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Mr. Larry E. Matejka
Executive Director
Illinois Student Assistance Commission
500 West Monroe Street, Third Floor
Springfield, Illinois 62704

AUG 20 2004

Dear Mr. Matejka:

Enclosed is our final audit report, Control Number ED-OIG/A05-D0040, entitled Audit of the Illinois Student Assistance Commission's Review of Lender Due Diligence and Post-Default Collections Related to Wage Garnishment. This report incorporates the comments you provided in response to the draft report. If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department officials, who will consider them before taking final Departmental action on this audit:

Theresa S. Shaw, Chief Operating Officer
Federal Student Aid
U.S. Department of Education
Union Center Plaza
Room 112G1
830 First Street, NE
Washington, D.C. 20202-5132

It is the policy of the U.S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be appreciated.

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

Sincerely,

Richard J. Dowd
Regional Inspector General
for Audit

Enclosure



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MEMORANDUM

AUG 20 2004

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

FROM: 
Richard J. Dowd
Regional Inspector General for Audit

SUBJECT: Final Audit Report
Audit of the Illinois Student Assistance Commission's Review of Lender Due
Diligence and Post-Default Collections Related to Wage Garnishment
Control Number ED-OIG/A05-D0040

You have been designated as the action official responsible for the resolution of the findings and recommendations in the attached final report. We have also provided a copy to the auditee and to your audit liaison officer.

The Office of Inspector General is required to review and comment on the proposed program determination letter (PDL) and the audit clearinghouse document (ACD) before the PDL is forwarded to the auditee. Our review of these documents will be handled through the Department's Audit Accountability and Resolution Tracking System (AARTS).

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.

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

If you have any questions, please contact me at 312-886-6503.

Enclosure

Audit of the Illinois Student Assistance
Commission's Review of Lender Due Diligence and Post-
Default Collections Related to Administrative Wage
Garnishment



FINAL AUDIT REPORT
ED-OIG/A05-D0040
August 2004

Our mission is to promote the efficiency,
effectiveness, and integrity of the
Department's programs and operations



U.S. Department of Education
Office of Inspector General
Chicago, Illinois

NOTICE

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

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

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Executive Summary

The objectives of our audit were to determine if, for the period October 1, 2002, through June 30, 2003, the Illinois Student Assistance Commission (ISAC) (1) adequately processed post-default collections related to administrative wage garnishments (AWG) and (2) properly submitted eligible reinsurance claims, specifically, default claims, to the U.S. Department of Education (ED). Our audit disclosed that the ISAC complied with the Higher Education Act of 1965, as amended, and relevant regulations regarding processing of post-default collections related to AWG. However, ISAC did not comply with the regulations regarding the submission of eligible reinsurance claims. Specifically, ISAC's

- Claim review process was not adequate to ensure that it claimed reinsurance only if the lender exercised due diligence in servicing the loan. ISAC's claim review process was limited to a brief review of summary information shown on its claim form. ISAC's claims analysts generally did not verify that the summary collection information shown on the claim form was supported by the underlying detailed collection history information and rarely used available software that would review claims for lender due diligence. We reviewed 50 claims, totaling \$123,521, selected from a universe of 21,732 claims that ISAC submitted for reinsurance during the audit period. We identified 32 claims, totaling \$75,077, that ISAC should have returned to the lenders because the claim packet was missing accurate collection and/or payment histories or contained evidence of a due diligence violation.
- Imaging policies and procedures did not ensure that ISAC maintained complete and accurate computer images of original claim packets. This is a repeat finding from our December 1999 audit report to ISAC (ED-OIG/A05-90002).
- Policies and procedures did not ensure that it maintained adequate support for Forms 2000 information to meet the records retention requirements in the regulations.

We recommend that the Chief Operating Officer, Federal Student Aid (FSA) instruct ISAC to:

1. Adhere to its policies and procedures and require lenders to provide accurate collection and payment histories sufficient for ISAC's claim analysts to review the claims for lender due diligence;
2. Require its claims analysts to verify lender due diligence activities shown on the claim form's summary of lender due diligence against detailed collection history information;
3. Review all claims submitted for reinsurance to ED during the period October 1, 2002, through June 30, 2003, and determine which claims had due diligence violations resulting in lost reinsurance or penalties;
4. Obtain the missing documentation for the 32 claims it should have returned to lenders

or repay ED \$75,077 for the claims that lost reinsurance and could not be cured;

5. Establish written policies and procedures requiring that the completeness and accuracy of imaging are verified before claim packets are destroyed and establish adequate management controls to ensure that the policies and procedures are followed;
6. Identify the claims that were improperly imaged during the period October 1, 2002, through June 30, 2003, and obtain the missing collection and payment histories;
7. Obtain the missing documentation for the 20 claims that were not adequately imaged or repay ED \$47,673 for the claims that lost reinsurance and could not be cured; and
8. Revise its policies and procedures and retain the electronic files used in preparing the Forms 2000 report and records of any manual adjustments long enough to meet the records retention requirement in the regulations.

