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# **U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2012**

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## **FINAL AUDIT REPORT**



**ED-OIG/A03N0001**

**March 15, 2013**

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

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U.S. Department of Education  
Office of Inspector General  
Philadelphia, Pennsylvania

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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

March 15, 2013

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

John W. Hurt, III  
Chief Financial 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 the Improper Payments  
Elimination and Recovery Act of 2010 for Fiscal Year 2012  
Control Number ED-OIG/A03N0001

Attached is the subject final audit report that covers the results of our review of the Department's compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2012. An electronic copy of the report has been provided to your Audit Liaison Officers. We received your comments which identified both concurrence and non-concurrence with the findings and recommendations.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your offices will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System. The Department's policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 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 6 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.

Thomas Skelly

John Hurt

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We appreciate the cooperation given us during this review. If you have any questions, please contact me at 202-245-6949 or Bernard Tadley, Regional Inspector General for Audit at 215-656-6279.

Attachment

cc: James Runcie, Chief Operating Officer, FSA  
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Abigail Cornish, Audit Liaison Officer, OCFO  
Danny Werfel, Controller, Office of Management and Budget

## **Abbreviations, Acronyms, and Short Forms Used in this Report**

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AFR	Agency Financial Report
CFO	Chief Financial Officer
Department	U.S. Department of Education
Direct Loan	William D. Ford Federal Direct Loan
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
IPIA	Improper Payments Information Act of 2002
IRS	Internal Revenue Service
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
Pell	Federal Pell Grant
SAP	Special Allowance Payments
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

## RESULTS IN BRIEF

The Improper Payments Elimination and Recovery Act of 2010 (IPERA) (Pub. L. No. 111-204), which amended the Improper Payments Information Act of 2002 (IPIA) (Pub. L. No. 107-300), and the Office of Management and Budget's (OMB) Circular-A-123, Appendix C, Parts I and II, "Requirements for Effective Measurement and Remediation of Improper Payments" (OMB Circular A-123) require Federal agencies to reduce improper payments and report annually on their efforts. IPERA and OMB Circular A-123 require that each agency's Inspector General review agency improper payment reporting in the Agency Financial Report (AFR) and accompanying materials, to determine whether the agency is in compliance with IPERA.

### What We Did

Our audit focused on the U.S. Department of Education's (Department) improper payments activities for Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended (Title I), the Federal Pell Grant (Pell), William D. Ford Federal Direct Loan (Direct Loan), and Federal Family Education Loan (FFEL) programs for fiscal year (FY) 2012. The objectives of our audit were to (1) determine whether the Department was in compliance with the requirements of IPERA, (2) evaluate the accuracy and completeness of the Department's reporting in the AFR, and (3) evaluate the Department's performance in reducing and recapturing improper payments.

### What We Found

We found that for FY 2012, the Department complied with IPERA. However, issues remained with the completeness of the calculation of the estimated improper payment rate for the Pell program. Also, the Department's proposed methodologies for estimating improper payment rates for the Pell, Direct Loan, and FFEL programs were flawed. In addition, we found that the Department used new methodologies for estimating improper payment rates that were not approved by OMB and that the Department did not follow OMB guidance for reporting of payment recapture audit programs.

### What We Recommend

The Department should ensure that, for the estimated improper payment rate for the Pell program computed under the OMB-approved methodology using the Free Application for Federal Student Aid (FAFSA)/Internal Revenue Service (IRS) Data Statistical Study, the issues identified in our previous audit are adequately addressed. The Department should also ensure that the proposed methodologies for estimating improper payment rates for all programs use the appropriate point estimate and disclose the estimate's confidence limits. The Department should also continue to work with OMB to get approved estimation methodologies for Pell, Direct Loan, and FFEL

programs to be used in FY 2013 reporting. In addition, the Department should also prepare the Improper Payment Reporting Details contained in subsequent AFRs in accordance with OMB's guidance. Specifically, an AFR's Improper Payment Reporting Details should contain (1) a list of programs and activities for which the Department has determined a payment recapture audit program would not be cost-effective and (2) a description of the justification and analysis that it used for such determinations.

We provided draft findings and recommendations to the Department for comment. In response to the Department's comments and to clarify our meaning, we deleted Finding 3 and Recommendation 3.1 from the draft report. We moved some information from draft report Finding 3 into Finding 1, and draft report Recommendation 3.1 is now Recommendation 2.4. In its response to the draft report, the Department concurred with our finding and recommendation on the FAFSA/IRS Data Statistical Study and generally concurred with our finding and recommendation on Improper Payment Reporting Details in the AFR. The Department did not concur with our finding and recommendations about its proposed methodology for calculating improper payment estimates. We summarize the Department's responses at the end of each finding and include its written response as an Appendix to this report.

## BACKGROUND

IPERA, which amended the IPIA, and OMB Circular A-123 require Federal agencies to reduce improper payments and report annually on their efforts. OMB issued governmentwide guidance on the implementation of IPERA on April 14, 2011, which is contained in OMB Circular A-123, Appendix C, Parts I and II.

IPERA and OMB Circular A-123 require each agency's Inspector General to review the agency's improper payment reporting in its AFR and accompanying materials, to determine whether the agency complied with IPERA.

### **Improper Payments**

Under Section 2(f)(2) of the IPIA, as amended by IPERA, an "improper payment" is any payment that should not have been made or that was made in an incorrect amount. Incorrect amounts are overpayments or underpayments that are made to eligible recipients. An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service or payments for goods or services not received and any payment that does not account for credit for applicable discounts. In addition, according to OMB Circular A-123, Appendix C, Part I, a payment lacking sufficient documentation is an improper payment.

