
U.S. Department of Education's Compliance with the Improper Payments Elimination and Recovery Act of 2010 for Fiscal Year 2013

FINAL AUDIT REPORT



**ED-OIG/A19O0002
April 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
Washington, DC

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES

April 15, 2014

Memorandum

TO: Thomas P. Skelly
Delegated the Functions and Duties of the Chief Financial Officer
Office of the 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 2013
Control Number ED-OIG/A19O0002

Attached is the **final audit report** that covers the results of our audit of the U.S. Department of Education's (Department) compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA) for fiscal year (FY) 2013. An electronic copy has been provided to your Audit Liaison Officers. We received your comments concurring or generally concurring 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. Department policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 days of the issuance of this report. The CAP should set forth the specific action items and targeted completion dates necessary to implement final corrective actions on the findings and recommendations contained in this final audit report.

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Thomas Skelly

John Hurt

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We appreciate the cooperation given to us during this review. If you have any questions, please contact me at (202) 245-6949 or Michele Weaver-Dugan, Director, Operations Internal Audit Team, at (202) 245-6941.

Enclosure

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EXECUTIVE SUMMARY

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), requires Federal agencies to reduce improper payments and to report annually on their efforts. The Office of Management and Budget (OMB) issued government-wide guidance on the implementation of IPERA on April 14, 2011, which is contained in OMB Circular A-123, Appendix C, “Requirements for Effective Measurement and Remediation of Improper Payments,” Parts I and II (OMB Circular A-123).

The objectives of our audit were to:

- Determine whether the U.S. Department of Education (Department) was in compliance with IPERA;
- Evaluate the accuracy and completeness of the Department’s reporting of improper payments data; and
- Evaluate the Department’s performance in reducing and recapturing improper payments.

We found that the Department complied with IPERA for fiscal year (FY) 2013. However, we found that improvements are needed in the Department’s improper payment rate estimation methodologies for the Federal Pell Grant (Pell) and William D. Ford Federal Direct Loan (Direct Loan) programs, specifically with regard to ensuring the methodologies’ completeness.

The Department calculated and reported an improper payment rate estimate for the Pell program using the Free Application for Federal Student Aid (FAFSA)/Internal Revenue Service (IRS) Data Statistical Study. This is the same methodology that the Department used to calculate improper payment rate estimates for the Pell program in its FY 2011 and FY 2012 Agency Financial Reports (AFRs). In previous reports on the Department’s compliance with IPERA, we noted that the Pell program’s estimation methodology does not consider populations of recipients who may pose a higher risk of improper payments and does not consider all potential sources of improper payments. We found that these issues were still present in the FY 2013 methodology. As a result, the Department continues to report an improper payment rate estimate for the Pell program that does not consider all potential improper payments.

The Department calculated and reported an improper payment rate estimate for the Direct Loan program using an alternative methodology that relies heavily on the use of program reviews and was approved by OMB only for AFR reporting for FY 2013. We found that the Direct Loan program’s estimation methodology does not maximize the use of the results of program reviews of schools. The Department, in conjunction with its contractor, analyzed all program reviews of schools conducted between October 1, 2012, and mid-August 2013. However, many of these reviews were subsequently not included in the improper payment rate estimation calculation because the reports from these reviews had not yet been issued or the reviews did not test for improper payment transactions. As a result, the Department is not currently reporting an estimated improper payment rate for the Direct Loan program that is as complete as possible.

We also found that the Department could improve the reporting of improper payments information in its AFR. While the Department did provide a detailed reporting of improper payments and its efforts to reduce them, it did not report a summary of its progress in completing the IPERA reporting requirements in the Management's Discussion and Analysis (MD&A) section of its AFR, as required by OMB. By not providing a summary of its progress in completing IPERA reporting requirements in the MD&A section of its AFR, readers of the AFR may not gain a complete understanding of whether the Department complied with IPERA reporting requirements.

Lastly, we found that the Department has shown progress in reducing and recapturing improper payments. However, the Department could improve its efforts to establish meaningful improper payment reduction targets. In its FY 2013 AFR, the Department set reduction targets for each of its programs through FY 2016 equal to the improper payment rate estimate it reported in the current year. Consequently, the Department's reduction targets do not actually set a target that, if met but not exceeded, would result in a reduction in improper payments. By not setting reduction targets that aim to reduce the levels of improper payments, the Department may not be intensifying its efforts to identify, prevent, and recover improper payments.

To correct the weaknesses identified, we recommend that the Chief Financial Officer (CFO) for the Office of the Chief Financial Officer, in conjunction with the CFO for Federal Student Aid:

- Continue working with OMB to obtain approval for an alternate methodology that addresses the limitations of the FAFSA/IRS Data Statistical Study for the Pell program as well as the limitations noted with the Direct Loan program methodology.
- Where improper payment estimates are based on the results of program reviews, include in the sample universe all program review reports that were issued, rather than program reviews conducted, within a sufficient period of time to obtain a larger sample size of program reviews with usable data.
- Provide a summary of the Department's progress in completing IPERA reporting requirements in the MD&A section of the AFR.
- Set targets that aim to reduce the rate of improper payments for all programs identified as susceptible to significant improper payments.