We provided a draft of this report to ISAC. In its response, ISAC partially disagreed with Finding 1 and agreed with Findings 2 and 3. ISAC affirmed that its adherence to relevant provisions in the Common Manual more than satisfactorily meet the federal regulation requirements governing claim payments and reinsurance. ISAC's response did not cause us to change our findings or recommendations. We have summarized ISAC's comments after each finding and included them in their entirety as an attachment.

Audit Results

Finding No. 1 ISAC Needs to Enhance Its Claim Review Procedures to Ensure Lenders' Default Claims are Fully Supported

ISAC's claim review process was not adequate to ensure that it claimed reinsurance only if the lender exercised due diligence in servicing the loan. ISAC's claim review process was limited to a brief review of summary information shown on its claim form. ISAC's claims analysts generally did not verify that the summary collection information shown on the claim form was supported by the underlying detailed collection history information as part of their review of due diligence, or utilize available software that would review claims for due diligence violations.

ISAC's claim form is a two-page form with nine sections. The sections are:

1. Claim information - described the type of claim and the date the condition occurred (DCO)¹;
2. Borrower information – contained the borrower's Social Security Number, name, address, phone number, etc.;
3. Loan information – included the loan type and identification, first distribution date, current principal balance, and interest rate;
4. Endorser/co-maker information;
5. Conversion to repayment - described the out of school date, notification date, and first payment due date;
6. Repayment information - included the total borrower payments, number of monthly payments, number of months of deferments/forbearances, and payment due date;
7. Requested claim amount – included the total amount disbursed, capitalized interest, principal repaid, principal used for the interest claimed and principal claimed;
8. Lender/servicer information and certification; and
9. Collection history.

The collection history is on page 2 of the claim form and summarizes the 270-day period prior to default. Page 2 is comprised of four columns of dates and codes corresponding to various collection activities, such as letters to borrowers and telephone contacts, performed by the lender. The claim form does not detail the specified due diligence letter or phone call attempts the lender is required to perform according to 34 C.F.R § 682.411 (c)-(n).²

ISAC required lenders to submit the claim form and supporting collection and payment histories as part of the claim packet. An ISAC claims analyst began the review of the claim form by matching it with ISAC's loan data system to verify the date and type of loan, lender code, and disbursement date. Once the claims analyst determined it was the proper loan and guaranteed by ISAC, he or she would begin the review of the lender's

¹ For default claims, the DCO is due date of the first unmet installment of the borrower's delinquency.

² We have included an example of ISAC's claim form as an attachment.

servicing. First, the claim analyst reviewed the claim packet to ensure the DCO was correct. To determine if the DCO was correct, the analyst started with the out of school date and added six months (grace period) and up to 45 days to arrive at the first payment due date listed on the claim form. Then the analyst added the number of borrower payments and deferment/forbearance months to the first payment due date (this total should equal the payment due date listed on the claim form). The payment due date should have been the same as the DCO. If the analyst did not arrive at the DCO, the analyst returned the claim to the lender.

ISAC officials informed us that claims analysts perform a brief "visual review" of the lender's due diligence efforts using the summary of due diligence activities sheet (page 2 of the claim form). The analysts review the form to determine if the lender performed the required activities. The analysts check for 4 letters, 4 phone contacts, a request for default aversion, a final demand, skip-tracing (if there is an invalid address or telephone number), and no 45 day gaps between each activity. After the brief "visual review" of due diligence efforts, the claims analyst then indicates verification of proper lender's due diligence by placing a check mark in the "Due Diligence Reviewed Checkbox" in Odyssey³ for that specific loan. This process is referred to as using the "turbo" feature of Odyssey because it bypasses the need to enter the dates and codes for due diligence performed by the lender.

The process also bypasses Odyssey's built-in due diligence checks. ISAC officials informed us that Odyssey has the capability to electronically evaluate lender due diligence provided the dates and codes of due diligence activities are entered into the system. However, ISAC officials decided that entering the due diligence information into Odyssey was too time-consuming and claims analysts rarely entered the information.

A claims analyst supervisor and a claims analyst told us supervisors seldom reviewed the analyst's work. The supervisors review was limited to a small sample of claims as part of the analysts job evaluation and claims the analysts would bring to the supervisor with questions.

Process Not Sufficient to Fulfill Administrative Oversight Responsibilities

According to 34 C.F.R. § 682.406(a)(1) and (3), a guaranty agency is entitled to reinsurance payments on a loan only if the lender exercised due diligence in making, disbursing, and servicing the loan as prescribed by the rules of the agency. Also, the lender must provide accurate collection and payment histories. The histories must be sufficient to support guarantor review for claim payment and show that the lender exercised due diligence in collecting the loan meeting the requirements in 34 C.F.R. § 682.411. In addition, 34 C.F.R. § 682.411(b)(2) states lenders may not permit a gap in collection activities of more than 45 days.

The accuracy of the collection and payment histories in support of the claim submission cannot be determined without verifying the claim summary data included on the claim

³ Odyssey is ISAC's computer system used in performing its due diligence review.

form to the supporting documentation. A guaranty agency cannot make a determination that the lender has complied with all due diligence requirements, particularly timely conversion to repayment, deferments/forbearances, first date of delinquency, required skip-tracing, and due diligence contacts, without reviewing and verifying the supporting documentation (collection and payment histories) to the claim summary. Without this review, a guaranty agency cannot be said to be fulfilling its administrative oversight function on behalf of the Secretary envisioned in 34 C.F.R. § 682.406.

