amount, including both overpayments and underpayments. In addition, program reviews identify improper payments associated with various root causes, and include those caused by inaccurate self-reported income, which was the sole focus of the prior estimation methodology for the Pell program. The Department stated that 14.25 percent of improper payments for the Pell program and 8.61 percent of improper payments for the Direct Loan program were associated with the root cause that includes inaccurate self-reported income.

## OIG Response

We changed the statement, on page 5 of the final report, to note that program reviews primarily *identify* overpayments. In the AFR, the Department reported that, for FY 2014, the Pell program's 2.16 percent improper payment rate consisted of overpayments of 2.11 percent and underpayments of 0.05 percent. The Direct Loan program's 1.50 percent improper payment rate consisted of overpayments of 1.46 percent and underpayments of 0.04 percent.

Program reviews cannot identify inaccurate self-reported income as a significant cause of improper payments. The data cited in the Department's comment supports this statement. The Department reported an improper payment rate of 2.16 percent for the Pell program. Of this percentage, the Department attributed 14.25 percent of improper payments, or an improper payment rate of 0.31 percent (2.16 percent times 14.25 percent), to root causes that include inaccurate self-reported income on the FAFSA. In contrast, in its comments, the Department stated that the Pell program's improper payment rate for FY 2014 would be 1.94 percent if calculated under the prior methodology used to calculate the FY 2013 estimate.<sup>20</sup> The prior methodology was based on the FAFSA/IRS Data Statistical Study, which focused solely on inaccurate self-reported income on the FAFSA. Comparing these results (0.31 percent using the current methodology versus 1.94 percent using the prior methodology) supports our statement that program reviews are unlikely to identify inaccurate self-reported income as a significant cause of improper payments.

The Department's current methodology, based on the result of program reviews, is approved by OMB. However, our concern that improper payment estimates may be understated by using program reviews as the sole source of information to estimate improper payments continues to exist. As a result, we included a recommendation for the Department to revise the estimation methodologies to include improper payments that are not identified in program reviews, such as those improper payments associated with recipients who do not use the IRS Data Retrieval Tool, who provide inaccurate self-reported income on the FAFSA, and who are not selected for income verification.

### 3. Program Reviews Grouped in the Third Stratum

#### Department Comments

The draft audit results stated that 40 Pell program reviews and 37 Direct Loan program reviews used for the improper payment estimates should have been grouped into a third stratum. The Department did not specifically disagree with the statement, but it explained the stratification of these Pell and Direct Loan program reviews. The Department stated that the numbers cited were from a report that was not available at the time the stratification was performed, as it stratified the population based on the limited initial program review information available in FY 2014. Going forward, the Department will confirm that the reason for each school's selection for a program review is documented and available so the population of program reviews can be properly stratified.

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<sup>20</sup> The Department did not provide support for this calculation.



## **OIG Response**

Under the OMB-approved methodology, program reviews were to be classified into one of three strata based on the reason a school was selected for a program review. The Department should have identified the correct strata (the reason a school was selected for a program review) before it initiated the program review and before it calculated an improper payment estimate based on the results of the program review report. The Department should ensure the correct strata are identified in the future.

## **4. Recommendation to Revise the Estimation Methodologies**

### **Department Comments**

Based on discussions with the Department, it agreed that program reviews risk not identifying improper payments to recipients who do not use the IRS Data Retrieval Tool, who provide inaccurate self-reported income on the FAFSA, and who are not selected for income verification. However, the Department did not concur with our recommendation 2.7 to revise the estimation methodologies to include improper payments that are not identified in program reviews. The Department raised concerns over the feasibility of including improper payments identified from sources other than program reviews in its improper payment estimates and the possibility of costs outweighing the benefits of including such payments in the estimates.

### **OIG Response**

We acknowledge the Department's concerns. However, to the extent possible, all known improper payments not currently captured by program reviews should be included in the improper payment estimates. Including such improper payments is needed to develop an effective plan to reduce improper payments. OMB guidance states that "...agencies shall identify the reasons their programs and activities are at risk of improper payments and put in place a corrective action plan to reduce them." An estimation methodology that does not consider categories of known improper payments does not provide the Department with the information necessary to formulate plans to address the root causes of such payments.

