
Assessment of
Direct Consolidation Loan Program
Administration and Operations by EDS, Inc.
Since December 1, 1997

FINAL AUDIT REPORT



Audit Control Number: 04-80009
May 1999

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

NOTICE

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TABLE OF CONTENTS

	<u>Page</u>
Executive Summary	i
Background	1
Audit Results	2
Finding No. 1 - All Required Standards and Reports in Modification No. 21 Not Timely Implemented and May Require Further Modification	2
Recommendations	5
Finding No. 2 - Discrepancies Noted in Data Used for Tracking and Billing Purposes	7
Recommendations	9
Purpose and Objectives	12
Scope and Methodology	12
Statement on Management Controls	13
Appendix 1 - Glossary of Technical Processes/Terms	
Attachment 1 - EDS' Comments	

EXECUTIVE SUMMARY

Federal Direct Consolidation Loans are being processed more efficiently (timely) by Electronic Data Systems, Inc. (EDS) since implementation of the revised consolidation process on December 1, 1997. Performance standards required by Modification No. 21 to the Loan Origination Subsystem (LOS) contract have now been developed. Performance reports for measuring the standards, which are also required by Modification No. 21, have been developed and are in production. For the most part, standards included in Modification No. 21 are being met. We did, however, note the following in our review:

- ! Implementation of required standards was delayed, including standards for system balancing and reconciliation. In addition, all tracking reports were not timely submitted to the Department; some required modification to determine whether standards were met; and some still may not be capturing needed information. These conditions have provided untimely or decreased assurance to the Department that performance standards established under the contract were being met.
- ! Some discrepancies existed in the data and calculations used for tracking and billing purposes. Mainly, discrepancies were noted for application receipt and funding dates between EDS' system and billing reports to the Department. Also, deactivation periods were overstated, and other deactivation/reactivations discrepancies were noted. These conditions may have resulted and can result in inaccurate billings and performance tracking reports.

Therefore, in order to address the issues identified above and assure a more efficient and effective Federal Direct Consolidation Loan Program, the Department needs to ensure that:

- o All future requirements for performance and tracking are timely and adequately implemented by EDS and that current tracking reports are capturing needed information.
- o Unresolved data discrepancies are corrected by EDS and adjustments are made to correct billings. Any required system changes should also be made to assure the accuracy of future billings and that borrowers are fully aware of their application statuses when deactivations occur.

EDS' response to our draft report is included as Attachment 1 to this report. Based on the comments received, changes have been made from the draft report to the final report where deemed appropriate by the OIG. Some comments are specifically addressed after each finding. Other comments will need to be addressed with the Action Official through the audit resolution process.

In addition, this report covers technical processes and terms involving Federal Direct Consolidation Loans. To enhance the understanding of readers unfamiliar with these processes and terms, a glossary of technical processes and terms is included as Appendix 1 to this report.

BACKGROUND

In July 1995, the Department of Education (the Department) awarded Electronic Data Systems, Inc. (EDS) a contract to develop and operate, by January 15, 1996, a Loan Origination Subsystem (LOS) for the William D. Ford Federal Direct Loan Program. The contract included a requirement for the origination of Federal Direct Consolidation Loans, where a borrower may combine his/her student loans into one loan and have the convenience of only one monthly statement, one monthly payment and one point of contact. The Department targeted 60 to 90 days to complete the consolidation process. EDS agreed to consolidate loans at approximately \$27 per unit.

Although EDS was to start consolidating loans in January 1996, start-up delays were experienced, and EDS did not start consolidating loans until September 16, 1996. Shortly after start-up, EDS began experiencing processing problems, resulting in untimely loan consolidations and inaccurate payoffs of loans to be consolidated. By August 1997, a significant backlog of approximately 85,000 consolidation applications existed at EDS. On August 26, 1997, the Department instructed EDS to stop accepting new consolidation applications until processing problems could be addressed. Modification No. 17 to the EDS/LOS contract was negotiated to clear up this backlog of applications.

