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Review of the Department's  
Oversight of Schools Participating in the  
William D. Ford Federal  
Direct Loan Program

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**FINAL AUDIT REPORT**



**Audit Control Number 04-70016**  
**September 1998**

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U.S. Department of Education  
Office of Inspector General  
Atlanta, GA

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## NOTICE

**Statements that management practices need improvement, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determination of corrective action to be taken will be made by appropriate Department of Education officials. This report may be released to members of the press and general public under the Freedom of Information Act.**



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL  
61 FORSYTH STREET, Room 18T71  
ATLANTA, GEORGIA 30303



September 25, 1998

**MEMORANDUM**

TO: Marshall Smith  
Acting Deputy Secretary  
Office of the Deputy Secretary

FROM: Carol S. Lynch  
Regional Inspector General for Audit

SUBJECT: FINAL AUDIT REPORT  
*Review of the Department's Oversight of Schools Participating in the William D. Ford Federal Direct Loan Program*  
Audit Control Number: 04-70016

Attached is our subject report presenting the findings and recommendations resulting from our review of the Department's Oversight of Schools Participating in the William D. Ford Federal Direct Loan Program.

Please provide us with your final response to each recommendation within 60 days of the date of this report, indicating what corrective actions you have taken or planned, and related milestone dates.

In accordance with Office of Management and Budget Circular A-50, we will keep this audit report on the OIG list of unresolved audits until all open issues have been resolved. Any reports unresolved after 180 days from the date of issuance will be shown as overdue in the OIG's Semiannual Report to Congress.

Please provide the Supervisor, Post Audit Group, Financial Improvement, Receivable and Post Audit Operations, Office of Chief Financial Officer and the Office of Inspector General, Planning, Analysis and Management Services with semiannual status reports on promised corrective actions until all such actions have been completed or continued follow-up actions are unnecessary.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information therein is not subject to exemptions in the Act. Copies of this audit report have been provided to the offices shown on the distribution list enclosed in the report.

We appreciate the cooperation given us during the review. If you have any questions concerning

the report, please contact me at (404) 562-6462. Please refer to Audit Control Number 04-70016 in all correspondence relating to this report.

Attachment

# TABLE OF CONTENTS

|   |    |
|---|----|
| EXECUTIVE SUMMARY .....   | i  |
| REVIEW RESULTS .....  | 1  |
| Finding 1 The Department Does Not Have Sufficient Data to Effectively<br>Monitor Schools Participating in the Direct Loan Program ..... | 1  |
| Recommendations .....   | 3  |
| Finding 2 The Department Needs to Improve Its Approach to Monitoring<br>Direct Loan Schools .....                                       | 5  |
| Recommendations .....   | 10 |
| Finding 3 Lack of Loan Level Matches Decreases Control Over Data Reliability .....  | 15 |
| Recommendations .....   | 19 |
| OBJECTIVES OF REVIEW .....  | 20 |
| BACKGROUND .....  | 20 |
| SCOPE AND METHODOLOGY .....   | 22 |
| STATEMENT ON MANAGEMENT CONTROLS .....  | 22 |
| APPENDICES:   |    |
| Appendix A - Student Financial Assistance Programs:<br>Components with Oversight Responsibility .....                                   | 24 |
| Appendix B - Proposed Method for Evaluating Cash Positions .....  | 25 |
| Appendix C - Year 5 Reconciliation Process .....  | 27 |
| EXHIBIT 1: Department's Initial Comments to the Draft Report .....  | 28 |
| EXHIBIT 2: Department's Additional Comments to Finding No. 3 .....  | 42 |

## EXECUTIVE SUMMARY

The Department has not adequately monitored the performance of schools participating in the Direct Loan program. Without effective monitoring, the Department is not able to identify and correct problems as they arise. The Office of Inspector General report, *Administration of the William D. Ford Federal Direct Loan Program by Schools*, indicated that schools have problems which could impact program accountability. If the problems are not corrected, the Department's financial statement reporting could be materially affected. For award year 1994 through award year 1997, approximately \$20 billion in direct student loans have been disbursed. As of November 1997, approximately 1,300 schools were full program participants. The Department needs to ensure that Direct Loan schools receive the oversight necessary to protect its assets and ensure data integrity.

Beginning in March 1997, a new Loan Origination Systems contractor began working with the Department. The contractually required management information reports, which had been routinely provided by the prior contractor, were not forthcoming. From March 1997 until January 1998, the Department did not have sufficient data to adequately oversee schools participating in the Direct Loan program. Currently, the primary cash management reports do not contain accurate data. Further, the Department does not have the needed on-line capability to query the Direct Loan data base. Although the Department is now receiving most of the management information reports, we are recommending that the Chief Financial Officer and the Assistant Secretary take the necessary actions to ensure that the Loan Origination contractor fulfills its contractual obligations to provide accurate reports and that the query capability is brought expeditiously on-line.

The Department needs to improve its approach for monitoring Direct Loan school performance. Although the Department has in place processes to monitor schools' Direct Loan program administration, those processes need improvement. In particular, we identified weaknesses in two important monitoring processes: cash management and compliance monitoring. Cash monitoring by individual components has been arbitrary and limited, with the potential for duplication of efforts. In some instances, guidance is needed to distinguish between technical assistance and compliance efforts. The number and scope of program reviews have been limited. In addition, schools' loan origination levels had not been periodically and routinely reviewed when additional data became available. We are recommending actions the Department can take to improve the effectiveness of its current monitoring processes and assure that adequate coverage is provided to Direct Loan schools.

The Department has eliminated the loan level reconciliation process which required a data match between school records and the loan origination center records, retroactive to Years 2 and 3 of the Direct Loan program. Data matching is important because processing omissions and problems are identified and the accuracy of records at the loan origination center and the schools is improved. By eliminating data matching, individual student records with errors may not be identified on a timely basis. We are recommending that periodic data verification be conducted on an interim basis until the Department has assurances that their new process is adequate and that

disbursements to borrowers be tied to school drawdowns.

### *Department's Reply*

On June 11, 1998, the Department provided a written response to our initial draft report. The Department noted that the report contains some useful suggestions for improvement, but expressed the concern that some statements were inaccurate or misleading. Their response describes actions taken or planned to strengthen management controls relating to monitoring the Direct Loan Program.

For Findings 1 and 2, the Department generally agreed with our recommendations or indicated that it was already performing the suggested actions. However, the Department stated that the OIG misunderstood its actions towards changing origination levels and cited supporting statistics.

For Finding 3, the Department was most concerned about the OIG's contention that data matching was an integral part of program controls. The Department did not concur with our recommendation to reinstate data matching. The Department believes that its new process, the Direct Loan School Account Statement, for controlling direct loan data will enhance controls and provide more effective monitoring over drawdown and disbursement activity. Prior reconciliation processes only confirmed that the Loan Origination Center received what the school transmitted.

Further, the Department disagreed with the idea of tying disbursements to drawdowns as an incentive for schools to provide timely and accurate reporting of disbursements. They indicated that OPE is moving toward a common origination and disbursement system that would tie drawdowns by schools to specific actual disbursements reported by the institutions. The Year 6 origination and disbursement process is being developed to support a "just-in-time" draw down process that will be supported by specific or actual disbursements reported by schools.

On September 4, 1998, the Department provided additional comments to our revisions to Finding 3. In these comments (**Exhibit 2**), the Department proposes to include steps in the program review process for the comparison between loan-level information at a school and the Direct Loan Servicer. In addition, the Department reiterated their disagreement with the OIG that a reconciliation process needs to be developed to associate cash draw downs to specific disbursements.

### *OIG Response*

We have carefully considered the Department's initial comments to the report and the additional comments to the revisions to Finding 3. Appropriate changes have been made where deemed necessary. Other than the changes to Finding 3, this final report remains basically unchanged from the draft version.

During the course of the review, the School Selection staff and the Direct Loan Task Force indicated that routine reevaluations of origination levels were not performed - partly due to lack of staff. In addition, neither group routinely received information, such as audit submissions or

provisional certifications, which could be considered for reevaluating origination levels.

As noted in Finding 3, we are not convinced that the new Direct Loan School Account Statement will provide the necessary means to ensure accurate data. Loan level data integrity will not be assured without a verification process that the Department can monitor on a current basis. We revised recommendation number 3.1 to recommend that the Department institute an interim measure for data verification until the new process is proven to provide adequate assurances that schools' loan level data is being transmitted accurately to the loan servicer. The Department is proposing to include steps in the program review process to cover data accuracy. When fully implemented this proposal should help in this area. However, our concern is whether this will be enough. As we have reported, past program reviews at Direct Loan schools have been limited in number.

Five different groups, including the OIG, have cited the need for tying disbursements to drawdowns as a vital control for the Direct Loan program. Without a data verification element or the tying of disbursements to specific drawdowns, the Department does not have the assurance that the loan information held by the loan servicer is correct. Furthermore, the Department indicated in its September 4, 1998 response the funding to support the "just-in-time" process was not included in the systems budget for Fiscal Year 1999 as earlier indicated. The seriousness of the problem is noted in the *Administration of the William D. Ford Federal Direct Loan Program by Schools* report, which cited error rates of 68 percent for loan disbursement and adjustment dates and 8 to 10 percent for loan balance data.

This report includes, after each recommendation or finding, a summary of the Department's comments. We have addressed areas where we disagree or where further clarification was needed. Copies of the Department's complete comments are included as **Exhibits 1 and 2**.

## REVIEW RESULTS

**Finding 1**  
**The Department  
Does Not Have  
Sufficient Data to  
Effectively  
Monitor Schools  
Participating in  
the Direct Loan  
Program**

The Department's Student Financial Assistance Program office has not had sufficient data to effectively oversee schools participating in the Direct Loan program. From March 1997 until January 1998, the Department's new loan origination system contractor (contractor) did not provide the contractually required management information reports. As of June 1998, the on-line data query capability was still not available. Thus, the Student Financial Assistance Program office has been operating without adequate data in the critical areas of loan origination, unbooked disbursements, school cash activity, and loan reconciliation. As a result, the Student Financial Assistance Program office has only limited assurance that schools are administering the Direct Loan Program adequately. Although other data sources were available, they often were not shared. The Student Financial Assistance Program office needs to take immediate action to correct the lack of accurate management information and to better share information currently available.

