



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

February 18, 2005

CONTROL NUMBER  
ED-OIG/A19-D0005

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

Jack Martin  
Chief Financial Officer  
Office of the Chief Financial Officer  
U.S. Department of Education  
Federal Building No. 6, Room 4E313  
400 Maryland Ave, SW  
Washington, DC 20202

Dear Ms. Shaw and Mr. Martin:

This **Final Audit Report** (Control Number ED-OIG/A19-D0005) presents the results of our audit of the Department of Education's (Department) payments to private collection agency (PCA) contractors.

## BACKGROUND

Since 1981, Federal Student Aid (FSA) has utilized PCA contractors to support collection and resolution of defaulted student loans maintained by the Department. The Department awarded task order contracts to 13 PCA contractors in September 2000. The terms of the solicitation and task orders were identical for all contractors. FSA uses manual and automated processes to determine collections and other activities for each contractor to generate information on commissions and fees due. FSA uses this information to prepare invoices and sends the invoices to the contractors for review. The contractors then sign and submit the invoices to the Department for payment. The PCA task orders authorize performance bonus payments at the end of every four-month evaluation period to the top three contractors at the rates of five percent for first place, three percent for second place, and one percent for third place. Through March

2004, the Department paid commissions and bonuses totaling \$346.6 million under the 13 PCA task orders.

FSA's Debt Collection Service (DCS) in Washington, DC, is the office responsible for managing collection activities, including the PCA contractors. FSA's Contract Services Branch (CSB) in Atlanta, Georgia, a component of DCS, monitors the performance of the PCA contractors. The Contracting Officer (CO) serves as the single official responsible for the overall administration of the contracts. The Contracting Officer's Representative (COR), an FSA staff member in Washington, DC, is responsible for overseeing the PCA task orders. An Assistant COR, who is on the CSB staff in Atlanta, is responsible for supervising the invoice process and reviewing invoices prior to sending them to the contractors. A management analyst and an information technology specialist are also involved in the invoice process and developed computer programs and Microsoft Access databases to facilitate the invoice preparation process.

## **AUDIT RESULTS**

Because FSA did not consistently maintain computer files used to prepare invoices, we could not achieve our original objective to assess the accuracy of the calculations in the process or the appropriateness of payments made. Our audit was limited to a review of the incentive payments made, and a review of internal controls over the invoice preparation process. We found the Department made incentive payments to PCA contractors totaling \$946,082 that were not consistent with the terms of the task orders. We also found that FSA needed to improve its internal controls over the invoice preparation process. As a result, payments made to the PCA contractors were not fully supported, and FSA did not have assurance that payments made to contractors were accurate and appropriate.

FSA responded to the draft report, concurring with the findings and recommendations. FSA stated that it has processed task order modifications to revise the incentive payment plan for large and small business contractors. FSA also described specific corrective actions it has taken and intends to take to address the issues noted. FSA requested revisions to Office of Inspector General (OIG) statements made in the draft report. However, OIG maintains its position on the issues and the requested changes were not made. Detailed information is provided after the recommendations for each finding regarding FSA's response, and OIG's comments to the response. The full text of the FSA response is included as Attachment 2 to this audit report.

### **Finding 1 Incentive Payments to PCA Contractors Were Not Consistent with Task Order Terms**

The Department paid incentive bonuses to PCA contractors that were not consistent with the terms of the task orders. In each of the nine performance evaluation periods ending August 2001 through April 2004, the Department paid incentive bonuses to four PCA contractors, rather than three contractors as specified in the task order contracts. We also noted one instance in which

two contractors were paid the highest bonus rate, when only one contractor was eligible for that rate.

The PCA task orders, Section B.3(d), "Special Contract Bonus Payment Plan," state that the top three contractors will be paid a bonus payment based upon the dollars collected during the preceding four-month evaluation period. Section H.4(B), "Competitive Performance and Continuous Surveillance (CPCS)," authorizes a bonus payment to the top three contractors at the rates of five percent for first place, three percent for second place, and one percent for third place.