While the backlog was being cleared, EDS and the Department also began to develop a new consolidation process and negotiate incentive-based pricing provisions. On December 1, 1997, EDS began accepting new consolidation loan applications under a revised consolidation process. The new process implemented a higher level of application review and instituted an underwriting process prior to funding and booking.

On January 27, 1998, Modification No. 21 to the EDS/LOS contract was finalized. The Modification re-priced consolidations and incorporated or required the development of a number of performance standards, mainly focusing on timeliness, to be applied to the new consolidation process which began on December 1, 1997. The Modification also required EDS to develop, no later than March 1, 1998, performance measures and a method of tracking/surveillance for use by the Department in determining whether performance standards were met and for billing purposes. EDS did provide the Department with the proposed measures and tracking methods, and EDS began being held accountable for meeting the performance standards contained in Modification No. 21 on April 1, 1998.

AUDIT RESULTS

Our review of EDS' revised Federal Direct Consolidation Loan process implemented on December 1, 1997, revealed that loans are being consolidated more timely than in previous periods. Previously, loans were consolidated in an average of 142 days. During the period from December 1, 1997, through June 30, 1998, EDS completed regular and in-school consolidations in an average of 56 days and completed fast track consolidations in an average of 14 days. In addition, our review of the implementation of Modification No. 21 requirements -- performance standards, measures, and tracking methods -- revealed that all standards have now been developed. Reports for measuring performance have been developed and are now in production. For the most part, EDS has been meeting standards established in Modification No. 21. We did, however, note the following in our review:

- Ö Implementation of required standards was delayed, including standards for system balancing and reconciliation. In addition, all tracking reports were not submitted timely to the Department; some required modification to determine whether standards were met; and, some still may not be capturing needed information.
- Ö Some discrepancies existed in the data and calculations used for tracking and billing purposes. Mainly, discrepancies were noted for application receipt and funding dates between EDS' system and billing reports to the Department. Also, deactivation periods were overstated, and other deactivation/reactivations discrepancies were noted.

EDS has taken some action to address the conditions noted above. However, further action is needed to ensure that: all future contract requirements for performance and tracking are timely and adequately implemented; current tracking reports are capturing needed information; and unresolved data discrepancies are corrected and adjustments are made to correct billings.

Finding No. 1 - All Required Standards and Reports in Modification No. 21 Not Timely Implemented and May Require Further Modification

Modification No. 21 was finalized on January 27, 1998. The modification incorporated a number of performance standards and pricing incentives/deductions to be applied to the revised consolidation process implemented by EDS on December 1, 1997. The modification, in part, required EDS to establish a process for tracking performance standards and reporting the results

to the Department and required the development of additional standards for balancing and reconciliation. We noted that the EDS was not held accountable for meeting standards until April 1, 1998, and that system balancing and reconciliation standards were not submitted to the Department until November 23, 1998. In addition, we noted that some tracking reports were untimely, required modification, and/or may not be capturing required or correct information.

Standards Not Timely Applied

Although Modification No. 21 applied to consolidation processing that began on December 1, 1997, it was not finalized until January 27, 1998. EDS was required to have draft performance criteria to the Department for review 3 business days after January 27th, or February 1, 1998. The Modification required EDS to have software for tracking the performance standards operational 30 days after criteria was fully developed or March 1, 1998, whichever was later. Agreed upon criteria was not finalized until March 1998, and EDS was not held accountable for meeting Modification No. 21 standards until April 1, 1998 -- 4 months after consolidation processing began. Modification No. 21 also required EDS to propose performance standards for system balancing and reconciliation no later than the due date for completion of Phase 1 of the System Balancing and Reconciliation task order that was in progress at the time of negotiations for the Modification. System balancing and reconciliation standards were not submitted to the Department until November 23, 1998. Timely implementation of established standards would have provided more timely feedback to the Department in determining whether the revised consolidation process was working and in determining the adequacy of EDS' system balancing and reconciliation process.