Federal regulations (34 CFR 685) identify the following areas that the Department should use to evaluate schools participating in the Direct Loan Program:

- < Timeliness of reporting;
- < Completeness and accuracy of origination records, disbursement records, and promissory notes;
- < Reconciliation process; and
- < Cash management.

*Key Reports  
were not  
Available*

In March 1997, a new contractor took over operational responsibility for the Direct Loan program loan origination system. The contract and subsequent modifications require the new contractor to provide management information reports which had been provided by the prior contractor. From March through August 1997, the only contractor data available to the Department for monitoring school performance from the contractor was a report on promissory notes. As of September 17, 1997, the following are examples of reports which were not available to the Department:

- < Loan Origination Summary
- < School Cash Activity
- < Monthly Cash Statement
- < Disbursement Summary for Unbooked Loans
- < Nightly Reconciliation Report
- < School Reconciliation and Aging Report

*More Reports  
Are Now  
Available*

On October 8, 1997, a Direct Loan Task Force official stated that the Department could not determine the number of schools that had disbursed funds for the Direct Loan program. On December 17, 1997, a Department official indicated that they had the loan origination summary, the school cash activity report, and the disbursement summary for unbooked loans. Although these reports will provide data, the remaining reports are still needed. In its June 11, 1998 reply, the Department noted that the Loan Origination contractor was providing most required reports. However, because two cash management reports (school cash activity report and the monthly cash statement) contain inaccurate data, the Department cannot correctly calculate school cash balances.

Without the information provided by accurate management information reports, the Department can not adequately evaluate school performance as required by the regulations. In addition, the Department has been hindered in its ability to identify potential problems and to proactively assist schools with problems.

*Query  
Capability is  
Limited*

Additionally, the Department originally contracted for query capability using a specific vendor's software. Because the originally proposed query software was not the same as the query software for the Department's new accounting system, the Department requested a vendor change and the contractor agreed. Although the contractor has not yet delivered data query capability, it agreed to provide a person to perform queries at an additional cost. As of November 30, 1997, the contractor had a person in place to perform queries. However, as of June 1998, the on-line query capability was not available to Departmental personnel. The Department still needs the on-line query capability as agreed to in the contract, so that the Direct Loan staff can have current data in order to provide technical assistance to the schools and resolve problems.

*Available  
Data Needs  
to be Better  
Shared*

Although the contractor is the Department's primary source of Direct Loan data on newly originated and consolidated loans, some information is available from other sources. School cash drawdown data is available from the Department's Payment Management System and some booked loan reports are available from the Central Data System. While these reports are available to some Headquarters staff, they are not routinely shared with the regional Client Account Managers who provide technical assistance to schools. Client Account Managers told us that the cash draws and booked loan reports would help them to assist schools.

Different Student Financial Assistance Program data bases contain information that is used to assist various components in the school monitoring process. These data bases included: the School Activity Monitoring System and the Tracking Summary reports used by the Accountability and Reconciliation Team (part of the Accounting and Financial Management Service); the Client Account Managers (part of the Policy, Training, and Analysis Service) tracking system; and the School Selection Team (part of the Institutional Participation and Oversight Service) data base. Although these data bases contain information that could be useful to other components, they are not always shared.

Department officials agreed that, because of the insufficient data provided by the contractor, they could not adequately monitor schools in the Direct Loan program. They also agreed that they need to better share available data.

**Recommendations**

We recommend that the Chief Financial Officer:

- 1.1 Enforce or modify the contract to obtain the required management information reports and query capabilities.
- 1.2 Require the contractor to either provide query capabilities to Departmental personnel or to provide sufficient personnel to handle all of the Department's query needs. This should entail no additional cost to the Department.

We recommend that the Assistant Secretary for Postsecondary Education:

- 1.3 Provide management information reports to all components having oversight responsibility, once the reports are available.
- 1.4 Conduct an inventory of Direct Loan data bases and determine which are needed and how the data might be combined and shared.

### **Department's Reply**

Although the Department stated in its response that OPE used alternative reports to monitor cash activity, they generally agreed to the findings and recommendations for Finding Number 1. In several instances, the Department indicated that the suggested actions are already being performed. See **Exhibit 1** for the full text of the Department's response to this finding.

**Finding 2**  
**The Department**  
**Needs to**  
**Improve Its**  
**Approach to**  
**Monitoring**  
**Direct Loan**  
**Schools**

The Department needs to improve its approach for monitoring Direct Loan school performance. Although the Department has in place processes to monitor schools' Direct Loan program administration, the processes need improvement. In particular, we identified weaknesses in two important monitoring processes: cash management and compliance monitoring.

Cash monitoring by individual components has been arbitrary and limited, with the potential for duplication of efforts. Compliance monitoring, particularly program reviews, have been limited; and origination levels have not been systematically reviewed. In some instances, guidance is needed in distinguishing between technical assistance and compliance efforts. Without effective cash and compliance monitoring, the Department is not able to identify and correct problems as they arise.

Oversight responsibilities are divided among the four organizational components charged with establishing management controls for the Direct Loan program. (See **Background and Appendix A** for additional descriptions of the components.) However, these components lack formal lines of communication and coordination to routinely share data and information related to Direct Loan schools. The Department should take immediate action to establish an effective and coordinated approach for monitoring Direct Loan school performance.

### **Cash Management Monitoring**

*Lack of Data  
and Staff  
Inhibit Cash  
Management  
Monitoring*

The Accounting and Reconciliation Team, which was transferred to the Accounting and Financial Management Service, is responsible for monitoring Direct Loan school cash management. Draft documents provided by the Accounting and Financial Management Service and discussions with the Accounting and Reconciliation Team (Team) leader indicate that the Team will be monitoring schools and providing technical assistance much as it did under the Direct Loan Task Force. However, since April 1997, the Team has been unable to monitor schools because of the lack of management information data. Further, the Accounting and Reconciliation Team staffing has not been approved.

*Past Monitoring  
Inconsistent,  
Inadequate, and  
Not Fully  
Documented*

Past monitoring activities performed by the Team were inconsistent, inadequate, and not fully documented. These problems may have been caused by the Team's lack of written policies and procedures. In many instances, it was not possible to determine why the Team ceased monitoring or failed to monitor schools with indicated problems. Schools would appear on the *Tracking Summary Report*, a report developed to document all the Team's monitoring activities, for several months and then be dropped with no indication of problem resolution.

Using the Team's benchmarks and February 28, 1997 data (the last data available from the loan origination system), we identified 184 schools that should have been monitored. We reviewed the *Tracking Summary Report* and found that only 114 of the 184 schools were monitored. The last documented monitoring by the Team was in April, 1997.

*Benchmarks Not  
Totally  
Representative of  
School Cash  
Position*

The primary benchmarks used by the Team to track schools were the school's adjusted cash balance and a ratio of disbursements to cash drawdowns. An adjusted cash balance of more than \$1 million indicated a school with a potential cash management problem. However, the calculations are not the most representative of a school's cash position, because the calculations understate cash balances during periods of higher drawdowns and overstate them during periods of lower drawdowns. To provide a more accurate measure of a school's ability to manage cash, we have proposed a variation of the current analysis. Accounting and Financial Management Service and Direct Loan Task Force officials agree that the proposed analysis should be used in conjunction with their other benchmarks. (An abbreviated comparison of the current and proposed methods is illustrated in **Appendix B.**)

*No Site Visit  
Procedures for  
Testing Cash  
Balances*

The Team and the Client Account Managers have various reports which provide information on schools' cash management. However, neither group has procedures which indicate when or if they should make site visits to determine whether schools are maintaining excess cash. In our opinion, without performing cash analysis on site, it is often difficult to be certain of a school's cash position.

*Potential For  
Duplication Of  
Effort Among  
Units Monitoring  
Cash*

While the Client Account Managers staff have developed a benchmark plan that includes analysis of the same indicators used by the Team, there are currently no plans by the Team to include Client Account Managers in cash monitoring. The Direct Loan Task Force and the Accounting and Financial Management Service acknowledge the potential for duplication of effort between the Team and the Client Account Managers and state that they will work to prevent it. However, none of the plans we reviewed or our interviews with officials showed how this issue will be addressed. Coordination will need to occur between the Direct Loan Task Force, the Accounting and Financial Management Service, and Policy, Training, and Analysis Service to prevent duplication of effort.

## **Compliance Monitoring**

*Program Reviews  
Limited*

For the three award years, July 1994 through June 1997, the Institutional Participation and Oversight Service performed reviews of the Direct Loan program at 23 schools. As of the end of this period, there were 1,300 participating schools with a cumulative loan portfolio of \$20 billion. The Director of the Institutional Participation and Oversight Service said that the limited number of reviews was due to the newness of the program.<sup>1</sup>

*Risk Analysis  
System Does  
Not Contain  
Direct Loan  
Funding Data*

The Institutional Participation and Oversight Service developed the Risk Analysis System to assist in prioritizing its work load. Direct Loan funding data was not included in the Risk Analysis System because the contractor could not develop trend analyses due to the late and incomplete data submitted by Direct Loan staff. Direct Loan staff were only able to provide total, not school level, funding data for award years 1994/95 and 1995/96. The next scheduled enhancement to the Risk Analysis System is expected to be completed by the end of calendar year 1998. At that time, Institutional Participation and Oversight Service officials believe that school level Direct Loan funding data will be available for incorporation into the Risk Analysis System.

Data Management and Analysis staff said they believe that until the enhancement is complete, the monitoring module, which includes data collected from audits and program reviews, will be adequate to provide the case management teams with information on Direct Loan schools.

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<sup>1</sup> Program reviews of all Title IV programs have been limited. For the 8 months ending May 31, 1997, Institutional Participation and Oversight Service performed only 61 program reviews.

Two Office of Inspector General surveys showed that, in the last fiscal year, program reviews have been limited and a serious backlog exists in the processing of the annual compliance and financial statement audits. Further, the lack of adequate management information reports from the Loan Origination contractor and the poor communication between components responsible may mean that the case management teams will have insufficient data to identify Direct Loan schools which may pose risks.

