UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services

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Lawrence A. Warder
Acting Chief Operating Officer
Federal Student Aid
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Union Center Plaza, Room 112G1
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Washington, D.C. 20002

Dear Mr. Warder:

This **Final Audit Report**, entitled *Federal Student Aid's Estimation of Improper Payments in the Federal Family Education Loan Program*, presents the results of our audit. The purpose of the audit was to assess Federal Student Aid's (FSA) methodology for estimating improper payments in the Federal Family Education Loan (FFEL) Program. Our review covered the methodology used for reporting in the U.S. Department of Education's (Department's) Performance and Accountability Reports (PARs) for fiscal year (FY) 2006 and FY2007.

BACKGROUND

The Improper Payments Information Act of 2002 (IPIA) (Public Law 107-300) requires agencies to annually review and report on improper payments in the programs and activities that they administer. The IPIA specifies the annual three-step process that the agencies are to use to meet the requirement. First, the agencies must review the programs and activities and identify those that may be susceptible to significant improper payments (risk assessment). Then, for each identified risk-susceptible program and activity, the agencies must estimate the annual amount of improper payments. Lastly, for programs and activities with improper payment estimates exceeding a specified threshold, the agencies are required to report on actions they are taking to reduce improper payments. The IPIA provides definitions for the terms "payment" and "improper payment."

The IPIA directs the Office of Management and Budget (OMB) to provide agencies with guidance on implementing the requirements of the Act. On August 10, 2006, OMB issued Appendix C to OMB Circular A-123, *Requirements for Effective Measurement and Remediation of Improper Payments* (Appendix C).[1] The OMB guidance requires agencies to "institute a systemic method of reviewing all programs [and activities] and identifying those which they believe to be susceptible to significant erroneous payments." The OMB guidance defines "significant erroneous payments" as annual improper payments in the program "exceeding both 2.5 percent of program payments and $10 million." However, OMB may determine on a case-by-case basis that a program or activity is subject to the annual PAR reporting requirement even if it does not exceed the 2.5 percent and $10 million thresholds in OMB's definition of "significant erroneous payments."

The FFEL Program was identified as a program subject to the annual PAR reporting requirement (i.e., estimation of the annual amount of improper payments). For loan guaranty programs, such as the FFEL Program, the OMB guidance provided the following clarification on the definition of an improper payment.

> Under a loan guarantee program, an improper payment may include disbursements to intermediaries, third-parties for defaults, delinquencies, interest and other subsidies, or other payments that are based on incomplete, inaccurate, or fraudulent information. They may also include duplicate disbursements, disbursements in the incorrect amount, or any disbursements that are not in compliance with law, program regulations, or agency policy.

The OMB guidance on estimating the annual amount of improper payments requires agencies to obtain a statistically valid estimate of the annual amount of improper payments that is based on a random sample with a specified confidence interval. The guidance states an agency may seek OMB approval to deviate from the required steps or use an alternative method. The OMB guidance also addresses the annual PAR reporting of the estimate and corrective action plan for reducing improper payments.

The Department's Office of the Chief Financial Officer (OCFO) has primary responsibility for issuance of the PAR. FSA is responsible for providing information to the OCFO on programs it administers. FSA's Financial Partners Services developed the methodologies for estimating the amount of improper payments for the FFEL Program reported in the PARs for FY2006 and FY2007.

[1] Appendix C consolidated requirements that were previously communicated to agencies in OMB memoranda issued on January 16, 2003, May 8, 2003, and May 21, 2003, and clarified and updated the requirements.

AUDIT RESULTS

FSA used different methodologies for estimating the improper payment rates for the FFEL Program that were reported for FY2006 and FY2007, and plans to use another methodology for FY2008. FSA consulted with OMB staff during the design and execution of the methodologies and generally followed the IPIA definition and OMB guidance for loan guarantee programs when it identified "payments" for the FFEL Program as the payments made by the Department to lenders and guaranty agencies. Nevertheless, there were several factors that affected the reliability of the improper payment rates reported in the PARs. To improve the reliability of the improper payment rates for the FFEL Program, we recommend that FSA: (1) ensure that factors related to the use of previously conducted audits and reviews are taken into account or their effects mitigated; (2) ensure that all methods of payment are taken into account when identifying the FFEL payments to be included in estimating methodologies; (3) ensure that future methodologies use information on improper payments for the fiscal year for the PAR or, if not available, for the prior fiscal year; (4) when sampling is used, consider focusing sample selection on higher-risk entities and areas to increase the likelihood of identifying improper payments; (5) finalize and revise the estimated improper payment rate for FY2007 in future PARs;[2] and (6) disclose in the PARs when the rate is based on an interim calculation or there are other limitations in the reported information on improper payments.

We also found that the program outlays for the FFEL Program reported in the Department's PARs for FY2006 and FY2007 and used to calculate the estimated dollars of improper payments reflected different payment universes. In addition, FSA used an estimated program outlay amount for the current year when information was available on the actual outlays for the year. We recommend that FSA develop and implement a revised policy for identifying and reporting program outlays for the FFEL Program in the PARs that provides consistent and comparable information on outlays and dollars of improper payments reported and utilizes the most currently available information on outlays.

In its comments on the draft report, FSA did not explicitly express concurrence with our findings and recommendations, but did state it would implement a methodology for estimating FFEL improper payments that meets OMB requirements. FSA also stated that it would finalize and report the estimated improper payment rate for FY2007, disclose in future PARs when an interim calculation is used or other limitations in reported information, and update its policy and procedures to ensure consistency in information reported in future PARs. The comments are summarized at the end of each finding and the full text of the comments is included as an Attachment to this report.

[2] The estimated improper payment rate of 0.032 percent reported in the PAR for FY2007 was based on an interim calculation. In April 2008, FSA updated its calculation of the estimated improper payment rate in order to respond to an information request from the OIG auditors. The recalculation resulted in an estimated improper payment rate of 0.218 percent.

FINDING NO. 1 – Several Factors Affected the Reliability of FSA's Estimated Improper Payment Rates

Several factors affected the reliability of the estimated improper payment rates for the FFEL Program reported in the PARs for FY2006 and FY2007. The reliability of the planned methodology for reporting in the FY2008 PAR also could be impacted by several of the factors identified in the earlier methodologies.

Estimated Improper Payment Rate Reported in the PAR for FY2006

FSA provided an internal document that described the methodology used to develop the estimated improper payment rate of 2.2 percent for FY2006. The methodology extrapolated the monetary findings from prior reviews of lenders, lender servicers, and guaranty agencies to the amount of payments made to the lenders and guaranty agencies. To identify the monetary findings, FSA's Financial Partners Services reviewed reports issued in FY2005 for the following types of reviews: single audits, program audits, OIG audits, and FSA program reviews of guaranty agencies, lenders and lender servicers.[3]

FSA compiled the identified monetary findings separately for lenders/lender servicers and guaranty agencies by type of review, and extrapolated the identified improper payments to all lenders and guaranty agencies.[4] FSA then added the calculated improper payments for each type of review (totaled $185,129,426 for all reviews) and divided the total by the total payments to guaranty agencies and lenders ($8,625,964,796) in FY2005 to derive the estimated improper payment rate of 2.2 percent for the FFEL Program.

