



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

December 4, 2012

Mr. Daniel Werfel  
Controller  
Office of Management and Budget  
1650 Pennsylvania Avenue  
Room 536  
Washington, DC 20503

Dear Mr. Werfel:

The purpose of this correspondence is to submit the U.S. Department of Education's (Department) FY 2012 Report on Improper Payments Elimination and Recovery Act (IPERA) Payment Recapture Audits. The enclosed report was prepared in accordance with OMB's revised Parts I and II to Appendix C of OMB Circular A-123, issued April 14, 2011 (M-11-16).

The report provides an update to the Department's payment recapture audit plan submitted on January 14, 2011. Additionally, it describes the Department's current efforts to recapture improper payments and presents the Department's perspective on the cost-effectiveness of conducting recovery audits for all programs with more than \$1 million in annual outlays. IPERA requires recovery audits for all programs exceeding this threshold, if conducting such audits would be cost-effective. The Department continues to implement the efforts and improvements described in the attached report to recover and prevent future improper payments.

If you have any questions, please contact me or Jim Ropelewski at #202-245-6221.

Sincerely,

Thomas P. Skelly  
Delegated to Perform Functions  
and Duties of the chief Financial Officer

Enclosure

cc: Honorable Joseph I. Lieberman  
Chairman, Committee on Homeland Security and Governmental Affairs

Honorable Susan M. Collins  
Ranking Member, Committee on Homeland Security and Governmental Affairs

Honorable Darrell E. Issa  
Chairman, Committee on Oversight and Government Reform

Honorable Elijah E. Cummings  
Ranking Member, Committee on Oversight and Government Reform

Michael Wetklow  
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Inspector General, U.S. Department of Education



## **FY 2012 Report on the Department of Education's Payment Recapture Audits in Accordance with the Improper Payments Elimination and Recovery Act (IPERA)**

The purpose of this report is to describe the U.S. Department of Education's (Department) efforts regarding payment recapture audits conducted in accordance with OMB's revised Parts I and II to Appendix C of Office of Management and Budget (OMB) Circular A-123, issued April 14, 2011 (M-11-16). The Department submitted an improper payment recapture audit plan on January 14, 2011. This plan reflects a 3-tier approach to payment recapture audits based on risk and cost effectiveness: Tier 1 focuses on grant programs, Tier 2 addresses contracts, and Tier 3 discusses plans in Federal Student Aid (FSA). The report below provides an update on current efforts and includes the results of updated cost-benefit analyses.

### ***Tier 1: Grant Programs***

The Department uses A-133 Single Audit reports, reports from the Department's Office of the Inspector General (OIG), and various grant and payment monitoring efforts to reduce or eliminate improper payments and recapture funds. We believe these efforts represent both a significant investment of Federal resources and a balanced approach to recapture improper payments in grant programs. The Department is strengthening its use of audit data to better identify and address the root causes of improper payments. In addition, the Department is leveraging continuous monitoring technology to help prevent improper payments, and is pursuing actions that could create incentives for States to conduct payment recapture audits.

The Department previously reported that we do not believe it is cost effective to conduct additional payment recapture activities beyond these efforts. In 2012, we maintain that it is still not cost effective to conduct recapture activities in the area of grants, and we have expanded the support for this conclusion by examining a range of specific costs and outcomes associated with current efforts. The analysis highlights three unique factors that suggest additional, program-specific recapture audits for the Department would be impractical:

- 1) As noted in the Department's improper payment recapture audit plan, the General Education Provisions Act (GEPA) establishes significant substantive and procedural requirements that the agency must meet before recovering questioned costs. These requirements reduce the potential "benefit" of any recapture audit program. Under GEPA, the Department must establish a prima-facie case that includes an analysis of the value of program services, and the Department can only recapture an amount of funds that is proportionate to the harm caused to an identifiable Federal interest. These substantive and procedural requirements would limit the effectiveness of recapture efforts carried out under IPERA.

In addition to these substantive requirements, GEPA also provides auditees with the right to administrative and judicial appeal of agency audit disallowances. This process can be lengthy



and require extensive staff time, particularly in cases where auditees vigorously contest audit disallowance. The cost associated with an appeal is just one reason the Department invests significant time during the audit resolution process—to sustain and attempt to recapture only those funds that are likely to be recoverable.

