Other Accompanying Information

Improper Payments Information Act Reporting Details

The Improper Payments Information Act of 2002 (IPIA) and the Office of Management and Budget's (OMB) Circular No. A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments, require agencies to annually review and assess all programs and activities to identify those susceptible to significant improper payments. The guidance in OMB Circular No. A-123, Appendix C, defines significant improper payments as those in any particular program that exceed both 2.5 percent of program payments and $10 million annually. For each program identified as susceptible, agencies are required to report to the President and the Congress the annual amount of estimated improper payments, along with steps taken and actions planned to reduce them.

To facilitate agency efforts to meet the reporting requirements of the IPIA, the OMB announced a new *President's Management Agenda* program initiative beginning in the first quarter of FY 2005 entitled Eliminating Improper Payments. Previously, the OMB tracked the Department's IPIA activities with other financial management activities through the Improving Financial Performance initiative. The establishment of a dedicated President's Management Agenda initiative focused the Department's improper payments elimination efforts. Under the new initiative, the Department's status and progress are tracked and reported to the OMB in quarterly scorecards.

The Department has divided its improper payment activities into the following segments: Student Financial Assistance Programs, Title I Program, Other Grant Programs, and Recovery Auditing.

Student Financial Assistance Programs

Risk Assessment

As required by the IPIA, Federal Student Aid inventoried its programs during FY 2007 and reviewed program payments made during FY 2006 (the most recent complete fiscal year available) to assess the risk that a significant amount of improper payments were made. The review identified and then focused on five key programs (Federal Family Education Loan Program, Federal Pell Grant Program, Federal Supplemental Educational Opportunity Grant and Federal Work-Study Programs, and Direct Loan Program) representing $48.5 billion (or 99.6 percent) of Federal Student Aid's FY 2006 outlays of $48.7 billion.

The criteria for determining susceptible risk within the programs were defined as follows:

- For those programs with annual outlays that did not exceed the OMB susceptibility threshold of $10 million, a comprehensive program risk assessment was not prepared, and the programs were determined to be unsusceptible to the risk of significant improper payments.
- For programs with outlays greater than $10 million but less than $200 million, estimates of improper payments were prepared using the susceptible threshold error rate of 2.5 percent. Programs with improper payment estimates of less than $5 million were deemed unlikely to be susceptible to the risk of significant improper payments.
- Programs were selected for further determination of susceptibility to significant improper payments if annual outlays exceeded $200 million.
- Finally, programs were automatically deemed susceptible if they were previously required to report improper payment

information under OMB Circular A-11, *Budget Submission*, former Section 57.[1]

Risk-Susceptible Programs

The following five Title IV programs were deemed to be potentially susceptible to the risk of significant improper payments based on the OMB threshold described above

Federal Family Education Loan Program. The Federal Family Education Loan (FFEL) Program is a guaranteed loan program established by the Higher Education Act of 1965, as amended (HEA). Under the FFEL Program, eligible students apply to lenders such as banks, credit unions, and savings and loan associations for loans to help pay for educational expenses for vocational, undergraduate, and graduate schools. If the lender agrees to make the loan, a state or private nonprofit Guaranty Agency insures the loan against default. The federal government subsequently reinsures this loan. FFEL Programs offer various repayment options and provide four types of loans to qualified applicants:

- Subsidized Stafford Loans—Need-based loans in which the government pays interest when the student is in school and during qualified periods of grace and deferment.
- Unsubsidized Stafford Loans—Loans on which the government does not pay interest.
- PLUS Loans—Loans to parents of dependent undergraduate students on which the government does not pay interest. As a result of the Higher Education Reconciliation Act of 2005, graduate or professional students are now eligible to borrow under this loan program, subject to eligibility.
- Consolidated Loans—Loans that allow borrowers to combine multiple outstanding federal student assistance loans.

The interest payments and special allowance subsidies paid to lenders, combined with the default, loan processing, issuance, and account maintenance fees paid to Guaranty Agencies, comprise the program outlays at risk.

Federal Pell Grant Program. The Federal Pell Grant (Pell Grant) Program provides need-based grants to low-income undergraduate and certain postbaccalaureate students to promote access to postsecondary education. Students may use their grants at any eligible postsecondary institution. Grant amounts are dependent on a student's Expected Family Contribution (EFC), the cost of attending the institution, whether the student attends full time or part time, and whether the student attends the institution throughout the entire academic year.

Under the terms of the HEA, eligibility for Pell Grant awards is determined through applicant self-reported income, family size, number of dependents in college, and assets. These data are key drivers in the determination of program eligibility and eligible amounts. However, historical analysis indicates that self-reported data is prone to error and that these errors subsequently increase the risk of improper payments within the Pell Grant Program.

While limited matching of some self-reported income is currently conducted with data from the Department of the Treasury's Internal Revenue Service (IRS) annual income tax filings, Federal Student Aid is pursuing additional authority to allow greater access to IRS data. Specifically, Federal Student Aid has requested authorization to verify 100 percent of the annual student financial aid applications with the financial data reported to the IRS in annual income tax returns. The ability to verify self-reported financial data could result in a significant reduction of the risk of improper payments in the Pell Grant Program. Legislation to amend the Internal Revenue Code to permit a 100-percent data match has not yet been enacted and at this time appears unlikely to be enacted. In the interim, Federal Student Aid is working with the OMB to develop alternative methods for investigating these data.

[1] The four original programs identified in OMB Circular A–11, Section 57, were Student Financial Assistance (now Federal Student Aid), Title I, Special Education Grants to States, and Vocational Rehabilitation Grants to States. Subsequently, after further review of the program risk, the OMB removed Special Education Grants to States and Vocational Rehabilitation Grants to States from the list. The OMB considers Section 57 programs susceptible to significant improper payments regardless of the established thresholds. OMB Circular A-136 also applies.

Federal Supplemental Educational Opportunity Grant and Federal Work-Study Programs. The Federal Supplemental Educational Opportunity Grant program is one of three campus-based[2] formula grant programs allocated to eligible institutions for the purpose of providing grants to needy undergraduate students.

The Federal Work-Study program is another of the three campus-based formula grant programs and provides part-time employment to needy undergraduate and graduate students.

