

**Written Testimony
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**"Improper Payments in the Federal Government: Student Aid"
Before the U.S. House of Representatives Committee on Oversight and Government Reform,
Subcommittees on Government Operations
and Intergovernmental Affairs**

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Thank you, Chairmen Meadows and Palmer, Ranking Members Connolly and Butler Demings, and members of the Subcommittees, for the opportunity to join you today. I am here to talk to you about improper payment estimates for the Federal Pell Grant (Pell Grant) and William D. Ford Direct Loan (Direct Loan) programs, the most recent audit of the Department's compliance with the *Improper Payments Elimination and Recovery Act of 2010* (IPERA), and our work to minimize the level of improper payments in these two programs.

FSA remains the largest source of Federal student aid for postsecondary education in the United States. In Fiscal Year 2016, FSA delivered nearly \$125 billion in aid, including Pell Grant funds and Direct Loans, to nearly 12 million students attending more than 6,000 postsecondary institutions.

FSA must balance the need to make the Federal student aid delivery process simple and efficient for students and their families with the need to protect taxpayer dollars. This balance has led us to create a highly-automated and integrated aid delivery process—that includes schools, Federal loan servicers, and others— with hundreds of controls to combat improper payments. We appreciate our partnership with the Department's Office of the Inspector General (OIG) in constantly searching for opportunities to improve this process. I also welcome the opportunity to discuss our work with you today.

Pell Grant and Direct Loan Improper Payment Estimation Methodology

The Office of Management and Budget (OMB) Circular A-123, Appendix C, Requirements for Effective Estimation and Remediation of Improper Payments, implements the provisions of the *Improper Payments Information Act of 2002* (IPIA), as amended by IPERA and the *Improper Payments Elimination and Recovery Improvement Act of 2012* (IPERIA). According to Appendix C, an improper payment is any payment that should not have been made or was made in an incorrect amount (i.e., too high or too low) under statutory, contractual, administrative, or other legally applicable requirements. An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services that were not received. In addition, when, as a result of insufficient or lack of documentation, an agency's review is unable to discern whether a payment was proper, this

payment must also be considered an improper payment. Therefore, not all improper payments result in assessed liabilities to the Federal Government, and in the case of student aid, not all improper payments reflect students receiving more or less aid than they should.

ED programs susceptible to significant improper payments, as defined by IPERA, that are administered by FSA include the Pell Grant and Direct Loan programs, both of which were designated as “high priority” by OMB. Because these programs are susceptible to significant improper payments, FSA is required to calculate an estimated improper payment rate for each program, and publish the rate and future target rates in its AFR.

In 2014, FSA obtained approval from OMB to use an alternative methodology for estimating improper payments for the Pell Grant and Direct Loan programs. The alternative methodology leverages data collected through FSA program reviews, which include procedures such as determining whether schools properly performed verification of students’ self-reported income, identified conflicting applicant data, confirmed student satisfactory academic progress, and verified eligibility for the disbursed funds for a sample of students in each review.

This alternative approach avoids significant costs that would otherwise be required for separate testing at schools if FSA were to use statistical sampling techniques. The alternative methodology also provides for a more efficient allocation of resources by integrating the improper payment estimation into core FSA monitoring functions.

In June 2016, FSA submitted updates to the alternative sampling plan and estimation methodology to OMB for approval in response to findings from the OIG’s FY 2015 IPERA Compliance Audit Report. OMB conditionally approved FSA’s updates to the alternative sampling plan and estimation methodology in for FY 2016 reporting in October 2016, noting the need for continued improvement of the methodology in future years.

The FY 2015 OIG report identified possible sources of improper payments that FSA’s previous methodology did not fully account for in the estimate. In response, ED modified its estimation methodology for FY 2016 to better account for those sources, including improper payments resulting from: (1) schools disbursing funds to students enrolled in ineligible programs/locations; and (2) inaccurately self-reported income by recipients who were not selected for income verification and who did not use the Internal Revenue Service Data Retrieval Tool (IRS DRT) to transfer tax data into the online *Free Application for Federal Student Aid* (FAFSA[®]) form. In normal circumstances, FSA encourages applicants to use the IRS DRT to help ensure the accuracy of applicants’ income—and as applicable, their parents’ income—to determine how much federal student aid they are eligible to receive. As you know, IRS DRT currently is unavailable while extra security and privacy protections are being added, thereby increasing the risk of inaccurately entered information, which could increase improper payment rates. The IRS DRT is scheduled to return on October 1, 2017, for the 2018–19 FAFSA form.