*No Systematic  
Review of  
Origination Levels*

Once a school's origination level has been established, neither the Direct Loan Task Force nor the Institutional Participation and Oversight Service require that it be reassessed, unless the school requests a change. The Direct Loan School Selection Team in the Institutional Participation and Oversight Service is responsible for establishing school origination levels and any subsequent review of the origination levels. The regulations at 34 CFR 685.402 allow the Secretary to lower the origination level of Direct Loan schools "... to ensure program integrity or if the school fails to meet the criteria and performance standards established by the Secretary."

School origination levels are initially determined on the basis of specific criteria applied by the School Selection Team. For example, a school which has a Perkins default rate greater than 30 % or was overdue on required financial and compliance audits, would be allowed to be a Direct Loan participant only at the lowest origination level (standard). Cash management is more controlled for Option 1 and Standard Origination schools. (See **Background** for additional information.)

From available data, we identified 125 schools (74 at the highest origination level) that had not submitted 1994-1995 audit reports and 190 (134 at the highest origination level) schools which were provisionally certified. Although these conditions could impact program integrity, Department officials stated that information on school certification status, audit report submission, and audit resolution was not routinely shared with various components needing

the information. Institutional Participation and Oversight Service officials indicated that even if they had the data, the School Selection Team does not have sufficient staff to perform reevaluations.

Information provided by the Direct Loan Task Force showed that it had changed the loan origination level of only one school during the first three years of the program. However, in its response, the Department provided data which indicated that 26 schools loan origination levels were reduced after being placed on reimbursement. An additional 29 provisionally recertified schools loan origination levels were lowered.

*Guidance Needed  
on Reporting  
Compliance Issues*

Client Account Managers, who have been integrated into the Policy, Training, and Analysis Service, generally will not become involved in compliance issues because as their procedures manual states: “the Account Managers’ role does not and will not include oversight authority.” Client Account Managers were instructed to report any problems found only to the regional leads, headquarters Client Account Manager staff, or to the Direct Loan Task Force. The Client Account Managers are not provided with guidance on when a problem at a particular school should no longer be treated as an issue requiring technical assistance and should instead be reported to offices having compliance and enforcement authority, such as the Institutional Participation and Oversight Service, Accounting and Financial Management Service, or Office of Inspector General.

*Quality Assurance  
Program Not  
Emphasized*

The Department’s initial quality assurance guide has expired; and schools are no longer required to report on quality assurance activities even though a quality assurance program is required by Federal law and regulations. Since the Department has established quality assurance contacts within the Client Account Manager regional office staff, the Client Account Managers should take the lead in reemphasizing the need for implementing quality assurance programs. This role would be in line with their philosophy of providing proactive, technical assistance.

Without an effective approach to monitoring, the Department runs the risk of not being able to identify and correct problems as they arise. The OIG report, *Administration of the William D. Ford Federal Direct Loan Program by Schools*, indicated that schools have problems which could impact program accountability. If the problems are not corrected, the Department’s financial statement reporting could be materially affected and may cause potential losses. The Department needs to take immediate action to correct the lack of management information. In addition, the Department needs to ensure that Direct Loan schools receive the necessary oversight.

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The Department generally agreed with our recommendations or indicated that it was already performing the recommended actions. After each recommendation is a synopsis of the Department's reply. In those areas where disagreements exist or further clarification is needed, we have provided a response. See **Exhibit 1** for the full text of the Department's response to this finding.

## Recommendations

We recommend that the Assistant Secretary for Postsecondary Education:

- 2.1 Clearly define and disseminate the Direct Loan program responsibilities for all components.

**Department's Reply:** The Department agreed with the recommendation. See **Exhibit 1** for details of actions taken.

- 2.2 Provide the Accounting and Financial Management Service with adequate staff to monitor Direct Loan cash management.

**Department's Reply:** The functions of the Direct Loan Task Force Accountability and Reconciliation Team were transferred to AFMS in the fall of 1997. OPE management made the determination that it was unable to divert resources from other critical SFAP activities to support the monitoring of Direct Loan cash management. Because additional staff will not be forthcoming, the AFMS cash management function will remain understaffed.

**OIG Response:** Without additional staff to monitor Direct Loan school's cash management, AFMS may not be able to adequately follow up, in a timely manner, on potential problems.

- 2.3 Incorporate the proposed cash analysis methodology, in Appendix B, into the Accounting and Reconciliation Team's monitoring process.

**Department's Reply:** The AFMS Program Operations Team will evaluate various cash balance calculations, including the proposed methodology included in Appendix B of the draft report. A reasoned cash balance calculation will be incorporated into the guidelines and procedures the AFMS Program Operations Team uses to monitor cash management activities.

- 2.4 Develop standards indicating when a cash analysis should be performed on site at a school and by whom.

**Department's Reply:** The Department agreed with the recommendation. See **Exhibit 1** for details of actions taken.

- 2.5 Require the responsible components to establish policies and procedures governing how the Client Account Managers and the Accountability and Reconciliation Team interact.

**Department's Reply:** The Department agreed with the recommendation. See **Exhibit 1** for details of actions taken.

- 2.6 Require the responsible components to develop guidelines as to when technical assistance ends and compliance becomes the issue.

**Department's Reply:** The Department agreed with the recommendation. See **Exhibit 1** for details of actions taken.

- 2.7 Reestablish the Direct Loan Quality Assurance Program guidance and make the program a priority.

**Department's Reply:** Although a quality assurance (QA) system (not program) is required by law, the law does not require or specify that schools must report on their QA activities. The law gives the Secretary discretion to define what the system will be. From the inception of the Direct Loan Program, the Department has taken a non-prescriptive approach to the QA requirement. Although the initial QA guide has expired, the Department has updated it annually and offered it as one of several options a school may choose to meet the statutory requirement.

**OIG Response:** The OIG believes that the Quality Assurance program could be the vehicle through which schools could readily identify and correct any problems. The current, non-prescriptive approach needs rethinking, with a redirection

towards a more proactive involvement of the CAMs.

- 2.8 Train Client Account Managers to be quality assurance program consultants who can provide hands-on assistance to schools.

**Department's Reply:** We do not concur with the recommendation as stated, as we believe the CAMs are currently able to provide such assistance. CAMs assist schools with process improvement in the course of providing on-site technical assistance to schools and assist schools with quality assurance program implementation upon request. The Department will continue to provide overall leadership in the development of the system, but believes overall improvement of data quality and system enhancements are a more cost effective use of limited resources.

**OIG Response:** CAMs are not proactively involved in assisting schools to implement a Quality Assurance program. We believe that a Departmental emphasis on quality assurance will lead to improvements in data quality and system enhancements.

- 2.9 Require the Institutional Participation and Oversight Service to develop a method for assuring that Direct Loan schools receive adequate coverage by the case management teams.

**Department's Reply:** It should be noted that the new case management approach for school oversight in OPE has strengthened compliance management significantly, allowing OPE to focus on-site compliance activities on cases where the need for strong scrutiny exists. Although program reviews were limited, the Department noted that, during FY 1997, IPOS recertified 1,222 of the 1,395 Direct Loan schools which drew down funds. Mostly through recertification, IPOS reviewed all schools in some manner. OPE does not agree that more program reviews need to be done by IPOS just for the sake of doing reviews, but agrees that IPOS will do program reviews where data analysis tells us they are needed. In the future, the Risk Management System will allow IPOS to target Direct Loan schools most in need of review.

**OIG Response:** Program reviews should not be done without a valid concern, but Direct Loan schools must be evaluated in the same fashion as all other schools. Adding the Direct Loan data to the Risk Management System should result in more effective targeting of schools for review. We are currently assessing IPOS' operations, which includes the case management approach and recertification efforts.

- 2.10 Require the Institutional Participation and Oversight Service to expedite inclusion of school level Direct Loan funding data into the risk analysis system.

**Department's Reply:** The AFMS Program Operations Team will be providing financial data to IPOS for inclusion into the Risk Management System. In November 1997, the Data Management and Analysis Division (DMAD) met with AFMS, and obtained Direct Loan gross commitments for all participants since inception, as well as the 790 report data (school cash activity) for the period 3/1/97-11/30/97. DMAD will continue to work with others in SFA on the enhancement of the Risk Management System for Direct Loans.

- 2.11 Require the Institutional Participation and Oversight Service to develop a systematic process to periodically review origination levels of Direct Loan schools as data becomes available. This process should define the data elements and the sources of data that would enable the Department to take the necessary actions to review origination levels. Assure that sufficient staffing is available to perform these reevaluations.

**Department's Reply:** School Selection staff in IPOS already routinely perform reviews of origination levels of Direct Loan schools, and will continue these automatic reviews to ensure that new information which may affect the origination levels of currently participating schools is analyzed. IPOS has developed triggers which will result in reviews of origination levels. Current triggers include those cases where schools go on reimbursement, have an ownership change, or request an origination level change. Future triggers will encompass the cohort default rates, scores from the Risk Management System, provisional certifications, missing audits, and issues from the Direct Loan Cross-cutting Issues Workgroup.

The Department stated that the OIG misunderstood its actions towards changing origination levels and cited statistics to support its case. During the first three years of the program, 26 schools placed on reimbursement had their origination levels reduced to Standard Origination. In program Year 2, at least 29 provisionally certified schools were notified that their loan origination levels changed from Level 1 to Level 2. An undetermined number of schools with high Perkins default rates also had their origination levels lowered.

**OIG Response:** During the time of our review, the School Selection staff did not routinely perform reviews of origination levels of schools participating in the Direct Loan program - partly due to lack of staff. However, the staff did review data, such as Perkins default rates and lack of audits, for all new schools which were requesting entry into the Direct Loan program or for schools requesting an origination level change. When schools went on reimbursement or had an ownership change, the change in origination level was triggered by an IPOS action or receipt of information, not a routine review by the School Selection staff. OPE must ensure that the information required for analysis of the triggers mentioned above is routinely disseminated to the School Selection staff.

**Finding 3**  
**Lack of Loan**  
**Level Matches**  
**Decreases**  
**Control Over**  
**Data Reliability**

The Department has eliminated the loan level reconciliation process which required a match between school records and the Loan Origination Center (LOC) records for each cash and loan transaction. In Year 5, the Loan Origination Center will generate a monthly statement containing a summary of the month's transactions and detail of drawdowns and excess cash returns. Schools will be expected to match the monthly statement's ending cash balance with its internal records. For Year 5, the loan level data matching between the school's record and the Loan Origination Center records will be optional. (See **Appendix C** for a description of the new process.) In addition, there is no loan level reconciliation or data matching between schools and the Direct Loan Servicer. The lack of loan level reconciliation or data matching between schools and either the Loan Origination Center or the Direct Loan Servicer, diminishes the control over data accuracy and completeness.