In its response to the draft finding point sheets, the Department concurred with Finding Nos. 2 and 3 and generally concurred with Finding No. 4. The Department's comments are summarized at the end of each applicable finding. The full text of the Department's response is included as Enclosure 2 to this report. No changes were made to the report as a result of the response.

BACKGROUND

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), requires Federal agencies to reduce improper payments and to report annually on their efforts. The Office of Management and Budget (OMB) issued government-wide guidance on the implementation of IPERA on April 11, 2011, which is contained in OMB Circular A-123, Appendix C, Parts I and II.¹

IPERA requires the head of each agency, in accordance with guidance prescribed by the Director of OMB, to periodically review all programs and activities that the agency head administers and identify all programs and activities that may be susceptible to significant improper payments. Significant improper payments are defined as gross annual improper payments (the total amount of overpayments plus underpayments) in the program exceeding (1) both 2.5 percent of program outlays and \$10 million of all program or activity payments made during the fiscal year reported, or (2) \$100 million (regardless of the improper payment percentage of total program outlays). Under IPERA, this threshold was set to decrease from 2.5 percent to 1.5 percent for fiscal year (FY) 2013. However, the Improper Payments Elimination and Recovery Improvement Act of 2012 (Pub. L. No. 112-248), which further amended IPIA, extended the 2.5 percent threshold through FY 2013. For each program and activity identified as susceptible to significant improper payments, the agency is required to produce a statistically valid estimate, or an estimate that is otherwise appropriate using a methodology approved by OMB, of the improper payments made by each program and activity and include those estimates in the accompanying materials to the agency's annual financial reports.

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

- Published a Performance and Accountability Report (PAR) or Agency Financial Report (AFR) for the most recent fiscal year and posted that report and any accompanying materials required by OMB on the agency website;
- Conducted a program-specific risk assessment for each program or activity that conforms with IPERA (if required);
- Published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessment(s) (if required);
- Published programmatic corrective action plans in the PAR or AFR (if required);
- Published, and has met, annual reduction targets for each program assessed to be at risk and measured for improper payments;

¹ Under Section 2(f)(2) of 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. OMB Circular A-123, Appendix C, Part I, expanded this definition to include any payment lacking sufficient documentation.

- Reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the PAR or AFR; and
- Reported information on its efforts to recapture improper payments.

If an agency does not meet one or more of these requirements, then it is not compliant with IPERA. In addition, the agency's Inspector General should evaluate the accuracy and completeness of the agency's reporting and performance in reducing and recapturing improper payments.

AUDIT RESULTS

We found that the U.S. Department of Education (Department) complied with IPERA for FY 2013. However, we found that improvements are needed in the Department's improper payment rate estimation methodologies for the Federal Pell Grant (Pell) and William D. Ford Federal Direct Loan (Direct Loan) programs, specifically with regard to ensuring the methodologies' completeness. The Pell program's estimation methodology does not consider populations of recipients who may pose a higher risk of improper payments and does not consider all potential sources of improper payments. The Direct Loan program's estimation methodology does not maximize the use of the results of program reviews of schools. As a result, the Department is not currently reporting estimated improper payment rates for the Pell and Direct Loan programs that are as complete as possible. We also found that the Department could improve the reporting of improper payments information in its AFR. While the Department did provide a detailed reporting of improper payments and its efforts to reduce and recover them, it did not report a summary of its progress in completing the IPERA reporting requirements in the Management's Discussion and Analysis (MD&A) section of its AFR, as required by OMB guidance. Lastly, we found that the Department has shown progress in reducing and recapturing improper payments, but could improve its efforts to establish meaningful improper payment reduction targets. In its FY 2013 AFR, the Department set reduction targets for each of its programs through FY 2016 equal to the improper payment rate estimate it reported in the current year. Consequently, the Department's reduction targets do not actually set a target that, if met but not exceeded, would result in a reduction in improper payments if program outlays remain constant or increase.

FINDING NO. 1 – The Department Complied with All IPERA Requirements

We found that the Department complied with all seven IPERA requirements. The results of our review are detailed below:

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 is required to publish on its website its AFR and any accompanying materials required under OMB guidance. The Department published its AFR and accompanying materials titled, "Improper Payments Reporting Details," on December 12, 2013.

2. Conducted a Risk Assessment

The Department complied with the requirement to conduct a risk assessment. Under Section 3(a)(3)(B) of IPERA, if required, an agency must conduct a program-specific risk assessment of all programs and activities to determine which ones are susceptible to significant improper payments. Under Section 2(a)(2) of IPERA, such risk assessments generally should be conducted in 2011 and at least once every 3 fiscal years thereafter.