Several factors affect the reliability of FSA's estimated improper payment rate for FY2006. Sole reliance on audits and FSA program reviews of guaranty agencies, lenders, and lender servicers excluded improper payments identified by other sources. Also, amounts extracted from reports on previously conducted audits and program reviews may not reflect actual improper payments for a federal fiscal year. Other factors were that the amounts used from the reports may be unrepresentative of all lenders and guaranty agencies, duplicate amounts included in another report, and contain amounts not applicable to the PAR reporting period. Also, the identified amount of improper payments was incomplete (i.e., exclusion of contested monetary findings and use of final determinations of liabilities). We also found that FSA had omitted certain payments to guaranty agencies from the total payments used to calculate the estimated improper payment rate.

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[3] Single audits are audits conducted in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Program audits are audits conducted in accordance with the Department's Audit Guide, *Compliance Audits (Attestation Engagements) for Lenders and Lender Servicers Participating in the Federal Family Education Loan Program*.

[4] For example, the FSA program reviews covered guaranty agencies who guaranteed $174,034,845,527 of the $300,142,555,788 in total loan balances. FSA identified $533,440 of monetary findings for program reviews at the reviewed guaranty agencies. Using the following formula, FSA calculated $919,978 as the amount of improper payments identified from program reviews at guaranty agencies:

$$\frac{\$300{,}142{,}555{,}788}{\$174{,}034{,}845{,}527} \times \$533{,}440 = \$919{,}978$$

Sole Reliance on Audits and FSA Program Reviews of Guaranty Agencies, Lenders, and Lender Servicers Excluded Improper Payments Identified by Other Sources

The amount of improper payments used in FSA's methodology may be incomplete because all sources for identifying improper payments were not utilized in the methodology. FSA did not include monetary findings from audits and reviews of institutions of higher education, guaranty agency reviews of lenders, or OIG investigations. Also, all improper payments self-identified by lenders or lender servicers were not included in the methodology.

- <u>Institutions of higher education reviews</u>. Institutions of higher education that administer the FFEL Program are subject to audits conducted by independent auditors and the OIG, as well as program reviews conducted by FSA and guaranty agencies. These audits and program reviews may have findings related to students' eligibility for FFEL disbursements, amount of the disbursement, or amounts to be returned to the lender. For example, students enrolled in ineligible programs or at ineligible institutions are not eligible for loans under the FFEL Program. Student eligibility is significant because payments made on behalf of loans disbursed to ineligible students, such as interest and special allowance subsidies paid to lenders and claims paid to guaranty agencies, are improper payments.

- <u>Guaranty agency reviews</u>. Guaranty agencies are required by federal regulations to conduct biennial program reviews of certain lenders participating in the FFEL Program. Federal regulations define the criteria for selecting the lenders for review, but guaranty agencies may consider other factors, including complaints from schools, students or borrowers, and evidence of potential fraud or abuse in a lender's FFEL Program participation. Guaranty agencies reported that common program review findings at lenders included errors on lender invoices in origination fee calculations, interest, and special allowance reporting. These types of errors could result in improper payments.

- <u>OIG investigations</u>. Documentation provided by OIG investigations showed that improper payments of almost $4 million were identified in FY2006 for all Student Financial Assistance programs, including but not limited to the FFEL Program. In one example, an OIG investigation identified $650,000 that the Department paid a guarantor for fraudulently consolidated federal student loans.

- <u>Lender self-reports</u>. FSA included $370,740 in self-reported lender liabilities that was recorded in the Department's Postsecondary Education Participants System (PEPS), but did not include adjustments made by lenders on their invoices. Adjustments of amounts included in prior invoices may occur when updated borrower information was subsequently received that impacts the calculation of interest and special allowance on the loans. Adjustments may also occur when the lender or lender servicer has identified errors in their billings. The lender invoice does not identify the reason for an adjustment.

By not including these additional sources when compiling monetary findings, FSA understated the improper payments used to develop its estimated improper payment rate.

Audit and Program Review Reports May Not Reflect the Actual Improper Payments For a Federal Fiscal Year

The reports from previously conducted audits and program reviews may not reflect the amount of actual improper payments. Audits and program reviews generally cover a small sample or focus on selected program requirements. Thus, there is a risk that the reviews may not detect conditions that may have resulted in improper payments. For example, FSA receives about 380 program audit reports annually. However, FSA identified only 11 program audit reports issued during FY2005 that contained monetary amounts for inclusion in the improper payment rate.

Even when the audits and reviews have detected reportable conditions, the reports may not contain information on the actual amounts of improper payment applicable to the period reported in the PAR. The reports may not include a quantification that reflects the improper payment amount, may be limited to the reviewed transactions, or be for a period other than the federal fiscal year.

- Reported monetary impact may not reflect the improper payment amount. This situation was demonstrated by FSA's use of monetary amounts from program audits. Our review of 4 of the 11 program audit reports confirmed that, for one audit report, an improper payment had occurred and that FSA had used an accurate amount in its development of the estimated improper payment rate. The other three audit reports included findings discussing conditions that may have resulted in improper payments. However, the amounts from the three reports that FSA used to develop its estimated improper payment rate were not a quantification of an improper payment made to a lender or guaranty agency. Instead, the amounts represented the principal balance of a loan or a loan disbursement.

- Quantification limited to reviewed transactions. Even when an audit or program review report includes a questioned cost (i.e., an improper payment), the amount is often limited to the specific erroneous transactions identified in the reviewed sample rather than an amount derived by projecting sample results across all transactions. Although not projecting sample results may have been valid (e.g., the sample was non-statistical), using only sample results understates the improper payment amount.

- Period covered by quantification may be other than a federal fiscal year. The 12-month federal fiscal year is used for improper payments reporting. In contrast, the period covered by audits and program reviews may be an entity's fiscal year, multiple fiscal years, or other period of time. Thus, monetary findings in audit and program review reports may be linked to a period of time other than the federal fiscal year or a period that is longer or shorter than the federal fiscal year. Using the reported monetary findings could consequently result in either overstating or understating the improper payments.

FSA also recognized in its methodology documentation that the improper payments were incomplete because monetary findings were not always quantified by FSA in the final program review report. The OIG audit report titled *Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers* (ACN A04E0009), issued September 2006, discussed this condition and recommended that FSA develop a consistent policy for identifying, quantifying, and reporting liabilities identified in program reviews.