Tracking Reports Not Timely Submitted/Required Modification/Not Capturing Required Information

Modification No. 21 required EDS to develop tracking methods for determining whether or not performance criteria contained in the Modification are met. The agreed upon time frame for having the tracking methods in place was April 1, 1998, so that EDS could submit the reports with the April 1998 invoice. EDS had developed, and the Department approved, the report formats for tracking prior to April 1, 1998. However, EDS officials stated that some of the reports would not be ready for submission with the April 1998 billing (to be submitted in May 1998) since methods for capturing needed information were still being developed. Subsequent review of invoices beginning with the month of April revealed that the invoice was submitted late, some tracking reports did not capture information needed for monitoring standards and required modification, and some still may need to be revised to capture required/correct information.

Invoices with Tracking Reports Submitted Late, Excluded Some Reports

As noted above, EDS was to be held accountable for meeting Modification No. 21 standards as of April 1, 1998, and tracking reports for measuring the standards were required with the April 1998 invoice. The April 1998 invoice, however, was not submitted to the Department for review and payment until mid-August 1998. In addition, two of the required reports -- CN and ICR reports -- were not included. CNs and ICRs are transactions that are created when certain borrower information is sent back and forth between EDS and the Direct Loan Servicer. The CN and ICR reports indicate the percentage of all CN/ICR transactions completed within 14 days of receipt. Both of the reports were included with the May 1998 invoice, which was submitted to the Department in late August 1998.

The late submission of the April 1998 invoice and tracking reports made it difficult for the Department to readily determine whether EDS was performing at established performance levels for the 4 months between May and August as required in Modification No. 21. Likewise, the Department has no assurance that EDS met the CN and ICR standards for April 1998 since the reports were never submitted.

Reports Not Capturing Complete/Correct Information for Tracking

During our review, we noted that EDS was not capturing complete/correct information for at least one report -- the Borrower Complaint Log. In addition, we have concerns over the logic used for reports that indicate the percentage of regular/fast track applications completed within the standard processing time of 80/38 days.

Borrower Compliant Log. Modification No. 21 requires EDS to resolve at least 90 percent of borrower complaints (inclusive of Department referred complaints) within 14 days, with no resolution taking more than 30 days. The requirement states that the standard applies to complaints resulting from systematic or processing conditions or errors caused by act or fault of EDS or the system.

EDS developed a borrower complaint log to measure whether it meets this standard. However, EDS initially only captured borrower complaints within a given month, with no report to indicate follow-through to determine resolution -- i.e. if a complaint was received during the last week of the month and was not yet resolved, the resolution was not going to be reported on the next month's report. In addition, EDS initially was only recording borrower complaints if a borrower threatened legal action, threatened to call the Department or their Congressional representative, or targeted a specific Customer Service Representative. We noted that EDS recorded only 22 customer complaints in April, May, and June 1998, and reported that the standard had been met -- complaints had been resolved in 14-30 days.

The Department subsequently required EDS to revise its procedures to record all borrower complaints as defined in the Modification and required that the tracking report (Borrower Complaint Log) be revised to reflect follow through resolution. However, for the 3 months -- April, May, and June 1998 -- the Department has no assurance that EDS met Modification No. 21 standards for borrower complaints as they were not properly recorded/reported.

Percentage of Loans Processed under 80/38 Days. Modification 21 stipulates that 90 percent of all regular consolidation applications shall be processed within the standard 80 days and that 90 percent of all fast track applications shall be processed within the standard of 38 days. The tracking reports included with EDS' invoices for April and May 1998 indicated that the standards were met.

