Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers

FINAL AUDIT REPORT

ED-OIG/A04E0009
September 2006

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

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

400 MARYLAND AVENUE, S.W.
WASHINGTON, DC 20202-1500

September 29, 2006

Memorandum

TO: Theresa S. Shaw
Chief Operating Officer
Federal Student Aid
Lead Action Official

James F. Manning
Acting Assistant Secretary
Office of Postsecondary Education

FROM: Helen Lew /s/
Assistant Inspector General for Audit Services

SUBJECT: Final Audit Report
Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers
Control Number ED-OIG/A04E0009

Attached is the subject final audit report that covers the results of our review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers. The objective of the audit was to evaluate the adequacy of Federal Student Aid's Financial Partners' processes for monitoring guaranty agencies, lenders, and servicers during the period October 1, 2003 through March 31, 2005. An electronic copy has been provided to your Audit Liaison Officer(s). We received your comments concurring and non-concurring with the findings and recommendations in our draft report. Your comments are included as an attachment to the report.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office(s) will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). ED policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 days of the issuance of this report. The CAP should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

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We appreciate the cooperation given us during this review. If you have any questions, please call Denise M. Wempe, Regional Inspector General for Audit at 404-562-6477.

Enclosure

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EXECUTIVE SUMMARY

The objective of our audit was to evaluate the adequacy of Federal Student Aid's (FSA) Financial Partners' (Financial Partners) processes for monitoring guaranty agencies, lenders, and servicers. We found that Financial Partners had not implemented an acceptable level of internal control over its monitoring and oversight of Federal Family Education Loan (FFEL) program participants as required by the Federal Managers Financial Integrity Act (FMFIA) of 1982. According to FMFIA, internal accounting and administrative controls of each executive agency shall be established in accordance with the U.S. Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government (Internal Control Standards).*

During our audit period (October 1, 2003 through March 31, 2005), we identified internal control weaknesses relating to five of the internal control standards – control environment, control activities, monitoring, information and communication, and risk assessment. Based on our review, Financial Partners did not provide adequate oversight and consistently enforce FFEL program requirements.

Weak Control Environment for Monitoring and Oversight
A positive control environment is the foundation for internal control. Financial Partners did not provide a positive control environment as evidenced by our findings. We found that Financial Partners

- Was not included in FSA's tactical goals for program monitoring and oversight.
- Emphasized partnership over compliance in dealing with guaranty agencies, lenders, and servicers in its mission statement on selected actions.
- Overstated the number of program reviews performed in the Postsecondary Education Participation System (PEPS) and did not consistently quantify liabilities in program reviews.
- Did not ensure that the Department's policies regarding delegation of authority for waiving liabilities were followed.
- Experienced high turnover in its General Manager position.

Insufficient Control Activities Over Monitoring of Program Reviews and Technical Assistance
Financial Partners did not adequately review, test, identify, and report significant instances of non-compliance in its program reviews and technical assistance. Specifically, we found that Financial Partners did not

- Follow policies and procedures for conducting and documenting program reviews.
- Have adequate policies and procedures for the program review process.
- Have policies and procedures for providing and documenting technical assistance.
- Have a process for monitoring the quality of program reviews or technical assistance.

Lack of an Effective Information and Communication Process Related to Policy Issues
Financial Partners does not have an effective information and communication process for requesting assistance on policy issues and communicating resolution to staff. As a result, Financial Partners staff does not receive timely policy guidance to determine whether guaranty agencies, lenders, and servicers are in compliance.

Risk Assessment Tool Not Fully Implemented
Financial Partners had not fully implemented its scorecards as a risk assessment tool and does not have sufficient information to evaluate whether the scorecard elements are useful in assessing risk. We found that Financial Partners had not

- Fully implemented its guaranty agency, lender, and servicer scorecards to assess risk to the FFEL programs.
- Developed written policies and procedures in the use of its guaranty agency, lender and servicer scorecards as a risk assessment tool and trained all users.
- Implemented a process to continually evaluate the effectiveness of the scorecards and identify and implement improvements.

To address the control environment weaknesses, we recommend that the Chief Operating Officer of FSA include compliance monitoring of guaranty agencies, lenders, and servicers in the tactical goals of FSA's strategic plan; amend Financial Partners' mission to better emphasize its role in compliance enforcement; accurately report program reviews performed; consistently quantify liabilities; and clarify and strengthen how it uses its authority to waive certain liabilities.

To address the control activity and monitoring weaknesses, we recommend that the Chief Operating Officer require Financial Partners to strengthen and follow its policies and procedures for program reviews; develop policies and procedures for technical assistance; and establish a quality assurance process for both program reviews and technical assistance.

To address the communication and information weaknesses, we recommend that the Chief Operating Officer develop an effective method/process for requesting policy interpretation assistance and communicating the results and decisions to all staff and develop timelines for the resolution of policy issues. For the risk assessment weakness, we recommend that the Chief Operating Officer require Financial Partners to develop policies and procedures for using the guaranty agency, lender, and servicer scorecards; train all staff on the use of the scorecards; and develop a methodology for evaluating the effectiveness of the scorecards.

In the joint response, FSA and OPE[1] disagreed with the first Finding that Financial Partners had a weak control environment for monitoring and oversight, but they generally concurred with the remaining three findings. Although FSA disagreed with the overall conclusion regarding the control environment, it acknowledged that areas exist for continued improvement in its monitoring and oversight activities.

[1] OPE was a joint respondent with FSA in the letter, but OPE was only involved in responding to Finding 3 - Lack of Effective Information and Communication Process Related to Policy Issues. As such, we will be referring to FSA's response in the body of the report relating to the issues with recommendations directed only to FSA.

FSA stated that it believes that the audit report failed to recognize the strong foundation of control that has been established over the past three years. The following are FSA's contentions on Financial Partners' foundations of control along with our responses. FSA contends that Financial Partners has

- **Established clear and specific annual goals for improving the process for monitoring and oversight.** However, OIG found that the tactical goals were not included in FSA's Strategic Plan, as detailed in Finding 1. Although FSA included action items related to monitoring and oversight activities in its Annual Plan, as detailed in Finding 2, we found sufficient weaknesses to demonstrate that the action plans were not effectively implemented.
- **Developed a program review schedule based on risk rather than frequency.** As OIG detailed in Finding 4, although FSA stated that scorecards were actively used as a risk assessment tool when Financial Partners developed its program review schedules for FY 2005 and 2006, the change in approach was made after the period of our review. We found nothing in the documentation provided to indicate that Financial Partners focused its efforts on the entities at most risk for the period of our review.
- **Completed the tracking and resolution of FFEL issues that impact the program and the taxpayer.** As OIG detailed in Finding 3, although we found that Financial Partners had a tracking mechanism, it did not ensure the timely resolution of long-standing, outstanding issues identified and tracked that impact the program and the taxpayer.
- **Continued the development and enhancement of tools to assist in the identification and mitigation of risk to the FFEL program.** As OIG indicated in Finding 4, the use of the scorecards to develop the program review schedule was a change made subsequent to the period of our review and we did not audit the effectiveness of Financial Partners' current approach.

In response to our draft report, FSA often made statements and conclusions to dispute our findings. FSA did not give its reasons for the disagreement nor provide the data necessary to support its position, as we requested in the letter transmitting the draft report. FSA also did not provide data to support its contention that Financial Partners has implemented key activities that form the foundation for a positive control environment. Collectively, all the deficiencies we found in Financial Partners' management philosophy, policies, procedures and operations, have created a weak internal control environment for monitoring and oversight. These deficiencies need to be addressed if Financial Partners is to promote a positive internal control environment.

BACKGROUND

The General Manager of Financial Partners has been delegated the programmatic authorities to administer the FFEL program authorized by Title IV, Part B of the Higher Education Act of 1965, as amended (HEA), as they relate to guaranty agencies, lenders, lending servicers, and other Federal agencies in Delegation Of Authority (DOA) Control Number EN/ENE/39. Pursuant to Section 432 of the HEA, certain functions may be delegated to employees in the regional office of the Department.

Within FSA, Financial Partners is the division responsible for the oversight of the FFEL Program. Financial Partners has approximately 75 staff located in Washington, D.C. and various regional offices. At headquarters in Washington, Financial Partners consists of the Partners Services Group, Partner Systems Group, National Student Loan Data System (NSLDS) Group, the State Agency Liaison and a Financial Analysis unit. Financial Partners has four regional offices in New York, Dallas, San Francisco, and Chicago, and duty stations in Atlanta and Boston; all report to the State Agency Liaison. Oversight responsibilities are assigned primarily to the Partners Services Group and the regional offices.

According to FSA's fiscal year (FY) 2004 Annual Performance Report, FSA works with over 3,400 lenders, 35 guaranty agencies, secondary markets, 72 third-party servicers and other entities. These entities participate in the Federal Family Education Loan (FFEL) program. According to the Financial Partners' functional statement, the regions are responsible for providing technical assistance to guaranty agencies, FFEL lenders and servicers or organizations on the FFEL program. Under the HEA, in the FFEL Program, state and private non-profit guaranty agencies use Federal funds to provide loan guarantees and interest subsidies on loans made by private lenders to eligible students. The Department reinsures the guaranty agencies and pays interest subsidies to lenders on qualifying loans.

During FY 2004, the FFEL program provided $39 billion in loans to 5.4 million FFEL borrowers. The FFEL program also provided $25.6 billion in Consolidation Loans to borrowers. In addition, FSA paid an estimated $3 billion to lenders for interest and special allowance subsidies. FSA also paid an estimated $3.9 billion for re-insurance, loan processing and insurance fees, and account maintenance fees required by the HEA to guaranty agencies.

Financial Partners conducts on-site program reviews of guaranty agencies, lenders and servicers that range from covering multiple areas of compliance to only one or two areas. It also performs desk reviews and special/other projects involving the same types of entities, such as reviews of exceptional performer applicants and Consolidation Loan rebate fees reviews of lenders.

In 1990 GAO included the FSA programs on its high-risk list. In high-risk updates, GAO reported various problems in FSA programs, including poor financial management and weak internal controls, fragmented and inefficient information systems, and inadequate attention to program integrity. In January 2005, GAO removed the FSA programs from its high-risk list.

However, GAO stated that FSA should continue its progress and take additional steps to fully address some of GAO's recommendations.

In July 2003, the Office of Inspector General (OIG) issued a report[2] on the results of nine audits of guaranty agencies' compliance with the HEA requirements for the establishment and operation of the Federal and Operating funds held by the guaranty agencies. The report showed that of the nine guaranty agencies reviewed, Financial Partners had completed program reviews at eight; however, Financial Partners had not identified any of the significant findings reported by OIG.

Financial Partners uses a system, called Data Mart, to serve as the central location for information associated with FFEL program activities among guaranty agencies, lenders, and servicers. The Financial Partners Data Mart (FPDM) system was developed and is maintained by an independent contractor for Financial Partners. The system pulls FFEL related data from the Financial Management System (FMS), the Postsecondary Education Participation System (PEPS), and the National Student Loan Data System (NSLDS). The FPDM system provides a mechanism to generate end user reports using data from several ED database source systems. The FPDM data provides information and decision support capabilities for key business functions, including portfolio analysis, customer relationship management, compliance management, and portfolio management.

Financial Partners developed scorecards for participating guaranty agencies, lenders, and servicers as one of its tools to assess risk to the FFEL program. These scorecards are part of the FPDM, and are populated with data in each of the critical elements identified on the scorecards. All Financial Partners staff have access to the FPDM. In addition, "PowerUsers" selected from each region and headquarters, were trained on aspects of the FPDM. These "PowerUsers" usually provided additional training to the regional reviewers.

