



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE INSPECTOR GENERAL

August 9, 2005

Control Number ED-OIG/A05-E0028

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

Sally L. Stroup, Assistant Secretary
Office of Postsecondary Education
U.S. Department of Education
1990 K Street, NW, Room 7115
Washington, D.C. 20006

Dear Ms. Shaw and Ms. Stroup:

This **Final Audit Report** presents the results of our audit of guaranty agencies' oversight of Federal Family Education Loan (FFEL) program loans disbursed directly to borrowers for attendance at foreign schools during the period January 1, 2004, through September 30, 2004. Our objective was to determine if guaranty agencies established policies and procedures that provided reasonable assurance they complied with the requirements of Dear Colleague Letter (DCL) G-03-348 for ensuring FFEL program funds are disbursed only to eligible borrowers accepted for attendance at eligible foreign schools.

Two guaranty agencies that guaranteed approximately 79 percent of all foreign school loans during the first six months of 2004 did not have policies and procedures that provided reasonable assurance they fully complied with the requirements of DCL G-03-348. Therefore, we concluded that policies and procedures are generally not in place to ensure that FFEL loans for attendance at foreign schools are disbursed in accordance with the requirements of DCL G-03-348. The two guaranty agencies did not perform the verification procedures set forth in DCL G-03-348 for every disbursement their lenders made directly to borrowers for attendance at foreign schools because lenders did not always adhere to the guaranty agencies' policies of notifying them when borrowers requested their FFEL foreign school loan disbursements be sent directly to them.

In response to the draft of this report (see ATTACHMENT), you concurred with two of the three recommendations and stated you are taking appropriate action, but you did not concur with the third recommendation (strengthen DCL G-03-348, specifically the section on lender

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requirements). You commented that the requirements in DCL G-03-348 are clear and do not need to be strengthened.

Though we agree that the requirements set forth in DCL G-03-348 are written in a clear manner, our audit work showed that at least four lenders have failed to adhere to those requirements and their guaranty agencies' policies. Because DCL G-03-348 focuses on the responsibilities of guaranty agencies, the letter should be strengthened to emphasize to lenders that their compliance is a condition for their loan guarantees. Therefore, we revised recommendation 1.3 to more clearly reflect the actions that are necessary to protect the FFEL programs.

BACKGROUND

In August 2003, the U.S. Department of Education (Department), Office of Postsecondary Education (OPE), issued DCL G-03-348, informing guaranty agencies of actions required to assist in the oversight of FFEL program funds for borrowers attending foreign schools. The letter outlined the requirements guaranty agencies must follow to ensure FFEL program loans are made only to eligible borrowers at eligible foreign schools. Guaranty agencies must (1) reconfirm that the institution is eligible to participate in the FFEL program before FFEL program funds are disbursed directly to a borrower for attendance at a foreign school, (2) verify that the borrower is accepted for enrollment at the foreign institution indicated on the loan application before FFEL program funds are disbursed directly to a borrower for attendance at a foreign school, (3) continue sending paper Student Status Confirmation Reports to institutions that are unable to connect with the Department's National Student Loan Data System, and (4) perform program reviews of foreign schools as appropriate. The Department expected the guaranty agencies to implement these additional procedures no later than three months from the publication of the DCL.

According to National Student Loan Data System data, the guaranty agencies guaranteeing the largest percentage of loans to borrowers for attendance at foreign schools for the period January 1, 2004, through June 30, 2004, were United Student Aid Funds, Inc. (USAF) with 59 percent, Great Lakes Higher Education Corporation (GLHEC) with 20 percent, and the Pennsylvania Higher Education Assistance Agency with 8 percent. We selected the two largest guaranty agencies (by foreign school loan volume) for this audit. According to USAF and GLHEC data, during the period January 1, 2004, through September 30, 2004, USAF guaranteed 26,732 foreign school loan disbursements totaling \$127,015,990, and GLHEC guaranteed 9,251 foreign school loan disbursements totaling \$40,376,195.