We found the codes, on page 2 of the claim form, identified only the general nature of the collection activities. The form did not contain information sufficient to assess the adequacy of the lenders' due diligence. For example, the code LC indicates a letter contact was made, but does not identify the type of letter, such as the initial 15-day letter or one of the other required follow-up letters, that was sent. Page 1 of the claim form also does not require the lender to provide an accurate borrower payment history; the form only contains summary information. The claim form states the total amount paid by the borrower. It also contains the equivalent number of monthly payments corresponding to the total amount of payments. However, it does not list the dates and amounts of payments made by the borrower that comprise the total amount paid. Pursuant to 34 C.F.R. § 682.414(a)(1)(ii)(C), a payment history must show the date and amount of each payment that was attributed to principal, accrued interest, collection costs, and other costs.

Further, the claim forms reviewed did not show the beginning or ending dates of the borrower's deferments/forbearances. The claim form does contain deferment/forbearance beginning and ending date codes. However, the lenders did not use the codes, and ISAC accepted the claims without the codes. ISAC's brief "visual review" did not include reviewing any of the collection and payment history the lender provided in support of the dates/codes for due diligence.

The regulations require a lender to convert a loan to repayment timely, to complete required due diligence efforts, engage in the required skip-tracing activities, ensure there are no 45 day gaps, and submit the claim timely. [34 C.F.R. §§ 682.406 & 682.411 (2002)] Except for administrative forbearances, deferments/forbearances generally require signed requests from the borrower and also require specific support. [34 C.F.R. §§ 682.210 & 682.211 (2002)] If a lender fails to meet the due diligence requirements, the regulations specify penalties, ranging from loss of interest for specified periods to loss of loan guarantee. ED allows lenders to cure the violations by receiving a full borrower payment and through reinstatement. [34 C.F.R. § 682 Appendices C and D (2002)]

Claims Should Have Been Returned to Lenders

We reviewed 50 claims, totaling \$123,521, selected from a universe of 21,732 claims that ISAC submitted for reinsurance during the audit period. We reviewed the information on the ISAC claim form and the supporting documentation included in the claim packet. We identified 32 claims, totaling \$75,077, that ISAC should have returned to the lenders because the claim packet was missing accurate collection and/or payment histories or

contained evidence of a due diligence violation. We found 30 claims missing support for deferments/forbearances, 12 with contradictory information, 11 with incomplete collection histories, 9 with due diligence violations, and 7 with incomplete borrower payment histories. Twenty-four claim files had more than one deficiency. Based on the results of our testing, we had a 64 percent sample occurrence rate. We are 90 percent confident that the actual error rate is between 51 and 75 percent.

Examples of claims that ISAC should have returned to lenders.

Example 1

The claim contained an unexplained gap from November 20, 1997, through March 20, 1998. The gap was 4 months long and occurred between the borrower's last payment and the beginning of forbearance. There was no explanation regarding this gap on page 2 of the claim form or in the supporting documentation. Because the gap was greater than 45 days, the claim had a due diligence violation.

The claim's collection history documentation showed 48 months of forbearances, but page 2 of the claim form did not list out the beginning and ending dates of the forbearances. The claim packet did not contain the borrower requests or documentation showing the borrower was eligible to receive the forbearances.

Based on ISAC's policy of using the first payment due date, plus the borrower payments, plus the months of deferments/forbearances, to arrive at the DCO on page 1 of the claim form, the DCO is off by 5 months. The DCO should be November 19, 2001, but page 1 of the claim form has April 19, 2002. ISAC's claim analyst did not catch this difference after performing the normal claim review and passed this claim through for reinsurance.

Example 2

The claim was missing the beginning and ending dates for 12 months of forbearances. The collection history documentation and page 2 did not make reference to a forbearance or contain supporting documentation showing the borrower was eligible to receive a forbearance.

The claim was missing the collection history from August 2, 2001, through June 16, 2002. The missing collection history was for the past 270 days of delinquency.

On page 2 of the claim form there was an unexplained gap from December 16, 2001, through May 3, 2002. The gap could not be explained because the collection history was missing from the claim packet.

The lender did not file the claim timely. The lender sent the borrower a final demand letter on December 16, 2001. Based on our review, the lender should have submitted the claim by January 16, 2002. The lender submitted the claim on April 4, 2003. As a result of filing the claim late, the lender violated the due diligence requirements.

Example 3

The claim was missing the beginning and ending dates for 29 months of deferments and 69 months of forbearances. Page 2 of the claim form did not list the deferments/forbearances. The repayment information on the claim form showed the borrower had deferments/forbearances, but did not support the exact beginning and ending dates for each. Also, the claim packet did not contain any documentation supporting the borrower was eligible to receive the deferments/forbearances.