During Year 4 (1997-1998), once the initial disbursement had been made and the initial obligation to repay had been created, schools were not required to perform any further loan detail data matching on subsequent changes to the student's account. Once the Loan Origination Center accepted additional disbursements, adjustments, and cancellations, those transactions were also considered reconciled. In our opinion, not matching subsequent account activity may have already weakened the Department's ability to identify individual student records with errors or omissions.

For Years 1 to 3, schools were required to match each cash and loan record with the Loan Origination Center on a monthly basis. Unreconciled records were tracked and aged and schools were encouraged to follow through and correct the records. This process enabled the Department to identify schools with potential problems and provided a measure of accuracy between the Loan Origination Center and each school. Theoretically, the detail records between schools and the Loan Origination Center should automatically match, but this has not always been the case. The OIG's report, *Administration of the William D. Ford Federal Direct Loan Program by Schools*, cited error rates of 68 percent for loan disbursement and adjustment dates and 8 to 10 percent for loan balance data.

For a loan program to operate effectively, it must have accurate loan balances and activity dates. Inaccurate data can lead to asset loss and

problems in servicing the loans. Without a data verification process, data reliability problems will continue to exist.

The Department believes its new process, the Direct Loan School Account Statement (DLSAS), for controlling Direct Loan data will enhance controls. They have stated that the problem with the prior data match process was that it compared only those records that the schools sent to the LOC; it did not identify those records that the school did not send, or those records whose dates or amounts were reported incorrectly. As a result, the data match process could not ensure that the school accurately submitted all disbursement records on its system

With the new DLSAS reconciliation process, schools will receive a monthly summary of all transaction activity, as well as an ending cash balance which will be reconciled to the Department's general ledger account identifying Direct Loan advances to schools. Using this information a school will be able to compare its internal records with the information provided and perform accurate reconciliations. To augment the DLSAS process, there are plans to provide an infrastructure for Certified Public Accountants (CPAs) to allow them to obtain confirmations from the Direct Loan Servicing System on loan activity when they are performing compliance audits, and to require the CPAs to review the school's reconciliation process.

We still have concerns as to whether the Department's proposed reconciliation/cash management processes will provide adequate assurances that loan level data will be accurate. The Department's own Internal Quality Control Unit reports indicate that problems exist with both the timeliness and accuracy of school data input. Not only are schools still attempting to process a significant number of Year 2 and 3 disbursement records, even though they may have made the disbursements to students long ago, but also there are substantial rejection rates for apparently inaccurate data.

The DLSAS process places complete reliance on the schools for reconciling cash balances on a monthly basis. Furthermore, the Department will not know, until some time after the fact, whether the schools have reconciled their statements with their internal records. Presently, no process exists to verify that schools have performed internal reconciliations. The requirement for CPAs to verify school data with the Direct Loan Servicing System and to review schools'

internal reconciliation practices will add necessary controls, but these processes are not likely to be implemented in the near future.

In our draft report, we recommended that the Department reinstate the data matching requirement for all transactions for each loan. We have revised this recommendation. We are now recommending that the Department institute an interim measure for data verification purposes until it has assurance from the CPAs' school audits that the data is accurate and schools are performing internal reconciliations. The Department needs to perform extended loan level data verification by comparing schools' and the Direct Loan servicer's data. Schools could be selected on a random and/or perceived risk basis. Implementation of our revised recommendation would identify disbursements that the schools did not send to the Loan Origination Center. This would help to minimize the Department's risk with regard to students' outstanding loan balances.

Furthermore, in our opinion, not only does the Department need to maintain a loan level data verification requirement, it also needs to tie individual student disbursements to specific cash drawdowns and excess cash activities. From the inception of the Direct Loan program, this recommendation has been made by: the Department's independent auditors; an independent consultant; the Advisory Committee on Student Financial Assistance; and the Office of Inspector General. In December 1997, an official in the Office of the Chief Financial Officer agreed that disbursements should be tied directly to drawdowns. As the independent consultant stated, the only way to provide an incentive to the schools for timely, accurate reporting of disbursements is to tie disbursements to drawdowns.

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***Department's Reply:*** The Department did not concur with our initial recommendation to reinstate data matching. The Department believes its new process, the Direct Loan School Account Statement (DLSAS), for controlling Direct Loan data will enhance controls. The DLSAS will provide a summarization of all drawdown and disbursement activity, as well as an ending cash balance. In its response to the revision of this finding, the Department believes loan-level verification is unnecessary if a school is able to reconcile its data using DLSAS. However, in response to recommendation 3.1, the Department proposes to include steps in the program review process for the comparison between loan-level information at a school and the Direct Loan Servicer. When the Case Management Teams select a Direct Loan school for an onsite program review, the reviewer will ascertain whether the information

contained in the Direct Loan Servicer's records is supported by the schools records for selected students.

In addition, the Department disagrees with recommendation 3.2 to develop a reconciliation process. In its initial response, the Department indicated that OPE is moving toward a common origination and disbursement system that would tie drawdowns by schools to specific actual disbursements reported by the institutions. The Year 6 origination and disbursement process is being developed to support a "just-in-time" draw down process that will be supported by specific or actual disbursements reported by schools. In its subsequent response, the Department indicated that the process would place a burden on Direct Loan schools under the current funding options and EDEXpress software. Funding was not available to support the "just-in-time" process in the systems budget for FY 1999. See **Exhibits 1 and 2** for the full text of the Department's replies.

***OIG Response:*** We still have concerns as to whether the Department's proposed reconciliation/cash management processes will provide adequate assurances that loan level data will be accurate. We have revised recommendation 3.1 to suggest that the Department institute an interim measure for data verification assurances. The Department's proposal in its September 4<sup>th</sup> comments, when fully implemented, should help in this area. However, our concern is whether this will be enough. As we have reported, past program reviews at Direct Loan schools have been limited in number.

We believe that the recommendation that the Department develop a reconciliation process which will associate each cash draw down to specific disbursement and excess cash activities is still valid. Furthermore, the Department indicated in its September 4<sup>th</sup> response that the funding to support the "just-in-time" process was not included in the systems budget for Fiscal Year 1999 as earlier indicated. Five different groups, including the OIG, have cited the need for tying disbursements to drawdowns as an important control for the Direct Loan program. Matching specific drawdowns with specific disbursements does not seem unrealistic. In our prior report (noted above) on direct loan schools, we suggested such a process that would afford better cash management while still giving schools the flexibility needed.

## **Recommendations**

We recommend that the Assistant Secretary for Postsecondary Education:

- 3.1 Conduct periodic (i.e., every six months) data verification for all transactions by comparing selected school's loan level information with that of the Direct Loan Servicer. This data verification process should be used as an interim measure until OPE has assurance from the CPAs' school audits that the loan level data is accurate and schools are performing internal reconciliations.
- 3.2 Develop a reconciliation process which will associate each cash drawdown to specific disbursement and excess cash activities.

## **OBJECTIVES OF REVIEW**

The objectives of this review were to examine the Department's processes for monitoring school administration of the Direct Loan program and to identify areas where improvements could be made. This review is a follow on to the OIG work performed for the report titled, *Administration of the William D. Ford Federal Direct Loan Program by Schools*, (Audit Control Number 03-60009). The Direct Loan school report summarized the results of OIG audits performed at 16 Direct Loan schools and made many recommendations for improving Departmental oversight of Direct Loan schools.

## **BACKGROUND**

The William D. Ford Federal Direct Loan program (Direct Loan program) was enacted by Congress to improve the Federal student loan system for student and parent borrowers, institutions, taxpayers and the Federal government. The primary goals of the Direct Loan program are to provide borrowers and participating schools with greater flexibility and more efficient service within a simpler, more automated, and accountable system than is available under the Federal Family Education Loan Program (FFELP).

The Direct Loan program consists of the borrower, the school, and the U. S. Department of Education (Department). The Department contracts with the private sector to provide origination, servicing, accounting systems and related services. Contracts are negotiated and monitored by the Contracts and Purchasing Operations group, a section under the Office of the Chief Financial Officer.

For the first year of the program, the Secretary of Education selected 103 schools to participate, representing approximately 7% of new federal student loan volume. By Year 2, approximately 1150 schools, representing 30% of new federal student loan volume, were participating in the program. Year 3 had more than 1300 participating schools, representing 32% of new federal student loan volume.

Schools can participate in the program under one of three options:

- ! Option 1 schools perform all functions except for drawdowns, which are performed by the Loan Origination Center.
- ! Option 2 schools perform all school functions, including loan origination, preparation and collection of signed promissory notes, drawdown, and disbursement of funds to students.
- ! Standard Origination schools have drawdowns and preparation and collection of promissory notes performed by the Loan Origination Center.

The Department's management controls over Direct Loan schools are the responsibility of Student Financial Assistance Programs (SFAP). The Department relies on four of its major

components within SFAP for management control as outlined in the following chart. (See **Appendix A** for additional information.)

**SFAP Components with Direct Loan Management Control Responsibility**

| <b>Component</b>   | <b>Management Control Responsibility</b>           | <b>How Performed</b>   |
|--|--|--|
| Direct Loan Task Force (DLTF)                            | Overall Responsibility for the Direct Loan Program | Coordinates Direct Loan Activities                                   |
| Accounting and Financial Management Service (AFMS)       | Financial Management/Cash Management               | Accounting and Reconciliation Team (ART) and Program Operations Team |
| Policy, Training, and Analysis Service (PTAS)            | Technical Assistance to Schools                    | Client Account Managers (CAMs)                                       |
| Institutional Participation and Oversight Service (IPOS) | Institutional Compliance with Regulations          | Case Management and Risk Analysis System                             |

The Office of Management and Budget’s Circular A-123, “Management Accountability and Control,” defines management controls for Federal executive agencies. Management controls are defined as the organization, policies and procedures used by agencies to reasonably ensure that: ( i) programs achieve their intended results; (ii) resources are used consistently with agency mission; (iii) program resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported and used for decision making.