In FY 2011, the Department conducted risk assessments for all Federal Student Aid (FSA)-managed programs. As a result of these risk assessments, the Pell, Direct Loan, and Federal Family Education Loan (FFEL) programs were identified as susceptible to significant improper payments. The Department is not required to conduct new risk assessments of these programs until FY 2014. In FY 2013, the Department conducted risk assessments of all other grant programs and contract payments. The Department found that these programs and payments were not susceptible to significant improper payments.

3. Published Improper Payment Estimates

The Department complied with the requirement to publish improper payment estimates. Under Section 3(a)(3)(C) of IPERA, if required, an agency must publish improper payment estimates for programs it identified as being susceptible to significant improper payments.

As required, the Department published improper payment estimates for programs identified as susceptible to significant improper payments—the Pell, Direct Loan, and FFEL programs. The Department also reported an estimated improper payment rate for Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended (Title I), as it is required to do so under separate reporting requirements contained in OMB Circular A-136, “Financial Reporting Requirements,” revised October 21, 2013.²

In its FY 2013 AFR, the Department published improper payment estimates for the Direct Loan and FFEL programs using methodologies that were tentatively approved for FY 2013 by OMB, pending overall agreement on a revised strategy for estimating improper payments for all FSA programs identified as susceptible to significant improper payments. [See Finding No. 2 for additional information.] The Department also published a supplemental improper payment estimate for the Pell program using an alternative methodology similar to that which was used in FY 2012, as OMB did not approve the Department’s proposed alternative methodology for the Pell program for FY 2013.³

4. Published a Report on Actions to Reduce Improper Payments

The Department complied with the requirement to report on its actions to reduce improper payments in the Pell, Direct Loan, and FFEL programs. Under Section 3(a)(3)(D) of IPERA, the Department is required to report its actions to reduce improper payments for programs it deemed susceptible to significant improper payments.

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

³ For comparison purposes, the Department also published an improper payment estimate for the Pell program using its proposed alternative methodology. This number was provided in a footnote to the primary table in the AFR, per agreement with OMB.

5. Published and Has Met Annual Reduction Targets

Under Section 3(a)(3)(E) of IPERA, the Department is required to report improper payment reduction targets for programs identified as susceptible to significant improper payments and to meet those targets. The Department published FY 2014 reduction targets for the Pell, Direct Loan, and FFEL programs in its FY 2013 AFR.

The Department met its approved FY 2013 reduction target for the Pell program, reporting an estimated improper payment rate of 2.26 percent, which is lower than the reduction target of 2.49 percent.

In its FY 2012 AFR, the Department did not publish FY 2013 reduction targets for the Direct Loan and FFEL programs that were based on OMB-approved methodologies. Instead, the Department published reduction targets for these programs based on proposed methodologies that were pending OMB approval when the AFR was published. [See Finding No. 4 for additional information.] Because the Department published FY 2014 reduction targets for all programs susceptible to significant improper payments, and met its sole OMB-approved reduction target for FY 2013, it complied with this requirement.

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 is required to report estimated improper payment rates of less than 10 percent for each program identified as being susceptible to significant improper payments for which an improper payment estimate is published. OMB guidance further specifies that these rates should be gross improper payment rates comprising both overpayments and underpayments.

Using the OMB-approved methodologies, the Department reported estimated improper payment rates of 2.26 percent in the Pell program, 1.03 percent in the Direct Loan program, and 0.00 percent in the FFEL program. These 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 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 5, 2013, the Department submitted to OMB its FY 2013 Report on IPERA Payment Recapture Audits.

FINDING NO. 2 – The Department Could Improve its Improper Payment Rate Estimation Methodologies for the Pell and Direct Loan Programs

We found that improvements are needed in the Department's improper payment rate estimation methodologies for the Pell and Direct Loan programs, specifically with regard to ensuring the methodologies' completeness. The Pell program's estimation methodology does not consider populations of recipients who may pose a higher risk of improper payments and does not consider all potential sources of improper payments. The Direct Loan program's estimation methodology does not maximize the use of the results of program reviews of schools.⁴

With regard to the FFEL program, we found that the Department's methodology for calculating an estimated improper payment rate for FY 2013 was accurate and complete.

Pell Program

The Department calculated and reported an improper payment rate estimate for the Pell program in FY 2013 using a methodology that relied on the results of the Free Application for Federal Student Aid (FAFSA)/Internal Revenue Service (IRS) Data Statistical Study.⁵ This is the same methodology that the Department used to calculate improper payment rate estimates for the Pell program in its FY 2011 and FY 2012 AFRs.⁶ In previous reports on the Department's compliance with IPERA, we noted that there are a number of issues related to the Department's use of the FAFSA/IRS Data Statistical Study for estimating improper payment rates.⁷ As part of this year's audit, we reviewed the most recent FAFSA/IRS Data Statistical Study and found that the Department had not addressed these previously-identified issues.