Findings in OIG Audits and FSA Program Reviews at Individual Entities May Not Be Representative of Improper Payments at Other Entities

Findings from OIG audits and FSA program reviews may not be representative of conditions effecting payments to all lenders and guaranty agencies. Because these audits and program reviews are generally selected on a judgmental basis that may consider risk, extrapolating their results across loan balances for all lenders and guaranty agencies may overstate the amount of improper payments. For example, FSA included an improper lender payment of $688,767 from an OIG audit report[5] and extrapolated the amount across loan balances for all lenders. Thus, the one OIG audit, which covered less than 0.4 percent of loan balances, accounted for $181 million[6] of the $185 million (97.7 percent) improper payments used to calculate the estimated improper payment rate for the FFEL Program.

Audits and Program Reviews Could Identify the Same Improper Payments

Audits and program reviews conducted by different organizations that review the same entity could identify the same improper payments. For example, program reviews conducted by FSA and the single audits and program audits conducted by independent public accountants may cover the same loan balances. FSA's documentation for lenders showed that the FSA program reviews provided oversight for 26 percent of loan balances and reported monetary findings of $621,300. Additionally, FSA's documentation showed that the single audits and program audits provided 95 percent coverage of the same loan balances and reported monetary findings of $864,400.

The likelihood of two reviewers identifying the same improper payment is minimized by the limited nature of the audits and program reviews. Auditors review an entity's internal controls and may limit their testing to a small sample of loans. Program reviewers may also only review documentation for a limited number of loans and may limit the scope of their reviews to certain aspects of the FFEL Program. However, if the auditors and program reviewers identify the same condition at a lender or guaranty agency, the projection of the improper payments to the total payments made to the entity could result in duplication of improper payment amounts.

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[5] *Special Allowance Payments to New Mexico Educational Assistance Foundation for Loans Funded by Tax-Exempt Obligations* (ED-OIG/A05E0017), issued May 2005.

[6] FSA calculated the amount of improper payments identified from OIG audit reports using the following formula:

$$\frac{\$281{,}140{,}952{,}852}{\$1{,}070{,}544{,}497} \times \$688{,}767 = \$180{,}880{,}488$$

Applicability of Identified Improper Payments to the Reporting Period

In its Appendix C guidance, OMB recommended that the annual estimate of improper payments reported in the PAR coincide with the fiscal year being reported, but allowed, in limited cases, that agencies report using the previous year's data. Improper payments identified by audits and program reviews may be for periods prior to both the fiscal year being reported and the previous fiscal year. FSA used audit and program review reports issued during FY2005 to identify the improper payments used to calculate the estimated improper payment rate reported in the PAR for FY2006. For example, the OIG audit report (ED-OIG/A05E0017) identified improper payments that occurred in FY2003 and FY2004. The identified improper payments become less applicable to the PAR reporting period as the time lengthens between the occurrence of the improper payments and the fiscal year used for reporting in the PAR.

Exclusion of Contested Findings and Use of Final Determinations of Liabilities Understate Improper Payments Identified in Audits and Reviews

The amount of improper payments used in FSA's methodology is understated due to FSA's exclusion of contested finding amounts (e.g., lender or guaranty agency disagreed with the finding) and use of the liability amounts from final determinations on reported findings.

- <u>Contested findings</u>. Improper payments identified in contested findings were not included in the improper payment total used to develop the estimated improper payment rate. The OIG audit report (ED-OIG/A05E0017) with the $688,767 improper payments that was mentioned in a prior section also included a finding that the lender may have been improperly paid $18.4 million in special allowance payments for loans that were not eligible to be billed under the 9.5 percent floor. FSA only included the $688,767 of improper payments, which related to a finding that the lender agreed with in its comments to the report.

- <u>Final determinations of liability</u>. FSA's document describing the FY2006 methodology showed that the amount of improper payments from FSA program review findings was obtained from the PEPS. FSA disclosed in its document that the PEPS data entry procedures, in effect at the time, delayed entry of the dollar amount of a program review finding into the PEPS until the review was closed on the system and monetary adjustments had taken place. FSA had delayed entering the amounts because the amounts in the final determination of a finding or after appeals may be different from the amount identified in the initial program review report.

Even when a contested finding is upheld or the final adjustment takes place, the amount of the improper payments can exceed the amount of the recorded liability. An OIG audit of a lender that was recently resolved provides an example of the possible magnitude of the difference. The audit report disclosed $278 million of improper payments.[7] While the finding was upheld, the Department determined a final liability of zero. Even when the Department decides not to establish or recover a liability, the improper payments should be included in determining the estimated improper payment rate.

Certain Payments to Guaranty Agencies Were Not Included

FSA omitted certain payments to guaranty agencies from the total payments used to calculate the estimated improper payment rate. When defining payments made to guaranty agencies, FSA only included transactions that passed through the Department's payment system. For example, for account maintenance fees, FSA included the $160.7 million in payments made through the payment system, but did not include the additional $103 million that guaranty agencies received by transferring funds from their Federal fund to their Operating fund. FSA also did not include the payments for default aversion fees in total payments. Guaranty agencies calculate these fees and receive payment by transferring funds from their Federal fund to their Operating fund. Guaranty agencies reported transferring about $86 million for default aversion fees for FY2005.

Estimated Improper Payment Rate Reported in the PAR for FY2007

FSA used a statistical sampling methodology to develop the estimated improper payment rate of 0.032 percent for FY2007. FSA reviewed statistically selected samples for two types of payments made during FY2005: payments to lenders and payments to guaranty agencies. For each payment type, FSA used a two-stage sampling process. In the first stage, a sample of payments was selected by Financial Partners Services. In the second stage, FSA selected a sub-sample of loan-level transactions from the invoice supporting the payment selected in the first stage. FSA's Financial Partner Eligibility & Oversight, a component of FSA's Program Compliance unit, selected the second stage sub-samples and conducted the associated reviews at the guaranty agencies, lenders, and lender servicers.

Pilot reviews began in late November 2006. Lessons learned from these reviews were incorporated into a 59-page review guide, which was finalized in March 2007. The guide included provisions for consistency of reviews, such as detailed electronic templates, and oversight over reviews. The team leaders, who conducted the pilot reviews, conducted training for the rest of the reviewers during February and March 2007.

- Payments from ED to Lenders: Lenders submit quarterly invoices to the Department via the Lender Reporting System (LaRS). Lenders invoiced the Department for interest and special allowance payments, which could be offset by loan origination and lender loan fees that lenders owed the Department. FSA identified 11,264 payments, totaling $3.2 billion, made in FY2005 to the approximately 3,200 lenders that participate in the FFEL Program (lender payment universe).

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[7] *Special Allowance Payments to Nelnet for Loans Funded by Tax-Exempt Obligations* (ED-OIG/A07F0017), issued September 2006. Since the audit report was issued in FY2006, the report was not included in the reports reviewed to identify improper payments for development of the estimated improper payment rate for FY2006. The FY2006 estimated rate was based on improper payments identified in reviews of audit and program review reports issued in FY2005.