The Federal Supplemental Educational Opportunity Grant and Federal Work-Study programs were surveyed and determined not to be at significant risk of improper payments. Combined, the two programs constituted $1.7 billion or just 3.6 percent of the Federal Student Aid's total payments in FY 2006. Annually, participating institutions complete the Fiscal Operations Report and Application to Participate, which serves as a mechanism to report prior-year funds usage and current-year need. Each year, the aggregated amount of need for all participating institutions far exceeds the appropriated amounts for both Federal Supplemental Educational Opportunity Grant and Federal Work-Study programs. Therefore, by design, the risk of over-awarding funds is inherently minimized, because award distribution is prioritized by order of need, and not all students with demonstrated need actually receive awards. Moreover, continuing oversight activities, including audits and program reviews, have not revealed significant risk in either of these programs.

William D. Ford Federal Direct Loan Program. Similar to the FFEL Program, the William D. Ford Federal Direct Loan (Direct Loan) Program provides the following four types of loans to qualified individuals to assist with the cost of postsecondary education: (1) Stafford Subsidized, (2) Stafford Unsubsidized, (3) PLUS, and (4) Consolidation.

Under the Direct Loan Program, the Department uses Department of the Treasury funds to provide loan capital directly to schools, which then disburse loan funds to students.

The Department works with multiple educational and financial institutions to originate, disburse, service, and collect Direct Loans, and the HEA and subsequent reauthorization actions determine the allowable interest rates and fees. Eligibility requirements are determined through the analysis of factors such as income and assets, and the schools make the final award decisions. As a result of this multifaceted structure that encompasses multiple entity involvement and variable annual eligibility requirements, a full and rigorous assessment of the rate of improper payments in the Direct Loan Program is extremely complex.

All Direct Loan schools are required to have an independent compliance and financial statement audit each year. The primary assessment of risk in the Direct Loan program is determined by computing the percentage of audit findings to total Direct Loan disbursements. The error rate for FY 2007 was 0.0015 percent. Potential overpayments on refunds to borrowers and lenders were also assessed. For all of these payments, the error rate was under the IPIA thresholds.

Academic Competitiveness Grant (ACG) and the National Science and Mathematics to Retain Talent (SMART) Grant Programs. In addition to the five preceding programs, in FY 2007, Federal Student Aid program managers discussed the potential risks and controls for avoiding improper payments in the recently authorized ACG and SMART Grant programs. Payment processes and risk categories have been identified, and a risk control matrix has been developed for these new programs. The first risk assessments for the ACG and SMART Grant Programs will take place after the initial audit cycle is complete.

Statistical Sampling

The size and complexity of the student aid programs make it difficult to consistently define "improper" payments. The legislation and the OMB guidance use the broad definition: "Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other

[2] Campus-based financial aid programs are administered to students by participating postsecondary institutions and not by the Department of Education.

legally applicable requirement." Federal Student Aid has a wide array of programs, each with unique objectives, eligibility requirements, and payment methods. Consequently, each program has its own universe (or multiple universes) of payments that must be identified, assessed for risk, and, if appropriate, statistically sampled to determine the extent of improper payments.

Federal Family Education Loan Program. The Department has been working with OMB on implementing the *President's Management Agenda* program initiative entitled Eliminating Improper Payments. This initiative involves a range of quarterly activities designed to ensure that the Department is prepared to meet the annual reporting requirements of the IPIA. Through meetings and discussions with OMB and other Department offices, Federal Student Aid finalized its sampling methodology for estimating improper FFEL program payments in compliance with the requirements of the IPIA.

In FY 2007, Federal Student Aid program review staff from its Program Compliance business unit reviewed 84 invoices selected statistically from payments made during FY 2005. The selected invoices for guarantors and lenders totaled $283,175,828. The payment error rate, based on completed reviews of the selected invoices, is 0.032 percent. That compares favorably to the error rate of 2.2 percent calculated for the FY 2006 PAR, which was based on payment errors identified in program reviews, single audit reports for Guaranty Agencies and lenders, and Office of Inspector General audits of those entities.

Federal Pell Grant Program. Section 484(q) of the HEA authorizes the Department to confirm directly with the IRS the Adjusted Gross Income (AGI), taxes paid, filing status, and number of exemptions reported by students and parents on the Free Application for Federal Student Aid (FAFSA). Under the Internal Revenue Code, Federal Student Aid is not authorized to view the complete data, but the IRS does provide summary data.

The Department began conducting studies with the IRS using FAFSA data for the 2000–01 award year. Data provided by the IRS study were used to estimate improper payments for the Pell Grant Program for the 2005–06 award year. Federal Student Aid is working with the IRS to match FAFSA data collected for the 2006–07 award year with IRS data for the 2005 income tax year.

In the most recent completed study, which compared 2005–06 FAFSA data with 2004 IRS data, a sample file of 184,168 FAFSA applicant records was provided to the IRS along with a sampling program designed to allow the IRS to select the desired analysis sample from the larger file. This was done to preserve IRS confidentiality requirements. The final sample, generated by the IRS, contained 48,152 independent undergraduates and 51,478 dependent undergraduates (for whom parental data were matched). The table titled Pell Grant Improper Payment Estimates in this section presents a historical analysis of the results of the IRS statistical study of Pell Grants.

The IRS matched the final sample to its main database, and when a match occurred, it extracted the fields for AGI, taxes paid, type of return filed, and earned income tax credit information for the tax filer and compared this information with similar information reported to the Department on the FAFSA. Using a computer program supplied by Federal Student Aid, the IRS calculated revised EFC and Pell Grant awards for matching records by substituting the IRS income information for the FAFSA income information. The IRS provided aggregated statistical tables to the Department that presented the results of these comparisons. The results allowed the Department to estimate the following Pell Grant improper payment information:

- Improper payment rate and amount—The average amount of over- and underreporting of FAFSA income data compared with the IRS income data and potential dollar amount of improper Pell Grant awards.
- Assessment of measurement accuracy—The volume of applicants for whom a mismatch between FAFSA and IRS data may be legitimate.
- Identification of further potential risks—Types of applicants who are more likely to misreport income on the FAFSA.