⁴ We noted that the Department's FY 2013 methodology also does not consider improper payments identified in Office of Inspector General (OIG) audits and investigations, an issue discussed in our audit of the Department's compliance with IPERA for FY 2012 ("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). However, we reviewed the corrective action plan submitted by the Department in response to that audit and noted that it has agreed to evaluate the possibility of incorporating findings from OIG work in the proposed statistical estimations for all programs, in consultation with OIG regarding sampling procedures and testing results.

⁵ The Higher Education Amendments of 1998 authorized the Secretary of Education to confirm directly with the IRS adjusted gross income and other information affecting students' eligibility for student aid. However, legislation to amend the IRS Code to permit a database match has not been enacted. The FAFSA/IRS Data Statistical Study, performed by the Department in conjunction with the IRS, is used to simulate a full match between the Department's and the IRS' databases to determine, among other things, the average amount of over- and under-reporting of FAFSA income data compared to IRS data and the potential misallocation of Pell program dollars that could be prevented by an IRS match.

⁶ The Department also reported an estimated improper payment rate for the Pell program in FY 2012 using an unapproved, alternative methodology.

⁷ "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, and "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.

Specifically, we noted the following:

- U.S. Social Security Administration (SSA) non-matches were not analyzed;
- The impact of IRS non-matches on improper payment rates was not assessed;⁸
- Recipients' eligibility for Pell grants was not considered;⁹ and
- Required recalculations of a Pell grant award when a recipient's enrollment status has changed were not considered.

Section 2(b)(1) of IPIA, as amended by IPERA, requires agencies to produce statistically valid improper payment estimates, or estimates that are otherwise appropriate using methodologies approved by the Director of OMB.

The FAFSA/IRS Data Statistical Study was originally developed for operational use and later adopted for the purpose of calculating an improper payment rate estimate for the Pell program. Since it was not developed for the purpose of generating an improper payment rate estimate that fully captures all risks of improper payments within the Pell program, limitations exist with using it for such purposes.

The methodology for the FY 2013 improper payment rate estimate for the Pell program is not complete because it does not consider all potential improper payments. The population of recipients whose data does not match SSA and IRS databases may represent a higher risk of improper payments than the population of recipients whose data matches the SSA and IRS databases. Since this potentially higher risk population is not analyzed for improper payments, the reported improper payment rate estimate may be understated. Additionally, since two potential sources of improper payments are not considered in the methodology—improper payments made to ineligible recipients and incorrect award amounts to students whose enrollment status has changed—it is likely that improper payment rate estimates for the Pell program are understated.

To address the issues identified in our previous reports, the Department developed an alternative methodology to be used in the calculation of Pell program improper payment rates that leverages program compliance reviews performed at institutions and considers additional risks and transactions not included in the FAFSA/IRS Data Statistical Study. However, OMB did not approve the use of this alternative methodology for FY 2013. The Department continues to work with OMB to refine and obtain approval for this alternate methodology. However, although this alternative methodology addresses some of the completeness issues noted with the FAFSA/IRS Data Statistical Study, it presents other completeness issues similar to those noted with the Direct Loan methodology, which we discuss below.

⁸ The FAFSA/IRS Data Statistical Study computes an error rate by comparing adjusted gross income reported on the FAFSA to adjusted gross income reported on tax returns for a sample of students (and their parents if they are dependents). However, students and parents whose social security numbers, names, and dates of birth do not match the SSA database are excluded from the review. Additionally, if a matching IRS record is not found for a student aid applicant, no effort is made to assign an error.

⁹ The FAFSA/IRS Data Statistical Study looks only at improper payments resulting from the incorrect reporting of adjusted gross income. It does not consider situations where a student may be ineligible for a Pell grant award, such as when a student has already earned a bachelor's degree or has already received a Pell grant award for 12 semesters.

Direct Loan Program

The Department calculated and reported an improper payment rate estimate for the Direct Loan program in FY 2013 using an alternative methodology that was approved by OMB only for FY 2013.¹⁰ We reviewed documentation supporting the Department's estimate and found issues with regard to its completeness. This occurred because the Department was unable to include data from a significant number of program reviews in its Direct Loan program improper payment rate calculation.¹¹

For FY 2013, the Department received OMB approval to use a new methodology that relies heavily on the results of program reviews of schools. The Department, in conjunction with its contractor, planned to select for analysis program reviews conducted between October 1, 2012 and June 30, 2013 (9 months), although it eventually extended its analysis to include program reviews conducted through mid-August 2013 (10.5 months). This resulted in program reviews of 180 schools being selected for the purpose of determining whether any improper payments were identified during the reviews. However, 109 of these program reviews (61 percent) were not included in the improper payment rate estimation calculation because the reports from these reviews had not yet been issued. This left the Department with the results of 71 program reviews of schools to analyze for improper payments. However, another 16 program reviews were excluded from the analysis because the program reviews did not test for improper payment transactions. As a result, the Department was ultimately left with 55 program reviews of schools—31 percent of the original 180—that were used to calculate an estimated improper payment rate for the Direct Loan program.