In the first stage, FSA randomly selected 47 primary sample units, where a primary sample unit was a payment for a specific fiscal quarter tied to a specific invoice from a lender or a lender servicer. Depending on the number of lender servicers used by a lender, that lender could be associated with multiple invoices and multiple payments for any one fiscal quarter. The 47 payments selected in the first stage random sample were made to 47 different lenders.

For the second stage sub-sampling, FSA obtained the lender or lender servicer data used to support the invoice that had been the basis for the Department's payment. The data was requested from the lender/lender servicer at the loan level, which linked each component of the invoice with a unique loan (i.e., a specific loan for a specific borrower.) In the second stage, FSA statistically selected unique loans and reviewed all transactions related to that loan which affected the selected invoice. For example, in an invoice, one loan might be associated with interest, special allowance, loan origination, and lender loan fee transactions, whereas another loan might only be associated with one of those transactions. The number of second stage sub-samples selected depended on the number of unique loans supporting the invoice.

For each sampled loan, the review guide required the FSA reviewer to obtain electronic and hardcopy documentation from the lender that the reviewer used to examine the accuracy of data and calculations supporting the lender's invoice. The activities that FSA reviewers were instructed to complete and document for each sampled loan included:

- Verify that totals on the lender's electronic back-up files agree with totals reported by the lender and paid through the LaRS process.
- Verify the existence of a valid signed promissory note. Compare the signature date with the date of the first disbursement to verify interest rates and special allowance categories that are based on the date.
- Verify that origination and lender fees due to the Department for loans originated during the quarter were paid timely and accurately.
- Verify eligibility for interest and special allowance benefits during the quarter by examining lender documentation pertaining to loan amount, disbursement date, current status, payment amount, deferment, and forbearance.
- Verify application of payments: Recalculate interest due on balance and verify that payment was applied correctly to interest, principal and late fees.
- After recalculating the ending balance, recalculate interest accrued for the quarter on subsidized loans and payable by the Department, and compare to amount invoiced by lender.
- Using transaction history, recalculate the average daily balance for the quarter and compare to amounts reported by lender to support special allowance payments by Department.

We concluded from our evaluation of the documentation for five of the FSA lender reviews that the reviewers had adhered to the review instructions specified in the review guide. However, as we noted later in the finding, the review process did not consider subsequent transactions, did not verify all components of the special allowance category code, and did not confirm that lenders had satisfied due diligence requirements.

After a cost-benefit discussion with OMB, FSA decided to cease the reviews before completion of all 47 lender reviews. FSA provided documentation showing that 42 of the 47 reviews were completed, of which 38 reviews were conducted on-site at lenders or lender servicers and 4 were conducted as desk reviews.[8] FSA documented that the invoices for the 42 completed reviews totaled about $12 million, and that the absolute value of the sub-samples reviewed for those invoices totaled about $29,243.

- Payments from ED to Guaranty Agencies: Guaranty agencies submit monthly invoices to the Department using the Guaranty Agency Financial Report (GAFR). Guaranty agencies request payments for various types of claims, such as claims for default, bankruptcy, death, disability, and closed schools. The amount invoiced would be offset by amounts the guaranty agency owed the Department for collections and refunds. FSA identified 488 payments, totaling $3.5 billion, made during FY2005 to the 35 guaranty agencies that participate in the FFEL Program (guaranty agency payment universe).

  In the first stage, FSA randomly selected 44 primary sample units, where a primary sample unit was a payment for a specific month to a specific guaranty agency. The 44 payments selected in the first stage random sample were made to 27 of the 35 guaranty agencies.

  As had been done for the lender payments, FSA obtained the loan-level data used to support the invoice from the guaranty agency and used the data to randomly select the second stage sub-sample. Then, FSA examined all transactions for the specific month that were related to the selected loan.

  Similarly, for each sampled loan, the review guide required the FSA reviewer to obtain electronic and hardcopy documentation from the guaranty agency that the reviewer used to examine the accuracy of data and calculations supporting the guaranty agency's invoice. The activities that FSA reviewers were instructed to complete and document for each sampled loan included:

  - Verify that totals on the guaranty agency's electronic back-up files agree with totals reported by the guaranty agency and paid through the GAFR process.
  - Analyze supporting documentation to determine the type of transaction being reviewed and determine if it was reported under the correct line item(s).
  - Verify the existence of a valid signed promissory note and compare it with loan and transaction records.
  - For claims, verify the accuracy of the invoiced amount by examining the supporting documentation pertaining to type of loan, disbursement/guarantee dates and amounts, and reinsurance rate. Verify that the claim payment date and amount paid to lender were correctly reported to the Department.
  - For collections, verify that payments received were reported timely and accurately by examining the supporting documentation pertaining to type of loan, first disbursement date, disbursed amount, reinsurance rate, receipt dates and amounts, payment attribution to all the borrower's loans, and amount attributed to the specific loan selected for the sub-sample.

[8] FSA used a number of criteria to determine if desk reviews were appropriate, such as entity portfolio size, complexity of known issues, and the lender's ability to provide appropriate requested information.

We concluded from our evaluation of the documentation for two of the FSA guaranty agency reviews that the reviewers had adhered to the review instructions specified in the review guide. However, as we noted later in the finding, the review process did not include a confirmation of required due diligence activities for default claims.

As discussed above, FSA curtailed the planned reviews. FSA informed us that it completed 42 of the 44 guaranty agency reviews, and conducted all 42 reviews on-site at the guaranty agencies.[9] FSA documented that the invoices for the 42 completed reviews totaled about $271 million, and that the absolute value of the sub-samples reviewed for those invoices totaled about $846,835.

FSA reviewers identified a gross total (i.e., absolute value of over- and under-payments) of $42.37 for the lender reviews (improper payments identified in 2 of 42 reviews) and $163.26 for the guaranty agency reviews (improper payments identified in 5 of 42 reviews.) For each invoice reviewed, FSA divided the amount of any improper payments by the total amount of the loan-level transactions reviewed for that invoice to calculate an error rate for the reviewed loan-level transactions. FSA then multiplied the error rate for the reviewed loan-level transactions by the total amount of the invoice to extrapolate an amount of improper payments for each invoice. FSA calculated the amount of improper payments for the 84 lender and guaranty invoices at $74,835. While conducting the guaranty agency reviews, FSA identified an additional $18,157 of improper payments that were outside the specific loan-level transactions reviewed. These two amounts totaled $92,992. However, due to a worksheet formula error when summarizing the amounts, FSA calculated $89,998 as the total improper payments. To calculate the estimated improper payment rate, FSA divided the $89,988 in total improper payments by the total payments for the 84 invoices reviewed ($283,175,828). The resulting estimated improper payment rate of 0.032 percent was reported in the FY2007 PAR.[10]

Several factors affected the reliability of FSA's improper payment rate for FY2007. The methodology did not take into account determinations of student eligibility and other loan-making activities. Also, an estimating methodology that relies on the results of a review of sampled payment invoices is impacted by the method of sample selection, completeness of the payment universe, use of FY2005 payment data, and design of the review process. Finally, the estimated improper payment rate reported in the PAR was based on an interim calculation that did not include all improper payments identified by the reviews.

