
**U.S. Department of Education’s Compliance With
Executive Order 13520, “Reducing Improper Payments” for
Fiscal Years 2012 and 2013**

FINAL AUDIT REPORT



**ED-OIG/A03N0004
September 22, 2014**

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

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

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**

September 22, 2014

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 Executive Order 13520,
‘Reducing Improper Payments’ for Fiscal Years 2012 and 2013”
Control Number ED-OIG/A03N0004

Attached is the subject final audit report that covers the results of our review of the Department’s compliance with Executive Order 13520 for the period from October 1, 2011, through September 30, 2013. An electronic copy has been provided to your Audit Liaison Officers. We received your comments partially concurring with the finding and nonconcurring with the recommendation.

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 finding and recommendation 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.

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

Attachment

cc: James Runcie, Chief Operating Officer, FSA
Karen Sefton, Audit Liaison Officer, FSA
Abigail Cornish, Audit Liaison Officer, OCFO
William Blot, Supervisory Systems Accountant, FSA
Phillip Juengst, Director of Internal Control, OCFO
Mark Reger, Interim Controller, Office of Management and Budget

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

AFR	Agency Financial Report
Department	U.S. Department of Education
DRT	Data Retrieval Tool
FAFSA	Free Application for Federal Student Aid
FSA	Federal Student Aid
FY	Fiscal Year
FY 2012 Accountable Official's Report	FY 2012 Accountable Official's Report on the Pell Grant High-Priority Program
FY 2013 Accountable Official's Report	FY 2013 Accountable Official's Report on the Pell Grant High-Priority Program
IRS	Internal Revenue Service
NSLDS	National Student Loan Data System
OIG	Office of Inspector General
OMB	Office of Management and Budget
Pell	Federal Pell Grant

RESULTS IN BRIEF

Executive Order 13520, “Reducing Improper Payments,” mandates that Federal agencies with high-priority programs intensify efforts to eliminate payment error, waste, fraud, and abuse in the major programs administered by the Federal Government. The Executive Order requires that Federal agencies with high-priority programs¹ name an accountable official to oversee an agency’s efforts to reduce improper payments. In fiscal year (FY) 2010, the Office of Management and Budget (OMB) designated the Federal Pell Grant (Pell) program as the only high-priority program administered by the U.S. Department of Education (Department). The Pell program provides need-based grants to low-income undergraduate and certain post-baccalaureate students for postsecondary education.

The Executive Order and implementing OMB guidance require an accountable official to report annually to its agency’s Office of Inspector General (OIG) on the agency’s methodology for identifying and measuring improper payments by the program, the agency’s plans for meeting improper payment reduction targets in the program, and the agency’s plan for ensuring that its efforts to reduce improper payments do not unduly burden eligible beneficiaries’ access and participation in the program. The OIG is required to review the accountable official’s annual report for compliance with the Executive Order requirements.

What We Did

Our audit focused on the Department’s FY 2012 and FY 2013 Accountable Official’s Reports on the Pell Grant High-Priority Program (FY 2012 Accountable Official’s Report and FY 2013 Accountable Official’s Report, respectively).² The FY 2012 Accountable Official’s Report covered the period from October 1, 2011, through September 30, 2012, and the FY 2013 Accountable Official’s Report covered the period from October 1, 2012, through September 30, 2013. Our objective was to determine whether the Department’s FY 2012 and FY 2013 Accountable Official’s Reports complied with the requirements of Executive Order 13520 “Reducing Improper Payments,” adequately addressed improper payment risks, and described an adequate level of oversight by Federal Student Aid (FSA) to reduce and recapture improper payments.

¹ A high-priority program is a program that is susceptible to significant improper payments as defined by legislation and OMB implementing guidance. For FY 2011, the error threshold for high priority programs was \$750 million in improper payments, as reported in an agency’s Agency Financial Report or Performance and Accountability Report. (OMB Circular A-123, Appendix C, Part III, Requirements for Implementing Executive Order 13520, “Reducing Improper Payments,” March 22, 2010).

² On July 2, 2014, we added the FY 2013 Accountable Official’s Report to the audit scope and objective.

