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**Federal Student Aid's Oversight and Monitoring of  
Guaranty Agencies, Lenders, and Servicers  
Needs Improvement**

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**FINAL AUDIT REPORT**

**LANI EKO & COMPANY, CPAS, PLLC  
ED-OIG/A20I0001  
April 2009**

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

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



**UNITED STATES DEPARTMENT OF EDUCATION**  
**OFFICE OF INSPECTOR GENERAL**

Audit Services

April 29, 2009

**MEMORANDUM**

**TO:** Matthew Yale  
Deputy Chief of Staff

**FROM:** Keith West /s/  
Assistant Inspector General for Audit

**SUBJECT:** Final Audit Report  
Federal Student Aid's Oversight and Monitoring of Guaranty Agencies, Lenders, and  
Servicers Needs Improvement  
Control Number ED-OIG/A20I0001

Attached is the subject final audit report that covers the results of the review of the appropriateness and effectiveness of Federal Student Aid's (FSA) internal control to ensure that guaranty agencies, lenders, and servicers are performing in accordance with relevant laws, regulation and guidance for the period from October 1, 2006, through March 31, 2008. We received FSA's response and its draft corrective action plan for each of the recommendations contained in the draft audit report.

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

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

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 the cooperation given us during this review. If you have any questions, please call me at (202) 245-7041.

Enclosure

cc: James Manning, Acting Chief Operating Officer, FSA  
Marge White, Audit Liaison Officer, Internal Audits, FSA

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<b>ATTACHMENT</b>	<b>Department Response to Draft Audit Report</b>	

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## EXECUTIVE SUMMARY

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The objective of our audit was to evaluate the appropriateness and effectiveness of Federal Student Aid (FSA) internal control to ensure that guaranty agencies, lenders and servicers are performing in accordance with relevant laws, regulations and guidance. Our audit covered the period from October 1, 2006, through March 31, 2008. During our audit, we identified internal control weaknesses relating to all five of the Internal Control Standards – control environment, risk assessment, control activities, information and communication, and monitoring as included in the Government Accountability Office’s (GAO) *Standards for Internal Control in the Federal Government (Internal Control Standards)*.

### **Improvement Is Needed in the Control Environment for Oversight and Monitoring of the Guaranty Agencies, Lenders and Servicers**

The control environment is the organizational structure and culture created by management and employees to sustain organizational support for effective internal control. Based on our audit, we found:

- Improvement was needed in oversight of Federal Family Education Loan (FFEL) Program participants.
- Delegation of authority was not properly aligned with oversight and monitoring of guaranty agencies, lenders and servicers.
- Potential conflicts of interest existed with the former general manager of Financial Partners Services (FPS).

### **Improvement Is Needed in the Financial Partners Eligibility & Oversight (FPE&O) Risk Assessment Process**

The financial and compliance impacts of identified risks were not properly assessed, quantified and documented; there was limited to no documentation to support selection of FFEL Program participants for program reviews; and no evidence that consideration was given to available staffing resources.

### **Control Activities Over Guaranty Agencies, Lenders and Servicers Need Improvement**

Control activities include the policies, procedures, and mechanisms in place to help ensure that an agency meets its objectives. Based on our audit, the following conditions existed:

- Process for monitoring lenders’ compliance with 34 Code of Federal Regulations (CFR) 682.305 (c)(1), which requires that certain lenders submit independent annual compliance audit reports, was not effective.

1. Partner Services Group (PSG) control activity was not effective with respect to monitoring lenders' compliance with the requirements of Section 428(b)(1)(U)(iii)(I) of the Higher Education Act of 1965, as amended (HEA) and 34 CFR 682.305(c)(1).
  2. PSG procedures for ensuring that lenders are addressing issues in the compliance audit reports were not timely.
  3. PSG had no written procedures for escalating auditor's opinion that is other than an unqualified opinion, material weaknesses, or significant noncompliance with laws and regulations.
- Published minimum reserve ratios for guaranty agencies were not calculated in accordance with Section 428(c)(9) of HEA, which requires certain guaranty agencies to maintain minimum Federal fund reserve ratio of 0.25 percent.
    1. The financial conditions of the guaranty agencies were overstated.
    2. Guaranty agencies were not adequately monitored by PSG.
    3. The Federal fund reserve ratios published on the Financial Partners website were overstated.
  - Reviews conducted under the Common Review Initiative (CRI) may not have satisfied guaranty agencies' obligations to conduct reviews of lenders.
    1. The use of the Common Manual, Unified Student Loan Policy (Common Manual) in the CRI reviews to ascertain lenders compliance with FFEL Program requirements may not have satisfied guaranty agencies' obligations to conduct reviews of lenders.
    2. The sampling method used was not consistent and not susceptible to projection.
    3. The tolerable error rate of 10 percent was too high.
    4. The sample selected in CRI reviews did not provide coverage of all lenders listed in the CRI report.
    5. Lender billing reviews were not conducted in all CRIs.
    6. CRI workpapers were not reviewed in a timely manner.
  - Incompatible duties were not separated and no written procedures were in place for providing technical assistance to guaranty agencies, lenders and servicers.

### **FSA Lacked Written Procedures on Sharing Information Related to Policy Guidance and Program Reviews**

- There were no written procedures in place to share program review reports that contain sensitive issues, political issues, and/or areas where the Office of Postsecondary Education (OPE) or the Office of General Counsel (OGC) has expressed an interest to ensure that program review findings are consistent with laws and regulations.
- FPE&O management lacked a tracking system for policy related matters.
- There were no written procedures for providing technical assistance.

## **FSA's Implementation of Corrective Actions**

FSA did not take timely corrective action to address findings and recommendations noted in a prior Office of Inspector General (OIG) audit report. The OIG report entitled *Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers*, dated September 29, 2006, identified 17 recommendations. FSA's Internal Report: Corrective Action Plan, dated March 5, 2008, indicated there were 14 open recommendations. Between March 5, 2008 and August 27, 2008, FSA reported the remaining recommendations completed. Of the 17 total corrective actions, we noted that only 2 corrective actions were completed by the proposed completion dates. For the remainder, proposed completion dates were extended once for 8 corrective actions, twice for 7 corrective actions. We also found that 5 corrective actions had not been fully implemented, and 3 corrective actions were not completed when reported.

For each of the identified weaknesses in the internal control standards, we provided recommendations, as defined in the Audit Results section, that if implemented will improve the effectiveness of oversight and monitoring of the guaranty agencies, lenders and servicers.

On May 1, 2008, subsequent to the scope of our audit, FSA issued *Financial Partner Eligibility and Oversight (FPE&O) Program Review Procedures (Standards)*. The title page of the Standards state, "This manual was created to provide standardized procedures for conducting Program Reviews." The Standards, if implemented as intended, should result in improvements to some of the issues noted in this audit report. Where applicable in the individual findings, we have noted the issues reported that the Standards address.

FSA provided its response to our draft audit report on March 24, 2009. In its response, FSA stated that actions it has taken, and plans to take in the near future, address many of the issues raised in the draft report. In addition, FSA provided a draft corrective action plan that included proposed actions to address each of the recommendations in the report. FSA's response is provided in full as an attachment to this report.

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## BACKGROUND

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FSA, an office of the U.S. Department of Education, was created as a Performance Based Organization under the 1998 amendments to the HEA. FSA's primary objectives are to: a) improve service to students and other participants in the Federal student financial assistance programs authorized under title IV, including making those programs more understandable to students and their parents; (b) reduce the costs of administering those programs; (c) increase the accountability of the officials responsible for administering the operational aspects of these programs; (d) provide greater flexibility in the management of the operational functions of the Federal student financial assistance programs; (e) integrate the information systems supporting the Federal student financial assistance programs; (f) implement an open, common, integrated system for the delivery of Federal student financial assistance under title IV; and (g) develop and maintain a Federal student financial assistance system that contains complete, accurate, and timely data to ensure program integrity.

FSA works with over 3,200 lenders, 35 guaranty agencies and 46 servicers that participate in the FFEL program. Under the HEA, in the FFEL Program, state and private non-profit guaranty agencies use Federal funds to provide loan guarantees and interest subsidies on loans made by private lenders to eligible students and parents.

As of September 30, 2007, FSA oversaw approximately \$363 billion in guaranteed loans, held by lenders, with estimated maximum government exposure on outstanding guaranteed loans of approximately \$359 billion. The government reinsures, through the guaranty agencies, 95 to 100 percent of the outstanding guaranteed loans. The remaining balance not reinsured by the government is paid by the guaranty agencies to lenders from the Federal funds administered by the guaranty agencies but owned by the federal government. In FY 2007, FSA managed, directly or through guaranty agencies, approximately \$24 billion of defaulted guaranteed loans and supported delivery of \$51 billion in net guaranteed federal loans to 6.2 million FFEL Program recipients.

Program Compliance is the primary organizational unit in FSA providing oversight and guidance to schools, guaranty agencies, lenders and servicers under the FFEL Program. The Business Operations unit is responsible for improving consistency, efficiency/effectiveness and coordination/communication of FSA operations. FPE&O and the PSG, components within Program Compliance and Business Operations, respectively, have direct responsibilities for monitoring the guaranty agencies, lenders and servicers to assess program compliance with HEA and the Department's regulations.

According to the functional statement on FSA's website, FPE&O is responsible for implementing program and financial reviews of guaranty agencies and FFEL Program lenders and related agencies or organizations; providing technical assistance to these groups on the proper administration and management of the FFEL Program; identifying and analyzing major issues affecting lender and guarantor compliance with program requirements; and developing national priorities, goals, and guidelines for monitoring the programmatic stability of the Federal student loan guarantors. In addition, FPE&O provides oversight over the guaranty agencies'



review of their top ten lenders under the CRI. FPE&O has four regional offices in New York, Dallas, San Francisco, and Chicago, and duty stations in Atlanta and Boston.

PSG is responsible for identifying and analyzing major issues affecting lenders, and guaranty agencies' financial stability. PSG is responsible for reviewing compliance audit reports to identify audit findings, issue Program Determination Letters (PDLs), and monitor the implementation of corrective actions to ensure that audit findings are properly addressed by the FFEL Program participants.<sup>1</sup>

In September 2006, the OIG issued a report, *Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders and Servicers*. The report concluded that FSA had not implemented an acceptable level of internal control over its monitoring and oversight. The report identified internal control weaknesses relating to the following internal control standards – control environment; risk assessment; control activities; and information and communication.

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<sup>1</sup> According to the Director of PSG, FPE&O assumed responsibilities for the review of the compliance audit reports effective October 1, 2007.

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## AUDIT RESULTS

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Controls implemented by FPE&O and PSG to ensure that guaranty agencies, lenders and servicers are performing in accordance with relevant laws, regulations and guidance needed improvement. Specifically, weaknesses existed in the (1) control environment for oversight and monitoring of the guaranty agencies, lenders and servicers; (2) FPE&O risk assessment process (3) control activities over guaranty agencies, lenders and servicers; (4) information and communication process for sharing policy guidance and program reviews; and (5) timeliness of corrective action plan implementation.

FSA provided its response to our draft audit report on March 24, 2009. In its response, FSA stated that actions it has taken, and plans to take in the near future, address many of the issues raised in the draft report. In addition, FSA provided a draft corrective action plan that included proposed actions to address each of the recommendations in the report. FSA's response is provided in full as an attachment to this report.

### **FINDING NO. 1 – Improvement Is Needed in the Control Environment for Oversight and Monitoring of the Guaranty Agencies, Lenders and Servicers**

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

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

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

Weaknesses that existed in the control environment at FSA with respect to the FFEL Program were as follows:

- Improvement was needed in oversight of FFEL Program participants,

- Delegation of authority was not properly aligned with the oversight and monitoring of guaranty agencies, lenders and servicers, and
- Potential conflicts of interest existed with the former general manager of Financial Partner Services.

### **Improvement Was Needed in Oversight of FFEL Program Participants**

In our discussions with the regional directors and review specialists, and our review of the program review reports and workpapers, we noted the following matters:

- FSA had not dedicated sufficient resources to effectively monitor FFEL Program participants' (i.e., guaranty agencies, lenders and servicers) compliance with FFEL Program law and regulations.
  - Improvement was needed in FSA management's role in the oversight of the program review process.
  - Program reviews were not properly supervised.
  - Program reviews were not performed consistently.
  - No mandatory training requirements existed for review specialists.
  - FSA had not developed a timeline for issuing program review reports.
  - FPE&O policy may have resulted in improper waiving of liability due to the government.
- FSA had not dedicated sufficient resources to effectively monitor FFEL Program participants' compliance with FFEL Program law and regulations.

FPE&O regional offices have the primary responsibility for the performance of the program reviews related to the monitoring and oversight of the FFEL Program participants. The following program reviews were scheduled for FY 2007 & FY 2008:

<b>Program Reviews</b>	<b>Program Reviews Initially Scheduled (FY 2007)</b>	<b>Program Reviews As Revised (FY 2007)</b>	<b>Program Reviews Scheduled (FY 2008)</b>
Consolidation Phase II			8
Fund Reviews			28
Conflict of Interest Phase 1			35
Conflict of Interest Phase 2			14
School with Eligible Lender Trust (ELT)	19		19
Eligible Lender Trust			7
Inducement Reviews		11	26
Consolidation Fee			38
Pilot of the Draft Standards			2
Focused Review - Mandatory Lenders/Servicers Review	1		1
Guaranty Agency Review	7		
Lenders/Secondary Markets Review	1		
Guaranty Agency Servicers Review	5		
Tax Exempt Entities	19		

<b>Program Reviews</b>	<b>Program Reviews Initially Scheduled (FY 2007)</b>	<b>Program Reviews As Revised (FY 2007)</b>	<b>Program Reviews Scheduled (FY 2008)</b>
Guaranty Agency IPIA <sup>2</sup>		27	-
Lender IPIA		17	-
Common Review Initiative Review		2	-
Full Scope Review		1	-
<b>Total</b>	<b>52</b>	<b>58</b>	<b>178</b>

In addition to the 178 program reviews planned for FY 2008, 11<sup>3</sup> program reviews for FY 2007 were not completed<sup>4</sup> as of September 30, 2007.

