UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services
Chicago/Kansas City/Dallas Audit Region

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Control Number
ED-OIG/A05I0026

Thomas V. Melillo
President
Carnegie Student Loans, Inc.
5005 Rockside Road
Suite 1125
Independence, OH 44131

Dear Dr. Melillo:

This **Final Audit Report**, *Carnegie Student Loans' Compliance with Lender Inducement Provisions*, presents the results of our audit. The objective of the audit was to determine whether Carnegie Student Loans, Inc. (CSL), offered, directly or indirectly, points, premiums, payments, or other inducements to secure applicants for loans made under the Federal Family Education Loan (FFEL) Program for the period July 1, 2007, through June 30, 2008 (award year 2007-2008). During our audit, we did not identify any evidence that indicated CSL offered, directly or indirectly, points, premiums, payments, or other inducements to secure applicants for loans made under the FFEL Program. Because we tested a judgmental sample of transactions, our results may not be representative of the universe of CSL's expenditures.

BACKGROUND

CSL, located in Independence, Ohio, is registered with the South Carolina Department of Insurance as a captive insurance company for Carnegie Health Systems.[1] Carnegie Health Systems owned CSL and Ohio College of Podiatric Medicine (OCPM) until it spun off CSL in January 2006. Thomas V. Melillo is President of CSL and OCPM.

For award year 2007-2008, CSL participated in the Federal Stafford Loan Program and the Federal PLUS Program and offered private loans. According to the National Student Loan Data System, CSL originated $462,628,013 in FFEL Program loans for award year 2007-2008 for

[1] Captives are an alternate type of self-insurance vehicle that affords businesses some flexibility with their risk management strategies. CSL issued one insurance policy in South Carolina for its President. Under Section 435(d)(1)(C) of the Higher Education Act of 1965, as amended, an insurance company can be an eligible lender.

students attending 214 schools. Subsequent to award year 2007-2008, CSL stopped originating FFEL Program loans.

As a lender, CSL did not participate in direct marketing activities to students, conduct any of its own advertising, or have any contact with schools. Instead, CSL had a partnership agreement with Sallie Mae, Inc. (Sallie Mae), dated June 1, 2006, that specified, among other things, that Sallie Mae would market CSL's Federal Stafford Loan Program and Federal PLUS Program loans to schools and produce marketing materials at its expense. CSL and Sallie Mae were also parties to a *Financing Agreement*, dated November 12, 1993, that provided funds for CSL to conduct student lending activities. Therefore, students applied to Sallie Mae for all FFEL Program loans that CSL originated.

Under Section 435(d)(5) of the Higher Education Act of 1965, as amended (HEA), and 34 Code of Federal Regulations (C.F.R.) § 682.200(b), in the definition of "lender," paragraph (5),[2] an "eligible lender" does not include any lender that the Secretary determines has (1) offered, directly or indirectly, points, premiums, payments, or other inducements to secure applicants for loans made under the FFEL Program; (2) conducted unsolicited mailings to students of student loan application forms, except to students who have previously received loans from the lender; (3) offered, directly or indirectly, loans as an inducement to a prospective borrower to purchase a policy of insurance or other product; or (4) engaged in fraudulent or misleading advertising.

AUDIT RESULTS

During our audit, we did not identify any evidence that indicated CSL offered, directly or indirectly, points, premiums, payments, or other inducements to secure applicants for loans made under the FFEL Program during award year 2007-2008. To determine whether CSL practiced improper inducement activities, we reviewed CSL's (1) lender agreements; (2) mailing, loan, and advertising activities; and (3) financial transactions. (Note: Other than discussing Sallie Mae's activities on behalf of CSL with a Sallie Mae official and reviewing a brochure promoting CSL's FFEL Program loans that Sallie Mae produced, we did not review any of Sallie Mae's activities on behalf of CSL).