What We Found

We found that for both FY 2012 and FY 2013, the Department complied with Executive Order 13520, adequately addressed improper payment risks, and described an adequate level of oversight to reduce and recapture improper payments. However, we found that the Department still had not addressed monitoring and oversight of the most significant root cause of potential improper payments, inaccurate self-reported income, for Pell program applicants who (1) do not use the Internal Revenue Service (IRS) Data Retrieval Tool (DRT) when completing their Free Application for Federal Student Aid (FAFSA) and (2) are not selected for verification of self-reported income. We had a similar finding in our audit of the FY 2011 Accountable Official's Report. The IRS DRT enables financial aid applicants to transfer certain income and tax information from an IRS Web site directly to their online FAFSA. Verification is a process that schools are required to conduct to confirm specific information the applicant reported on the FAFSA. OMB guidance states that agencies shall identify the reasons their programs and activities are at risk of improper payments and put in place a corrective action plan to reduce them.³

What We Recommend

The Department should include the self-reported income component in a study of Pell program recipients who do not use the IRS DRT and who are not selected for verification. This study will assist the Department in determining whether it has adequate controls in place to mitigate the risk of improper payments to that population of Pell program recipients.

In April 2014, we provided a draft of the finding and recommendation, based on our audit of the FY 2012 Accountable Official's Report, to the Department for comment. The Department partially concurred with the finding and did not concur with the recommendation. We summarized the Department's response at the end of the finding and included its written response as an appendix to this report.

In August 2014, we provided a draft of the finding and recommendation, based on our review of the FY 2013 Accountable Official's Report, to the Department for comment. The Department instructed us to consider its previous response as the final response to our audit of both the FY 2012 and FY 2013 Accountable Official's Reports.

³ OMB Circular A-123, Appendix C, Part I, "Improper Payment Elimination and Recovery," April 14, 2011.

BACKGROUND

Executive Order 13520, “Reducing Improper Payments”

On November 20, 2009, the President signed Executive Order 13520 (74 Federal Register 62201, November 25, 2009), which states that when the Federal Government makes payments to individuals and businesses as program beneficiaries, grantees, or contractors, or on behalf of program beneficiaries, it must make every effort to confirm that the right recipient is receiving the right payment for the right reason at the right time. The purpose of the order was to reduce improper payments by intensifying efforts to eliminate payment error, waste, fraud, and abuse in the major programs administered by the Federal Government, while continuing to ensure that Federal programs serve and provide access to their intended beneficiaries. The order mandates that OMB and Federal agencies with high-priority programs, such as the Pell program, take actions to reduce and prevent improper payments and report on these efforts.

OMB Circular A-123, Appendix C, Part III, “Requirements for Implementing Executive Order 13520, Reducing Improper Payments,” March 22, 2010, provides guidance for the implementation of Executive Order 13520.

Improper Payments

Under Section 2(f)(2) of the Improper Payments Information Act of 2002 (Pub. L.107-300), as amended by the Improper Payments Elimination and Recovery Act of 2010 (Pub. L.111-204), an improper payment is any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) to eligible recipients. An improper payment also includes any payment made to an ineligible recipient, payment for an ineligible good or service, or payments for goods or services not received. In addition, according to OMB Circular A-123, Appendix C, Part I, if an agency cannot determine whether a payment is proper because of insufficient or lack of documentation, the agency must also consider this payment an error.

Accountable official reports must include the agency’s methodology for calculating the high-priority program’s estimated improper payment rate, plans for meeting improper payment reduction targets, and plans to ensure program access and participation by eligible beneficiaries. Under OMB Circular A-123, Appendix C, Part III, Section C, the report to the agency’s OIG must contain the following.

1. A description of the agency’s methodology for obtaining a statistically valid estimate of annual improper payments. This information should include the improper payment rate measurement methodology, sample size and related calculations, results of annual measurements, and other measurement-related information as applicable.

2. The agency's plans and supporting analysis for meeting the reduction targets for improper payments, which include
 - root causes of error in the program;
 - corrective actions that are being implemented and their full implementation date;
 - the types of errors the corrective actions will address and their expected impact;
 - the anticipated costs of the corrective actions and their likely return on investment (that is, amount of errors prevented or reduced for each dollar spent); and
 - an explanation of the program's performance in meeting its reduction targets.

3. The agency's plan, together with supporting analysis, for ensuring that initiatives to reduce and prevent improper payments do not unduly burden program access and participation by eligible beneficiaries.

