



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL  
1999 BRYAN STREET, HARWOOD CENTER, SUITE 2630  
DALLAS, TEXAS 75201-6817  
PHONE: (214) 880-3031 FAX: (214) 880-2492



JAN 8 2003

MEMORANDUM

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

FROM : Sherri L. Demmel *Sherri L. Demmel*  
Regional Inspector General  
for Audit

SUBJECT: Final Audit Report  
**ARIZONA AUTOMOTIVE INSTITUTE'S ADMINISTRATION OF THE  
WILLIAM D. FORD FEDERAL DIRECT LOAN PROGRAM**  
Control Number ED-OIG/A06-B0025

Attached is our subject report presenting the findings resulting from our audit of Arizona Automotive Institute.

In accordance with the Department's Audit Resolution Directive, you have been designated as the action official responsible for resolution of the findings in this report.

If you have any questions or wish to discuss the contents of this report, please contact me at 214-880-3031. Please refer to the audit control number in all correspondence relating to this report.

Attachment



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JAN 8 2003

Mr. Bill Gresham, Director  
Arizona Automotive Institute  
6829 North 46<sup>th</sup> Avenue  
Glendale, Arizona 85301

Dear Mr. Gresham:

This **Final Audit Report** (Control Number ED-OIG/A06-B0025) presents the results of our limited-scope audit of the Arizona Automotive Institute (AAI). The objectives of our audit were to determine if AAI reconciled and accounted, with the Department, for William D. Ford Federal Direct Loan Program (Direct Loan) funds monthly, and closed Direct Loan accounts in accordance with program requirements. Our review focused on Direct Loan Program Years 1997-1998 through 1999-2000.

A draft of this report was provided to AAI. In its response, AAI generally agreed with our findings and recommendations. We have summarized AAI's comments after the Recommendations. A copy of the complete response is enclosed with this report.

## BACKGROUND

AAI is a proprietary school located in Glendale, Arizona. The Accrediting Commission of Career Schools and Colleges of Technology accredits the school. AAI received initial approval to participate in the Title IV, Student Financial Assistance programs on May 9, 1972, and began participating in the Direct Loan Program on March 1, 1995. American Trades Institute purchased AAI on April 30, 1999. AAI received about \$7.2 million in Direct Loan funds for the three program years ending June 30, 2000.

AAI operated under the standard origination option during most of our audit period. Being on the standard origination option allowed AAI to originate Direct Loan records and disburse funds. Under the standard origination option, AAI did not handle promissory notes or draw down funds. The Direct Loan Origination Center (LOC) performed those functions for the school. The Department placed AAI on the reimbursement payment method from October 29, 1997, until August 15, 2000.

## AUDIT RESULTS

AAI did not reconcile and account, with the Department, for Direct Loan funds monthly, and did not close Direct Loan accounts in accordance with program requirements. As of January 31, 2001, AAI had annual ending unaccounted for cash balances totaling approximately \$1,107,669 for the last three Direct Loan program years. By November 8, 2002, the total unaccounted for cash balance had been reduced to \$253,006. The potential interest cost to the Federal Government associated with the total unaccounted for cash balance was approximately \$62,587 as of November 8, 2002.

In order for a loan to be reconciled, it must be booked. A loan is booked when the LOC receives and accepts a loan origination record; the borrower signs a promissory note and the LOC accepts the promissory note; and a first disbursement record is transmitted to and accepted by the LOC.

Schools are also required under 34 C.F.R. § 685.300(b) to comply with all requirements established by the Department relating to the Direct Loan Program. As stated in 34 C.F.R. § 685.300(b)(6), a school must “provide assurances that the school will comply with requirements established by the Secretary relating to student loan information with respect to loans made under the Direct Loan Program....” According to 34 C.F.R. § 685.300(b)(7), a school must also provide that it “will accept responsibility and financial liability stemming from its failure to perform its functions....”