### **Significant Improper Payments**

IPERA and OMB Circular A-123 establish specific reporting requirements for agencies with programs that possess a significant risk of improper payments and for reporting on the results of improper payment recovery auditing activities. Agencies are required to review and assess, at least triennially, all programs and activities to identify those susceptible to significant improper payments. The guidance in OMB Circular A-123, Appendix C, Part I defines “significant improper payments” as those in any particular program that exceed (a) both 2.5 percent of program outlays and \$10 million of all program or activity payments made during the fiscal year reported or (b) \$100 million, regardless of the improper payment percentage of total program outlays. For each program identified as susceptible and determined to be at risk of significant improper payments, agencies are required to report an estimate of the annual amount of improper payments, along with steps taken and actions planned to reduce them.



## COMPLIANCE WITH IPERA

We found that the Department complied with IPERA for each of the following compliance areas for the Title I, Pell, Direct Loan, and FFEL programs.

### **1. Published an Agency Financial Report**

The Department complied with the requirement to publish an AFR. Under Section 3(a)(3)(A) of IPERA, the Department was required to publish on its Web site its AFR and any accompanying materials required under OMB guidance. The Department published its AFR and accompanying materials titled, “Improper Payments Reporting Details.”

### **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 to determine which ones are susceptible to significant improper payments. Under Section 2(a)(2) of the IPIA, as amended by IPERA, such risk assessments generally should be conducted in 2011 and at least once every 3 fiscal years thereafter.

For FY 2012, the Department conducted a risk assessment of the Title I Program.<sup>1</sup> The Department did not conduct a risk assessment of the Title IV programs of the Higher Education Act of 1965, as amended (Title IV programs), because it did so for its FY 2011 AFR, and therefore was not required to do so for its FY 2012 AFR.

### **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.

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<sup>1</sup> The Department stated that because the Title I Program was a former Section 57 program under OMB Circular A-11, “Preparation, Submission and Execution of the Budget,” it was required to perform a risk assessment for the program. The Title I Program was listed on Exhibit 57B, “Programs for Which Erroneous Payment Information is Requested,” of the former Section 57 of OMB Circular A-11. OMB Circular A-123, Appendix C, Parts I and II, does not include a requirement to report on former Section 57B programs. However, under OMB Circular A-136, “Financial Reporting Requirements,” agencies are required to report on those programs previously identified in the former Section 57B of OMB Circular A-11. In the FY 2011 and FY 2012 AFRs, the Department reported that the Title I program was not susceptible to significant improper payments.

Because the Department determined that the Title I program was not susceptible to significant improper payments, it was not required under IPERA to publish an improper payment estimate for the Title I program. However, as noted in Footnote 1, the Department explained it had reporting obligations for Title I under OMB Circular A-136, and published an improper payment estimate for Title I to meet that obligation.

The Department published improper payment estimates for the Pell, Direct Loan and FFEL programs, and calculated these estimates using a new methodology that was pending OMB approval when the AFR was published. The Department noted in its AFR that the estimates it published for these programs were based on a methodology that OMB had yet to review.

#### **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. Under Section 3(a)(3)(D) of IPERA, the Department was required to report its actions to reduce improper payments for programs it deemed susceptible to significant improper payments. The Department reported its actions to reduce improper payments in the Pell, Direct Loan, and FFEL programs. Because the Department did not identify the Title I program as susceptible to significant improper payments, this requirement did not apply to the program.

#### **5. Published and Has Met Annual Reduction Targets**

The Department complied with the requirement to publish and meet targets for reducing improper payments. Under Section 3(a)(3)(E) of IPERA, the Department was required to report improper payment reduction targets for programs identified as susceptible to significant improper payments and to meet those targets.

Because the Department did not identify the Title I program as susceptible to significant improper payments, it was not required to publish and meet annual reduction targets for the program.

Using a methodology OMB had approved, the Department calculated and published a target for reducing improper payments for the Pell program. In FY 2012, the estimated improper payment rate for the Pell program was 2.49 percent, which is less than the FY 2012 target of 2.72 percent that the Department established in the FY 2011 AFR.

The Department published improper payment reduction targets for the Direct Loan and FFEL programs and calculated these reduction targets by using methodologies that were

pending OMB approval when the AFR was published. The Department noted in its AFR that these published targets are based on methodologies that OMB had yet to review and approve. We discuss the new methodologies in Finding 2.

## **6. Reported Improper Payment Rates 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, the Department was 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 was published.

Using an OMB-approved methodology, the Department reported an estimated improper payment rate of 2.49 percent in the Pell program for FY 2012. The Department also published estimated improper payment rates for the Pell (2.10 percent), Direct Loan (0.58 percent), and FFEL (1.93 percent) programs that it calculated using the new methodologies that were pending OMB approval. The estimated improper payment rates were significantly below the 10 percent threshold.

## **7. Reported Efforts to Recapture Improper Payments**

The Department complied with the requirement to report its efforts to recapture improper payments as required by Section 2(d) of the IPIA, as amended by IPERA, and in accordance with OMB Circular A-123. The Department reported on its efforts to recapture improper payments in the AFR. In addition, on December 4, 2012, the Department submitted to OMB its “FY 2012 Report on the Department of Education’s Payment Recapture Audits in Accordance with the Improper Payments Elimination and Recovery Act (IPERA)”.