OMB designates a program as high-priority based on improper payment information in an agency's annual Agency Financial Report (AFR) or Performance and Accountability Report and annually reevaluates the high-priority program list after agencies publish those reports. Beginning with FY 2010 reporting and for all subsequent years, OMB will notify agencies of the new improper payment threshold⁴ and whether any programs will be added or removed (based on reporting errors above or below the new threshold) from the high-priority list within 30 calendar days of the agency publishing its AFR or Performance and Accountability Report. OMB designated the Pell program, which FSA administers, as a high-priority program in FY 2010. The Department issued its FY 2012 Accountable Official's Report on March 15, 2013, and its FY 2013 Accountable Official's Report on April 11, 2014.

The agency's OIG is responsible for reviewing the agency's accountable official's report for compliance with Executive Order 13520. Additionally, the OIG must assess the level of risk associated with the applicable programs; determine the extent of oversight warranted; and provide the agency head with recommendations, if any, for modifying the agency's methodology, improper payment reduction plans, or program access and participation plans.

⁴ The threshold for FY 2012 and FY 2013 is \$750 million in improper payments as reported in the AFR or Performance and Accountability Report.

COMPLIANCE WITH EXECUTIVE ORDER 13520

We found that the Department complied with the Executive Order 13520 as it related to the Pell program for each of the following compliance areas:

1. Reported Improper Payment Rate Measurement Methodology, Sample Size, Results of Annual Measurements, and Related Calculations

The Department complied with the requirement to report its improper payment rate (error rate) measurement methodology, sample size, and the results of annual measurements and related calculations for both the FY 2012 and FY 2013 Accountable Official's Reports. The Department reported that the improper payment rates for both fiscal years were based on the OMB-approved methodology: the FAFSA/IRS Data Statistical Study. The Department also used a proposed alternate estimation methodology, which was based on program reviews, to calculate an improper payment rate. The proposed estimation methodology includes a baseline statistical estimate with a stated confidence interval based on data from the results of program reviews of schools. This methodology was pending OMB approval at the time of our audit.

For FY 2012, the OMB-approved methodology to calculate the improper payment rate was based on a sample of 3,299,819 applicants drawn from the Title IV Central Processing System. Based on the Department's analysis, the error rate was 2.49 percent, resulting in estimated improper payments of \$829 million.

Using the proposed alternate methodology, the improper payment rate was based on the analysis of a sample of 802 students across 61 institutions with program reviews conducted from October 1, 2011, through May 31, 2012. Based on the Department's analysis, the error rate was 2.10 percent⁵, resulting in estimated improper payments of \$699 million.

For FY 2013, the OMB-approved methodology to calculate the improper payment rate was based on a sample of 1,375,256 applicants drawn from the Title IV Central Processing System. Based on the Department's analysis, the error rate was 2.26 percent, resulting in estimated improper payments of \$731 million. Using the proposed alternate methodology, the error rate was 2.22 percent, or \$718 million.

⁵ The 2.10 percent error rate the Department improperly reported was the lower bound of the estimate's confidence interval; the point estimate was 3.36 percent and the upper bound of the estimate's confidence interval was 4.62 percent.

Improper Payment Rate Percentages and Amounts by Methodology and Fiscal Year

Fiscal Year	FAFSA/IRS Data Statistical Study		Program Reviews	
	Percentage	Amount (millions)	Percentage	Amount (millions)
2012	2.49	\$829	2.10	\$699
2013	2.26	\$731	2.22	\$718

In our reports on the Department’s compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA) for FY 2012 and FY 2013, we found weaknesses with both methodologies: the FAFSA/IRS Data Statistical Study and the program reviews.⁶ For FY 2012 and FY 2013, we found that the estimation methodology based on the FAFSA/IRS Data Statistical Study did not consider populations of recipients who may pose a higher risk of improper payments and did not consider all potential sources of improper payments. Specifically, the FAFSA/IRS Data Statistical Study did not analyze non-matches with the U.S. Social Security Administration or IRS, eligibility factors other than an applicant’s income, and recalculations of a Pell grant award when a recipient’s enrollment status changes. For FY 2013, we found that the estimation methodology based on program reviews was not complete, because the Department was unable to include in the calculation data from a significant number of program reviews. In addition, for FY 2012, we found that the estimation methodology based on program reviews replaced the point estimate with its confidence interval’s lower bound and excluded other sources of potential improper payments, such as the FAFSA/IRS Data Statistical Study and the work of the OIG.