The program reviews are performed by the review specialists in the regional offices. At the time of our review, there were 28 staff in the regional offices (3 regional directors, 2 Information Technology specialists, 22 review specialists and 1 administrative staff), located in the 4 regions and the 2 duty stations nation-wide. Based on discussion with a review specialist, while the FFEL Program requirements have expanded significantly in the last five years, the staff resources needed to perform oversight over FFEL Program participants have declined significantly. Even if these positions are backfilled, there will be a loss of experience and institutional knowledge. In addition, a review specialist told us that FPE&O reduced its management staff from four to three regional directors. According to a regional director, the Western region has experienced significant staff turnover; in the last few years, the regional director, two senior review specialists and the administrative assistant have retired. The two senior review specialists and the administrative assistant positions have not been filled, and the Northern regional director also serves as the director for the Western region. The shortage of qualified review specialists hampers FSA's ability to effectively perform its legislatively mandated monitoring and oversight responsibilities over FFEL Program participants. As shown in the table above, FSA planned a significant increase in the number of program reviews to be performed by FPE&O personnel in FY 2008; as a result, a significant increase in resources is critical if FSA is to complete the scheduled reviews and effectively monitor FFEL Program participants' compliance with law and regulations.

Of 58 program reviews in the revised schedule for FY 2007, 29 review reports<sup>5</sup> were issued by FPE&O between October 1, 2006 and March 31, 2008. Program reviews of FFEL Program participants consist of reviews of 28 elements in the Guaranty Agency Review Guide or 14 elements in the Lender/Service Review Guide. According to the review specialists, depending on the nature of the review (comprehensive/full scope review, focus/targeted review, or guaranty agency/lender review), testing of review procedures is completed in three to six days, with a team of three to five reviewers, and a scope period covering two to five fiscal years. A senior

<sup>2</sup> Note: In FY 2007, most program review staff was used to perform Improper Payments Information Act (IPIA) reviews of the FFEL Program.

<sup>3</sup> Out of 58 program reviews in the revised schedule for FY 2007, 9 inducements reviews, 1 CRI review, and 1 full scope review were not completed as of the end of FY 2007.

<sup>4</sup> We determined that program reviews were completed in cases where the review reports were not issued.

<sup>5</sup> The 29 program review reports were made up of 26 IPIA reviews that did not follow the guaranty agency or lender review guide, 1 inducement review, 1 CRI review, and 1 full scope lender review.

review specialist told us that two weeks (including four days of traveling time) was not sufficient to complete all assigned elements in the review guide, and if time did not permit, the review specialists judgmentally selected for testing elements they believe to be more important. In addition, review specialists and a regional director told us that FFEL Program participants were relied upon to complete procedures in the review guides and determine the liability due FSA. Two senior review specialists stated that there was no formal procedure to verify the results of work performed by the FFEL Program participants.

Because of the lack of adequate resources, program reviews performed by FPE&O cannot be relied upon to assess FFEL Program participants' compliance with the HEA, and rules and regulations prescribed by the Secretary of Education (Secretary).

- Improvement was needed in FSA management's role in the oversight of the program review process.

During our audit, program review specialists voiced concerns with decisions made by FSA management with respect to the program reviews. Six of the 13 review specialists we talked to expressed such concerns. A few examples follow:

- One review specialist stated that a servicer was found to be taking adverse actions against borrowers without issuing a final determination letter and/or allowing the borrowers to respond to the determination letter or cure defects in the loans as required by legislation. The servicer indicated that the failure to issue the determination letters was due to errors in a computer program and agreed with FSA to fix the problem. The review specialist was assigned to determine if the problems had been corrected. The servicer's officials refused to cooperate with the review specialist, and the review specialist was asked to contact FSA officials at the Washington Headquarters. The review specialist was advised by an FSA management official that the servicer had outsourced the function of issuing the letters of determination to another firm. However, based on the limited review performed at the servicer and knowledge of the servicer's programs, the review specialist issued a draft review report with observations and findings. The specialist stated that while on vacation, the final review report was issued under the specialist's name; however, all of the findings and observations in the draft review report had been removed. While the review specialist expressed concerns to FSA management, no modification was made to the final review report to address those concerns.
- In another instance, the draft report of a Conflict of Interest review of a guaranty agency that was submitted to the FSA management was neither finalized nor posted to Postsecondary Education Participants Systems (PEPS). Instead, the guaranty agency was rescheduled for the same review in the 2008 Annual Work Plan. The review specialist expressed frustration, stating that, *I do not have control over what happens to my findings when they get up there (Washington Headquarters)*. According to the review specialist who performed the review, the Conflict of Interest review was requested by the Director of FPE&O. We made inquiry of the Director of FPE&O who stated that to the best of their knowledge they were not aware of any instances where a program review report had

not been issued. The Director of FPE&O further stated that if they had instructed a review specialist to perform a program review and no report was issued, they would at least have the review specialist document the reason why the report was not issued.

- On an inducement review, two review specialists stated that FSA's management denied the review team's request that the lender provide additional documents, primarily marketing materials, that the review team had concluded was necessary to complete the inducement review. Contrary to the FSA management claim, the review team stated that the proposed second request for additional documents did not duplicate the first request for documents. The initial request for documentation had been submitted to the lender directly by FSA management. We made inquiry of the Director of FPE&O, who stated that the review team leaders were instructed not to request additional information from the lender until the information received from the initial letter was reviewed.
- A senior review specialist indicated to us that in the past data files of the transaction populations were requested and the specialist performed analytical procedures utilizing the data from the file. In instances when such analysis resulted in findings, the senior review specialist had been criticized by FSA management for doing additional work beyond testing of the first 30 transactions in the sample. According to the senior review specialist, FSA management stated that – *It is the lender's duty to review the population. You are not doing audit; this is a review.*

Perceptions regarding FPE&O management's attitude towards financial and programmatic reviews and failure to finalize and issue a program review report that has findings may raise concerns about FPE&O's commitment to compliance and the program review process.

- Program reviews were not properly supervised.

The senior review specialists who serve as the team leaders on reviews are GS-13 staff and have no supervisory responsibility over the review specialists.<sup>6</sup> According to three team leaders, while the team leaders reviewed the workpapers of the review specialists, the team leaders do not take responsibility for the work of the review specialists. There are 3 regional directors who have the responsibility for reviewing all the workpapers and reports resulting from the program reviews included in the FY 2008 Annual Work Plan as well as the FY 2007 inducements reviews that will be completed in FY 2008. We noted that the workpapers for two program reviews, a CRI review and a Consolidated Rebate Fee review performed by the regional staff in FY 2007 and FY 2008, respectively, had no evidence of a regional director's review.

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<sup>6</sup> This finding was consistent with the audit finding noted in the prior OIG Audit Report, *Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers*, dated September 2006, (hereafter referred to as the prior OIG audit report) in which the auditors found that Financial Partners procedures lacked any requirement for supervisory review.

- Program reviews were not performed consistently.

Through our discussions with the review specialists, we determined that there was a lack of consistency in the way review guide procedures were performed.<sup>7</sup> Some review specialists were of the opinion that the specific review guide elements completed and the procedures performed are at the discretion of the review specialists. Another review specialist believed that unless it is justified by extenuating circumstances all the review guide elements and procedures must be completed. In some instances, some of the review specialists use statistical sampling while others use judgmental sampling. In addition, some review specialists requested that FFEL program participants project errors to the population while other review specialists do not project errors to the population. Based on inquiries of the review specialists, we determined that samples selected were not always representative of the populations because samples were selected from inappropriate populations. As an example, if the review element was “Deferments,” the sample should only be selected from the Deferment population rather than the entire population. In other instances, samples were selected from incomplete quarters. We reviewed the report and workpapers of Lender Reporting System (LaRS) billings and National Student Loan Data System (NSLDS) reporting review performed by FPE&O under the CRI, and noted that the statements on work performed and the review results were not fully supported by the review evidence.

- No mandatory training requirements existed for review specialists.

We reviewed the documentation of training taken by 14 FPE&O staff, which consisted of 2 regional directors and 12 review specialists, during the period from October 2006 through January 2008. We noted that a significant number of the review specialists had not completed adequate training to retain or improve their skill sets. Out of the 14 FPE&O staff, 5 completed IPIA training and 12 completed inducement training. In addition, for 6 of the 12 staff that completed the inducement training, this course was the only training course taken that was relevant to their positions. According to a regional director and a review specialist who participated in the FPE&O training courses, the duration of the IPIA and inducement training courses was two to three hours each.

Based on discussions with the regional directors and the review specialists, we noted that 10 of the 14 FPE&O staff lacked accounting and financial backgrounds that are important in the oversight and monitoring of FFEL program participants. Because of the inherent risks of FFEL Program and the magnitude of the financial transactions, background or training in finance and accounting is important in analyzing Form 2000 data, LaRS billings and Federal funds. Without mandatory training requirements, FPE&O staff may not be adequately trained and may lack the appropriate skill sets to perform their job responsibilities.

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<sup>7</sup> This finding was consistent with the audit finding noted in the prior OIG audit report, in which the auditors found that although Financial Partners has policies and procedures for conducting and documenting program reviews, the procedures were not consistently followed.

- FSA had not developed a timeline for issuing program review reports.

According to a program review specialist, program review reports are typically issued 30 to 45 days from the date of fieldwork completion. For example, according to the Revised FY 2007 Annual Work Plan, the fieldwork for eight inducement reviews was scheduled to be completed by July 2007. However, only one report was issued as of March 31, 2008. In addition, a program review was completed in April of 2007; however, the program review report was not issued until January 23, 2008. Because of delay in issuing program review reports, program review findings that pose financial and compliance risks to FFEL Program may not be addressed timely.<sup>8</sup>

- FPE&O policy may have resulted in improper waiving of liability due to the government.

Review specialists told us that they did not calculate liability because they believe that the samples were not statistically valid. The review team often relies on the FFEL Program participants to complete testing of the samples if the errors in the sampled population exceeded the tolerable error rate. In addition, calculation of liability is at the discretion of the reviewers for non-systemic errors. FPE&O established a condition in which liability is recorded depending on if the errors are systemic or non-systemic. A systemic error is defined as an error that is equal or greater than 10 percent of the sampled population (e.g. three errors out of a sampled population of 29 or 30). Examples would include errors resulting from misinterpretation of statutes, regulations or policies, or errors attributed to information systems programming errors. A non-systemic error is defined as an error that is less than 10 percent of the sampled population and is unusual or caused by human errors. According to the FPE&O guidance, systemic errors are extrapolated to the population to calculate potential liability. Because of the lack of clear and consistent FPE&O guidance when non-systemic errors are identified in program reviews, review specialists may inappropriately waive liabilities due to the Department.<sup>9</sup>

On May 1, 2008, subsequent to our audit scope, FSA issued standards for performing program reviews. The Standards, if implemented as written, should address issues noted above related to supervision of program reviews, consistency of program reviews, establishing a timeline for program review report preparation, and issuance and calculation/waiver of liabilities.<sup>10</sup> On June 30, 2008, FSA reported implementing a quality assurance process for program reviews as part of the Standards. The document summarizing the quality assurance process was subsequently removed from the standards as it is not a process that program reviewers would follow. As of March 9, 2009, the quality assurance document is on a shared drive in FSA, but has not been

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<sup>8</sup> This finding was consistent with the prior OIG audit report in which the auditors found that three program reviews were not issued or closed in reasonable timeframes. Of the three program reviews, two program reviews were open for 248 and 199 calendar days, respectively, and the third program review had not been issued for 252 calendar days from the date the fieldwork was completed.

<sup>9</sup> This finding is consistent with the prior OIG audit report, where the auditors found that program review reports rarely included monetary liabilities and that program reviewers did not consistently quantify liabilities.

<sup>10</sup> We reviewed the current version of the Standards obtained from FSA as of March 6, 2009, to update information in the draft audit report.



formally issued as a policy to ensure its implementation. One quality assurance review was issued September 29, 2008.

### **Delegation of Authority Was Not Properly Aligned with the Oversight and Monitoring of Guaranty Agencies, Lenders and Servicers**

OMB Circular A-123, *Management's Responsibility for Internal Control*, states that within the organizational structure, management must clearly define and appropriately delegate authority and responsibility throughout the agency. Also, in accordance with the Departmental Directive: OM:1-102 "Delegations of Authority," dated July 26, 2005, a delegation of authority is required for taking actions, and making decisions, which have legal significance.

The Delegation of Authority (Control No. EN/ENE/39) in effect at the time of our review related to the oversight and monitoring of the guaranty agencies, lenders and servicers, is from the Chief Operating Officer (COO) of FSA to the general manager of Financial Partners Channel. The delegation of authority was certified on December 9, 1999. However, FSA underwent a reorganization in March of 2006 to combine the functional responsibility for oversight and/or monitoring of the schools, lenders, guaranty agencies and other state or financial organizations that participate in the student financial assistance programs to a new organization called Program Compliance. FPE&O is a component within Program Compliance with oversight and/or monitoring responsibility over guaranty agencies, lenders and servicers. One of the key stated objectives of the reorganization was to increase the focus on program integrity (i.e., oversight, monitoring and compliance functions).

Under the delegation of authority described above, the general manager of Financial Partners Channel was delegated the authority for certain functions and decisions including: returning of federal funds and assets; disqualifying, limiting, suspending or terminating a lender's or third party servicer's eligibility to participate in FFEL Program; permitting transfer of guarantees to guaranty agencies; waiving the Secretary's right to require payment of a liability; and calculating and publishing FFEL Program cohort default rates.