- Analysis of existing edits—Validity of the current verification selection edits and information to further refine them.

William D. Ford Federal Direct Loan Program. The analysis and corrective actions developed for the Pell Grant Program, relative to application accuracy, will also improve the accuracy of Direct Loan Program applications, because (1) the same application is used for both programs and (2) eligibility for subsidized direct loans are founded on the same need-based analysis formula and institutional cost of attendance.

Corrective Actions

Federal Family Education Loan Program. Federal Student Aid is working closely with the OMB and other Department offices in the development of an action plan designed to (1) improve the accuracy of the FFEL improper payment estimate and (2) reduce the level of risk and amount of known improper payments in the FFEL Program. In the first quarter of FY 2008, discussions will be held with Oak Ridge National Laboratory regarding the possibility of developing a revised methodology for identifying improper payments in the FFEL program. Understanding and developing systems of internal controls over program payments is crucial to meeting these goals.

Federal Student Aid has a number of existing internal controls integrated into its systems and activities. Program reviews and independent audits and Inspector General audits of Guaranty Agencies, lenders, and servicers are some of its key management oversight controls. Other control mechanisms include the following:

- System Edits—The systems used by the Guaranty Agencies, lenders, and servicers to submit fee bills for payment include "hard" and "soft" edits to prevent erroneous information from being entered into the system and translated into erroneous payments. The hard edits prevent fee bills with certain errors from being approved; these errors must be corrected before proceeding with payment processing. The soft edits alert the user and Federal Student Aid to potential errors. Federal Student Aid reviews these warnings prior to approval of payment.
- Reasonability Analysis—Data stored in the National Student Loan Data System are used as a tool to assess the reasonability of fee billing and determine payment amounts for account maintenance and loan issuance processing fees paid to Guaranty Agencies. Federal Student Aid also performs trend analysis of previous payments to Guaranty Agencies, lenders, and servicers as a means of evaluating reasonableness of changes in payment activity and payment levels.
- Focused Monitoring and Analysis—Federal Student Aid targets specific areas of FFEL payment processing that are at an increased risk for improper payments as areas of focus for increased monitoring and oversight.

These existing controls are re-evaluated on a regular basis to determine their effectiveness and allow Federal Student Aid to make necessary corrections. Federal Student Aid's action plan also incorporates the development of additional internal controls designed to improve the accuracy of future FFEL payments to Guaranty Agencies, lenders, and servicers. These internal controls include the following:

- Special Allowance Payments—Increased focus and review of payments of fees to lenders and servicers associated with loans eligible for tax-exempt special allowance payments.
- Guaranty Agencies—Enhanced review of the Guaranty Agency Financial Report (Form 2000) to report collection activities, claims reimbursement, and loan portfolio status; and under- and over-billings for account maintenance, loan issuance, and processing fees associated with incorrect National Student Loan Data System reporting.

Additional controls are being considered for both cost efficiency and effectiveness in reducing FFEL payment errors. Updates to the corrective action plan will be reported to the OMB in the quarterly scorecard for Eliminating Improper Payments.

Federal Pell Grant Program. Federal Student Aid has several initiatives under way designed to improve its ability to detect and reduce improper payments made through the Pell Grant Program, including the statistical study described above. Working with the OMB on quarterly action plan objectives designed to facilitate full implementation of the IPIA, it has identified additional methods to determine the error rate and estimate the annual amount of improper payments.

Preliminary Analysis. Eligibility for Title IV student aid is determined through applicant self-reported income, family size, number of dependents in college, and assets. These data are reported through the FAFSA, which applicants typically complete prior to the April 15 IRS tax filing deadline. The FAFSA data are key drivers in the determination of student aid program eligibility and eligible amounts. Federal Student Aid performs routine analyses of the accuracy of income and other financial data submitted via the FAFSA. These analyses include a variety of methods and techniques designed to ensure payment accuracy, including the following:

- Annual Analysis of System Data—Analysis of central processing system data for anomalies.
- Focus Groups—Meetings with educational institutions to discuss improving the integrity of Federal Student Aid programs.
- Quality Assurance—Enhanced program integrity processes.
- Verification—A process by which institutions compare applicant data with IRS data for the same period.

Federal Student Aid is also using the IRS statistical study in which financial data from a random sample of FAFSA submissions are compared with financial data reported to the IRS in annual income tax filings to identify new solutions for preventing improper payments.

The analysis of the IRS statistical study indicates that failure to accurately report income, family size, number of dependents in college, and assets may be the primary cause of improper payments within the Pell Grant Program. It is expected that a decrease in financial reporting errors would have the greatest impact on the reduction of estimated improper payments. In an effort to achieve this reduction, Federal Student Aid has requested authorization to perform a 100-percent match of the financial data reported on the FAFSA with the financial data reported to the IRS on applicant income tax returns. However, current law does not permit Federal Student Aid to verify income data with the IRS. Although Federal Student Aid plans to pursue this option, it must continue to meet the reporting requirements of the IPIA. Federal Student Aid is pursuing alternative approaches that will accomplish the same result: reduced improper payments in the Pell Grant Program.

Alternatives to Verifying Self-Reported AGI. Working with officials from the OMB and the Department, Federal Student Aid has been exploring alternatives to the 100-percent IRS match for verifying self-reported financial information reported on the FAFSA and assessing the strengths and weaknesses of those alternatives. Listed below are some of the alternative approaches that are being considered:

- Require actual tax returns prior to disbursement.
- Require update to income data at tax filing deadline.
- Expand verification beyond 30 percent.
- A pilot program for matching FAFSA data with IRS data based on consent.

The ongoing action plan details the steps necessary to (1) perform statistical analysis, (2) complete the review of the alternative approaches, (3) incorporate current IRS statistical analysis, and (4) submit the recommended alternative approach or combination of alternative approaches. Progress in completing actions will continue to be reported to the OMB in the quarterly scorecard for Eliminating Improper Payments.