As provided in 34 C.F.R. § 685.102, schools must reconcile Direct Loan funds “on a monthly basis.” According to 34 C.F.R. § 685.301(d), schools are required to submit loan origination records, promissory notes, and disbursement records to the LOC within 30 days of the initial and subsequent disbursements. The Department requires schools to close out each program year with an ending cash balance of zero by submitting all records and promissory notes by a deadline established by the Department. The deadlines to close Direct Loan accounts were August 2, 1999 for Program Year 1997-1998; July 31, 2000 for Program Year 1998-1999; and August 10, 2001 for Program Year 1999-2000.

The school’s corporate office provided documents that indicated some effort was made to reconcile open Direct Loan accounts, but those efforts were not made on a monthly basis. During the period March 11, 1997, through October 18, 2000, the LOC recorded 260 line items of contact between the LOC and AAI in an effort to help the school reconcile its account. An LOC Reconciliation Accountant and a Client Account Manager offered to conduct a site visit to the school; however, the National Financial Aid Director declined assistance until February 2002. AAI did not submit any records within 30 days of loan disbursement and did not provide adequate oversight to ensure funds were reconciled. As a result of not submitting its records timely and not successfully reconciling on a monthly basis, AAI did not end any of the Direct Loan program years we reviewed with a cash balance of zero as required.

The unaccounted for cash balances occurred because AAI relied on its corporate office to perform the monthly reconciliation, AAI and the corporate office did not have written policies and procedures for reconciling and closing Direct Loan accounts, and the corporate office National Financial Aid Director did not completely understand the reconciliation process. For

instance, the Controller told us that neither she nor the National Financial Aid Director was aware of the monthly Direct Loan reconciliation requirement.

Because AAI did not reconcile monthly for Program Years 1997-1998 through 1999-2000 and return the unaccounted for cash balances at the time the funds were unaccounted for, we calculated the potential interest cost to the Federal government and taxpayers to be approximately \$62,587 as of November 8, 2002<sup>1</sup>. On January 31, 2001, the school had a negative balance for Program Year 1997-1998 and had positive balances for the other two years. On November 8, 2002, the school had a positive balance for only Program Year 1999-2000. That balance was \$253,006. The unaccounted for cash balances and the potential cost to the government are detailed in the following table.

<b>Program Year</b>	<b>Ending Unaccounted for Cash Balance As of January 31, 2001</b>	<b>Ending Unaccounted for Cash Balance As of November 8, 2002</b>	<b>Potential Interest Cost to Government As of November 8, 2002</b>
1997-1998	(S 336,299)	(\$ 129,140)	\$ 0.00
1998-1999	S 273,097	(\$ 127,793)	\$ 0.00
1999-2000	S 834,572	\$ 253,006	\$ 62,586.75
<b>*Totals</b>	<b>\$ 1,107,669</b>	<b>\$ 253,006</b>	<b>\$ 62,586.75</b>

\* Totals were calculated only for the positive numbers. The negative numbers indicate (1) loan amounts that are booked for which the institution has not received the funds and (2) loans that need to be adjusted.

## RECOMMENDATIONS

We recommend that the Chief Operating Officer for Federal Student Aid:

1. Require AAI to immediately either account for the \$253,006 in unaccounted for funds or return the funds to the Department of Education plus any interest.
2. Require AAI to develop management controls and procedures to ensure that it reconciles with the Department on a monthly basis.

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<sup>1</sup> We calculated that cost by applying the Current Value of Funds Rate, which was five percent for the period July 1, 1997, through December 31, 2000, six percent for the period January 1, 2001, through December 31, 2001, and five percent for the period January 1, 2002, through November 8, 2002, to the ending cash balances.

