
Review of Non-Tax Delinquent Debt
at the U.S. Department of Education

MANAGEMENT INFORMATION REPORT



ED-OIG/A17-90001
September 1999

Our mission is to promote the efficient
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in support of American education



U.S. Department of Education
Office of Inspector General
Washington, DC

NOTICE

Statements that management practices need improvement, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. This report may be released to members of the press and general public under the Freedom of Information Act.



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

DATE: SEP 27 1999

TO: Greg Woods
Chief Operating Officer
Office of Student Financial Assistance

FROM: Lorraine P. Lewis
Inspector General *Lorraine Lewis*

SUBJECT: Final Management Information Report "Review of Non-Tax Delinquent Debt at the U.S. Department of Education" -- ED-OIG/A17-90001

Attached is a copy of the final management information report resulting from our review of non-tax delinquent debt at the U.S. Department of Education.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued by the Office of Inspector General are made 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. Copies of this report have been provided to the offices shown on the distribution list enclosed in the report.

We appreciate the cooperation shown to us. If you have any questions or wish to meet to discuss the contents of this report, please contact me at 205-5439.

Attachment

cc: Jack Reynolds, Acting Service Director, Debt Collection Service
Larry Oxendine, Service Director, Guarantor and Lender Oversight Service
Linda Paulsen, Service Director, Accounting and Financial Management Service
Audit Liaison Official

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OVERVIEW

The U.S. Department of Education (ED)/Office of Inspector General conducted a review of ED's compliance with the Debt Collection Improvement Act of 1996 (DCIA). The review is part of a President's Council on Integrity and Efficiency (PCIE) government-wide review of non-tax delinquent debt.

The objectives of the PCIE review were to determine the amount of non-tax delinquent debt (existence), to assess the collectibility of the non-tax delinquent debt (valuation), and to assess debt management activities (portfolio management).

Our review focused primarily on student financial assistance loans and the Debt Collection Service (DCS), a service area within ED 's Office of Student Financial Assistance Programs. In addition to DCS, there are three other service organizations that are responsible for collecting ED's delinquent debt: guaranty agencies, a direct loan servicer, and the Office of the Chief Financial Officer.

ED functions as a debt collection center to service its own student financial assistance loan debt. ED's authority to function as a debt collection center was granted by the U.S. Department of Treasury (Treasury), for a three-year period to be reevaluated upon expiration in the year 2001.

Our review disclosed that ED has worked diligently in meeting the intent of the DCIA which is to maximize collections of delinquent debts owed to the Federal government, and reduce losses arising from inadequate debt management activities.

ED uses a wide variety of collection tools to collect on its own non-tax delinquent debt. Delinquent debt collected by effort and tracked through DCS's Debt Collection Management System for Fiscal Year 1998 totaled \$713,398,260. Of the total amount collected for Fiscal Year 1998 in-house collection efforts accounted for \$451,820,542 while collection agencies efforts accounted for \$261,577,718. For Fiscal Year 1998, the Federal Family Education Loan Program (FFELP) loan payments from borrowers paid on defaulted loans at the guaranty agencies and on U.S. Department of Treasury/Internal Revenue Service offsets that are guaranty agency held loans totaled \$1.4 billion. Of all the collection tools employed the Treasury Offset Program resulted in the most dollars collected.

For Fiscal Year 1998, ED reported non-tax delinquencies totaling \$28.3 billion. In the Student Financial Assistance Loan Programs a loan is considered to be delinquent one day after a payment has been missed and default typically starts after 180 days of delinquency. Loans made through FFELP and the William D. Ford Federal Direct Loan Program accounted for \$27.4 billion or 97 percent of ED's total reported non-tax delinquencies.

This review did not address the objectives on the existence and valuation of the non-tax delinquent debt. To accomplish the objective of determining the amount of non-tax delinquent debt (existence)

and the objective of assessing the collectibility of the non-tax delinquent debt (valuation) we planned to rely on audit work performed by external auditors conducting the Fiscal Year 1998 Financial Statement Audit. However, the preparation and audit of the Fiscal Year 1998 Financial Statements is not complete. Upon completion of the financial audit and issuance of the final audit report, we will provide a copy to Treasury.

BACKGROUND

At the end of Fiscal Year 1998, the Federal government reported approximately \$60 billion in delinquent non-tax receivables and guaranteed loans. The U.S. Department of Education (ED) accounted for roughly \$28 billion, or 47 percent, of the \$60 billion in non-tax delinquent debt. Previous concern over the non-tax delinquent debt prompted Congress to enact the Debt Collection Improvement Act of 1996 (DCIA).

Signed by President Clinton on April 26, 1996, as part of the budget reconciliation bill, the DCIA (Public Law 104-134, Chapter 10) became effective and amended the debt collection authority granted by the Debt Collection Act of 1982. The purpose of the DCIA is to:

- ▶ maximize collection of delinquent debt owed to the Government;
- ▶ consolidate debt collection functions to minimize costs;
- ▶ ensure that debtors are provided appropriate due process rights;
- ▶ improve government credit management to minimize delinquency rates;
- ▶ ensure that the public is fully informed of the Government's debt collection policies and that debtors are cognizant of their financial obligations;
- ▶ utilize services of private collection agencies, when appropriate; and
- ▶ encourage agencies to sell delinquent debt under certain circumstances.