Section 2(b)(1) of IPIA, as amended by IPERA, requires agencies to produce statistically valid improper payment estimates, or estimates that are otherwise appropriate using methodologies approved by the Director of OMB.

The Department first developed the methodology used for the Direct Loan program for the FY 2012 AFR. The methodology was not approved by OMB for reporting in FY 2012, and the Department noted that it has since worked with OMB to refine the methodology and obtain approval. Although OMB approved the methodology for the FY 2013 AFR, the Department continues to work with OMB to evaluate, refine, and obtain approval on long-term estimation methodologies for all risk-susceptible programs.

The Department stated that its new estimation methodologies that leverage program reviews avoid significant costs that it would otherwise incur for separate testing at schools and institutions. The Department believes that leveraging its existing investments in the program review process provides for a more efficient allocation of resources.

¹⁰ As with the Pell program, the Department and OMB continue to work toward a long-term agreement on a suitable methodology that meets OMB requirements and is cost effective.

¹¹ As noted above, issues with regard to the completeness of the alternative methodology used in calculating an estimated improper payment rate for the Direct Loan program are also applicable to the alternative methodology for the Pell program. We noted only minor differences in the numbers of schools with usable program review data between these two programs.

The Department stated that it stopped analyzing program reviews in mid-August 2013 to give it sufficient time to calculate the improper payment rate estimates and report them in the AFR. The Department stated that it did not select program reviews conducted prior to October 2012 because it was looking only at program reviews conducted for the 2011-12 award year (July 1, 2011, through June 30, 2012) and these reviews did not begin until the fall of 2012.

The Department is not currently reporting an estimated improper payment rate for the Direct Loan program that is as complete as possible. By using program reviews conducted over a period of time in which most of the reports from these reviews were not yet issued, the Department drastically reduced (by 69 percent) the number of program reviews of schools that it could include in its sample for analyzing improper payments.

Recommendations

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

- 2.1 Continue working with OMB to obtain approval for a methodology that addresses the limitations of the FAFSA/IRS Data Statistical Study for the Pell program as well as the limitations noted with the Direct Loan program methodology.
- 2.2 Where improper payment rate estimates are based on the results of program reviews, include in the sample universe all program review reports that were issued, rather than program reviews conducted, within a sufficient period of time to obtain a larger sample size of program reviews with usable data.

Department Comments

The Department concurred with the finding and recommendations. The Department agreed that the Pell program findings identified in previous OIG reports were not directly addressed in the calculation of the FY 2013 improper payment rate based on the FAFSA/IRS Data Statistical Study. With regard to the use of program reviews in calculating improper payment rate estimates, the Department agreed that it could improve the precision of the estimates by increasing the size of the pool of reviews sampled and the sample size. The Department noted that it has modified its FY 2014 estimation methodologies to expand the pool of available program reviews to sample.

FINDING NO. 3 – The Department Could Improve its Reporting of Improper Payments Information

The Department could improve the reporting of improper payments information in its AFR. While the Department did provide a detailed reporting of improper payments and its efforts to reduce and recover them, it did not report a summary of its progress in completing the IPERA reporting requirements in the MD&A section of its AFR.

OMB Circular A-123, Appendix C, Part I(A)(18) requires agencies to include a summary of their progress in completing IPERA reporting requirements in the MD&A section of their PARs or AFRs.

Although the Department concedes that a summary of its progress in completing IPERA reporting requirements was not included in the MD&A section of its AFR, it believes that this requirement was met through its reporting in the “Other Information” section. OMB guidance, however, requires both a summary of progress in meeting IPERA reporting requirements and a detailed discussion of improper payments reporting. The information in the “Other Information” section satisfies the detailed reporting requirement, but does not satisfy the requirement to provide a summary of reporting requirements in the MD&A section of the AFR.

By not providing a summary of its progress in completing IPERA reporting requirements in the MD&A section of its AFR, readers of the AFR may not gain a complete understanding of whether the Department complied with IPERA reporting requirements.

Recommendation

We recommend that the CFO for OCFO—

- 3.1 Provide a summary of the Department’s progress in completing IPERA reporting requirements in the MD&A section of the AFR.

Department Comments

The Department concurred with the finding and recommendation. The Department stated that it will assess the revised OMB Circular A-136 guidance for FY 2014 and look for better opportunities to improve disclosures.