FSA announced a reorganization effective May 28, 2006, which made changes to the Financial Partners organizational structure. According to FSA, the reorganization realigns all program compliance functions under a single unit reporting directly to the Chief Operating Officer. Under the realignment, the regional staff reporting to the State Agency Liaison Officer are transferred to the unit whose primary function will be program compliance. The effective date of the reorganization was subsequent to our audit period.

[2] Oversight Issues Related to Guaranty Agencies' Administration of the Federal Family Education Loan Program Federal and Operating Funds – July 2003.

AUDIT RESULTS

We found that Financial Partners has not implemented an acceptable level of internal control for monitoring and providing oversight of guaranty agencies, lenders, and servicers. Specifically, we found weaknesses in Financial Partners' (1) control environment for monitoring and oversight; (2) control activities over and monitoring of the program reviews and technical assistance; (3) information and communication process for resolving findings related to policy issues; and (4) implementation of a risk assessment tool. Based on the weaknesses identified in our review of Financial Partners' program review and technical assistance processes, Financial Partners did not provide adequate oversight and consistent enforcement of FFEL program requirements.

In its comments to the draft report, FSA did not concur with Finding No. 1 and generally concurred with Findings No. 2 through 4. FSA's comments and our response are summarized at the end of each finding. The full text of FSA's comments on the draft report is included as an attachment to the report.

Finding No. 1 – Weak Control Environment for Monitoring and Oversight

GAO's Internal Control Standards state that a "positive control environment is the foundation for all other standards." The standards further state, "a positive control environment provides discipline and structure as well as the climate, which influences the quality of internal control."

The GAO Internal Control Standards identify the following seven key factors that affect the Control Environment:

1. The integrity and ethical values maintained and demonstrated by management and staff;
2. Management's commitment to competence;
3. Management's philosophy and operating style, which include the degree of risk that it is willing to take and its philosophy towards performance-based management;
4. An agency's organizational structure;
5. The manner in which an agency delegates authority and responsibility throughout the organization;
6. Good human capital policies and practices; and
7. An agency's relationship with Congress and central oversight agencies.

Based on our review, Financial Partners did not provide a positive control environment. We found that Financial Partners

- Was not included in FSA's tactical goals for program monitoring and oversight.
- Emphasized partnership over compliance in its mission statement.

- Overstated the number of program reviews conducted in PEPS and did not consistently quantify program review liabilities.
- Did not ensure that the Department's requirements for delegation of authority for waiving liabilities were followed.
- Experienced high turnover in its General Manager position.

Oversight and Monitoring Not Included In the Tactical Goals of FSA's Strategic Plan

Section 141(c) of the HEA requires FSA to develop a five-year performance plan that establishes measurable goals and objectives. The Government Performance and Results Act requires that strategic plans contain "a description of how goals and objectives are to be achieved." FSA's Strategic Objective 2, Improve Program Integrity, states that "FSA will ensure that aid under the federal student aid programs is delivered directly by FSA and through school, lender, and guarantor participants in a manner that reduces the vulnerability of these programs to fraud, waste, error, and mismanagement." While FSA's strategic objectives mention lenders and guarantors, the tactical goals, which are the actions to implement the stated objectives, do not include program monitoring and oversight of guaranty agencies, servicers, and lenders.

FSA's tactical goals include a description of the actions that will be taken to monitor postsecondary educational institutions participating in the Title IV programs; however, the plan does not include a similar description for monitoring guaranty agencies, lenders, and servicers. FSA's only mention of guaranty agencies, lenders, and servicers is in its tactical goals' discussion of improvements in the cohort default rate where it refers to them as "the private sector partners in the loan programs."

Although FSA's strategic plan does not include a description of program monitoring and oversight of guaranty agencies, lenders, and servicers, FSA's FY 2004 Performance Plan included a Financial Partners' action item to enhance program monitoring and oversight. The business need in the Performance Plan was to conduct comprehensive program reviews of guaranty agencies and lenders/servicers in an effort to provide proper oversight and monitoring of Financial Partners and provide the necessary guidance and feedback to raise effectiveness and efficiencies. Based on the weaknesses we identified, Financial Partners is not providing proper oversight and monitoring of guaranty agencies, lenders, and servicers.

Our findings on oversight and monitoring relate to key factor one – integrity and ethical values, and key factor two – management's commitment to competence.

Financial Partners Viewed Guaranty Agencies, Lenders, and Servicers as Partners

In its mission and functional statements, Financial Partners emphasized partnership over compliance in dealing with guaranty agencies, lenders, and servicers. Weaknesses we identified confirmed that stated emphasis on partnership.

Financial Partners' stated mission is "to promote the best in business and strive for greater program integrity through innovative technical development, oversight, technical assistance, partnership and community outreach programs by working in partnership with Guaranty

Agencies, Lenders, Servicers, Trade Associations, Trustees, Schools and Secondary Markets to ensure access for students to federal student loans." The mission statement indicates that Financial Partners views guaranty agencies, lenders, and servicers as partners as opposed to participants in the FFEL program. The mission statement does not address the fact that these entities receive billions of dollars in benefits from the Federal government and have specific statutory and regulatory compliance requirements for which Financial Partners has oversight responsibility.

Partnership is also emphasized in the functional statement of the State Agency Liaison. Financial Partners' regional offices are responsible for conducting program and financial reviews of guaranty agencies, lenders, and servicers, referring cases to OIG, and recommending action to resolve or avoid financial or compliance problems. The regional offices report to, and are supervised by the State Agency Liaison, who, among other duties, is the designated advocate for guaranty agencies within the Department. According to the functional statement for that position,

> [The] State Agency Liaison is responsible for providing support and communications to state agencies to ensure a network of effective and satisfied state agency partners. To accomplish this mission, State Agency Liaison:
>
> - Works with state guarantee and non-guarantee agencies to ensure appropriate levels of communication between FSA and the agencies.
> - Provides state agencies with a liaison and advocacy function within Education and FSA.

This reporting structure creates an inherent organizational conflict of interest, with the advocate for guaranty agencies supervising the staff responsible for compliance and oversight of those same entities. We noted the following instances where Financial Partners emphasized partnership over compliance.

- A program reviewer recommended a method for a guaranty agency to reduce the amount of usage fees it must pay to the Federal Fund by disaggregating classes of assets in order to fall below the threshold for paying usage fees. The issue was reported as a program review observation rather than a finding with a liability.
- A guaranty agency failed to conduct all of its required lender reviews and the program reviewer provided the guaranty agency with data to respond to the finding and justify not being required to conduct the reviews.
- A Financial Partners Regional Director provided internal pre-decisional documents to a secondary market official because the official requested it. The lender then used the documents in an unsuccessful attempt to obtain a Federal court order to block the issuance of an OIG audit report.

Our finding that Financial Partners emphasized partnership over compliance relates to key factor one – integrity and ethical values, and key factor four – agency and organizational structure.

Financial Partners Overstated Program Reviews in PEPS and Did Not Consistently Quantify Liabilities

We found that Financial Partners overstated the number of program reviews performed in PEPS and did not consistently quantify liabilities identified in the reviews. Overstating the number of program reviews conducted and not quantifying liabilities gives the impression of greater oversight and fewer problems identified from the review. As a result, Financial Partners is not presenting accurate information to upper management in FSA, the Department, Congress, and other interested parties regarding its program review coverage.

Our finding that Financial Partners overstated program reviews and did not consistently quantify liabilities relates to key factor three – philosophy and operating style risk.

Number of Program Reviews Conducted Overstated in PEPS. Financial Partners has a standard practice of including all of the lenders serviced by a servicer as having received a lender program review. This results in an overstatement of the number of lender reviews performed. In FY 2004, we found that Financial Partners' southern and eastern regions conducted seven servicer reviews and entered into PEPS that they reviewed 842 lenders through these seven servicer reviews. Financial Partners' Acting Director of State Agency Liaison stated that its practice of reviewing multiple lenders at the servicer locations enables Financial Partners to be more efficient in conducting its reviews, since most servicers perform identical duties for several lenders, which are covered during program reviews. Our review of supporting documentation for servicer reviews showed that the samples tested by reviewers were not sufficient to provide adequate coverage of each lender's portfolio. In addition, we could not determine from our file review whether Financial Partners evaluated the degree to which individual lenders were serviced to provide a basis for concluding that its review coverage was adequate for each lender serviced.

Based on our detailed file review and review of PEPS data, we determined that the eastern and southern regions conducted only 36 lender reviews during FY 2004. The FY 2004 annual report stated that Financial Partners had completed 598 lender reviews. If the other two regions conducted a similar number of lender reviews as the regions we reviewed – the eastern and southern regions--the number of lender reviews reported in the FY 2004 annual report is substantially overstated.

In our detailed file review, we also identified duplicate reviews, as well as incomplete program reviews entered into PEPS, increasing the reported number of program reviews performed. For example, for one file in our sample, the Regional Director told us that a new staff person had incorrectly performed a lender review and that it should not be included in our file review. However, the incomplete review was listed in PEPS as issued. In this same region, a lender review was performed that resulted in liabilities being owed to Education. Documentation in the program review file showed that the reviewer closed the original review in PEPS and opened another program review number to collect the liabilities. As a result, it appeared that two lender reviews were conducted, when in fact there was only one. Furthermore, in this same region, two limited guaranty agency reviews were entered into PEPS; however, both reviews were site visits to the same guaranty agency for the purpose of reviewing the agency's calculation of funds it

claims Education owes the agency involving loan rehabilitations. There was no review report issued for either of the visits.

Liabilities not consistently quantified. We found that program review reports rarely included monetary liabilities and that program reviewers did not consistently quantify liabilities. In the corrective action phase for report findings, program reviewers allowed some entities to research errors and/or resolve any balance due to the Department. In two instances, the reports included observations when a compliance finding would have been more appropriate. In another instance, the report contained a finding without quantifying the liability due the Department that was evidenced in the reviewer's supporting documentation. These practices resulted in low or no liabilities being reported in the program review reports.

Delegation of Authority for Waiving Liabilities Not Followed

Sections 428 and 432 of the HEA provide the authority for the Secretary to waive certain liabilities. The Secretary delegated this authority to the Chief Operating Officer for Student Financial Assistance and according to the December 8, 1999, delegation of authority; this function was further delegated to the General Manager for Financial Partners. This delegation to the General Manager provides that the authority to waive liabilities, which is reflected in 34 C.F.R. § 682.406 and § 682.413 cannot be further delegated. We found no evidence that this waiver authority was delegated to the regional directors. We also found that the delegations to the Chief Operating Officer and the General Manager did not include adequate controls regarding monetary limits or any requirement to consult with other departmental offices.

In the absence of the authority granted by the HEA, the Department would be required by the Federal Claims Collections Standards to obtain the approval of the Department of Justice before any claim in excess of $100,000 could be waived or compromised. Within the Department of Justice, the level of approval required varies based on the amount of the claim or compromise. While the Chief Operating Officer and Financial Partners' General Manager have the authority to waive liabilities, the delegations to them did not specify monetary limits on the claims that could be waived, and did not include a requirement that FSA consult with other departmental offices.

In addition, Financial Partners does not have a formal process for tracking and granting waivers. We identified an instance where a Regional Director waived a guaranty agency's liability. We found that one of Financial Partners' guaranty agency reviews included a finding that the agency failed to pay lenders within the required time frames for defaulted loans and returned loans to lenders for reasons not allowed by the regulations. As a result, $259,648 in loans should have lost eligibility for reinsurance. The Department also incurred imputed interest costs as a result of the guaranty agency's actions. Although the guaranty agency was not entitled to the reinsurance amount, the Regional Director waived the requirement for the guaranty agency to repay the reinsurance. We found no evidence in the file that the General Manager approved the waiver. Without a formal process for tracking and granting waivers, Financial Partners' management cannot ensure that waivers are handled in accordance with the Secretary's delegation.