We determined that the authority for these functions that had been delegated to the general manager of the Financial Partners Channel was not transferred to the Manager of Program Compliance as part of the March 2006 reorganization. The authority for the Manager of Program Compliance is not clearly aligned with the responsibilities of the office. Because the responsibility for decision making at Program Compliance is not properly linked to the assignment of authority, individuals may not be aware of the extent or limit of their responsibilities and may not be held accountable accordingly. Also, Program Compliance and FPE&O management could potentially make unauthorized decisions related to guaranty agencies, lenders and servicers.

The Director of FPE&O was appointed in June of 2006. We noted an instance when the Director for FPE&O did not exercise the authority of the office. The CRI is a concept designed to create efficiencies and consistency in lender program reviews conducted by guarantors. The CRI was implemented on a pilot basis on January 1, 2004. FPE&O has the responsibility to monitor

guaranty agencies' compliance requirements for lender reviews. However, we noted that the extension of the pilot phase of the CRI for an additional year was authorized by the former general manager of FPS on January 3, 2007, or nine months after the responsibility to monitor guaranty agencies' compliance requirements for lenders was transferred to FPE&O from PSG.

The functional responsibilities for the review of the compliance audit reports submitted by the guaranty agencies, lenders and servicers were transferred to FPE&O as part of FSA's reorganization that occurred in March of 2006. While the Director of FPE&O was appointed in June 2006, according to PSG staff, the Director of FPE&O did not assume responsibilities for the review of the compliance audit reports until October 1, 2007, which was approximately 18 months after the reorganization. According to the Director of PSG, there were two PSG staff dedicated to the review of the compliance audit reports. As of September 30, 2007, there were 397 compliance audit reports submitted by the guaranty agencies, lenders and servicers for review. When the function was transferred to FPE&O only one employee in Headquarters was assigned to compliance audit reviews.

Because the responsibility for decision-making regarding certain FPE&O functions was not linked to the assignment of authority, managers may not be held accountable for actions or performance in functional areas that are not clearly delegated to their office.

On May 22, 2008, subsequent to our fieldwork, FSA management stated it was working with the Department's Office of the Secretary and the OGC to make appropriate modifications to the current Delegation of Authority. The revised Delegation of Authority from the Department's Secretary to FSA COO and the Redelegation of Authority from the FSA COO to the Manager of Program Compliance were executed and certified on May 29, 2008, and July 1, 2008, respectively. The execution of these delegations, if followed, corrects the delegation issues noted during the scope of our audit.

### **Potential Conflicts of Interest Existed with the Former General Manager of Financial Partner Services**

According to the GAO's Internal Control Standards, one of the factors affecting positive control environment is the integrity and ethical values maintained and demonstrated by management and staff. Agency management plays a key role in setting and maintaining the organization's ethical tone. Department officials at a certain position level are required to submit annual financial disclosure reports. The former general manager of FPS was on paid administrative leave since April 6, 2007, related to alleged conflicts of interest. The alleged conflicts of interest arose when it was determined that the general manager held and sold stocks of a FFEL Program participating lender, while maintaining the responsibilities for the oversight and monitoring of the guaranty agencies, lenders and servicers. The former general manager of FPS resigned from FSA effective September 2, 2008.

Transparency in management actions in the execution of their job functions creates a culture in which ethical behavior is encouraged and promotes employee perception that doing the right thing is expected and supported by management.

**RECOMMENDATIONS:**

We recommend that the Under Secretary ensure that the COO for FSA takes action to:

- 1.1 Dedicate sufficient FPE&O resources to perform oversight of the FFEL Program.
- 1.2 Ensure that FPE&O implements its new program review Standards to ensure that supervisory reviews of program review working papers are timely and are documented.
- 1.3 Formalize the quality assurance process into a policy to ensure program reviews are monitored for consistency and compliance with the Standards.
- 1.4 Develop core competencies for the regional directors and review specialists, and implement mandatory training requirements to ensure that staff obtains appropriate training in the core competencies to effectively perform their job functions.
- 1.5 Ensure that liability due to the Department resulting from systemic and non-systemic errors is reported by the review specialists, with authority to waive such liability exercised only by the Program Compliance Manager in accordance with the restrictions contained in Delegation EN/ENA/60 (July 1, 2008).
- 1.6 Ensure that any liability resulting from program review of FFEL Program participants which has not been waived by the Program Compliance Manager is recovered by the Department.
- 1.7 Ensure that management functional responsibilities and the decision making process are properly aligned with the updated delegations of authority.
- 1.8 Evaluate decisions made by the former general manager of FPS to determine if any decisions were inappropriate, take corrective actions as necessary, and assess the impact on the FFEL Program.

**FINDING NO. 2 – Improvement Is Needed in the FPE&O Risk Assessment Process**

FPE&O's risk assessment process needed improvement. Based on our discussions with FPE&O management and staff, and review of risk identification documents, annual work plans and risk assessment tools, the financial and compliance impacts of identified risks were not properly assessed, quantified and documented. Within a given risk area, there was limited to no documentation to support the selection of FFEL Program participants for program reviews. Also, in the FY 2008 Annual Workplan, there was no evidence that consideration was given to available staffing resources, and no documentation on how the values assigned to the risks ratings were derived. As discussed in Finding No. 1, while the number of planned program reviews increased from 58 in FY 2007 to 178 in FY 2008, there was no commensurate increase in FPE&O resources. According to GAO's Internal Control Standards, "internal control should

provide for an assessment of the risks the agency faces from both internal and external sources. Once risks have been identified, they should be analyzed for their possible effect. Management then has to formulate an approach for risk management and decide upon the internal control activities required to mitigate those risks and achieve the internal control objectives of efficient and effective operations, reliable financial reporting, and compliance with laws and regulations.”

As part of the risk assessment process to develop the annual work plan in FY 2008, FPE&O conducted two risk assessment sessions, with each session lasting about two hours. Participants at the sessions included the FPE&O Director and the three regional directors, officials of the Enterprise Risk Management Group (ERMG), Business Operations, the FSA Acting COO, the COO Chief of Staff, and staff from OGC and OPE. According to the Director of FPE&O, at the first meeting, the team covered the type of risks, mitigation strategies, and the availability of data for review. After the first meeting, participants submitted their comments for review, and where appropriate, the comments were incorporated into the agenda for the second meeting. At the second meeting, results from the comments from the first meeting were vetted and refined, and consensus reached on the final result of the risk assessments. While the Director of FPE&O emphasized the participatory nature of the risk assessments process, the Directors of Policy Liaison and Implementation (PLI) and ERMG who participated in the two sessions stated that their offices played limited roles in the FPE&O risk assessment process. The Director of ERMG stated that their participation was advisory in nature and limited to the discussions on risk identification.

In the risk assessment process, first the types of risks (i.e., inducements, conflict of interest, etc.) were identified. Then the risk significance (assessment of the magnitude or potential impact or effect of a specific risk) and the risk likelihood (assessment of the probability of the occurrence of a specific risk) were assigned a number from 1 (low or very remote) to 5 (very high or very likely) for each type of risk. The aggregate risk score, which is the total cumulative amount of exposure associated with a specific risk, was derived mathematically from the risk significance and risk likelihood factors. Therefore, the magnitude of a risk or the aggregate score was dependent on the number, 1 through 5, which is assigned to the risk significance and risk likelihood factors respectively, based on the judgment of the session participants.

FPE&O did not provide documentation to support how numbers assigned to the risk significance and risk likelihood factors were determined. However, other documentation provided showed that issues such as inducements and conflicts of interest were determined to have the highest aggregate scores. For example, inducement, conflict of interest, and guaranty agency financial stability risks were calculated to have aggregate risk scores of 11, 10 and 6.5, respectively. Stated differently, the risk of bad publicity attributed to inducements and conflict of interest were deemed to be of more risk to the organization than financial losses that may impair guaranty agency financial stability. The impact of the financial risks and stability of the guaranty agencies can be measured by the fact that at September 30, 2007, the Department had an estimated guaranteed loans loss exposure in excess of \$359 billion in the FFEL Program. Also, in FY 2007, the Department paid approximately \$6 billion and \$11 billion for defaulted loans and interest subsidies, respectively.

FPE&O did not provide documentation to support the basis for the selection of the FFEL Program participants for the reviews. According to the Director of FPE&O, FPE&O relied on the judgment of the participants in the risk assessments sessions, data analysis, and referrals from the OIG and student loan industry. We inquired why certain lenders and guaranty agencies were selected for program reviews in FY 2008 instead of larger lenders and guaranty agencies with multiple deficiencies (or risk scorecard triggers) as reflected on the risk scorecards. The Director of FPE&O was not able to provide this information because the discussions in the risk assessment sessions were not documented. In addition, we inquired why FFEL Program participants with multiple risk scorecards triggers were not selected for reviews; we were told that risk scorecards were not used to select FFEL Program participants for review but rather used as additional information if there was data related to the risk area being reviewed. Based on the FY 2007 and the FY 2008 Annual Work Plans, a significant portion of FPE&O resources were focused on small lenders that pose limited risks to the FFEL Program.

The focus of the program reviews in FY 2007 and FY 2008 and the risk assessment process were items such as inducements and conflict of interest, rather than the items that represent significant financial and compliance risks to the FFEL Program such as the financial stability of guaranty agencies and interest subsidy payments to lenders. The 178 program reviews planned for FY 2008 include 49 Conflict of Interest reviews and 26 Inducement reviews. Twenty seven of the 28 Federal Fund reviews in FY 2008 were in response to the OIG recommendation from another report that FSA perform onsite program reviews to examine supporting records for the establishment of the Federal and Operating Funds at the guaranty agencies not previously reviewed by the OIG to ensure that the funds were established in accordance with the HEA.<sup>11</sup> In addition, 38 Consolidation Rebate Fees desk reviews are planned. No full scope program reviews of guaranty agencies, lenders or servicers are planned for FY 2008.

FPE&O has many risk assessment tools at its disposal that it did not incorporate into the risk assessment process to improve accuracy and objectivity of the risk rating and for selecting guaranty agencies, lenders and servicers for program reviews. These tools include the risk scorecards, compliance audit reports, monthly and annual Form 2000 – Guaranty Agency Financial Report, LaRS reports, and the CRI reports. Between 4 and 16 guaranty agencies, depending on the calculation method used, had Federal fund reserve ratios below the legislatively mandated minimum of 0.25 percent in 2006, as such, these guaranty agencies represent more risk than others with Federal fund reserve ratios above the 0.25 percent. In FY 2007, the top ten lenders account for over 72 percent of the outstanding guaranteed FFEL Program loan portfolio. In addition, many guaranty agencies, lenders and servicers have risk scorecard results that raise financial and compliance concerns. These guaranty agencies, lenders and servicers merit more focus in the risk assessment process given their overall financial impact on the FFEL Program.

Four out of 13 review specialists we interviewed raised concerns about how FFEL Program participants were selected for review. A review specialist stated that FSA's problems are

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<sup>11</sup> OIG Inspection Report, *Review of Federal Student Aid's Monitoring of Guaranty Agency Compliance with the Establishment of the Federal Fund and the Operating Fund*, dated September 7, 2007.

political not programmatic which is why small schools and lenders have been selected by FSA managers for review. The review specialist questioned why there are not more frequent program reviews of a particular large lender. According to the review specialist, *They (FSA managers) do not want us to do the work, all our bosses are from [the lender] and that is why we do not go to [the lender] very often.* Another review specialist stated that in the last two to three years, the review specialists have been restricted in their reviews by FPE&O management. In addition, four review specialists expressed their concerns that the program reviews are driven by newspaper headlines and external pressure including OIG and Congress; and raised questions why larger lenders do not receive more attention as they would appear to be the source of the more significant risks. We were informed that in the past the review specialists participated in the risk assessment process by suggesting FFEL Program participants for program reviews. However, in the last few years, the review specialists have not participated in the risk assessment process.

In accordance with the FSA 2006-2010 Five-Year Plan, the enterprise risk management function was established to develop risk assessments and provide a more strategic downstream risk potential to better equip FSA senior management to anticipate, analyze, and manage risks inherent in the Federal student financial assistance programs. In addition, the plan states that ERMG will provide risk management oversight and guidance, perform internal reviews and risk assessments, and drive strategies and formulate plans for assessing, monitoring and addressing risks for all business units. At the time of our review, ERMG had not evaluated FFEL Program risks. According to the Director of ERMG, since ERMG's inception in 2003, it has conducted risk reviews in five FSA business units including Facilities, Communications, Services, Human Resources, and Conferences and Administration. At each business unit, ERMG identified risks, categorized risks, rated risks, and assessed whether business units were properly managing risks and adopting better practices in identifying and managing risks. These business units are not as critical to the strategic objectives of FSA as FPE&O. The Director of ERMG stated that their participation in the risk assessment sessions was advisory in nature and limited to the discussions on risk identification. ERMG did not assist FPE&O in rating and categorizing risks, using risk assessments to select FFEL Program participants for review, or in developing best practices for identifying, assessing or managing risks.

FPE&O's failure to use risk based criteria for selecting FFEL Program participants for reviews, and to properly assess risks could a) raise issues regarding transparency and whether FPE&O is effectively using its program review resources to address FFEL Program financial and compliance risks, b) have adverse financial consequences for the FFEL Program, c) result in a loss of public confidence, and d) result in possible noncompliance with the laws and regulations by the FFEL Program participants.

On May 1, 2008, subsequent to our audit scope, FSA issued standardized procedures for performing program reviews. Chapter 3 of the Standards, updated February 24, 2009, addresses developing the annual program review schedule. If implemented as written, the new Standards should address issues noted above related to evaluation and documentation of risk impacts, documentation to support entities selected for program reviews, and consideration of available staff resources. The Standards also provide for participation of lead reviewers in the process.