AUDIT RESULTS

Finding Stronger Control Needed over FFEL Program Loans Disbursed Directly to Borrowers for Attendance at Foreign Schools

USAF and GLHEC continued sending paper Student Status Confirmation Reports to institutions that were unable to connect with the Department's National Student Loan Data System. In addition, the guaranty agencies had policies to perform program reviews of foreign schools if they deemed such a review was appropriate. However, the guaranty agencies did not have

policies and procedures that provided reasonable assurance they fully complied with the requirements of DCL G-03-348. USAF and GLHEC guaranteed approximately 79 percent of FFELP loans disbursed for attendance at foreign schools during the first six months of 2004. Therefore, we concluded that policies and procedures are generally not in place to ensure that FFELP loans for attendance at foreign schools are disbursed in accordance with the requirements of DCL G-03-048.

The guaranty agencies' policies required lenders to notify them when FFEL program funds were to be disbursed directly to a borrower for attendance at a foreign school. When notified, the guaranty agencies reconfirmed that the foreign institution was eligible to participate in the FFEL program before FFEL program funds were disbursed directly to a borrower for attendance at a foreign school and verified that the borrower was accepted for enrollment at the foreign institution indicated on the loan application. However, lenders did not always notify the guaranty agencies when borrowers requested direct disbursements; therefore, the guaranty agencies did not always perform the DCL verification procedures.

- Three of USAF's lenders (Citibank, N.A.; Bank of America; and Educaid), generating 15 percent of USAF's foreign school loan volume during the audit period, did not follow USAF's policy and notify USAF when borrowers requested FFEL disbursements be sent directly to them. USAF disseminated its policy to its lenders and stated the process was effective November 25, 2003. The policy requires lenders or disbursing agents, via e-mail, to ask USAF to verify that the foreign school is eligible to receive FFEL funds and that the borrower is enrolled at the foreign school. The lenders and disbursing agents are not to disburse funds until receiving USAF's approval.
- During a recent review,¹ USAF reviewed a random sample of 100 foreign school loan disbursements made by Citibank and determined that 25 borrowers requested disbursements be sent directly to them. For all 25 borrowers, Citibank did not notify USAF of the borrower's request. As a result, USAF asked Citibank to identify and provide USAF a listing of all the loans that were disbursed to borrowers for the period November 1, 2003, through September 30, 2004. Citibank identified an additional 91 borrowers. In total, USAF tested 116 (25+91) borrowers and found one ineligible borrower received FFEL funds. For the ineligible borrower, USAF canceled the loan's insurance.
- We could not test Bank of America or Educaid borrowers because USAF's computer system lacked sufficient information. Unless Sallie Mae was the disbursing agent, USAF's system did not contain information indicating whether disbursements were sent to the foreign schools or directly to the borrowers.
- Northstar, a lender with a blanket certificate of guaranty with GLHEC, did not follow GLHEC's policy. GLHEC's policy required Northstar to notify it prior to disbursement if a disbursement would be sent directly to the borrower. GLHEC would then perform DCL verification procedures. GLHEC's Director of Internal Audit told us that GLHEC does not have documentation of notifications from Northstar or documentation that anyone performed the required verification procedures.

¹ USAF began its review of Citibank on September 1, 2004. USAF reviewed Citibank's foreign school loans for the period November 1, 2003, through June 30, 2004.

Guaranty Agencies Must Confirm Eligibility Prior to Loan Disbursement

According to DCL G-03-348, issued in August 2003, guaranty agencies must (1) reconfirm that the foreign institution is eligible to participate in the FFEL program before FFEL program funds are disbursed directly to a borrower for attendance at a foreign school, (2) verify that the borrower is accepted for enrollment at the foreign institution indicated on the loan application before FFEL program funds are disbursed directly to a borrower for attendance at a foreign school, (3) continue sending paper Student Status Confirmation Reports to institutions that are unable to connect with the Department's National Student Loan Data System, and (4) perform program reviews of foreign schools as appropriate. The Department expected the guaranty agencies to implement these additional procedures no later than three months from the publication of the DCL.