Non-Compliance with IPERA Due to Missed Improper Payment Rate Estimate Targets

In its report issued May 17, 2017, “Government Efficiency and Effectiveness: Opportunities to Address Pervasive Management Risks and Challenges while Reducing Federal Costs,” the

Government Accountability Office (GAO) noted that “IGs at 15 of the 24 CFO Act agencies found their respective agencies to be noncompliant under IPERA for fiscal years 2014 and 2015, the highest total since IGs began their annual compliance reviews.” Many of those agencies, including the Department of Education, were found to be non-compliant because of missed reduction targets.

The FY 2016 estimated improper payment rates for the Pell Grant and Direct Loan programs increased above the FY 2015 estimated rates and the FY 2016 reduction targets. Below is a table of the estimated FY 2015 rates, FY 2016 target rates set in FY 2015, and estimated FY 2016 rates.

	Pell Grant	Direct Loan
FY 2015 Rates (revised rates as reported in the FY 2016 AFR, based on the FY 2015 estimation methodology)	1.52%	2.63%
FY 2016 Reduction Targets (as reported in the FY 2015 AFR, based on the FY 2015 estimation methodology)	1.87%	1.29%
FY 2016 Rates (as reported in the FY 2016 AFR, based on the FY 2016 estimation methodology)	7.85%	3.98%
Compliant with IPERA?	No	No

The increase in the improper payment rates is due, in part, to the change in methodology; it is also potentially attributable to inherent variability in the current improper payment estimation methodology. The improper payment rate estimates are primarily based on the assessment of completed program reviews, which are carried out as part of FSA’s monitoring function. Schools are selected for program review based on the results of an annual risk assessment, and other risk triggers. FSA also selects a small set of schools for review randomly – typically schools that are at lower risk of improper payments. Because schools are not selected for program reviews based on statistically valid sampling methods, the extrapolation of the findings from these reviews does not produce an estimate that is representative of the full population of payments.

In order to reduce the variability of the estimate to a tolerance level of 0.1 percent, which is the percentage points above a set reduction target that a program can be to still be considered to have met a set reduction target, FSA would need to expand significantly the pool of lower-risk schools it selects for program reviews every year, requiring FSA to spend millions more on its program review process, which would require additional staffing and impose significant burdens on roughly 1,000 schools. FSA might have to divert its resources to these randomly selected lower-risk schools away from the higher-risk program reviews. Such a shift to improve our estimate would be at the expense of the identification and recovery of improper payments and adherence with other Title IV requirements at the higher risk schools. Based on the inherent variability of the estimation methodology, the 90 percent confidence interval for the FY 2016 Pell Grant improper payment rate is between 4.19 and 11.51 percent and for the FY 2016 Direct Loan rate is between 0.00 and 10.83 percent.

IPERA does not allow us to update our rate targets, even though we updated our methodology to capture some additional sources of improper payments. .

Although the FY 2016 IPERA Compliance Audit Report issued by the OIG on May 12, 2017 identified the Department as noncompliant with IPERA due to missing its improper payment reduction targets, the OIG found that the Department's improper payment reporting, estimates, and methodologies were "generally accurate and complete."

Work to Minimize Improper Payments in the Pell Grant and Direct Loan Programs

FSA has developed robust internal controls to prevent, detect, and, where appropriate, recover improper payments. In designing controls, FSA strives to strike the right balance between providing timely and accurate payments to students and ensuring that the controls are not too costly and burdensome for students, families, and institutions. Having performed risk assessments, FSA finds that some of the root causes of improper payments are the student's ineligibility for Pell Grant funds or a Direct Loan, incorrect self-reporting of an applicant's income, incorrect processing of student data by institutions, student account data changes not applied or processed correctly, the school's failure to apply the satisfactory academic progress policy, and incorrectly calculating the amount of Title IV student aid funds that need to be returned to the Department. Additionally, examples of Direct Loan consolidation and refund improper payment root causes include insufficient document to support the payments, loan verification certificate processing errors, and refunds made to an ineligible party or for an ineligible purpose. In FY 2016, approximately 93 percent of estimated improper payments were attributable to administrative or process errors made by other parties, which, in this case, may often be students and schools.