## FINDINGS AND RECOMMENDATIONS

### **FINDING NO. 1 - Issues Remained With the Completeness of the Estimated Improper Payment Rate for the Pell Program**

The Department calculated and reported two improper payment rate estimates for the Pell program in its FY 2012 AFR. One calculation was based on a new methodology that was still pending approval from OMB. We discuss the methodology in Finding 2. The other calculation was based on OMB-approved methodology that used the FAFSA/IRS Data Statistical Study, which is the same methodology the Department used to calculate the FY 2011 estimated improper payment rate for the Pell program. However, our report, “U.S. Department of Education’s Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2011,” March 15, 2012, ED-OIG/A03M0001, identified the problems with that methodology. Specifically, we identified the following problems, which affected the completeness of the Department’s estimated improper payment rate calculation for the Pell program:

- U.S. Social Security Administration non-matches were not analyzed;
- the impact of IRS non-matches on improper payment rates was not assessed;
- recipients’ eligibility for Pell grants, as determined under requirements in regulations, was not considered<sup>2</sup>; and
- required recalculations of a Pell grant award when a recipient’s enrollment status has changed were also not considered.

The Department concurred with our findings and recommendations in our previous report and stated it planned to change its estimation methodology for FY 2012. The Department reported that its planned methodology for FY 2012 would resolve some of the problems we had identified by expanding the scope of the FAFSA/IRS Data Statistical Study to include Pell grant recipients who did not match either the IRS or Social Security Administration databases.

According to the Department’s FY 2012 AFR, limitations in the most recently completed FAFSA/IRS Data Statistical Study, which compared 2011-2012 FAFSA data with 2010 IRS data, resulted in changes to the Pell methodology for FY 2012. Consequently, the Department proposed a new methodology for calculating the FY 2012 Pell program improper payment rate estimate, which was based on the results of a sample of onsite program reviews rather than the FAFSA/IRS Data Statistical Study. This new methodology was pending OMB’s approval when the Department published the FY 2012 AFR.

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<sup>2</sup> For example, if a student has a federal or state drug conviction, the student may not qualify for Title IV funds.

Because the Department used the FAFSA/IRS Data Statistical Study to estimate one of the two published FY 2012 Pell program improper payment rate estimates despite not having resolved the problems we identified last year, we found that issues remained with the completeness of the Department's calculation of the estimated improper payment rate for the Pell program.

In addition, we learned that if OMB does not approve the Department's proposed methodologies, for FY 2013, FSA will use the FAFSA/IRS Data Statistical Study to report an estimated improper payment rate for Pell and will report no rates for Direct Loan and FFEL programs, as it did in the FY 2012 AFR. If OMB does not approve the proposed methodologies, which as described in Finding 2 require improvements, the Department does not correct the flaws we identified with the FAFSA/IRS Data Statistical Study methodology for the Pell program and/or the Department does not report estimated rates for the Direct Loan and FFEL programs, then the Department will continue to report estimated improper payment rates that are not correct or complete.

## **RECOMMENDATION**

We recommend that the Chief Financial Officer (CFO) for the Office of the Chief Financial Officer (OCFO), in conjunction with the CFO for Federal Student Aid (FSA), require FSA to—

- 1.1 Ensure that, for estimates calculated under the OMB approved methodology using the FAFSA/IRS Data Statistical Study, the issues identified in this finding are adequately addressed when calculating subsequent years' estimates of improper payments for the Pell program.

## **Department Response**

The Department concurred with the finding and recommendation. The Department informed us that if OMB approves the new estimation methodology for calculating an improper payment rate estimate for the Pell program, then the new methodology will replace the FAFSA/IRS Data Statistical Study. Further, the Department explained that its decision whether to continue to report the results of the FAFSA/IRS Data Statistical Study will depend on whether OMB approves the new estimation methodology.

## **OIG Response**

Although the Department concurred with our finding and recommendation, replacing the FAFSA/IRS Data Statistical Study with the new estimation methodology is not adequate because we found flaws with the Department's proposed estimation methodology. We discuss the flaws that we identified in Finding 2.

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## **FINDING NO. 2 - The Department's Proposed Estimation Methodologies for the Pell, Direct Loan, and FFEL Programs Are Flawed**

The Department calculated improper payment rate estimates using new methodologies for the Pell, Direct Loan, and FFEL programs (2.10 percent, 0.58 percent, and 1.93 percent respectively). As set forth below, we reviewed the proposed methodologies and identified some flaws with each.

### **Pell Program**

The Department used a contractor to calculate the FY 2012 estimated improper payment rate for the Pell program. The contractor proposed an estimation methodology that used a baseline statistical estimate derived from a sample of program reviews<sup>3</sup>. We identified several problems with the proposed methodology, which we discuss below.

The sample included 61 program reviews conducted from October 2011 through May 2012, containing student data for 802 students. FSA's Program Compliance division, School Participation Teams, conducted the program reviews. According to FSA, the program reviews focus on high-risk institutions. As part of this audit, we did not evaluate FSA's methodology for selecting schools for a program review.

To arrive at the published estimate of improper payments for the Pell program, the contractor computed a point estimate (3.36 percent), and using a 90 percent confidence level, calculated the upper bound (4.62 percent) and the lower bound (2.10 percent) of the estimate's confidence interval.<sup>4</sup> Instead of reporting the point estimate and upper and lower bounds of the confidence level, the contractor reported in the AFR only the lower bound of the confidence interval. That is, the Department reported that the estimated improper payment rate was 2.10 percent (the lower bound of the estimate) and did not report either the point estimate (3.36 percent) or the estimate's upper bound (4.62 percent) in the AFR.