**RECOMMENDATIONS:**

We recommend that the Under Secretary ensure that the COO for FSA takes action to:

- 2.1 Ensure effective implementation of the Standards related to developing the annual program review schedule to provide a rigorous, objective risk assessment methodology that is fully documented to support decisions.
- 2.2 Include FPE&O and PSG as high priority areas for ERMG evaluations.

**FINDING NO. 3 – Control Activities Over Guaranty Agencies, Lenders and Servicers Need Improvement**

GAO's Internal Control Standards state that "control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives, such as the process of adhering to requirements for budget development and execution. They help ensure that actions are taken to address risks. Control activities are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results." Improvement is needed in FPE&O and PSG's procedures, techniques and mechanisms for ensuring that FFEL Program participants adhere to certain provisions of the HEA, and rules and regulations prescribed by the Secretary. Specifically, we noted the following:

- Process for monitoring lender's compliance with 34 CFR 682.305(c)(1), which requires that certain lenders submit independent annual compliance audit reports, was not effective.
- Published minimum reserve ratios for guaranty agencies were not calculated in accordance with Section 428(c)(9) of the HEA.
- Reviews conducted under the CRI may have not satisfied guaranty agencies' obligations to conduct reviews of lenders.
- Incompatible duties were not separated and no written procedures were in place for providing technical assistance to guaranty agencies, lenders and servicers.

**Process for Monitoring Lenders' Compliance With 34 CFR 682.305(c)(1), which Requires that Certain Lenders Submit Independent Annual Compliance Audit Reports, Was Not Effective**

We determined that PSG's reviews of compliance audit reports were not an effective tool for monitoring that:

- The *Lender's Interest and Special Allowance Request and Reports* (ED Form 799s) are materially correct and in conformity with FFEL Program law and regulations, and
- The lender or servicer has complied with – and, as of assertion date, the servicer has effective control over compliance with – the identified statutory and regulatory provisions applicable to its participation in or administration of the FFEL Program.

During our audit scope, PSG was responsible for monitoring lenders' compliance with 34 CFR 682.305(c)(1), which requires lenders originating or holding more than \$5 million in FFEL loans during its fiscal year to submit an independent compliance audit report to FSA on an annual basis.<sup>12</sup> PSG tracks lenders' submission of the compliance audit reports using PEPS. PSG's personnel review compliance audit reports for acceptability by completing a PEPS checklist to ensure that the compliance audit reports included Independent Public Accountant (IPA) reports; the IPA reports address management assertions and prior years' audit findings, and the Corrective Action Plan, if applicable, adequately addresses the audit findings. If the IPA's opinion is other than an unqualified opinion, or if audit findings are noted in the report of internal control or report on compliance with laws and regulations, PSG issues a PDL to the lender to ensure that corrective actions are implemented to address audit findings. The PDL requires that the lender's IPA verify and comment on the corrective actions taken by the lender in the "Prior Years' Audit/Examination Resolution Matters" section of the next regularly scheduled compliance audit report.

PSG issues warning letters to lenders who failed to submit compliance audit reports within six months of the end of the audit period or within nine months after the end of the audit period for OMB A-133 audits, the legislatively mandated timeframe. After the second warning letter, lenders who do not respond may be placed on "administrative hold" and interest and special allowance payments withheld until the compliance audit reports are submitted.

We noted the following matters with respect to the effectiveness of PSG's audit review as a monitoring tool for FFEL Program compliance:

- PSG control activity was not effective with respect to monitoring lenders' compliance with the requirements of Section 428(b)(1)(u)(iii)(I) of the HEA, and 34 CFR 682.305(c)(1), which require that certain lenders submit independent annual compliance audit reports.

We reviewed work performed by the PSG personnel to determine acceptability of the compliance audit reports. We judgmentally selected for review 28 FFEL Program participants (20, 5 and 3 from the lenders, servicers and guaranty agencies, respectively) from 397 compliance audit reports submitted to PSG as of September 30, 2008. We noted the following conditions:

- PSG had no documented procedures for reviewing the acceptability of compliance audit reports submitted by the guaranty agencies; or tracking guaranty agencies' audit opinions that are other than unqualified opinions, audit findings or implementation of corrective action plans.
- None of the acceptability checklists completed by PSG staff for the 25 compliance audit reports submitted by the lenders and servicers, had evidence of supervisory review.
- In two instances, the acceptability review was not performed timely.

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<sup>12</sup> According to the Director of PSG, FPE&O assumed responsibilities for the review of the compliance audit reports effective October 1, 2007. The results presented were for operations under PSG during FY 2007, the scope of our review.



- Compliance audit reports were not provided for our review for three out of five servicers.
- The PDL was not issued timely for one lender. The lender's compliance audit report for the year ended December 31, 2005 was received by PSG on June 30, 2006. The PDL was issued on November 20, 2006.

Because of weaknesses in the review of the compliance audit reports, FSA may not have assurance that FFEL Program participants are appropriately managing the FFEL Program.

- PSG procedures did not provide for a means to ensure that lenders are addressing issues in the compliance audit reports timely.

In instances where FFEL Program participants received adverse or disclaimer of opinions, significant deficiencies noted in the internal control structure, and/or material non-compliance with laws and regulations, PSG's monitoring of significant issues identified in the compliance audit reports was not timely. Based on our inquiries with PSG financial analysts, PSG did not determine the status of current year findings until the following fiscal year's audit report was received. In accordance with the HEA, a lender is required to submit the compliance audit report within six months of the end of the audit period; therefore, PSG would not determine whether significant audit findings have been resolved until the next reporting period. For example, a lender with a fiscal year ended June 30, 2007, is required to submit its compliance audit report by December 2007 at the earliest. Therefore, PSG will not know the status of the findings identified as of June 30, 2007, until December 2008 or later, when the next compliance report is due, or at least 18 months after the end of the fiscal year in which the issue was noted. As a result, FSA runs the risk that findings disclosed in the compliance audit reports that possess significant financial and compliance risks to the FFEL Program are not addressed effectively and timely. There was no process to request status reports through the PDL to assess corrective actions being taken for significant issues prior to the next report.

- PSG had no written procedures for escalating auditor's opinion that is other than an unqualified opinion, material weaknesses, or significant noncompliance with laws and regulations.

PSG had no written procedures for escalating an auditor's opinion that is other than an unqualified audit opinion, material weaknesses, or significant noncompliance with laws and regulations disclosed in the compliance audit reports to appropriate FSA officials, or business units (i.e., FPE&O, PLI, etc.), or to OPE or OGC, to ensure that issues that might impair compliance with the FFEL Program requirements or could have adverse financial consequences on the FFEL Program are addressed timely and effectively. Because PSG had no effective procedures for escalating material matters in auditors' reports to appropriate officials and business units, FSA runs the risk that findings disclosed in the compliance audit reports that possess significant financial and compliance risks to the FFEL Program are not addressed effectively and timely.

Subsequent to our fieldwork, FPE&O management provided a process flowchart to show various scenarios for escalating compliance audit issues to FPE&O management. The scenarios included

failure to submit audit reports, substandard or untimely audits, qualified opinion and other serious compliance issues. FPE&O informed us that all compliance audit reports are now being reviewed and the checklists are signed off by the supervisor. Further, FSA stated that FPE&O began the process of developing written policies and procedures in this area that will support the process flows provided and expects a final product by May 30, 2009.

### **RECOMMENDATIONS:**

We recommend that the Under Secretary ensure that the COO for FSA takes action to:

- 3.1 Ensure the development and implementation of written procedures for reviewing the acceptability of compliance audit reports, and for tracking audit opinions other than unqualified opinions, audit findings, and implementation of corrective action plans.
- 3.2 Ensure the procedures include requirements that acceptability checklist reviews are completed timely, supervisory reviews of completed acceptability checklists are documented, and PDLs are issued timely.
- 3.3 Ensure the procedures include evidence of proper staff supervision in the review of compliance audit reports.
- 3.4 Develop and implement a requirement for close monitoring in instances where FFEL Program participants received adverse or disclaimer of opinions, significant deficiencies noted in the internal control structure, and/or material non-compliance with laws and regulations. Incorporate in program determination letters requirements for submission of quarterly or semi-annual status reports to allow FSA to monitor the entities' implementation of corrective actions.
- 3.5 Implement procedures to escalate significant financial and compliance related findings identified in audit compliance reports to FSA business units, and officials in OPE and OGC, as appropriate.

### **Published Minimum Reserve Ratios for Guaranty Agencies Were Not Calculated In Accordance with Section 428(c)(9) of the HEA**

Pursuant to the HEA, Section 428(c)(9) – Guaranty Agency Reserve Level, the guaranty agencies under agreements with the Secretary are required to maintain in their Federal Student Loan Reserve Fund a current minimum reserve ratio level of at least 0.25 percent of the total attributable amount of all outstanding loans guaranteed by the agency. If any guaranty agency falls below the required minimum reserve level in any two consecutive years, the guaranty agency's Federal reimbursement payments are reduced to 85 percent, or if the Secretary determines that the administrative or financial condition of the guaranty agency jeopardizes the guaranty agency's continued ability to perform its responsibilities under its guaranty agency agreement, then the Secretary of Education shall require the guaranty agency to submit and

implement a management plan acceptable to the Secretary within 45 working days of any such event. The management plan should include the means by which the guaranty agency will improve its financial and administrative conditions to the legislatively mandated level within 18 months. The four guaranty agencies that have entered into Voluntary Flexible Agreements with the Secretary are not subject to this requirement.

Based on our discussions with FSA management, review of prior year and current year reserve ratio calculations, and the guaranty agencies' management plans, we determined that the financial conditions of the guaranty agencies were overstated, guaranty agencies were not adequately monitored by PSG, and that the Federal fund reserve ratios published on the Financial Partners website were overstated.

- The financial conditions of the guaranty agencies were overstated.

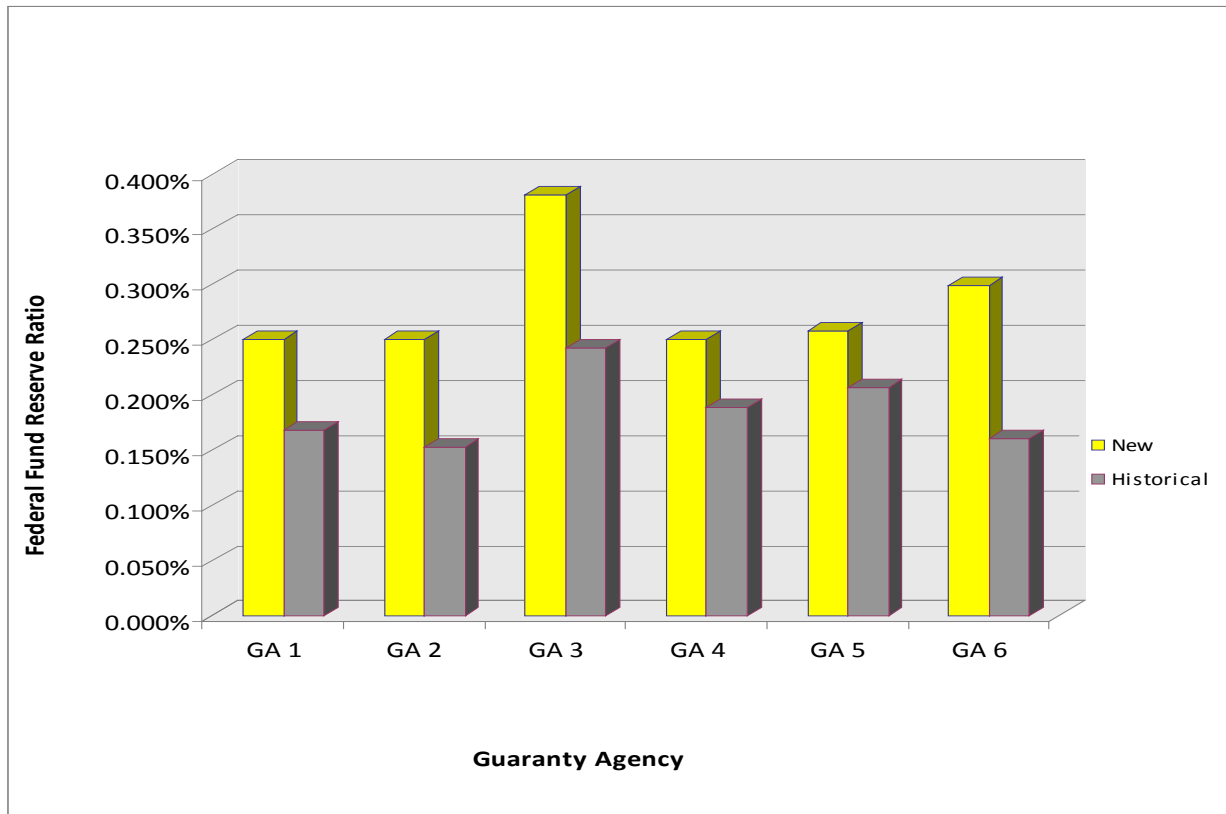
FSA determines the Federal fund reserve ratios using information provided by the respective guaranty agencies reported on the Annual Form 2000, *Guaranty Agency Financial Report*. This calculation utilizes the data from Line AR-26, entitled Ending Fund Balance, of Annual Form 2000 which represents the amount of the Federal Fund Balance. This balance is divided by the total attributed amount of all outstanding loans (Original Principal Outstanding). This calculation is referred to as the historical calculation. The Director of PSG stated that the guaranty agency community expressed concerns that the historical method used for the calculation of the Federal fund reserve ratios understates the financial strength of the guaranty agencies. As a result, FSA management made revisions to the historical calculation method. The new method for the calculation of the Federal fund reserve ratios includes an amount from the Annual Form 2000, Line AR-56, entitled Allowances and Other Non-Cash Charges. This amount is added to the Federal Fund Balance described above to arrive at a revised Federal Fund balance.