Department Directive OCFO [Office of the Chief Financial Officer]: 2-108, "Contract Monitoring For Program Officials," defines contract administration as:

Formal actions taken by the Government (primarily the contracting officer) during the life of a contract to ensure that all commitments of the contractor and the Government are met and that the contract is modified as necessary to meet the Government's needs and to protect the Government's interest. Such actions include the review and approval of incurred costs, subcontracts, invoices, and deliverables, and the issuance of modifications.

Federal Acquisition Regulation (FAR), Part 16.4, "Incentive Contracts," states,

Incentive contracts are designed to obtain specific acquisition objectives by- (1) Establishing reasonable and attainable targets that are clearly communicated to the contractor; and (2) Including appropriate incentive arrangements designed to- (i) motivate contractor efforts that might not otherwise be emphasized....

#### **Four Contractors Were Paid Incentives in Each Period**

In each performance evaluation period, the Department paid a three percent bonus to a small business, in addition to the bonus payments paid to the top three contractors. The small business was not one of the three top-performing contractors and therefore did not qualify for the bonus payments. In total, the Department provided the small business with \$804,015 in incentive payments that were not consistent with the terms of the task orders.

The Department issued one solicitation for PCA services and indicated that it intended to award 10 to 12 task orders, plus at least two task orders as a set aside for small businesses. The language in the individual task orders awarded was identical for all contractors. One sentence in the solicitation stated that small businesses would compete for a separate pool of accounts to be serviced. However, the sections of the solicitation and task orders that provided for the incentive bonus payment plan stated bonuses would be paid to the three top-performing contractors, and did not mention any separate incentive pool or competition for bonuses for small businesses. The former CO stated that FSA intended for the small business contractors to compete against one another and to be eligible for a separate pool of incentives. FSA staff said that since only

two task orders were awarded to small businesses, it decided that a three percent bonus would be paid to the top-performing small business contractor and that the second place contractor would not be eligible for any incentive. However these intentions were not documented in the solicitation, task orders, or any modifications issued. Nor was any other documentation of these decisions found in the contract files or provided by FSA.

### **Two Contractors Were Paid Highest Incentive Rate in One Period**

In one performance evaluation period, the Department paid the two top-performing contractors incentives at five percent, rather than one at five percent and one at three percent. The amount of incentives paid to the second-place contractor that were not consistent with the task orders was \$142,067 (the difference between the five percent rate paid and the three percent rate for which the contractor qualified).

FSA staff stated that both large business contractors were paid the higher incentive rate in one period because there was only a minor difference in the contractors' performance during that period. The performance statistics for this period, however, ranked one contractor in first place and the other in second place. FSA did not modify the task orders, or otherwise document the decisions made regarding the incentives for this period.

### **Interim Audit Memo Issued**

We reported these issues concerning incentive payments to the Department in an Interim Audit Memorandum dated, July 30, 2004. In its response, FSA agreed with the findings and agreed that it did not have documentation to support the decisions made concerning the incentive plan. However, FSA did not agree that the payments represented unauthorized payments. With respect to the additional three-percent bonus paid to the small business contractor, FSA stated:

We agree that incentives were paid to four contractors, however we do not agree that these were unauthorized payments... The small business was the top-performing contractor within its pool... While ED [the Department] could have paid the contractor a 5% bonus and the second place finisher 3%, the Contracting Officer determined that a single bonus of 3% to the top finisher was more appropriate since only two PCAs were participating in the small business set-aside pool.

With respect to the payment of two contractors at the highest bonus rate, FSA stated:

Again, we agree with the finding, but do not agree that it represents unauthorized payments. The top two PCAs in the unrestricted pool finished in a statistical tie for CPCS performance period #2. The Contracting Officer agreed the PCAs were tied and concluded that the task orders required that both PCAs receive a 5% bonus, since both finished in first place... We have initiated a modification to the

task orders to clarify what constitutes a tie and to reflect the Contracting Officer's interpretation of the task orders.