## **FINDING NO. 3 – The Department Needs to Improve the Completeness of its Improper Payment Reporting**

The Department's AFR and its "FY 2014 Improper Payment Estimation Methodologies" posted on the Department's Web site were incomplete. The Department did not provide statistical sampling details for the Pell program and did not report amounts of improper payments associated with each category of root cause. OMB Circular A-136, Section II.5.8., "Improper Payments Information Act of 2002 (as amended by IPERA) Reporting Details" establishes the reporting requirements for each agency that has programs susceptible to significant improper payments.

In the Department's published methodology document, the statistical sampling details for the Pell program estimate lacked the level of detail (for example, the number of students and schools

in the sample and in the universe) it provided for both the Direct Loan and FFEL programs. OMB Circular A-123, Appendix C, Part I, Section A.14 requires agencies to provide a summary of the alternate methodology that should include statistical sampling details.

The Department’s AFR and the published methodology document do not contain all of the required root cause information (reasons for the improper payment). The Department did not report the amounts of improper payments associated with each category of root cause. The Department reported only the percentage of improper payments associated with each root cause. OMB Circular A-136, Section II.5.8 states that agencies must report root cause information, including error rate and error amount, based on root cause categories.

The Department reported error rates in the two categories of root causes (documentation and administrative errors and verification errors), as shown in Table 3.

**Table 3. Department’s Reported Percentages of Improper Payments by Root Cause**

Root Cause Category	Pell Grants	Direct Loans	Direct Loan Consolidations	FFEL
Documentation and Administrative Errors	15%	19%	100%	100%
Verification Errors	85%	81%	0%	0%

Source: Department’s FY 2014 AFR, page 128.

The Department should have reported the error amounts associated with the error rates. Based on documentation provided by the Department, we calculated the error amounts associated with each root cause category. The Department should have reported information similar to that in Table 4.

**Table 4. OIG-Calculated Amounts of Improper Payments by Root Cause**

Root Cause Category	Pell Grants	Direct Loans	Direct Loan Consolidations <sup>1</sup>	FFEL
Documentation and Administrative Errors	\$55,274	\$78,188	\$290,950	\$0
Verification Errors	\$310,733	\$327,180	\$0	\$0

<sup>1</sup> The Direct Loan Consolidations consist of \$123,122 of overpayments and \$167,829 of underpayments.

The Department did not provide users of the annual report on improper payments, such as Congress, OMB, and agency managers, with sufficient details about the sampling the Department used to derive the Pell program’s improper payment rate, and the amounts of improper payments associated with each category of root cause.

## **Recommendations**

We recommend that the CFO for the Department, in conjunction with the COO for FSA, require the CFO for FSA to—

- 3.1 In its annual reporting on improper payments, (1) provide sufficient details as to the samples used in calculating the estimated improper payment rates and (2) include the error amounts when reporting on the root causes of improper payments.

## **Department Comments**

The Department concurred with the finding and recommendation.

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## OBJECTIVES, SCOPE, AND METHODOLOGY

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The objectives of our audit were to (1) determine whether the Department complied with IPERA; (2) evaluate the accuracy and completeness of the Department's improper payments reporting; (3) evaluate the Department's performance in reducing and recapturing improper payments; and (4) for the Pell high-priority program, (a) evaluate the quality of the Department's improper payment estimate and methodology, (b) evaluate the Department's assessment of the level of risk associated with the program, and (c) review the oversight or financial controls described by the Department to identify and prevent improper payments.

Our audit covered the Department's improper payment measurement methodologies, reporting and performance in reducing and recapturing improper payments for the Pell, Direct Loan, and FFEL programs from October 1, 2013, through September 30, 2014.

Our audit was for the limited purpose described and would not necessarily identify all deficiencies in internal controls. To accomplish our objectives, we gained an understanding of internal controls applicable to the Department's compliance efforts with IPERA and development of its improper payment rate estimates, as detailed below. We identified deficiencies in the Department's system of internal control that were significant to our audit objectives; we fully discuss these deficiencies in the Audit Results section of this report. We reviewed applicable laws, OMB circulars, and guidance. Specifically, we performed the following.