The new method for calculating the Federal fund reserve ratios improperly overstates the financial conditions of the guaranty agencies. There are several transactions in Line AR-56, including allowance for loan loss and deferred Federal default fees. The concept of allowance for loan loss was introduced to the Federal fund balance by FSA as part of the 1998 Reauthorization amendments which required guaranty agencies to return to the Department \$250 million in reserve funds from fiscal years 2002, 2006, and 2007, with each agency's share being based on a formula prescribed in the 1998 Reauthorization Amendments. Including the allowance for loan loss in the calculation of the reserve ratios understates the Federal fund balance exposure to future losses and overstates the solvency of the Federal fund balance. The concept of allowance for loss is similar to the way FSA reports exposure to future losses in its financial statements.

Deferred Federal default fees, which are part of Line AR 56, are not available for paying claims until earned. Adding deferred fees to Federal fund balance overstates the Federal funds resources available to pay claims and overstates the financial strength of the guaranty agencies.

According to the Director of PSG, PSG is responsible for the monitoring of guaranty agencies compliance with the Section 428(c)(9) of the HEA, which requires that the guaranty agencies maintain a minimum Federal reserve ratio of 0.25 percent. In FY 2006, only 4 guaranty agencies had Federal fund reserve ratios below 0.25 percent under the new method, compared with 16 guaranty agencies under the historical method. As a result of implementing the new method, FSA runs the risk that there are 12 guaranty agencies that did not receive closer monitoring mandated under the HEA. Under the historical method used for calculating Federal funds reserve ratios, these 12 guaranty agencies would have had to file management plans and have 18 months to improve the Federal fund reserve ratios, or would have been subject to administrative holds of their reimbursements. Also, the new method adopted for calculation of Federal fund reserve ratio may not comply with the HEA. See Figure 1 for an illustration of the impact of the new and historical calculation methods in assessing whether the guaranty agencies meet the legislatively mandated minimum Federal fund reserve ratio of 0.25 percent.

**FIGURE 1: FY 2006 FEDERAL FUND RESERVE RATIO COMPARISON OF NEW AND HISTORICAL CALCULATION METHODS FOR SIX GUARANTY AGENCIES**



The Director of PSG was unable to provide an explanation for why the new method for calculating the Federal fund reserve ratios better presented the financial solvency of the guaranty agencies. The Director of PSG indicated that the decision to adopt the new method for 2006 was made by the former COO, former Chief Financial Officer of FSA, and the former general

manager of the FPS – all of whom are no longer employed by FSA. The Director of FSA's PLI, and officials of the Department's OGC and OPE participated in the preliminary discussions relating to the revision to the method used to calculate the Federal fund reserve ratios. However, none of those officials formally concurred with the new method.

- Improvements were needed in PSG's monitoring of guaranty agencies.

Improvements were needed in PSG's monitoring of guaranty agencies to ensure that management plans were submitted when required, or to exercise other administrative actions (i.e., withhold a portion of reimbursements payments due guaranty agencies) when the required management plans are not submitted to PSG after adequate notices had been provided to the guaranty agencies. Based on the new method used to calculate the Federal fund reserve ratios, PSG identified two guaranty agencies with two consecutive years (FY 2005 and FY 2006) of Federal fund reserve ratios below 0.25 percent. According to the Director of PSG, management plans were not requested for the two guaranty agencies because PSG was monitoring the guaranty agencies under the management plans submitted for FY 2004 and FY 2005. We noted that the management plans, referred to by the Director of PSG, were no longer effective for the current period; therefore, PSG should have requested new management plans. PSG was unable to provide evidence that other actions were taken to monitor the financial conditions of the guaranty agencies. As a result, the guaranty agencies may not have received monitoring as mandated under HEA.

- The Federal fund reserve ratios published on the Financial Partners website were overstated.

Based on information provided by the Director of PSG, due to growing concerns from the guaranty agency community in FY 2003 regarding the Federal fund reserve ratios posted on the Financial Partners website, FSA decided to review alternative methods used to calculate the Federal fund reserve ratios. According to PSG's briefing points on the minimum Federal fund reserve ratios, FSA noted that the posted Federal fund reserve ratios were consistently low and the guaranty agencies did not like the fact that the public could review these Federal fund reserve ratios. To address the guaranty agencies' concerns, published Federal fund reserve ratios for FY 2003, FY 2004 and FY 2005 were recalculated based on a new methodology. This new methodology was not consistent with FSA internal Federal fund reserve ratios used to monitor the guaranty agencies. The Director of PSG stated that the guaranty agencies are aware of the differences between the published and internal Federal fund reserve ratios, and that members of the general public who want the official Federal funds reserve ratios, calculated using the historical calculation, can file Freedom of Information Act requests. Because the Federal fund reserve ratios posted on the FSA website are not sanctioned by FSA management to assess the financial conditions of the guaranty agencies, the Congress, general public and oversight agencies (i.e., GAO, OMB, etc.) may rely on guaranty agency financial information that is misleading.

PSG informed us that it will seek formal concurrence from OGC, OPE and PLI that the new method adopted in FY 2006 for the calculation of Federal fund reserve ratios is in compliance with the HEA.

**RECOMMENDATIONS:**

We recommend that the Under Secretary ensure that the COO for FSA takes action to:

- 3.6 Suspend the new method adopted for the calculation of the Federal fund reserve ratios until FSA obtains formal concurrence from PLI, OPE, and OGC that the new method is in compliance with the HEA.
- 3.7 Ensure that PSG establishes and implements controls to appropriately monitor guaranty agencies with Federal fund reserve ratios below 0.25 percent in two consecutive years by providing notification to guaranty agencies of the requirement to submit management plans, ensuring the plans are submitted, and monitoring the implementation of the management plans to ensure that the guaranty agencies reach the mandated Federal reserve ratio within 18 months.
- 3.8 Recalculate the Federal fund reserve ratios available on FSA's website under the historical method until approval is received for the new method.
- 3.9 Ensure that the new method for calculating the Federal fund reserve ratios presented on FSA's website is consistent with Federal fund reserve ratios used by FSA to monitor the guaranty agencies financial condition.

**Reviews Conducted Under the Common Review Initiative May Not Have Satisfied Guaranty Agencies' Obligations to Conduct Reviews of Lenders**

Each guaranty agency is required by enabling FFEL Program law and regulations (34 CFR 682.410(c)) to perform comprehensive biennial on-site program reviews of lenders whose dollar volume of FFEL loans made or held by the lender and guaranteed by the guaranty agency in the preceding year is equal to or greater than two percent of the total of all loans guaranteed in that year by the agency; or was one of the ten largest lenders whose loans were guaranteed in that year by the guaranty agency; or equal to or greater than \$10 million in the most recent fiscal year. At the request of the National Council of Higher Education Loan Programs, Inc. (NCHELP), which represents guaranty agencies, lenders and servicers, FSA approved the CRI process to comply with these requirements.

The CRI is a concept designed to create efficiencies and consistency in lender program reviews conducted by guarantors. Participating CRI guarantors cooperate to conduct lender reviews using common review procedures. CRI was intended to eliminate redundant guarantor reviews. The CRI was in a pilot phase from January 1, 2004 to December 31, 2007. FSA approved the CRI process on an ongoing basis beginning January 1, 2008. The approval will remain in effect unless and until the Department notifies the guaranty agencies that the CRI process cannot be used. In addition, a review of the entity's compliance with LaRS requirements, consolidation rebate fees and inducements was added to the scope of the CRI reviews to be performed by guaranty agencies.

CRI reviews focus on conducting comprehensive reviews at a servicer level rather than at a lender level. CRI reviews test lenders' compliance with regulatory requirements and Common Manual policies. CRI reviews cover the 14 elements outlined in the Lender/Servicer Review Guide including deferments, forbearance, disbursements, credit bureau reporting, and reconciliations of billings. According to NCHelp's website, in 2004 and 2005, 11 CRI reviews were conducted which covered 248 reviews required by the regulations, resulting in the elimination of 237 individual lender reviews. In 2006 and 2007, 13 CRI reviews were completed through report issuance.

Based on our inquiries of FSA management and review of CRI reports, we noted matters relating to CRI reviews that identify issues with respect to guaranty agencies' compliance with the requirements of 34 CFR 682.410(c).

- The use of the Common Manual in the CRI reviews to ascertain lenders' compliance with FFEL Program requirements may not satisfy the guaranty agencies' obligations to conduct reviews of lenders.

The Common Manual was developed by the NCHelp and approved by its governing board. According to NCHelp, the Common Manual provides a single, standardized set of current student loan rules and FFEL Program policy guidance for schools and lenders. Both OPE and PLI indicated that the Common Manual is not sanctioned by the Department; hence, it is not an authoritative guide for ascertaining lenders' compliance with FFEL Program law and regulations. According to the CRI Lender Servicer Program Review Guide, the Department's participation in the CRI review process does not constitute an endorsement of the Common Manual. While the Director of FPE&O referred to the Common Manual as a reference tool, there were instances in the CRI reports in which the Common Manual was the sole document cited to support certain lenders non-compliance with FFEL Program law and regulations. The Common Manual may not reflect the most current regulations or may be incorrect; as a result, the CRI reviews may not be conducted properly.

- The sampling method used was not consistent and not susceptible to projection.

In accordance with the 34 CFR 682.410(c), the guaranty agency is required to conduct comprehensive biennial on-site program reviews of lenders, using statistically valid techniques to calculate liabilities to the Secretary that each review indicates may exist. Utilizing the guidance provided in the CRI Lender/Servicer Program Review Guide, an initial sample of 29 items is selected based on a 95 percent confidence level and tolerable error rate of 10 percent. In accordance with the American Institute of Certified Public Accountants (AICPA) Audit Sampling Guide referenced in the CRI Lender/Servicer Program Review Guide, if no instances of noncompliance are noted in the 29 samples, the testing is considered complete. If 1 critical error is noted in the sample of 29, the sample size is increased to 46; if 2 critical errors are noted, the sample size is increased to 61 from 46; and the process continues until the maximum sample size of 179 is reached and maximum of 11 critical errors are discovered in the sample. We noted instances in the CRI review reports in which the sample size was not increased even though critical errors were discovered during the reviews. In 1 case, for Servicer A, 4 errors were noted

in a sample of 29 borrowers. However, the sample size was neither increased nor the error projected to the entire population even though the 4 errors exceeded the sampling tolerable error rate of 10 percent. Out of the 13 CRI review reports examined, there were errors in the application of the AICPA Audit Sampling Guide in 11 reviews.

Of the 13 CRI reviews completed in 2006 and 2007, only 1 included calculation of funds due to the Department – a liability of \$326.05. During FY 2006 and FY 2007, FSA disbursed approximately \$20 billion in interest subsidy payments to all lenders participating in the FFEL Program. As a result, errors may not be identified and fully developed, and improper payments made to lenders may not be returned to the Department.

- The tolerable error rate of 10 percent was too high.

The FPE&O has established a tolerable error rate of 10 percent in the sampling plan for all program reviews, including the CRI reviews. The tolerable error rate is the maximum errors in the population that the examiner would be willing to accept and still conclude that the results from the sample have achieved the review objectives. Based on discussions with a regional director who represents FSA in the CRI Council, the original sampling methodology for the CRI review was reviewed by one of the Department's statisticians.

The use of a tolerable error rate of 10 percent possibly exposes the government to significant losses. In FY 2007, FSA reported in its financial statements interest subsidy payments of approximately \$11 billion, claim payments of \$6 billion, and fee collections of \$4 billion. Applying an error rate of 10 percent, projected errors of \$1.1 billion in interest subsidy payments, \$600 million in claim payments and \$400 million in loan origination fees would not be deemed material.

As stated above, we noted that the CRI review teams increased sample size when errors in the sample population exceeded the allowable errors in some instances. In other instances, when the errors exceeded the tolerable error rate of 10 percent, the review team neither calculated the liability nor increased the sample size.

- The samples selected in CRI reviews did not provide coverage of all lenders listed in the CRI report.

Under CRI, lenders' compliance with the requirements of the FFEL Program are evaluated at lender identification number level. Most of the large and national lenders participating in the FFEL Program have multiple lender identification numbers. For CRI reviews performed in the 2006 - 2007 cycle, we found instances in which CRI reviews covered over 60 lender IDs. In the review of the 14 elements in the Lender/Servicer Review Guide, a statistical sample of 29 loans was selected for each review element. We noted that in the CRI reviews, the majority of the lenders IDs were not represented in the samples for any of the elements in the review guide. For example, for five of the servicers reviewed in the 2006 and 2007 CRI review cycle, we noted the following results:



- Servicer A: 63 Lender IDs included in the CRI – 36 Lender IDs with no borrowers sampled, 15 Lender IDs with 3 or fewer borrowers sampled.
- Servicer B: 17 Lender IDs included in the CRI – 6 Lender IDs with no borrowers sampled, 4 Lender IDs with 3 or fewer borrowers sampled.
- Servicer C: 52 Lender IDs included in the CRI – 24 Lender IDs with no borrowers sampled, 14 Lender IDs with 3 or fewer borrowers sampled.
- Servicer D: 77 Lender IDs included in the CRI – 37 Lender IDs with no borrowers sampled, 23 Lender IDs with 3 or fewer borrowers sampled.
- Servicer E: 6 Lender IDs included in the CRI – 3 Lender IDs with no borrowers sampled, 1 Lender ID with 3 or fewer borrowers sampled.