Federal Student Aid's ability to project improper payment reductions is dependent upon the completion of the corrective action plan and selection of an alternative approach to a 100-percent IRS income match for every application. This will not be a quick or easy process. The system development life cycle for the pertinent Federal Student Aid systems requires significant lead time for requirements development, testing, coding, and implementation to deploy the changes necessary to reduce improper payments.

Federal Student Aid Summary

The following table presents the improper payments outlook for the primary Federal Student Aid Programs.

Federal Student Aid Improper Payment Reduction Outlook Fiscal Years 2006–10
($ in millions)

	Actual			Estimated											
	2006			2007			2008			2009			2010		
Program	Outlays	IP %	IP $	Outlays	IP %	IP $	Outlays	CY IP %	IP $	Outlays	CY IP %	IP $	Outlays	CY IP %	IP $
FFEL Program[1]	$11,718	2.2%	$258	$5861	0.032%	$2	$4,307	0.032%	$1	$4,307	0.032%	$1	$4,307	0.032%	$1
Pell Grant Program[2]	$12,725	3.54%	$446	$12,240	3.54%	$433	$12,543	3.50%	$439	$12,543	3.50%	$439	$12,543	3.50%	$439

Note Direct Loan payments are not included in the chart this year because they are not considered risk susceptible since the risk assessment identified these payments to be below the OMB threshold criteria.

[1] Source of FFEL outlays for FY 2006 is FY 2006 Total FFEL Payments. Source of FFEL outlays FY 2007–08 is the FY 2008 Budget Appendix, page 341, line 90.00. Outlays were assumed to remain at the FY 2008 estimate for FY 2009 and FY 2010.

[2] Source of Pell outlays for FY 2006 is COD Project Briefing dated July 31, 2007. Source of Pell outlays for FY 2007–08 is the FY 2008 Budget Appendix, page 330, line 90.00, with detail support from Budget Service in file "Breakout of Student Financial Assistance Outlays by Program." Outlays were assumed to remain at the FY 2008 estimate for FY 2009–10. The FY 2007 chart above uses the actual IP% for FY 2006 for both FY 2006 and FY 2007. This is a change from the prior year's chart which reflected the estimated error rate of 3.48 percent. The estimated error rate used for FY 2008–10 is 3.5 percent.

Manager Accountability

Federal Student Aid program managers are responsible for making recommended improvements and achieving quantifiable savings. The Federal Student Aid Executive Leadership Team monitors these efforts. The Executive Leadership Team is composed of key managers and is the executive decision-making body within Federal Student Aid. The Office of Inspector General conducts periodic audits of student aid programs and makes appropriate recommendations to management and the Congress.

Reducing improper payments in the Pell Grant Program has been a performance measure in the Department's Strategic Plan since 2002. The IRS statistical study has also been included in Federal Student Aid's Annual Plans. In addition, projects have been included in the Federal Student Aid Annual Plan to improve the verification process results.

Beginning in 2005, a control group of FAFSA applicants who had estimated their 2004 income when completing the application were advised after April 15 to revise the application with the correct and known information filed on their 2004 income tax return.

Statutory or Regulatory Barriers

Consistent with the administrative proposal present in the 2008 President's Budget, Education and Treasury are continuing to work toward a consent-based approach to perform data matching between Federal Student Aid applications and tax return data, to confirm income and household information. This data matching would virtually substantially reduce improper payments in the Pell Grant program, as the large majority of errors are the result of misreporting of income and related data fields. However, legislation to amend the Internal Revenue Code to permit the database match has not yet been enacted and at this time appears unlikely to be enacted.

Title I Program

The Department performed a risk assessment of the *Elementary and Secondary Education Act of 1965* Title I Program, parts A, B, and D, during FY 2006. The Erroneous Payments Risk Assessment Project Report documented that the risk of improper payments under current statutory requirements is very low. To validate the assessment data, the Department conducted an on-site monitoring review in FY 2006 that encompassed all states and territories receiving Title I funds with a three-year review cycle. The Office of the Chief Financial Officer participated with the Office of Elementary and Secondary Education in the monitoring process, beginning in March 2005, to provide technical support regarding fiduciary compliance. There were no findings in the monitoring reviews with questioned costs that contradicted the data in the risk assessment.

The Department is continuing to review and monitor for data quality. A key element of the monitoring process involves the wide use of the number of children who qualify for free and reduced-price meals to determine an individual school's Title I eligibility and allocation by local educational agencies. The Title I statute authorizes local educational agencies to use these data, provided under the U.S. Department of Agriculture's national School Lunch Program, for this purpose. In many districts these data are the only indicator of poverty available at the individual school level.

The U.S. Department of Agriculture is working with states and localities to improve program integrity, within the existing statutory and regulatory framework, through enhanced monitoring and auditing. The U.S. Department of Agriculture is also working with the Department and other federal agencies that have programs that make use of these data to explore long-term policy options.

Other Grant Programs

During FY 2007, the Department continued to work with the Department of Energy's Oak Ridge National Laboratory to perform data mining on information available in the Federal Audit Clearinghouse's Single Audit Database, the Department's Grant Administration and Payment System, and the Department's Audit Accountability and Resolution Tracking System to assess the risk of improper payments in its remaining grant programs.

The Department's approach to the risk assessment process for non-Federal Student Aid grant programs was to develop a methodology to produce statistically valid measures that could be applied uniformly across the Department's programs. The intent was to use the same methodology across all non-Federal Student Aid grant programs to establish a level of quality control for all programs and, at the same time, produce a cost-effective measure. The Department deemed it cost effective to utilize the results of the thousands of single audits already being conducted by independent auditors on grant recipients.

Risk Assessment

One of the concerns that resulted from the FY 2005 Oak Ridge National Laboratory study was the definition of what constitutes a "program." The Department's original approach was to address programs at a high level to effectively match anticipated outlays as defined in our budget submissions and consequently grouped many Catalogue of Federal Domestic Assistance (CFDA) numbers into a single "functional program." The concern with this definition was that calculating estimated improper error rates at such a high level can effectively mask the potentially higher rates that might exist if "program" is defined at the CFDA level. To further refine the Department's methodology, beginning with the FY 2006 risk assessment, Oak Ridge National Laboratory was tasked with performing the assessment at the CFDA level in addition to the functional program level. To conduct the risk assessment screening, Oak Ridge National Laboratory augmented the Audit Accountability and Resolution Tracking System database with imputed values for the likely questioned costs for grants that were not audited. The imputed and real questioned costs could then be tabulated to provide a reasonable upper-bound estimate of the rate of erroneous payments for each of the functional programs of interest.