1. Reviewed background information about the Department and its programs susceptible to improper payments (Pell, Direct Loan, and FFEL programs).
2. Reviewed the following laws, regulations, and guidance:
  - a. Improper Payments Elimination and Recovery Improvement Act of 2012;
  - b. Improper Payments Elimination and Recovery Act of 2010;
  - c. Improper Payments Information Act of 2002;
  - d. OMB Circular A-123, Appendix C, "Requirements for Effective Estimation and Remediation of Improper Payments," October 20, 2014;
  - e. Executive Order 13520, "Reducing Improper Payments," November 20, 2009;
  - f. OMB Circular A-136, Section II.5.8., "Improper Payments Information Act of 2002 (as amended by IPERA) Reporting Details," September 18, 2014; and
  - g. Guidance developed by the U.S. Social Security Administration OIG for the Council of Inspectors General on Integrity and Efficiency for evaluating an agency's compliance with the improper payment requirements.
3. Reviewed the Department's AFR for FY 2014, including the "Improper Payments Reporting Details," the "FY 2014 Improper Payment Estimation Methodologies," and the documentation supporting the Department's improper payment measurement methodologies, reporting, and performance in reducing and recapturing improper payments in effect at the time the AFR was issued.

4. Interviewed officials from FSA's Finance and Program Compliance offices and FSA's designated contractor (Deloitte Consulting) for its OMB Circular A-123, "Management's Responsibility for Internal Control Testing."
5. Reviewed prior OIG audit reports relevant to our audit objectives, including:
  - a. U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2013 (A19O0002);
  - b. U.S. Department of Education's Compliance with Executive Order 13520, "Reducing Improper Payments" for Fiscal Year 2012 and 2013 (A03N0004);
  - c. U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2012 (A03N0001);
  - d. U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2011 (A03M0001), and
  - e. U.S. Department of Education's Compliance with Executive Order 13520, "Reducing Improper Payments" for Fiscal Year 2011 (A03M0004).

The Department provided recalculated improper payment estimates in its response dated April 21, 2015. We did not perform any work related to these revised calculations.

Use of computer-processed data for the audit was limited to documentation provided by the Department to support its improper payment rate estimates and progress in reducing and recapturing improper payments. We used the data to evaluate the accuracy and completeness of the Department's estimation methodologies for the Pell, Direct Loan, and FFEL programs and to verify recovery amounts. We assessed the reliability of this data by comparing reported data to data contained in the supporting documentation and by interviewing Department officials and its contractor knowledgeable about the data. Based on our analysis, we concluded that the computer-processed data were sufficiently reliable for the purposes of our audit.

We conducted onsite visits at the Department's offices, located in Washington, D.C., on December 16, 2014, and February 26, 2015. We briefed Department officials on the results of our audit on March 25, 2015, and again on May 14, 2015.

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

## Enclosure 1

### Acronyms, Abbreviations, and Short Forms Used in This Report

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AFR	Agency Financial Report
CFO	Chief Financial Officer
COO	Chief Operating Officer
Department	U.S. Department of Education
Direct Loan	William D. Ford Federal Direct Loan
EFC	Expected Family Contribution
FAFSA	Free Application for Federal Student Aid
FFEL	Federal Family Education Loan
FSA	Federal Student Aid
FY	Fiscal Year
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPERIA	Improper Payments Elimination and Recovery Improvement Act of 2012
IRS	Internal Revenue Service
OIG	Office of Inspector General
OMB	Office of Management and Budget
Pell	Federal Pell Grant
Title I	Title I, Part A of the Elementary and Secondary Education Act of 1965, as Amended
Title IV	Title IV of the Higher Education Act of 1965, as Amended

## Enclosure 2



### MEMORANDUM

DATE: April 21, 2015

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

Bernard Tadley  
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FROM: Thomas P. Skelly /s/  
Delegated to Perform the Function and Duties of the Chief Financial Officer  
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SUBJECT: Response to OIG's Review of the Department's Improper Payment Reporting Requirements

We appreciate the opportunity to respond to the draft audit results of the Office of Inspector General's (OIG) Review of the Department's Improper Payment Reporting Requirements.