Our findings that Financial Partners did not follow the delegation of authority for waiving liabilities, and did not have a formal process for tracking and granting waivers relate to key factor five – delegation.

A high turnover in Financial Partners' General Manager position contributed to the weaknesses we identified in Financial Partners' monitoring and oversight activities. Financial Partners' staff have had seven different General Managers and acting General Managers within the last six years. According to the GAO Internal Control Evaluation Tool, high turnover in upper management can be a problem for the control environment because it can impair internal control as a result of employing many people new to their jobs and unfamiliar with the control activities and responsibilities.

RECOMMENDATIONS

We recommend that the Chief Operating Officer for FSA

1.1 Include compliance monitoring of guaranty agencies, lenders, and servicers in the tactical goals of FSA's strategic plan.

1.2 Amend the Financial Partners' mission statement to better emphasize compliance and clarify the role of Financial Partners. Amend the functional statements for Financial Partners and Program Compliance to establish clear lines of responsibility and authority for oversight, monitoring, and compliance enforcement.

1.3 Eliminate the organizational conflict of interest by removing the State Agency Liaison from any involvement in oversight and monitoring.

1.4 Require Financial Partners to stop recording as lender program reviews, program reviews that are actually only servicer reviews.

1.5 Develop a consistent policy for identifying, quantifying, and reporting all liabilities identified in program reviews regardless of whether they are resolved.

1.6 Request an amendment to the Chief Operating Officer's delegation of authority for waiving liabilities to include additional controls for monetary limitations and consultation with other Department officials. Eliminate the redelegation to the Financial Partners' General Manager, and include appropriate controls in a replacement redelegation to the appropriate Program Compliance Officer. Ensure that managers and staff know and understand the delegation of authority for waiving liabilities.

1.7 Require the tracking and documentation of the reasons for waiving a liability when exercising the waiver authority.

FSA COMMENTS

FSA did not concur with Finding 1 and did not concur with five of the seven recommendations. FSA stated that Finding 1 addressed only two to three of the seven key factors cited by the GAO under the Control Environment section of the Internal Control Standards, but did not identify which of the standards it believed were addressed

FSA stated that it believes that Financial Partners provides a positive control environment. FSA also stated that the finding was too broad and not substantiated by the associated findings and work papers.

OIG RESPONSE

Our findings identified significant deficiencies in five of the seven GAO key factors for a control environment.[3] We have revised the report to include which of the key factors relate to each of our findings. Also, as we mentioned in this report, the high turnover in financial Partners' General Manager position contributed to the weaknesses we identified in Financial Partners monitoring and oversight activities. Significant deficiencies in any of the key factors would have a negative impact on the control environment, and FSA acknowledges that our findings address two to three of the key factors. In addition, FSA failed to identify which key factors were not addressed in the report. As such, we made no changes to the finding.

Although FSA contends that our conclusion is too broad and is not substantiated by the associated findings and work papers, FSA did not provide any explanation, support, or documentation for this statement. Prior to responding to our draft audit report, FSA and Financial Partners' staff requested access to our electronic work papers. FSA's limited review was not sufficient or appropriate to question the adequacy of support for our audit, which was performed in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

While FSA did not concur with the finding and five of the seven recommendations, it did identify management actions to address each of the seven recommendations. Since FSA provided only general statements and conclusions and did not provide data necessary to support its position and to dispute the finding, we did not change our finding except as indicated above.

FSA provided specific comments corresponding to the sub-headings within our finding, some of which were inconsistent with the documentation that was available during the audit and were not supported in FSA's response. FSA's comments and our rebuttal follow.

Oversight and Monitoring Not Included in the Tactical Goals of FSA's Strategic Plan

FSA Comments. FSA acknowledged that there was no specific reference to oversight and monitoring of lenders, servicers, and guaranty agencies in its Strategic Plan, but it maintained

[3] We did not evaluate the key factors covering human capital and relationship with Congress or central oversight agencies as part of our audit objective.

that those goals are "discussed in general terms under the Program and Monitoring section" of the plan. FSA stated that our draft audit report acknowledges that tactical goals are included in its Annual Performance Plan.

According to the response, FSA's

> …Strategic Plan is a high-level document that presents Federal Student Aid's long-term strategic objectives. It does not specifically address all of the tactical goals that are established and monitored on a monthly and annual basis through our Annual Performance Plan, which establishes specific tactical initiatives to achieve each of our strategic objectives.

FSA contends that our conclusion that Financial Partners is not providing proper oversight and monitoring has no relevance to whether goals of monitoring and oversight are included in the Strategic Plan. FSA stated that it believes that the "rigor of the tactical goals outlined in [its] Annual Performance Plan demonstrates a strong control environment." Although FSA did not concur with Recommendation 1.1, the response stated that it incorporated specific tactical action steps from the Annual Performance Plan in Appendix A of the FY 2006-2010 Five-Year Plan.[4]

OIG Response. FSA acknowledges that oversight and monitoring (of guaranty agencies, lenders, etc.) is not described in its Strategic Plan, but it contends that they are discussed in general terms under the Program Monitoring and Oversight section. Contrary to FSA's contention, the section referred to, which is part of the Strategic Plan's "Tactical Goals," did not mention guaranty agencies, lenders, and servicers. That section addresses goals for monitoring and oversight of schools. The omission of any goals for monitoring and oversight of guaranty agencies, lenders, and servicers indicates that oversight and enforcement by Financial Partners was not of strategic importance to FSA. The deficiencies we have identified, in particular, the emphasis on partnership, the failure to consistently quantify liabilities, and the failure to resolve issues that could have a financial impact, confirm the lack of strategic emphasis on oversight.

To clarify, our draft audit report did not state that FSA's Annual Plan includes "tactical goals" related to oversight and monitoring. Rather, our draft report recognized that FSA's FY 2004 Annual Performance Plan included Financial Partners' action items to enhance program monitoring and oversight. Annual action items are not long-term objectives in the Strategic Plan, which is our report finding. The annual plan contains 43 action items of an operational nature, six of which relate to oversight and monitoring by Financial Partners. However, since none of the items were part of the Strategic Plan, the relative or strategic importance of oversight is not apparent.

In response to Recommendation 1.1, FSA stated that it has incorporated specific tactical action steps from the Annual Performance Plan in Appendix A of the FY 2006-FY 2010 Five-Year Plan.

[4] Our finding, FSA's comments, and our response all refer to FSA's FY 2004-2008 Strategic Plan, which was in effect during our audit period. FSA has published an FY 2006-2010 Strategic Plan, which we have not evaluated as part of this audit.

Financial Partners Viewed Guaranty Agencies, Lenders, and Servicers as Partners

FSA Comments. FSA did not concur with OIG's assertion that Financial Partners emphasizes partnership over compliance in dealing with guaranty agencies, lenders, and servicers. FSA stated that it obtains more effective compliance through partnership rather than at the expense of it. FSA provided an example of what it considered compliance through partnership – a servicer's willingness to "self report" infractions when the risk of discovery was low and the consequences were great, resulting in its loss of the Exceptional Performer designation. The response further stated that this audit was too focused on the partnership aspects of the Financial Partners office, while failing to recognize the more significant oversight activities.

Although FSA did not concur with Recommendation 1.2, it stated that effective May 2006 all program compliance functions were consolidated under a single unit reporting directly to the Chief Operating Officer. According to FSA, the realignment was done to strengthen oversight and monitoring of program participants.

FSA did not concur with Recommendation 1.3. However, under the reorganization, the regional staff reporting to the State Agency Liaison Officer are transferring to another unit whose primary function will be program compliance. The response added that the functional description of the State Agency Liaison position would be re-evaluated and modified as necessary.

OIG Response. FSA based its non-concurrence of Recommendation 1.2 on an example of a servicer's disclosure of an Exceptional Performer violation, which it characterized as compliance through partnership. We disagree that this example is representative of obtaining compliance through partnership; it also does not address our finding or recommendations. Under the Exceptional Performer designation, the risk of discovery of due diligence violations is very high given the additional statutory audit requirements to support, on a quarterly basis, a 97 percent compliance rate. The regulations for the Exceptional Performance program at 34 C.F.R. § 682.415(b)(7)(ii) warn that if a lender or lender servicer with the Exceptional Performer designation fails to comply with program regulations, the lender or servicer will be considered in violation of the False Claims Act. Under the False Claims Act, 31 U.S.C. § 3729, the Government may recover treble damages and penalties if program participants submit false claims. FSA did not provide any other evidence to support its assertion that partnership resulted in better results than compliance monitoring.

While FSA believes our audit focused too much on the partnership aspects, the response reinforces its emphasis on partnership and is consistent with Financial Partners' mission statement.[5]

FSA's realignment and consolidation of all program compliance functions under a single unit reporting to the Chief Operating Officer in response to the recommendations, in and by itself, does not completely address the findings and the related recommendation. According to the GAO Internal Control Standards, a "good internal control environment requires that the agency's organizational structure clearly define key areas of authority and responsibility and establish

[5] See page 7, under the sub-section "Financial Partners Viewed Guaranty Agencies, Lenders, and Servicers as Partners."

appropriate lines of reporting." The current functional statement on the FSA website for the new organization shows that Financial Partners' and the new Program Compliance functional statements have overlapping jurisdiction over compliance and monitoring. It is also unclear which component is responsible for resolving compliance violations. Until the functional statements and responsibilities are clarified and effectively implemented, FSA will continue to have control environment weaknesses.

The following addresses FSA's specific concerns in each of the examples supporting our conclusion that Financial Partners emphasized partnership over compliance.

Supervisory role of the State Agency Liaison

FSA Comments. In response to our finding of an organizational conflict of interest between the dual roles of the State Agency Liaison as supervisor of the Financial Partners Regional offices and advocate and liaison for guaranty agencies, FSA stated that

> The [audit] report fails to acknowledge that the position description of the State Agency Liaison is focused on the advocacy function of this position with respect to state agencies that specifically administer the Leveraging Educational Assistance and Partnership (LEAP) and Special Leveraging Educational Assistance and Partnership (SLEAP) grant programs for which primary oversight responsibility rests with individual state auditors and is not a function of the Financial Partners regional offices.

OIG Response. Our review focused on the functional statement, which is the public description of the responsibilities and authorities of Financial Partners. That statement did not limit the Liaison's role to the LEAP and SLEAP advocacy functions. FSA did not provide a copy of the position description to support its statement that the State Agency Liaison focused on the advocacy function of the position with respect to the LEAP and SLEAP grant programs. Even if the position description limited the role of the State Agency Liaison beyond that stated in the organizational functional statements, it would still be a conflict for one individual to advocate the interests of the agencies for some programs, while supervising their oversight under other programs. We also disagree with FSA's contention that the primary oversight of the LEAP and SLEAP grant programs rests with individual state auditors. These are Federal programs and the primary oversight rests with the administering Federal office.

Although the response disagreed with the finding, FSA stated that

- Under the realignment plan effective May 28, 2006, the regional staff that are reporting to the State Agency Liaison Officer are moving to another organization whose primary function will be program compliance.
- The functional description of the State Agency Liaison position will also be re-evaluated and modified as necessary.

A program reviewer recommended a method for a guaranty agency to reduce fees

FSA Comments. In response to the example that a program reviewer recommended a method for a guaranty agency to reduce the amount of usage fees to pay to the Federal Fund, FSA stated

that it concurred that the rationale should have been documented in the program review files. However, FSA contended that the audit report did not correctly characterize the events. FSA stated that Financial Partners took the approach to address the actual value of furniture and equipment that included depreciation. The initial estimates of fair market value for determination of the usage fees was done at full value without depreciation, which would have led to overcharging the usage fees.