FINDING NO. 4 – The Department Has Shown Progress in Reducing and Recapturing Improper Payments, But Could Improve its Efforts in Establishing Reduction Targets

We found that the Department has shown progress in reducing and recapturing improper payments. Specifically, we found that, when comparing rates reported based on similar methodologies, estimated improper payments in risk-susceptible programs generally decreased between FY 2012 and FY 2013. We also noted that the Department made progress in its efforts to recapture improper payments during the same time period. However, we found that the Department could improve its efforts to establish meaningful improper payment reduction targets.

Reducing Improper Payments

In its FY 2013 AFR, the Department reported reduced improper payment rate estimates for the Pell and FFEL programs compared to those reported in FY 2012: from 2.49 percent to 2.26 percent, and 1.93 percent to 0.00 percent, respectively. However, for the same time period, the Department reported a higher improper payment rate estimate for the Direct Loan program.¹² Specifically, the improper payment rate estimate for the Direct Loan program increased from 0.58 percent in FY 2012 to 1.03 percent in FY 2013.

See Table 1 for a summary of reported FY 2012 and FY 2013 improper payments and improper payment rates:

¹² The Department also reported a higher improper payment rate estimate for the Title I program. However, the Title I program's improper payment rate estimate remains very low (0.39 percent) and, because it was not identified as susceptible to significant improper payments based on the Department's risk assessment, the Department is not required to meet IPERA requirements for this program.

Table 1 – Summary of Reported FY 2012 and FY 2013 Improper Payment Data

Program	FY 2012			FY 2013		
	Outlays (in millions)	Improper Payment Rate*	Improper Payment Dollars (in millions)	Outlays (in millions)	Improper Payment Rate	Improper Payment Dollars (in millions)
Pell	\$33,299	2.49%	\$829	\$32,338	2.26% ↓	\$731 ↓
Direct Loan	\$105,810	0.58%	\$614	\$102,497	1.03% ↑	\$1,056 ↑
FFEL	\$28,620	1.93%	\$552	\$10,817	0.00% ↓	\$0 ↓
Title I	\$15,208	0.19%	\$28	\$14,724	0.39% ↑	\$57 ↑
Total	\$182,937	1.11%	\$2,023	\$160,376	1.15% ↑	\$1,844 ↓

*The Department calculated and reported FY 2012 improper payment rate estimates for the Pell and Title I programs based on OMB-approved methodologies; improper payment rate estimates for the Direct Loan and FFEL programs were calculated and reported based on proposed methodologies.

We found that, in its FY 2012 AFR, the Department reported on the Direct Loan program's improper payment rate estimate using the lower-bound of the estimate's confidence interval.¹³ However, in its FY 2013 AFR, the Department used the point estimate of the confidence interval as we recommended in our FY 2012 report, which resulted in a higher improper payment rate estimate. We found that the Department used similar methodologies to calculate the Direct Loan improper payment rate estimates it reported for FY 2012 and FY 2013. We also found that, had the Department used the point estimate of 1.21 percent in reporting on the Direct Loan program's improper payment rate estimate for FY 2012, it would have reported a higher improper payment rate estimate for that year than it did for FY 2013. Consequently, the FY 2013 AFR would have reflected a reduction in the improper payment rate estimate and would have reflected the Department's progress between FY 2012 and FY 2013 in reducing improper payments in the Direct Loan program. In addition, the FY 2013 AFR would have reflected an overall decrease in estimated improper payments from FY 2012 to FY 2013 had the Department reported the point estimate for the Direct Loan program in its FY 2012 AFR.

See Table 2 for a summary of FY 2012 and FY 2013 improper payments and improper payment rates reflecting use of the point estimate in FY 2012:

¹³ As noted, the Department established the FY 2013 Direct Loan program target rate of 0.58 percent based on its reporting of the lower bound of the FY 2012 estimate's confidence interval. To determine an improper payment rate estimate, the Department computes a statistical point estimate (1.21 percent for the Direct Loan program in FY 2012) and then, using its desired confidence level, calculates an upper bound and a lower bound of the estimate's confidence interval. Each value in this range has an equal likelihood of representing the true error rate in the population. However, in our report on the Department's compliance with IPERA for FY 2012 ("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 noted that reporting only the lower bound of an estimate's confidence interval is problematic because it may be affected by changes in sample size from year to year. In its FY 2013 APR, the Department reported the point estimate for all programs and established target rates based on these numbers.

