

## **Federal Student Aid FY 2024 Statistically Valid Improper Payment Sampling and Estimation Methodology Plan**

### **Introduction**

Federal Student Aid (FSA) management is committed to preventing and reducing improper payments and unknown payments. To this end, FSA continues to strengthen payment controls, refine improper and unknown payment estimation methodologies, and develop analytics to monitor payments made for FSA programs. Accurate estimation of improper and unknown payments is essential to inform root cause analysis and corrective actions, as described in the Office of Management and Budget (OMB) Data Call.

### **FSA Programs Susceptible to Significant Improper Payment Risk**

In FY 2024, the Federal Pell Grant (Pell) and William D. Ford Federal Direct Loan (Direct Loan) programs were the only FSA programs identified as susceptible to significant improper payment risk. As required by statute, FSA performs improper payment risk assessments on all FSA-managed programs at least once every 3 years, with the exception of the Pell and Direct Loan programs, to determine if any other programs are risk susceptible. The last risk assessment was performed in FY 2023. As a result, this estimation methodology is specific to the Pell and Direct Loan programs.

### **Statistically Valid Sampling and Estimation Methodology Plan**

FSA estimates the annual amount of improper payments and unknown payments for the Pell and Direct Loan programs by reviewing the sustained results of annual compliance audits. Most schools that participate in an FSA program must have an independent auditor conduct an annual audit of the school's compliance with the laws and regulations that are applicable to the Title IV programs in which the school participates (a compliance audit). Section 487(c) of the Higher Education Act of 1965 (HEA) requires each Title IV participating institution to submit to the Department a compliance audit and a financial audit "on at least an annual basis." That statutory provision provides that the audit requirements can be met by submission of audits conducted under the *Guide for Audits of Proprietary Schools and For Compliance Attestation Engagements of Third-Party Servicers Administering Title IV Programs* issued by the Department's Office of the Inspector General (OIG) (i.e., the "OIG Audit Guide"), the *Guide for Financial Statement Audits and Compliance Attestation Engagements of Foreign Schools* (i.e., the "Foreign Audit Guide"), or by submission of the results of an audit of the institution conducted under the Single Audit Act of 1984 (Single Audit Act), as amended in 1996. Compliance audits must be conducted in accordance with the standards contained in the U.S. Government Accountability Office (GAO) Government Auditing Standards.

The type of compliance audit that a school must undergo depends on the type of entity: for-profit, public, or nonprofit. For-profit schools are subject to the OIG Audit Guide and public and nonprofit schools are subject to the Single Audit Act. For both OIG Audit Guide and Single Audit Act audits, the auditor draws a sample from the complete population of students who received Title IV program funds during the engagement period (fiscal year) according to the guidelines set forth in the compliance audit guidance. As it relates to for-profit schools, the OIG Audit Guide requires auditors to perform random sampling. For public and nonprofit schools, auditors are required to follow American Institute of Certified Public Accountants (AICPA) standards (i.e., AU-C section 530, Audit Sampling) per the OMB Compliance Supplement to 2 Code of Federal Regulation (CFR) Part 200. AU-C section 530 requires

auditors to follow AICPA statistical sampling guidance and use audit techniques and sample sizes that are sufficient to reduce sampling risk to an acceptably low level. Additionally, 2 CFR Part 200 provides the following regarding the scope of the audit in §200.514:

- (a) The audit must be conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS).
- (d) (4) The compliance testing must include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient appropriate audit evidence to support an opinion on compliance.

In FSA's methodology, the second stage sampling (i.e., payments to students) for public and nonprofit schools covered by compliance audits is based on the requirements in 2 CFR §200.514 and the OMB Compliance Supplement and, therefore, it is assumed that any non-random student sample selection is performed in a manner consistent with those requirements, namely, in a manner which would avoid intentional under-representation of improper payment risk factors. The statutory and OMB requirements follow accepted audit standards and practices.

Auditors select samples to test for reporting, student eligibility, disbursements, verification, and, if appropriate, withdrawal calculations. Instances of noncompliance identified as part of the compliance audits are reported as findings, even when subsequent corrective actions have been taken by schools. For compliance audits prepared in accordance with the OIG Audit Guide, the audit reports include all identified instances of noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of the federal awards, regardless of materiality. For compliance audits prepared in accordance with the Uniform Guidance, per 2 CFR 200.516, the auditor must report known questioned costs that are greater than \$25,000 for a type of compliance requirement for a major program (i.e., findings of material noncompliance). However, instances of immaterial noncompliance should be included in the auditors' workpapers and, for audits prepared in accordance with the 2019 OMB Compliance Supplement and forward, auditors are required to report this information directly to FSA as part of the "Required Information for the Pell Grant and Direct Loan Programs." In FY 2022, FSA collaborated with OMB and the independent audit community (through representatives from the AICPA and the National Association of State Auditors, Comptrollers, and Treasurers (NASACT)) to draft mutually agreeable language that would more closely align with the requirements in OMB Circular A-123 Appendix C. That language, which was vetted with FSA stakeholders, OMB, and the audit community, was included in the April 2022 release of the Compliance Supplement and continues to remain in the most recent Compliance Supplement released in May 2024.

A small population of public and nonprofit schools may apply for and receive an exemption from the compliance audit requirement. For-profit schools may likewise apply for a waiver from submitting a compliance audit or financial statements for a period of up to three years. Schools that receive waivers and exemptions comprise a small fraction of the total disbursements across the Pell and Direct Loan programs. FSA accounts for these disbursements by including them in the statistically valid sampling.