2. Reported Root Causes of Errors in the Program

The Department complied with the requirement to report the root causes of Pell program errors in both the FY 2012 and FY 2013 Accountable Official’s Reports. The Department identified the inaccuracy of self-reported financial income on the FAFSA as the most significant root cause of potential Pell program improper payments and deemed the error to be a verification error,⁷ as defined in OMB Circular A-123, Appendix C, Part III, (B)(1)(b). The report also identified documentation and administrative errors⁸ as a root cause of improper payments in the Pell program.

⁶ “U.S. Department of Education’s Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2012,” and “U.S. Department of Education’s Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2013.”

⁷ Verification errors are errors caused by the failure or inability to verify recipient information or errors due to beneficiaries failing to report correct information to an agency.

⁸ Documentation and administrative errors are errors caused by the absence of supporting documentation necessary to verify the accuracy of a payment; or errors caused by incorrect inputting, classifying, or processing of applications or payments.

Root Causes of Improper Payments Identified for Pell Grants

Fiscal Year	Verification Errors	Documentation and Administrative Errors
2012	64%	36%
2013	73%	27%

3. Reported Corrective Actions and Implementation Date

The Department complied with the requirement to report corrective actions and related implementation dates to address the root cause of improper payments in the Pell program for both the FY 2012 and FY 2013 Accountable Official's Reports.

The FY 2012 Accountable Official's Report stated that its corrective actions will include a test of its internal controls on Pell program payments, as a function of the FY 2013 OMB Circular A-123, Appendix A assessment,⁹ for students who did not use the IRS DRT and who were not selected for verification (this corrective action is discussed in Finding No. 1 of this report). The Department also stated that FSA continues to use two corrective actions reported in the FY 2011 Accountable Official's Report: the IRS DRT and school's verification of income reported by applicants.

In addition, the Department noted in the FY 2012 Accountable Official's Report that it implemented new controls to address issues related to the Pell program. The new controls are enhancements to student eligibility functionality in FSA systems. The new functionality includes a Pell program Lifetime Eligibility Used percentage and warning indicator, and an Unusual Enrollment History indicator in the Institutional Student Information Record process. The Department also noted that schools administering the Pell program are also subject to corrective actions through FSA's program review process.

For the FY 2013 Accountable Official's Report, the Department implemented two additional new controls to address issues related to the Pell program. The new controls consist of the National Student Loan Data System (NSLDS) Fraud Loan Flag, and two new IRS Display Flags added to the Central Processing System and included in FAFSA reports sent to institutions and students: the Student IRS Display Flag and the Parent IRS Display Flag.

The NSLDS Fraud Loan Flag notifies both the institution and the FAFSA applicant that NSLDS indicates a student has one or more student loans that may have been obtained fraudulently, and as a result, is not eligible to receive any student aid until the issue is resolved.

⁹ OMB Circular A-123, Appendix A, "Internal Control Over Financial Reporting."

The IRS Display Flags inform schools whether the student or parent completing the FAFSA was given the option to use the IRS DRT. For example, the IRS DRT is not available to applicants who use a paper FAFSA, have a conflict between the marital status reported on the FAFSA and the tax return filing status, or filed an amended tax return. The IRS Display flags are used in addition to the Student IRS Request Flag and Parent IRS Request Flag, which describe the student or parent's use of the IRS DRT. The IRS Request Flags inform schools if the applicant was eligible for the IRS DRT, if the data was retrieved from the IRS, and if the data from the IRS was modified.

The Department also noted that it continues to utilize the verification process as a key action in addressing the inaccuracies on the FAFSA by enhancing verification regulations which are published in the Federal Register annually.

In addition, the Department reported that it continues to refine the verification process and to conduct statistical analysis to establish the most effective and efficient criteria for selecting applicants for verification who have the highest probability of error on their FAFSA submissions. Changes to the 2014-2015 award year include adding “other untaxed income” and “identity/statement of educational purpose”¹⁰ to the FAFSA items selected for the verification process.