OIG Response. We did not recommend that the rationale for the program reviewer's recommended approach to the guaranty agency to reduce its usage fee be documented. The approach was documented, but the rationale conflicts with FSA's response. In the supporting documentation, the program reviewer told the guaranty agency to disaggregate the assets so that each asset would be below the threshold level for reporting and payment of usage fees; there was no evidence that the Regional Manager approved the approach. FSA provided no support that the purpose of the approach was to adjust for depreciation.

A guaranty agency failed to conduct all of its required lender reviews

FSA Comments. FSA stated that the guaranty agency in question performed 100 percent of its required lender reviews, but due to an error in procedures, the agency had focused on the loan holders and had not reviewed the actual originators of the loan. The response also noted that the program reviewer evaluated the guaranty agency's data and subsequently required it to perform additional reviews at those entities that had not been reviewed.

OIG Response. FSA did not provide documentation to support its statement. FSA's response also conflicts with the documentation in the program review file. The documentation stated that the guaranty agency had not performed all of the required lender reviews. Specifically, the supporting documentation and the subsequent email traffic associated with this program review confirm that the guaranty agency omitted six lenders from its review and asked for a waiver of the review requirements pertaining to the omitted lender IDs that were covered by other reviews during that period. The reviewer provided technical assistance and the guaranty agency was granted a waiver. The rationale for the waiver was not explained in the working papers, nor was there any evidence that the program reviewer sought approval from the Regional Manager prior to granting the waiver.

Regional Director provided internal pre-decisional documents

FSA Comments. FSA acknowledged that a Financial Partners' Regional Director provided internal pre-decisional documents to a secondary market official because the official requested it. FSA stated that the release of the information was believed to have resulted from an error in judgment on the part of the individual and was not indicative of a systemic problem. FSA added that to address the specific situation, management took immediate steps to reinforce disclosure requirements to the staff and initiated disciplinary action against the employee. FSA asserted that this one event did not substantiate the finding that Financial Partners emphasizes partnership over oversight.

OIG Response. Although this was the only example of its kind that came to our attention during the audit, the level of the individual, one of the four regional directors, demonstrates this manager's philosophical emphasis on partnership over compliance. An entity's control

environment has a pervasive influence on the control consciousness of its people, including the judgments they make. The regional director provided internal pre-decisional documents to a secondary market official because the official requested it. FSA's response downplayed the incident by classifying it as an error in judgment on the part of the individual. We believe that FSA's emphasis on partnership over compliance increased the risk that this type of error in judgment could occur. We acknowledge that FSA addressed the specific situation, initiating disciplinary action against the employee.

Financial Partners Overstated Program Reviews in PEPS and Did Not Consistently Quantify Liabilities

FSA Comments. FSA disagreed with the report's assertion that Financial Partners has overstated the number of program reviews performed. At issue is the methodology that Financial Partners uses to record the number of reviews conducted for lenders whose servicing functions are performed in whole or part by a separate servicing organization. FSA explained that, in general,

> Financial Partners conducts three types of lender reviews. These include on-site reviews of the lender, off-site or desk reviews in the Financial Partners regional office of lender data and information, and lender reviews conducted on-site at the servicer performing duties on the lender's behalf. Each lender review is accurately recorded in the Postsecondary Education Participants System (PEPS) with a separate and distinct code that clearly differentiates the type of lender review that has been performed. This is the number that was accurately reported.

FSA also stated that a comprehensive and thorough review of a servicing entity that yields no findings indicates that the functions it is performing on behalf of its lenders are in compliance with the applicable legislative and regulatory requirements.

FSA did not concur with Recommendation 1.4. However, to address OIG's concern, FSA stated that it would begin publishing the figures as they are recorded on the PEPS system. FSA also stated that it will reevaluate the processes and procedures associated with the way data are entered into the PEPS system.

FSA acknowledged that program reviewers did not consistently quantify liabilities. In addressing Recommendation 1.5, FSA stated that it plans to evaluate the processes and procedures in place for identifying, quantifying, and reporting liabilities for schools and tailor those processes for program reviews at guaranty agencies, lenders, and servicers.

OIG Response. We acknowledge that FSA used separate codes for different types of reviews involving lenders in its PEPS system. Due to the limited scope of FSA's servicer reviews, defining and coding a single servicer review as separate lender reviews for all of the servicers drastically overstates the number of actual reviews performed. Financial Partners' methodology for performing reviews at servicers is insufficient to draw valid conclusions about the compliance of the servicer's lender clients. As a result, a servicer review cannot be coded or considered as lender reviews. Our detailed analysis of Financial Partners' servicer reviews and the sampling methodology used by program reviewers showed that Financial Partners did not

provide adequate coverage of lenders through its servicer reviews. In planning the reviews, there was no evidence that Financial Partners considered the extent of, and types of services provided to each lender, or whether the lenders used multiple servicers.

The supporting documentation for servicer reviews showed that the samples tested were insufficient and not statistically valid to project to the universe of lenders. For example, for six servicer reviews that were coded as 794 lender reviews, we found –

- One review where a reviewer started with a sample size of 20 interest billing amounts for each of the fiscal years 2001, 2002, and 2003 but concluded the review after testing only 20 items because noncompliance was not found. The reviewer did not explain which fiscal years the 20 samples covered.
- Four of the six servicer reviews did not identify the universe or describe the sampling methodology.
- One review did not document the sampling methodology or work performed.

Although Financial Partners reported all lenders serviced as separate reviews, it had not done sufficient work in the servicer reviews to determine that all lenders were in compliance. Based on the examples identified in our review, FSA had no basis to conclude that Financial Partners' program reviews constituted a comprehensive and thorough review of a servicing entity, or that no findings in a servicer review supported a conclusion that each of its lenders was in compliance with all applicable statutory and regulatory requirements.

FSA stated that it would publish the program review figures recorded in PEPS. However, Recommendation 1.4 recommends that Financial Partners discontinue its practice of recording as lender program reviews, program reviews that are actually only servicer reviews. As such, FSA's response does not adequately address the recommendation.

Although FSA concurred that reviewers did not consistently quantify liabilities, it did not address Recommendation 1.5, which was to develop a consistent policy for identifying, quantifying, and reporting liabilities. FSA stated that it plans to evaluate the processes and procedures in place for schools and tailor those processes for program reviews at guaranty agencies, lenders, and servicers. We did not evaluate the schools processes and procedures for identifying, quantifying, and reporting liabilities to determine the applicability of those procedures to reviews of guaranty agencies, lenders, and servicers.

Delegation of Authority for Waiving Liabilities Not Followed

FSA Comments. FSA stated that it

> will modify the Chief Operating Officer's delegation of authority to the General Manager of Financial Partners Services to include additional controls for monetary limitations and consultation with other Department officials and ensure that managers and staff know and understand the delegation of authority for waiving liabilities…. [and] will develop a mechanism to track waivers that are granted, including the reasons for waiving a liability.

OIG Response. Although FSA concurred with amending the redelegation to the General Manager, it did not address the second part of the recommendation to request an amendment to the Chief Operating Officer's delegation of authority. We made no changes to the recommendation that the Chief Operating Officer request an amendment to her delegation from the Secretary. We did amend the recommendation to include a redelegation to the appropriate Program Compliance Officer.

FINDING No. 2 - Insufficient Control Activities Over Monitoring of Program Reviews and Technical Assistance

Two of the five GAO standards for internal control relate to control activities and monitoring. GAO's standards for internal control state "Control activities are an integral part of an entity's planning, implementing, reviewing and accountability for stewardship of government resources and achieving effective results" and "monitoring should assess the quality of performance over time." We found that Financial Partners has not implemented sufficient control activities and monitoring. Specifically, we found that Financial Partners did not

- Follow its policies and procedures for conducting and documenting program reviews.
- Have adequate policies and procedures for the program review process.
- Have policies and procedures for providing and documenting technical assistance.
- Have a process for monitoring the quality of program reviews or technical assistance.

As a result of the control activity and monitoring weaknesses identified in the program review process, we concluded that Financial Partners did not adequately review, test, or identify potentially significant instances of non-compliance. Further, Financial Partners has not provided adequate oversight and monitoring to ensure compliance with the HEA, regulations, and guidance.

Policies and Procedures Were Not Followed

Although Financial Partners has policies and procedures for conducting and documenting program reviews, the procedures were not consistently followed. We also found that the Acorde system[6] was not consistently utilized.

As summarized in Table 2.1, we reviewed 58 program review files and found one or more deficiencies in 55 of the 58 files.[7]

[6] The Acorde system is an imaging system used by Financial Partners to store its program reviews along with the supporting documentation.

[7] We selected and reviewed all guaranty agency reviews, full lender/servicer reviews, and Common Review Initiative (CRI) projects and selected the first three reviews by issue date for each region's limited reviews, joint reviews, and desk reviews in the eastern and southern regions.

Table 2.1 -- Summary File Review Results

	Files with deficiencies
Inadequate documentation of work performed	55
Reviews not issued / closed within 190 to 250 calendar days	3
Acorde system not consistently utilized	12
No reviewer identified as preparer on element sheets	21

Inadequate Documentation of Work Performed. According to the program review guides for guaranty agencies, lenders, and servicers, review specialists are to use pre-formatted element sheets to document the work performed for each element, including the purpose, methodology, activity, and conclusion for guaranty agency, lender, and servicer reviews.

- For 7 of the 55 files with inadequate documentation, we found insufficient evidence to support the review performed. These seven reviews contained no documentation of the work performed for six or more applicable program review elements.[8] For example, we found copies of preformatted element sheets containing no evidence of analysis; handwritten notes listing the review element containing no legible analysis of the work performed; and, in other cases, only a statement of "no finding" in the conclusion section of the element sheet with no other evidence that any analysis had occurred. One of the seven files contained no element sheets, even though the review was listed in PEPS as being issued on March 7, 2005. In addition, where there were descriptions of the work performed the descriptions were inadequate to determine the extent of the analysis and testing.

- For 48 of the 55 files with inadequate documentation, we found one or more instances where there was either inadequate or no documentation of the work performed for five or fewer program review elements. Examples of inadequate documentation include – incomplete description of the samples used to test compliance with program review areas; deviations from minimum suggested sample sizes without explanation; interview write-ups lacked detail to support conclusions; and review of an entity's policies lacked detail on the policies reviewed and the basis for conclusions. For 20 of these files classified as special reviews or projects, the files lacked standard element sheets to describe the work performed and basic descriptions of the scope, methodology, results, and conclusions.

- For 21 of the 58 files, we found 67 instances where the element sheets did not include a preparer's name or signature, as required by the program review guide.

[8] A guaranty agency program review generally focuses on approximately 28 review elements; a lender review generally focuses on 13 review elements. However, some elements may not be applicable to the entity reviewed.

Established Timeframes for Program Review Reports Not Met. Although Financial Partners has timelines for resolving and closing program reviews, three program reviews were not issued or closed in reasonable timeframes. Financial Partners' management stated that program review reports are typically published 30 to 60 days from the date the fieldwork is completed. In addition, according to Financial Partners' written procedures, reviews have six months (180 days) to be closed. The procedures further states that if there is a decision that needs to be made outside the region it can take months or years to get that decision and the reviews remain open. As of July 1, 2005, the end of our on-site audit fieldwork, two of the reviews have remained open for 248 and 199 calendar days, respectively, because of unresolved program review findings. The third program review has not been issued for 252 calendar days because the reviewer's computer crashed and several of the working papers had to be re-created.