## **SCOPE AND METHODOLOGY**

To achieve an understanding of the Department's controls and processes relating to the oversight of Direct Loan schools, we focused on the monitoring activities of the Direct Loan Task Force; the Client Account Management (CAM) Group; the Accountability & Reconciliation Team (ART); Accounting and Financial Management Service (AFMS); and Institutional Participation & Oversight Service (IPOS). We interviewed Office of Student Financial Assistance Program officials, reviewed related procedures, policies, and regulations, examined available data bases, analyzed IPOS data on monitoring, and reviewed files as necessary. For issues relating to management information reports, we interviewed Program Systems Service (PSS) officials and reviewed the reporting requirements of the Loan Origination System contract. We also reviewed work associated with the Department's fiscal year 1996 financial statement audit.

To achieve an understanding of the regional Client Account Managers' roles, we interviewed selected individuals in Washington, D.C.; Philadelphia, Pennsylvania; Atlanta, Georgia; Dallas, Texas; and San Francisco, California. We talked with a cross-section of staff in order to better understand their responsibilities, particularly as they related to technical assistance and training.

Our review focused on current and future monitoring controls and processes. We performed fieldwork at selected regional offices and at the headquarters of Student Financial Assistance Programs during the period August 4, 1997 through October 1, 1997. On October 17, 1997, we discussed our review results with the Department; and on December 17 and 18, 1997, we performed a limited update on information previously provided to us. On August 5, 1998, a follow up exit conference was held with Department officials to discuss the draft report and the revision to Finding 3. Our review was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

## **STATEMENT ON MANAGEMENT CONTROLS**

In order for the management control process to be effective, the process must be monitored and modifications made as needed. As a part of our review, we assessed the Department's monitoring of schools participating in the Direct Loan program. Our assessment was performed to determine the type and level of monitoring performed by the various component offices in the Office of Student Financial Assistance Programs, which is responsible for oversight of the Direct Loan program. (See **Appendix A** for a description.) For the purposes of this review, we evaluated the monitoring activities in the following SFAP components:

- C Direct Loan Task Force
- C Accounting and Financial Management Service
- C Policy, Training, and Analysis Service
- C Institutional Participation and Oversight Service

Because of inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses. Our review identified weaknesses

in the cash management and compliance monitoring processes performed by the above components. Monitoring was also impacted by the lack of management information data. These weaknesses and their effects are fully discussed in the REVIEW RESULTS section of this report.

APPENDIX A

**Student Financial Assistance Programs**  
**Components with Oversight Responsibility**

***Direct Loan Task Force.*** The Direct Loan Task Force, depicted as an unofficial organization on the Office of Postsecondary Education organizational chart dated June 1997, has the ultimate responsibility for Direct Loan program administration. The Task Force reports directly to the Office of the Deputy Assistant Secretary for Student Financial Assistance Programs. Its most recent focus has been on the loan origination system, consolidations, and outreach to attract new schools. School monitoring is spread among the other components.

***Policy, Training and Analysis Service.*** The Client Account Managers, also an unofficial organization, operate as part of the Policy, Training and Analysis Service. Mostly located in the regions, they provide technical assistance and training to Direct Loan schools. They act as proactive program advocates who generally do not become involved in compliance issues.

***Accounting and Financial Management Service.*** In the simplest terms, Accounting and Financial Management Service has the responsibility for cash and will monitor Direct Loan schools' cash management. When data is available, this team will be able to analyze daily cash activities and contact schools needing assistance.

***Institutional Participation and Oversight Service.*** Institutional Participation and Oversight Service has several different components which provide many varied functions. The case management divisions are responsible for institutional recertification, financial statement analysis, audit resolution, and program reviews of all Title IV participants, including Direct Loan schools. The Data Management and Analysis Division operates the document control central where school audits are received and conducts risk analysis to target high risk schools for oversight. The Performance Improvement and Procedures Division has the responsibility for approving schools to participate in the Direct Loan program and for setting the schools' origination levels.

***Program System Service.*** Although Program System Service does not have school monitoring obligations, it oversees the EDS Loan Origination System contract. As part of the LOS contract, EDS is obligated to provide management information reports which could be used to monitor schools.

APPENDIX B

Page 1 of 2

**Proposed Method for Evaluating Cash Positions**

The Accountability and Reconciliation Team’s benchmarks for monitoring school performance included analysis of adjusted cash balances in excess of \$1 million, and analysis of school’s ratio of disbursements to drawdowns (90% or less considered problematic). They calculated adjusted cash balance as:

$$\begin{aligned}
 &\text{Cash Balance (based on drawdowns from ED/Payment Management System and} \\
 &\quad \text{disbursements received and booked at the Loan Origination Center (LOC)} \\
 &\text{(Minus) Drawdowns within the last 30 days (from ED/PMS data)} \\
 &\text{(Minus) Unbooked Disbursements (from the LOC)} \\
 &= \text{Adjusted Cash Balance}
 \end{aligned}$$

ART calculates the ratio of disbursements to drawdowns as:

$$\frac{\text{Cumulative Disbursements (booked and unbooked, from the LOC)}}{\text{Cumulative Drawdowns (excluding drawdowns within the last 30 days)}}$$

In calculating adjusted cash balances and the ratio of disbursements to drawdowns, ED staff remove the most recent 30 days’ drawdowns and add any unbooked disbursements into the cumulative disbursements as shown above. ED staff explained that these adjustments account for the 30 days schools are allowed to report disbursements. We believe that these adjustments do not give the Department the most accurate picture of the school cash balances. Instead, we suggest that the Department use cash balances and ratios after allowing 30 days for processing, i.e., reviewing data through September 30 as of October 31. Consider the following example:

|               | Total Value of Records Received by LOC in July | Total Value of Records Received by LOC in August | Total Value of Records Received by LOC in September | Total Value of Records Received by LOC in October              | Total Value of Records Received by LOC in November                       |
|---------------|--|--|---|--|--|
| Drawdowns     | \$0  | \$1,000,000                                      | \$2,000,000   | \$200,000  | \$250,000  |
| Disbursements | \$0  | A \$200,000                                      | A \$500,000<br>S \$400,000<br>Ttl \$900,000         | A \$200,000<br>S \$1,000,000<br>O \$100,000<br>Ttl \$1,300,000 | A \$100,000<br>S \$200,000<br>O \$50,000<br>N \$150,000<br>Ttl \$500,000 |

In the disbursements row, “A” signifies disbursements dated in August; “S”, disbursements dated in September; “O”, disbursements dated in October; and “N”, disbursements dated in November.

APPENDIX B

In the illustration above, the school began participating in the Direct Loan program in August, with no previous Direct Loan cash balance. In August, the school drew down \$1,000,000. Disbursements totaling \$200,000 relating to the August drawdown had been received at the LOC by the end of August. In September, the school drew down \$2,000,000. Disbursements totaling \$500,000, dated in August and relating to the August drawdown, were received by the LOC in September, as well as \$400,000 of disbursements dated in September, relating to the September drawdown, and so on.

|                             | ED Calculation          | Proposed Calculation    |
|-----------------------------|-------------------------|-------------------------|
| <b>August:</b>              | Calculated August 31    | Calculated September 30 |
| Adjusted Cash Balance       | (\$200,000)             | \$300,000               |
| Disbursement/Drawdown Ratio | Cannot calculate        | 70%                     |
| <b>September:</b>           | Calculated September 30 | Calculated October 31   |
| Adjusted Cash Balance       | (\$100,000)             | \$700,000               |
| Disbursement/Drawdown Ratio | 110%                    | 77%                     |
| <b>October:</b>             | Calculated October 31   | Calculated November 30  |
| Adjusted Cash Balance       | \$600,000               | 450,000                 |
| Disbursement/Drawdown Ratio | 80%                     | 86%                     |

As demonstrated above, the Department’s calculations understate cash balances during periods of higher drawdowns and overstate cash balances during periods of lower drawdowns. While still allowing 30 days for reporting, the proposed calculation more closely matches drawdowns to disbursements and provides the Department with a more accurate view of school cash balances. The proposed method should clearly indicate whether the school has excess cash or meets the 30 day disbursement reporting requirement.

We provided this proposed methodology to DLTF and AFMS officials for comment. They indicated that it would be a useful tool to supplement their current analyzes.

APPENDIX C

**Year 5 Reconciliation Process**

- C At the end of each month, the Loan Origination Center (LOC) will generate a "Direct Loan School Account Statement" and send the electronic file to the schools. This statement will include transactions processed during the period. Additional reports listing detail records recorded on the Department's data base will be available upon request. Schools will import the file and a report may be printed. All reconciliation will be done as of the end of the month, rather than having the schools choose reconciliation end dates as is currently done.
- C The Direct Loan School Account Statement will contain beginning and ending cash balances and totals for categories of booked items processed during the period. Unbooked transactions will be listed on the report, in total, after the ending cash balance. The school will also receive a file which shows detail for all cash items, and upon request, one for loan detail.
- C Since all cash balances will be as of the end of the month, the cash balances will tie to the Financial Accounting and Reporting System (FARS) balances.
- C Using the statement and detail file(s) received, the school will be responsible for reconciling to their internal records. Three options will exist to assist schools in doing this: (1) new tools in EDEExpress will help analyze differences for EDEExpress users; (2) schools can use their own software to analyze differences; and (3) schools can send a file to the LOC for analysis and the LOC will generate an exception report of transactions which do not match.
- C The data matching component of reconciliation will be eliminated. Schools will no longer have a reconciliation status flag for each transaction. Loan elements will have a status code indicating whether the loan has booked.
- C The responsibility for reconciliation will be the school's. ED will have no report by which to determine whether schools are reconciling.

**EXHIBIT 1**

June 11, 1998

Carol S. Lynch  
Regional Inspector General for Audit  
U.S. Department of Education  
100 Alabama Street, Room 18T71  
Atlanta, Georgia 30303

Dear Ms. Lynch:

Thank you for the opportunity to review and comment on the Office of Inspector General's draft report entitled, "Review of the Department's Oversight of Schools Participating in the William D. Ford Federal Direct Loan Program." The objectives of the audit, as stated in the report, were to examine the Department's processes for monitoring school administration of the Direct Loan Program and to identify areas where improvements could be made.