We noted that EDS uses, as a basis of reporting applications that were processed, loans that booked for the first time, as well as, deactivated, withdrawn, or canceled applications within the month. According to EDS, the number of days to process does not include any deactivation periods; any delay days incurred because a loan is added after certification completion, but before a Promissory Note is issued; or any delay days derived from CN and CR processing in excess of the allowable response periods.

We believe, however, that the method used by EDS in calculating the percentage of processed applications is not reflective of the intent of the standard. The 80 days referred to in the standard is the target processing time for an application that is booked -- not for applications that are deactivated, withdrawn, or canceled. Therefore, these applications should not be included in EDS' calculation. We noted for regular applications that booked for April and May 1998, that only 86 percent and 82 percent of the applications were consolidated in 80 days or less -- not more than 90 percent as reported by EDS based on their method.

RECOMMENDATIONS

To ensure full compliance with Modification No. 21 and to ensure a more efficient and effective Federal Direct Consolidation Loan process, we recommend that:

1. The Department take steps to assure that contract requirements, including development of standards and tracking reports, are timely and adequately implemented in the future. EDS should be held accountable when such time frames are missed, if EDS is deemed to be at fault.
2. EDS and the Department reconsider the approved method for calculating the percentage of loans completed within 90/38 days to assure that the methodology used is reflective of the intent of the standard. The 80 days referred to in the standard is the target time frame for consolidating a loan -- not deactivating or canceling a loan.

EDS' COMMENTS

EDS' comments to Finding No. 1 are included in Attachment 1 to the report. A number of the comments explained why the conditions occurred. Other important comments provided in response to Finding No. 1 include the following (in summary):

- System Balancing and Reconciliation standards were provided to the Department on November 23, 1998. All system changes supporting production and tracking have been made. The requirements have been tested and validated and have passed all tests to date. EDS believes it is in full compliance with the requirements.
- Procedures for tracking borrower complaints will be updated and included in the March update of the LOC manual. The report currently being used reflects data being recorded for borrower complaints to demonstrate compliance with Modification No. 21.
- EDS' feels the method used for calculating the percentage of loans completed within 80/38 days is appropriate because it takes the sum of all loans received in a given month into account and reflects that a loan must be processed to a logical conclusion before it is considered completed. Also, the standards were reviewed by the Department and were jointly approved.

OIG's RESPONSE

The final report was modified to address EDS' comments. Specific to the comments noted above, we changed the following from the draft report to the final report:

- The condition for non-implementation of System Balancing and Reconciliation standards was changed to reflect that the standards were not implemented timely and the applicable recommendation was changed accordingly.
- The condition related to borrower complaints remained the same, but the recommendation specific to borrower complaints was removed.
- No changes were made regarding the condition related to the method used for calculating the percentage of loans completed within 80/38 days. It is our opinion that the

standard is meant to reflect consolidated applications and not deactivated, withdrawn, or cancelled applications.

Finding No. 2 - Discrepancies Noted in Data Used for Tracking and Billing Purposes

Modification No. 21 required that "EDS shall consolidate loans from receipt of an application through funding, booking, and transfer to the Central Data System." The Modification also allowed for consolidation application deactivations and reactivations. EDS, for invoicing purposes and tracking purposes, prepares a report entitled "Initial Booking Detail Listing Report" that provides a detail listing for fast track and standard applications that are booked for the month. The report includes the date of receipt of the application, the date first booked to the servicer, elapsed days to book, number of days deactivated (reactivation date minus deactivation date of the application), and total processing days to booking (elapsed days minus number of days deactivated). The total processing days to booking is the date used to calculate the rate to pay for the consolidation -- base rate of \$71 for the standard number of days, plus incentive/deduction. Modification No. 21 also allows EDS to claim \$27 for a deactivated application. However, the amount paid for the deactivation is credited back if the application is reactivated within 120 days. Our review of the data used for reporting with respect to the application receipt date and the booked date indicated discrepancies in what was reported and what was indicated on EDS' system. In addition, discrepancies were noted in reported deactivation periods and actual deactivation periods, and other deactivation/reactivation discrepancies were noted.