Inconsistent Use of Acorde. We found that the two regional offices we reviewed inconsistently used the Acorde system. One of the regional offices maintained its closed program reviews in Acorde, while the second regional office did not. One Regional Director stated that no formal procedures were issued from Financial Partners' management about what must be in Acorde.[9]

We found Acorde difficult to query and difficult to use to retrieve review documents. In the region that used Acorde for closed reviews, we found that there was no index to assist in locating reviews in the system; some reviews contained duplicate documents; and some review work paper sections could not be located.

Inadequate Program Review Policies and Procedures

Financial Partners has policies and procedures for program reviews in place, however the procedures lacked any requirement for supervisory review. For six program reviews, we found 14 instances where findings and observations identified in the program review report were not supported by the work papers.[10] For 55 out of the 58 files reviewed, we found that the files did not contain adequate documentation to support the review. We identified two other instances of a lack of supervision – a program review observation involving usage fees should have been identified and reported as a finding; and a program review report that was issued before the Regional Director and team leader had documented their review of the working papers. The number of instances and types of weaknesses noted in our file review indicate a lack of adequate supervisory review over the work performed by individual reviewers and over the performance of the Regional Directors.

Although not required by Financial Partners' policies and procedures, it was standard practice for the Regional Director and team leader to sign the working paper index as certification of their review of the working papers and agreement with the documented conclusions. We found that program review reports were issued for 34 of the 58 files in our sample. These files included the working paper index certification in the file. For 33 of 34 files, the team leader, regional manager or both, signed the certification. For one issued report file, the team leader or regional

[9] Draft procedures drafted by Financial Partners in May 2005 provide that program reviews and supporting working papers will be maintained in Acorde.

[10] The May 26, 2005, Draft Procedures Manual states that an observation may include concerns about the entity's systems, staffing, potential conflicts of interests, or other problems observed at an entity.

manager did not sign the working paper index. We also noted that for 6 of the 33 files, another staff member signed the working paper index on behalf of the team leader. Both regional directors and one team leader stated that team leaders were not required to sign or initial individual element sheets prepared by team members. Two other team leaders also stated they do not typically review each team member's work or supporting documentation. The majority of the deficiencies we identified could have been detected and corrected had there been adequate supervision.

Lack of Technical Assistance Procedures

Financial Partners had no written procedures for documenting technical assistance. We could not determine how often Financial Partners' staff provided technical assistance to FFEL program participants. We found that Financial Partners' staff provided technical assistance to guaranty agencies, lenders, and servicers via telephone, email, in person during on-site program reviews and during training sessions; but this assistance was rarely documented. Because of the lack of documented technical assistance, Financial Partners has no assurance that its staff is providing uniform or accurate guidance to guaranty agencies, lenders, and servicers. Further, without data on technical assistance, Financial Partners can not identify and track potential problematic issues and concerns at entities; nor can it reasonably assess whether or not technical assistance results in improved compliance by guaranty agencies, lenders, and servicers.

No Process for Monitoring Program Review or Technical Assistance Quality

Financial Partners has not established a process for monitoring program review or technical assistance quality over time to ensure that regional staff are adhering to policies and procedures and whether changes in policies and procedures are needed to strengthen the processes. In addition to the GAO standard for internal control on monitoring, Office of Management and Budget (OMB) Circular A-123, Management Accountability and Control, provides that "Federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results . . . Agency managers should continuously monitor and improve the effectiveness of management controls associated with their programs."

May 2005 Draft Policies and Procedures Manual. In response to our preliminary findings, Financial Partners developed a draft internal procedures manual, dated May 26, 2005, that includes procedures for supervisory review, organizing and indexing working papers, determining when to conduct a desk review versus an on-site review; determining a finding versus an observation, resolving review findings, and scanning program review work papers and documentation into Acorde. The manual also includes procedures for providing technical assistance and training to financial institutions. Since this internal procedures manual has not been finalized and fully implemented, we were not able to audit these procedures to assess the adequacy of their application. However, even in areas where Financial Partners had documented procedures and guidance, we found that those procedures and guidance were not followed. Because Financial Partners does not have a process for monitoring the quality of program reviews and regional compliance with existing procedures and guidance, changes to policies and procedures alone will not resolve the problems identified in this audit.

During discussions with Financial Partners' officials, the Acting Director of State Agency Liaison stated that the Procedures Manual was still in draft, but that all staff were trained on the manual on November 9, 2005.

RECOMMENDATIONS

We recommend the Chief Operating Officer for FSA

2.1 Ensure that Financial Partners follows its procedures and guidance for its program review process.

2.2 Require Financial Partners to enhance and implement its guidance to include procedures that addresses the program review weaknesses we identified.

2.3 Require Financial Partners to enhance and implement its guidance to include procedures that address the technical assistance weaknesses and provide oversight to the regions to ensure that technical assistance is consistently provided and properly documented.

2.4 Ensure that Financial Partners strengthens its program review process to ensure consistency in the program review process and that program reviews are issued and closed within established timeframes.

2.5 Require Financial Partners to establish a quality assurance process that would ensure that program reviews are conducted properly, that work papers support the conclusions reached and findings are adequately documented.

2.6 Require Financial Partners to establish a quality assurance process that would ensure the quality and the adequacy of technical assistance.

FSA COMMENTS.

FSA did not dispute the finding and agreed to leverage the work done on program review procedures and standards by the Application, School Eligibility, and Delivery Services (ASEDS) organization to address all six of the recommendations. However, FSA disagreed that Financial Partners did not identify potentially significant instances of non-compliance, and that it has not provided adequate oversight and monitoring to ensure compliance with the Higher Education Act of 1965, as amended (HEA), regulations, and guidance. FSA asserted that neither the draft report nor the work papers supporting this audit identified specific examples where instances of non-compliance were missed.

In addition, FSA stated that

> As the draft report points out, Financial Partners had enhanced its internal policy and procedures in May 2005 to address the specific areas identified in this report. The new procedures were formally implemented for the FY 2006 program review cycle and staff training was conducted in November 2005. In

addition, the FSA organizational realignment combines the program review staff from Financial Partners with the staff performing program compliance reviews of schools. Federal Student Aid's Schools Eligibility Channel has undergone an extensive business re-engineering effort to address the program review, technical assistance, and quality monitoring of the oversight activities for schools. Financial Partners is currently working with this office to identify a way these efforts can also be applied to the processes and procedures for the oversight activities associated with guaranty agencies, lenders and servicers.

OIG RESPONSE.

We found that Financial Partners has not provided adequate oversight and monitoring efforts to ensure regional compliance with existing procedures and guidance. Financial Partners had policies and procedures covering several of the deficiencies identified in the finding. However, without management oversight and monitoring efforts to ensure implementation, the revised procedures will not resolve the problems identified.

We disagree with FSA's assertion that our audit does not support instances of noncompliance. Also, our work papers contain sufficient evidence to support our audit. Throughout the audit report, we have provided selected examples to support that Financial Partners did not adequately review, test, or identify potentially significant instances of non-compliance.[11] As stated in the report, we found two instances in which reports included observation when a compliance finding would have been more appropriate. For one guaranty agency review, the report contained a finding without quantifying the liability due the Department that was evidenced in the reviewer's supporting documentation. Based on our review, we did not change our finding and recommendations.

FINDING No. 3 - Lack of Effective Information and Communication Process Related to Policy Issues

GAO's fourth standard for internal control relates to information and communication. According to this standard, "Information should be recorded and communicated to management and others within the entity who need it and in a form and within a timeframe that enables them to carry out their internal control and other responsibilities." Financial Partners does not have a reliable process to obtain timely guidance on proper application of the HEA and program regulations or how to resolve issues consistent with Department policy or prior determinations. While Financial Partners has an informal process for obtaining guidance, the process leaves issues unresolved for long periods of time. As a result, Financial Partners staff does not receive timely guidance to determine whether guaranty agencies, lenders, and servicers are in compliance. Financial Partners also does not have an effective process for communicating the resolution of issues to all regional staff.

[11] In addition, instances of Financial Partners' missing noncompliance are contained in an OIG audit report on Oversight of Guaranty Agencies referred to in the Background section of this report. See Footnote number 2 for the specific reference to that report.

The Office of Postsecondary Education (OPE) is responsible for establishing Department policy for the Title IV programs. OPE issues program regulations and administrative guidance interpreting program requirements. FSA has a Policy Liaison and Implementation Staff responsible for identifying and analyzing policy issues, serving as liaison with OPE, and disseminating policy determinations to FSA staff. The Office of General Counsel (OGC) is responsible for providing legal advice on the FFEL program.

Financial Partner's Management Not Always Informed of Policy Guidance Requests for Settled Issues

When Financial Partners' regional staff have questions about proper application or resolution of program requirements, we found that regional staff usually forward questions via email and telephone directly to staff within OPE. If the question involves a settled issue under the HEA, regulations, or prior policy determinations, OPE staff usually respond directly to the regional staff that are asking the question. According to the Director of the FSA Policy Liaison and Implementation Staff, his office does not receive many inquiries from Financial Partners' regional staff. We also found that Financial Partners does not have a documented process to regularly obtain OGC review and advice on program reviews or other significant program determinations.

The Financial Partners' Acting Director of State Agency Liaison and Regional Directors are not always provided information on the resolution of the inquiries to OPE and may not know that a staff person had contacted OPE. Neither Financial Partners nor OPE track what are considered routine policy questions and their resolution. Because Financial Partners management is not kept informed of the issues that are raised with OPE, they are unaware of whether there is a systemic issue that should be dealt with, or whether there is a need to provide additional training to staff.

Process for Resolving Open Issues Does Not Provide Timely Guidance

When Financial Partners' staff request guidance from OPE on an issue that is unusual, unsettled, controversial, or that OPE otherwise determines requires further review, OPE staff generally confer with OGC and inform Financial Partners staff that the issue cannot be resolved quickly. OPE and FSA have biweekly meetings to discuss policy issues. The biweekly meetings cover policy issues related to all aspects of the Title IV programs, not just Financial Partners. Meeting participants do not record minutes of the meetings, the agenda serves as the only documentation that the meeting occurred, and there are no timeframes for resolution of issues. According to OPE's Staff Director for Policy & Budget Development, items discussed at the meeting requiring follow-up are captured in an annotated agenda, which is sometimes sent to meeting attendees. According to Financial Partners' General Manager an issue might be brought up in more than one meeting.

The OPE Policy Director stated that communicating policy decisions with Financial Partners' staff is not his office's role, but rather FSA's responsibility. Other FSA and Financial Partners' staff stated that resolution of some of the higher-level issues is out of Financial Partners' control.

In January 2004, Financial Partners began using a "hot issues" log to track progress of unresolved issues, identify the status of pending issues and target problem areas. The General

Manager, other managers, and the Regional Directors are able to contribute to the log and all staff has access. The Acting Director of State Agency Liaison stated that policy related issues and management decisions are communicated to staff through weekly meetings with the Regional Directors and staff; and weekly meetings with only the Regional Directors. The May 2, 2005, log contained 35 outstanding hot issues. We selected and reviewed four issues during our audit period to determine the number of days these issues remained outstanding. Table 3.1 details the four issues we reviewed from Financial Partners' May 2, 2005, hot issues log.

Table 3.1 Selected Outstanding Hot Issues (as of May 2, 2005)

		Days Outstanding
Servicer Conflict of Interest	Servicer appealed conflict of interest in default aversion and post-default collection finding in a recent program review. Issue referred to OPE /FSA on 6/4/2004. Ongoing since 5/26/2004.	341
Dead Loans	Oct. 2004 - Assistance requested from FSA on PLUS loans. May 2005 - Financial Partners regions told to contact GAs with Stafford Loans.	213
Common Claim Initiative (CCI)[12]	ED did not endorse CCI. Several GAs cited in program reviews for lack of documentation and claim packet review. Guidance is needed. Ongoing since 7/30/2004.	276
Waiver from Servicer	Waiver requested from the Secretary for the servicer's next EP[13] compliance audit for a self-reported due diligence failure. Servicer did not submit required quarterly audit with auditor attestation for EP designation. Ongoing since 12/13/2004.	140

As indicated in Table 3.1, two issues identified in program reviews were not resolved in a timely manner. As of May 2, 2005, the cited issues remained outstanding between 140 and 341 days. According to notes in the log, the CCI issue was first identified in July 2004, added to OPE's August 2004 meeting agenda, and discussed with OPE staff in September 2004. However, program reviews involving the CCI remained open because the issue had not been resolved.