4. Reported the Types of Errors the Corrective Actions Will Address and Their Expected Impact

The Department complied with the requirement to report on the types of errors and the expected impact that the reported corrective actions will address for both the FY 2012 and FY 2013 Accountable Official's Reports. The FY 2012 Accountable Official's Report indicated that its internal control testing should determine whether its existing controls are sufficient to mitigate the risks of improper payments. Both the FY 2012 and FY 2013 Accountable Official's Reports indicated that the Department continues to use the IRS DRT and school verification of income because it expects these corrective actions contribute to fewer instances of inaccurate self-reported financial information and a reduction in improper payments.

¹⁰ Identity/statement of educational purpose requires that the student appear in person at the school and present a valid, government-issued photo identification. The student must also sign a statement of educational purpose that certifies who they are and that the Federal student aid they may receive will be used only for educational purposes and for the cost of attending the school for the corresponding school year (students who are unable to appear in person must use a notary public to sign the statement of educational purpose, and then submit supporting documentation to the school for verification).

5. Anticipated Cost of Corrective Actions and Return on Investment

The Department complied with the requirement to report on the anticipated cost of the corrective actions and the return on the investment from implementing the corrective actions for both the FY 2012 and FY 2013 Accountable Official's Reports. The Department stated that the anticipated costs to improving the IRS DRT so that more FAFSA applicants use the tool are marginal compared to projected savings and increased simplicity of use. The Department stated that the increased cost to schools and colleges that performed the income verification was more significant, but it could not estimate those costs. However, the Department stated that to the extent applicants use the IRS DRT, school verification efforts will be reduced.

6. Explained Program's Performance in Meeting its Reduction Targets

The Department complied with the requirement to explain the Department's performance in meeting the reduction targets for the Pell program for both the FY 2012 and FY 2013 Accountable Official's Reports. For the last six fiscal years (2008 through 2013) the Department reported a decrease in annual improper payment and target rates from 3.69 percent in FY 2008, to 2.26 percent in FY 2013, as measured using estimates based on the FAFSA/IRS Study. The Department received approval from OMB to keep the target rate at its most recent reported improper payment rate estimate.¹¹

7. Reported Plan for Ensuring Initiatives Do Not Unduly Burden Program Access

The Department complied with the requirement to report its plan for ensuring that its initiatives for reducing Pell program improper payments do not unduly burden participants' access to the program for both the FY 2012 and FY 2013 Accountable Official's Reports. The Department's efforts include using the IRS DRT, decreasing the average time it takes to complete the FAFSA online, and offering additional FAFSA application methods. FSA's Customer Experience group announced a new partnership alliance between FSA and the IRS that will focus on reaching more people in low- to moderate-income communities with the goal of providing them with information, assistance, and access to relevant IRS and FSA services. In addition, the FY 2013 Accountable Official's Report noted a new IRS "Get Transcript Online" tool enabling the tax filer to request and receive their tax transcripts more easily, which potentially reduces the burden on FAFSA applicants who are requested to provide their transcripts to the schools for verification. The Department believes that its efforts will reduce improper payments without burdening applicants' program access and participation.

¹¹ The FY 2012 Accountable Official's Report reflected a target rate of 2.49 percent through FY 2015, while the FY 2013 Accountable Official's Report reflected a target rate of 2.26 percent through FY 2016.

Improper Payment Risk

The Department complied with the requirement to adequately address improper payment risks. Both the FY 2012 and FY 2013 Accountable Official's Reports identified the inaccuracy of self-reported financial income on the FAFSA as the most significant root cause (risk) of potential improper payments. In addition, the Department stated that it has implemented significant controls to prevent and detect inaccurate data and to mitigate the risk that inaccurate data results in improper payments. Some of the controls include data checks or edits on FAFSA data within the Central Processing System, matching FAFSA data against various authentication sources, expanding the IRS DRT, and enhancing verification of FAFSA information by schools.

In the FY 2012 Accountable Official's Report, the Department implemented new control enhancements in its systems that include a Pell program Lifetime Eligibility Used percentage and warning indicator, and an Unusual Enrollment History indicator in the Institutional Student Information Record process.

In the FY 2013 Accountable Official's Report, the Department implemented two additional control enhancements in its systems. These enhancements include the NSLDS Fraud Loan Flag, and two new IRS Display Flags added to CPS and included in FAFSA reports sent to schools and students: the Student IRS Display Flag and the Parent IRS Display Flag.