If the computed upper-bound percentage was below 2.5 percent, then the actual value would be lower than 2.5 percent. If the computed upper-bound percentage was greater than 2.5 percent, then the actual value may be greater or less than 2.5 percent, but the Department would need additional information to determine the appropriate estimate.

The key results of the analysis are presented in the following table, which contains the estimates of the average functional program rates of questioned costs for recent years. The most striking result was the generally low rate of questioned costs. The key finding of this analysis was that for the most recent year for which data are available (FY 2005), none of the functional programs exceed the threshold value

Non-FSA Grant Programs

Improper Payment Risk Assessment

Functional Program	2002 (%)	2003 (%)	2004 (%)	2005 (%)
Education Research, Statistics, and Assessment	0.02	0.36	0.0	0.1
Elementary and Secondary Education	0.12	0.13	0.6	0.7
English Language Acquisition	0.02	0.10	0.1	0.6
Higher Education	0.29	0.21	0.4	0.5
Impact Aid	0.55	0.04	0.4	0.0
Innovation and Improvement	0.21	0.23	0.1	0.2
Rehabilitation Services and Disability Research	0.12	0.32	2.1	0.3
Safe and Drug-Free Schools	0.33	0.13	1.2	2.0
Special Education	0.06	0.83	0.1	0.1
Title I	0.16	1.19	0.2	0.7
Career, Technology and Adult Education	0.25	0.12	0.2	0.9
Overall Risk	**0.04**	**0.16**	**0.4**	**0.5**

of 2.5 percent. Consequently, none of the programs would be labeled as susceptible to significant erroneous payments. The assessment at the CFDA level revealed similar results, with the exception of two CFDAs (Even Start and Safe and Drug-Free Schools) that were slightly above the upper bound. The Department continues to seek methods to enhance the risk assessment for potential improper payments in grant programs and is taking the following actions to further improve its monitoring efforts.

Risk Management Service. The Department has established a new organization, the Risk Management Service, in the Office of the Secretary. The mission of this office is to identify and take effective action to manage and mitigate risks in the area of grants management that may adversely affect the advancement of the Department's mission. To achieve this objective, the Risk Management Service will develop and coordinate a Department-wide risk management strategy and coordinate and support consistent, high-quality management of formula and discretionary grants Department-wide.

The office will focus on identifying potential high-risk grantees before problems begin to occur and providing assistance to those grantees regarding their financial management practices through the program offices and Risk Management Service staff members. In the case of grantees identified as high risk, resources will be directed toward solving and managing issues of misuse, abuse, or waste of federal funds. The office will also provide customer service in the form of training and responses to inquiries on policy interpretations to grantees, grant applicants, and program offices awarding and monitoring grants.

Managing Risk in Discretionary Grants. In FY 2007, the Department managed more than 10,000 discretionary grant awards. Due to the vast legislative differentiation and the complexity of the Department's grant award programs, ensuring that our program staff are fully aware of potentially detrimental issues relating to individual grantees is a significant challenge. Program offices designate specific grants as high risk in accordance with Departmental regulations.

In an effort to reduce risk and promote efficiency, the Department has established the Grants High-Risk Module. This module is housed within the Department's Grant Administration and Payment System, and program office staff are required to review and certify their awareness of the high-risk status of applicable grantees before making awards.

Policies and procedures were developed to support the implementation of the module. System input to the module's database is limited to specific grants policy staff who are fully trained in policy and system use. In addition to the module's certification requirement, various reports are provided so that continual monitoring of grantee risk is made available to Department program administrators.

Implementation of the module provides greater accountability and significantly reduces risk within the Department's grant award process by ensuring program office awareness of potentially detrimental grantee issues prior to award determination. We anticipate that increased accessibility and communication across our program offices will promote further monitoring of high-risk grantees, resulting in a reduction of the number of grantees so designated.

Manager Accountability. The Department categorized OMB Circular A-133 single audit findings to provide feedback to program managers regarding the frequency and type of findings within their programs. This assists managers in tailoring their program monitoring efforts to the type of findings that most frequently occur. Additionally, post-audit follow-up courses have been developed to associate audit corrective actions with monitoring to minimize future risk and audit findings. In FY 2007, the Department developed internal control training for managers that addressed controls to eliminate improper payments. The mandatory one-day seminar for all Department managers was completed in September 2007 and provided a framework for addressing the requirements of the Improper Payments Information Act utilizing applicable regulations, guidelines, and best practices. Part of the training presentation focused on management responsibility to utilize risk assessment criteria to properly assess the risk of improper payments in the Department's programs**.**

Planned Corrective Actions. In addition to the actions previously outlined under the Student Financial Assistance Programs and Title I Program sections, the Department will configure any corrective action plans based on the results of the initiatives outlined above. The Department will record and maintain corrective action plans as required, which will include due dates, process owners, and task completion dates.

Information Systems and Infrastructure. The Department has submitted budget requests of $450,000 for FY 2008 and FY 2009 for information system infrastructure improvements. A portion of the funds will be used to continue the refinement of the Oak Ridge National Laboratory data mining effort. It is also anticipated that the Department will incur costs related to mitigation activities.

Recovery Auditing Progress

To effectively address the risk of improper administrative payments, the Department continued a recovery auditing initiative to review contract payments. The Department utilized a contractor who performed a rigorous statistical analysis of FY 2006 payment transactions based on nineteen criteria for identifying duplicate payments. The contractor also sampled Department contracts and purchase orders from FY 2003 through FY 2006 to ensure agreement between contract amounts and invoiced amounts. No improper payments were indicated in either review. Additionally, the contractor's review of all FY 2006 contract invoices with potential interest overcharges exceeding $50 found no more than $1,500 in potential recoveries. The Department's purchase and travel card programs remain subject to monthly reviews and reconciliations to identify potential misuse or abuse.