The contractor stated that it discarded the point estimate of 3.36 percent in favor of reporting the lower bound of the estimate's confidence interval because it presumed that schools in the sample (schools with program reviews) had more improper payments than schools that did not have program reviews. Therefore, the contractor concluded that using a sample of such schools would result in an overstated estimate. According to the contractor, reporting the lower bound would correct for what would otherwise be an overstated estimate.

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<sup>3</sup> A program review evaluates institutional compliance with regulations and may identify liabilities owed to the Department for errors in compliance, and improves future institutional capabilities.

<sup>4</sup> A 90 percent confidence interval is a sample-based estimated range for a parameter. Its calculation depends on the sample estimate, variability of the sample estimate, population size, sample size, and the desired probability that the interval would contain the parameter of interest.

Replacing an estimate with its confidence interval's lower bound and reporting only the lower bound is problematic because confidence interval width may be affected by sample size. This means that if, in future years, the number of program reviews selected for the sample changes, the confidence interval width also could change. For example, to calculate the estimated improper payment rate for FY 2012, the contractor used program reviews conducted from October 2011 through May 2012 to select 61 program reviews. In future years, the contractor could select a sample from program reviews conducted in a different date range that could result in the contractor selecting a smaller sample of students. This change in sample size, in turn, could result in a smaller lower bound being reported as the estimated improper payment rate. Thus, even if the point estimate remained the same from year to year, the lower bound of the estimate's confidence interval could become smaller or larger simply as a function of changing the sample size. Therefore, changes in the reported estimated improper payment rate (that is, the lower bound of an estimate's confidence interval) from year to year could result from changes in the sample size used to produce the estimate and may not, in fact, reflect true changes in the rate of improper payments.

Additionally, the contractor justified using the lower bound of the estimate's confidence interval because the contractor performed a supplemental non-statistical estimate, for comparison purposes, based on a sample of public, non-profit, and proprietary school compliance audits<sup>5</sup> and their associated findings. However, we question the accuracy of estimates based on this audit data. First, the contractor excluded schools that had program reviews from the sample it used to calculate the supplemental non-statistical estimate. Using the contractor's own reasoning, excluding such schools could potentially result in an understated estimate. Second, the contractor's documentation indicated the supplemental non-statistical estimate may have been understated because audits and program reviews are not comprehensively focused on improper payments.

Finally, our review found that the proposed methods exclude a potential source of improper payments. The contractor did not consider the findings of the FAFSA/IRS Data Statistical Study in calculating an estimated improper payment rate for Pell. This study provided a unique source of improper payments resulting from misreported income on the FAFSA, which is considered a documentation and administrative error. The FAFSA/IRS Data Statistical Study suggests an improper payment rate of 2.49 percent. As we discussed in Finding 1 and last year's report, we believe the rate is understated because it included only the improper payments due to misreported income on the FAFSA. However, under its proposed methodology, FSA reported a lower rate of 2.10 percent which included all sources of improper payments. Further, in the

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<sup>5</sup> Section 487(c) of the Higher Education Act of 1965, as amended, requires all schools to have an annual compliance audit performed by an independent auditor. Public and private schools must have their audits conducted in accordance with Office of Management and Budget Circular A-133. Proprietary schools satisfy this requirement by having audits conducted in accordance with OIG guidance.

AFR, FSA stated that 36 percent of the Pell improper payment amount resulted from documentation and administrative errors. This means that FSA suggests that the Pell improper payment rate due to documentation and administrative errors is 0.76 percent (2.10 percent multiplied by 36 percent). This is less than one-third of the FAFSA/IRS Data Statistical Study error rate of 2.49 percent, which is only one measure of documentation and administrative errors. By not including a potential source of documentation and administrative errors, even if that source is incomplete, FSA could be understating the actual improper payment rate.

### **Direct Loan Program**

The contractor proposed an estimation methodology for the Direct Loan program using a baseline statistical estimate consisting of three components: onsite program reviews, loan consolidation activity<sup>6</sup>, and loan refund activity<sup>7</sup>. The contractor sampled 747 recipients at 56 institutions with program reviews conducted from October 2011 through May 2012. The contractor calculated the component for loan consolidation activity by sampling 60 overpayments and 60 underpayments from July 2011 through June 2012, and calculated the component for loan refund activity by sampling 180 refunds from July 2011 through June 2012. The contractor applied the results of the three components to their representative FY 2012 payment amounts and calculated an estimated improper payment rate of 0.58 percent for the Direct Loan program.

However, the contractor used the same estimation methodology for the Direct Loan program as it used for the Pell estimated improper payment rate. Instead of reporting the point estimate based on the sample (1.21 percent), the contractor reported only the estimate's lower bound (0.58 percent) and did not report the upper bound (1.83 percent) of the 90 percent confidence interval. The contractor's rationale for discarding the point estimate in favor of reporting only the lower bound was the same as the rationale it used with respect to reporting an estimated improper payment rate for the Pell program. However, as described in the discussion of the Pell program above, we question the accuracy of this methodology, and the resulting estimate could be understated.

As it did with Pell, the contractor performed a supplemental non-statistical estimate for the purpose of comparing it to the proposed estimate. We disagree that the supplemental non-statistical estimate based on public, non-profit, and proprietary school compliance audits supports reporting the lower bound as the estimated improper payment rate. Because the

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<sup>6</sup> Loan consolidation activity results in improper payments when the Department's payments to lenders, to pay off the borrower's loans that are to be consolidated, are more or less than the loans' outstanding balances.