The Department is committed to preventing the occurrence of improper payments and detecting and recovering them when they do occur. Accordingly, we also appreciate the OIG's work identifying issues pertaining to the way we calculate, document, and report improper payments. We have recalculated the improper payment rates based on the sum of your findings excluding the change from the original OMB-approved methodology resulting in a 0.04% decrease in the FY 2014 Direct Loan rate and a 0.05% increase in the FY 2014 Pell rate. In addition, we completed the recommended modifications to our alternative improper payment methodology documentation and received OMB approval for the changes on April 3, 2015.

As noted in our recent Agency Financial Reports (AFRs), we have implemented an alternative estimation methodology that leverages program review reports to develop estimates for each of our risk-susceptible

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programs. By leveraging program review reports and underlying data, this methodology evaluates a more robust, expanded set of improper payment risks than prior methodologies. In FY 2014, OMB approved this methodology for all three programs: Pell, Direct Loan, and FFEL. As noted in the “Change in the Improper Payment Estimation Methodology for the Pell Program” section on page 2 of your draft results, this approval resulted in a change for Pell in FY 2014 from the old FAFSA/IRS Data Statistical Study that was used to calculate the FY 2013 estimate. We changed the methodology because we recognized and acknowledged the inherent limitations of the study for this purpose (e.g., that only one payment type and one improper payment risk are considered). Using the study to calculate the FY 2014 estimate would have resulted in an estimate of 1.94 %, continuing the year-over-year downward trend based on the study.

We disagree with the conclusion that you could not evaluate the Department’s performance in reducing improper payments, because of the issues noted under Finding 2, “The Department Needs to Improve the Accuracy, Completeness, and Quality of its Improper Payment Estimates and Estimation Methodologies”. In correcting for the errors identified, we found that they had a minor impact on the overall estimates under the new methodology, as modified. Similar to last year, where the OIG “found that, when comparing rates reported based on similar methodologies, estimated improper payments in risk-susceptible programs generally decreased”<sup>1</sup>, except for Direct Loan you should have observed a continuation of this downward trend from FY 2013 to FY 2014. For Direct Loan, the rate increased due to changes in the underlying methodology and sample data.

Our responses to each of the draft findings and recommendations are included below.

**Department’s Response to Finding 1:**

The Department concurs with Finding 1.

We appreciate the recognition in the report that the Department met five of the six criteria for compliance and, for the sixth, did not meet the requirement for reduction targets for only one of three risk-susceptible programs. The reduction targets and recalculated estimates are presented in the table below. As noted, the estimate for Direct Loan reported in the FY 2014 AFR exceeded the reduction target of 1.03% reported for FY 2014 in the FY 2013 AFR.

Program	FY 2014 Reduction Target	FY 2014 Reported Improper Payment Rate	Reduction Target Met
Direct Loan Program	1.03%	1.46%	No
Pell Program	2.26%	2.21%	Yes
FFEL Program	0.00%	0.00%	Yes

<sup>1</sup> “U.S. Department of Education’s Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2013”, ED-OIG/A19O0002, April 15, 2014.



For FY 2013 reporting, OMB provisionally approved the Department's proposed Direct Loan Program improper payment methodology and the reduction targets reported were flat-lined pending the Department's refinements to the methodology for final OMB approval. As reported on page 125 of the FY 2013 AFR, OMB approved the Direct Loan methodology only for that fiscal year while the Department continued to work with OMB on gaining final approval for a mutually agreeable strategy for improper payments for all FSA programs. The targets reported in the FY 2013 AFR were based on the estimation results of prior year methodology and, by definition, did not consider the new methodology for FY 2014 that was not approved by OMB until September 17, 2014.

**Department's Response to Recommendation 1.1**

The Department concurs with Recommendation 1.1.

As a function of the Department's standard improper payment reporting process for Direct Loan and all risk-susceptible programs regardless of whether or not they met their reduction target we will continue to evaluate the root cause for improper payments identified. We will evaluate corrective actions for each root cause to determine whether they may be enhanced or if new corrective actions may be implemented to further reduce or prevent improper payments.

**Department's Response to Recommendation 1.2**

The Department concurs with Recommendation 1.2. The Department will prepare and submit the required remediation plan to Congress and OMB within 90 days of the issuance of the report.

**Department's Response to Finding 2:**

The Department partially concurs with this finding. The Department agrees that it needs to correct the deficiencies found and correct the OMB-approved methodology documentation.