Program Reviews Remain Unresolved for Extended Periods

As a result of the current process for resolving program review issues, program reviews go unresolved for long periods of time. We found that four guaranty agency reviews performed during our audit period remained open from more than four months to over one year awaiting a policy decision/interpretation. Table 3.2 details the number of days these reviews have remained open along with the unresolved issue.

[12] CCI was a joint project between the National Council of Higher Education Loan Program and the Student Loan Servicing Alliance. CCI standards were finalized in 2001.
[13] Exceptional Performer.

Table 3.2- Number of Days Program Reviews Open

			Unresolved Issue(s)
1	June 8, 2004	388	CCI[14] and Asset Disposition
2	June 16, 2004	380	CCI
3	October 19, 2004	220	Conflict of Interest
4	March 2, 2005	121	CCI

The "hot issues log" also noted that conflict of interest issues remained open and unresolved. We found documentation indicating that a September 2004 meeting with OPE and OGC to review three guaranty agencies resulted in a decision to assign a low priority to resolving outstanding conflict of interest issues. The conflict of interest issue involving a guaranty agency reviewed was first identified in a 1995 program review and was reported as a finding again in 2004, resulting in the issue remaining outstanding for almost 10 years (Table 3.2, guaranty agency 3).

Asset disposition issues at another guaranty agency remained unresolved for over 6 years after the program review was completed. Financial Partners' General Manager provided the audit team with a copy of its October 7, 2005, letter to the guaranty agency relinquishing ownership of the disposed assets along with documentation supporting the guaranty agency's transfer payment from its operating account to the Federal account. The General Manager stated that Financial Partners management is in the process of resolving other outstanding asset disposition issues involving two guaranty agencies.

A program review report involving the eligibility of loans for the 9.5 percent special allowance floor for loans financed by certain tax-exempt obligations was delayed for a year. In the summer of 2002 regional staff identified an issue related to eligibility of loans for the 9.5 percent floor. Regional staff prepared a draft program review report requiring a recalculation of a lender's special allowance billings in October 2002, and sent the draft to headquarters for review. In November 2003, after discussions with officials of OPE, including the Assistant Secretary, Financial Partners officials decided not to pursue the issue as a finding. The program review report issued in December 2003 noted the issue as an observation.

Process Improvements Needed

Financial Partners lacks policies and procedures on obtaining guidance, specific timeframes for addressing policy questions, and how Financial Partners should proceed if an answer cannot be provided within the required timeframe. In addition, we found that Financial Partners does not have a clear and effective process for staff to obtain policy assistance from OPE or FSA's Policy Liaison and Implementation Staff and for management's communication of policy decisions and advice to staff. As a result, Financial Partners' regional offices and management may not correctly and consistently resolve compliance and other program issues. In addition, the guidance provided may be incorrect, or different guidance may be given to different reviewers, which could result in inconsistent interpretation and application between reviewers and regional offices.

[14] Common Claim Initiative.

The lack of an effective information and communication process for policy issues prevents Financial Partners from issuing or resolving reports in a timely manner. Untimely responses may create an environment that discourages review specialists from addressing unusual or potentially controversial issues, developing findings of non-compliance, or quantifying liabilities. In the absence of adequate policy or management direction, specialists may report issues as "observations" rather than as findings requiring corrective action, including repayment of liabilities.

RECOMMENDATIONS

We recommend the Chief Operating Officer for FSA working in cooperation with the Assistant Secretary for Postsecondary Education and the General Counsel

3.1 Develop written policies and procedures for obtaining timely guidance for resolution of program issues and for communicating the results and decisions.

3.2 Develop written policies and procedures for regular review by OGC of program reviews and other significant program determinations.

FSA COMMENTS

In the joint response, FSA and OPE concurred with the finding and Recommendation 3.1. They agreed that the process for tracking and documenting policy guidance could be improved. Both offices agreed to evaluate these processes and implement any identified improvement, including documenting the procedures that support these processes and the mechanisms for communicating results and decisions. FSA added that it will develop metrics for measuring the time required to obtain policy and legal guidance, and OPE, OGC, and Federal Student Aid will review those metrics monthly.

FSA did not concur with Recommendation 3.2, but it agreed to ensure that program review findings associated with issues that are considered unusual, unique, or controversial will be reviewed.

OIG RESPONSE

While FSA and OPE concurred that the processes for tracking and documenting policy guidance can be improved and agreed to evaluate the processes and procedures used to track and document policy and legal guidance, the response does not clearly address the recommendation. The recommendation is to develop written policies and procedures for obtaining timely guidance for resolution of program issues and for communicating the results and decisions. In addition, establishing and reviewing metrics for measuring the time required for obtaining policy and legal guidance is not sufficient without establishing a goal for timely resolution and guidance.

FSA did not concur with Recommendation 3.2. The response does not specify OPE's position on the recommendation and does not identify FSA's reasons for not concurring with the

recommendation. We have not changed our recommendation, which, if followed, could ensure that all of Financial Partners' program reviews and significant program decisions are legally supportable, and consistent with the HEA, program regulations, and agency precedent. A desire to limit legal review does not reflect positively on management's philosophy and its operating style. It also accepts too much unnecessary risk, which impacts the control environment reported in Finding 1. If legal advice had been requested by Financial Partners on previous issues, Financial Partners may have avoided some of the deficiencies identified in this report.

Finding No. 4 – Risk Assessment Tool Not Fully Implemented

GAO's standard for internal control related to risk assessment states that "Internal control should provide for an assessment of the risks the agency faces from both external and internal sources." In addition, the Office of Management and Budget (OMB) and the GAO require the Department to safeguard the integrity of the program. According to OMB Circular A-123, "Federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Agency managers should continuously monitor and improve the effectiveness of management controls associated with their programs." Based on our review, we found that Financial Partners had not

- Fully implemented its guaranty agency, lender, and servicer scorecards to assess risk to the FFEL programs.

- Developed written policies and procedures in the use of its guaranty agency, lender and servicer scorecards as a risk assessment tool and trained all users.

- Implemented a process to continually evaluate the effectiveness of the scorecards and identify and implement improvements.

We found evidence that Financial Partners' regional staff began using and evaluating the guaranty agency scorecard as part of the program review process in January 2005. Regional staff also provided the scorecard to the guaranty agencies for comment. However, we found no evidence of the use and evaluation of the lender and servicer scorecards in the files we reviewed.

Financial Partners' management has not developed written scorecard policies and procedures detailing how the reviewers are to use the scorecards as a risk assessment tool. One regional manager stated that Financial Partners' staff attended a national training session in September 2004 that included the guaranty agency scorecard. Another regional manager stated that no formal training on the guaranty agency scorecard was provided to review staff in the region. More than half of the regional staff we interviewed indicated that there has not been sufficient training and guidance on the use of the guaranty agency scorecard.

Financial Partners has not implemented a process to continually evaluate the effectiveness of the scorecards and identify and implement improvements. Further, Financial Partners has not developed any written policies and procedures for evaluating the effectiveness of the scorecards.

Financial Partners produced two quarterly analysis reports on the guaranty agency scorecard, one in April 2005 and another in July 2005. Both reports contained recommendations for changes to the guaranty agency scorecard. However, Financial Partners has not made all of the recommended changes identified in its initial evaluations of the guaranty agency scorecard. In addition, we found no analysis of the effectiveness of the lender or servicer scorecards.

As a result, Financial Partners has not fully implemented the scorecard and does not have sufficient information to evaluate whether the scorecard elements were useful in assessing risk. The scorecard is a risk assessment tool that Financial Partners developed to assess risk based on an evaluation of financial information. Given the size of the FFEL program, a delay in the effective implementation of a risk assessment tool based on financial information, hampers Financial Partners' ability to identify risk areas at guaranty agencies, lenders, and servicers.

RECOMMENDATION

We recommend that the Chief Operating Officer for FSA Require Financial Partners to

4.1 Develop written policies and procedures on the use of the guaranty agency, lender, and servicer scorecards as a risk assessment tool and train users on their use.

4.2 Implement a process to continually assess the effectiveness of the scorecard; and identify and implement improvements.

FSA COMMENTS

FSA concurred with the finding and Recommendations 4.1 and 4.2. FSA stated that Financial Partners has developed a program review schedule based on risk rather than frequency, and continued the development and enhancement of tools to assist in the identification and mitigation of risk to the FFEL Program.

FSA did not concur with the statement that its ability to identify risk areas has been hampered because the scorecards were not fully implemented. Specifically, FSA stated that

> The scorecards represent only one of several risk assessment mechanisms used by Financial Partners. As the scorecards have evolved, the overall use of the scorecard has changed from a tool for individual review staff to a higher-level risk assessment and planning tool. Follow-up documentation demonstrating this was provided to the OIG staff and shows that the scorecards were actively used as a risk assessment tool when Financial Partners developed its program review schedules for FY 2005 and FY 2006.

OIG RESPONSE

Financial Partners was to use the guaranty agency and lender scorecards to reduce risks and improve the review process, and to evaluate the use of guaranty agency and lender scorecards. Financial Partners stated that the scorecards were one of several tools used to assess risk, such as

reserve ratio monitoring, Forms 2000 reviews, and review of prior audit reports. The scorecards are a part of the Data Mart system, and are populated with financial data in each of the critical elements. While FSA maintains that the scorecards represent only one of several risk assessment tools, the scorecards contain critical financial data needed to assess risk. We reviewed the data Financial Partners provided subsequent to our exit conference as documentation of its use of the scorecards in planning and developing FYs 2005 and 2006 program review schedules. However, we found nothing in the documentation provided to indicate that Financial Partners focused its efforts on the entities at most risk.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our audit objective was to evaluate the adequacy of Financial Partners' processes for monitoring guaranty agencies, lenders, and servicers. Audit coverage included Financial Partners' monitoring activities for the periods FY 2004 (October 1, 2003 to September 30, 2004) and half of FY 2005 (October 1, 2004 to March 31, 2005).

As part of our review, we compared Financial Partners' monitoring activities to GAO's *Standards for Internal Control in the Federal Government* to determine whether or not the activities met the specific five standards. We did not perform an internal control review over Financial Partners' entire organizational structure. Specifically, we evaluated the controls that solely pertained to Financial Partners' monitoring activities, in which we identified weaknesses detailed in the audit findings.

We conducted our audit fieldwork at Financial Partners' headquarters office in Washington and the eastern (New York/Boston) and southern (Dallas) regions. We chose these two regions because we determined, through a review of Financial Partners' program review data and other departmental data, that the southern and eastern regions conducted the highest number of guaranty agency and lender reviews during our audit period. In addition, six of the top 10 current holders of FFEL loans for 2003 and 2002 were located in the eastern and southern regions.

To determine the number of program reviews Financial Partners conducted in its eastern and southern regions, we examined PEPS data and conducted detailed file reviews. We found that the southern and eastern regions reportedly conducted 82 program reviews of guaranty agency, servicers and lenders during FY 2004 and part of FY 2005. See the following table for the breakdown by type of review.