<sup>7</sup> Loan refund activity occurs when borrowers make payments in excess of their loan balance and they are due a refund for the excess amount. Improper payments occur when the Department disburses a loan refund payment to an incorrect payee or to a borrower with unpaid balances on other loan accounts.



contractor excluded the presumed higher risk schools that had program reviews from the methodology of the supplemental estimate, the resulting estimate from the remaining schools might be understated. Additionally, based on the contractor's own reasoning, if the compliance audits in the sample were not focused on improper payments, the resulting estimated improper payment rate could be understated.

### **FFEL Program**

The contractor proposed an estimation methodology for the FFEL program using a baseline statistical estimate consisting of onsite reviews FSA conducted at a sample of financial institutions holding or servicing commercially held FFEL loans. The contractor selected a sample of 362 loan accounts at 2 lenders and 7 servicers. FSA's Financial Institution Oversight Service selected the lenders and servicers to conduct program reviews in FY 2012. When it began each program review, Financial Institution Oversight Service selected loan samples to test at each lender and servicer.

The contractor's methodology was based on transaction points posing the highest risk of improper payments. The identified high-risk areas for improper payments included special allowance payments (SAP)<sup>8</sup>, interest benefit payments, and reinsurance claims paid to guaranty agencies. Reinsurance claims paid to guaranty agencies were tested on a limited basis due to scheduling and timing issues in performing the program reviews and limited data available from the program reviews sampled;<sup>9</sup> therefore, a statistically valid estimate for this population could not be produced.

The contractor used an estimation methodology similar to that used for the Pell and Direct Loan programs; however, for the FFEL program, the contractor reported the point estimate calculated (1.93 percent) and did not report the lower bound (1.41 percent) or the upper bound of the estimate (2.46 percent) of the estimate's 90 percent confidence interval.

We found that the Department included negative SAP in the sum of the total FFEL outlays, which includes both negative SAP collections from lenders as well as SAP payments to lenders and other FFEL payments to lenders and guaranty agencies (such as reinsurance default claims). Negative SAP are not "payments" as defined in the OMB guidance.

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<sup>8</sup> In the FFEL program, lenders may receive an interest subsidy, called a special allowance, from the Government to ensure a guaranteed rate of return on their loans. Special allowance payments vary by loan type, are determined quarterly, and are based on current borrower interest rates and market yield formulas. For periods when the borrower interest rate exceeds the special allowance rate on loans made on or after April 1, 2006, lenders would remit the difference to the government (negative SAP).

<sup>9</sup> The program reviews sampled were selected from a list of all participating entities in the FY 2012 program review schedule.

Because the contractor could not produce a statistically valid estimate for reinsurance claims paid to guaranty agencies and because it included negative SAP in the sum of the total FFEL outlays, the estimation methodology for improper payments is flawed.

The contractor also performed a supplemental non-statistical estimate based on review of compliance audits of lenders and servicers participating in the FFEL program. The contractor concluded the error rate using the supplemental estimate was 0.00 percent.

In addition to the flaws described above in the methodologies for the Pell, Direct Loan, and FFEL programs, these methodologies do not consider work from the OIG. For example, in a recent Management Information Report<sup>10</sup> issued by our office, we described the results of a risk analysis regarding student aid fraud ring activity associated with the electronic processing of Federal student aid applications. The Department should consider these reports and other resources that provide information about improper payments.

## **RECOMMENDATIONS**

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

- 2.1 Ensure that each program's estimation methodology uses the appropriate point estimate and that the upper and lower confidence limits are disclosed in the AFR.
- 2.2 Work with OMB to determine how negative SAP should be treated when estimating improper payments for the FFEL program.
- 2.3 Consider improper payments identified in OIG issued reports, FSA program reviews, and if applicable and available, OIG investigations in its Pell, Direct Loan, and FFEL estimated improper payment calculation.
- 2.4 Continue to work with OMB to get approval for the Department's proposed estimation methodologies for Pell, Direct Loan, and FFEL programs to be used in FY 2013 reporting.

## **Department Response**

The Department concurred with Recommendations 2.2 and 2.4 (which was Recommendation 3.2 in the draft report). The Department did not concur with Recommendations 2.1 and 2.3. In its response, the Department noted that in the AFR, a range that meets IPERA requirements was calculated for each of the programs, and that any point in the range is equally likely, as the confidence interval indicates the probability that the true population rate is captured by the

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<sup>10</sup> Student Aid Fraud Ring Assessment January 17, 2013, Control No. ED-OIG/X18M0001

estimated range. Because each point in the range is equally likely, management may choose to report any point in the range above or below the midpoint and still have a statistically valid estimate. The Department references OMB Circular A-123 Appendix C, Part IA, Section 7, Step 2c, which states that the estimates shall be based on the equivalent of a statistically random sample of sufficient size to yield an estimate with a 90 percent confidence interval of plus or minus 2.5 percentage points around the estimate of the percentage of improper payments.

The Department agreed that collaboration with OMB is needed to consider negative SAP in the new FFEL methodology and that it will include coverage of guaranty agencies in the calculation of the FFEL rate for FY 2013.

The Department stated that findings from OIG investigations and reports cannot be included in the baseline rates because the timing of the findings identified by OIG may not apply to the fiscal year tested by FSA management and because various aspects about the OIG work are not available to FSA management.