Methodology Did Not Take Into Account Determinations of Student Eligibility and Other Loan-Making Activities

Educational institutions often perform loan-making activities that impact whether payments to lenders and guaranty agencies are proper. For example, educational institutions determine the borrower's eligibility for loans and loan amounts. They may also perform other loan-making activities, such as explaining borrower's rights and responsibilities under the loan. When certain loan-making activities are not performed correctly, the federal guarantee on the loan may be impacted. In addition, educational institutions and lenders rely on statements made by borrowers

[9] One of the two cancelled reviews was for a closed guaranty agency.

[10] The estimated improper payment rate would have been 0.033 percent if FSA had used the correct amount for the total of estimated improper payments ($92,992) in its calculation.

on their loan applications. Inaccurate application information could result in an improper determination of student eligibility for the loan and, thus, impact the federal guarantee on the loan. Payments made to lenders for interest and special allowances and payments to guaranty agencies for claims on loans that do not have a valid federal guarantee are improper payments. In addition, activities performed by educational institutions that take place over the loan's life-cycle may impact federal interest payments to lenders.

While student eligibility and other loan-making activities could effect the payments to lenders and guaranty agencies that were reviewed under FSA's methodology, it would not have been feasible for FSA to evaluate these activities as part of its review. Loan-making activities are completed by numerous educational institutions located throughout the nation. Also, the student's preparation of the application and the loan-making and other activities performed by educational institutions may have occurred several years earlier.

Even when audits and program reviews of educational institutions have identified loans that were made to ineligible students, the lender and guaranty agency may continue to receive payments on the ineligible loans. When FSA identifies ineligible loans through its program reviews at educational institutions, FSA requires the educational institution to assume the liability for the interest subsidy cost and risk of loss from default by the borrower for the ineligible amount of the loan.[11] FSA uses the estimated actual loss formula to determine the institution's liability amount,[12] and establishes a receivable to recover from the school the estimated costs resulting from a school's disbursement of the ineligible loan. According to FSA's procedures, the school is not given the option of purchasing the ineligible loan from the lender.[13] Since FSA establishes the receivable directly with the school, the lender and guaranty agency may have no knowledge of the loan's ineligibility. Even though payments to the lender for interest and special allowance and the guaranty agency for claims on the ineligible loans may be allowable payments to those entities, they should be classified as improper payments for the purpose of estimating the improper payment rate.

Sample Size and Use of Simple Random Sampling

FSA used statistical software (EZ-Quant) to determine the number of payments to be selected for review in the lender and guaranty agency universes and the related loan-level transactions (i.e., sample sizes). FSA's goal was to determine the sample sizes at a 95% confidence level with a presumed 3 percent error rate and precision of +/-5 percent. However, FSA did not enter the correct amounts into the EZ-Quant's input screens for the "desired maximum precision amount" when it determined the sample sizes. FSA entered an amount equal to 5 percent of the total dollar amount of the payment universe instead of 5 percent of the presumed dollar amount of improper payments (i.e., 3 percent of the dollar amount of the payment universe). For example, to determine

[11] Except for certain exceptions, such as cases involving fraud or cases where the student never attended school.

[12] The formula takes into account a school's default rate and the amount of the ineligible disbursements to calculate an amount that includes the estimated actual loss to the government for which the school is now liable.

[13] FSA does not provide the school with the option of purchasing the ineligible loan from the lender and establishing a receivable from the borrower as this may deprive the borrower of certain benefits, such as consolidating their loans or requesting income contingent repayment plans. In addition, the loan agreement gives the borrower benefits, such as deferment and cancellation provisions, that may not be easily enforced against the school.

the sample size from the guaranty agency universe, FSA used $175,360,350 (5 percent of the total payments of $3,507,207,010) for the "desired maximum precision amount" instead of $5,260,811 (5 percent of the presumed improper payments of $105,216,210).[14] Due to the procedural error, FSA used sample sizes that were significantly smaller than those recommended by the EZ-Quant software. In the above example, EZ-Quant recommended a sample size of 484 from the universe of 488 guaranty agency payments, basically a 100 percent review, to obtain FSA's goal of a sample with a 95% confidence level with a presumed 3 percent error rate and precision of +/-5 percent. FSA had determined a sample size of 44. The impact of using smaller sample sizes will not be known until a statistical projection of the actual sample results is performed. The following table shows the amount of the payments made to lenders and guaranty agencies in FY2005 that were selected for detailed review.

Table 1. Amounts In Payment Universes and Related Samples

Payment Type	**Payment Universe**	**Payments for Selected Invoices** (First Stage Sample)	**Payments for Selected Loans** (Second Stage Sub-Sample)
Lender Payments	$3.2 billion	$12 million	$29,243
Guaranty Agency Payments	$3.5 billion	$271 million	$846,835

Use of stratified sampling, rather than simple random sampling, could improve the efficiency of sampling. FSA used a simple random selection process to identify the invoices and loans in its samples. In its Appendix C guidance, issued August 10, 2006, OMB suggested that "most agencies will need to consult with a statistician to design an appropriate sample that may involve . . . multiple stages of selection or stratification (rather than a simple random sample)." Although FSA conferred with a statistician and used a two stage sample selection process, the samples in each of the two stages were selected by a simple random process, which gave every item an equal chance of selection. FSA's discussions with the statistician did not include consideration of alternatives to a simple random sample selection process. Stratification, where a universe is divided into strata, is an alternative for sample selection that can be used to give special emphasis to certain groups within the payment universes, such as invoices of high dollar values or those with a great error potential.

Completeness of the Payment Universe

The lender and guaranty agency payment universes did not include all types of payments. The lender payment universe was based entirely on information in FSA's payment system which did not include "accounts receivable" invoices. These are invoices where, after netting amounts due from the Department against amounts due from lenders, the lenders owed the Department. Because FSA did not include the "accounts receivable" invoices in the lender payment universe, the amount payable by the Department on those invoices was excluded from the improper payment review process.

[14] The presumed improper payment amount is calculated by multiplying the payment universe amount ($3,507,207,010) by the presumed error rate (3%).

The guaranty agency payment universe, which was also based on information in FSA's payment system, did not include amounts that guaranty agencies received by transferring funds from their Federal fund to their Operating fund. For example, the amounts transferred for the default aversion fees mentioned in an earlier section of this report.

Use of FY2005 Payment Data

The lender and guaranty agency payment universes did not use the most current payment information available in its methodology. FSA's use of the FY2005 payment information exceeded the one year allowance outlined in OMB's Appendix C guidance, issued August 10, 2006, and resulted in the application of an estimated improper payment rate for FY2005 to program outlays for FY2007 and later. We also noted that FSA's use of FY2005 payment information provided no coverage of excess interest fees during the improper payment reviews. However, the exclusions of the excess interest fee likely had no impact on the estimated improper payment rate since the fee became effective on April 1, 2006 and totaled about $1.5 million in FY2006.