Overall implementation authority for DCIA was assigned to the U.S. Department of the Treasury (Treasury). Treasury delegated DCIA implementation authority to its Financial Management Service (FMS) which established the Debt Management Service to develop and manage the debt recovery. The DCIA specifically mandates that Federal agencies, with certain exceptions, transfer non-tax debt over 180 days delinquent to Treasury for collection. The DCIA refers to "non-tax debt" as any debt or claim that is not under the Internal Revenue Code of 1986. According to DCIA a debt is delinquent if it has not been paid by the payment date or by the end of any grace period contractually provided. The date of delinquency is the payment due date for an installment payment and the date of mailing of notice for an administrative debt. The date of delinquency starts the clock for the 180-day period stipulated in the DCIA.

The DCIA authorizes two key tools for collection of referred delinquent debt: government-wide cross-servicing and centralized administrative offset. Under the Treasury Cross-Servicing Program, FMS

uses a variety of collection tools and strategies, such as collection agencies, demand letters, and negotiated repayment agreements to collect non-tax delinquent debt. The centralized administrative offset program known as the Treasury Offset Program (and formerly known as the Federal Tax Refund Offset Program and the Federal Offset Program) matches Federal payments against debts owed to the Government. When a match occurs, the payment is offset up to the amount of debt.

Similarly, the DCIA requires Federal agencies to aggressively pursue the collection of debt once it becomes delinquent. In this regard, Federal agencies may employ collection tools such as demand letters, negotiated repayment agreements, wage garnishment, and debt sales to collect non-tax delinquent debt. In addition, the DCIA requires Federal agencies to reduce losses arising from debt management activities by requiring proper screening of potential borrowers, aggressive monitoring of all accounts, and sharing of information among other Federal agencies.

ED functions as a debt collection center to service its own student financial assistance loan debt. ED's authority to function as a debt collection center was granted by Treasury, for a three-year period to be reevaluated upon expiration in the year 2001. Treasury acknowledged that certain Federal debts have unique servicing requirements and that it may not be cost effective to transfer the debt to FMS for collection. Treasury approved ED's waiver request for the following reasons:¹

- ▶ Debt collections activities for the Office of Postsecondary Education (OPE) are centralized in DCS;
- ▶ DCS has demonstrated its expertise in collecting student loan debt;
- ▶ DCS utilizes the full range of debt collection tools outlined in the DCIA;
- ▶ Student loan debt is unique in that it is not subject to the statute of limitations; and
- ▶ The likelihood of collection increases as the debt ages.

¹ Waiver was granted on November 2, 1998. The decision to approve the waiver request was based on results of an initial evaluation conducted by Financial Management Service (FMS) staff and a subsequent review by the Application Review Committee. The Committee, comprised of officials from Departmental offices at Treasury and the U.S. Department of Justice, analyzed the evaluators' findings and concurred with the recommendation.

Through the [Report on Receivables Due from the Public](#) (Standard Form 220-9)², a government-wide report used to capture credit and debt management information, ED reported the following information on total receivables, total delinquencies, total collections, and total write-offs to Treasury for Fiscal Years 1997 and 1998.

	<i>FY 97</i>	<i>FY 98</i>	<i>Dollar Change</i>	<i>% Change</i>
Total Receivables	\$44,783,647,878	\$59,375,760,848	\$14,592,112,970	33%
Total Delinquencies	\$22,035,702,100	\$28,271,919,976	\$ 6,236,217,876	28%
Total Collections	\$ 2,561,535,527	\$ 3,412,724,829	\$ 851,189,302	33%
Total Write-Off's	\$ 352,107,047	\$ 588,280,008	\$ 236,172,961	67%

Appendix 2 reflects a break down of the total figures for Fiscal Year 1998 non-tax receivables, delinquencies, collections, and write-offs by program.

OBJECTIVES, SCOPE AND METHODOLOGY

The objective of the President's Council on Integrity and Efficiency (PCIE) government-wide review of non-tax delinquent debt were to:

- ▶ Determine the amount of non-tax delinquent debt (existence);
- ▶ Assess the collectibility of the non-tax delinquent debt (valuation); and
- ▶ Assess the debt management activities (portfolio management).

This review did not address the objectives on the existence and valuation of the non-tax delinquent debt. To accomplish the first and second objectives, we planned to rely on audit work performed by external auditors conducting the Fiscal Year 1998 Financial Statement Audit. However, the preparation and audit of the Fiscal Year 1998 Financial Statements is not complete. The external auditors will be reporting out in that audit product on any issues that may arise on the first and second objectives listed above. Upon completion of the financial audit and issuance of the final audit report, we will provide a

² The [Report on Receivables Due from the Public](#) covers the status of outstanding receivables including unpaid principal on direct loans and defaulted guaranteed loans acquired by the government, changes for the period, use of debt collection tools, adjudication activity, and other information.

copy to Treasury. Therefore, the scope of this review focuses on the third objective, debt management activities.