The Department stated that it is currently working with OMB to gain approval of the proposed estimation methodologies for the Pell, Direct Loan, and FFEL programs. When the Department's published its FY 2012 AFR, OMB's approval of the new methodologies was pending. The Department agreed to continue to work with OMB to get approval for the proposed estimation methodologies to be used in the FY 2013 reporting.

### **OIG Response**

We do not agree with the Department's response regarding the proposed methodology. Selecting any value out of a confidence interval does not meet the OMB guidance referenced in the Department's response.

OMB guidance requires agencies to calculate "an estimate with a 90 percent confidence interval of plus or minus 2.5 percentage points around the estimate of the percentage of improper payments." While the contractor documentation showed an estimate having a confidence interval that met the requirements set by OMB guidance, FSA reported a value that was not the estimate that had the required attributes. That is, the value that the Department reported did not have a 90 percent confidence interval of plus or minus 2.5 percentage points. Instead, in the AFR, FSA reported the lower bound of the confidence interval and not the estimate. While the lower bound may have come from a range determined by a statistical confidence interval, reporting the lower bound was a FSA management decision and was not the result of a statistical point estimate as required by OMB guidance. Additionally, it is misleading to replace a point estimate with the lower bound of the confidence interval without disclosing the entire interval or the point estimate.

Further, FSA's management decision to report the lower bound of the confidence interval as the estimate for Pell, considering that it differed from what was indicated in the FAFSA/IRS Data Statistical Study is not appropriate.<sup>11</sup> Because the Department had the FAFSA/IRS Data Statistical Study, which indicated a higher estimate of improper payments than the lower bound of the confidence interval, the lower bound of the confidence interval should not have been reported as the estimated improper payment rate. The OIG maintains that FSA needs to ensure that the estimation methodology for all programs uses the appropriate point estimate and discloses the confidence limits.

In addition, we disagree that the results of OIG's work cannot be included in estimating improper payments because the findings may not apply to the same fiscal year tested by FSA management. The use of FSA's program reviews poses a similar problem: the program reviews completed and reported upon by FSA during a given time period may apply to payments made during multiple, different fiscal years. FSA management can access information on OIG's completed work. Furthermore, the results of identified improper payments are included in our Semi-Annual Reports to Congress.

### **FINDING NO. 3 – The Department Did Not Follow OMB Guidance on Reporting of Payment Recapture Audit Programs**

The FY 2012 AFR describes the Department's efforts to recapture improper payments through audits and program reviews of the Title IV program participants. In addition, the Department described its efforts to recapture improper payments by working with grantees to resolve amounts identified in A-133 Audits, OIG audits, and reviews conducted by the Department. The Department noted that payment recapture audit programs of contracts and grantees would not be cost-effective. However, the Department did not include in its FY 2012 AFR all the information OMB's guidance requires it to report in this area.

According to OMB Circular A-123, Appendix C, Part I, an agency must report annually in its AFR (1) a list of programs and activities for which it has determined a payment recapture audit program would not be cost-effective and (2) a description of the justification and analysis that it used for such determinations.

Although this information was not provided in the FY 2012 AFR as required, information on the Title I and Title IV programs and contracting activities was detailed in the Department's "FY 2012 Report on [IPERA] Payment Recapture Audits" submitted to OMB on December 4, 2012. In the report, the Department described the justification and analysis for its conclusion that payment recapture audits for these programs would not be cost-effective.

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<sup>11</sup> The FAFSA/IRS Data Statistical Study is an alternate source of information that OMB approved for use in the calculation of the Fiscal Year 2011 estimated improper payment rate.

## RECOMMENDATION

We recommend that the CFO for the OCFO, in conjunction with the CFO for FSA—

- 3.1 Prepare the Improper Payment Reporting Details contained in subsequent AFRs in accordance with OMB's guidance. Specifically, an AFR's Improper Payment Reporting Details should contain (1) a list of programs and activities where the Department has determined a payment recapture audit program would not be cost effective and (2) a description of the justification and analysis that it used for such determinations.

## Department Response

The Department generally concurred with the recommendation and agreed that for FY 2013, it will incorporate additional details in the AFR to fully describe the payment recapture cost-benefit analyses and justifications for recapture audits, consistent with OMB guidance.

## OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to (1) determine whether the Department was in compliance with the requirements of IPERA, (2) evaluate the accuracy and completeness of the Department's reporting in the AFR, and (3) evaluate the Department's performance in reducing and recapturing improper payments.

Our review covered the Department's reporting and performance in reducing and recapturing improper payments for the Title I, Pell, Direct Loan, and FFEL programs. Our audit covered October 1, 2011, through September 30, 2012.

To accomplish our objectives, we performed the following steps.

1. Reviewed the following laws, regulations, and guidance.
  - a. IPERA (Pub. L. No. 111-204) (2010)
  - b. IPIA (Pub. L. No. 107-300) (2002)
  - c. OMB Circular A-123, Appendix C, Parts I and II, "Requirements for Effective Measurement and Remediation of Improper Payments," April 14, 2011
  - d. OMB Circular A-136, Financial Reporting Requirements, Revised, October 27, 2011
  - e. OMB Circular A-123, Appendix C, Part III, "Requirements for Implementing Executive Order 13520: Reducing Improper Payments," March 22, 2010