The claim packet was missing collection history documentation from May 31, 2002, through November 26, 2002. Page 1 of the claim form showed a DCO of March 5, 2002. The collection history documentation and page 2 of the claim form supported a 6th day delinquent letter (opening letter of delinquency) sent to the borrower on February 11, 2002. The due diligence dates on page 2 of the claim form supported a DCO of February 5, 2002. The DCO on page 1 of the claim form was off by 1 month.

As a result of the contradiction mentioned above, there were 2 due diligence violations. The lender sent both the default aversion and final demand letters early for the DCO date of March 5, 2002.

Example 4

The claim was missing support for 6 months of deferments and 6 months of forbearances. The collection history documentation contained a deferment/forbearance history; however, it did not contain the supporting documentation showing the borrower was eligible to receive either one. The claim was missing the complete borrower payment history. The borrower payment history documentation included in the claim packet did not contain the entire payment history.

This claim contained a skip-tracing due diligence violation. The lender found a valid telephone number for the borrower on May 15, 2002. The lender called the number on May 17, 2002, and learned the number was disconnected. The lender continued to call the number and stated it left a message on June 5, 2002. The lender called back on June 21, 2002, and got no answer. Then on July 8, 2002, the lender again said the number was disconnected. According to 34 C.F.R. § 682.411 (I)(3), the lender should have begun skip-tracing activities on May 17, 2002, when it learned the number was disconnected.

Example 5

The claim was missing support for 19 months of forbearances. Page 2 of the claim form did not identify any borrower forbearances. The collection history documentation included a deferment/forbearance history, but it did not contain documentation supporting the borrower was eligible to receive the forbearance. The claim was missing the payment history. There was no payment history documentation to support the accuracy of the \$740 of borrower payments or repaid principal of \$339.58 stated on page 1 of the claim form.

The collection history documentation was missing activity prior to December 31, 2002. Page 1 of the claim form stated the DCO was August 15, 2002. However, page 2 of the claim form showed the first due diligence activity was on June 17, 2002, and contained due diligence activity dates supporting an earlier DCO. Also, the collection history

documentation on March 14, 2003, stated the lender changed the due date from June 11, 2002, to August 11, 2002, because the borrower made 5 payments since a prior forbearance. Page 1 of the claim form showed zero borrower payments and there was no payment history included in the claim packet to support the borrower made 5 payments.

Because of the contradictory information above, there were 2 due diligence violations claim. The lender sent the default aversion and final demand letters too early for the August 15, 2002, DCO.

ISAC Cannot Support Its Claim for Reinsurance

Without an adequate review of the lenders' claims, ISAC cannot support its claims for reinsurance or that the lenders serviced the claims according to 34 C.F.R. § 682.411. An accurate collection history, including beginning and ending dates for deferments and forbearances, and borrower payment information is critical in determining whether (1) the lender performed all required due diligence while servicing the loan; (2) the loan's guarantee was lost; (3) there were any due diligence violations that would result in penalties; and (4) information submitted by lenders on the claim form is accurate and reliable.

Recommendations

We recommend that the Chief Operating Officer, FSA, instruct ISAC to:

- 1.1 Adhere to its policies and procedures and require lenders to provide accurate collection and payment histories sufficient for ISAC's claims analysts to review the claims for lender due diligence.
- 1.2 Require its claims analysts to verify lender due diligence activities shown on the claim form's summary of lender due diligence against all detailed collection history information, support for periods of deferments/forbearances, and dates and amount of borrower payments.
- 1.3 Obtain the missing documentation for the 32 claims it should have returned to lenders or repay ED \$75,077 for the claims that lost reinsurance and could not be cured.
- 1.4 Review all claims submitted for reinsurance to ED during the period October 1, 2002, through June 30, 2003, and determine which claims had due diligence violations resulting in lost reinsurance or penalties.

Auditee Comments

ISAC partially disagreed with the finding. ISAC affirmed that it adheres to the relevant provisions in the Common Manual, which more than satisfactorily meet the federal regulations governing claim payments and reinsurance. ISAC also believes that the manner in which certain documentation was collected and reviewed by the OIG provided

reasonable assurance that claims were being thoroughly evaluated and properly paid.

ISAC realizes that the OIG and ED have called select provisions of the Common Manual into question. In response to this, ISAC prepared a work plan, which will enable it to implement the four recommendations. The work plan will ensure that ISAC:

- Adheres to its policies and procedures and requires lenders to provide accurate collection and payment histories.
- Requires its claim analysts to verify lender due diligence activities on the claim form's summary of due diligence against all detailed collection and payment history information.
- Reviews the claim volume for one month during the nine month period (October 1, 2002, through June 30, 2003) the OIG reviewed. ISAC then will make a determination whether to generalize from the sample in question leading either to a recovery of funds from lenders or a payment to the ED from ISAC's Operating Fund. The results of the sampling will be shared with FSA and OIG. If ISAC's sampling results in a meaningful variance between claims paid and submitted for reinsurance, ISAC will implement a plan to systematically work, over a time period, all of the claims for the nine month period.
- Obtains the missing documentation for the 32 claims it should have returned to the lender. ISAC will review the documentation and determine whether the claims will be returned to the lender or a payment to ED will be made.