To accomplish the third objective, we conducted interviews with managers and staff responsible for administering debt collection and portfolio management activities at ED. Our primary focus was on DCS with a limited review of guaranty agencies, the Office of the Chief Financial Officer, and the direct loan servicer. In addition, we met with Treasury personnel responsible for oversight of the PCIE sponsored review and the implementation of the DCIA.

Specifically, we:

- ▶ Compared agency performance to the requirements of the DCIA and implementing regulations;
- ▶ Traced delinquent debt accounts receivable balances to supporting documentation;
- ▶ Evaluated the aging schedules and collectibility of delinquent debt accounts receivable;
- ▶ Examined procedures used to certify the existence of the delinquent debt;
- ▶ Examined procedures used to document and classify delinquent debt; and
- ▶ Examined procedures used to resolve delinquent debt returned by Treasury to ED as not eligible for collection.

Reports prepared by ED and the information extracted from its systems were the basis for many conclusions and much of the data included in the information report. Government Auditing Standards (GAS) require that auditors conduct reliability assessments of computerized records and reports when the information contained in them is the basis for review conclusions. We did not conduct a risk assessment or data testing as required by the standards. We concluded that the level of assessment work and testing required by GAS would require significant resources and that a scope limitation would not compromise the value of the information report.

The review covered Fiscal Year 1998 (October 1, 1997 through September 30, 1998). Fieldwork was conducted from December 1998 through April 1999. Except as noted above, the review was conducted in accordance with generally accepted government auditing standards.

REVIEW RESULTS

The results of our review disclosed that ED has worked diligently in meeting the intent of the DCIA. The following is a presentation of what our work revealed.

Debt Management Activities

ED uses a wide variety of collection tools to collect on its own non-tax delinquent debt. Delinquent debt collected by effort and tracked through DCS's Debt Collection Management System for Fiscal Year 1998 totaled \$713,398,260. Of the total amount collected for Fiscal Year 1998 in-house collection efforts accounted for \$451,820,542 while collection agencies efforts accounted for \$261,577,718. For Fiscal Year 1998, the Federal Family Education Loan Program (FFELP) loan payments from borrowers paid on defaulted loans at the guaranty agencies and on U.S. Department of Treasury/Internal Revenue Service (IRS) offsets that are guaranty agency held loans totaled \$1.4 billion. Of all the collection tools employed the Treasury Offset Program resulted in the most dollars collected.

The DCIA authorizes two key tools for collection of referred delinquent debt: government-wide cross-servicing and centralized administrative offset.

Cross-Servicing

The first collection tool, government-wide cross-servicing, requires that delinquent debts over 180 days be referred to Treasury for centralized collection efforts. This provision also permits the voluntary transfer of debts less than 180 days delinquent. FMS is managing this process and utilizes a variety of collection tools and strategies including private collection agencies, demand letters, administrative offset and negotiated repayment agreements.

A specific class of debt may be excluded for government-wide cross-servicing by the Secretary of the Treasury at the request of the head of an executive agency, as is the case at ED. In addition, debts may be excluded from transfer when any one of the five instances below exist:

- ▶ debts are in litigation or foreclosure;
- ▶ debts that will be disposed of under an asset sales program within one year after becoming eligible for sale, or later than one year if consistent with an asset sales program and a schedule established by the agency and approved by the Director of the Office of Management and Budget (OMB);
- ▶ debts that have been referred to a private collection contractor for collection for a period of

- time determined by Treasury;
- ▶ debts that have been referred to a Debt Collection Center with the consent of Treasury and for a period of time determined by Treasury; and
- ▶ debts that will be collected under internal offset if such offset is sufficient to collect the debt within three years after the debt is first delinquent.

ED voluntarily refers institutional liability debt to Treasury for collection through cross-servicing. On January 15, 1997, ED (Office of the Chief Financial Officer) entered into an agreement with Treasury for referring institutional liability debt for cross-servicing. However, in the agreement ED reserved the right to retain or recall certain exceptional delinquent or sensitive cases. In addition, ED reserved the right to assign individual non-Title IV delinquent debts to DCS for internal servicing. As of August 31, 1998, ED referred \$770 million to Treasury. For Fiscal Year 1998, Treasury collected approximately \$184,000 for ED through cross-servicing.

ED's Title IV Student Financial Assistance Programs and institutional debts under the College Housing Loans, the Higher Education Facilities Loans and the College Housing and Academic Facilities Loan programs are exempt from and therefore do not participate in Treasury's cross-servicing program.

Treasury Offset

Through the Offset Program, Treasury has developed a process to match Federal payments against debts owed to the Government. When a match occurs, the payment is offset up to the amount of the debt, less a pre-determined fee to cover operational expenses. As of August 31, 1998, ED referred \$13.4 billion to Treasury with a balance of \$2.7 billion that was not referred. The balance that was not referred to Treasury was being worked for due process afforded to delinquent entities.

In cooperation with the IRS, ED began a program in 1985 to collect defaulted student loans by offset against Federal income tax refunds (the first offsets were performed in 1986). Of all the collection tools employed for Fiscal Year 1998, the Treasury Offset Program resulted in the most dollars collected.