- f. Executive Order 13520, “Reducing Improper Payments” November 20, 2009
  - g. Social Security Administration OIG’s guidance to the Council of Inspectors General on Integrity and Efficiency, “OIG Responsibilities Under Improper Payments Elimination and Recovery Act,” July 29, 2011
- 2. Reviewed the Department’s AFR for FY 2012, including the attachment, titled “Improper Payments Reporting Details.”
- 3. Reviewed the AFR to determine the Department’s compliance with IPERA. Specifically, we reviewed the AFR to determine whether the Department—
  - a. published an AFR for the most recent fiscal year;
  - b. conducted a program specific risk assessment, if required;
  - c. published improper payment estimates, if required;
  - d. published programmatic corrective action plans, if required;
  - e. published improper payments reduction targets;
  - f. reported an improper payment rate of less than 10 percent for each program for which an estimate was published;
  - g. reported information on its efforts to recapture improper payments; and
  - h. established payment recapture audit programs.
- 4. Interviewed officials from the Department’s OCFO and FSA’s Business Operations office.
- 5. Interviewed officials from the Department’s contractor, Deloitte, who assisted with the Department’s activities to measure, remediate, reduce, and report on improper payments.
- 6. Reviewed the Department’s methodologies for estimating improper payments and the related supporting documentation to assess whether the estimates were accurately calculated and based on complete data.
- 7. Reviewed the Department’s “FY 2012 Report on the Department of Education’s Payment Recapture Audits in Accordance with the Improper Payments Elimination and Recovery Act (IPERA)” December 4, 2012, which updated the Department’s payment recapture audit plan submitted on January 14, 2011.

Use of computer-processed data for the audit was limited to reports provided by the Department to support its improper payment estimations and methodologies. We used the data contained in these reports to determine the accuracy and completeness of the Department’s improper payment

estimation methodologies. We assessed the reliability of the Department's estimated improper payment rate data by (1) reviewing and analyzing some of the data and the data elements, (2) reviewing the methodologies and supporting documentation, and (3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the objectives of this report.

We performed fieldwork at the Department's offices, located in Washington, D.C., from December 2012 through February 2013. We briefed Department officials on the results of our audit on February 20, 2013.

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



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF THE CHIEF FINANCIAL OFFICER

## *Memorandum*

**TO :** Patrick Howard  
Assistant Inspector General for Audit  
Office of Inspector General

**FROM :** Thomas P. Skelly  
Delegated to Perform Functions and Duties  
of the Chief Financial Officer

John Hurt  
Chief Financial Officer  
Federal Student Aid

**SUBJECT:** "U.S. Department of Education Compliance with the Improper Payments Elimination and Recovery Act of" Control Number A03N0001

Thank you for providing us with an opportunity to respond to the Office of Inspector General's (OIG) draft findings.

We are pleased your audit found the Department in compliance with the requirements of IPERA. The Department is committed to reducing and preventing improper payments. Since the enactment of IPERA, the Department has intensified efforts to identify and eliminate errors as well as potential for fraud, waste, and abuse. We have implemented a strong program to reduce the estimated rate of improper payments, especially in our Federal Student Aid programs, and we look forward to further strengthening our efforts through your review and recommendations.

Our responses to each of the draft findings are attached. Once again, thank you for your recommendations and the opportunity to review and respond.

cc: Bernard Tadley, Regional Inspector General for Audit  
Erin Hudson, Auditor



**Note:** The Department's response to each draft finding is presented below. We have excluded from this attachment our draft findings.

**FINDING NO. 1 –Issues Remained with the Completeness of the Calculation of the Estimated Improper Payment Rate for the Pell Program.**

**Department Response**

1.1 We concur with Finding #1 that the findings identified in OIG's report, "U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2011" were not directly addressed in the calculation of the FAFSA/IRS Data Statistical Study for reporting in the FY2012 AFR. However, in the 2<sup>nd</sup> paragraph of the Estimation Methodology section in the AFR (page 119), we stated that for FY2012, FSA implemented new estimation methodologies for all risk-susceptible programs reported, including the Pell program. The new estimation methodologies produce statistically valid estimates for each program and a measure of precision. The new methodology replaces the FAFSA/IRS Data Statistical Study for the purposes of reporting the FY2012 improper payment estimates.

The new Pell estimation methodology uses disbursement level data and leverages onsite program review tests of actual payments that were made to students based on whether the awards were correctly applied for a number of transaction risks. The sample of students for each program review was selected from a total population of all students who received a Pell disbursement, regardless of whether the student in its FAFSA application matched to SSA or IRS databases.

We acknowledge that the new FY2012 Pell estimation methodology is still pending OMB review and approval. Thus, the determination to continue to report the results of the IRS Data Statistical Study is dependent on OMB's approval of the new methodology. If OMB approves the new FY2012 methodology, we will close this finding as resolved.

**FINDING NO. 2 -The Department's Proposed Estimation Methodology for the Pell, Direct Loan, and FFEL Program Are Flawed**

**Department Response**

2.1 We do not concur with the interpretation of the "appropriate point estimate" as noted in Recommendation 2.1. Finding No. 2 describes that the point estimate was discarded in favor of reporting only the lower bound of the confidence interval, and doing so was inappropriate. OMB Circular A-123 Appendix C states in Part IA, Section 7, Step 2c, that the estimates shall be based on the equivalent of a statistically random sample of sufficient size to yield an estimate with a 90 percent confidence interval of plus or minus

2.5 percentage points around the estimate of the percentage of improper payments. We noted in the AFR that a range that meets IPERA requirements was calculated for each of the programs, and that any point in the range is equally likely as the confidence interval indicates the probability the true population rate is captured by the estimated range. Because each point in the range is equally likely, management may choose to report any point in the range above or below the midpoint and still have a statistically valid estimate. While the midpoint is conventional, in FY2012 the sample set of schools was known not to be random and represents the highest risk of institutions. Consequently, we chose to report the lower bound of the confidence interval for the Pell and DL programs because the program reviews do represent a higher risk of identifying improper payments, based on the risk assessment performed by the Program Compliance School Participation Division (SPD) in order to select schools for on-site program reviews. Also, we reported the lower bound of the confidence interval because of the results of the supplemental non-statistical estimate, which influenced management's decision.