## **AAI'S COMMENTS TO THE DRAFT REPORT AND OIG'S RESPONSE**

AAI stated that, "AAI has made every possible attempt to reconcile the accounts for Award Years 1997/98 through 1999/2000. These efforts continue." As of November 8, 2002, the total unaccounted for amount was \$253,006 for Award Year 1999-2000. AAI stated that it stopped participating in the Direct Loan Program after Award Year 2000/01. "However, in light of the progress made over the last few months, if AAI is given the chance to continue to work with the LOC towards resolving this problem, all of the award years in question will be reconciled." AAI also questioned whether the regulations require monthly reconciliation

After evaluating AAI's comments, we modified the unaccounted for funds amount in Recommendation 1 from \$466,515 to \$253,006. We encourage AAI to continue working with the Loan Origination Center to reconcile and account for all Direct Loan funds. Under 34 C.F.R. § 685.300(b), Direct Loan schools must comply with requirements established by the Secretary; monthly reconciliation is one of those requirements.

### **OBJECTIVES, SCOPE, AND METHODOLOGY**

The objectives of our audit were to determine if AAI reconciled and accounted, with the Department, for Direct Loan funds monthly, and closed Direct Loan accounts in accordance with program requirements. To accomplish our objectives, we:

- Interviewed Department, LOC, AAI, and corporate office personnel to determine the reconciliation process.
- We compared the Department's ending cash balances against AAI's ending cash balances, for Direct Loan Program Years 1997-1998 through 1999-2000, to determine the magnitude of Direct Loan funds that were unreconciled at the end of the program years.
- We reviewed the LOC's records from March 11, 1997, through October 18, 2000, to determine whether technical assistance was provided to AAI to assist the school in the reconciliation process.

We relied on computerized cash balance data applicable to AAI from the Department's Loan Origination System. We visited the LOC during the week of March 19, 2001. We conducted our fieldwork at AAI from June 26, 2001, through June 29, 2001, and at the corporate office on July 3, 2001. We held an exit conference on July 17, 2001. We also performed additional work at the LOC from April 30, 2002, through May 7, 2002. The audit was conducted in accordance with generally accepted government auditing standards appropriate to the audit scope described above.

## STATEMENT ON MANAGEMENT CONTROLS

As part of our audit, we gained an understanding of AAI's and the corporate office's system of management controls and practices over the reconciliation and close out procedures for the Direct Loan Program. We gained this understanding to assist us in determining whether management controls contributed to AAI's inability to reconcile and account for Direct Loan funds monthly, and close Direct Loan accounts in accordance with program requirements.

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 a management control weakness that adversely affected AAI's ability to reconcile its Direct Loan records. That weakness is discussed in the Audit Results section of this report.

## ADMINISTRATIVE MATTERS

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 U.S. Department of Education official, who will consider them before taking final Departmental action on the audit:

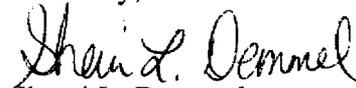
Theresa S. Shaw, Chief Operating Officer  
Federal Student Aid  
U.S. Department of Education  
Union Center Plaza  
830 1<sup>st</sup> Street, NE  
Room 112G1  
Washington, DC 20202

Office of Management and Budget Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, we request receipt of your comments within 30 days.

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.

If you have any questions or if you wish to discuss the contents of this report, please contact me at 214-880-3031. Please refer to the control number in all correspondence related to this report.

Sincerely,



Sherri L. Demmel  
Regional Inspector General  
for Audit

Enclosure

**WHITAKER, CHALK, SWINDLE & SAWYER, L.L.P.**  
ATTORNEYS AT LAW

3500 CITY CENTER TOWER II  
301 COMMERCE STREET  
FORT WORTH, TEXAS 76102-4186

(817) 878-0500  
METRO (817) 429-6268  
WWW.WHITAKERCHALK.COM

JOHN ALLEN CHALK  
DIRECT DIAL (817) 878-0575

FAX (817) 878-0501  
JCHALK@WHITAKERCHALK.COM  
Refer to File No. 14062.012

November 26, 2002

***Federal Express***

Sheri L. Demmel  
Regional Inspector General for Audit  
U. S. Department of Education  
Office of Inspector General  
1999 Bryan St., Suite 2630  
Dallas, TX 75201-6817

Re: Draft Audit Report Control Number ED-OIG/A06-B0025; Our File No. 14062.012

Dear Ms. Demmel:

Having reviewed the Draft Audit Report (Control Number ED-OIG/A06-B0025) sent to Arizona Automotive Institute ("AAI") dated October 28, 2002, we appreciate this opportunity to clarify some of the information contained in the report for Award Years, 1997/98 through 1999/2000.