Other Collection Initiatives

The Emergency Unemployment Compensation Act of 1991 added a new provision to the Higher Education Act of 1965. The provision authorized ED to seek recovery of outstanding debts through the offset of ten percent of the disposable pay of employed individuals who have defaulted on their student loan obligations. This law created authorization to garnish wages without a requirement for obtainment of a legal judgement or court order. ED began implementing the authority given to them on a pilot basis in fiscal year 1993. Collections through wage garnishment totaled \$44 million for Fiscal Year 1998.

On August 22, 1996, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 was passed requiring employers to report newly hired employees to the State Directory of New Hires.

States are then required to report the new hires, quarterly wages, and unemployment income benefits to the National Directory of New Hires (NDNH). Every social security number received by the NDNH will be processed through Social Security Administration's social security number verification process. The successful implementation of this legislation, beginning October 1, 1997, would have a long-term impact upon federal debt collections. Obtaining a defaulted student loan borrower's employer information is critical to the success of the administrative wage garnishment collection tool. ED assisted the U.S. Department of Health and Human Services (HHS) in drafting legislative language to require data matches between the National Directory of New Hires and student loan defaulter information and authorize necessary disclosures of National Directory of New Hires information. On May 19, 1999, the Director of OMB signed and transmitted to Congress a legislative proposal containing this language.

Credit bureau reporting was in place at ED prior to the enactment of the DCIA. The Debt Collection Act of 1982, as amended, gave federal agencies the authority to report non-tax delinquent consumer debts to credit bureaus. Once all due process procedures have been observed and a debtor is given sixty days to respond to a notification of the intention of referral to credit repositories, DCS reports debt to the appropriate credit repositories on a monthly basis.

Over ten years ago, DCS shifted the bulk of the collection effort from federal employees to private collection agencies. As a result, DCS' federal employee staffing fell from 1200 employees to just over 200 employees currently employed. Presently DCS has eighteen contingency fee contracts with private collection agencies. Through their contract with ED, collection agencies are entitled to a certain percentage of the dollar amount that they collect on defaulted loans. The private collection agencies employ around 1000 individuals dedicated to collecting defaulted loans assigned to ED. For Fiscal Year 1998 the dollars collected through the efforts of collection agencies totaled almost \$262 million. Reported delinquent debt collected by effort and tracked through DCS's Debt Collection Management System, for Fiscal Year 1998, is summarized below.

Delinquent Debt Collected by Effort³

<i>Collection Effort</i>	<i>ED Collections</i>
Treasury Offset (ED held accounts)	\$ 273,895,489
Regular (Voluntary collections)	101,121,631
Federal Direct Student Loan Program Consolidations ⁴	30,346,695
Wage Garnishment	17,705,186
Department of Justice Litigation	12,848,115
Federal Salary Offset ⁵	7,472,214

³ Information was obtained from DCS's Debt Collection Management System. This system maintains loan level detail on defaulted loans assigned to ED. Figures cited in the table above and throughout the report are gross collection figures. Even though reported as delinquent some collections represent loans that are current and are in repayment.

⁴ The Higher Education Act provides for a loan consolidation program under both FFELP and the Direct Loan Program. Loan consolidations simplify loan repayment by combining several types of Federal education loans (that may have different terms and repayment schedules or may have been made by different lenders) into one new loan.

⁵ Annual matches are conducted with the Office of Personnel and Management and the U.S. Postal Service for all current and retired Federal employees.

Loan Rehabilitation ⁶	6,397,668
FMS Collections (Financial Management Service/Treasury)	1,302,694
Federal Family Education Loan Program Consolidations ⁴	730,850
TOTAL ED COLLECTIONS	\$451,820,542

<i>Collection Effort</i>	<i>Collection Agencies</i>
Regular	\$ 95,174,861
Federal Direct Student Loan Program Consolidations ⁴	89,874,192
Federal Family Education Loan Program Consolidations ⁴	47,619,685
Wage Garnishment	26,362,920
Loan Rehabilitation ⁶	2,546,060
TOTAL COLLECTION AGENCIES	\$261,577,718

TOTAL COLLECTIONS (FY 98)	\$713,398,260
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For Fiscal Year 1998, FFELP unassigned loan payments from borrowers paid on defaulted loans at the guaranty agencies and on IRS offsets that are guaranty agency held loans totaled \$1.4 billion.

ED's student loans are unsecured. However, before a loan is disbursed a student must sign a promissory note; a legally binding contract between the borrower and the lender, which contains the terms and conditions of the loan, including how and when the loan must be repaid.

Section 3 of the Higher Education Technical Amendments of 1991 (Public Law 102-26), eliminated any statute of limitations that applied to enforcement actions to collect student loans made or insured under Title IV of the Higher Education Amendments. In addition, with the exception of ED selling individual loans back to a lender after a loan has been rehabilitated, ED does not sell its debt. ED hired a financial advisor to evaluate DCS' present collection strategies and propose unique collection and disposition strategies. The financial advisor recently determined a loan sale would not be in the best interest of the Government. A sophisticated lease arrangement where there would be a combination of the public sector collection tools and the private sector's management expertise was recommended.