Review Process Did Not Consider Subsequent Transactions

FSA's review process did not consider subsequent transactions when reviewing loan-level transactions for lender payments. A transaction would be considered accurate if it was accurate for the quarter reviewed, even if it had been adjusted in a subsequent quarterly invoice. As mentioned in a previous section of this report, subsequent adjusting transactions are required when lenders receive updated borrower information or identify errors in their procedures. When examining the transactions for a loan for the sampled quarterly invoice, FSA's review process did not include reviewing later invoices to determine whether any subsequent adjustments had been made, and if so, to determine the reason for the adjustment. Thus, FSA's process for reviewing loan-level transactions may not have identified improper payments.

Review Process Did Not Verify All Components of the Special Allowance Category Code

FSA's review process for lender payments did not include verification of all components of the special allowance category code, which is used to calculate the special allowance subsidy payable by the Department. The selection of the appropriate special allowance category code is determined by four loan characteristics: loan type, date, borrower status, and funding source (i.e., from either taxable or tax-exempt sources). The review process included verification of the first three loan characteristics, but did not include verification of the funding source. FSA management stated that it was not practical to verify the funding source, because funding documentation is maintained at the lender whereas most of the reviews were conducted at the lender servicer. Additionally, FSA management stated that the funding sources were not confirmed because FSA reviewers had knowledge of the type of funding source generally used by a lender and that separate on-going reviews were examining the funding source used to support special allowance invoicing. Thus, FSA's review of sampled loans would not have identified improper payments that could have occurred from lenders placing loans in an inappropriate special allowance category for the funding source. The OIG audit report (ED-OIG/A05E0017), which was included in the methodology used for the FY2006 PAR, identified a substantial amount of improper payments that resulted from a lender's use of the inappropriate special allowance category for the funding source.

Review Process Did Not Confirm That Lenders Satisfied Due Diligence Requirements

FSA's review process for lender payments and guaranty agency payments on default claims did not include a confirmation that lenders performed required collection activities (referred to as due diligence). The federal guarantee on the loan may be lost if a lender fails to complete the required activities within certain timeframes. If the guarantee on a loan is lost, the lender also loses the right to collect interest and special allowance until the lender completes the activities required to reinstate the guarantee. Guaranty agencies may only submit default claims for loans that have a valid federal guarantee. An FPE&O team leader informed us that FSA had made a decision not to include due diligence in the review process.

Improper Payment Rate Reported in PAR Was Based on Interim Calculation

The estimated improper payment rate of 0.032 percent reported in the PAR for FY2007 was based on an interim calculation that did not include all improper payments identified by the reviews. FSA provided documentation confirming that, as of September 30, 2007, reviews had been completed of the 84 lender and guaranty agency invoices. However, FSA did not include the results of some reviews in the calculation of the rate because, at the time the calculation was prepared, FSA had not yet determined the actual amount of the improper payments for those reviews. According to the FSA staff responsible for conducting the calculation, the related program review report had not yet been provided to him or FSA was awaiting information from the lender or guaranty agency to determine the improper payment amount.

In April 2008, FSA updated its calculation of the estimated improper payment rate in order to respond to an information request from the OIG auditors. The revised calculation identified a gross total of $203 improper payments for the lender reviews (improper payments identified in 3 of 42 reviews) and $1,140 improper payments for the guaranty agency reviews (improper payments identified in 11 of 42 reviews.) After FSA extrapolated the identified errors to the related invoices, the improper payment amount for the 84 invoices totaled $569,850. FSA increased the amount for the additional improper payments identified outside the reviewed loan-level transactions to $51,798. The two amounts totaled $621,648. Due to the same worksheet formula error that we noted in the previous calculation, FSA calculated $618,644 as the total of estimated improper payments. To calculate the updated improper payment rate for the 84 invoice reviews, FSA divided the $618,644 in total improper payments by the total payments for the 84 invoices reviewed ($283,175,828). The calculation resulted in an estimated improper payment rate of 0.218 percent.[15] The FSA staff stated that the calculation may be further revised after FSA reviews responses and additional documentation provided by lenders and guaranty agencies and makes final determinations of the improper payments for the individual reviews.

[15] The estimated improper payment rate would have been 0.220 percent if FSA had used the correct amount for the total of estimated improper payments ($621,648) in its calculation.

The Department did not disclose in the PAR that the reported rate was based on an interim calculation that did not include all improper payments identified in its reviews. Both the reported rate and the recalculated rate are well below the benchmark (2.5 percent) for significant erroneous payments. Nevertheless, the PAR should contain complete and accurate information and disclose limitations in reported information on improper payments. The PAR should also disclose the statistical precision of the estimated improper payment rate.

Improper Payments Methodology Planned for FY2008

FSA plans to use another methodology to estimate improper payments for the FFEL Program for reporting in the FY2008 PAR. On February 27, 2008, FSA signed an interagency agreement with the U.S. Department of Energy's Oak Ridge National Laboratory (ORNL). The agreement's Scope of Work states that "ORNL will evaluate available data sources and develop a model that utilizes that data to evaluate the relative risk of erroneous payments in the FFEL Program. The model shall also evaluate the relative risk of [the Department] being billed inappropriately by lenders or guaranty agencies. If enough relevant data can be extracted from identified data sources, an estimated percentage of improper payments, by payment types and/or type of recipient (GA or lender) will be calculated." The project description stated that data on audits was available in PEPS and from the Department's Audit Accountability Resolution Tracking System. Other data for lenders and guaranty agencies was contained in the Department's National Student Loan Data System and Financial Management System (FMS). If ORNL develops a model that uses the results of previously conducted audits and reviews, the reliability of ORNL's risk assessment, and any estimated percentage of improper payments, may be similarly impacted by the factors discussed in this report for FSA's FY2006 methodology.

Recommendations

We recommend that the Acting Chief Operating Officer for FSA—

1.1 Ensure that the design and implementation of any future improper payment estimating methodologies that utilize results of previously conducted audits and reviews take into account or mitigate the effects of the following factors, when feasible: (1) improper payments identified in reviews other than single audits, program audits, OIG audits, and FSA program reviews of lenders and guaranty agencies (including improper payments self-reported by lenders); (2) lack of quantification of monetary impact of findings in the reports; (3) review periods that do not correlate to the federal fiscal year; (4) not being representative of all lenders and guaranty agencies; (5) duplicate identification of improper payments; (6) the time between the occurrence of the improper payments and the fiscal year used for reporting in the PAR; and (7) improper payments identified in contested monetary findings and findings without a final determination of liabilities.

1.2 Ensure that future methodologies appropriately include all payments, such as payments made by transferring funds between accounts (i.e., guaranty agencies' transfer of funds from their Federal fund to their Operating fund) and payments netted by larger amounts due to the Department (i.e., accounts receivable invoices).

1.3 Ensure that future methodologies use information on improper payments for the fiscal year used for reporting in the PAR or, if not available, for the prior fiscal year.