Although other risks and causes of improper payments exist, the Department believes that its controls assist it in its efforts to minimize and eliminate improper payments.

FINDING AND RECOMMENDATION

Level of Oversight by FSA

The Department generally described an adequate level of oversight to reduce and recapture improper payments in its sole high-priority program. The FY 2012 and FY 2013 Accountable Official's Reports described the controls in the Department's systems, the proposed estimate methodology, improvement to the IRS DRT, and enhancements to the verification requirements for schools. All of these elements are part of FSA's oversight efforts to reduce and recapture improper payments. However, as we found for FY 2011 ("U.S. Department of Education's Compliance with Executive Order 13520, 'Reducing Improper Payments' for Fiscal Year 2011"), we found that again for FYs 2012 and 2013, the Department's oversight efforts and improper payment monitoring did not adequately consider the population of Pell program applicants who did not use the IRS DRT and who were not selected for verification.

FINDING NO. 1 - FSA Needs To Include the Self-Reported Income Component From FAFSA in its Analysis of Pell Program Applicants That Did Not Use the IRS DRT and Who Were Not Selected for Verification in its Monitoring and Oversight Efforts

Both the FY 2012 and FY 2013 Accountable Official's Reports detailed the Department's current and planned monitoring and oversight efforts to reduce Pell program improper payments. These efforts focus on (1) Pell program applicants who use the IRS DRT to transfer their income to their FAFSA and (2) Pell program applicants selected for verification. However, the oversight and monitoring efforts described in both Accountable Official's Reports did not include a description of how the Department plans to address inaccurate self-reported data on the FAFSA and the resulting risk of improper payments to Pell program applicants who do not use the IRS DRT and who are not selected for verification. OMB Circular A-123, Appendix C, Part I, Section (A)(7) Step 3c states that agencies must ensure that their managers and accountable officers, programs, and program officials are held accountable for reducing improper payments. Part I, Section (A)(14) states that agencies should annually review their existing corrective actions to determine whether any existing action can be intensified or expanded, resulting in a high-impact return-on-investment in terms of reduced or prevented improper payments. In addition, Part I, Section (A)(7) Step 3a states that agencies shall identify the reasons their programs and activities are at risk of improper payments and put in place a corrective action plan to reduce them.

We determined that the Department's corrective actions in response to our report, "U.S. Department of Education's Compliance With Executive Order 13520, 'Reducing Improper Payments' for Fiscal Year 2011" (A03M0004), did not adequately address the finding and recommendation contained in our report. We found that for FY 2011, the Department did not consider Pell program applicants who did not use the IRS DRT and who were not selected for verification in its improper payment monitoring and oversight efforts. For these populations of

Pell program applicants, there is a risk of inaccurate self-reporting of income data on the FAFSA. We recommended that the Department study this population of Pell program applicants to determine whether adequate controls are in place to mitigate the risk of improper payments to the population of Pell program applicants who did not use the IRS DRT and who were not selected for verification.

In response to our prior finding and recommendation, the Department tested its existing controls to confirm that this population of applicants was eligible to receive a Pell Grant based on Pell Grant eligibility requirements. Examples of eligibility requirements the Department tested included an applicant's graduation status, social security number, signature on application, citizenship status, and Selective Service status for males. However, the Department did not include verification of self-reported income in its testing. We identified in our finding, and the Department also identified, inaccurate self-reported income as the most significant root cause of improper payments. For this population of Pell program applicants, the risk of improper payments based on inaccurate self-reporting of income data on the FAFSA remains.

RECOMMENDATION

We recommend that the Chief Financial Officer for the Office of the Chief Financial Officer, in conjunction with the Chief Financial Officer for FSA, require FSA to —

- 1.1** Perform a valid statistical analysis of the Pell program applicants who did not use the IRS DRT and who were not selected for verification that includes the most significant root cause of potential Pell program improper payments (self-reported income component of the FAFSA) to determine whether the Department has adequate internal controls in place or needs to implement additional controls to mitigate the risk of improper payments to this population of Pell program applicants.

Department Comments

The Department partially concurred with the draft finding and acknowledged that it did not verify self-reported income in its testing of the Pell population in question. However, the Department stated that its risk model for verification selection, based on yearly statistical analysis, identifies the most error-prone records.