In a joint effort ED and Treasury recently kicked-off a "1800IWILLPAY" campaign to reach out to student loan borrowers to increase awareness of student loan repayment options for students who are in default or may be near default and to acquaint them with the DCIA and its impact on them.

⁶ After 12 consecutive payments have been made on a formerly defaulted loan, it is eligible to become a rehabilitation loan. Once a loan becomes rehabilitated, it becomes a new loan. A borrower again becomes eligible for participation in Title IV programs.

Documenting and Classifying Delinquent Debt

For Fiscal Year 1998, ED reported non-tax delinquencies totaling \$28.3 billion. Loans made through the FFELP and the William D. Ford Federal Direct Loan Program (Direct Loan Program) accounted for \$27.4 billion or 97 percent of the total reported non-tax delinquencies. Appendix 3 provides a breakdown of the total delinquencies by program at the end of Fiscal Year 1998.

FFELP, regulated by Title 34 of the Code of Federal Regulations (CFR) Part 682, is a guaranteed loan program and includes the Federal Stafford Loans, subsidized and unsubsidized; Federal Parent Loans for Undergraduate Students (PLUS); Federal Supplemental Loans to Students (SLS)⁷; and Federal Consolidation Loans. FFELP is the largest postsecondary education guaranteed loan program of the Federal government and its primary purpose is to increase postsecondary educational opportunities for eligible students.

FFELP loans are made by private lenders, guaranteed by a state or private nonprofit guaranty agency, and insured by the federal government. Unassigned loan receivables represent that portion of the defaulted portfolio in which loans are maintained and serviced by a guaranty agency. Assigned loan receivables represent that portion of the defaulted loan portfolio which has been transferred from the guaranty agency's to ED's DCS.

Student loans, under FFELP, are considered to be delinquent one day after a payment has been missed and default typically starts after 180 days for a loan repayable in monthly installments, and for 240 days for a loan repayable in less frequent installments. As part of the Higher Education Amendments of 1998 the statutory definition of default was changed. FFELP loans that are effected are those for which the first date of delinquency occurs on or after the date of enactment of the Higher Education Amendments of 1998 (October 7, 1998). The definition of "default" includes only such defaults as have existed for 270 days in the case of a loan which is repayable in monthly installments, or 330 days in the case of a loan which is repayable in less frequent installments. For loans on which ED itself is trying to collect, defaulted cases are not received until both lenders and the guaranty agencies have attempted collection, a process which typically lasts at least 4 years after the debt became delinquent.

Under the Direct Loan Program, regulated by 34 CFR Part 685, there are only three entities: the student, the school and ED. There are four types of Direct Loans: Federal Direct Stafford/Ford Loans (Direct Subsidized Loans); Federal Direct Unsubsidized Stafford/Ford Loans (Direct Unsubsidized Loans); Federal Direct PLUS Loans; and Federal Direct Consolidation Loans. The school determines how much a student will need to borrow and electronically transmits all the required loan information to ED. When a loan is approved, the student signs a promissory note and the school credits the student's tuition account.

⁷ No new loans were originated after July 1, 1994. The authority for this program ended July 1, 1994.

Prior to the Higher Education Amendments of 1998 default for direct loans occurred if the borrower failed to repay the loan and the condition persisted for 180 days. Defaulted loans would be transferred to DCS after 270 days. Through the enactment of the Higher Education Amendments of 1998, Direct Loans are considered defaulted at the 270th day and transferred to DCS after 360 days.

Accounts Receivable

Existence of Accounts Receivable, Collectibility, and Revenue Recognition

To accomplish the objectives for the accounts receivable portion of our review we planned to rely on audit work performed by external auditors conducting the Fiscal Year 1998 Financial Statement Audit. However, the preparation and audit of the Fiscal Year 1998 Financial Statements is not complete.

The external auditors will primarily focus on loans receivable under the Direct Loan, Federal Family Education Loan, and Facilities Loans Programs. Detailed audit work will be performed in two areas that relate to loans receivable:

- ◆ Principal and interest receivable.
- ◆ Collectibility of loans receivable.

For loans under the Direct Loan Program the external auditors plan to select a sample of loans receivable and review promissory notes; origination and disbursement records; and records of borrowers payments to test the outstanding principal balance of September 30, 1998. In addition, for each of the loans selected the interest receivable balances will be tested by verification that the interest rate used complies with applicable laws and regulations, and recalculation of accrued interest as of September 30, 1998.

To test assigned loans receivable balances under the FFELP a comparison will be made of the September 30, 1997 audited balances to the September 30, 1998 beginning balance. The major components of Fiscal Year 1998 activity that will be tested are, new assignments, write-off's, and borrower payments.

The external auditors plan to confirm unassigned defaulted FFELP loans receivable principal and interest balances with all guaranty agencies as of September 30, 1998. A comparison will be made of the confirmed amount with amounts previously reported by the guaranty agencies and amounts recorded in ED's general ledger.

A similar approach used in testing the assigned FFELP loans receivable will be used in testing Facilities Loans receivables. Supporting documentation, such as borrower payments, will be reviewed for significant current year activity.