Guaranty Agencies Need to Strengthen Their Control over Foreign School Loans

USAF and GLHEC did not monitor lenders to ensure they adhered to their policies. Bank of America's Vice President of Operations told us that Bank of America did not notify USAF when a borrower requested that a disbursement be sent directly to him or her. Instead, Bank of America sent USAF an electronic transmission of its foreign school loan disbursements and considered the transmission as sufficient notice to USAF. We told USAF's compliance officials about Bank of America's procedures. The compliance officials told us that Bank of America's electronic transmission would not have sufficient information for USAF to know which borrowers requested disbursements be sent directly to them because some of the required information would not be known until after preparation of the notices of guarantee.

Educaid's Loan Processing Supervisor told us Educaid did not notify USAF or have USAF perform the DCL verification procedures. The Loan Processing Supervisor said that Educaid performs the DCL verifications prior to making a disbursement of FFEL funds directly to a borrower for attendance at a foreign school. Educaid would ask the guarantor or the Department to determine foreign school eligibility (Educaid does not have access to the Postsecondary Education Participant System, or PEPS); Educaid would then maintain a record of the verification work it performed. We told USAF's Supervisor of Compliance and one of USAF's internal auditors about Educaid's policy, and they appeared surprised because they were unaware of Educaid's procedures, speculating that Educaid may have more than one policy in this area.

GLHEC did not realize it did not perform any DCL verifications on Northstar borrowers until our audit. GLHEC's Director of Internal Audit told us that Northstar and GLHEC established procedures in November 2003 for foreign school disbursements that are sent directly to borrowers. The procedures specified that Northstar would, via e-mail, notify GLHEC about the disbursement. GLHEC then would perform the required verification procedures and let Northstar know if the borrower or foreign school was ineligible. However, GLHEC did not keep copies of any e-mails received from Northstar or any documentation supporting verification of foreign school eligibility or borrower enrollment. We asked Northstar's Operations Manager if Northstar maintained the e-mail verifications sent to GLHEC during the audit period. The official told us that Northstar did not keep those e-mails.

No Assurances FFEL Loans Were Disbursed to Eligible Borrowers

Because the guaranty agencies did not perform the DCL verification procedures for every disbursement made directly to a borrower, the Department does not have reasonable assurance that FFEL foreign school loans were disbursed only to eligible borrowers. For example, USAF does not have any record of DCL verification procedures being performed for Citibank, Bank of America, or Educaid borrowers. The three lenders made 3,953 foreign school loan disbursements during the audit period. For Bank of America (561) and Educaid (976) loan disbursements, the information was not available for us to determine the number of borrowers who requested disbursements be sent directly to them and for whom USAF did not perform the verification procedures. In addition, USAF did not perform the verification procedures for 116 Citibank borrowers until it began a review of Citibank in September 2004, after the loans had been disbursed. Citibank disbursed one FFEL loan to an ineligible borrower.

In addition, after our exit conference, GLHEC's Director of Internal Audit told us GLHEC asked Northstar to provide a list of all foreign school loans disbursed directly to borrowers during our audit period. Of the 40 Northstar borrowers, 8 had their disbursements sent directly to them without any evidence of the DCL verification procedures being performed.

Recommendations

We recommend that the Chief Operating Officer for Federal Student Aid, in conjunction with the Assistant Secretary for Postsecondary Education:

- 1.1 Require guaranty agencies to establish and implement policies and procedures for monitoring, on a regular basis, lenders' compliance with the guaranty agencies' verification policies and DCL G-03-348.
- 1.2 Require guaranty agencies to test all disbursements made to borrowers for attendance at foreign schools, for all lenders that did not submit notifications during the period January 1, 2004, through September 30, 2004, and cancel the loan guaranty for all ineligible loans identified.
- 1.3 Send DCL G-03-348 to all lenders and highlight the section on lender requirements. Emphasize that, in order to qualify for a loan guaranty, lenders must follow their guaranty agencies' policies prior to disbursing loans directly to borrowers for attendance at foreign schools.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to determine if guaranty agencies had established policies and procedures that provided reasonable assurance they were complying with the requirements of DCL G-03-348. Our audit covered FFEL program loans disbursed directly to borrowers for attendance at foreign schools and disbursed during the period January 1, 2004, through September 30, 2004.