- 2) The Department has the discretion to return recaptured funds to a grantee under the "grant back" provisions in GEPA. To justify the cost of a recapture audit program, the Department would need to consider the extent to which recaptured funds may be reduced by amounts returned to grantees. When audit findings are sustained, the grant back provisions afford the grantee an opportunity to apply for those grant monies to be returned. The law states that the Secretary may consider those recovered funds to be additional funds available for that program and may repay the recipient affected by the recapture action an amount not to exceed 75 percent of the recovered funds if the Secretary determines that, 1) the violation has been corrected; 2) the recipient has submitted a plan to the Secretary regarding the use of those funds and, to the extent possible, be used for the benefit of the population that was affected by the failure; or 3) use of those funds in accordance with that plan would serve to achieve the purposes of the program under which the funds were originally paid. Although grantbacks are discretionary—the Department is not required to approve any such request that it receives—the existence of this authority would need to be considered in conducting a cost benefit analysis of private IPERA recovery contracts in the context of programs subject to the requirements of Part D of GEPA.
- 3) The majority of Department grant funds are awarded through State-administered formula programs, e.g., IDEA-B and Title I, and the majority of funds awarded under those programs are subgranted by State's to local educational agencies (LEAs). State-administered grant programs hold the State responsible for conducting programmatic and fiscal monitoring of sub-grantees, including LEAs. States are also responsible for addressing most A-133 Single Audit findings pertaining to sub-grantees. As a result, it would be challenging and somewhat duplicative for the Department to conduct recapture audits of LEAs. The Department recognizes the importance of partnering with States to improve the management and impact of our grant investments. This includes partnering to improve fiscal oversight and reduce improper payments. However, IPERA provides incentives only for Federal agencies to conduct payment recapture audits. The Department has held conversations with our OIG and initiated discussions with OMB to determine the best way to provide an enhanced framework of incentives for States, and to work more collaboratively with our State partners in recovering potential improper payments. One specific area the Department has explored is excess interest earned on advances made by States to sub-recipients at the local level. This type of improper payment would seem to be one of the easiest to recapture. It comes up frequently in recent OIG audits, particularly OIG audits of ARRA grantees where substantial amounts of excess interest may have been earned on large advances. However, the Department has determined there are outstanding legal questions that must be resolved before significant audits and recoveries of such interest would be feasible.

As described above, these three unique factors combine to increase the cost and reduce the benefit of any recapture audit program the Department might attempt to implement, which would be in addition to existing auditing and monitoring efforts. These factors suggest a recapture audit program would be impractical. To reinforce this conclusion, the Department conducted additional, quantitative analyses.

The result is a combination of anecdotal examples and actual recovery data that demonstrate the costs of a recapture audit program would, indeed, exceed the benefits:

#### Cost of Recapture Audit

Our analysis found that the estimated cost of an A-133 audit is \$35,000 on average. In addition to this cost, there is a significant investment of audit followup time for every audit finding before it is sustained and issued by the Department. This personnel cost can approach \$10,000. A recent OIG audit and internal control review both confirmed that most external audits take more than six months to resolve. Below is one example of this:

Possible misuse of funds in the amount of \$500,000 was identified in a State-administered program and reported to the Department. In order to gather sufficient information to support a conclusion on whether or not to sustain the finding, a conservative estimate suggests the following staff time was invested: 10-12 hours in staff time for each of two (GS-14) Fiscal Specialists; 10-12 hours of Project Officer Time (GS-13); 6-8 hours of the Manager's time (GS-15); 10-12 hours of Special Assistant time (GS-14); 6-8 hours of General Counsel staff time (GS-14); 4-6 hours of General Counsel time (GS-15); and 6-8 hours of Program Director time (GS-15).

These personnel costs do not reflect the cost of work delays, travel expenses, operational expenses, impact on staff workload, or grant funds being spent by the respective grantee representatives to collect, report, and analyze data. These costs also do not reflect any potential appeal, should the Department attempt to recapture funds. However, they reflect the tremendous added burden that would be placed on Department personnel if additional audits were to be conducted.

#### Benefit of Recapture Audit

Our analysis found that the Department is generally able to sustain and seeks to collect only a fraction of amounts that are originally questioned in audits. Below are several examples that illustrate this point:

We reviewed the last three years of A-133 audits (2009-2011) with questioned costs exceeding \$500,000 for the Title I program. For audits that have been closed, the Department sought to recapture \$65,285 out of nearly \$14 million in questioned costs.

We reviewed the last five years of OIG audits with questioned costs for the Title I program. For audits with questioned costs between \$400,000 and \$700,000 that have been closed, the Department sought to recapture \$46,197 out of \$2.1 million in questioned costs. For audits and audit findings with substantial questioned costs that have been closed, the Department sought to collect \$11.6 million out of \$33 million in questioned costs.

These examples illustrate the extent to which the Department is able to seek recapture of only a small percentage of questioned costs. The examples also illustrate that the benefit of a recapture audit program like that envisioned by IPERA would likely be far less than the cost of the audits and necessary followup activities. OIG audit results suggest that a limited number of very thorough audits could result in substantial findings. However, we believe it is unlikely any new audit program could replicate the scope and depth of the OIG's work to achieve similar results in a cost effective manner—especially when



considering the outcome of the appeal process. As reported in the Department's Agency Financial Report, the Department consistently recaptures less than 35 percent of the amount we attempt to collect, after factoring in the appeal process.

### ***Tier 2: Contracts***

The Department findings from payment recapture audits of contracts have been consistently insignificant. For FY 2004-2011, the Department relied on several different approaches to conduct payment recapture audits for the Department's contracts and purchase orders, which total approximately \$1.5 billion annually. The amount recovered has consistently been insignificant, less than one percent (.0025 percent).