Effective July 15, 1993, the Statement of Federal Financial Accounting Standard No. 2 required that the net present value of subsidy costs (interest subsidies, defaults, fee offsets, and other cash flows)

associated with direct loans and loan guarantees for a given year be recognized as an expense in the year the loans are disbursed. In addition, re-estimates of prior year cohorts are done every year and the resulting difference from prior estimates is included as a subsidy expense. Cumulative estimates of subsidy costs associated with all outstanding loans are used to develop allowances for direct loans receivable and defaulted guaranteed loans and a liability for loan guarantees.

For the compliance with the Statement of Federal Financial Accounting Statement No. 2 the external auditors plan to assess: ED's computer-based cash flow models; significant assumptions used in calculating the liability for loan guarantees; and the Direct Loan Program and FFELP allowances.

Upon completion of the financial audit and issuance of the final audit report, we will provide a copy to Treasury. At this time, we are not in a position to address the existence, collectibility, or revenue recognition.

ED'S REPLY

ED commented on our draft report in a memorandum dated August 2, 1999. A copy of the complete text of the response is contained in Appendix 5.

OIG RESPONSE

ED's response to our draft report does not warrant any changes. We look forward to working with ED in the future.

Appendix 1

DEBT COLLECTION SERVICE

ED functions as a debt collection center to service its own student financial assistance loan debt. ED's authority to function as a debt collection center was granted by Treasury, for a three year period to be reevaluated upon expiration in the year 2001.

Debt collection activities are centralized at ED. DCS, a component within the Office of Student Financial Assistance Programs (OSFAP), provides debt management services for the defaulted student loan portfolio assigned to ED. Unassigned defaulted loans are managed by thirty-six guaranty agencies located throughout the United States.

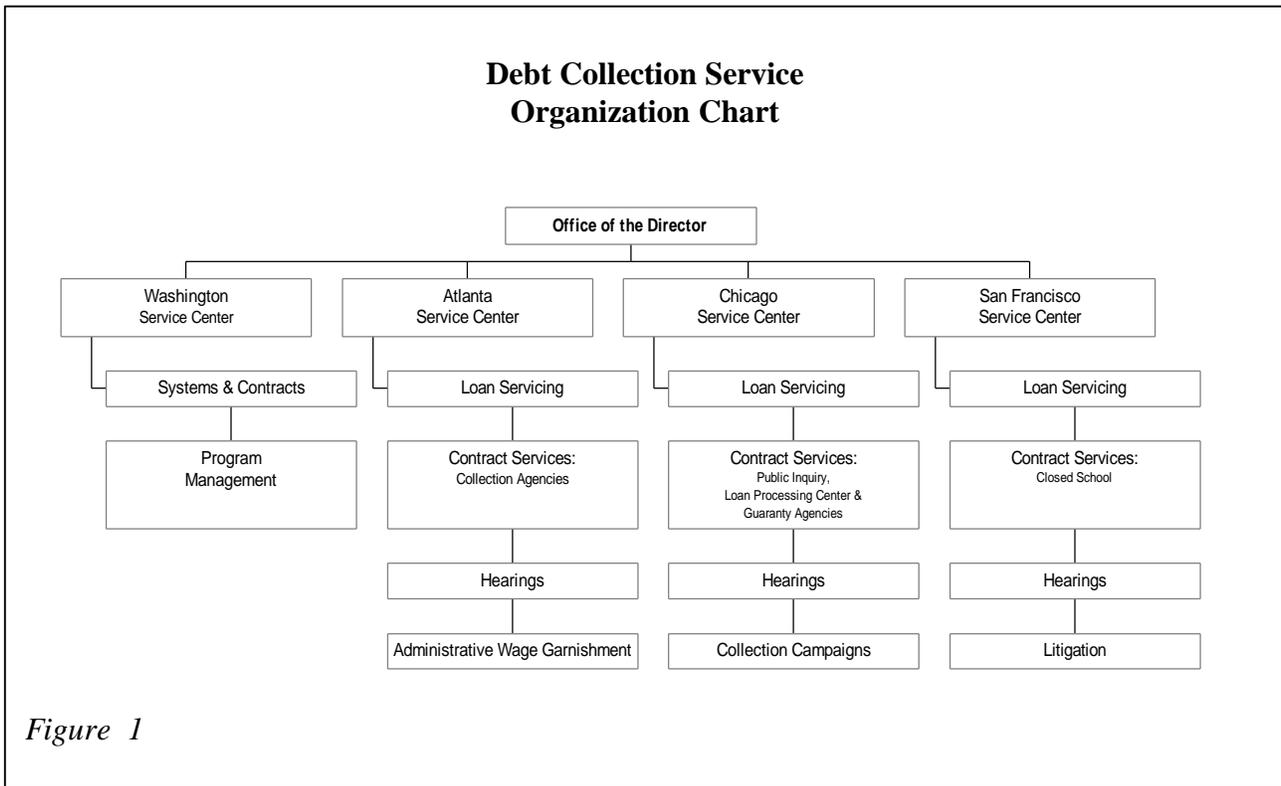
The mission of DCS is to provide quality customer service and sound credit management to maximize net revenue on collections. To carry out its mission DCS utilizes tools outlined in DCIA which include: Treasury and Internal Revenue Offset, private collection agencies, credit bureau referrals, litigation, wage garnishment, phone calls and letters. DCS' primary customers are the taxpayers and student borrowers. DCS maintains a philosophy that taxpayers are entitled to an effective and efficient collection program and borrowers are entitled to maintain their dignity as they repay their debts.