Within the methodology approved by OMB, the Department did not intend to perform a statistical extrapolation; rather, the Department used an alternative methodology to estimate the improper payment rates for its programs due to the method used to obtain the sampling population. Upon initial calculation the Department realized that the result was not reasonable, not meeting expectations, and potentially unreliable. As shown in the table below, we noted significant fluctuation in the school count weighted FY 2014 rate compared to prior year published rates. As described later in this response to finding #2, we changed our methodology to use the dollar weighted estimation. We failed to document this change in the original FY2014 methodology document and to obtain OMB approval for this change until April 2015. Making this change and applying the other corrections recommended by the OIG in the draft report, we recalculated the rates as presented below. These recalculated rates varied slightly from the rates published in the AFR. The updated Direct Loan improper payment rate is now 1.46%; the Direct Loan improper payment rate published in the FY 2014 AFR was 1.5%, and the updated Pell extrapolation rate is now 2.21%; the Pell improper payment rate published in the FY 2014 AFR was 2.16%.

Recalculated FY 2014 Improper Payment Rates				
Program	2013 Published Rates (and FY14 Target)	2014 Published Rates	Recalculated by OIG using the Sept. 2014 OMB-Approved Methodology	Recalculated by the Dept. using the Apr. 2015 OMB-Approved Methodology
Pell	2.26 %	2.16 %	4.28 %	2.21 %
Direct Loan	1.03 %	1.50 %	2.64 %	1.46 %

On page 3 of its report, the OIG makes the following statements regarding the “Change in the Improper Payment Estimation Methodology for the Pell Program”:

*“The FY 2014 improper payment estimate for the Pell and Direct Loan programs were based on the results of program reviews of schools performed by FSA. Program reviews focus primarily on overpayments that need to be returned to the Department rather than underpayments. Furthermore, program reviews are unlikely to identify inaccurate self-reported income on the FAFSA as a significant cause of improper payments.”*

We disagree with that statement. All general assessment and focused program reviews that include student level assessment test for improper payments, that is, any payment that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. As noted above and in the report these program reviews assess risks beyond inaccurate self-reported income, the sole focus of the old methodology. Leveraging program reviews resulted in an expansion of the root causes identified as reported on page 126 of the FY 2014 AFR. The root cause most associated with inaccurate self-reported income under the new methodology is Incorrect Awards based on Expected Family Contribution (EFC), resulting in 14.25% of the total Pell estimate and 8.61% of total Direct Loan estimate.

On page 8, the OIG makes the following statement:

*“We concluded that the Department changed its estimation methodologies from the OMB-approved methodologies after learning that the estimates using the OMB-approved methodologies were higher than the previous year’s estimates.”*

This statement is an inaccurate representation of the Department’s actions.

The methodology was changed not due to the estimate being higher, but rather due to the inaccuracies within the estimate which made the estimate an unreliable method. In other words, running the data through the methodology revealed deficiencies in the methodology that needed to be addressed. To estimate the FY 2014 improper payment rates for its risk susceptible programs, and similar to the estimation performed in FY 2012, FSA used the dollar weighted ratio (ratio estimation) in the two stages of the sampling, instead of the dollar weighted ratio (ratio estimation) used in the first stage of sampling

and the school count weighted ratio (mean estimation) used in the second stage of sampling to estimate the improper payment rates in FY 2013. The mean estimation uses the average of the amount being estimated (in this case the improper payment amount) associated with each sample item; this type of estimate can be more biased if, as we observed for FY 2014, the average population recorded amount is not similar to the average sample recorded amount. To help correct for the bias introduced by the difference between these two averages, and given the constraints of a smaller than expected sample size in FY 2014, FSA used the ratio estimation to provide a less biased weighting to extrapolate the sample improper payment amount to population improper payment amount.

Finally, on page 9, the OIG makes the following statement:

*"We found that 40 Pell program reviews and 37 Direct Loan program reviews used for the improper payment estimates should have been grouped into a third stratum".*

These numbers were based on a Postsecondary Education Participants System (PEPS) report which included information not available at the time the stratification was performed. The Department stratified the population based on the limited initial program review information available in FY 2014. Going forward, FSA will confirm the program review trigger is documented and available before the sample is selected, so the population can be properly stratified based on the approach.

**Department's Response to Recommendation 2.1:**

The Department concurs with this recommendation.