The Department did not concur with the draft recommendation to perform a valid statistical analysis of Pell applicants who did not use the IRS DRT and who were not selected for verification. It stated that the various statistical analyses and reviews currently performed adequately address and mitigate the risk of improper payments.

OIG Response

In its comments to the draft finding, the Department stated that its risk model for verification selection identifies the most error-prone records. The Department has identified inaccurate self-reported income as the most significant cause of improper payments. However, the Department does not have information on how the self-reported income error rate for applicants selected for verification compares to applicants not selected for verification. Information on these error rates would help to inform the risk model.

The Department stated that it had determined that its eligibility determination controls were operating effectively for the Pell program in general and for the population of Pell applicants who did not use the IRS DRT and who were not selected for verification. The Department conducted testing of Pell applicants who did not use the IRS DRT and who were not selected for verification. Based upon this testing, the Department concluded this population was low-risk. However, the Department acknowledged that the testing performed did not include authentication or verification of self-reported income data, because the applicants are not required to provide documentation of income reported by the applicant. As a result, the Department's testing provided no basis for concluding that this population of Pell applicants presented a low risk of reporting inaccurate self-reported income.

Based on the information provided by the Department in response to the draft finding and recommendation, no changes were made to the final report.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine whether the Department's "FY 2012 and FY 2013 Accountable Official's Reports on the Pell Grant High-Priority Program" (1) complied with the requirements of Executive Order 13520, "Reducing Improper Payments;" (2) adequately addressed improper payment risks; and (3) described an adequate level of oversight by FSA to reduce and recapture improper payments.

Our audit covered the Department's FY 2012 and FY 2013 Accountable Official's Reports and the Department's improper payment measurement methodology, plans, and supporting analysis for reducing and recapturing improper payments and for ensuring access for the Pell program from October 1, 2011, through September 30, 2013.

Our audit was for the limited purpose described and would not necessarily identify all deficiencies in internal controls. We gained an understanding of the Department's internal controls for preventing improper payments in the Pell program through interviews of Department officials and reviews of the Department's processes, plans, and corrective actions detailed below.

To accomplish our objectives, we performed the following.

1. Reviewed background information about the Department and the Pell program.
2. Reviewed the following laws, regulations, and guidance:
 - a. Improper Payments Elimination Recovery Act of 2010;
 - b. Improper Payments Information Act of 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 Memorandum M-11-04, "Increasing Efforts to Recapture Improper Payments by Intensifying and Expanding Payment Recapture Audits," November 16, 2010;
 - e. OMB Circular A-123, Appendix C, Part III, "Requirements for Implementing Executive Order 13520: Reducing Improper Payments," March 22, 2010; and
 - f. Executive Order 13520, "Reducing Improper Payments," November 20, 2009.
3. Reviewed the Department's AFR for FYs 2012 and 2013, including the attachment, "Improper Payments Reporting Details." We compared information within the AFRs to the applicable Accountable Official's Report.
4. Reviewed the FY 2012 and FY 2013 Accountable Official's Reports to determine the Department's compliance with Executive Order 13520. Specifically, we reviewed the report to determine whether the Department reported the following:
 - a. Pell program improper payment rate measurement methodology, sample size, results of annual measurements and related calculations;
 - b. root causes of improper payments in the Pell program;
 - c. corrective actions and implementation dates;
 - d. the types of improper payments the corrective actions will address and their expected impact;
 - e. the anticipated cost of corrective actions and their return on investment;
 - f. an explanation of the Pell program's performance in meeting its reduction targets; and
 - g. a plan for ensuring that initiatives to prevent and reduce improper payments do not unduly burden program access.
5. Interviewed officials from FSA's Finance office and FSA's designated contractor (Deloitte Consulting) for its OMB Circular A-123, "Management's Responsibility for

Internal Control Testing”. Additionally, we consulted with the OIG audit team for FY 2013 Improper Payment Elimination and Recovery Act Audit.

6. Reviewed “U.S. Department of Education’s Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2012,” March 15, 2013, ED-OIG/A03N0001. We also reviewed the Department’s corrective action plans in response to the recommendation contained in the OIG’s audit of the “U.S. Department of Education’s Compliance With Executive Order 13520: Reducing Improper Payments for Fiscal Year 2011” (A03M0004).
7. Reviewed “U.S. Department of Education’s Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2013,” April 2014, ED-OIG/A19O0002.