Discrepancies Noted With Application Receipt/Booked Dates

Our review of a random sample of invoiced/booked consolidations, from January and March 1998, revealed the number of days to process as reported/billed did not agree with our calculation of days based on our review of EDS' files. Based on our review, discrepancies were noted in 140 of 185 loans (or 75 percent) reviewed. We noted that the application receipt date per the date stamp on the loan application preceded the application receipt date per EDS' invoice. In addition, we noted that the booked date per the invoice preceded the booked date per the EDS/LOS funding detail screen. We were told by EDS staff that possible causes for the discrepancies were: (1) the application receipt date per the invoice represented the date an application was imaged; or (2) the booked date per the invoice represented an initial funding date or interim funding date rather than the last funding date (the date the last loan to be consolidated was paid off).

Based on our recalculation, we determined that total days to process was understated by 337 days for the items included in our sample, which resulted in a \$235 over billing to the Department based on the terms in Modification No. 21. If applied to the population for the 2 months reviewed, the over billed amount could be as high as \$14,731. If this practice continues, the amount of over billing could significantly increase as application volumes increase.

Discrepancies Noted With Deactivation Periods

In May 1998, EDS began to reduce elapsed days to consolidate by the number of days a loan was deactivated. In our review of EDS' calculations for determining the number of days deactivated, we noted that the deactivation periods were overstated for some consolidations resulting in an understatement of days to consolidate for billing purposes. We determined that part of the reason for the miscalculations was a problem in the logic used in the calculation that did not account for

overlapping periods of deactivation for the same borrower. We recalculated the number of days to consolidate for loans with deactivation periods included on the proposed billing reports for May and June 1998. Our recalculation revealed potentially overstated billing amounts of \$1,125 for the two months, representing 114 consolidations, because of overstated deactivation days. During our review work, EDS officials took action to address this issue. If this issue had not been brought to EDS' attention, future billings would have been affected resulting in more significant over billed amounts. In addition, EDS subsequently corrected/adjusted billings since December 1, 1997.

Other Discrepancies Noted with Deactivations

In comparing loan deactivation/reactivation information with booked loan information provided by EDS, we noted the following conditions as of June 30, 1998, which may have or could have an impact on tracking and billing reports:

- There were 163 instances where the same application ID has been reported and billed for a booked loan, but also had been reported and billed for a deactivation (excluding deactivations which have been reported as a reactivation).
- There were 332 instances where the same application ID was reported for a booked loan and a reactivation (but not as a deactivation).
- There were 370 instances where EDS reported the same application ID more than once as a deactivation and did not refund the overcharge with a reactivation.

In addition, in our review files for 30 borrowers with deactivated applications in February 1998, we noted that 29 files did not contain complete documentation to fully support deactivation status. Four included dates on the monthly detail report that were 3 to 34 days earlier than the dates supported in the LOS Loan Consolidation Borrower File Screens. None of the borrower files contained copies of letters to borrowers of Notice To Deactivate.

Reactivation status was warranted for nine of the deactivated borrower files, yet the nine files did not contain adequate documentation to fully support reactivation status. One of nine lacked any reactivation support, even though the application was reported as being reactivated, per the Deactivation / Reactivation Report for February 1998. According to the report, five of the nine reactivations occurred on the day of deactivation.

System limitations or incomplete case notes as entered by Customer Service Representatives excluded some of the information from borrower files necessary to fully support deactivation and reactivation statuses. It was noted that Letters of Notice To Deactivate are system generated and EDS officials stated that is why a copy is not maintained. It was noted also that from December 1, 1997, to May 15, 1998, reported deactivation dates were improperly captured. After that time, deactivation/reactivation dates and reasons for deactivations/reactivations began to be captured separately in the system and the problem was eliminated. Prior to that time, however, there is no assurance that deactivations and reactivations were properly recorded.