Summary

The Department is continuing its efforts to comply with the IPIA. Although there are still challenges to overcome, the Department is committed to ensuring the integrity of its programs. The Department continues to be scored by OMB as "green" on the implementation progress scorecard for the President's Management Agenda initiative on Eliminating Improper Payments.

The Department is focused on identifying and managing the risk of improper payments and mitigating the risk with adequate control activities. In FY 2008, we will continue to work with OMB and the Inspector General to explore additional opportunities for identifying and reducing potential improper payments and to ensure compliance with the IPIA.

Report to Congress on Audit Follow-up

The *Inspector General Act of 1978*, as amended, requires that the Secretary report to the Congress on the final action taken for the Inspector General audits. With this *Performance and Accountability Report*, the Department of Education is reporting on audit follow-up activities for the period October 1, 2006, through September 30, 2007.

The Audit Accountability and Resolution Tracking System is the Department's single database system used for tracking, monitoring, and reporting on the audit follow-up status of the Government Accountability Office (GAO) audits; the Office of Inspector General-issued internal audits, external audits, and alternative products; and single audits of funds held by non-federal entities. The Department's audit follow-up system functionalities allow the following:

- Tracking of internal, external, GAO, sensitive, and alternative product types from inception to final disposition.
- Evaluation and escalation points for audit reports and recommendations at appropriate levels in the user hierarchy.
- Notifying users of audit decisions and approaching or expiring events and transactions.
- Downloading report and query results into electronic file formats.
- Attaching files to the audit record.
- Providing a personal portal (Digital Dashboard) for user-assigned transactions.
- Providing a search function to query application (Audit Report) data.
- Providing for both a defined and an ad hoc report generation environment.

Number of Audit Reports and Dollar Value of Disallowed Costs

At the start of this reporting period, the balance for audit reports with disallowed costs totaled 72, representing $42.9 million. At the end of the reporting period, the outstanding balance was 66 audits, representing $53.6 million. The information in the table below represents audit reports for which receivables were established.

Final Actions on Audits with Disallowed Costs
Fiscal Year Ended September 30, 2007

	Number of Reports	Disallowed Costs
Beginning Balance as of 10/1/2006	72	$ 42,876,962
+ Management Decision	201	39,202,383
Pending Final Action	273	$ 82,079,345
- Final Action	207	28,495,066
Ending Balance as of 9/30/2007	66	$ 53,584,279

Number of Audit Reports and Dollar Value of Recommendations That Funds Be Put to Better Use

The Department has a total of five audit reports, totaling $899.6 million, with recommendations that funds be put to better use. Two of these, totaling $7.2 million, have been resolved. Resolution occurs when there is agreement between the program office and the Department's Office of Inspector General on the corrective actions required to address the findings and recommendations in an audit report.

Reports Pending Final Action One Year or More After Issuance of a Management Decision

As of September 30, 2007, the Department has a total of nine Office of Inspector General internal and nationwide audit reports on which final action was not taken within a year after the issuance of a management decision; 33 percent were over two years old. Many corrective actions are dependent upon major system changes that are currently being implemented. For detailed information on these audits, refer to the Department's *Semiannual Report to Congress on Audit Follow-up Number 37*.

Credit Management and Debt Collection Improvement Act

The Department of Education has designed and implemented a comprehensive credit management and debt collection program that enables us to effectively administer our multi-billion-dollar student loan and other programs. The credit management and debt collection program covers each phase of the credit cycle—including prescreening of loan applicants, account servicing, collection, and close-out—and it conforms to the government-wide policies in the Federal Claims Collection Standards, OMB Circular A–129, and the *Debt Collection Improvement Act of 1996 (DCIA).* As a result, the Department has made significant strides in student loan default management and prevention.

The Department has been working diligently with schools and partners in the student loan industry to reduce the cohort default rate. The FY 2005 cohort default rate is 4.6 percent. This low default rate is a function of the Department's improved borrower counseling and the steps we have taken in gatekeeping to remove schools with high default rates from participating in federal student loan programs.

Borrowers who default on student loans face serious repercussions, such as the withholding of federal income tax refunds and other federal payments, wage garnishment, adverse credit bureau reports, denial of further student aid, and prosecution. To avoid these sanctions, defaulters now have the option to consolidate their loans and establish an income-based repayment plan that more realistically matches their ability to pay.

The Department also continues to conduct computer matches with other federal agencies as part of our effort to strengthen the management and oversight of student financial assistance programs. The computer matches are designed to ensure that students meet various eligibility criteria and increase the collections from students who have defaulted on their loans.

The Department categorizes its debt into two basic categories: student loan debt, which accounts for approximately 99 percent of all of the Department's outstanding debts, and institutional and other administrative debt. The Department of the Treasury granted the Department a permanent exemption from the cross-servicing requirements of the DCIA for defaulted student loans and approval to continue to service our own internal student loan debts because of our successful track record. However, we have been referring eligible student loan debts—those we previously tried to collect using all other available tools—to the Department of the Treasury for tax refund offset since 1986.

The Department handles its institutional and administrative debts outside of the systems established for student loans. The Department was one of the first to participate in the Treasury Cross Servicing Program and has been referring delinquent debts since October 1996. As of September 30, 2007, we have forwarded approximately 96 percent of all institutional and administrative debts eligible for cross servicing to the Department of the Treasury.

Management Challenges for Fiscal Year 2008

The Office of Inspector General (OIG) works to promote efficiency, effectiveness, and integrity in the programs and operations of the U.S. Department of Education (Department). Through our audits, inspections, investigations, and other reviews, we continue to identify areas of concern within the Department's programs and operations and recommend actions the Department should take to address these weaknesses.

The Reports Consolidation Act of 2000 requires OIG annually to identify and summarize the top management and performance challenges facing the Department, as well as to provide information on the Department's progress in addressing those challenges. Based on our recent work and knowledge of the Department's programs and operations, we have identified six specific challenge areas for the Department for fiscal year (FY) 2008: (1) student financial assistance programs and operations; (2) information security and management; (3) new programs and programs nearing reauthorization; (4) grant and contract awards, performance, and monitoring; (5) data integrity; and (6) human resources.