1.4 If sampling is used in future methodologies, consider focusing sample selection on higher-risk entities or types of transactions, such as subsequent adjustments and special allowance subsidies, to increase the likelihood of identifying improper payments.

1.5 Finalize its calculation of the estimated improper payment rate for FY2007 (including the measure of the statistical precision of the estimated rate) and use the finalized rate and its statistical precision when reporting the estimated improper payments for FY2007 in the PAR for FY2008. The FY2008 PAR should also include an explanation of the change from the rate reported in the FY2007 PAR.

1.6 In future PARs, disclose when the information presented on improper payments is based on interim calculations and the limitations of the reported information.

FSA Comments

FSA stated it will design and implement, in consultation with OMB, a methodology for estimating FFEL improper payments that meets the requirements of Circular A-123, Appendix C, and that the Department's Office of the Chief Financial Officer and FSA have been meeting with OMB regularly to reach agreement on a methodology for fiscal years 2009 and beyond. FSA's comments did not address the specific actions contained in Recommendations 1.1, 1.2, 1.3, and 1.4. In its comments on Recommendations 1.5 and 1.6, FSA stated it will calculate and use the final rate from the reviews to report the FY2007 improper payments in the FY2008 PAR and will note the change from the rate used in the FY2007 PAR. FSA stated it will disclose in future PARs when information presented is based on interim calculations and any limitations of reported information.

OIG Response

In April 2008, the OIG provided FSA with a preliminary draft of this finding for use in the design and implementation of the methodology for FY2008. The execution of the methodology should be substantially complete at this time. As FSA noted in its comments, decisions are currently being made, in conjunction with OMB, on the design of the methodology for FY2009. FSA should ensure that the actions in Recommendations 1.1, 1.2, 1.3, and 1.4 are taken, if applicable, when evaluating and reporting limitations, if any, in the FY2008 methodology, and when designing, implementing, and reporting on the FY2009 and future methodologies.

FINDING NO. 2 – FFEL Program Outlays Reported in PARs Represented Different Payment Universes and Did Not Reflect the Most Current Information

The outlays for the FFEL Program reported in the Department's PARs for FY2006 and FY2007 and used to calculate the estimated dollars of improper payments reflected different payment universes. Also, the PARs contained an estimated outlay amount for the current year when information was available on the actual outlays for the year.

The annual PAR includes a table showing the improper payment reduction outlook. The table contains improper payment information for each risk-susceptible program for five fiscal years: prior year, current year, and the next three years. The dollars of improper payment shown in the table are calculated by multiplying the amount of the program outlays by the estimated improper payment rate. The following table shows the amounts that FSA reported in the PAR for FY2007.

Table 2. Improper Payment Reduction Outlook Reported in the FY2007 PAR for the FFEL Program

	FY2006 (Prior Year)	**FY2007 (Current Year)**	**FY2008** (a) **(Current Year+1)**
Program outlays for fiscal year (b)	$11,718 million	$5,861 million	$4,307 million
Estimated improper payment rate (c)	2.2 percent	0.032 percent	0.032 percent
Estimated dollars of improper payments for fiscal year	$258 million	$2 million	$1 million

(a) The amounts for FY2008 were also used in the PAR to report for FY2009 (Current Year+2) and FY2010 (Current Year+3).

(b) The program outlays for FY2006 reflect the actual payments made to lenders and guaranty agencies in FMS (the Department's financial management system). The program outlays for FY2007 and later years reflect the estimated outlays for FY2007 and FY2008 reported in the President's Budget for FY2008.

(c) The rate used for FY2006 was developed using monetary findings identified in audit and program review reports issued in FY2005. The rate used for FY2007 and future years was developed from reviews of a random sample of payments made to lenders and guaranty agencies in FY2005. As we disclosed in Finding No. 1, the 0.032 percent was derived from an interim calculation that did not include all improper payments identified in the reviews and, thus, understates the estimated improper payment rate. Finding No. 1 provides additional details on the two methodologies.

For the prior year's program outlays, FSA used an amount obtained from FMS. The amount reflected actual payments made by the Department to lenders and guaranty agencies during the fiscal year. For the current and future years' program outlays, FSA used estimated outlay amounts reported in the President's Budget. The amounts reflected the net present value of the anticipated payments that will be made to lenders and guaranty agencies for guaranteed loans disbursed by lenders during the respective fiscal year. Thus, the program outlays in the President's Budget represent amounts for payments that will be made to lenders and guaranty agencies over an extended period of years in the future. The payment universe reflected in the President's Budget is substantially different from the payment universe reflected in FMS. For example, the President's Budget for FY2008 reported actual outlays of $27,132 million for FY2006. As shown in Table 2, the amount of actual outlays from FMS was $11,718 million.

FSA advised us that amounts obtained from FMS and the President's Budget were used to comply with OMB requirements. OMB Circular A-123, Appendix C instructs agencies to follow the format required by OMB Circular A-136, *Financial Reporting Requirements* for reporting improper payment information in the PAR. OMB Circular A-136, III.5.7, IV (a)(vi) provides the following guidance on amounts to be used when reporting on improper payments—

> [A]gencies are expected to report on CY [current year] activity, and if not feasible, then PY [prior year] activity is acceptable. (Future year outlay estimates (CY+1, +2, and +3) should match the outlay estimates for those years as reported in the most recent President's Budget).

While FSA complied with the instructions in the OMB Circular, its use of different payment universes for program outlays resulted in dollars of improper payments presented in the PAR that were not comparable among the fiscal years.

Also, as noted in Table 2, FSA used estimated outlays from the President's Budget for FY2008 for current year outlays reported in the FY2007 PAR. Since the PAR, which was issued in November 2007, contained the Department's financial statements for FY2007, the actual outlay amounts for the current year should have been available for improper payment reporting. The OMB Circular expects agencies to report current year activity, when available.

Recommendation

2.1 We recommend that the Acting Chief Operating Officer for FSA develop and implement a revised policy for identifying and reporting program outlays for the FFEL Program in the PARs that provides consistent and comparable information on outlays and dollars of improper payments reported and utilizes the most currently available information on outlays.

FSA Comments

FSA stated that its operational policy and procedures are being updated to include the FFEL payment universe definition, steps used to extract the payment universe for outlay reporting, and queries to use for improper payment reporting to ensure consistency in future PARs.

OBJECTIVE, SCOPE, AND METHODOLOGY

The purpose of the audit was to assess FSA's methodology for estimating improper payments in the FFEL Program. Our review covered the methodology used for reporting in the PARs for FY2006 and FY2007.

To gain an understanding of the methodologies and related internal controls, we interviewed FSA management and staff in the Business Operations unit and Program Compliance's Financial Partner Eligibility and Oversight (FPE&O) unit. We also contacted FSA's offices of the Chief Financial Officer and Enterprise Performance Management Services, as well as the Department's OCFO, to understand their involvement in FSA's IPIA efforts for the FFEL Program.