Table 1 --Reviews Conducted in the Eastern and Southern Regions

					Totals
2004	Southern	8	8[15]	23	39
2004	Eastern	4	5[16]	13[17]	22
2005	Southern	6	2[18]	0	8
2005	Eastern	5	0	8[19]	13
	Totals	**23**	**15**	**44**	**82**

[15] Four reviews (Missouri Higher Education, EFSI, Iowa Student Loan Liquidity & F.I.S.C.) reportedly covered **408** entities/lenders.
[16] Three reviews (SLMA, Wyoming Student Loan Corp., American Ed. Service/PHEAA) reportedly covered **434** entities/lenders.
[17] One review was a special project involving consolidated loan rebate fees, which reportedly covered **31** lenders.
[18] Both reviews covered **19** entities.
[19] One review was a special project involving consolidated loan rebate fees, which reportedly covered **539** entities / lenders.

To accomplish our audit objectives we

- Interviewed Financial Partners' management officials and staff in headquarters and in the southern and eastern regions.

- Interviewed officials in OPE, OGC and other FSA officials to determine methodology for handling FFEL program policy issues. We reviewed available supporting documentation for the various policy decisions made by these groups.

- Analyzed and reviewed applicable laws and regulations, the most recent copies of the Program Review Guides (guaranty agency and lender/servicer), PEPS technical guide, Data Mart training manual, previous OIG audit reports, and Financial Partners' Draft Internal Procedures Manual dated May 26, 2005.

- Examined program review reports and supporting documentation files for program reviews conducted by Financial Partners' eastern and southern regions during our audit period. To perform our review, we selected all guaranty agency reviews, full lender/servicer reviews, and CRI projects conducted by Financial Partners' eastern and southern regions. Also, we reviewed the eastern and southern regions' limited reviews, joint reviews, and desk reviews by selecting the first three reviews for each office by issue date.

We reviewed a total of 58 files as detailed in Table 2 below.

Table 2-- Sampled Files Reviewed

		Eastern Region
FY 2005		
Guaranty Agency Reviews	6	5
Servicer / Lender Reviews	2	0
Lender Reviews	0	8
Other Reviews	0	3
FY 2004		
Guaranty Agency Reviews	8	4
Servicer /Lender Reviews	4	2
Full Joint Reviews[20]	2	0[21]
CRI Reviews	0	1[22]
Limited Reviews	4	3
Other Reviews	3	3
Totals by Region	29	29
Total Number of File Reviews Performed --- 58		

[20] Two reviews – Wells Fargo Bank New Mexico, and Zions FNBAS Trustee for NMEAF were covered under the New Mexico Educational Assistance Foundation.
[21] Eastern Region did not perform any Full Joint Reviews for FY2004.
[22] Student Loan Servicing was covered under AES-PHEAA. Audit team counted as one review.

To meet the objectives of our audit, we relied on computer-processed data to identify and select a sample of program reviews for the eastern and southern regions. Although our review of the PEPS data identified issues with the program review classification and input data (as discussed in the Results Section), we determined that the PEPS data was sufficiently reliable for use in meeting our audit objective.

We performed our audit work from December 2004 through November 2005 at Financial Partners' headquarters office in Washington, DC; Financial Partners' regional offices in Dallas, TX, and New York, NY; and Financial Partners' duty locations in Atlanta, GA and Boston, MA. We conducted additional fieldwork in Washington, DC with Financial Partners' management and, OPE, OGC and FSA officials and staff during the week of September 12, 2005. We discussed the results of our audit with Financial Partners' management in a briefing on August 30, 2005 and in an exit conference on February 8, 2006. Our audit was conducted in accordance with *Government Auditing Standards* appropriate to the scope of the review described above.

UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, D.C. 20202-_____

JUN -5 2006

TO: Helen Lew
Assistant Inspector General for Audit
Office of Inspector General

FROM: Theresa S. Shaw
Chief Operating Officer
Federal Student Aid

James F. Manning
Acting Assistant Secretary
Office of Postsecondary Education

SUBJECT: Draft Audit Report – "Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Servicers and Lenders," Control Number ED-OIG/A04-E0009

Thank you for providing us with an opportunity to respond to the Office of Inspector General's (OIG) draft audit report, "Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Servicers and Lenders," Control Number ED-OIG/A04-E0009, dated April 4, 2006. The draft report states that your audit found the following weaknesses:

1) A weak control environment for monitoring and oversight;
2) Insufficient control activities over monitoring of program reviews and technical assistance;
3) Lack of an effective information and communication process related to policy issues; and
4) The risk assessment tool was not fully implemented.

Federal Student Aid is committed to continuously improving the monitoring and oversight of guaranty agencies, servicers, and lenders. Over the past three years, Federal Student Aid completed a number of initiatives that improve monitoring and oversight of Federal Family Education Loan (FFEL) Program participants. We established clear and specific annual goals for improving the process of monitoring and oversight, developed a program review schedule based on risk rather than frequency, completed the tracking and resolution of FFEL issues that directly impact the program and the taxpayer, and continued the development and enhancement of tools to assist in the identification and

mitigation of risk to the FFEL Program. These initiatives establish a strong foundation for continuous improvement and provide for a more proactive approach to the monitoring and oversight activities performed by Financial Partners Services and Federal Student Aid.

In the attachment, we are providing a response to each finding and recommendation. We acknowledge that areas exist for continued improvement in our monitoring and oversight activities. However, we disagree with the audit's overall conclusion reached regarding Financial Partners control environment. After a review of the U.S. Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government*, and the OIG work papers for the audit, we believe that the audit report fails to recognize the strong foundation of control that has been established over the past three years.

Specifically, Federal Student Aid has implemented key activities that form the foundation for a positive control environment. Examples of these controls are included in our response to the findings. In addition, observations from our review of the GAO's *Standards for Internal Control in the Federal Government* and the OIG's work papers for this audit, and a description of actions implemented to date that address your findings are included in the attachment.

Thank you again for the opportunity to review and comment on this report.

Attachment

cc: Patrick J. Howard, Director, OIG Student Financial Assistance Advisory & Assistance Team
Denise M. Wempe, Regional Inspector General for Audit

Finding No. 1 – Weak Control Environment for Monitoring and Oversight

The draft report states that Financial Partners did not provide a positive control environment, as described by the GAO standards for internal control, because it was found that Financial Partners:

- Was not included in FSA's tactical goals for program monitoring and oversight;
- Emphasized partnership over compliance in dealing with guaranty agencies, lenders, and servicers in its mission statement on selected actions;
- Overstated the number of program reviews conducted in PEPS and did not consistently quantify program review liabilities;
- Did not ensure that the Department's requirements for delegation of authority for waiving liabilities were followed; and
- Experienced high turnover in its General Manager position.

Overall Response:

The report cites the GAO standards for internal control that state that a "positive control environment is the foundation for all other standards…and provides discipline and structure as well as the climate, which influences the quality of internal control." Based on this, the report concludes that Financial Partners did not provide a positive control environment.

The *Control Environment* section of the GAO standards lists a number of key factors that affect the control environment. These factors include:

- The integrity and ethical values maintained and demonstrated by management and staff;
- Management's commitment to competence;
- Management's philosophy and operating style, which include the degree of risk that it is willing to take and its philosophy towards performance-based management;
- An agency's organizational structure;
- The manner in which an agency delegates authority and responsibility throughout the organization;
- Good human capital policies and practices; and
- An agency's relationship with Congress and central oversight agencies.

Federal Student Aid does not concur with Findings No. 1, which addresses only two to three of the seven key factors cited by the GAO. We believe that Financial Partners does provide a positive control environment. It is our position that the OIG's assertion is too broad and is not substantiated by the associated findings and work papers.

Oversight and Monitoring Not Included In the Tactical Goals of FSA's Strategic Plan

Federal Student Aid does not concur with the report's conclusion that the tactical goals associated with the oversight and monitoring of guaranty agencies, servicers, and lenders are not included in Federal Student Aid's Strategic Plan. While we acknowledge there is no specific reference in the Strategic Plan regarding the oversight and monitoring of lenders, servicers, and guaranty agencies, it is discussed in general terms under the Program and Monitoring section.

By its very nature, the Strategic Plan is a high-level document that presents Federal Student Aid's long-term strategic objectives. It does not specifically address all of the tactical goals that are established and monitored on a monthly and annual basis through our Annual Performance Plan, which establishes specific tactical initiatives to achieve each of our strategic objectives. Item 3.7 in each of the Annual Performance Plans for fiscal years (FY) 2005 and 2006, entitled "Enhance program monitoring and oversight," details the Department's tactical goals for improving oversight of lenders, servicers, and guaranty agencies.

The draft audit report concludes by acknowledging that tactical goals are included in the Annual Plan but ends with the following statement:

"Based on the weaknesses we identified, Financial Partners is not providing proper oversight and monitoring of guaranty agencies, lenders, and servicers."

Federal Student Aid believes that this statement has no relevance to the topic of whether or not the goals of monitoring and oversight are included in the Strategic Plan. We further believe that the rigor of the tactical goals outlined in Federal Student Aid's Annual Performance Plan demonstrate a strong control environment that is being evaluated by all levels of management within Federal Student Aid and that it does not support the audit report's premise that Federal Student Aid has not provided a positive control environment.

Recommendation 1.1 – Include compliance monitoring of guaranty agencies, lenders and servicers in the tactical goals of FSA's strategic plan.

Although we do not concur with the finding and this recommendation, Federal Student Aid has incorporated specific tactical action steps from the Annual Performance Plan in Appendix A of the FY 2006-2010 Five-Year Plan.

Financial Partners Viewed Guaranty Agencies, Lenders, and Servicers as Partners

Federal Student Aid does not concur with OIG's assertion that we emphasize partnership over compliance in dealing with guaranty agencies, lenders and servicers. We have found that more effective compliance can often be achieved through partnership rather

than at the expense of it. An example of this is Collegiate Funding Services (CFS) Suntech's willingness to "self report" infractions when the risk of discovery was low and the consequences were great, resulting in their loss of the Exceptional Performer designation. Additionally, we believe that this review was too focused on the partnership aspects of our office, while failing to recognize the more significant oversight activities we perform.

The report cites several examples of Financial Partners' emphasis of partnership over oversight but does not present them within the context of our overall oversight. Our response to each example was developed after careful consideration and review of the supporting OIG work papers.

1. The supervisory role of the State Agency Liaison over the Financial Partners Regional offices and the corresponding functional statements associated with the State Agency Liaison position.

   The report fails to acknowledge that the position description of the State Agency Liaison is focused on the advocacy function of this position with respect to state agencies that specifically administer the Leveraging Educational Assistance and Partnership (LEAP) and Special Leveraging Educational Assistance and Partnership (SLEAP) grant programs for which primary oversight responsibility rests with individual state auditors and is not a function of the Financial Partners regional offices.

2. A program reviewer recommended a method for a guaranty agency to reduce the amount of usage fees it must pay to the Federal Fund.

   This statement does not correctly characterize the actual events associated with this particular scenario. This approach was taken to address the actual value of furniture and equipment that included depreciation. The initial estimates of fair market value for determination of the usage fees was done at full value without depreciation. This would have led to the Department of Education (Department) overcharging usage fees. Federal Student Aid concurs with the OIG that the rationale for this approach should have been documented in the program review files.

3. A guaranty agency failed to conduct all of its required lender reviews and the program reviewer provided the guaranty agency with data to respond to the finding and justify not being required to conduct the reviews.

   This statement does not correctly characterize the actual events associated with this particular scenario. The guaranty agency in question had performed one hundred percent of its required lender reviews, but due to an error in procedures, it had focused on the loan holders and had not reviewed the actual originators of the loan. The program reviewer evaluated this data and subsequently required the guaranty agency to perform additional reviews at those entities that had not

been reviewed by the Department. Federal Student Aid concurs with the OIG that the rationale for this approach should have been documented in the program review files.