We concur that the sample for the supplemental estimate excluded the schools that had program reviews. The schools from the baseline statistical estimate were excluded from the supplemental sample in order to increase the overall coverage of institutions. We will include all of the population as subject to sample if it continues to use the supplemental estimate in FY2013.

We do not concur that contractor documentation indicated the supplemental non-statistical estimate may have been understated because compliance review procedures [A-133 audits and proprietary school audits] are not comprehensively focused on improper payments. While we understand that the comprehensive focus of the Compliance Audits and Program Reviews is not improper payments, there is no evidence suggesting that the improper payment estimate would be higher or lower if it were.

We concur with the finding that the confidence interval may fluctuate year over year; depending on the sample size and outcomes of the testing, we do not intend to decrease sample sizes and rather intends to do the opposite. The FY2012 methodology incorporated the General Assessment Review program review type only, while the FY2013 methodology will include the Focused and Compliance Assurance Review program review types. The current plan for FY2013 includes a sample of approximately 180-200 schools for program review testing.

Overall, for FY2013 and future years, we will continue to work with SPD to increase the number of data points collected and also to choose data points from a more random

assortment of schools, thereby producing an IP range where the midpoint may be the most appropriate to report.

We do not concur that the new Pell methodology excluded a potential source of relevant data in the IRS Data Statistical Study results. The new methodology includes testing of the verification process for each program review performed; verification is required for institutions to verify the students' income data to tax returns filed to the IRS.

Additionally, we do not agree that the IRS study results can be combined into the new Pell methodology, because the detailed information about how the students selected for the IRS study relate to the sampling population used in the program reviews is not available, and because the IRS study does not report precision.

We do not concur with the finding that the new Direct Loan estimation methodology is not appropriate. Similar to the Pell Grant response above, for the program review portion of the overall Direct Loan methodology, FSA management will continue to work with SPD to increase the number of data points collected and also to choose data points from a more random assortment of schools, thereby producing an IP range where the midpoint may be the most appropriate to report.

We do not concur with the statement in the third paragraph of the FFEL section that states that "The contractor did not explain why it departed from the approach it used to report an estimated improper payment rate for the Pell and Direct Loan programs; it simply reported the point estimate rather than the lower bound as the Direct Loan's estimated improper payment rate". During the meetings to explain the FFEL methodology, FSA management explained to the OIG that for the FFEL program a conservative approach was taken as 1) the FFEL had not been calculated in recent years, and 2) data for guaranty agencies a significant component of FFEL payments, were not sufficient to incorporate into the overall rate for the Program.

2.2 We concurs that collaboration with OMB is needed to consider negative SAP in the new FFEL methodology. In addition, for FY2013, we will include coverage of guaranty agencies in the calculation of the FFEL rate.

2.3 FSA management has concluded that findings from OIG investigations and reports cannot be included in the baseline rates, because the timing of the findings identified by OIG may not apply to the fiscal year tested by FSA management, and because information about the OIG work, such as sample selections, tests performed, precision and the improper payment rate are not available to FSA management. FSA management requests the availability of detailed OIG documentation in order to assess whether the

pertinent testing conducted by OIG can be included in the overall rates for the Pell, DL, and FFEL programs.

**FINDING NO. 3 – The Department Used New Estimation Methodologies that were Not Approved by OMB**

**Department Response**

We are currently working with OMB to gain approval of the proposed estimation methodologies for the Pell, Direct loan, and FFEL programs. At the time the Department's FY 2012 AFR was published, OMB's approval of the new methodologies was pending. Annually, OMB reviews the Department's AFR prior to its publishing and gives its assent to what the Department proposes to report on improper payments. Because OMB's approval of the new methodologies was pending at that time, OMB requested for us to report the previously approved methodology for the Pell Grant Program only and also report the newly proposed methodologies for Pell, Direct Loan, and FFEL. We agreed to OMB's request and reported as requested by OMB in the FY 2012 AFR. We will continue to work with OMB to get approval for the proposed estimation methodologies to be used in the FY 2013 reporting.

3.1 Please see our response for Findings 1 and 2 above. We will work to address the issues identified in these two findings.

3.2 We concur with this recommendation. We will continue to work with OMB to get approval for the proposed estimation methodologies to be used in the FY 2013 reporting.

**FINDING NO. 4 – The Department Did Not Follow OMB Guidance on Reporting of Payment Recapture Audit Programs**

**Department Response**

We generally concur with this recommendation. In FY2013, we will incorporate additional details in the AFR to fully describe our payment recapture cost-benefit analyses and justifications for recapture audits, per OMB guidance.

However, as long as we continue to determine that payment recapture audits, as authorized in IPERA, would not be cost effective for Department grant programs, we think it would be unnecessarily cumbersome to list every individual Department grant program in this section of the AFR. We believe it would be consistent with OMB guidance to simply explain that our justification applies to all such programs. We encourage the OIG to consider if there is any flexibility with this specific requirement, including whether explicit permission from OMB to not list each grant program would satisfy the requirement.