In researching and responding to questions from the OIG during their fieldwork for the FY 2014 IPERIA Compliance Audit, it came to our attention that the OMB-approved alternative improper payment methodology document included in the formula section a school count weighted ratio (mean estimation) instead of the dollar weighted ratio (ratio estimation) actually performed. OMB was notified of the change to the alternative improper payment methodology document on March 17, 2015 and provided approval of the updated document to the Department on April 3, 2015.

In addition, all of the errors identified during the audit were corrected and new improper rates calculated for Direct Loan and Pell, resulting in a 0.04% decrease in the FY 2014 Direct Loan rate and a 0.05% increase in the FY 2014 Pell rate.

**Department's Response to Recommendation 2.2:**

The Department concurs with this recommendation.

For the changes identified as a result of Recommendations 2.1 and 2.5, the Department will publish the recalculated improper payment rates, notify OMB and Congress of the changes, and explain the revisions within the FY 2015 AFR.

**Department's Response to Recommendation 2.3:**

The Department concurs with this recommendation.

Based on actions taken in response to Recommendation 2.1, the results of the recalculated Pell improper payment rate (2.21%) meet the FY 2014 Reduction Target for Pell (2.26%). Therefore, no additional action is necessary.

**Department's Response to Recommendation 2.4:**

The Department concurs with this recommendation.

The Department will coordinate with OMB on the FY 2015 methodology, including the total number of program reviews to be used.

The FY 2014 estimation methodology attempted to increase the sample size from the sample used in FY 2013 through modifying the methodology performed in FY 2013 to include draft Program Review Reports (PRRs), Expedited Determination Letters (EDLs) and Final Program Review Determinations (FPRDs) for the same award year (2011-12) used in FY 2013. The intent of this modification was to allow for more reports to be available for review during the FY 2014 improper payments assessment. In FY 2014, 98 Pell and 96 Direct Loan reports were reviewed as compared to the 63 Pell and 55 Direct Loan reports reviewed in FY 2013, which demonstrates that additional reports were reviewed in FY 2014.

Going forward, the Department will continue to evaluate ways to increase the pool of available PRRs, EDLs, and/or FPRDs to sample for purposes of developing improper payment estimates for Pell and Direct Loan.

Further, we will update the methodology document to clarify the number of reviews we anticipate to have available to sample in FY 2015 based in part on our FY 2014 and prior year results. The number of reviews planned to be performed in FY 2013 as documented in the FY 2014 methodology document was 311. However, the intent was not to receive all 311 reports due to the timing of when reports are issued. We will use a footnote for Pell and Direct Loan in the updated document similar to footnote 5 of the FY 2014 Improper Payment Methodology document approved by OMB for the FFEL program:

*"Due to the timing of testing and completion of reviews, it is not possible to include all Program Reviews in the annual estimation of improper payments."*

**Department's Response to Recommendation 2.5:**

The Department concurs with this recommendation.

All of the errors identified during the audit were corrected and new improper rates calculated for Direct Loan and Pell, resulting in a 0.04% decrease in the FY 2014 Direct Loan rate and a 0.05% increase in the FY 2014 Pell rate.

**Department's Response to Recommendation 2.6:**

The Department concurs with this recommendation.

As noted in Recommendation 2.1, OMB was notified on March 17, 2015 of the change from the school-count weighted ratio to dollar weighted ratio and provided approval of the updated methodology on April 3, 2015. Furthermore, going forward the Department will incorporate all citations to statistical formulas used in the methodology, as approved by OMB.

**Department's Response to Finding 3:**

The Department concurs with Finding 3. While the Department published root cause information and the percentage of errors for each category, the Department did not include the amount of improper payments for each category. The Department also did not include the same sampling details for the Pell Grant program as it did for the Direct Loan and FFEL programs.

**Department's Response to Recommendation 3.1**

The Department concurs with this recommendation.

The Department will provide sufficient details as to the samples used in calculating estimated improper payment rates and will include the error amount when reporting on the root causes of improper payments.

Once again, we appreciate the opportunity to review and respond to the report. If you have any questions or need additional information regarding this response, please contact Bill Blot at (202) 377-3097 or Jay Hurt at (202) 377-3453.

cc: Robert Janney