**AAI History in Title IV Program**

AAI initially became eligible for Title IV funds beginning May 9, 1972, and then began participating in the Direct Loan Program ("DLP") March 1, 1995. AAI was on the reimbursement payment method under the standard origination option from October 29, 1997 to August 15, 2000. However, it is important to note that during this period, specifically on April 30, 1999, AAI's assets and name were purchased by ATI Enterprises of Florida, Inc., a Texas Corporation ("ATI"). At the time of the purchase in 1999, ATI was told that all the loan records for AAI were reconciled, it was only after the purchase that AAI became aware of unreconciled DLP funds.

Since this purchase, ATI has worked and continues to work diligently on an almost daily basis with individuals at the Direct Loan Origination Center ("LOC"), specifically DELETED and DELETED to reconcile the accounts for Award Years 1997/98 through 1999/2000. Unfortunately, it has been very difficult to get enough information or help from LOC to be able to reconcile these years. For example, DELETED from LOC and DELETED a Client Account Manager with Region IX, visited AAI's Corporate Office on April 17 and 18, 2002, to run the Compare Program for Award Years 1997/98 and 1998/99 so that AAI could further determine what adjustments, if any, needed to be made to ATI's DLP ending cash balances. Despite their efforts, neither one was able to run the program while at ATI. ATI finally had to call DELETED in Washington to run the program for ATI. Only then was ATI able to determine some necessary adjustments. But even after this program was run, ATI has uncovered additional adjustments.

Currently, AAI is not in the DLP, having withdrawn from the DLP after Award Year 2000/01 in order to have the time to reconcile prior Award Years' DLP fundings. Additionally, AAI did not want to continue in the DLP until they could resolve problems with the LOC and reconcile all past Award Years.

### **Problems with the LOC**

Many of the problems with reconciling Award Years stem from problems at the LOC. After a Final Program Review Determination ("FPRD"), dated February 22, 2002, which resulted from a review of the records at LOC, it was incorrectly determined that AAI had an excess cash balance of \$109,702.00 for the award year 1998/99. ATI appealed this FPRD in Docket No. 02-40-SP, PRCN: 200221119489. While investigating this claim and prosecuting its FPRD appeal, AAI determined that LOC records reflected an incorrect amount of DLP funding on January 27, 1999 of \$575,818.00 to AAI for award year 1998/99 and an incorrect amount of DLP funding on January 27, 1999 of \$345,482.00 for award year 1997/98. See Exhibits R-1 through R-5. LOC subsequently recognized this mistake and notified AAI that the Education Department ("E.D.") would authorize a "drawdown" to AAI for \$118,890.00 for 1998/99 and \$92,585.00 for 1997/98. See Exhibit R-6. AAI confirmed this amount by e-mail to LOC on August 28, 2002. See Exhibit R-7. On October 30, 2002, the Department of Education signed a Settlement Agreement with AAI in light of these LOC mistakes and the subsequent reconciliations, thereby ending ATI's appeal proceeding. See R-8 and R-9. Since that agreement was reached, AAI and LOC have continued to reconcile both Award Years resulting in a **negative** balance of \$129,140.00 for 1997/98 and **negative** balance of \$127,793.85 for 1998/99, as of November 12, 2002, according to LOC records. See Exhibit R-10.