RECOMMENDATIONS

To increase data accuracy for tracking and billing purposes and to ensure a more efficient and effective Federal Direct Consolidation Loan process, we recommend that the Department require EDS to:

1. Ensure that actual booked dates are used for reporting and invoicing purposes.
2. Review and correct invoices since December 1, 1997, to reflect actual application receipt and booked dates and make proper billing adjustments.
3. Ensure that dates listed on the Monthly Deactivation/Reactivation (detail) Report agree to dates supported on the LOS borrower files - the Application Detail Screen, the Certification Detail Screen, and/or the Borrower Detail screen. Borrower files should contain sufficient evidence to verify that borrowers are properly notified of the status of their application when deactivations, reactivations, or cancellations occur. Implementation of this recommendation may require a Design Modification Request from the Department.
4. Review OIG provided schedules of exceptions for instances where discrepancies were noted between loan deactivation/reactivation information as compared to booked loan information and determine their impact on funding and booking. Adjustments should be made where appropriate.

EDS' COMMENTS:

EDS' comments to Finding No. 2 are included in Attachment 1 to the report. A number of the comments explained why the conditions occurred. Other important comments provided in response to Finding No. 2 include the following (in summary):

- Regarding the use of actual receipt dates, EDS agrees that actual receipt date should be used and stated that changes have been made to assure that this date is captured by assuring all applications are scanned/imaged the day they are received. These changes occurred in the first quarter of 1998. Assurances are provided to the Department that this is occurring. EDS, however, does not agree that it should have to go back and correct existing application receipt dates since EDS was acting in good faith when the errors were occurring, with no intent to adversely impact the borrower or the Department; because this issue was immediately corrected upon clarification from the Department, with no request at the time to correct existing application receipt dates; and because the effort required would be disproportionate to the benefits to be incurred.
- Regarding application booked dates, EDS provides detailed explanations as to why final booked dates should not be used as the date in calculating time to consolidate. Part of the reasoning is because of supplemental loans and the fact that a borrower may change their mind regarding which loans to consolidate/not consolidate. According to EDS, the system does not currently support these capabilities.
- EDS has made a concerted effort to correct discrepancies with deactivation periods and has taken a number of steps to resolve all issues. A new process for tracking was developed to assure any automated deactivation updates tracking tables; system logic problems were corrected; and utilities were written to synchronize system application information with deactivation/reactivation tracking tables. After making the changes,

EDS re-ran billing reports from December 1997 forward.

-- Regarding other discrepancies noted with deactivations, EDS provided explanations as to how these “may” occur. However, no specific determinations were made and provided in their response as to the specific loans that were in our list of exceptions provided to EDS with our draft report.

OIG’s RESPONSE

The final report was modified to address EDS’ comments. Specific to the comments noted above, we changed the following from the draft report to the final report:

- The recommendation that the Department “ensure that actual receipt dates and final booked dates are used for reporting” was changed to “ensure that actual booked dates are used for reporting.” Modification No. 21 states that EDS will consolidate loans from application through funding, booking, and transfer to the Central Data System. A consolidation is not complete until all loans to be consolidated are booked.
- The recommendation to review and correct invoices since December 1, 1997, was not changed. The Action Official should decide if this is worth the effort considering all possible implications, including data integrity.
- Given that corrections have been made in the deactivation area, the recommendation that EDS review and correct invoices on which deactivation periods were subtracted and that system changes be made as required was removed.
- Given that specific determinations were not made regarding the noted discrepancies of booked loans, we added a recommendation that EDS review the schedule of exceptions provided with the draft report; make a determination of the impact on tracking and billing; and make appropriate adjustments.