To gain a more complete understanding of the requirements of the IPIA, we interviewed the OMB personnel who were involved with the development of Appendix C to OMB Circular A-123 and with whom FSA coordinated its IPIA activities.

To assess the methodologies, we reviewed FSA's written policies and procedures, written communications between FSA and OMB, and supporting documentation for each methodology.

- For the FY2006 methodology, our review was limited to review of FSA's documentation of its methodology and four program audits, and interviews with the staff who had implemented the methodology.

- For the FY2007 methodology, we reviewed FSA's documentation of its methodology and assessed the quality of FPE&O's reviews during our site visits to its western and southern regional offices. At the western region, we examined all four reviews that had been completed by FPE&O at the time of our visit (reviews of one guaranty agency and three lender invoices). At the southern region, we judgmentally selected three reviews for examination (reviews of one guaranty agency and two lender invoices) to include reviews conducted by both the Dallas and Atlanta field offices and a review that had been conducted as a desk review. We compared source documentation from lenders/lender servicers and guaranty agencies against the data documented in FPE&O reviewers' summary worksheets. We used FSA's GAFR guide to verify the reinsurance rates and retention rates for the guaranty agency reviews, and FSA's LaRS guide and information provided by the National Council of Higher Education Loan Programs to verify the special allowance category codes and interest rates for the lender/lender servicer reviews. We reviewed the logic and consistency of formulas in the reviewers' electronic worksheets. We also interviewed the statistician, assigned to the Department's Institute of Education Sciences, National Center for Education Statistics, to gain an understanding of his role in reviewing FSA's methodology for selecting a statistically valid sample and for projecting the sample results.

We conducted our audit fieldwork at FSA's headquarters office in Washington, D.C. and at its western (San Francisco) and southern (Dallas) regional offices. We judgmentally chose San Francisco because of its proximity to our Sacramento audit office and Dallas to meet with the FPE&O staff who had obtained the supporting data for the stage one samples and used it to select the stage two sub-samples for the FY2007 entity reviews.

We held an exit briefing with FSA officials on April 10, 2008. Our audit was conducted in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

ADMINISTRATIVE MATTERS

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

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

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

We appreciate the cooperation given us during this review. If you have any questions, please call Gloria Pilotti at (916) 930-2399.

Sincerely,

/s/
Keith West
Assistant Inspector General for Audit

Attachment

ATTACHMENT

FSA's Comments on the Draft Report

AUG 19 2008

TO: Keith West
Assistant Inspector General for Audit Services
Office of Inspector General

FROM: Lawrence A. Warder
Acting Chief Operating Officer

SUBJECT: Draft Audit Report – "Federal Student Aid's Estimation of Improper Payments in the Federal Family Education Loan Program," Control Number ED-OIG/A09H0015

Thank you for providing us with an opportunity to respond to the Office of Inspector General's (OIG) Draft Audit Report, "Federal Student Aid's Estimation of Improper Payments in the Federal Family Education Loan (FFEL) Program," dated July 9, 2008.

Federal Student Aid is committed to meeting the requirements of OMB Circular A-123, Appendix C, for estimating improper payments in the FFEL program. As you know, Federal Student Aid contracted with Oak Ridge National Laboratory to provide an FFEL improper payment estimate for FY 2008. In addition, the Department's Office of the Chief Financial Officer and Federal Student Aid are meeting with OMB regularly to reach agreement by the end of this fiscal year on a methodology for fiscal years 2009 and beyond that will satisfy OMB's requirements.

Our response to each of the recommendations follows:

Finding 1, recommendation 1: Ensure that the design and implementation of any future improper payment estimating methodologies that utilize results of previously conducted audits and reviews take into account or mitigate the effects of the following factors, when feasible: 1) improper payments identified in reviews other than single audits, program audits, OIG audits, and FSA program reviews of lenders and guaranty agencies (including improper payments self-reported by lenders); 2) lack of quantification of monetary impact of findings in the reports; 3) review periods that do not correlate to the federal fiscal year; 4) not being representative of all lenders and guaranty agencies; 5) duplicate identification of improper payments; 6) the time between the occurrence of the improper payments and the fiscal year used for reporting the PAR; and 7) improper payments identified in contested monetary findings and findings without a final determination of liabilities.

Response: Federal Student Aid will design and implement, in consultation with OMB, a methodology for estimating FFEL improper payments that meets the requirements of Circular A-123, Appendix C.

Finding 1, recommendation 2: Ensure that future methodologies appropriately include all payments, such as payments made by transferring funds between accounts (i.e., guaranty agencies' transfer of funds from their Federal fund to their Operating fund) and payments netted by larger amounts due to the Department (i.e., accounts receivable invoices).

Response: Federal Student Aid will design and implement, in consultation with OMB, a methodology for estimating FFEL improper payments that meets the requirements of Circular A-123, Appendix C.

Finding 1, recommendation 3: Ensure that future methodologies use information on improper payments for the fiscal year used for reporting in the PAR, or if not available, for the prior fiscal year.

Response: Federal Student Aid will design and implement, in consultation with OMB, a methodology for estimating FFEL improper payments that meets the requirements of Circular A-123, Appendix C.

Finding 1, recommendation 4: If sampling is used in future methodologies, consider focusing sample selection on higher-risk entities or types of transactions, such as subsequent adjustments and special allowance subsidies, to increase the likelihood of identifying improper payments.

Response: Federal Student Aid will design and implement, in consultation with OMB, a methodology for estimating FFEL improper payments that meets the requirements of Circular A-123, Appendix C.

Finding 1, recommendation 5: Finalize its calculation of the estimated improper payment rate for FY 2007 (including the measure of the statistical precision of the estimated rate) and use the finalized rate and its statistical precision when reporting the estimated improper payments for FY 2007 in the PAR for FY 2008. The FY 2008 PAR should also include an explanation of the change from the rate reported in the FY 2007 PAR.

Response: Federal Student Aid will use the final rate from the 2007 reviews to calculate the 2007 improper payments in the 2008 PAR and will note the change from the rate used in the 2007 PAR.

Finding 1, recommendation 6: In future PARs, disclose when information presented on improper payments is based on interim calculations and the limitations of the reported information.

Response: Federal Student Aid will so disclose in future PARs.

Finding 2, recommendation 1: Develop and Implement a revised policy for identifying and reporting program outlays for the FFEL Program in the PARs that provides consistent and comparable information on outlays and dollars of improper payments reported and utilizes the most currently available information on outlays.

Response: Federal Student Aid is updating operational policy and procedures to include the FFEL payment universe definition, steps used to extract the payment universe for outlay reporting, and queries to use for improper payment reporting to ensure consistency in future PARs.

Once again, we thank you for your recommendations and the opportunity to review and respond to the report.

cc: Gloria Pilotti, Regional Inspector General for Audit
Patrick J. Howard, Director, Student Financial Assistance Advisory and Assistance Team