We performed fieldwork at the Department’s offices, located in Washington, D.C., from September 18, 2013, through September 19, 2013. We conducted follow-up work from February 10, 2014, through February 13, 2014, and from July 16, 2014, through July 17, 2014. We briefed Department officials on the results of our audit on April 2, 2014, and on August 7, 2014.

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

Appendix



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

April 25, 2014

MEMORANDUM

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

Bernie Tadley
Regional Inspector General for Audit
Office of Inspector General

FROM: Thomas P. Skelly /s/
Delegated to Perform the Function
and Duties of the Chief Financial Officer
Office of the Chief Financial Officer

John W. Hurt, III /s/
Chief Financial Officer
Federal Student Aid

SUBJECT: Draft Response to OIG Review of the Department's Accountable Official's Report
Under Executive Order 13520

We appreciate the opportunity you have given us to respond to the Office of Inspector General's (OIG) draft report on the Pell Grant High-Priority Program, and the way in which you collaborated with the Department in conducting this review. We are pleased your audit found the Department in compliance with the Executive Order 13520, *Reducing Improper Payments*, as it relates to the Pell Grant Program.

The Department has worked diligently to implement Executive Order 13520. We will continue to re-assess and implement strategies to reduce improper payments in the Pell Grant Program. Our response to this finding is included below.

Response to Finding 1

The Department partially concurs with this finding. The Department acknowledges that verification of self-reported income was not included in its testing of the Pell population in question (Pell Program applicants who did not use the IRS Data Retrieval Tool (DRT) and who were not selected for verification). However, the Department contends that its risk model for verification selection, based on yearly statistical analysis, identifies the most error-prone records. Annually, the Department selects approximately 30 percent of all FAFSA applicants for verification in accordance with Code of Federal Regulations (34 CFR 668.51–61) and the realization that 100 percent verification is not currently feasible

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for over 20 million FAFSA applicants. The current verification process limits the administrative burden on students and schools while ensuring access to federal student aid is not impacted.

In addition, over 90 percent of all applicants selected for verification are Pell-eligible applicants. Thus, the annual verification process is heavily in favor of Pell-eligible applicants. As previously reported, the Department considers the use of the IRS DRT when selecting a record for verification. In most cases, if the student or parent used the IRS DRT and did not change any of the data that was transferred, we will not select that record for verification. This means that we are able to select other, more error prone Pell-eligible applicants who did not use the IRS DRT within our selection pool.

Response to Recommendation 1

The Department does not concur with the OIG's recommendation to perform a statistical analysis for applicants who did not use the IRS DRT and who were not selected for verification.

The Department now performs various statistical analyses of the Pell program, to include annual reviews of our CPS risk model (to determine who is selected for verification) and two improper payment estimation methodologies. Our historical, OMB-approved improper payment estimation methodology uses an IRS statistical study to assess for all applicants the most significant root cause of potential Pell Program improper payments (i.e., errors in self-reported income data on the FAFSA used to determine eligibility and the amount of award). As described in our report we have improved the IRS DRT and have expanded and strengthened verification requirements to address this root cause resulting in year-over-year reductions in our improper payment rate. Based on upward trends in IRS DRT usage, the percentage of recipients who do not use the IRS DRT and who are not selected for verification is expected to decrease.

Our proposed new estimation methodology that we continue to work with OMB to review, edit, and approve expands our analysis to additional improper payment risks. Part of our intent in developing this methodology is to better inform root cause analysis, for example by quantifying error by type, associating to a corrective action (e.g., improved controls), and targeting specific reductions.

The recommendation states that we should perform this analysis to determine whether we have sufficient controls in place to mitigate the risk of improper payment to this segment of the population. We annually assess and have confidence in the effectiveness of our overall controls over Pell payments. As noted in the draft report, for our 2011 corrective action we assessed the effectiveness of eligibility determination controls for Pell recipients, including those who did not use the IRS DRT and who were not verified, and determined that these controls were operating effectively overall and for this segment of the population. These tests did not include authentication or verification of self-reported income data for those recipients who did not use the IRS DRT and who were not verified, because these applicants are not required to provide this data.

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

cc: Robert Janney, Assistant Regional Inspector General for Audit
John McLemore, Auditor
Erin Hudson, Auditor