PURPOSE AND OBJECTIVES

The overall objective of our review was to determine whether Direct Consolidation Loans were being processed efficiently and effectively by EDS, Inc., under the new consolidation process implemented on December 1, 1997. To achieve this objective, we focused our efforts on determining if the revised Loan Consolidation (LC) process was operational and achieving performance levels as prescribed by Modification 21 to the Loan Origination Subsystem (LOS) contract. It should be noted that, because Modification No. 21 contained few quality standards, our review was limited in determining overall quality of processed consolidations. As a result, we did not assess the overall effectiveness of the Federal Direct Consolidation Loan process.

We also performed limited work to determine: whether EDS' Data Correction Action Plan and Recycle File Action Plan for LC activity before December 1, 1997, were implemented timely and completed successfully; whether data problems are still occurring and, if so, what are plans for correcting the problems; whether issues identified by the ED Program Systems Service and ED Accounting and Financial Management Service before December 1, 1997, were addressed properly; and the intentions of the Department and EDS for further enhancements and / or changes to the revised LC process. The limited work in these areas provided no reportable conditions and are not addressed in this report.

SCOPE AND METHODOLOGY

To achieve the purpose and objectives, we reviewed documentation pertinent to the revised Federal Direct Consolidation Loan process that was implemented by EDS on December 1, 1997, as well as Modification No. 21 to the EDS/LOS contract and related documents, such as Design Modification Requests. We specifically reviewed processing policies and procedures, staffing, established consolidation standards, performance tracking procedures and reports, status reports and briefing documentation, and invoices to the Department. We observed selected consolidation operations for exam entry, imaging and retrieving, mailroom, data entry, certification, promissory note issuance, and funding and booking.

We reviewed information from EDS' Independent Quality Control Unit -- Price Waterhouse -- and interviewed IQCU officials as necessary. We selected samples of booked loan consolidations, cancellations, deactivations/reactivations and reviewed file documentation and confirmed selected information with borrowers, as necessary. We performed analyses on computer generated data, mainly related to booked loans and deactivated and reactivated applications. We reviewed data correction plans and issue reports covering periods prior to December 1, 1997, to determine their status. We interviewed EDS personnel, including managers and supervisors, as well as Department personnel from the Direct Loan Consolidation Team, Program Systems Services office, Office of Student Financial Assistance, as well as from Contracts and Purchasing Operations Office, Office of The Chief Financial Officer.

Our audit covered the period December 1, 1997, through September 23, 1998. We performed fieldwork at the EDS Loan Origination Center(s) in Montgomery, AL and Louisville, KY during

the months of March, April, and May 1998. We performed our audit in accordance with government auditing standards appropriate to the scope of the review described above.

Data Reliability Assessment

To achieve our audit objectives, we relied extensively on computer-processed data contained in databases at EDS. As part of our review, we assessed the reliability of this data including the relevant general and application controls implemented by the Contractor and the Department and found them to be adequate. We tested the accuracy, authenticity, and completeness of the data by comparing source records to computer data and computer data to source records. We did note discrepancies related to application receipt dates and booked dates as well as problems in the methodology related to the calculation of deactivation periods as discussed in the audit results section of this report. Based on these tests and assessment, we concluded that the data was sufficiently reliable to be used in meeting the limited assignment's objective.

STATEMENT ON MANAGEMENT CONTROLS

As part of the review, we assessed EDS's management control structure, written procedures and policies, as well as day-to-day operating practices applicable to the Federal Direct Consolidation Loan process after December 1, 1997. Our assessment was performed to determine the level of control risk for establishing the nature, extent, and timing of our substantive tests to accomplish the audit objectives. For the purpose of this report, we assessed and classified the significant management controls into the following categories:

- Loan Consolidation (LC) operations at EDS and the achievement of performance levels as prescribed by Modification No. 21 to the Loan Origination Subsystem (LOS) contract;
- Implementation and results of EDS' Data Correction Action Plan and Recycle File Action Plan;
- Potential re-occurrence of data problems and plans for correcting the problems;
- Status of the issues identified by ED Program Systems Service and ED Accounting and Financial Management Service prior to December 1, 1997;
- Intentions of the Department and EDS for further enhancements and/or changes to the revised LC process.