The predominant challenge facing the Department within each of these areas is implementation and coordination of effective internal controls. "Internal controls" are the plans, methods, and procedures aimed at providing reasonable assurance that an agency meets its goals and achieves its objectives, while minimizing operational problems. While the Department is working to make progress in these areas, it is evident that additional focus, attention, and emphasis are needed. Only by significantly improving its internal controls and demanding accountability by its managers, staff, program participants, and contractors will the Department be an effective steward of the billions of taxpayer dollars supporting its programs and operations.

Challenge: Student Financial Assistance Programs and Operations

The federal student financial aid programs involve over 6,000 postsecondary institutions, more than 3,000 lenders, 35 guaranty agencies, and many third party servicers. During FY 2007, Federal Student Aid (FSA), the Department office with responsibility for these programs, provided $82 billion in awards and oversaw an outstanding loan portfolio of over $400 billion. FSA must conduct effective monitoring and oversight and demand accountability from its staff, program participants, and contractors to help protect higher education dollars from waste, fraud, and abuse. OIG work has shown that this is a significant challenge for FSA, as it does not have the capacity and resources necessary to identify and implement effective oversight and monitoring of its program participants.

The Department's Progress: FSA has agreed to improve its management of its programs and to develop and implement consistent oversight procedures. FSA made changes to the organizational structure of one of its internal offices, Financial Partners, and transferred the regional offices out of Financial Partners to a new Program Compliance organization in 2006. In addition, the Department has taken steps in response to our audit work on 9.5 percent special allowance payments (SAP). The Department now requires all lenders billing at the 9.5 percent SAP rate to be paid at the regular rate until the Department receives the results of audits to determine the eligibility of loans for payments at the 9.5 percent rate. The Department, with advice from OIG, established a methodology to determine the eligibility of loans to be billed at the 9.5 percent SAP rate, and has hired a contract auditor, or requires the lender to hire its own auditor, to conduct a 9.5 percent SAP audit in accordance with an Audit Guide issued by the OIG. Also, in response to an OIG recommendation, the Department agreed to add the issue of lender inducements to negotiated rulemaking sessions held this year. When the negotiators could not reach an agreement, the Department formed a lender task force to advise the Secretary on needed regulations. Rules addressing inducements and preferred lender lists were issued on November 1, 2007. Last year, the Department also established a separate inducement task force to compile and assess all allegations of improper inducements and design corrective actions as needed.

Challenge: Information Security and Management

The *Federal Information Security Management Act* (FISMA) requires each federal agency to develop, document, and implement an agency-wide program to provide information security and develop a comprehensive framework to protect the government's information, operations, and assets. To ensure the adequacy and effectiveness of information security controls, Inspectors General conduct annual independent evaluations of the agencies' information security programs and report the results to the Office of Management and Budget (OMB).

In our information security audits to support our FISMA requirements, we have identified security weaknesses that the Department must address to protect its systems and to maintain their security certification and accreditation. These weaknesses include certain management, operational, and technical security controls; the incident handling process and procedures; intrusion detection system deployments; and enterprise-wide technical configuration standards for all systems.

With regard to information management, the Department's anticipated information technology (IT) capital investment portfolio for FY 2008 is over $540 million, with many resource-intensive projects pending. It is critical that the Department have a sound IT investment management control process that can ensure that technology investments are appropriately evaluated, selected, justified, and supported. This oversight and monitoring process must address IT investments as an agency-wide portfolio. It must also ensure that individual projects are appropriately managed so they meet their technical and functional goals on time and on budget. This is an area that continues to challenge the Department.

The Department's Progress: The Department continues its efforts to establish a mature computer security program as it relates to technical configuration standards for all of its systems, managing its outsourced contractors who operate its critical information systems, and ensuring the proper identification and response to its incident handling program and intrusion detection systems. In addition, the Department recently established plans to improve its controls relating to the protection of personally identifiable information in order to meet the standards and good practice requirements established by OMB. However, management, budget, and contracting constraints have hampered the Department in moving forward with improving these controls.

With regard to IT management, while the critical issue of independent assessment remains unaddressed, the Department has recently strengthened the IT capital investment program by expanding membership on two of its review groups, the Investment Review Board and the Planning and Investment Review Working Group. The Department continues its efforts to strengthen individual business cases and to map proposed investments to an agency-wide enterprise architecture strategy.

Challenge: New Programs and Programs Nearing Reauthorization

In any given year, Congress creates new federal education programs, such as the American Competitiveness Grant program and the National Science and Mathematics Access to Retain Talent Grant program, both established by the *Higher Education Reconciliation Act of 2005*. In any year, Congress also may be scheduled to reauthorize a specific education law, as it is presently with the *Elementary and Secondary Education Act of 1965* (ESEA), as amended by the *No Child Left Behind Act of 2001*, and the *Higher Education Act of 1965* (HEA), as amended. As states, schools, students and their families, and others rely on the numerous programs and funding allotted through federal education programs, it is critical that the Department ensures they are operating effectively and efficiently. The Department should establish appropriate internal controls as it implements new programs and identify ways to improve accountability in programs that are about to be reauthorized.

The Department's Progress: In an effort to improve accountability and the operation of its programs, the Secretary mandated internal controls training for all Department managers. The Department is also making suggestions to Congress to strengthen provisions of the ESEA and the HEA during these reauthorization processes. In addition, the Department has taken action in response to our work to address weaknesses in two of its ESEA-related programs, Reading First and Migrant Education programs. With Reading First work, the Secretary put new leaders in place to coordinate the program, and worked with the states to identify possible issues or concerns the states may have had with the implementation of the program. In response to our work in the Migrant Education Program, the Department proposed a series of action steps, including short-term steps to immediately prevent and detect over-counting of ineligible children, and long-term steps, including options for Congress to consider during reauthorization of the ESEA to help ensure that only eligible migrant children are served by the program and that migrant children are accurately counted for funding purposes.