Review of Lender Agreements

We did not identify any evidence that CSL participated in any agreements or offered incentives that were prohibited by Section 435(d)(5)(A) of the HEA and 34 C.F.R. § 682.200(b), in the definition of "lender," paragraph (5)(i). Specifically:

- CSL's agreements with Sallie Mae did not set forth improper inducement activities aimed at securing applicants for loans made under the FFEL Program.
- CSL did not have any relationships, contact, or agreements with schools aimed at securing applicants for loans made under the FFEL Program, and did not have any exclusive relationships with the schools that suggested any conflict of interest.

[2] All regulatory citations are to the July 1, 2007, volume.

- CSL did not pay schools, school affiliated individuals, or other entities improper inducements to secure applicants for FFEL Program loans.
- CSL did not sponsor any advisory board, council, or similar entity, or hire any consultants on behalf of schools.
- Minutes from CSL's board meetings did not include any discussions related to lender inducement activities, and CSL's policies and procedures did not provide for any incentives to borrowers or institutions.

Review for Prohibited Activities – Mailing, Loan, and Advertising Activities
We did not identify any evidence that CSL participated in prohibited activities related to mailing, loan, or advertising activities that are specified in Section 435(d)(5)(B), (C), and (D) of the HEA and 34 C.F.R. § 682.200(b), in the definition of "lender," paragraphs (5)(ii) through (iv). Specifically:

- CSL did not participate in direct marketing activities to students, conduct any of its own advertising, or have any contact with schools to secure applicants for loans made under the FFEL Program.
- A brochure promoting CSL's FFEL Program loans that Sallie Mae produced did not contain fraudulent or misleading advertising or offer an incentive to secure applicants for FFEL Program loans.

Review of Financial Transactions
We did not identify any evidence that CSL participated in prohibited activities specified in Section 435(d)(5)(A) of the HEA or 34 C.F.R. § 682.200(b), in the definition of "lender," paragraph (5)(i). During our review of documentation supporting $4,001,169 (28 percent) of CSL's expenditures totaling $14,472,108,[3] we did not identify any transactions between CSL and any school, any school affiliated individual, or Sallie Mae that included evidence of improper inducements.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to determine whether CSL offered, directly or indirectly, points, premiums, payments, or other inducements to secure applicants for loans made under the FFEL Program for award year 2007-2008.

To achieve our objective, we performed the following procedures.

1. Gained an understanding of the FFEL Program and CSL relevant to our audit objective by reviewing the Department of Education's Web site, reviewing work performed by Federal Student Aid, Financial Partners Eligibility and Oversight related to one of its lender inducement program reviews, and reviewing CSL's Web site and organizational chart.

[3] See the Objective, Scope, and Methodology, number 8, for description of our sample selection.