From 2007-2011 the Department conducted payment recapture audits of contract payments as part of its A-123 review process. The findings from these reviews consistently demonstrated the low risk of improper payments in contract administration. In 2012, the Department refocused its resources and took the initiative to strengthen and expand its payment recapture efforts by leveraging recent advances in data mining technologies. The Department is in the final stages of awarding a contingency-based contract; proposals are currently being paneled and award is anticipated in the first quarter of FY13. The contractor will conduct a payment recapture audit of all Department contract payments for fiscal years 2007-2012 beginning with the most recent fiscal years. The audit will focus on identifying improper payments including overpayments, duplicate payments, payments to the wrong recipient, and payments for ineligible goods or services. Further, the data yielded will be used to investigate and report the root causes of all identified improper payments so corrective actions can be implemented. There is a possibility that the use of new data mining approaches may identify a small but significant number of improper payments previously undetected. A payment recapture audit of this kind supports the Department's strategic goal to improve its organizational capacity by increasing the efficient and effective use of contract resources.

### ***Tier 3: Federal Student Aid***

As noted in last year's report, prior assessments had determined that cost recovery or payment recapture audits would not likely be cost effective as a replacement for or supplement to existing controls for Title IV programs, including program reviews. These prior assessments included program reviews conducted by Program Compliance, a business unit within Federal Student Aid responsible for the oversight, monitoring and enforcement activities of postsecondary and financial institutions. In FY2012, Federal Student Aid engaged contractor support to conduct a cost-benefit analysis for a payment recapture audit program along with new improper payment estimation methodologies. Federal Student Aid's assessment was performed to determine the cost effectiveness of conducting additional recovery operations (e.g., a contractor-led recovery audit) above and beyond current Federal Student Aid operations. Data from FY2011 was used to perform the cost-benefit analysis.



Consistent with prior efforts, the preliminary results of the cost benefit analysis suggest that additional actions may not be cost-beneficial. In summary, the analysis compared the costs of programs and activities to identify improper payments vs. the anticipated amounts to be recovered. To determine the cost amount, Federal Student Aid considered current operational activities associated with prevention and detection of improper payments, to include those activities impacting recoverability of identified overpayments. Program Compliance's direct costs incurred in support of institutional audits and program reviews were calculated using the activity-based cost method. These direct costs included activities that represent Federal Student Aid's normal day-to-day operations and oversight responsibilities in meeting their ongoing mission, which support IPERA compliance. These ongoing efforts lead to compliance and oversight activities that inherently detect improper payments and report overpayments as receivables. In addition, Federal Student Aid's costs incurred internally in support of preventative activities related to institutional audits and program reviews were considered. To determine the 'benefit' amounts, or those amounts deemed recoverable, Federal Student Aid evaluated program review findings and assessed liabilities related to improper payments. These liabilities were a result of Program Compliance's program reviews and oversight of institution audits, and is tracked in and queried from various Federal Student Aid systems for the Pell, Federal Family Education Loan (FFEL), and Direct Loan risk-susceptible programs. The cost benefit analysis is preliminary, because actions are on-going to obtain or estimate final cost amounts for relevant controls.

Federal Student Aid will continue to consider how to improve existing controls related to the efficient identification of improper payments, to include good practices outlined by OMB in Appendix C<sup>1</sup>. For example, Federal Student Aid will consider the lessons learned from the new FY2012 annual estimation methodologies, as well as on-going quality assurance programs within Program Compliance, to develop and implement process improvement recommendations for these processes to more efficiently and/or effectively identify improper payments. These actions may result in better alignment of due diligence and risk oversight and better prioritization of verification activities based on effectiveness. Federal Student Aid will continue to explore and expand the use of data analytics to identify anomalies, trends, and patterns in application and disbursement data to help identify potential risk factors that may inform risk-based decisions on program oversight, including where to conduct program reviews. Federal Student Aid will continue to evaluate its existing data matches with other agencies and, if/as applicable, may expand these data matches through Treasury's Do Not Pay solution. Federal Student Aid will coordinate with OIG to obtain and consider how to leverage the significant Pell fraud work completed to inform decisions on how to improve controls, including data analytics and program reviews.

Federal Student Aid plans to continue utilizing ongoing recovery efforts in the day-to-day monitoring activities, including resolution of improper payments identified in program reviews, compliance audits, as well as OIG audits and investigations, as described in the previous year's report.

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<sup>1</sup> Memorandum M-11-16, dated 4/14/2011, revised OMB Circular A-123, Appendix C to incorporate IPERA requirements. Part I, Section A, Question 15d, "Approaches to consider" lists good practices for identifying, preventing, and recapturing improper payments. These include predictive modeling, forensic accounting tools, data matches, alignment of due diligence and risk oversight, prioritization of verification activities based on effectiveness, and financial incentives. Question 16 lists lessons learned from implementation of the Recovery Act. These include: closely monitoring programs to identify risk before they occur; using cutting edge data mining tools; partnering with agency IGs and audit teams to focus on fraud prevention; and training.