While the report contains some useful suggestions for improvement, we are concerned that some statements in it are inaccurate or misleading. Further, some of the current efforts to address issues raised in the report are not reflected. This response describes actions taken or planned to strengthen management controls related to the Direct Loan Program both in our responses to individual OIG findings and recommendations in the Appendix and in the paragraphs below.

Although the Office of Postsecondary Education's (OPE) new Loan Origination System contractor did not provide management information reports or data query capability from March through November 1997, OPE used alternative reports to monitor cash activity. OPE has been able to determine drawdown activity for schools using the Payment Management System. In addition, OPE could obtain detailed information about school disbursement activity, including number, date, and amount of transactions through ad hoc queries from the Loan Origination contractor. Steps are being taken to ensure that financial management reports related to Direct Loan schools are shared with Institutional Participation and Oversight Service (IPOS) and the Client Account Management Group (CAMG).

OPE has been committed to a coordinated approach to monitoring the performance of schools participating in the Direct Loan Program for several years. As the program has matured in the last year, the areas of OPE responsible for oversight activities (the Accounting and Financial Management Service (AFMS), IPOS and CAMG) have developed a coordinated approach for monitoring cash management and school performance. As part of this coordinated approach, OPE has established two workgroups. The AFMS Program Operations Team and the CAMG workgroup monitors and improves cash management at schools and the Direct Loan Cross-cutting Issues workgroup handles school compliance and performance issues. In addition, it should be noted that the new case management approach to school oversight in IPOS has strengthened compliance management significantly. Plans are also underway to add additional Direct Loan data to the Risk Management System to improve the analysis for Direct Loan schools

where the Direct Loan data might indicate there is a problem.

Two of the statements in the report, both regarding the review of schools' origination levels, do not provide an accurate understanding of changes made in schools' origination levels. The report states that "Once a school's origination level has been established, neither the Direct Loan Task Force nor the Institutional Participation and Oversight Service require that it be reassessed, unless the school requests a change." The report also states that "Information provided by the Direct Loan Task Force showed that it has changed the loan origination level of only one school during the first three years of the program." We identified over 50 Direct Loan Schools whose loan origination level was reduced during the first 3 years of the Direct Loan program by school selection staff, some while the staff were part of the Direct Loan Task Force and others after the staff were transferred to IPOS. Problems were identified in at least 25 schools that were designated Level 1 or Level 2 at the time, and the schools' origination levels were reduced and the schools placed on the reimbursement system of payment. Other schools' origination levels were reviewed and reduced when the schools were provisionally recertified because they underwent a change in ownership.

We are also concerned with the underlying premise of the OIG's finding related to the data matching issue. After analyzing both data transmittal and processes in use during the first four years of the program, we have developed alternative controls to data matching which will provide for much more effective monitoring by both schools and OPE. OPE is not eliminating controls over data. To the contrary, OPE is enhancing controls over drawdown and disbursement activity. Under the new reconciliation process, the schools will receive a monthly statement summarizing all drawdown and disbursement activity and a beginning and ending cash balance. The cash amount held at the school will be reconciled to the Department's general ledger account identifying the Direct Loan cash advanced to schools. This is a clear improvement over the present process that gives the school only confirmation of what the Loan Origination Center received from the school, and the CFO is fully supportive of this change.

Again, we appreciate the opportunity to review and comment on the draft report and we will take appropriate steps to address the issues identified in the report. The attached Appendix summarizes the Office of Inspector General's (OIG) findings and corresponding recommendations. General comments have been included after each finding, where applicable, followed by specific comments to each recommendation.

Sincerely,

**(Signed copy of Letter on File in Area Office)**

Marshall S. Smith  
Acting Deputy Secretary

Enclosure

cc: David A. Longanecker  
Donald Rappaport

## APPENDIX

### **Finding 1**

*The Department does not have sufficient data to effectively monitor schools participating in the Direct Loan Program.*

#### Response to Recommendations:

Recommendation 1.1. *Enforce or modify the contract to obtain the required management information reports and query capabilities.*

Response. The key management information reports cited in the OIG report are listed in the loan origination contract Master Billing Table as the following deliverables:

- Loan Origination Summary - Deliverable 25
- Monthly Cash Activity - Deliverable 52
- Disbursement Summary of Unbooked Loans - Deliverable 55
- School Reconciliation and Aging Report - Deliverable 34

Since January 1998, the Loan Origination contractor has been compliant in the timely submission of deliverables 25, 52, and 55. The Nightly Reconciliation Report and the School Reconciliation and Aging Report will no longer be required by the Department due to the changes in the reconciliation process, which became effective in February 1998. The School Cash Activity Report is provided to the Department by the Direct Loan Servicing contractor and is not a required deliverable under this contract.

The contracting officer will work with OPE in identifying all required management information reports to be incorporated into the contract; and enforce the timely submission of all deliverables as specified.

Recommendation 1.2. *Require the contractor to either provide query capabilities to Departmental personnel or to provide sufficient personnel to handle all of the Department's query needs. This should entail no additional cost to the Department.*

Response. The Department made the decision to use the Departmental standard querying software in lieu of the contractor's originally proposed query software. The contractor will continue to provide manual querying capability support until the Department's selected software is in production. The pilot to provide and test query capabilities of Departmental personnel is currently scheduled for April 1998.

Recommendation 1.3. *Provide management information reports to all components having oversight responsibility, once the reports are available.*

Response. As indicated in the draft audit report, OPE has not had sufficient reports to oversee schools participating in the Direct Loan Program effectively. The primary reports for monitoring school cash activity are the School Cash Activity Report and the Monthly Cash Statement. While these reports are currently being delivered to the Department, neither report contains accurate data which is necessary to correctly calculate school cash balances. AFMS is working with Program Systems Service (PSS) and the Loan Origination contractor to ensure that the Loan Origination Center (LOC) provides the Department with accurate and timely financial information that is necessary for the AFMS Program Operations Team to monitor school cash activity.

Once the AFMS Program Operations Team begins to receive accurate financial data, it will coordinate the distribution of the data to IPOS and the Client Account Managers. This should ensure that all parties have the same information and should prevent any duplication of effort. The information will also be available to the Direct Loan Task Force and other Department components on request.

Recommendation 1.4. *Conduct an inventory of Direct Loan data bases and determine which are needed and how the data might be combined and shared.*

Response. We will inventory all existing data bases, determine the extent to which they are still useful, and assess whether they can be made readily available to additional staff. We note that two of the data bases mentioned in the report, the School Activity Monitoring System, developed and maintained by the Accounting and Financial Management Service (ART) and the Client Account Managers\* (CAMs) tracking system are no longer being used. The School Selection System (SSS) is still being used for internal tracking. We are looking at whether the Direct Loan module in PEPS, which is available to regional as well as Headquarters staff, can be expanded to house additional information currently maintained in SSS or whether SSS should be upgraded and revamped to provide for retention of historical records, better query capability and access by regional and Headquarters staff.

In addition to its responsibility for ensuring the accuracy of financial data produced by the LOC, the AFMS Program Operations Team is also responsible for coordinating the dissemination of financial data to all components having oversight responsibility. The AFMS Program Operations Team is working together with all oversight components to ensure that financial data is being shared and not duplicated.

## **Finding 2**

### ***The Department Needs an Effective Approach To Monitoring Direct Loan Schools***

#### **General Comments**

##### ***Program Reviews Limited***

While the number of on-site program reviews was limited during this period, IPOS actually reviewed more schools than ever through the recertification process. Over 3,300 schools were reviewed during FY 1997. With respect to Direct Loan schools specifically, during Fiscal Years 1995, 1996 and 1997, of the 1,395 schools that drew down Direct Loan funds, 1,222 were recertified by IPOS. Thus, it is incorrect to conclude that because the number of on-site program reviews at Direct Loan schools has not been high, that these schools received inadequate oversight. Through the recertification process and case management, we have reviewed all Direct Loan schools in some manner. Recertification involved analyzing schools' annual financial statements, compliance audits, default rates and available program review reports, as well as the information provided on the recertification application itself. Conducting an on-site program review is only one of many options available to IPOS for monitoring schools.

##### ***Risk Analysis System Does Not Contain Direct Loan Funding Data***

In reference to the comment in the first sentence of this section, that IPOS developed the Risk Management System to assist in prioritizing its work load, we note that the system does more than prioritize work; it helps IPOS target institutions most in need of oversight.

##### ***No periodic Review of Origination Levels***

We are concerned about two statements in the report related to origination levels. The report states that "Once a school's origination level has been established, neither the Direct Loan Task Force nor the Institutional Participation and Oversight Service require that it be reassessed, unless the school requests a change." Secondly, it states that "Information provided by the DLTF showed that it has changed the loan origination level of only one school during the first three years of the program." We are not sure what the source of these statements was, but we can state that the DLTF reviewed schools' origination levels automatically in at least three different situations: (1) Beginning in June 1995, when a school was placed on reimbursement, if the school were a Level 1 or Level 2 school, it was automatically and immediately reduced to Level 3. (2) For the first two years of the program, when a school underwent a change in ownership, and was reappraised for participation in Title IV programs under provisional certification, the school's origination level was reviewed and was reduced to Level 2, if the school had been a Level 1 school. (Beginning with the 1996-97 year, the regulations did not reference provisional certification as a criterion for determining origination level; hence, no changes were made routinely to a school's origination level based on its being recertified provisionally.) (3) For the 1995-96 year, the regulations specified that a school with a Perkins Loan default rate above 30% could participate at a Level 2, at most. In subsequent years, a Perkins Loan default rate in excess

of 30% was deemed to be indicative of a severe performance deficiency. Beginning with 1996-97, initial participants with such rates were assigned Level 3 or standard origination. In 1996, current Direct Loan participating schools were rereviewed, and their origination levels reduced to Level 3 or standard origination level if they had previously been participating at a Level 1 or 2.

We queried the PEPS Direct Loan module and identified twenty-six schools during the first three years of the program whose origination level was reduced to Level 3/Standard origination when the school was placed on reimbursement. Further, Direct Loan records indicate that in Year 2 of the program, at least 29 schools that were provisionally certified were notified that their loan origination levels changed from Level 1 to Level 2. Schools with high Perkins Loan default rates were notified that their Direct Loan origination level was being reduced as a result of the default rate; records reflect action taken on appeals of the revised origination level. The SSS also indicates DLTF action to reduce origination levels, but the actions are reflected only in the "notes" section and we were therefore not able to run a query to determine the total number of such actions.