To achieve our objective, we –

- Interviewed USAF and GLHEC officials and staff;
- Reviewed USAF's and GLHEC's written policies and procedures for verifying school eligibility and borrower enrollment prior to disbursements of FFEL funds directly to students for attendance at foreign schools;
- Reviewed USAF's and GLHEC's policies and procedures for (1) sending paper Student Status Confirmation Reports to institutions that were unable to connect with the Department's National Student Loan Data System and (2) performing program reviews of foreign schools as appropriate;
- Interviewed various lender officials; and
- Tested a sample of borrowers and reviewed borrower comment screens on both USAF's and GLHEC's systems, imaged information (PEPS printouts), and Sallie Mae's LFM and CLASS systems to ensure USAF and GLHEC performed the DCL verification procedures.

We used statistical random sampling techniques to select borrowers for our review of USAF's adherence to the DCL verification procedures. We randomly selected 500 of 3,074 borrowers from 4 of USAF's 5 largest disbursing agents (Sallie Mae-LFM, Bank of America, Educaid, and Sallie Mae-CLASS)² but could test only 422 borrowers. For the LFM and CLASS disbursing agents, we randomly selected and tested 200 borrowers from each group (LFM universe was 1,173, and CLASS universe was 1,286). For Bank of America and Educaid, we randomly selected 50 borrowers from each (Bank of America universe was 300 and Educaid universe was 315). We tested only 10 Bank of America borrowers and 12 Educaid borrowers because USAF's EAGLE II system did not contain sufficient information to determine if the disbursement was sent to the school or directly to the borrower.

We used statistical random sampling techniques to select borrowers for our review of GLHEC's adherence to the DCL verification procedures. We randomly selected 70 borrowers from a universe of 336 but could test only 60 borrowers. We divided our universe into two groups: GLHEC-disbursed and non-GLHEC-disbursed loans. For the GLHEC-disbursed loans, we randomly selected and tested 50 borrowers from a universe of 283. For the non-GLHEC-disbursed loans, we randomly selected 20 borrowers from a universe of 53. However, we could not test 15 of the 20 selected borrowers because (1) 14 were Northstar borrowers, and (2) GLHEC did not guarantee the one other borrower's disbursement. We could not test Northstar borrowers because GLHEC did not have data to support the performance of the DCL verification procedures. Therefore, we tested only the 5 Sallie Mae borrowers from our randomly selected sample and all 5 additional Sallie Mae borrowers from the non-GLHEC-disbursed universe.

We also relied, in part, on computer-processed data contained in USAF's and GLHEC's guarantor systems. The data consisted of all the FFEL foreign school loans USAF and GLHEC

² Citibank is one of USAF's larger disbursing agents. However, USAF officials told us that, during the audit period, Citibank did not notify USAF of any disbursements to be sent directly to borrowers. We excluded Citibank borrowers from our sampling because USAF initiated its own review. USAF identified one ineligible borrower and canceled the loan's insurance.

guaranteed for the period January 1, 2004, through September 30, 2004. We tested the reasonableness of the data by comparing it to the borrower comment history screens and hard copy documents (imaged copies and Sallie Mae printouts). Based on these tests, we concluded the data was sufficiently reliable to be used in meeting the audit objective.

We conducted our audit work at USAF's office in Indianapolis, Indiana; GLHEC's office in Madison, Wisconsin; and our office in Chicago, Illinois, from October 2004, through April 2005. We conducted the audit in accordance with generally accepted government auditing standards appropriate to the scope of the audit described above.

STATEMENT ON INTERNAL CONTROL

We made a study and evaluation of the internal control system over foreign school loan disbursements of USAF and GLHEC guaranteed loans in effect during the period January 1, 2004, through September 30, 2004. For the purpose of this report, we classified significant internal control procedures into the following categories:

- USAF's foreign school loan disbursements sent directly to borrowers
- GLHEC's GLHEC Servicing and Sallie Mae foreign school loan disbursements sent directly to borrowers
- GLHEC's BCG Lenders' foreign school loan disbursements sent directly to borrowers

To perform our assessment of USAF's and GLHEC's systems of internal control, we assessed risk exposure for USAF's and GLHEC's foreign school loans process, identified and documented USAF's and GLHEC's procedures for guaranteeing FFEL funds disbursed to borrowers for attendance at foreign schools, and determined if that control provided reasonable assurance of compliance with DCL G-03-348.