The guaranty agencies have not fulfilled their responsibility to review those lenders for which no transactions were sampled. It is questionable whether the lenders for whom a very small number of borrowers were reviewed should also be considered adequately reviewed. The sample size is not sufficient, considering the inherent risks of the FFEL Program and the large volume of the transactions processed for the guaranty agencies, to support a reliable conclusion on the lenders' compliance with federal law, regulations and guarantors' policies.

As indicated in the CRI Lender/Servicer Program Review Guide dated July 1, 2007, "If there are multiple servicers for a specific lender number, and a CRI program review is not scheduled to be performed at each of the servicers, the affected guarantor will need to determine whether it needs to conduct a separate program review of that servicer. The affected guarantor will need to contact its ED regional office in these instances. These reviews will not be covered under the CRI process." As a result, in instances where a lender ID is serviced by multiple loan servicers, the CRI reviews do not cover all transactions of the specific lender IDs unless the CRI reviews are scheduled for all the servicers. There were no written procedures in place to ensure that the guaranty agencies perform program reviews for each of the servicers where a lender number has multiple servicers.

- Lender billing reviews were not conducted on all CRIs.

Review procedures related to the LaRS billings were neither performed by FPE&O nor guarantors for 13 of the 15 CRI reviews performed by the guaranty agencies in 2006 and 2007. LaRS billings are used by the lenders to invoice FSA for interest subsidies and report loan origination fees collected by the lenders on behalf of FSA. According to FSA audited financial statements, for both FY 2006 and FY 2007, interest subsidy payments and fee collections totaled approximately \$20 billion and \$7.8 billion, respectively.

In our discussion with a regional director who represents FSA on the CRI Council, the proposal for the continuance of the CRI pilot program included a request for clarification on who was responsible for performing the review procedures related to the entity's compliance with the LaRS. FPE&O performed reviews of LaRS billings for all of the CRI reviews conducted in 2004 and 2005. According to the regional director, it was the understanding of the guaranty agencies that FPE&O was responsible for performing reviews of the LaRS billings. However, because the clarification on the party responsible for reviews of LaRS billings was not issued until December

21, 2007, LaRS billings reviews were not performed in most CRIs for the 2006-2007 cycle. FPE&O performed LaRS reviews on 2 of 15 CRI reviews conducted in 2006 and 2007. Because LaRS billings have not been reviewed for 13 of 15 CRI reviews conducted during FY 2006 and FY 2007, loan origination fees collected by the lenders on behalf of FSA may have been inaccurate, and interest subsidy payments to lenders may be improper.

On December 21, 2007, FSA approved the CRI process, which will remain in effect unless and until the Department notifies the guaranty agencies that the CRI process cannot be used. As part of the condition for approval, FSA, NCHLP and the CRI Council agreed that the CRI scope would include review of entities' compliance with LaRS requirements. This agreement would have no impact on the 13 CRI reviews completed in the 2006 and 2007 CRI review cycle for which LaRS billings were not reviewed.

- CRI workpapers were not reviewed in a timely manner.

According to a regional director who represents FPE&O on the CRI Council, FPE&O does not review CRI reports and workpapers until the end of the CRI review cycle. As a result, as of March 2008, the workpapers for the 13 CRI reviews completed in 2006 and 2007 by the guaranty agencies have not been reviewed by FPE&O. Timely review of the CRI workpapers should ensure that deficiencies in the execution of the CRI review procedures (e.g., errors in defining appropriate population for CRI review) are detected timely and properly communicated to the CRI review teams for correction in subsequent CRI reviews. Also, patterns of misapplication of the HEA and regulations noted during the CRI reviews should be identified and communicated to the guaranty agencies and servicers in a timely manner.

## **RECOMMENDATIONS:**

We recommend that the Under Secretary ensure that the COO for FSA takes action to:

- 3.10 Require the CRI review teams to discontinue use of the Common Manual and rely only on the HEA, regulations, Departmental guidance and instructions as review criteria.
- 3.11 Suspend the CRI reviews until FPE&O obtains formal concurrence from PLI, OPE, and OGC that the CRI reviews meet the requirements for guaranty agencies' biennial program reviews of certain lenders as prescribed by 34 CFR 682.410 (c).
- 3.12 Develop a sound statistical sampling plan that is consistent with practices in the Federal government and industry, and establish tolerable error rates and confidence levels that appropriately reflect the level of risks in the FFEL Program.
- 3.13 Exclude Lender IDs serviced by multiple servicers from the scope of CRI reviews unless the CRI reviews cover all the multiple servicers.

- 3.14 Ensure that the Director of FPE&O enforces the requirements for the guaranty agencies to perform the LaRS billings procedures during the CRI reviews.
- 3.15 Ensure that the Director of FPE&O requires guaranty agencies to complete, or has FPE&O staff complete, the review of the LaRS billings for the remaining 13 CRI reviews performed during the 2006–2007 cycle.
- 3.16 Require FPE&O to enhance its oversight of the CRI reviews to include timely review of CRI workpapers.

**Incompatible Duties Were Not Separated and No Written Procedures Were in Place for Providing Technical Assistance to Guaranty Agencies, Lenders and Servicers**

According to GAO's Internal Control Standards, key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. Also, a good internal control environment requires that the agency's organizational structure clearly define key areas of authority and responsibilities and establish appropriate lines of reporting.

Based on discussions with FPE&O management and personnel, and the review of FSA documents, we determined that incompatible duties are not separated.

FPE&O did not have written policies and procedures and an organizational structure that help to ensure that incompatible duties of oversight and monitoring of FFEL Program participants are segregated from technical assistance. We noted that the review specialists were providing technical assistance on issues which they may be expected to perform a program review of the entity at a later date; or which they may not have the technical expertise to address. Based on the FSA Functional Statement for Program Compliance, one of the functions of FPE&O is to provide technical assistance to guaranty agencies, FFEL Program lenders and related agencies or organizations on the proper administration and management of the FFEL Program. It further states that each regional component (office) is responsible for, among other things, providing technical assistance to lenders, guaranty agencies, the general public, and congressional offices, through site visits, follow-up reports, correspondence (e.g. email) and telephone communications. In addition, the Director of FPE&O stated that technical assistance is communicated to the FFEL Program participants during FSA conferences.

We also found in our discussions with the review specialists and review of the FSA's website that the states within the regions are allocated among review specialists to address technical assistance and policy related inquiries and questions. In one instance, a regional director indicated that the specialists were not supposed to provide technical assistance because it was considered a conflict of interest. However, the same regional director provided us with a form

utilized by the review specialists to address questions received from the FFEL Program participants that may require input from offices outside of FPE&O (e.g. OPE or PLI).<sup>13</sup>

### **RECOMMENDATIONS:**

We recommend that the Under Secretary ensure that the COO for FSA takes action to:

- 3.17 Develop and implement procedures to ensure that FPE&O oversight and monitoring duties are segregated from technical assistance to the FFEL Program participants.

### **FINDING NO. 4 – FSA Lacked Written Procedures on Sharing Information Related to Policy Guidance and Program Reviews**

According to GAO’s Internal Control Standards, “Pertinent information should be identified, captured, and distributed in a form and time frame that permits people to perform their duties efficiently.”

We found that FPE&O has not established a formalized process for obtaining and tracking policy decisions related to the proper application of the HEA and FFEL Program regulations, or to resolve issues consistent with Department policy or prior determinations. Nor were there appropriate processes in place to share and disseminate policy decisions.

According to our discussions with FPE&O regional directors and staff, and the Director of PLI, under the current FSA process, policy and legal related issues can be directed to FPE&O, PLI, OPE, and/or OGC. PLI is responsible for identifying and analyzing policy issues, serving as liaison with OPE and OGC, and disseminating policy determinations to appropriate FSA staff. OPE is responsible for formulating federal postsecondary education policy including policy relating to the federal student financial assistance programs, and collecting and disseminating student financial assistance program data. Lastly, OGC is responsible for providing legal advice to Departmental offices.

We noted the following matters during our review of the internal controls related to policy and legal interpretations:

- There were no written procedures in place to share program review reports that contain sensitive issues, political issues, and/or areas where OPE or OGC has expressed an interest to ensure that program review findings are consistent with laws and regulations.

Based on a discussion with an OPE official, the School Eligibility Channel (SEC), which is responsible for providing integrated oversight and management improvement services to institutions receiving Federal student financial assistance program funds, shares draft PDLs with

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<sup>13</sup> In the prior OIG audit report, the auditors found that there was a lack of technical assistance procedures and no process for monitoring the quality of technical assistance.

OPE at least 48 hours prior to the issuance of the program review reports. The PDLs are shared for program reviews with findings or issues that are considered sensitive, political, or of interest to OPE. We found that neither program review reports nor PDLs issued by FPE&O are currently shared with OPE. As a result, FPE&O runs the risk that program review findings and/or proposed corrective actions may not be consistent with the HEA and the Department's policies.

As presented in Finding 3, FSA management did not have written procedures in place to escalate significant audit findings identified by the lender's independent auditors to the appropriate officials.<sup>14</sup>

- FPE&O management lacked a tracking system for policy related matters.

FPE&O has not implemented a tracking system for policy related issues and determinations, whether issues remain settled or unsettled. We noted that when FPE&O personnel identify policy related issues related to the proper application or resolutions of FFEL Program requirements that are unusual, unsettled, controversial, or that require extensive research and review, they request guidance from the PLI, OPE, and/or OGC. The responses to policy questions are not timely. Based on a discussion with the Director of PLI, many of these issues are discussed during conference call meetings and there is no process for tracking policy issues.

We requested documentation of policy issues addressed by PLI and FPE&O between October 1, 2006 and February 28, 2008. The Director of PLI could only provide a schedule of policy topics addressed during the meetings. The schedule, which was prepared based solely on our request, was a summary of the Director's of PLI calendar. The Director of PLI was only able to provide the discussion topics for the most recent 8 months, not the 17 months requested. The schedule was not sufficient to obtain an understanding of how policy issues are addressed, resolved, or timeliness of responses.

Also, bimonthly meetings are held between FSA, OPE, and OGC to discuss policy issues related to all aspects of the Title IV programs. According to an OPE official, there are no meeting minutes kept for the bimonthly meetings; the agenda serves as the only documentation that the meeting occurred. The OPE official indicated that FPE&O and FPS management should take notes on policy discussions relating to FSA and implement the consensus reached by the participants.

A formal tracking system and minutes of bimonthly meetings of FFEL Program policy issues and determinations can serve as a knowledge base for decision making and for responding timely to issues related to FFEL Program.

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<sup>14</sup> This finding was consistent with the finding noted in the prior OIG audit report in which the auditors found that there was no documented process to regularly obtain OGC review and advice on program reviews and other significant program determinations.

- There were no written procedures for providing technical assistance.

Consistent with the OIG's prior audit finding,<sup>15</sup> we found that FSA management has not established formalized policies and procedures for providing technical assistance to the guaranty agencies, lenders and servicers. The regional directors are not always informed by the program review specialists of technical assistance questions and inquiries received from the FFEL Program participants. In many cases, if the review specialist feels the question can be answered, they perform their own research and provide a response. One review specialist stated that there are no formal procedures for monitoring or escalating technical assistance to the regional director. Review specialists also stated that they are not aware of any formalized procedures for tracking technical assistance; they use their judgment to address technical assistance matters. In one discussion with an FPE&O management official, the official stated that FPE&O personnel do not provide technical assistance as a distinct activity; but rather, FFEL Program participants are informed if they are not in compliance with laws and regulations, and are provided information as to how to become compliant which in itself is technical assistance.

Also, FPE&O management was not always informed of policy and legal interpretations. According to our discussions with Departmental staff and managers, when review specialists have questions about the proper application or resolution of FFEL Program requirements, they can submit questions and inquiries via email or telephone directly to FPE&O, PLI, OPE, or OGC. In most cases, when questions involve settled issues under the HEA, regulations, or prior policy determinations, responses are usually sent directly to the review specialists who submitted the questions.

Overall, review specialists have different approaches to providing technical assistance. We noted that when technical assistance is provided via telephone, review specialists did not document the technical assistance questions or responses provided to the FFEL Program participants. In cases when technical assistance was documented, the review specialist typically documented responses in the review specialist's personal files or in the FFEL Program participants' files.

A written process for providing technical assistance promotes common and uniform understanding of the FFEL Program law and regulations among stakeholders, ensures consistency in the answers provided to FFEL Program participants, and standardizes procedures for informing FPE&O management of technical assistance matters.

Subsequent to our fieldwork, on May 16, 2008, OPE issued an operating procedure entitled, "Request for Policy Guidance from Federal Student Aid Components." If implemented as written, the operating procedure should address issues noted above related to a tracking system for policy-related matters, including the timeliness of responses. The new Standards issued by FSA on May 1, 2008, also provide guidelines for requesting guidance on program review

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<sup>15</sup> The prior OIG audit report presented findings related to the lack of technical assistance procedures. The report specifically noted that Financial Partners had no written procedures for documenting technical assistance.

findings. These policies do not address issues noted related to the lack of written policy and procedures on providing technical assistance.

### **RECOMMENDATIONS:**

We recommend that the Under Secretary ensure that the COO for FSA take action to:

- 4.1 Ensure effective implementation of the operating procedure on providing policy guidance and procedures, including monitoring for compliance with timeframes established.
- 4.2 Develop and implement written policies and procedures for sharing program review reports and PDLs with significant policy issues with PLI, OPE, and/or OGC before they are issued.
- 4.3 Develop and implement written policies and procedures on providing technical assistance, including the staff that should and should not provide technical assistance, and how such assistance is to be documented.

### **FINDING NO. 5 – FSA’s Implementation of Corrective Actions**

Audit follow-up is an integral part of good management, and is a shared responsibility of management officials and auditors. Corrective actions taken by management to resolve findings and implement recommendations in timely manner are essential to improving the effectiveness and efficiency of its operations. We found that FSA had not timely implemented corrective actions for the prior OIG report, and that the status of some corrective actions were not accurately reported in AARTS.