The draft audit report states that the auditors identified 125 schools that had not submitted 1994-95 audit reports, but there is no information given on the origination level of these schools. Although we recognize the importance of schools submitting required audit reports, we must point out that: (1) The criteria for loan origination levels in effect for 1995-96 provided that a school with missing audits could participate at a Level 2 or Level 3/Standard origination; and (2) Beginning with 1996-97, the regulations provide that for a school to originate loans, it must be current on audits "for the 12-month period immediately preceding the date of application to participate in the Direct Loan Program." A school that was not current could still participate as a Standard origination school. Thus, treatment of missing audits is explicit in the regulations. Failure to submit 1994-95 audits would have had an impact on determination of 1996-97 origination levels for new schools; the DLTF solicited information on audit report submission and resolution as part of its school screening process, and IPOS provided the information, and it was used accordingly to determine origination levels.

The report also notes that 134 schools were provisionally certified, but the report indicates neither the time period covered nor the origination level assigned to such schools. For 1995-96, the regulations specify that a provisionally certified school could not be designated as a Level 1 school, but there was nothing to preclude assigning it a Level 2 or Level 3/Standard origination level. Beginning with 1996-97, the regulations are silent with respect to using provisional certification status as a criterion for assigning origination levels.

### ***Quality Assurance (QA) Program Not Emphasized***

The draft audit report says that schools are no longer required to report on quality assurance activities. We note that while a QA system (not program) is required by law, the law does not require or specify that schools must report on their QA activities. The law gives the Secretary discretion to define what the system will be.

### **Response to Recommendations:**

Recommendation 2.1. *Clearly define the Direct Loan program responsibilities for all components.*

Response. We have defined the program responsibilities for all components.

The AFMS Program Operations Team has the primary responsibility for ensuring that loan origination operations of the Direct Loan Program result in correct information being transmitted to the Department's Financial Management Support System (FMSS). The AFMS Program Operations Team has the responsibility for ensuring that all financial data produced by the Loan Origination System (LOS) is complete and accurate and that the data provided by schools to the LOS is complete and accurate. AFMS is also responsible for the cash management and reconciliation activities previously performed by the DLTF Accountability and Reconciliation Team.

IPOS treats Direct Loan schools the same way it treats schools that do not participate in the Direct Loan Program. It provides monitoring, oversight, and technical assistance to insure compliance with Title IV legislation and regulations and takes compliance actions when warranted.

The CAM function is customer service, which includes providing training and technical assistance. The AFMS Program Operations Team will provide financial data to the CAMs which they will use to target those schools whose cash balance gives the appearance of a potential performance issue. CAMs will then contact those schools and provide training and other assistance as necessary to address performance issues.

Recommendation 2.2. *Provide the Accounting and Financial Management Service with adequate staff to monitor Direct Loan cash management.*

Response. For fiscal year 1998, the FTE ceiling for OPE was reduced by 18 FTE. This reduction made it necessary to reduce the FTE ceiling for the Student Financial Assistance Programs (SFAP) by 14 FTE. The reduction of 14 FTE left SFAP with very little flexibility to provide additional FTE for cash management activities.

The functions of the Direct Loan Task Force Accountability and Reconciliation Team were transferred to AFMS in the fall of 1997. OPE management made the determination that it was unable to divert resources from other critical SFAP activities to support the monitoring of Direct Loan cash management. Thus, no FTE slots have been transferred to AFMS for this purpose, and the function is not adequately staffed. However, some efforts were made to accommodate this activity, including the transfer of two Direct Loan Task Force employees to AFMS to help support the AFMS Direct Loan Program operational coordination and management activities, including monitoring cash activity. Prior to their transfer, these two employees were extensively involved in and provided leadership to the Direct Loan Task Force for cash management and reconciliation activities.

Recommendation 2.3. *Incorporate the proposed cash analysis methodology, in Appendix B,*

*into the Accounting and Reconciliation Team's monitoring process.*

Response. The AFMS Program Operations Team will evaluate various cash balance calculations, including the proposed methodology included in Appendix B of the draft report. A reasoned cash balance calculation will be incorporated into the guidelines and procedures the AFMS Program Operations Team uses to monitor cash management activities.

Recommendation 2.4. *Develop standards indicating when a cash analysis should be performed on site at a school and by whom.*

Response. AFMS will work with IPOS to develop standards to determine when a cash analysis should be performed on site and procedures for IPOS to use during a site visit to analyze a school's cash position.

Recommendation 2.5. *Require the responsible components to establish policies and procedures governing how the Client Account Managers and the Accountability and Reconciliation Team interact.*

Response. The AFMS Program Operations Team and the CAMG meet weekly to discuss and evaluate school performance issues. Policies and procedures are being developed in this and the Direct Loan Cross-cutting Issues Workgroup forums. (See response to Recommendation 2.6 below).

Recommendation 2.6. *Require the responsible components to develop guidelines as to when technical assistance ends and compliance becomes the issue.*

Response. The areas in OPE responsible for oversight activities have worked together for several years to monitor school performance. As the program has matured in the last year, and many functions have been reintegrated into other parts of SFA from the DLTF, these units have been working together in a routine manner on performance monitoring. The Direct Loan Cross-cutting Issues Workgroup, with representatives from the CAMs, the AFMS Program Operations Team and IPOS, will serve as the forum in which guidelines will be developed to determine when technical assistance ends and compliance action is needed. This group will develop procedures for coordinating the handling of school compliance and performance issues, both among the various functional areas at ED and with the contractors involved in the origination and servicing of Direct Loans. The AFMS Program Operations Team and IPOS will meet regularly to discuss specific schools that may need IPOS review.

Recommendation 2.7. *Reestablish the Direct Loan Quality Assurance (QA) Program guidance and make the program a priority.*

Response. From the inception of the Direct Loan Program, the Department has taken a non-prescriptive approach to the QA requirement. Given that many quality controls were inherent in the structure of the program, such as edits built into EDExpress, and operating on the knowledge that costs to schools would rise if they did not do things right and have adequate tools to track

performance, the Department opted to provide tools and guidance, but make their use voluntary. Although the initial QA guide has expired, the Department has updated it annually and offered it as one of several options a school may choose to meet the statutory requirement. This specific guidance was provided to Direct Loan institutions in DL Bulletin 97-13, April 1997. The DLTF plans to reissue this guidance for the 1998-99 award year (Year 5). The draft of the Direct Loan Training materials and school guide have been updated accordingly for Year 5. The OIG's draft report entitled "Administration of the William D. Ford Federal Direct Loan Program in Schools," contained a related finding (Finding No. 8, Schools Did Not Implement A system of Quality Assurance). OPE has provided, and will continue to provide, guidance in this area.

Recommendation 2.8. *Train Client Account Managers to be quality assurance program consultants who can provide hands-on assistance to schools.*

Response. We do not concur with the recommendation as stated, as we believe the CAMs are currently able to provide such assistance.

The CAMs currently provide hands on assistance to schools on all aspects of the Direct Loan Program. They are familiar with the Direct Loan QA requirements and the Direct Loan QA guidance furnished to the schools by the Department. CAMs provide training to schools on Direct Loan QA requirements and the QA Guide at Direct Loan EDExpress sessions. CAMs assist schools with process improvement in the course of providing on-site technical assistance to schools and assist schools with quality assurance program implementation upon request.

The Department will continue to provide overall leadership in the development of the system, but believes overall improvement of data quality and system enhancements are a more cost effective use of limited resources.

Recommendation 2.9. *Require the Institutional Participation and Oversight Service to develop a method for assuring that Direct Loan schools receive adequate coverage by the case management teams.*

Response. It should be noted that the new case management approach for school oversight in OPE has strengthened compliance management significantly, allowing OPE to focus on-site compliance activities on cases where the need for strong scrutiny exists.

The inclusion of Direct Loan data into the Risk Management System will help focus attention on Direct Loan schools where the Direct Loan data indicates there is a problem. Also, the Cross-cutting Issues Workgroup is a step in ensuring appropriate oversight for Direct Loan schools. OPE does not agree that more program reviews need to be done by IPOS just for the sake of doing reviews, but we do agree that IPOS will do program reviews where data analysis tells us they are needed.

Recommendation 2.10. *Require the Institutional Participation and Oversight Service to expedite inclusion of school level Direct Loan funding data into the risk analysis system.*

Response. The AFMS Program Operations Team will be providing financial data to IPOS for inclusion into the Risk Management System.

In November 1997, the Data Management and Analysis Division (DMAD) met with AFMS, and obtained Direct Loan gross commitments for all participants since inception, as well as the 790 report data (school cash activity) for the period 3/1/97-11/30/97. For reasons cited in the OIG draft report, DMAD was not able to obtain complete school reconciliation and/or cash management data. The data that were provided were forwarded to the DMAD contractor for analysis. Independently, the Direct Loan gross commitments were provided to the case management teams for use in researching cases. DMAD will continue to work with others in SFA on the enhancement of the Risk Management System for Direct Loans.

Recommendation 2.11. *Require the Institutional Participation and Oversight Service to develop a process to periodically review origination levels of Direct Loan schools as data becomes available. This process should define the data elements and the sources of data that would enable the Department to take the necessary actions to review origination levels.*

Response. IPOS already has some triggers in place that result in a review of and changes in origination levels (see "A" below), and there are plans to expand these triggers (see "B" below).

#### A. CURRENT TRIGGERS/REVIEWS

School Selection staff in IPOS already routinely perform reviews of origination levels of Direct Loan schools, and will continue these automatic reviews to ensure that new information which may affect the origination levels of currently participating schools is analyzed. The following are examples of established triggers for origination level reviews:

- 1) When a school that participates in the Direct Loan Program is placed on reimbursement School Selection staff automatically change the school to standard origination if it is currently participating under full origination.
- 2) When a Direct Loan school undergoes a change-in-ownership (CIO), School Selection staff review the school's origination level. Since the beginning of FY 98, School Selection has reviewed 42 Direct Loan Program schools which have undergone a CIO.
- 3) When the AFMS Program Operations Team determines that a school's origination level should be reduced, based on a review of the school's cash management, the School Selection staff takes action.
- 4) When schools request a review of their origination level School Selection staff research to determine if level changes are warranted. During the past 15 months, School Selection staff have performed special origination level reviews on approximately 100 schools. Of these, 62 schools have had their levels changed, 32 schools were kept at their existing level, and 6 are pending further review.