2. Identified and gained an understanding of the HEA, regulations, and program guidance significant within the context of the audit objective and in effect for the audit period.
3. Reviewed CSL's policies and procedures regarding incentives related to student loans that may be provided to borrowers and institutions, and CSL's board meeting minutes.
4. Reviewed the following reports to determine whether they included any findings relevant to our audit objective: CSL's independent auditor's financial audit report, *Carnegie Student Loans, Inc., Financial Statements and Supplemental Information, June 30, 2007 and Six Months Ending June 30, 2006*; the Government Accountability Office report, *Federal Family Education Loan Program: Increased Department of Education Oversight of Lender and School Activities Needed to Help Ensure Program Compliance* (GAO-07-750), dated July 2007; the United States Senate Health, Education, Labor and Pensions Committee's *Report on Marketing Practices in the Federal Family Education Loan Program*, dated June 14, 2007, and *Second Report on Marketing Practices in the Federal Family Education Loan Program*, dated September 4, 2007; and *SallieMae Lender Servicing Compliance Attestation Examination for Lenders and Lender Servicers Participating in the Federal Family Education Loan Program*, year ended December 31, 2007.
5. Reviewed CSL's agreements for indications of improper inducement activities aimed at securing applicants for loans made under the FFEL Program: *Agreement* between Sallie Mae and CSL, dated June 1, 2006; *ExportSS Agreement of May 1, 2004 between Student Loan Marketing Association, Ohio College of Podiatric Medicine, and Carnegie Insurance Company*, dated May 1, 2004; *Amendment of July 1, 2005, to ExportSS Agreement, dated May 1, 2004*; *Financing Agreement* between Sallie Mae and OCPM, dated November 12, 1993; and *Amendment of April 1, 2006, to Financing Agreement, dated November 12, 1993*.
6. Gained an understanding of CSL's system of internal control over its administration and marketing activities aimed at securing applicants for loans made under the FFEL Program by interviewing CSL and National Marketing Consultants, LLC[4] officials and a Sallie Mae official. Other than discussing Sallie Mae's activities on behalf of CSL with a Sallie Mae official and reviewing a brochure promoting CSL's FFEL Program loans that Sallie Mae produced, we did not review any of Sallie Mae's activities on behalf of CSL.
7. Obtained and reviewed CSL's complete chart of accounts and identified accounts, such as Consulting Fees, Marketing, Travel & Meetings, Contribution, and Royalty to OCPM, that might have contained financial transactions for payments other than FFEL Program proceeds; and a list of financial transactions for all of CSL's accounts to identify any transactions between CSL and any school, any school affiliated individual, or Sallie Mae that appeared to be payment for something other than FFEL Program proceeds.
8. Reviewed invoices, cancelled checks, and other supporting documentation for a judgmentally selected sample of CSL's expenditures and adjusting journal entries (AJE). We judgmentally selected (a) 38 of 222 non-AJE transaction lines totaling $814,102, which was 45 percent of the total dollar amount of non-AJE expenditures ($1,797,882); and (b) 6 of 32 AJEs, consisting of 31 transaction lines and totaling $3,187,067, which was 25 percent of the total dollar amount of the 32 AJEs ($12,674,226). We based our judgmental sample selection, in part, on the accounts to which the transactions were

[4] During award year 2007-2008, CSL outsourced its administration (including interaction with Sallie Mae representatives), accounting, and legal functions to National Marketing Consultants, LLC.

charged, transaction descriptions, and vendor names. We generally selected larger transactions and those that appeared out of the ordinary. In total, we reviewed 69 transaction lines totaling $4,001,169, which was 28 percent of the total dollar amount of expenditures.[5] Because we selected our sample judgmentally, our results might not be representative of the universe of CSL's expenditures.

In addition, we relied, in part, on computer-processed general ledger reports from CSL's accounting system. To assess the reliability of the reports, we reviewed them for completeness, validity, and accuracy. We ensured that the universe of financial transactions generally agreed with supporting, non-computer generated evidence, such as original invoices or images of cancelled checks, or both. We concluded that the computer-processed data were sufficiently reliable for the purpose of our audit.

We conducted our audit from August 2008 through November 2009 at CSL's office in Independence, Ohio, and at our offices. We discussed the results of our audit with CSL's President on November 17, 2009.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

ADMINISTRATIVE MATTERS

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

No action on your part is required. However, if you would like to comment on this report, please send your comments to:

William J. Taggart
Chief Operating Officer
Federal Student Aid
U.S. Department of Education
Union Center Plaza, Room 112G1
830 First Street, N.E.
Washington, DC 20202

[5] The universe of CSL's expenditures for the audit period consisted of 340 transaction lines totaling $14,472,108. Within this universe of 340 transaction lines, 222 transaction lines, totaling $1,797,882, were non-AJE expenditures and 118 transaction lines, totaling $12,674,226, comprised 32 AJEs. All dollar amounts in this report are rounded to the nearest dollar.

We appreciate the cooperation and assistance extended by your staff during the audit. If you have any questions, please contact me at 312-730-1620.

Sincerely,

/s/

Gary D. Whitman
Regional Inspector General
for Audit

Acronyms and Abbreviations Used in This Report

AJE	Adjusting Journal Entry
C.F.R.	Code of Federal Regulations
CSL	Carnegie Student Loans, Inc.
FFEL	Federal Family Education Loan
HEA	Higher Education Act of 1965, as amended
OCPM	Ohio College of Podiatric Medicine
Sallie Mae	Sallie Mae, Inc.