4. A Financial Partners Regional Director provided internal pre-decisional documents to a secondary market official because the official requested it. The lender then used the documents in an unsuccessful attempt to obtain a Federal court order to block the issuance of an OIG audit report.

   We believe that this situation resulted from an error in judgment on the part of an individual and is not indicative of a systemic problem. To address this specific situation, Management took immediate steps to reinforce disclosure requirements with the staff as well as initiate disciplinary action against the employee. More importantly, this one event does not substantiate the finding that Financial Partners emphasizes partnership over oversight.

Recommendation 1.2 – Amend Financial Partners' mission to better emphasize Financial Partners' role in compliance enforcement.

Federal Student Aid does not concur with this recommendation. However, to strengthen our oversight and monitoring of program participants, we have consolidated all program compliance functions under a single unit reporting directly to the Chief Operating Officer. This realignment was effective May 28, 2006.

Recommendation 1.3 – Eliminate the organizational conflict of interest caused by the State Agency Liaison supervising the regional offices, and re-assign supervisory responsibility to an official whose responsibilities do not include advocating the interests of entities regulated by Financial Partners.

Federal Student Aid does not concur. However, under the realignment described in our response to Recommendation 1.2 above, the regional staff reporting to the State Agency Liaison Officer are moving to another organization whose primary function will be program compliance. The functional description of the State Agency Liaison position will also be re-evaluated and modified as necessary.

Financial Partners Overstated Program Reviews in PEPS and Did Not Consistently Quantify Liabilities

Federal Student Aid disagrees with the report's assertion that Financial Partners has overstated the number of program reviews it has performed. At issue is the methodology that Financial Partners uses to record the number of reviews conducted for lenders whose servicing functions are performed in whole or part by a separate servicing organization. In general, Financial Partners conducts three types of lender reviews. These include on-site reviews of the lender, off-site or desk reviews in the Financial Partners regional office of lender data and information, and lender reviews conducted on-site at the servicer

performing duties on the lender's behalf. Each lender review is accurately recorded in the Postsecondary Education Participants System (PEPS) with a separate and distinct code that clearly differentiates the type of lender review that has been performed. This is the number that was accurately reported.

The report further suggests that reviews conducted on-site at the servicing entity should be considered a servicer review and not classified as a lender review. This suggestion does not acknowledge the function that the servicer plays, which is to perform the functions of the lender on behalf of the lender. A comprehensive and thorough review of a servicing entity that yields no findings indicates that the functions it is performing on behalf of its lenders are in compliance with the applicable legislative and regulatory requirements. Federal Student Aid does not believe that it is overstating the number of program reviews conducted by further stating that the lenders being serviced by this entity are also in compliance with the applicable legislative and regulatory requirements.

Federal Student Aid concurs with the finding that program reviewers do not consistently quantify liabilities and this item will be addressed through the Corrective Action Plan (CAP).

Recommendation 1.4 – Require Financial Partners to stop recording as lender program reviews, program reviews that are actually only servicer reviews.

As stated above, Federal Student Aid does not concur with this finding and recommendation. However, to address OIG's concern, Federal Student Aid will begin publishing the figures as they are recorded on the PEPS system: on-site reviews of the lender, off-site or desk reviews in the Financial Partners regional office of lender data and information, and lender reviews conducted on-site at the servicer performing duties on the lender's behalf. Federal Student Aid will also re-evaluate the processes and procedures associated with the way data are entered into the PEPS system to address the OIG's concerns regarding errors resulting from data entry.

Recommendation 1.5 – Develop consistent policy for identifying, quantifying, and reporting all liabilities identified in program reviews regardless of where they are resolved.

After the implementation of the organizational realignment, Federal Student Aid will evaluate the processes and procedures in place for identifying, quantifying, and reporting liabilities for schools and tailor those processes for program reviews at guaranty agencies, lenders, and servicers.

Delegation of Authority for Waiving Liabilities Not Followed

Federal Student Aid concurs with the need to re-evaluate the delegation of authority provisions implemented in 1998 and 1999.

Recommendation 1.6 – Request an amendment to the Chief Operating Officer's delegation of authority to the General Manager for waiving liabilities to include additional controls for monetary limitations and consultation with other Department officials and ensure that managers and staff know and understand the delegation of authority for waiving liabilities.

Federal Student Aid will modify the Chief Operating Officer's delegation of authority to the General Manager of Financial Partners Services to include additional controls for monetary limitations and consultation with other Department officials and ensure that managers and staff know and understand the delegation of authority for waiving liabilities.

Recommendation 1.7 – Require the General Manager to track when a waiver is granted and to document the reasons for waiving a liability when exercising waiver authority.

Federal Student Aid will develop a mechanism to track waivers that are granted, including the reasons for waiving a liability.

Finding No. 2 – Insufficient Control Activities Over Monitoring of Program Reviews and Technical Assistance.

The draft report states that Financial Partners had not implemented sufficient control activities and monitoring because Financial Partners did not:

- Follow its policies and procedures for conducting and documenting program reviews;
- Have adequate policies and procedures for the program review process;
- Have policies and procedures for providing and documenting technical assistance; or
- Have a process for monitoring the quality of program reviews or technical assistance.

Overall Response:

As the draft report points out, Financial Partners had enhanced its internal policy and procedures in May 2005 to address the specific areas identified in this report. The new procedures were formally implemented for the FY 2006 program review cycle and staff training was conducted in November 2005. In addition, the Federal Student Aid organizational realignment combines the program review staff from Financial Partners with the staff performing program compliance reviews of schools. Federal Student Aid's Schools Eligibility Channel has undergone an extensive business re-engineering effort to address the program review, technical assistance, and quality monitoring of the oversight activities for schools. Financial Partners is currently working with this office to identify

a way that these efforts can also be applied to the processes and procedures for the oversight activities associated with guaranty agencies, lenders and servicers.

Federal Student Aid disagrees with the statement that, as a result of these identified weaknesses, Financial Partners did not identify potentially significant instances of non-compliance, and that it has not provided adequate oversight and monitoring to ensure compliance with the Higher Education Act as of 1965, as amended (HEA), regulations, and guidance. Neither the draft report nor the work papers supporting this audit identified specific examples where instances of non-compliance were missed as a result of these deficiencies.

However, Federal Student Aid will leverage the work done on program review procedures and standards by the Application, School Eligibility, and Delivery Services (ASEDS) organization and implement improvements to support each of the following six recommendations:

Recommendation 2.1—Ensure that Financial Partners follows its procedures and guidance for its program review process.

Recommendation 2.2—Require Financial Partners to enhance and implement its guidance to include procedures that address the program review weaknesses we identified.

Recommendation 2.3—Require Financial Partners to enhance and implement its guidance to include procedures that address the technical assistance weaknesses and provide oversight to the regions to ensure that technical assistance is consistently provided and properly documented.

Recommendation 2.4--Ensure that Financial Partners strengthens its program review process to ensure consistency in the program review process and that program reviews are issued and closed in a timely manner.

Recommendation 2.5—Require Financial Partners to establish a quality assurance process that would ensure that program reviews are conducted properly, that work papers support the conclusions reached and findings are adequately documented.

Recommendation 2.6—Require Financial Partners to establish a quality assurance process that would ensure the quality and the adequacy of technical assistance.

Finding No. 3 – Lack of Effective Information and Communication Process Related to Policy Issues

The draft report states that Financial Partners does not have a reliable process to obtain timely guidance on the proper application of the HEA and program regulations or how to resolve issues consistent with Department policy and prior determinations. The report

acknowledges that Financial Partners does have a process for obtaining guidance but finds that this process leaves issues unresolved for long periods of time and that the communications mechanism for resolved issues is not effective.

Overall Response:

Federal Student Aid and the Office of Postsecondary Education (OPE) concur that the processes for tracking and documenting policy guidance can be improved, and we agree to evaluate these processes and implement any identified improvements in response to Recommendation 3.1. This includes documenting the procedures that support these processes and the mechanisms for communicating results and decisions. In particular, we will evaluate the following areas of concern:

- The tracking and resolution of routine questions about the proper application or resolution of program requirements;
- The flow of these questions from Federal Student Aid to OPE and the Office of General Counsel (OGC); and
- The tracking, resolution, and communication of responses to non-routine questions or issues.

Issues described in the audit report as unusual, unsettled, or controversial are unique and require differing levels of involvement within the Department to reach an ultimate decision. Federal Student Aid will continue to track these issues. The log will be shared with OPE and OGC on a bi-weekly basis so that everyone involved fully understands the impact that delays in key decisions have on the timely issuance of program review reports. Federal Student Aid and OPE will also develop guidance for Financial Partners headquarters and regional staff to follow when seeking policy guidance and legal analyses from OPE and OGC, respectively.

Federal Student Aid does not concur with Recommendation 3.2 that a process should be developed that provides for the regular review by OGC of Financial Partners' program review findings. As part of the process described above, Federal Student Aid will ensure that program review findings associated with issues that are considered unusual, unsettled, or controversial will be reviewed.

Recommendation 3.1—Develop written policies and procedures for obtaining timely guidance for resolution of program issues and for communicating the results and decisions.

Federal Student Aid will assess the processes and procedures used to track and document policy and legal guidance. Based on this assessment, OPE, the OGC, and Federal Student Aid will develop a best of practice solution for tracking and resolving policy and legal matters. Finally, metrics will be developed for measuring the time required to obtain policy and legal guidance. These metrics will be reviewed by OPE, OGC, and Federal Student Aid monthly.

Recommendation 3.2—Develop written policies and procedures for regular review by OGC of program reviews and other significant program determinations.

Federal Student Aid does not concur with this recommendation, but it will ensure that the process described above will provide for a review of all program review findings associated with unusual, unique, and controversial issues.

Finding No. 4 – Risk Assessment Tool Not Fully Implemented

The draft audit report states that Financial Partners' ability to identify risk areas at guaranty agencies, lenders, and servicers is hampered because the effective implementation of the associated scorecards has been delayed. Specifically, the document states that Financial Partners had not:

- Fully implemented its guaranty agency, lender, and servicer scorecards to assess risk to the FFEL programs;
- Developed written policies and procedures in the use of its guaranty agency, lender and servicer scorecards as a risk assessment tool and trained all users; or
- Implemented a process to continually evaluate the effectiveness of the scorecards and identify and implement improvements.

Federal Student Aid concurs with the report and recommendations 4.1 and 4.2 which indicate that written policies and procedures have not been developed for the use or ongoing evaluation of guaranty agency, lender, and servicer scorecards. As part of its CAP, Federal Student Aid will document these policies and procedures and ensure that the appropriate users are trained.

Federal Student Aid does not concur with the statement that its ability to identify risk areas has been hampered because the scorecards were not fully implemented. The scorecards represent only one of several risk assessment mechanisms used by Financial Partners. As the scorecards have evolved, the overall use of the scorecard has changed from a tool for individual review staff to a higher-level risk assessment and planning tool. Follow-up documentation demonstrating this was provided to the OIG staff and shows that the scorecards were actively used as a risk assessment tool when Financial Partners developed its program review schedules for FY 2005 and FY 2006.

Recommendation 4.1—Develop written policies and procedures on the use of guaranty agency, lender, and servicer scorecards as a risk assessment tool and train the appropriate users.

Financial Partners will document the policies and procedures for the use of guaranty agency, lender, and servicer scorecards as a risk assessment tool and train the appropriate users.

Recommendation 4.2—Implement a process to continually assess the effectiveness of the scorecard, and identify and implement improvements.

Financial Partners will develop, document, and implement a process to continually assess the effectiveness of the guaranty agency, lender, and servicer scorecards and implement improvements.