OIG Response

ISAC's response did not cause us to change the finding or recommendations. ISAC stated it prepared a work plan, which will help it implement our recommendations. However, ISAC did not provide us with the work plan or any indication a work plan was being developed. We do not know how ISAC is planning to draw a sample of the monthly claims or which month it will choose to review. In addition, ISAC said it would obtain the missing documentation for the 32 claims and review the documentation to determine whether the claims will be returned to the lender or to repay ED. We do not have a timeframe of when ISAC will obtain or review the documentation.

Finding No. 2 ISAC Needs to Strengthen Controls Over Document Imaging to Ensure Adequate Support for Reinsurance Claims

ISAC's imaging policies and procedures did not ensure that ISAC maintained complete and accurate computer images of original claim packets. This is a repeat finding from our December 1999 audit report to ISAC (ED-OIG/A05-90002). We reported that ISAC did not maintain copies of all documents lenders submitted with their request for claim reimbursement and recommended ISAC improve management controls over imaging.

According to 34 C.F.R. § 682.406(a)(3), a guaranty agency is entitled to a reinsurance payment on a loan only if the lender provided accurate collection and payment history. The histories must be sufficient to support guarantor review for claim payment and show that the lender exercised due diligence in collecting the loan meeting the requirements in 34 C.F.R. § 682.411.

Also, 34 C.F.R. § 682.414(a)(ii)(A) and (G) state a guaranty agency shall maintain all documentation supporting the claim filed by the lender and any additional records that are necessary to document its right to receive or retain payments made by the Secretary.

ISAC's Imaging Department did not have a written policy to verify that it imaged lenders' claim packets correctly. ISAC's Imaging Department Manager informed us that ISAC had an unwritten rule requiring imaging personnel to verify that the first 10 pages of each claim packet were imaged correctly. The first 10 pages generally include the most important documents for the claim including the two-page ISAC claim form. After ISAC images the claim, it destroys the claim packet, leaving the computer image as the only evidence of its right to reinsurance.

We found that 20, totaling \$47,673, of 50 claims, totaling \$123,521, sampled from a universe of 21,732 claims that ED paid reinsurance to ISAC between October 1, 2002, and June 30, 2003, were not adequately imaged. Four claim packets were missing the second page of the ISAC claim form, a summary of the lender's due diligence activities from the latest 270-day period of delinquency. We found 15 claim packets,⁴ all from the same lender, that had dates cutoff from the imaged copy, including collection, payment, deferment, and forbearance dates. Also, we found one claim that did not have an imaged copy in ISAC's computer system. Based on the results of our testing, we had a 40 percent sample occurrence rate. We are 90 percent confident that the actual error rate is between 28 and 53 percent.

Without a complete and accurate computer image of the claim packet, ISAC does not have adequate documentation to support its request for reinsurance or support that the lender serviced the claim properly.

⁴ Two claims were also missing page 2.

Recommendations

We recommend that the Chief Operating Officer, FSA, instruct ISAC to:

- 2.1 Establish written policies and procedures requiring that the completeness and accuracy of imaging are verified before claim packets are destroyed and establish adequate management controls to ensure that the policies and procedures are followed.
- 2.2 Identify the claims, from our audit period, that were not adequately imaged and obtain the missing collection and payment histories.
- 2.3 Obtain the missing documentation for the 20 claims that were not adequately imaged or repay ED \$47,673 for the claims that lost reinsurance.

Auditee Comments

ISAC agreed with the finding and recommendations and said it obtained the necessary documentation for the sample of 20 claims we questioned. ISAC said it would review the documentation to ensure that it is properly imaged. In addition, ISAC said management has revised operating policies and procedures for imaging claim packets and communicated the new policies to staff, and provided additional training to staff. ISAC's Imaging and Claims Services departments are working together to implement a quality assurance process.

ISAC did not provide us with the revised operating policies and procedures for the imaging department.

Finding No. 3 ISAC Did Not Maintain Adequate Support for Forms 2000 Information Submitted to ED

ISAC's policies and procedures did not ensure it met the records retention requirements. ISAC reports AWG collections and claims reinsurance payments to ED through Forms 2000 reports. We requested support for the summary AWG and reinsurance amounts ISAC reported on its Forms 2000 for the period October 2002 through June 2003. Although ISAC was eventually able to provide supporting records that reconciled reasonably close to the amounts reported on Forms 2000, it required several weeks of effort and several extracts from its computer system.

According to 34 C.F.R § 682.414(a)(1)(ii)(G), a guaranty agency shall maintain any additional records that are necessary to document its right to receive or retain payments made by the Secretary and the accuracy of reports it submits to the Secretary. The regulation further states in section (a)(2) a guaranty agency must retain the records for not less than 3 years following the date the borrower repays the loan, or for not less than 5 years following the date the agency receives payment in full from any other source.

To prepare its Forms 2000 reports, ISAC extracts information at the end of each month

from its Odyssey computer system. The data extract is compared to the previous month's data extract to create a file containing the detailed records for the current month's activity. ISAC summarizes the current month's activity to prepare the Forms 2000 report submitted to ED for payment. Any adjustments to the Guaranty Agency Monthly Financial Report are processed manually. ISAC retains electronic copies of the data extracts for approximately 6 months.