## B. EXPANSION OF TRIGGERS/TARGETING

- 1) IPOS School Selection staff plan to match all Direct Loan Program schools against the new FY 95 cohort default rates (CDRS) to ensure that any Option 2 school with a high default rate is changed to standard origination. The threshold level has not been determined, but the plan is to factor in the FY 95 CDR with the FY 94 and 93 rates.)
- 2) School Selection staff are exploring the use of the newly developed IPOS Risk Management System to determine if any Direct Loan Program schools score high on the risk analysis factor list. School Selection staff will ask IPOS Case Management Teams for more specific information on the schools in question. Also, if a Case Management Team determines that any Option 2 school has a serious problem, based on available data and analysis, School Selection will, at minimum change the origination level to standard. School Selection staff recently took risk analysis training to better understand how Case Teams use the Risk Management System.
- 3) School Selection staff are also planning to examine schools in the Direct Loan Program that recently have been provisionally recertified by Case Teams. If any Option 2 schools fall into this category, they will be reevaluated and the origination level changed to standard if appropriate.
- 4) School Selection staff plan to request a list of all Direct Loan Program schools which have current missing audits; if a full origination school has a current missing audit, School Selection staff will reevaluate that school's origination level.
- 5) School Selection staff participate in the Direct Loan Cross-cutting Issues Workgroup. This group determines effective courses of action for ED to pursue for those Direct Loan schools that have problems/issues. It is establishing standard procedures for determining when school problems should be referred to IPOS for action, including changing a school's origination level.

### **Finding 3**

#### ***Eliminating Controls Over Data May Cause Future Problems***

##### **General Comments**

The auditors\* assessment that the reconciliation process that will be in effect for the 1998-99 processing year will eliminate controls over data is invalid. In fact, it is OPE and the CFO\*s belief that the new process will enhance controls. On a monthly basis, schools will receive the Direct Loan School Account Statement (DLSAS) which will provide a summarization of all drawdown and disbursement activity, as well as an ending cash balance. The DLSAS will also provide detail information for disbursement and drawdown activity. Schools will be required to reconcile this information to their internal records. The new process will not add any burden to the schools, as schools will be provided with the necessary information and tools to assist in the reconciliation process.

The total of the ending cash balances provided to all schools on all DLSASs is designed to agree with Department\*s general ledger advance account cash balance. When fully staffed, the AFMS Program Operations Team will use this information to monitor schools\* cash management by reviewing cash balances on a regular basis and addressing consistently high balances.

The report stated that the detail records between the schools and the LOC do not always match, but there were no examples presented in the finding and the magnitude of the problem was not addressed. Nor did the report address the cause of the problem. We have not identified any instances where the acknowledgment record from the LOC did not match the record submitted.

We disagree with the premise that the only way to provide an incentive to schools for timely, accurate reporting of disbursements is to tie disbursements to drawdowns. The DLSAS will provide this incentive by reflecting the school\*s ending cash balance and requiring that schools reconcile their internal records to the DLSAS. The AFMS Program Operations Team will be monitoring these cash balances. Schools with consistently high cash balances will have the necessary corrective action taken by either the AFMS Program Operations Team or IPOS. This will provide schools with the incentive to make sure their internal records reconcile to the DLSAS. Additionally, in order for schools to close out an award year, schools must ensure that they have a zero ending balance on their DLSAS.

##### **Response to Recommendations:**

**Recommendation 3.1.** *Reinstate the data matching requirement for all transactions for each loan.*

**Response.** We do not concur with this recommendation. The problem with the data match process is that it compares only those records that the schools sent to LOC; it cannot identify those records that the school did not send, or those records whose dates or amounts were reported incorrectly. As a result, the data match process cannot ensure that the school accurately

submitted all disbursement records on its system. The data match process is basically a verification of data that the school has already sent to the LOC and which has been previously verified through the acknowledgment process. The acknowledgment includes not only affirmation of the acceptance of the record by the LOC but also provides to the school verification of the amount disbursed to date on each loan. The acknowledgment process provides the quality assurance check referred to in the Department's 1996 financial statement audit.

OPE and the CFO believe that the reconciliation process that has been developed for 1998-1999 provides more appropriate financial controls for the Department and more useful information to assist the Department and schools in managing Direct Loan funds. With the new DLSAS reconciliation process schools will receive a monthly summary of all transaction activity, as well as an ending cash balance which will be reconciled to the Department's general ledger account identifying Direct Loan advances to schools. Using this information a school will be able to compare its internal records with the information provided and perform accurate reconciliations. Using these tools, a school would be able to quickly identify those situations that require it to provide additional documentation to the Department or return excess cash. In addition, the Department will be better able to focus its resources on cash management activities because it will not have to provide support for an ineffective process.

Coupled with the plan to provide an infrastructure for Certified Public Accountants (CPAs) to allow them to obtain confirmations from the Direct Loan Servicing System on loan activity when they are performing compliance audits, and the requirement for the CPA to review the school's reconciliation process, we believe that this new process will provide the assurance that all disbursements have been recorded against the advance amounts for which schools are responsible.

Recommendation 3.2. *Develop a reconciliation process which will associate each cash drawdown to specific disbursement and excess cash activities.*

Response. At this time, SFA does not plan to make changes to implement this recommendation for all schools. The finding does not contain any specific evidence which supports the need to implement the new process described in this recommendation. However, it is important to note that SFA is moving toward a common origination and disbursement system that would tie drawdowns by schools to specific actual disbursements reported by the institutions. This is also part of the EASI vision. In addition, the Year 6 origination and disbursement process is being developed to support a Just-in-Time drawdown process that will be supported by specific or actual disbursements reported by schools.

The current plans are to continue to support an advance funding mechanism, and we believe that the ending cash balance on the DLSAS will reflect whether the school has accounted for all drawdowns during that monthly period through the submission of disbursement records or the return of excess cash. In essence, the DLSAS will tie total drawdowns to disbursements on a monthly basis, and it should provide much more meaningful information to the Department than could be accomplished if the reconciliation process required disbursements to be tied to specific drawdowns.

The Direct Loan Schools Account Statement will clearly indicate to a school its ending cash balance and the monthly transactions that result in that balance. By the monthly reconciling of a school's internal records to the DLSAS, a school will be able to determine those situations where it needs to submit disbursement records or return excess cash.

EXHIBIT 2

September 4, 1998

Carol S. Lynch  
Regional Inspector General for Audit  
U.S. Department of Education  
100 Alabama Street, Room 18T71  
Atlanta, Georgia 30303

Dear Ms. Lynch:

Thank you for the opportunity to review and comment on the Office of Inspector General's (OIG's) revision of Finding 3 and accompanying recommendations that were included in your draft report entitled, Review of the Department's Oversight of Schools Participating in the William D. Ford Federal Direct Loan Program (ACN 04-70016), dated July 1998. We also found the discussion with you and other OIG staff on August 5, 1998, to discuss revised Finding 3 and the Department's approach to a responsive solution, to be beneficial. As you requested at that meeting, we are providing a written response to the revised finding.

In the draft audit report, Finding 3 was entitled, "Eliminating controls over data may cause future problems." Recommendations included with the finding were:

- 3.1 *Reinstate the data matching requirement for all transactions for each loan.*
- 3.2 *Develop a reconciliation process which will associate each cash draw down to specific disbursement and excess cash activities.*

The revised title for Finding 3 is, "Lack of loan level matches decreases control over data reliability." The revised Recommendation 3.1 is as follows:

- 3.1 *"Conduct periodic (i.e., every six months) data verification for all transactions by comparing selected school's loan level information with that of the Direct Loan Servicer. This data verification process should be used as an interim measure until OPE has assurance from the CPAs' school audits that the loan level data is accurate and schools are performing internal reconciliations."*

I appreciate the time and effort you and your colleagues have expended to research the issues and listen to our comments and concerns. As we discussed at our recent meeting, in order to address the revised Recommendation 3.1, the Department proposes to include steps in the program review process for the comparison between loan-level information at a school and the Direct Loan Servicer. Thus, when the Case Management Teams select a Direct Loan school for an on-site program review, the institutional reviewer will ascertain whether the information contained

Page 2 - Carol S. Lynch

in the Direct Loan Servicer's records is supported by and accurately reflects information in the school's records for selected students.

Recommendation 3.2, which was not revised, follows:

- 3.2 *Develop a reconciliation process which will associate each cash drawdown to specific disbursement and excess cash activities.*

As we have indicated previously, we do not agree that we need to develop such a reconciliation process. It would place a great and unnecessary burden on Direct Loan schools under the current funding options and EDExpress software. Further, a Just-in-Time funding process is being discussed under Project EASI and will be an option in the future, although funding was not available to support this new process in the systems budget for FY 1999. Such a process will relate disbursements to drawdowns: we will not need another reconciliation process.

We do have some additional, remaining concerns. First, based on language in the title of the finding and in the finding itself, OIG continues to believe the Department needs to maintain a school-to-Department loan level verification requirement. We believe loan-level verification is unnecessary if a school is able to reconcile its data using the Direct Loan School Account Statement (DLSAS). If a school is having difficulty reconciling, it has the option of requesting loan-level data from the Direct Loan Origination Center. Second, we note that Year 2/3 closeout information provided in the report is inaccurate; we are working with accounting for less than 0.2 percent of all drawdowns for Years 2 and 3. Further, the revised finding cites a 68 percent disbursement and adjustment date error rate contained in a related OIG audit report, "Administration of the William D. Ford Federal Direct Loan Program in Schools", issued in October 1997. That error rate is due to schools not reconciling their student accounts to the system or software that sends Direct Loan records to the Loan Origination Center. Data matching never caught those kinds of errors.

Again, thank you for the opportunity to provide additional comments. We believe our approach will ensure both accountability of public funds and the best use of resources. If you have any questions, please contact Linda Paulsen at (202) 708-4664.

Sincerely,

**(Signed Letter on file in Area office)**

Diane E. Rogers  
Acting Deputy Assistant Secretary

cc. Robert Seabrooks  
Pat Howard

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