USAF and GLHEC are responsible for establishing and maintaining systems of internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of the system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that the transactions are executed in accordance with management's authorization and are recorded properly so as to permit effective and efficient operations.

Because of inherent limitations in any system of internal control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our assessment disclosed a significant weakness in the guaranty agencies' systems of internal control over foreign school loan disbursements in effect during the period January 1, 2004, through September 30, 2004, that, in our opinion, results in more than a relatively low risk that errors or irregularities that could be material may occur and not be detected within a timely period. Guaranty agencies did not have monitoring procedures in place for ensuring that lenders

followed their verification policies. Guaranty agencies have informed their lenders of the DCL requirements, including sending lenders their policies. However, as a practice, guaranty agencies relied on lenders to notify them when borrowers requested loan disbursements be sent directly to them. See the Audit Results section of this report.

ADMINISTRATIVE MATTERS

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

Corrective actions proposed (resolution phase) and implemented (closure phase) by your offices will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). The Department's policy requires that you develop a 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 finding 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.

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.

We appreciate your timely response to the draft of this report. If you have any questions, please call Richard J. Dowd or Gary D. Whitman, Assistant Regional Inspector General for Audit, at 312-886-6503.

Sincerely,



Helen Lew
Assistant Inspector General for Audit

ATTACHMENT



UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, D.C. 20202- _____

JUL 12 2005

TO: Richard Dowd
Regional Inspector General for Audit
Office of Inspector General

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

Sally L. Stroup *SLS*
Assistant Secretary
Office of Postsecondary Education

SUBJECT: Comments on the Draft Audit Report of the Guaranty Agencies' Oversight of
FFEL Program Loans Disbursed Directly to Borrowers for Attendance at Foreign
Schools
ACN: ED-OIG/A05-E0028

Thank you for providing Federal Student Aid (FSA) and the Office of Postsecondary Education (OPE) with an opportunity to comment on the Office of Inspector General's (OIG) Draft Audit Report on the guaranty agencies' oversight of FFEL loans disbursed to borrowers for attendance at foreign schools. The following are FSA's and OPE's comments to the findings and recommendations:

Finding – Stronger Controls Needed over FFEL Program Loans Disbursed Directly to Borrowers for Attendance at Foreign Schools.

Recommendation 1.1 – Require guaranty agencies to establish and implement policies and procedures for monitoring, on a regular basis, lenders' compliance with the guaranty agencies' verification policies and DCL G-03-348.

FSA concurs with the OIG's recommendation and is taking appropriate action. Financial Partners Services (FPS) will issue a letter by July 29, 2005, informing guaranty agencies (GAs) of the requirement that policies and procedures be implemented to regularly monitor lender compliance with the GAs verification policies and DCL G-03-348. GAs will be instructed to submit their policies and procedures to their FPS assigned regional office for review by August 15, 2005. This process has a planned completion date of October 30, 2005.

Recommendation 1.2 – Require guaranty agencies to test all disbursements made to borrowers for attendance at foreign schools, for all lenders that did not submit notifications during the period January 1, 2004, through September 30, 2004, and cancel the loan guaranty for all ineligible loans identified.

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FSA concurs with the OIG's recommendation and is taking appropriate action. FPS will notify all GAs by letter, no later than July 29, 2005, that they must test all disbursements made to borrowers for attendance at foreign schools, for lenders that did not submit notifications during the period January 1, 2004, through September 30, 2004, and cancel the loan guaranty for all ineligible loans identified. GAs will be instructed to submit all documentation to their assigned FPS regional office for review. This process has a planned completion date of March 31, 2006.

Recommendation 1.3 – Strengthen DCL G-03-348, specifically the section on lender requirements, to make it clear that, in order to qualify for a loan guaranty, lenders must follow their guaranty agencies' policies prior to disbursing loans directly to borrowers for attendance at foreign schools.

FSA and OPE do not concur with recommendation 1.3 because we believe that the requirements as articulated in the DCL are clear and do not need to be strengthened. If you would like to discuss the response in more detail, please contact David Bergeron at 202-502-7815.