Table 2 – Summary of FY 2012 and FY 2013 Improper Payment Data Using FY 2012 Point Estimate

Program	FY 2012			FY 2013		
	Outlays (in millions)	Improper Payment Rate*	Improper Payment Dollars (in millions)	Outlays (in millions)	Improper Payment Rate	Improper Payment Dollars (in millions)
Pell	\$33,299	2.49%	\$829	\$32,338	2.26% ↓	\$731 ↓
Direct Loan	\$105,810	1.21%	\$1,280	\$102,497	1.03% ↓	\$1,056 ↓
FFEL	\$28,620	1.93%	\$552	\$10,817	0.00% ↓	\$0 ↓
Title I	\$15,208	0.19%	\$28	\$14,724	0.39% ↑	\$57 ↑
Total	\$182,937	1.47%	\$2,690	\$160,376	1.15% ↓	\$1,844 ↓

*The Department calculated and reported FY 2012 improper payment rate estimates for the Pell and Title I programs based on OMB-approved methodologies; improper payment rate estimates for the Direct Loan and FFEL programs were calculated and reported based on proposed methodologies.

Improper Payment Rate Targets

Despite its progress in reducing improper payment estimates, the Department could improve its efforts to establish meaningful improper payment reduction targets. In its FY 2013 AFR, the Department set reduction targets for each of its programs through FY 2016 equal to the improper payment rate estimate it reported in the current year. Consequently, the Department's reduction targets do not actually set a target that, if met but not exceeded, would result in a reduction in improper payments if program outlays remain constant or increase. For example, in FY 2013, the Department reported outlays of \$32.34 billion and an improper payment rate estimate of 2.26 percent for the Pell program. This equated to an estimated \$731 million in improper payments. The Department also set an improper payment reduction target of 2.26 percent for the Pell program in each succeeding fiscal year. If Pell program outlays remain constant or increase and the Department meets, but does not exceed, its target rate of 2.26 percent, then there will be no reduction in improper payments.

Recapturing Improper Payments

We found that the Department took corrective actions to address a recommendation on reporting noted in the FY 2012 OIG report. Specifically, we found that the Department's FY 2013 AFR included (1) a summary of the programs and activities for which it determined that 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. The Department's overall conclusion, as noted in both its FY 2012 and FY 2013 Reports on IPERA Payment Recapture Audits, and in its FY 2013 AFR, was that it would not be cost effective to conduct additional recovery activities outside of those already in place. However, the Department also noted that it issued a contingency-based

contract in FY 2013 to audit all contract payments for FYs 2007 through 2012 for possible errors and recovery. In its FY 2013 Report on IPERA Payment Recapture Audits, the Department noted that any questioned costs identified by the contractor were reviewed and determined to be proper payments; as a result, there have been no improper payments identified to date. In its FY 2013 AFR, the Department stated that it worked with program participants to resolve and recover amounts identified through compliance audits, OIG audits, and program reviews. Based on the results, the Department appears to have had success in recapturing improper payments. We found that the Department showed an increase in the percentage of funds recovered for both compliance audits and OIG audits from FY 2012 to FY 2013. In addition, while the percentage of funds recovered from program reviews decreased slightly, the amount of funds recovered increased from FY 2012 to FY 2013. Overall, the Department reported that it recovered nearly twice the amount of improper payments identified in FY 2013 compared to FY 2012, while also increasing the percentage of improper payments recovered by over five percentage points.

See Table 3 for a summary of the Department's recapture audit performance for FY 2012 and FY 2013:

Table 3 – Summary of Payment Recapture Audit Performance

Agency Source	FY 2012			FY 2013		
	Amount Identified (in millions)	Amount Recovered* (in millions)	Percent Recovered	Amount Identified (in millions)	Amount Recovered* (in millions)	Percent Recovered
Compliance Audits	\$21.7	\$4.3	19.82%	\$19.8	\$7.7 ↑	38.89% ↑
OIG Audits	\$2.7	\$0.2	7.41%	\$22.1	\$5.2 ↑	23.53% ↑
Program Reviews	\$30.7	\$6.7	21.82%	\$38.9	\$8.0 ↑	20.57% ↓
Total	\$55.1	\$11.2	20.33%	\$80.8	\$20.9 ↑	25.87% ↑

*Per the Department's FY 2013 AFR, these numbers include all amounts recovered during the year, not just recoveries of amounts identified during the year.

OMB Circular A-123, Appendix C, Part I(A)(7) Step 3(b) states that when agencies compile their plans to reduce improper payments, they shall set reduction targets for future improper payment levels. These reduction targets must be approved by the Director of OMB.

Officials within FSA's Finance Group stated that OMB has allowed the Department to set targets equal to the calculated improper payment rate estimate while the Department and OMB seek agreement on long-term improper payment estimation methodologies. According to the same officials, once the long-term improper payment estimation methodologies are approved, the Department will begin setting reduction targets that aim to reduce improper payments.

Although OMB approved the Department setting targets at current year improper payment rate estimates, the Department could improve its efforts to reduce improper payments by setting targets that aim for a reduction of improper payment rates. By not setting targets that aim to reduce the levels of improper payments, the Department may not be intensifying its efforts to identify, prevent, and recover improper payments.