According to OMB Circular A-50, *Audit Followup*, an agency’s audit follow-up system should require prompt resolution and corrective actions on audit recommendations. Resolution shall be made within a maximum of six months after issuance of a final report. Corrective action should proceed as rapidly as possible. GAO’s Internal Control Standards state that, “monitoring of internal control should include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved. Also, managers are to (1) promptly evaluate findings from audits and other reviews, including those showing deficiencies and recommendations reported by auditors and others who evaluate agencies’ operations, (2) determine proper actions in response to findings and recommendations from audits and reviews, and (3) complete, within established time frames, all actions that correct or otherwise resolve the matters brought to management’s attention.

*The Inspector General Act of 1978*, as amended, Title 5 U.S.C., Appendix, states, “The head of a Federal agency shall make management decisions on all findings and recommendations set forth in an audit report of the inspector general of the agency within a maximum of six months after the issuance of the report...The head of a Federal agency shall complete final action on each management decision...within 12 months after the date of the inspector general’s report.” FSA

management officials are responsible for receiving and analyzing audit reports, providing timely responses to the audit organization, and taking corrective action where appropriate. A corrective action is considered resolved when the FSA management and the audit organization agree on the action to be taken on reported findings and recommendations. When FSA management has concluded that all necessary actions with respect to the findings and recommendations in the audit report have been executed, the corrective actions are then considered complete.

FSA had not timely implemented corrective actions to address all of the 17 recommendations in the prior OIG audit report, dated September 29, 2006. The audit recommendations were resolved on September 4, 2007 – nearly a year after the final report was issued. During our review, FSA and OIG staff periodically provided us with Corrective Action Plans (CAPs) from the Department's Audit Accountability and Resolution Tracking System (AARTS). The following chronology is provided:

- As of August 28, 2007, prior to the start of the current audit, the CAP showed that 3 of the 17 corrective actions had been completed, and 14 remained open. This CAP showed that of the 14 open actions, the proposed completion date for 11 had been extended – 9 for an additional 3 to 6 months, and 2 indefinitely (no revised completion date was recorded).
- As of November 7, 2007, the CAP showed the same 14 corrective actions still awaiting completion.
- As of March 5, 2008, the same 14 corrective actions awaited completion.
- Between March 5, 2008, and July 1, 2008, FSA reported an additional 13 recommendations as complete.
- On August 27, 2008, FSA provided the final CAP, which reported completion of the last open recommendation.

Of the 17 total corrective actions, between August 2007 and March 2008, we noted that only two corrective actions were completed by the proposed completion dates. For the remainder, proposed completion dates were extended once for 8 corrective actions and twice for 7 corrective actions.

To obtain an understanding of the delay in completing corrective action plans, we made inquiry of the Director of FPE&O who was designated as the responsible manager on 14 of the 17 recommendations. The Director attributed the delay in completing the recommendations in the OIG report to issues related to the transition phase resulting from the FSA reorganization that was implemented in March of 2006. The Director also indicated that there were other priorities that FSA had to address with the resources available. The Manager of Program Compliance, who has direct authority over FPE&O, attributed the delay in implementation of the corrective actions to the development of the program review standards.

We also noted instances where FSA's corrective actions did not adequately address the OIG recommendations. Our assessment of the corrective actions taken by FSA related to the prior OIG recommendations is presented in Appendix A. In summary, we found that the status of



corrective actions for 8 of the 17 recommendations (47 percent), was not accurately recorded in AARTS:

- Corrective actions to address 5 recommendations in the prior report were not fully implemented (Recommendations 1.2, 2.3, 2.5, 2.6, and 4.2), and
- Corrective actions to address another 3 recommendations had not been accomplished by the date the actions were reported as completed (Recommendations 1.4, 1.5, and 2.2). These corrective actions were noted as completed with the *issuance* of the FPE&O standards on May 1, 2008. However, when a corrective action was to *implement* a new process, additional steps are needed to ensure effective implementation beyond merely issuing a policy. Actions must be taken to ensure staff are following the policy. Some of the recommendations in this category may still require corrective action to be considered completed.

This finding is consistent with a prior audit of FSA's audit followup system that noted FSA's audit followup process did not support the completion of all corrective action items, or that the process did not always support completion of corrective action items on the date reported in AARTS.<sup>16</sup>

Please see Appendix A for details on the evaluation of corrective actions planned and taken for each recommendation in the prior OIG report.

## RECOMMENDATIONS:

We recommend that the Under Secretary ensure that the COO for FSA takes action to:

- 5.1 Reconsider Recommendations 1.2, 2.3, 2.5, 2.6, and 4.2 from the prior OIG audit marked as "complete" to assess if the implemented actions adequately addressed the OIG recommendations, and update AARTS accordingly.
- 5.2 Evaluate the accuracy of the completion dates recorded for Recommendations 1.4, 1.5, and 2.2 from the prior OIG report, and update AARTS accordingly.

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<sup>16</sup> *Audit Followup Process for Office of Inspector General Internal Audits in Federal Student Aid*, dated September 8, 2005.

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## OBJECTIVE, SCOPE, AND METHODOLOGY

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Our audit objective was to evaluate the appropriateness and effectiveness of FSA internal control to ensure that guaranty agencies, lenders and servicers are performing in accordance with relevant laws, regulations and guidance. The audit period is October 1, 2006 to March 31, 2008. Our audit was performed in accordance with the GAO's *Standards for Internal Control in the Federal Government* and *Internal Control Management and Evaluation Tool*, and the OMB's Circular A-123, *Management's Responsibility for Internal Control*, and government auditing standards generally accepted in the United States. We did not perform an internal control review over FSA's entire organizational structure. Specifically, we evaluated those controls that solely pertained to FPE&O and PSG's monitoring activities, in which we identified weaknesses detailed in the audit findings.

We gained an initial understanding of the operations at FPE&O and PSG by reviewing the HEA, GAO reports, and U.S. Department of Education OIG reports, FY 2007 Performance and Accountability Report, FY 2007 OMB Circular A-123 reports, and other available documents and reports as deemed appropriate.

We reviewed 13 CRI review reports issued by the guaranty agencies, and workpapers for two program reviews completed by the northern region. At PSG we obtained an understanding of the criteria used to identify lenders who are required to provide compliance audit reports and the procedures employed to monitor lenders with material weaknesses. In addition, we gained an understanding of the procedures for computing the guaranty agencies Federal fund reserve ratios under the historical and new methods. We recalculated the Federal fund reserve ratios for FY 2006 under the historical method and compared our results with PSG Federal fund reserve ratios under the new method.

We conducted interviews with the regional directors and all the review specialists at the northern (Chicago, Illinois) and southern (Dallas, Texas) regions, and the Atlanta duty station. We chose these two regions because we determined that the regional director at the northern region has a dual responsibility of being the regional director for the western region (San Francisco) which gives us an insight into the oversight activity at the western region. Dallas was selected because it conducted one of the largest number of program reviews during FY 2007. The Atlanta duty station was selected because it is under the southern region, and its two senior review specialists have significant institutional knowledge of the oversight of the FFEL Program.

At FSA Headquarters in Washington, D.C., we interviewed management and officials of various business units including FPE&O, Program Compliance, Business Operations, FPS, Partner Systems Group, PSG, ERMG, and PLI. In addition, we made inquiries of staff of the OGC, OPE, and OIG – Investigations.

Our entrance conference was held on November 6, 2007. We discussed the results of our audit with FSA management in an exit conference held on May 22, 2008. Our audit was conducted in accordance with *Government Auditing Standards* appropriate to the scope of the review described above.

Federal Student Aid's Oversight and Monitoring of Guaranty Agencies, Lenders, and Servicers Needs Improvement

**Assessment of FSA's Corrective Actions Taken to Address OIG recommendations in the report entitled "Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers," issued September 29, 2006**

<b>Recommendation 1.1</b>	Include compliance monitoring of guaranty agencies, lenders, and servicers in the tactical goals of FSA's strategic plan.
<b>Original Proposed Completion Date</b>	06/29/2006
<b>Status Reported</b>	Completed, 06/29/2006
<b>FSA Planned Corrective Action</b>	Incorporate specific tactical Action Steps from the Annual Performance Plan in Appendix A of the FY 2006-2010 Five-Year Plan
<b>Auditor Assessment of Action</b>	We reviewed the FY 2006-2010 Five Year Plan, and confirmed that FSA included compliance monitoring of guaranty agencies, lenders, and servicers in the tactical goals of FSA's strategic plan. This corrective action was completed.

<b>Recommendation 1.2</b>	Amend the Financial Partners' mission statement to better emphasize compliance and clarify the role of Financial Partners. Amend the functional statements for Financial Partners and Program Compliance to establish clear lines of responsibility and authority for oversight, monitoring, and compliance enforcement.
<b>Original Proposed Completion Date</b>	12/31/2007
<b>Status Reported</b>	Completed, 07/18/2008
<b>FSA Planned Corrective Action</b>	Consolidate all program compliance functions under a single unit reporting directly to the Chief Operating Officer and made changes to the function statements to reflect the consolidation.
<b>Auditor Assessment of Action</b>	<p>We confirmed that all program compliance functions were consolidated under a single unit reporting directly to the Chief Operating Officer. However, our query of FSA website on August 28, 2008, did not show changes to the functional statement to reflect consolidation of program compliance functions. This corrective action was not fully completed.</p> <p>In addition, during our review, we noted that FPE&amp;O did not have the policies and procedures, and organizational structure that help to ensure that incompatible duties of oversight and monitoring of FFEL Program participants are segregated from</p>

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	technical assistance. (See Findings 3 and 4 for more details.)
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<b>Recommendation 1.3</b>	Eliminate the organizational conflict of interest by removing the State Agency Liaison from any involvement in oversight and monitoring.
<b>Original Proposed Completion Date</b>	06/24/2007
<b>Status Reported</b>	Completed, 07/08/2007
<b>FSA Planned Corrective Action</b>	Reassigned the State Agency Liaison to other duties, and the position will not be filled.
<b>Auditor Assessment of Action</b>	Based on our inquiry of the Acting Director of FPS and review of the FSA Organizational Structure, we determined that State Agency Liaison had been removed from the oversight and monitoring of guaranty agencies, lenders and servicers. However, changes have not been made to the FSA functional statements to reflect the elimination of the functions of the State Agency Liaison. The planned corrective action was completed. However, FSA should also update the functional statement to reflect the changes made.

<b>Recommendation 1.4</b>	Require Financial Partners to stop recording as lender program reviews, program reviews that are actually only servicer reviews.
<b>Original Proposed Completion Date</b>	03/31/2008
<b>Status Reported</b>	Completed, 04/28/2008
<b>FSA Planned Corrective Action</b>	Federal Student Aid will enhance PEPS so that servicer reviews reflect the lenders that are covered as part of the review. These lenders will not be given a PRCN and therefore will not be counted in the lender review counts.
<b>Auditor Assessment of Action</b>	We reviewed the copy of FSA's announcement to all PEPS users and supervisors titled "PEPS April 2008 Software Release (RL 0804B)," dated April 28, 2008, the date this action was recorded as completed. We noted that the announcement referred to <u>planned</u> updates to PEPS. Because the updates to PEPS had not yet been made, this corrective action was not completed as of the date recorded.

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<b>Recommendation 1.5</b>	Develop a consistent policy for identifying, quantifying, and reporting all liabilities identified in program reviews regardless of whether they are resolved.
<b>Original Proposed Completion Date</b>	12/31/2007
<b>Status Reported</b>	Completed, 05/01/2008
<b>FSA Planned Corrective Action</b>	Federal Student Aid will evaluate the processes and implement procedures for identifying, quantifying, and reporting liabilities for schools and tailor those processes for program reviews at the guaranty agencies, lenders, and servicers.
<b>Auditor Assessment of Action</b>	Subsequent to the scope of our audit, on May 1, 2008, FSA issued new Standards related to program reviews. We reviewed the Standards and noted the Standards included policy for identifying, quantifying and reporting liabilities identified during program reviews. If the Standards are implemented as written, they should satisfy the corrective action stated. However, the corrective action to <i>implement</i> procedures was recorded as completed on the day the Standards were <i>issued</i> . The completion date for successful implementation should not be recorded until FSA has assurance that the new Standards have indeed been implemented by FSA staff and are achieving their designed purpose. This corrective action was not completed as of the date recorded.

<b>Recommendation 1.6</b>	Request an amendment to the Chief Operating Officer's delegation of authority for waiving liabilities to include additional controls for monetary limitations and consultation with other Department officials. Eliminate the redelegation to the Financial Partners' General Manager, and include appropriate controls in a replacement redelegation to the appropriate Program Compliance Officer. Ensure that managers and staff know and understand the delegation of authority for waiving liabilities.
<b>Original Proposed Completion Date</b>	12/31/2007
<b>Status Reported</b>	Completed, 07/01/2008
<b>FSA Planned Corrective Action</b>	Federal Student Aid will request an amendment to the Chief Operating Officer's delegation of authority for waiving program review and audit liabilities to include additional controls for monetary limitations and consultation with other Department

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	officials. The delegation will be redelegated to the appropriate Program Compliance official. Staff will be informed via memo of the changes so that they know and understand the delegation of authority for waiving liabilities.
<b>Auditor Assessment of Action</b>	We reviewed the delegation of authority from the Secretary to the FSA COO, noting that the delegation of authority was properly executed on May 29, 2008. We also confirmed that the redelegation of authority from the FSA COO to the Program Compliance Officer was executed on July 01, 2008. The delegations also addressed additional controls for monetary limitations and consultation with other Department officials. This corrective action was completed.