### **Pell Grant Program**

For both the Pell and Direct Loan improper payment and unknown payment estimates, FSA selects a statistically valid sample of compliance audits. Randomized sampling of compliance audits is used to produce valid and unbiased point estimates and confidence intervals around those estimates. Sampling at the second stage is performed by independent compliance auditors in accordance with the standards

summarized in the preceding section. FSA selects the most recently completed corresponding compliance audit for which the Student Financial Assistance (SFA) Cluster is a major program and reviews it to identify improper payments and unknown payments. If the audit is deemed deficient, the audit must also have a Final Audit Determination (FAD) letter issued for it to be included in the sample. Otherwise, FSA will default to the most recently completed compliance audit that identifies the SFA Cluster as a major program and, if deficient, has a FAD issued.

The Pell estimate is based in part on all improper payments and unknown payments identified by the auditor for each sampled compliance audit. Additionally, the Pell estimate incorporates improper payment rates reported in the Free Application for Federal Student Aid (FAFSA) / Internal Revenue Service (IRS) Data Statistical Study ("Study") to account for improper payments associated with misreported income. Improper payments identified in the compliance audits that relate to misreported income are excluded from the estimate, as they are accounted for by applying the Study rates to the Pell current year disbursements. Procedurally, the Pell improper payments related to misreported income are zeroed-out (i.e., recorded as \$0 improper payments) in the compliance audit fieldwork plan to avoid double counting improper payments. The improper payments and unknown payments for each sampled audit are extrapolated to the population of Pell disbursing schools to produce a Pell improper payment and unknown payment estimates, respectively.

Based on this analysis, the Pell estimated improper and unknown payment error rates and dollar amounts for FY 2024 were **2.61%** and **\$861.52** million, and **0.03%** and **\$10.63** million, respectively. The following table provides the combined totals of the Pell improper and unknown payment rates for FY 2024.

<b>FY 2024 Pell Grant Estimates Two-Stage Estimator</b>	
<b>Improper Payment and Unknown Payment Estimates</b>	
Point Estimate of Improper Payments and Unknown Payments (in millions)	\$872.15
Overpayment Improper Payment Estimate (in millions)	\$458.55
Underpayment Improper Payment Estimate (in millions)	\$271.83
Technically Improper Payment Estimate (in millions)	\$131.14
Unknown Improper Payment Estimate (in millions)	\$10.63
Point Estimate (as % of Population Total)	2.64%
Precision Rate (as a % of Population Total) based on 95% Confidence Interval	+/- 0.47%

## Direct Loan Program

The Direct Loan improper payment and unknown payment estimates each include three components:

- The Direct Loan compliance audit estimate, which is calculated in a manner similar to the Pell compliance audit estimate;
- An estimate derived from the sampling of loan consolidations; and,
- An estimate derived from the sampling of refund payments.

To estimate overall Direct Loan improper payments and unknown payments, these three independent statistical sample estimates are combined.

The loan consolidation component of the Direct Loan improper payment and unknown payment estimates is computed by sampling five overpayments and five underpayments from the universe of all overpayment and underpayment activities for each of the 12 months from July 2023 through June 2024 for a total sample size of 120. An independent sample of Federal Family Education Loan (FFEL) Program Loan to Direct Loan consolidation overpayment and underpayment activity is selected using a Probability Proportional to Size (PPS) technique based on dollar amount to draw the sample to reduce the probability that small Direct Loan consolidations are selected. After selecting the monthly samples, each overpayment and underpayment is reviewed to determine which of these transactions are considered improper payments or unknown payments. Any improper payments and unknown payments found in the sample are extrapolated to create a 95 percent statistical confidence interval range of the overall improper payment and unknown payment rates for loan consolidation activity. The absolute value of improper payments and unknown payments divided by the aggregate absolute value of the samples comprises the baseline rates for Direct Loan consolidation.

The third component of the Direct Loan improper payment and unknown payment estimates is Direct Loan refund activity. A refund is due to the borrower when a payment is received for more than the amount due, resulting in a credit balance. In the case that the credit balance is less than \$5, the account is closed out and written up to zero, unless the borrower requests a refund. A refund can also occur when a payment resides in an unapplied state in suspense and cannot be matched to a borrower's account. An independent sample of Direct Loan refund activity is selected using a PPS technique to reduce the probability of selecting transactions that are deemed small. The PPS sample of Direct Loan refunds is based on samples of 10 refunds for each month from July 2023 to June 2024 for a total of 120 sample items. Once monthly samples are selected, each refund is tested to determine if the samples are improper payments or unknown payments. The absolute value of improper payments and unknown payments divided by the aggregate absolute value of the samples comprises the baseline rate for Direct Loan refunds.

The Direct Loan compliance audit, consolidation, and refund rates are then applied to their representative FY 2024 disbursements. The aggregate estimated improper payment and unknown payment amounts for all three components is then applied to the total disbursement activity for the Direct Loan program to determine the overall Direct Loan estimated improper payment and unknown payment rates and dollar amounts.

Based on this analysis, the Direct Loan estimated improper and unknown payment error rates and dollar amounts for FY 2024 were **0.93%** and **\$808.53** million, and **0.01%** and **\$6.34** million, respectively. The following table provides the combined totals of the Direct Loan improper and unknown payment rates for FY 2024.

<b>FY 2024 Direct Loan Estimates Two-Stage Estimator</b>	
<b>Improper Payment and Unknown Payment Estimates</b>	
Point Estimate of Improper Payments and Unknown Payments (in millions)	\$814.87
Overpayment Improper Payment Estimate (in millions)	\$83.00
Underpayment Improper Payment Estimate (in millions)	\$6.08
Technically Improper Payment Estimate (in millions)	\$719.45
Unknown Improper Payment Estimate (in millions)	\$6.34
Point Estimate (as % of Population Total)	0.94%
Precision Rate (as a % of Population Total) based on 95% Confidence Interval	+/- 0.69%