Recommendation

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

- 4.1 Set targets that aim to reduce the rate of improper payments for all programs identified as susceptible to significant improper payments.

Department Comments

The Department generally concurred with the finding and recommendation. The Department stated that it will set reduction targets for programs identified as susceptible to significant improper payments to achieve its goal of reducing improper payments. The Department further stated that it will continue to work with OMB to refine the proposed estimation methodologies and to establish a long-term solution that will inform the identification of specific root causes that, when addressed, will allow for the measurement and targeting of rate reductions.

OBJECTIVES, SCOPE, AND METHODOLOGY

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

To accomplish our objectives, we gained an understanding of internal control applicable to the Department's compliance with IPERA and development of improper payment rate estimates. We reviewed applicable laws, OMB circulars, and guidance developed by the SSA OIG for the Council of Inspectors General on Integrity and Efficiency. In addition, to identify potential vulnerabilities, we reviewed prior OIG audit reports relevant to our audit objectives.

Our review covered the Department's reporting and performance in reducing and recapturing improper payments for the Pell, Direct Loan, and FFEL programs for the period October 1, 2012, through September 30, 2013 (FY 2013).

To determine whether the Department was in compliance with IPERA for FY 2013 and to evaluate its performance in reducing and recapturing improper payments, we relied primarily on information contained in the Department's AFRs for FYs 2012 and 2013. We also held discussions with OCFO officials and reviewed related supporting documentation, including risk assessments of all non-FSA grant programs and contract payments that were conducted in FY 2013 and Reports on IPERA Payment Recapture Audits for FYs 2012 and 2013. To evaluate the accuracy and completeness of the Department's reporting of improper payments data, we reviewed the Department's estimation methodologies for the Pell, Direct Loan, and FFEL programs and related supporting documentation. We also held discussions with officials in FSA's Finance Office and with the Department's contractor, Deloitte.

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

We conducted fieldwork at Department offices in Washington, D.C., during the period January 2014 through March 2014. We provided our audit results to Department officials during an exit conference held on March 26, 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 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.

**Acronyms/Abbreviations/Short Forms
Used in this Report**

AFR	Agency Financial Report
CAP	Corrective Action Plan
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
MD&A	Management's Discussion and Analysis
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
Pell	Federal Pell Grant
SSA	U.S. Social Security Administration
Title I	Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended

Department Response to Draft Finding Point Sheets



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

THE CHIEF FINANCIAL OFFICER

TO: Michele Weaver-Dugan
Director, Operations Internal Audit Team

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

John Hurt
Chief Financial Officer for
Federal Student Aid

John V. Hurt

SUBJECT: "Department's Compliance with the Improper Payments Elimination and Recovery Act of 2010 and its Performance in Reducing and Recapturing Improper Payments" A19-O0002

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 full compliance with the requirements of IPERA in FY 2013. 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: Keith Cummins, Assistant Director, Operations Internal Audit Team
Bryan Erickson, Auditor

Enclosure

A19-00002 "Department's Compliance with the Improper Payments Elimination and Recovery Act of 2010 and its Performance in Reducing and Recapturing Improper Payments"

Department's Response to Finding Point Sheets

Finding #2

We concur with this finding and the recommendations.

We concur that the Pell findings identified in prior year OIG IPERA Compliance reports were not directly addressed in the calculation of the FAFSA/IRS Data Statistical Study for reporting in the FY2013 AFR. As noted in the point sheets [report?], FSA implemented new estimation methodologies for all risk-susceptible programs reported, including the Pell program. The new estimation methodology for Pell addresses the limitations of and, for the purposes of reporting improper payment estimates, replaces the old FAFSA/IRS Data Statistical Study. We acknowledge that the new estimation methodologies are 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 this methodology.

We concur that where estimates are based on program reviews, such as the Direct Loan improper payment estimate reported in the FY2013 AFR, we may improve the precision of the estimate by increasing the size of the pool of reviews sampled and the sample size. We have modified our proposed FY2014 estimation methodologies to expand the pool of available program reviews to sample.

If OMB approves the new FY2014 methodology, we will close this finding as resolved.

Finding #3

We concur with this finding and recommendation.

In general, OMB provides an advisory statement that, within the Management's Discussion and Analysis, agencies should provide a brief description of their progress on eliminating and recovering improper payments; however, the detail is reserved for other information. In this and other matters, we will assess the revised A-136 guidance for FY14 and look for better opportunities to improve disclosures.

Finding #4

We generally concur with this finding and recommendation.

We share the goal of reducing improper payments generally and, specifically, for all programs identified as susceptible to significant improper payments and will establish reduction targets to achieve this aim. As noted in the AFR and in these point sheets, we continue to work with OMB to refine our proposed estimation methodologies and establish a long-term solution. We intend that our long term solution will inform the identification of specific root causes that, when addressed, will allow for the measurement of and targeting of rate reductions.