ISAC provided us a series of AWG and reinsurance data extracts. ISAC officials stated that much of the discrepancy in the Forms 2000 totals and data extracts resulted from an incomplete and consensual understanding between ISAC officials and the OIG audit team relative to the precise data elements required for review. ISAC officials also said another contributing variable was the fact that ISAC had to pull data from two different computer systems, one of which was deactivated September 2002. ISAC officials did not believe that similar problems would recur because any data requested in the future would be provided entirely from its current computer system and substantial internal controls are in place. ISAC officials also believe that its information systems and record retention efforts satisfy regulatory requirements.

However, we believe support for Forms 2000 data could still be a problem because ISAC currently only maintains the data used to populate Forms 2000 for approximately 6 months. System changes, subsequent adjustments to account balances, and other factors could adversely affect ISAC's ability to reconstruct support for the amounts reported on the Forms 2000.

Recommendation

We recommend that the Chief Operating Officer, FSA, instruct ISAC to:

- 3.1 Revise its policies and procedures and retain the electronic files used in preparing the Forms 2000 report and records of any manual adjustments long enough to meet the records retention requirement in the regulations.

Auditee Comments

ISAC agreed with the finding and recommendations and said it has revised policies and procedures to ensure that documentation used to prepare Forms 2000 are consistent with the records retention requirement found in the federal regulations.

ISAC did not provide us with its revised policies and procedures.

BACKGROUND

Title IV of the Higher Education Act of 1965, as amended, authorizes several Federal Family Education Loan (FFEL) programs. These programs include the federal: (1) Stafford Loan, which encourages making loans to eligible undergraduate, graduate, and professional students; (2) PLUS, which encourages making loans to parents of eligible, dependent undergraduate students; and (3) Consolidation Loan, which encourages

making loans to eligible borrowers for the purpose of consolidating their payment obligations.

A guaranty agency guarantees a lender against losses due to borrower default on FFEL loans, and ED reinsures the guaranty agency for all or part of the default claims the agency pays to lenders. As part of the reimbursement claim process, a guaranty agency reviews claim packets to determine that the lender exercised due diligence in collecting loans. The collection efforts must meet the requirements of 34 CFR §§ 682.406 and 682.411. All regulatory citations in this report are to the compilation dated July 1, 2002.

A guaranty agency must engage in collection efforts on a loan on which it paid a default claim. As part of this process, it must initiate AWG proceedings against all eligible borrowers. If a guaranty agency decides to garnish the disposable pay⁵ of a borrower who is not making payments on a loan held by the agency, it follows the procedures in 34 C.F.R. § 682.410(b)(9)(B-I). Some of the requirements the guaranty agency must perform are to (1) properly notify the borrower of the wage garnishment action at least 30 days before initiation of garnishment proceedings, (2) offer the borrower an opportunity to inspect and copy agency records related to the debt, (3) offer the borrower an opportunity to enter into a written repayment agreement, (4) offer the borrower an opportunity for a hearing concerning the existence and amount of the debt, and (5) send a withholding order to the employer within 20 days after the borrower fails to make a timely request for a hearing.

In 1957, the Illinois General Assembly created ISAC (originally called the Illinois State Scholarship Commission) to provide all Illinois residents access to higher education. ISAC is a state agency backed by the faith and credit of the State of Illinois and has three different locations (Springfield, Chicago, and Deerfield, Illinois). Its main operations are in Deerfield, Illinois.

ISAC guarantees loans for qualified borrowers for use at any eligible institution of higher learning, provided the borrower is eligible for a loan under the Higher Education Act of 1965, as amended. All lenders must execute an ISAC Lender Agreement prior to participating in the FFEL program through ISAC. The lenders must have received ED approval prior to executing a Lender Agreement. ISAC will cancel a guarantee if the lender fails to comply with federal regulations or ISAC's rules or procedures.

According to its computerized records, ED paid ISAC \$95,648,039 in claims and ISAC received \$11,726,470 in AWG collections from October 1, 2002, through June 30, 2003. ISAC guarantees approximately \$1.1 billion in student loans each year and has a portfolio of defaulted loans valued at \$650 million. ISAC collects approximately \$14 million annually through AWG action.

⁵ Disposable pay is defined as the remaining part of the borrower's compensation from an employer after the deduction of any withheld amounts required by law.

OBJECTIVES, SCOPE AND METHODOLOGY

The objectives of our audit were to determine if, for the period October 1, 2002, through June 30, 2003, ISAC (1) adequately processed post-default collections related to AWG and (2) properly submitted eligible reinsurance claims, specifically, default claims, to ED. Specifically, we wanted to ensure ISAC adhered to laws and regulations related to processing of post-default collections received through AWG and ED's payment to ISAC of reinsurance on lender claims.