After the settlement was reached with E.D., AAI continued to take steps to reconcile Award Year 1999/2000 with the LOC in order to reach a cash balance of zero. This is a time-consuming process, but within the last few months AAI in conjunction with LOC has been able to reduce the cash balance for Award Year 1999/2000 from \$446,000.00 to \$253,006.10, as of November 12, 2002, according to LOC records. See Exhibit R-10. If allowed to continue to work through the 1999/2000 Award Year, AAI in conjunction with LOC can achieve a zero ending cash balance for this award year as well.

### **Reconciliation**

In the past, although AAI has tried, it has been impossible for AAI to reconcile accounts on a monthly basis. The Blue Book, the only publication to describe monthly reconciliation, states that the school's Direct Loan records should be compared to the Direct Loan School Account Statement ("DLSAS") generated by the LOC. The DLSAS calculates a school's cash balance by adding and subtracting the following cash records: drawdowns, returns of excess cash, disbursements to borrowers, and adjustments to disbursements. The problem in AAI's monthly reconciliation efforts stems from the fact that the LOC simply does not have current numbers especially if any refunds or excess cash has been returned within 120 days of a disbursement because any such refunds have to be sent directly to the Payment Center and are not accounted for in the DLSAS.

Additionally, neither 34 C.F.R. 685, 34 C.F.R. 668, nor the *Student Financial Aid Handbook* require schools to make a monthly accounting. While, 34 C.F.R. § 685.102 mentions a monthly reconciliation under the standard origination option, this section is merely definitional and precatory, not mandatory. No other section mentions a monthly reconciliation. The requirements of 34 C.F.R. § 685.300(b) do not include a monthly reconciliation. Although the Blue Book mentions DLP monthly reconciliations, this publication provides guidance not prescriptions to Title IV eligible schools. Therefore, while a monthly reconciliation is a good idea, and AAI is trying to achieve this, it is not a regulatory requirement.

Similarly, the 34 C.F.R. 685, 34 C.F.R. 668 and the *Student Financial Aid Handbook* do not require a yearly reconciliation; nor do they establish a reconciliation deadline to close out the years. Therefore, except for the required audits under 34 C.F.R. § 668.23(a)(4), AAI is unaware of regulatory deadlines in which to reconcile the Award Years in question.

### **Management Controls and Procedures**

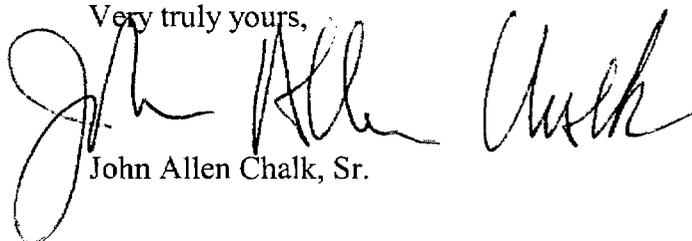
AAI is not currently in the DLP; therefore, they do not currently have an implemented management controls and procedures manual. However, AAI does have a management controls and procedures manual that will be implemented when they decide to rejoin the DLP.

### **Conclusion**

AAI has made every possible attempt to reconcile the accounts for Award Years 1997/98 through 1999/2000. These efforts continue. Given the difficulties in getting adjustments booked by the LOC, it has taken much longer than AAI hoped or anticipated. However, in light of the progress made over the last few months, if AAI is given the chance to continue to work with the LOC towards resolving this problem, all of the Award Years in question will be reconciled.

If you should have any questions or comments or need to reach me with regard to this matter, please do not hesitate to contact me at 817-878-0575.

Very truly yours,



John Allen Chalk, Sr.

JAC:kgd  
Enclosures

c: Peggy Rogers (w/enclosures)  
Joe Mehlmann (w/ enclosures)

# REPORT DISTRIBUTION LIST

Control Number OIG/A06-B0025

## Auditee

Mr. Bill Gresham, Director  
Arizona Automotive Institute  
6829 North 46<sup>th</sup> Avenue  
Glendale, AZ 85301

## Action Official

Theresa S. Shaw  
Chief Operating Officer  
Federal Student Aid

## Other ED Officials (electronic copy)

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