Figure 1 depicts the organizational structure of DCS. DCS is headquartered in Washington, DC, with regional servicing offices located in Atlanta, Georgia; Chicago, Illinois; and San Francisco, California. DCS regional employees oversee contractor operations and perform the following governmental functions: dispute resolution, hearings, claims adjudication, system design/development, and handle specialty collection activities. To facilitate discharging its responsibilities, DCS makes use of various contractors, including the use of eighteen private collection agencies through performance-based contracts, a public inquiry contractor, a central repository for collections, and a computer processing company.

The Washington Service Center provides oversight of all collection related activities, including oversight of and coordination between the regional servicing offices, contractors and vendors. This center is responsible for developing collection policies and plans, as well as program and operating budgets, and interacts with vendors and other service providers to ensure that the Debt Management and Collection System remains state-of-the-art. Most all national issues and interfaces with other Federal and non-federal agencies are handled here.

Currently, collection support activities are managed through three major branches: Loan Servicing, Contract Services and Hearings.

Each of the three regional service centers maintain a Loan Servicing branch (LS). LS resolves disputes between the borrowers and the Federal government and ED's vendors. In addition, LS provides a



number of services such as, adjusting loan balances, loan consolidation and loan rehabilitation services, credit reporting, and borrower credit counseling.

The duties of the Contract Services branch differ in each of the regional service centers. The Atlanta Contract Services branch handles the day-to-day oversight of the private collection agency contracts. The Chicago Contract Services branch oversees the Public Inquiry Contractor, the Student Loan Processing Center, and the National Payment Center. The San Francisco Contract Services branch provides oversight of vendors processing closed school and bankruptcy discharges.

The Hearings branches in each of the regional service centers ensure that the rights of due process are afforded to borrowers, especially before involuntary payment methods are employed. Student loan borrowers have a right to a hearing by a Federal employee prior to Treasury offset, wage garnishment, credit bureau reporting or Federal Salary offset.

The Atlanta Service Center provides consultative assistance to employers required by law to comply with ED's garnishment orders. In an environment where collection agencies employ the vast majority of collection staff, a small group of Federal employees from the Chicago Service Center, have been tasked to establish benchmarks for the collection agencies to achieve or exceed and to develop innovative recovery campaigns. DCS' San Francisco litigation branch is solely responsible for the litigation process and oversees the preparation of litigation packages submitted to the Department of Justice and/or their representatives. The bulk of the litigation packages are prepared by DCS' private collection agencies and reviewed by the litigation branch in San Francisco.

Appendix 2

**NON-TAX RECEIVABLES, DELINQUENCIES, COLLECTIONS, AND WRITE-OFFs
BY PROGRAM
FOR FISCAL YEAR ENDING SEPTEMBER 30, 1998**

<i>Program</i>	<i>Total Receivables</i>	<i>Total Delinquencies</i>	<i>Total Collections</i>	<i>Total Write-Offs</i>
Federal Family Education Loans (Unassigned) ¹	\$17,288,684,275	\$17,249,468,154	\$1,375,106,410	\$331,774,489
Federal Family Education Loans (Assigned) ¹	6,466,254,625	6,466,254,625	519,768,911	90,980,893
Federal Direct Loans ²	34,196,450,645 ³	3,711,030,206	1,349,564,762	28,283,949
Departmental Management (non-OPE) ⁴	709,130,816	705,839,369	55,649,507	129,622,291 ⁵
Federal Student Loan Insurance Fund	136,225,034	136,225,034	43,827,677	7,192,520
College Housing Loans	386,742,854	2,668,271	43,653,464	209,399
Higher Education Facilities Loans	36,119,591	237,348	6,886,934	216,467
College Housing & Academic Facilities Loans	156,153,008	196,969	18,267,164	0
TOTAL NON-TAX (FY 98)	\$59,375,760,848	\$28,271,919,976	\$3,412,724,829	\$588,280,008

¹ Under FFELP when the guaranty agencies have exhausted their collection efforts or a loan meets specific ED criteria (34 CFR § 682.409) it is permanently assigned to ED. The guaranty agencies assign all rights and title to the loans. Once loans of this type are transferred to ED and processed, an adjusting entry is made in the general ledger to reduce the unassigned loans receivable and increase the assigned loans receivable. As of September 30, 1998, ED reported \$110 billion in loans outstanding under FFELP.

² As of September 30, 1998, ED reported approximately \$33 billion in loans outstanding under the Direct Loan Program.

³ Approximately \$1.4 billion of the total receivables account for dollars advanced to schools. For financial statement purposes the advance account is treated similar to a loan receivable.

⁴ Includes amounts from the Pell and Impact Aid Programs and the result of ED's post audit efforts.

⁵ Total write-offs consist of \$117,958 from the Pell Program and \$129,504,333 from ED's post audit efforts.