To accomplish our objectives we –

- Talked to ED officials, key ISAC officials and staff, representatives from the State of Illinois' Auditor General's office, and its special assistant auditors.
- Reviewed written AWG and claims review policies and procedures.
- Reviewed prior audit reports on ISAC conducted by other entities and ED-OIG's 1999 ISAC audit report.
- Reviewed imaged claim packet information submitted by lenders.
- Reviewed imaged claim packets on ISAC's computer system.
- Developed a spreadsheet to capture the information we collected through our review of imaged claim files on ISAC's computer system.
- Developed a series of spreadsheets for our review of post-default AWG collections on ISAC's computer system.
- Reviewed accounting and AWG collection information contained in ISAC's computer system.
- Reviewed 50 claims selected from ISAC's universe of 21,732 claims paid by ED from October 1, 2002, to June 30, 2003.
- Reviewed ISAC's processing of post-default AWG collections for 56 borrowers selected from ISAC's universe of 10,351 borrowers making payments on defaulted loans from October 1, 2002, to June 30, 2003.

We used statistical sampling techniques to select borrowers for our review of ISAC's processing of post-default collections related to AWG. We first defined the sample unit (the borrower's SSN), sample universe (10,351 borrowers), and sampling frame (all the borrower SSNs in the data extract). We randomly selected a total of 70 borrowers. We selected 50 borrowers from a universe of 9,290 borrowers as shown on ISAC's Odyssey computer system.⁶ ISAC officials later informed us that the universe did not include 1,061 borrowers due to a problem with truncated loan identification numbers. We later selected 20 borrowers from the universe of 1,061 borrowers not included in the original

⁶ The 50 borrowers selected from the universe of 9,290 borrowers included 4 replacement borrowers. We replaced 4 borrowers because they were included in a list of 395 borrowers having an increased chance for selection due to making payments on student loans of their own in addition to making payments on loans for dependent children.

universe.⁷ We reviewed ISAC's processing of post-default collections for 56 of the 70 borrowers selected.⁸ We did not review processing of post-default collections for all 70 borrowers selected for testing due to lack of reportable findings during our testing of 50 borrowers selected for review from the original universe and 6 borrowers tested from the second universe. We used a computer software random number generator to select a sample from each strata.

We used statistical sampling techniques to select the reinsurance claims for review. We first defined our sample unit (one default claim), sample universe (21,732 claims), and sampling frame (defaulted claims in the data extract). We analyzed the sampling frame and divided our universe of claims into two strata based on dollar volume per month.⁹ We randomly selected 50 claims paid by ED from October 1, 2002, to June 30, 2003. We selected 15 claims paid by ED in May 2003, and 35 claims paid by ED from October 2002, to April 2003, and June 2003. We used a computer software random number generator to select a sample from each strata.

To achieve the audit's objectives, we relied in part on computer-processed data contained in ISAC's Odyssey system. ISAC converted to the Odyssey system in October 2002 and there were no existing reports or studies on its computer-processed data. We decided not to test any data from ISAC's prior system because the data was not in a comparable format with the Odyssey data. The prior system was based on a borrower level, while the Odyssey data is based on a loan level.

We tested the accuracy and completeness of the data by comparing Forms 2000 amounts to the AWG and reinsurance data extracts. We also compared selected data in the hard copies for the sampled items to the data extracts. Based on these tests, we concluded that the data were sufficiently reliable to be used in meeting the audit's objectives.

We performed our work at ISAC's Deerfield, Illinois offices from August 20, 2003 through March 8, 2004. We completed additional work in our Chicago office from March 9, 2004 through March 26, 2004. We discussed the results of our audit with ISAC officials on March 19, 2004. We conducted our audit in accordance with generally accepted government auditing standards appropriate to the scope of review described above.

⁷ The 1,061 borrowers were not included in the original universe of 9,290 borrowers provided by ISAC due to a problem with the final digit being dropped off the loan identification number in ISAC's Odyssey database.

⁸ We tested 50 borrowers from ISAC's original universe of 9,290 borrowers and 6 borrowers from ISAC's second universe of 1,061 borrowers.

⁹ Approximately 30 percent of the total reinsurance amount paid by ED during the October 1, 2002, to June 30, 2003 period was paid in May 2003. The large payment increase from ED in May 2003 corresponded to an increase in claims processed by ISAC during March 2003.

STATEMENT ON MANAGEMENT CONTROLS

As part of our review, we assessed the system of management controls, policies, procedures, and practices applicable to ISAC's claims review and post-default collections related to wage garnishment. Our assessment was performed to determine the level of control risk for determining the nature, extent, and timing of substantive tests needed to accomplish the audit objectives.

For the purpose of this report, we assessed and classified ISAC's significant controls into the following:

- Processing of post default collections related to AWG
- Reinsurance claim processing

Because of inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the management controls. However, our assessment disclosed significant management control weaknesses, which adversely affected ISAC's ability to administer the FFEL programs. These weaknesses included inadequate procedures for (1) reinsurance claim processing, (2) document imaging, and (3) retaining support for Forms 2000 information submitted to ED. These weaknesses and their effects are fully discussed in the **Audit Results** section of this report.