Challenge: Grant and Contract Awards, Performance, and Monitoring

The success of an organization's mission and the achievement of its goals depend on how well it manages its programs, and it cannot effectively manage its programs without establishing and maintaining appropriate internal accountability. Our recent audits, inspections, and investigations continue to uncover problems in the area of grant and contractor activities, including: inadequate oversight and monitoring of grantee performance; failure to identify and take corrective action to detect and prevent fraudulent activities by grantees; potential conflicts of interest and other improprieties in the evaluation of certain grant applications; not ensuring that the procurement and contract management processes provide assurance that the Department receives quality goods and services for its money; and inadequate attention to improper payments.

The Department's Progress: The Department has initiated steps to improve its performance in this area. The Secretary recently established a new Risk Management Services office and a Grants Policy Team, which are considering all policies, including requirements for monitoring, with the objective of developing standards that would apply across all formula programs. The Grants Policy Team also is completing the process of revising the Education Department General Administrative Regulations to incorporate performance management requirements for funded applicants.

In addition, the Office of Elementary and Secondary Education (OESE) has enhanced its monitoring system and will conduct Title I program reviews of all states at least once during a three-year monitoring cycle (2006–07 through 2008–09). OESE and the Office of Special Education and Rehabilitative Services have changed their monitoring protocols for the Title I and IDEA programs to ensure that states and districts are providing a proportionate share of these programs' funds to new or expanding charter schools in a timely manner.

The Department is also implementing an Enterprise Risk Management program throughout the Department. As a part of the program, the Department has contracted with the Oak Ridge National Laboratory to assist in developing a systemic, risk-based approach to monitoring grant compliance and performance. This system will incorporate a conceptually valid methodology that uses data collected from a variety of sources to assess grantees relative to established risk factors.

With regard to contracts, in FY 2005 and FY 2006, the Office of the Chief Financial Officer developed and sponsored an agency-wide training program that reinforced the Department's contracting processes, laws, and regulations. It also developed procedures for writing contract monitoring plans, and updated and distributed other pertinent contract procedural documents to improve controls and efficiencies. The Department is currently exploring available tools to facilitate electronic documentation and tracking of contract receipts and deliverables.

Challenge: Data Integrity

Data integrity is both a compliance issue and a performance issue. For example, programs within the ESEA that tie funding directly to student achievement and accountability require states to report on performance in many categories. Programs within IDEA have similar requirements. The utility of this reporting, and ultimately funding decisions, depend on the collection of valid and reliable data. Without valid and reliable data, the Department cannot make effective decisions on its programs or know if the funds it disburses are indeed reaching the intended recipients.

The Department's Progress: The Department recognized the need to improve its data quality and data reliability, and, in 2004, launched the Performance-Based Data Management Initiative to streamline existing data collection efforts and information management processes. The resulting Education Data Exchange Network (EDEN) provides state educational agencies and the federal government the capacity to transfer and analyze information about education programs. Through EDEN, the Department instituted data validation and verification steps and required states to address their data issues before the Department will officially accept their data.

In addition, the Department has advised us that it is working in coordination with the Data Quality Campaign and the National Forum on Education Statistics to help state educational agencies implement, by 2009, high-quality, longitudinal data systems that include a state data audit system assessing data quality, validity, and reliability. The Department has also advised us that it worked with a task force of state, local, and federal experts (organized through the National Center for Education Statistics) to develop a resource document for local educational agencies to use with their staff to ensure and improve data quality.

Challenge: Human Resources

Like most federal agencies, the Department will see a significant percentage of its workforce eligible for retirement in 2008. The Department is also continuing to experience a significant change in critical skill requirements for many of its staff. Identification and prompt implementation of needed action steps to adequately address these succession planning and workforce issues, including recruitment, hiring and retention, is critically important. In recent years, the Department has committed a significant amount of time to human resource initiatives at considerable expense, with no measurable results.

The Department's Progress: The Department stated that it is committed to improving the strategic management of human capital. In response to its 2006 Federal Human Capital Survey results, the Department took a three-pronged approach to address the performance culture concerns identified by the survey: (1) senior leadership involvement; (2) principal office action plans; and (3) the Department-wide Action Planning Team (APT). The APT comprised 13 members from different Department offices who were tasked with studying and making recommendations to address performance culture. The Team produced 50 long-term and short-term recommendations that were presented to Department senior leaders in August. In September, senior officials announced to the APT that they had accepted 49 of the recommendations and would begin implementation immediately. In addition, the Department recently completed its Annual Employee Survey, and has stated that the Human Capital Officer will hold workshops with Department managers to discuss and take action on the 2007 survey results.

Summary of Financial Statement Audit and Management Assurance

The following tables provide a summarized report on the Department's financial statement audit and its management assurances. For more details the auditor's report can be found on pages 147–164 and the Department's Management assurances on pages 26-29.

Summary of Financial Statement Audit					
Audit Opinion	Unqualified				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weaknesses	**0**	**0**	**0**	**0**	**0**

Summary of Management Assurances					
Effectiveness of Internal Control over Financial Reporting - Federal Manager's Financial Integrity Act (FMFIA) 2					
Statement of Assurance	Unqualified				
Material Weaknesses	Beginning Balance	New	Resolved	Reassessed	Ending Balance
Total Material Weaknesses	**0**	**0**	**0**	**0**	**0**
The Department had no material weaknesses in the design or operation of the internal control over financial reporting.					

Effectiveness of Internal Control over Operations - FMFIA 2					
Material Weaknesses	Beginning Balance	New	Resolved	Reassessed	Ending Balance
Information Technology Security	√			√	√
Program Management Control	√		√		
Monitoring and Oversight of Guarantee Agencies, Lenders and Servicers		√			√
Total Material Weaknesses	**2**	**1**	**1**	**1**	**2**

Conformance with Financial Management System Requirements - FMFIA 4					
Statement of Assurance	The Department systems conform to financial management system requirements.				
Non-Conformance	Beginning Balance	New	Resolved	Reassessed	Ending Balance
Total Non-conformance	**0**	**0**	**0**	**0**	**0**

Compliance with Federal Financial Management Improvement Act		
	Agency	Auditor
Overall Substantial Compliance	Yes	No
1. System Requirements	Yes	No
2. Federal Accounting Standards	Yes	Yes
3. United States Standard General Ledger at Transaction Level	Yes	Yes