Source: Figures reported by ED to Treasury through the [Report on Receivables Due from the Public](#) for Fiscal Year 1998. Figures will be audited as part of ED's Fiscal Year 1998 Financial Audit. Figures include principal and interest.

Appendix 3

**NON-TAX DELINQUENT DEBT BY PROGRAM
FOR FISCAL YEAR ENDING SEPTEMBER 30, 1998**

<i>Program</i>	<i>Total Delinquencies</i>	<i>Total Delinquent Debt over 180 Days</i>
Federal Family Education Loans (Unassigned) ¹	\$17,249,468,154	\$17,249,468,154
Federal Family Education Loans (Assigned) ¹	6,466,254,625	6,466,254,625
Federal Direct Loans ²	3,711,030,206	479,025,427
<i>Subtotal (FFELP and Direct Loans)</i>	<i>27,426,752,985</i>	<i>24,194,748,206</i>
Departmental Management (non-OPE) ³	705,839,369	586,165,611
Federal Student Loan Insurance Fund	136,225,034	136,225,034
College Housing Loans	2,668, 271	2,177,379
Higher Education Facilities Loans	237,348	229,000
College Housing & Academic Facilities Loans	196,969	125,740
TOTAL NON-TAX (FY 98)	\$28,271,919,976	\$24,919,670,970

¹ Under FFELP when the guaranty agencies have exhausted their collection efforts or a loan meets specific ED criteria (34 CFR § 682.409) it is permanently assigned to ED. The guaranty agencies assign all rights and title to the loans. Once loans of this type are transferred to ED and processed, an adjusting entry is made in the general ledger to reduce the unassigned loans receivable and increase the assigned loans receivable. As of September 30, 1998, ED reported \$110 billion in loans outstanding under FFELP.

² As of September 30, 1998, ED reported approximately \$33 billion in loans outstanding under the Direct Loan program.

³ Includes amounts from the Pell and Impact Aid Programs and the result of ED's post audit efforts.

Source: Figures reported by ED to Treasury through the [Report on Receivables Due from the Public](#) for Fiscal Year 1998. Figures will be audited as part of ED's Fiscal Year 1998 Financial Audit. Figures include principal and interest.

Appendix 4

List of Acronyms	
Acronym	Definition
CFR	Code of Federal Regulations
DCIA	Debt Collection Improvement Act of 1996
DCS	Debt Collection Service in ED
Direct Loan Program	William D. Ford Federal Direct Loan Program
ED	U.S. Department of Education
FFELP	Federal Family Education Loan Program
FMS	U.S. Department of Treasury/Financial Management Service
HHS	U.S. Department of Health and Human Services
IRS	U.S. Department of Treasury/Internal Revenue Service
LSB	Loan Servicing Branch in ED
NDNH	National Directory of New Hires
OIG	Office of Inspector General in ED
OMB	Office of Management and Budget
OPE	Office of Postsecondary Education in ED
OSFAP	Office of Student Financial Assistance Programs in ED
PCIE	President's Council on Integrity and Efficiency
PLUS	Federal Parent Loans for Undergraduate Students
SLS	Federal Supplemental Loans to Students
Treasury	U.S. Department of Treasury



UNITED STATES DEPARTMENT OF EDUCATION
THE OFFICE OF STUDENT FINANCIAL ASSISTANCE
WASHINGTON, D.C. 20202-5132

AUG - 2 1999

MEMORANDUM

TO: Chelton T. Givens
Area Manager, Washington Field Office
Office of Inspector General

FROM: Greg Woods
Chief Operating Officer 

SUBJECT: DRAFT INFORMATION REPORT
Review of Non-Tax Delinquent Debt at the U.S. Department of Education

We thank the Office of Inspector General for issuing a thorough, high quality, and valuable information report on the status of the Department's compliance with the Debt Collection Improvement Act of 1996 (DCIA). As the principal office that oversees debt collection activities for the student financial assistance programs, we are pleased that your review found that we have worked diligently in meeting the intent of the DCIA. We believe that the Office of Student Financial Assistance's current reinvention activities will help maximize collections of delinquent debt, minimize delinquency rates, and reduce costs associated with debts owed to the Federal government.

cc: Linda Paulsen
Jack Reynolds
Pat Howard

REPORT DISTRIBUTION SCHEDULE

ED-OIG/A17-90001

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<i>Office of Student Financial Assistance Programs</i> Acting Director, Debt Collection Service Director, Guarantor and Lender Oversight Director, Accounting and Financial Management Service Audit Liaison Official	3 3 3 1
<i>Office of the Chief Financial Officer</i> Acting Chief Financial Officer Supervisor, Post Audit Operations Audit Liaison Official	3 1 1
<i>Office of Public Affairs</i>	1
<i>Office of Inspector General</i> Inspector General Deputy Inspector General Congressional Liaison Assistant Inspector General for Audit Deputy Assistant Inspector General for Audit Assistant Inspector General for Operations - Eastern Area Assistant Inspector General for Operations - Western Area Director, Student Financial Assistance Advisory & Assistance Programs Director, Planning, Analysis & Management Services	1 1 1 1 1 1 1 1 1 2