Because of inherent limitations, a study and evaluation made for the limited purposes described above would not necessarily disclose all material weaknesses in the control structure. However, our assessment disclosed weaknesses specifically related to (1) implementation of performance standards and reporting/tracking methods; and (2) data for tracking and billing purposes. These weaknesses are discussed in the "Audit Results" section of this report.

*Appendix 1**Glossary of Technical Processes/Terms*

<i>CN Transaction</i>	Consolidation Notification transaction. An electronic transaction that is sent from EDS to the Central Database System (CDS) for each borrower in the system requesting consolidation of a Federal Direct Loan. CDS creates a separate CN transaction to Direct Loan Servicing for each loan held by the borrower. Servicing electronically certifies the loans and returns responses for each CN to CDS, who then forwards the responses to EDS.
<i>ICR Transaction</i>	Income Contingent Repayment transaction. An electronic transaction, consisting of an image of a borrower's Income Contingent Repayment plan waiver request. The transaction is sent from EDS to the Central Database System for forwarding to the Internal Revenue Service for income verification. When the IRS responds, a transaction is sent back to CDS and is then forwarded back to EDS for use in processing the borrower's loan.
<i>Deactivated Application</i>	A consolidation application that is no longer actively worked by the contractor. Applications may be deactivated when the borrower does not respond to correspondence sent by the contractor within a predetermined turnaround time or the borrower requests cancellation of the application.
<i>Fast-Track Consolidation</i>	A consolidation of previously defaulted student loans that are held by contractors for the Department's Debt Collection Services. The contractors provide complete consolidation application packages (including certified pay-off amounts and promissory notes) to EDS for processing. The process takes less time than regular and in-school consolidations because communication is not required between EDS and lenders and EDS and borrowers.

Modification No. 21

Modification to the EDS/LOS contract that was finalized on January 27, 1998. The modification re-priced the per-unit rate EDS was receiving for consolidations and implemented consolidation performance standards. In the modification, the Department agreed to a base unit price of \$71 for every consolidation completed in 80 days (90 days from December 1, 1997, through February 28, 1998). The \$71 base unit rate would be increased by \$1 per day, up to a maximum of \$113 (\$123 from December 1, 1997, through February 28, 1998), for each consolidation completed in advance of 80/90 days and decreased \$1 per day, to a minimum of \$0, for consolidations completed in excess of 80/90 days.

Regular Consolidation

A consolidation of at least one fully disbursed Direct Loan or Federal Family Education Loan, neither of which is in an in-school period. Borrowers may also include other Student Loan such as Federal Perkins Loan and eligible health profession student loans. Applications for regular consolidations are initiated by the borrower. Unlike Fast-Track consolidations, communication must take place between EDS and borrowers as well as between EDS and lenders.

In-school Consolidation

A consolidation of Direct Loans or Federal Family Education Loans only. At least one fully disbursed loan must be in an in-school period. Applicants must meet the same requirements as for regular consolidations and certain other stipulations apply. These loans are processed in the same manner as regular consolidations.

System Balancing/Reconciliation

The balancing and reconciling of all financial transactions both internally within the Contractor's database and externally to each system with which it interfaces. Examples of balancing and reconciliation activities include: cash receipts and cash disbursements to related activity - loans booked, canceled, etc; electronic transfers and checks to Treasury confirmations; and resolution of returned payoff checks.

Reactivated Application

A consolidation application that was previously deactivated, subsequently reactivated and is being actively worked by the contractor. A reactivation normally occurs at the request of a borrower or when a response to previously requested information is received from the borrower after a pre-determined turnaround time has passed. Reactivations may occur within 120 days of the last deactivation of an application. Once the application has been aged, the application cannot be reactivated.

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