<b>Recommendation 1.7</b>	Require the tracking and documentation of the reasons for waiving a liability when exercising the waiver authority.
<b>Original Proposed Completion Date</b>	12/31/2007
<b>Status Reported</b>	Completed, 06/27/2008
<b>FSA Planned Corrective Action</b>	Federal Student Aid will develop a mechanism to record waivers that are granted including documenting the reason for waiving a liability.
<b>Auditor Assessment of Action</b>	FPE&O Standards, Chapter 21, issued June 26, 2008, addresses the conditions for granting, recording and documenting reasons for waiving liabilities resulting from program reviews. Also, we confirmed that FPE&O conducted training for the review specialists on the standards. This corrective action to develop a mechanism was completed.

<b>Recommendation 2.1</b>	Ensure that Financial Partners follows its procedures and guidance for its program review process.
<b>Original Proposed Completion Date</b>	03/31/2008
<b>Status Reported</b>	Completed, 02/28/2008
<b>FSA Planned Corrective Action</b>	Financial Partner Eligibility & Oversight will provide staff with training on the revised program review guidance.
<b>Auditor Assessment of Action</b>	We confirmed that training on the FPE&O Standards was conducted on February 26-28, 2008 for FPE&O staff. This corrective action was completed.

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<b>Recommendation 2.2</b>	Require Financial Partners to enhance and implement its guidance to include procedures that addresses the program review weaknesses we identified.
<b>Original Proposed Completion Date</b>	12/31/2007
<b>Status Reported</b>	Completed, 05/01/2008
<b>FSA Planned Corrective Action</b>	Financial Partner Eligibility & Oversight will enhance its program review guidance, including procedures that address the weaknesses identified.
<b>Auditor Assessment of Action</b>	Subsequent to the scope of our audit, on May 1, 2008, FSA issued new Standards which addressed program review weaknesses identified in OIG's audit report. If the Procedures are implemented as written, they should satisfy the corrective action stated. However, the corrective action to <i>implement</i> guidance was recorded as completed on the day the Standards were <i>issued</i> . The completion date for successful implementation should not be recorded until FSA has assurance that the new Standards have indeed been implemented by FSA staff and are achieving their designed purpose. This corrective action was not completed as of the date recorded.

<b>Recommendation 2.3</b>	Require Financial Partners to enhance and implement its guidance to include procedures that address the technical assistance weaknesses and provide oversight to the regions to ensure that technical assistance is consistently provided and properly documented.
<b>Original Proposed Completion Date</b>	03/31/2008
<b>Status Reported</b>	Completed, 06/05/2008
<b>FSA Planned Corrective Action</b>	Under the reorganization, program reviewers in the Financial Partners Oversight and Eligibility Office (FPE&O) of Program Compliance (formerly Financial Partners Services) do not conduct technical assistance activities. Requests for technical assistance and/or policy guidance are submitted to the Director of the Policy Liaison and Implementation (PLI) Staff in Federal Student Aid, who will either respond to the request directly or forward the request to OPE to ensure all responses, are consistent and appropriate. The procedures detail the process for submitting requests and responding to requests and include response times and recordkeeping requirements.



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<b>Auditor Assessment of Action</b>	Although the reorganization occurred in March 2006, we noted during our review that FPE&O staff continued to provide technical assistance (see Finding 3) and that improvements were needed in obtaining and sharing policy guidance (see Finding 4). Subsequent to our fieldwork, on May 16, 2008, OPE issued an operating procedure to address requests for policy guidance. This procedure, if implemented as written, should address the corrective action related to policy guidance. However, the issue related to FPE&O staff providing technical assistance remained. FSA did not provide any information or new policy to address that issue. As such, this corrective action was not fully completed.
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<b>Recommendation 2.4</b>	Ensure that Financial Partners strengthens its program review process to ensure consistency in the program review process and that program reviews are issued and closed within established timeframes.
<b>Original Proposed Completion Date</b>	03/31/2008
<b>Status Reported</b>	Completed, 05/01/2008
<b>FSA Planned Corrective Action</b>	Financial Partners Eligibility & Oversight will enhance its program review guidance to ensure process consistency and timeliness and provide staff with training on the procedures.
<b>Auditor Assessment of Action</b>	Subsequent to the scope of our audit, on May 1, 2008, FSA issued new Standards related to program reviews. We confirmed that FPE&O conducted a 3-day training session on the Procedures for its staff. The Standards establish guidance for consistently performing program reviews and established timelines for report issuance. If the Standards are implemented as written, they should satisfy the corrective action stated. This corrective action was completed.

<b>Recommendation 2.5</b>	Require Financial Partners to establish a quality assurance process that would ensure that program reviews are conducted properly, that work papers support the conclusions reached and findings are adequately documented.
<b>Original Proposed Completion Date</b>	06/30/2008
<b>Status Reported</b>	Completed, 06/30/2008
<b>FSA Planned</b>	Financial Partners Eligibility & Oversight will leverage the

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<b>Corrective Action</b>	work done on the quality assurance processes by the School Eligibility Channel and implement a process that supports this recommendation.
<b>Auditor Assessment of Action</b>	Subsequent to the scope of our audit, on May 1, 2008, FSA issued new Standards related to program reviews. On June 30, 2008, FSA initially included a quality assurance process for program reviews in the Standards. This process document was later removed from the Standards and placed on a shared location on FSA's computer system. No policy has been issued to establish the quality assurance process on an ongoing process. The first quality assurance review was issued on September 29, 2008. This corrective action was not completed on the date indicated, since the first quality assurance review was not completed until the end of September 2008. This corrective action should also not be considered completed as the quality assurance aspect has been removed from the Standards and not otherwise issued as a policy.

<b>Recommendation 2.6</b>	Require Financial Partners to establish a quality assurance process that would ensure the quality and the adequacy of technical assistance.
<b>Original Proposed Completion Date</b>	06/30/2008
<b>Status Reported</b>	Completed, 06/05/2008
<b>FSA Planned Corrective Action</b>	Under the reorganization, program reviewers in FPE&O do not conduct technical assistance activities. All requests for guidance are forwarded to Federal Student Aid's PLI for a response. Therefore, FPE&O does not need to establish a quality assurance process. The procedures developed and implemented by PLI and OPE will ensure the quality and adequacy of all responses for technical assistance.
<b>Auditor Assessment of Action</b>	Although the reorganization occurred in March 2006, we noted during our review that FPE&O staff continued to provide technical assistance (see Finding 3) and that improvements were needed in obtaining and sharing policy guidance (see Finding 4). Subsequent to our fieldwork, on May 16, 2008, OPE issued an operating procedure to address requests for policy guidance. This procedure, if implemented as written, should address the corrective action related to policy guidance. However, the issue related to FPE&O staff providing technical assistance remained. FSA did not provide any information or new policy to address

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	that issue. As such, this corrective action was not fully completed.
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<b>Recommendation 3.1</b>	Develop written policies and procedures for obtaining timely guidance for resolution of program issues and for communicating the results and decisions.
<b>Original Proposed Completion Date</b>	04/01/2008
<b>Status Reported</b>	Completed, 05/16/2008
<b>FSA Planned Corrective Action</b>	OPE and FSA (with assistance from OGC) will develop a set of written procedures that will enable the offices to track policy guidance questions and issues and to respond in a timely manner. The procedures developed will explicitly reference the responsibilities of each of the three offices as they relate to the type of question or issue raised.
<b>Auditor Assessment of Action</b>	Subsequent to our fieldwork, on May 16, 2008, OPE issued an operating procedure to address requests for policy guidance. This procedure, if implemented as written, should address the issues noted. This corrective action was completed.

<b>Recommendation 3.2</b>	Develop written policies and procedures for regular review by OGC of program reviews and other significant program determinations.
<b>Original Proposed Completion Date</b>	12/31/2007
<b>Status Reported</b>	Completed, 05/01/2008
<b>FSA Planned Corrective Action</b>	Financial Partners Eligibility & Oversight will ensure that there are policies and procedures that will provide for review by OGC of all program review findings associated with unusual, unique, and controversial issues.
<b>Auditor Assessment of Action</b>	Chapter 18.3.1, "When to Solicit Guidance," of the Standards, was cited by FPE&O as evidence that FSA addressed the OIG recommendation above. We reviewed Chapter 18.3.1, noting that the chapter addressed procedures to be followed to request guidance from the regional directors and the Director of PLI for program review findings without precedent – especially those pertaining to unusual, unique or politically sensitive issues. The current version of the Standards referenced the operating procedure, "Request for Policy Guidance from Federal Student Aid Components." The operating procedure was issued by

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	<p>OPE on May 16, 2008. That procedure included policy guidance to be provided by OPE and/or OGC.</p> <p>The corrective action was to establish policies and procedures, as such, the program review Standards and OPE operating procedure, if implemented as written, should satisfy this corrective action. However, as the OPE operating procedure was not implemented until May 16, 2008, the completion date recorded should be no earlier than that date. This corrective action is considered completed.</p>
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<b>Recommendation 4.1</b>	Develop written policies and procedures on the use of the guaranty agency, lender, and servicer scorecards as a risk assessment tool and train users on their use.
<b>Original Proposed Completion Date</b>	03/31/2008
<b>Status Reported</b>	Completed, 05/01/2008
<b>FSA Planned Corrective Action</b>	Federal Student Aid will document the policies and procedures for the use of guaranty agency, lender, and servicer scorecards as a risk assessment tool and train the appropriate users.
<b>Auditor Assessment of Action</b>	We reviewed the Standards, Chapter 14.1.15 – Lender/Servicer Scorecard – and determined that FPE&O has developed policies for the use of scorecard as a risk assessment tool during lenders and servicers' program reviews. We also noted that Chapter 3 of the Standards included evaluation of scorecards in the process for developing the annual program review schedule, specifically in the area of selecting entities for review. We also confirmed that FPE&O training covered discussions on the scorecard. These policies, if implemented as written, satisfy the corrective action to document policies and procedures. This corrective action was completed.

<b>Recommendation 4.2</b>	Implement a process to continually assess the effectiveness of the scorecard; and identify and implement improvements.
<b>Original Proposed Completion Date</b>	07/31/2007
<b>Status Reported</b>	Completed, 07/27/2007
<b>FSA Planned Corrective Action</b>	Federal Student Aid will develop, document, and implement a process to continually assess the effectiveness of the guaranty agency, lender, and servicer scorecards and implement

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	improvements.
<b>Auditor Assessment of Action</b>	<p>FSA provided a copy of “Procedures for Capturing, Evaluating and Implementing Changes to the Financial Partners Data Mart (FPDM).” This document was distributed and posted on July 27, 2007. If implemented as written, this document should satisfy the corrective action. However, the corrective action to <i>implement</i> procedures was recorded as completed on the date of the document. The document is not part of a policy or the Standards. As such, the procedures do not appear to have been formally established as an ongoing process. FSA also did not yet have assurance that the new procedure would be effective. The completion date for successful implementation should not be recorded until FSA has formally issued the procedure and has assurance of effective implementation. This corrective action was not fully completed.</p>



March 24, 2009

Mr. Keith K. West  
Assistant Inspector General for Audit  
U.S. Department of Education  
Office of Inspector General  
400 Maryland Avenue, SW  
Washington, DC 20202-1500

RE: Response to the Draft Audit Report, "Federal Student Aid's Oversight and Monitoring of Guaranty Agencies, Lenders, and Servicers Needs Improvement" (Control Number ED-OIG/A2010001)

Dear Mr. West:

Thank you for providing us with an opportunity to respond to the Office of Inspector General's (OIG) draft audit report entitled, "Federal Student Aid's Oversight and Monitoring of Guaranty Agencies, Lenders, and Servicers Needs Improvement" (Control Number ED-OIG/A2010001). In the report, the OIG concluded that controls implemented by Federal Student Aid (FSA) to ensure that guaranty agencies, lenders, and servicers are performing in accordance with relevant laws, regulations, and guidance need improvement. The purpose of this memo is to provide a final response to that draft report.

The Department of Education, FSA is committed to the implementation of a strong internal control environment, including the implementation of effective control activities over guaranty agencies, lenders and servicers. FSA has taken many actions to improve its oversight of guaranty agencies, lenders, and servicers in response to recommendations the OIG made in prior audits. We are pleased to report that the actions we have taken, and plan to take in the near future, address many of the issues raised by this audit report.

We are also pleased to note that in addition to the audit conducted by the OIG, in Fiscal Year (FY) 2008, FSA performed two self-assessments of internal controls and had an independent assessment of internal controls from the Department's financial statement auditor. First, as required under the Federal Managers Financial Integrity Act, the Department conducted its own assessment of the effectiveness of its internal control, the result of which identified no material weaknesses related to monitoring and oversight.

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Second, the Department assessed the effectiveness of internal control over financial reporting as part of OMB Circular A-123, Appendix A. The processes that were reviewed included many of the processes reviewed as part of this OIG audit (e.g., program reviews, annual compliance audits, and GA reserve ratios). No material weaknesses or significant deficiencies were identified for the internal control over financial reporting. Finally, as part of the Department's financial statement audit, the OIG assessed control risks and tested controls for the purpose of expressing an opinion on the Department's financial statements. A significant deficiency noted during the FY07 financial statement audit, titled "Additional Focus on Program Monitoring Activities is Needed" was not reported as a repeat condition. The FY08 status of this FY07 finding was reported by the auditor as "Improvements noted in updating policies and risk assessment processes. Continued focus on implementation and resources is warranted – Not classified as a Significant Deficiency at September 30, 2008."

Enclosed is a revised corrective action plan addressing each of your findings and recommendations. Thank you for providing us the opportunity to respond to your report and we look forward to working with your office to implement these changes.

Sincerely,

James F. Manning  
Acting Chief Operating Officer  
Federal Student Aid

Enclosure