In FY 2016, FSA documented and assessed 328 controls to detect and prevent improper payments and found that 99.7 percent (327 out of 328) of the controls tested were designed effectively, and 96.6 percent (172 out of 178) were operating effectively. Examples of some of FSA's improper payment controls include:

- Under normal circumstances, promoting use of the IRS DRT, which allows eligible FAFSA filers (approximately 10 million each year) to electronically transfer IRS tax return information;
- Requiring school verification of applicant data on the FAFSA form, and updating that selection criteria annually;
- Conducting annual program risk assessments and reviews of program participants, including schools, lenders, guaranty agencies, and contractors;
- Comparing data on the FAFSA form to the Social Security Administration's Death Master File to ensure that an identity thief is not attempting to use the process to steal Federal funds;
- Using the Federal excluded parties list database to ensure that schools and school officials that participate in the Federal student aid process were not previously barred from receiving Federal funds;
- Using Unusual Enrollment History flags to identify persons who are receiving aid at multiple schools over a short period of time;
- Conducting annual training for more than 6,000 postsecondary institutions on how to properly administering federal student aid and manage Federal funds; and

- Analyzing nearly 30,000 referrals from the OIG about potential student-level fraud, and driving each referral to a final, conclusive action.

Additionally, FSA has identified corrective actions to address the root causes of improper payments. These corrective actions include, but are not limited to

- Promoting the use of the IRS DRT (scheduled to return for the 2018–19 FAFSA form on October 1, 2017), which enables FAFSA filers and, as needed, parents of filers, to transfer certain tax return information from an IRS website directly to the online FAFSA form. Although FSA encourages use of the IRS DRT, in order to require use of the DRT for all eligible applicants, Congress would need to change the law pertaining to consent to sharing taxpayer information;
- Continuing to use data-based statistical analysis to enhance verification selection of the FAFSA filers with the highest statistical probability of error and the impact of such error on award amounts. Enhancement to verification procedures is a continuous process that is reviewed annually;
- Beginning on October 1, 2016, for the 2017–18 award year, FAFSA filers completed their FAFSA form using “prior-prior” year tax return information. For the 2017–18 award year, students and families provided tax return information from calendar year 2015 (not from calendar year 2016). This is in contrast with the “prior year” process previously employed, where many filers submitted their FAFSA forms before their tax returns were completed. The “prior year” process resulted in the need for some filers to estimate tax return information that, subsequently, would need to be corrected once the tax return was filed; or worse, was never corrected. The FAFSA form changes enacted for Award Year 2017–18 reduced the proportion of filers who had to use estimated tax information.;
- Coordinating with our contracted loan servicers to develop and implement corrective action plans to address consolidation errors, such as funds returned due to duplicate funding or multiple Loan Verification Certificates, inclusion of student loans that the borrower desired to exclude or were determined to be ineligible, and payoffs sent to the wrong address; and
- Coordinating with our contracted loan servicers to develop and implement corrective action plans to address refund errors, such as refunds made to ineligible lenders and borrowers, made for ineligible purposes, made in the incorrect amount, and/or sent to the incorrect payee.

FSA is continuously working to identify new controls to combat improper payments. In addition, existing controls—such as the regression analyses used to choose applicants for school verification—are continuously updated to improve our ability to detect and prevent improper payments. Despite our vigilance and our continuous efforts to reduce improper payments and protect taxpayer dollars, it would be irresponsible for us to leave Congress and the American public with the impression that a zero-percent improper payment rate is feasible. In its 2016 Global Fraud Study, the Association of Certified Fraud Examiners found that its members who participated in the survey estimated that the typical organization loses five percent of revenues in a given year as a result of fraud. As currently defined by IPERA and OMB, improper payments include much more than fraud, such as unintentional inaccurate reporting and insufficient

documentation by applicants and schools. FSA's estimated improper payment rate in FY 2016—when aggregating the Pell Grant and Direct Loan rates—was 4.85 percent.

Conclusion

I appreciate the opportunity today to describe to you our improper payment estimation methodology, the cause of our non-compliance with IPERA, and our robust set of controls over improper payments. We will continue to work with our partners to further simplify the process to deliver aid to students and their families, to make our programs more effective, and to protect taxpayer dollars.

I welcome any questions you may have today.