IX. Collection History (the 270 day period prior to default date)			
60. Borrower's Social Security #			
61. Borrower/Co-maker(s)		Endorser(s)	
Date/Code	Date/Code	Date/Code	Date/Code
6/17/02	LC	11/21	LC
6/20	LC	12/6	TA
7/15	IA	12/12, 13	TA
7/15	LC	12/16, 20	LC
7/16	IA	1/24/03	LC
7/22	LC	1/25	LC
7/26	IA	2/11	TA
7/29	TA	2/18	LC
7/30	LC	2/27	TA
7/30	TC	3/21	LC
7/30	VA/UT	3/25	LC
8/9	TA	4/2	TA
8/15	LC		
8/20	LC	4/9/03	FD
9/4	PC		
9/11, 12	TA		
9/16	LC		
9/17	TA		
9/20	LC		
10/4	LC		
10/11, 14	TA		
10/15, 21	LC		
10/24	TA		
10/24	LC		
11/8	PC		
11/15	LC		
11/20	LC		



July 8, 2004

Mr. Richard J. Dowd
Regional Inspector General for Audit
United States Department of Education
Office of Inspector General
111 North Canal Street, Suite 940
Chicago, Illinois 60606-7204

Illinois
Student
Assistance
Commission



Dear Mr. Dowd:

I am responding on behalf of Larry Matejka in response to the draft audit report (Control Number ED-OIG/A05-D0040) dated June 8, 2004.

With respect to the three findings presented in the report, ISAC's positions are stated below:

Finding No. 1: ISAC needs to enhance its claim review procedures to ensure lenders' default claims are fully supported.

ISAC Response: Partially Disagree. ISAC continues to affirm that the adherence to relevant provisions in the Common Manual are more than satisfactory to meet the requirements of federal regulations governing the processing of claims for reimbursement of defaulted student loans. Throughout the process of the OIG's review of claims processing, documentation was presented reinforcing ISAC's proper handling of claims and, further, the belief that the manner in which certain documentation was collected and reviewed provided reasonable assurance that claims were being thoroughly evaluated and properly paid.

However, we understand that select provisions of the Common Manual have been called into question by both the OIG as well as representatives of the Department of Education. Recognizing this reality, we are moving to comply with the specific terms of the recommendations proffered as described below.

We have prepared a work plan which will enable us to implement the four recommendations outlined in the report. This work plan specifically identifies actions which will ensure that ISAC:

Adheres to its policies and procedures and requires lenders to provide accurate collection and payment histories sufficient for ISAC's claims analysts to review the claims for lender due diligence (1.1).

Requires its claims analysts to verify lender due diligence activities show on the claim form's summary of lender due diligence against all detailed collection history information, support for periods of deferments/forbearances, and dates and amount of borrower payments (1.2).

Reviews all claims submitted for reinsurance to ED during the period October 1, 2002, through June 30, 2003, and determine which claims had due diligence violations resulting in lost reinsurance or penalties (1.3). Note that the project team to be formed for the purpose of implementing the work plan will first review the claim volume for one month during the 9 month period after which a determination will be made as to whether to generalize from the sample in question leading either to a recovery of funds from lenders or servicers or a payment to the Department from existing Student Loan Operating Fund resources. The results of the sampling will be shared with both FSA as well as the OIG prior to any cost recovery actions. The agency

does not expect that the sampling will result in a meaningful variance between claims paid and submitted for reinsurance during the time period and the outcome of the post-facto review. However, if such should be the case, ISAC will then implement a plan to systematically work, over a time period yet to be identified, all of the claims for the nine-month period in question. Obtain the missing documentation for 32 claims included in the OIG sample (1.4). The missing documentation will be reviewed and a determination made as to whether the claims will be returned to lenders or a payment to ED in the amount \$75,077 will be made for the claims in question.

Finding No. 2: ISAC needs to strength controls over document imaging to ensure adequate support for reinsurance claims

ISAC Response: **Concur.** ISAC has initiated the necessary documentation for the sample of 20 in question in order to verify that the claims were paid properly and reinsurance was received appropriately. This documentation will be reviewed to ensure that it is properly imaged.

ISAC has taken the following steps to address the finding 2.1:

ISAC management has revised documented operating policies and procedures for imaging claim packets and has communicated the policies and procedures to staff. A specific effort is being made to ensure that adequate controls are in place to address imaging exceptions. Staff has also received additional training in this area.

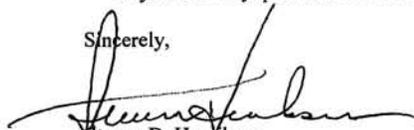
An internal reconciliation process has been established to ensure that a complete claim file resides on ISAC's imaging system. Staff from the Imaging and Claims Services departments are working collaboratively to implement this quality assurance process for claim file documentation. Follow-up is occurring on irregularities and exceptions to determine the cause and implement corrective action.

Finding No. 3: ISAC did not maintain adequate support for Forms 2000 information submitted to ED.

ISAC Response. **Concur.** ISAC has revised policies and procedures to ensure that documentation used in preparing the Forms 2000 report as well as that substantiating manual adjustments made for reporting period(s) are consistent with the records retention requirement found in federal regulations at 34 C.F.R. 682.414 (a)(1)(i)(G) and (a)(2).

If you have any questions concerning our responses, please don't hesitate to contact me.

Sincerely,



Steven D. Henriksen
Director, Business and Financial Services Division
Illinois Student Assistance Commission

CC: Larry Matejka
Marcia Thompson
Theresa Morgan
Chris Peterson