OIG maintains its position that the incentive payments were not consistent with the terms of the task orders because there were no modifications or other documentation to support a change in the incentive plan or authorize separate incentives for small businesses. FSA did not include separate language in the solicitation, task orders, or other documentation concerning a separate incentive pool for the two small businesses. OIG has noted that in the July 2004 solicitation for the recompetition of the PCA contracts, the Department included language establishing two separate pools for evaluating contractor performance, specifying that the top three performing contractors in the unrestricted pool will receive bonuses, and the top two contractors in the small business pool will receive bonuses.

OIG also maintains its position that only one contractor should have been paid a five percent bonus. The ranking given reflects each contractor's performance at the end of the evaluation period and is the basis for determining the incentive rate for each contractor as specified in the task order. FSA received no additional services for paying the second place contractor additional funds. The performance statistics ranked one large business contractor in first place, and the other in second place.

In total, for the period August 2001 through April 2004, the Department paid \$946,082 in incentives that were not consistent with the task orders. The additional incentive payments made resulted in funds not available for other uses. Inconsistent payment of incentives could create confusion among competing contractors, and could create the perception of bias. Allowing incentive payments that are not consistent with the terms of the task orders increases the risk of future improper payments. Without documentation of the decisions made, and appropriate changes to the task orders, the Contracting Officer's decisions could be viewed as arbitrary and subject the Department to disputes from contractors who did not receive incentives.

### **Recommendations:**

We recommend that the Department's Office of the Chief Financial Officer, and FSA's Chief Operating Officer:

- 1.1 Ensure that incentive bonuses paid to contractors are consistent with terms of the PCA task orders and are based on appropriate bonus rates.
- 1.2 Ensure that appropriate actions are taken to document decisions, and if appropriate, to modify the task orders, when decisions are made that impact the terms and conditions.
- 1.3 Ensure all contractors are informed of any changes in the performance incentive plan.

### **FSA Response and OIG Comments:**

In its response to the draft report, FSA requested that OIG revise its statements that the incentive bonuses were not paid as specified in the task order contracts. FSA stated there were two separate pools of task orders, each of which specified the Department would pay bonuses to the top three contractors. FSA also requested that OIG revise its statements that the small business contractor was not one of the top three performing contractors and therefore did not qualify for bonus payments. OIG's position remains unchanged. The solicitation and task order contracts did not include any language to indicate that two separate pools existed. FSA stated if bonuses were based on both pools together the small business' performance scores would still place it in the top three contractors for each period. However, data provided by FSA during our review showed that the small business was ranked at ninth or below in each period reviewed.

FSA further requested that OIG revise its statements that only one contractor was eligible for the highest bonus rate, and that it received no additional services for paying the second place contractor additional funds. OIG maintains its position. FSA's payment of the same bonus rate to two contractors was not in accordance with the task order terms at the time of payment. Further, incentive payments should have been paid at five percent for the first place contractor, and three percent for the second place contractor.

FSA agreed with all three recommendations for this finding.

## **Finding 2 Internal Controls Over the Invoice Preparation Process Need Improvement**

FSA's internal controls over the invoice preparation process need improvement. We found that FSA used manual and automated processes to evaluate contractors' compliance with laws, regulations, policies, and procedures, and to calculate invoice amounts payable to PCA contractors. However, FSA had not established adequate internal controls over these processes. Specifically, we noted that FSA did not:

- Adequately maintain and archive collection data used to support payments made to contractors.
- Document manual and automated invoice processes for calculating commissions, fees, and bonuses.
- Formalize the process for reviewing changes to program logic and obtain independent verification and validation of the invoice preparation process.
- Ensure continuity of operations over the invoice preparation process.

An OIG Action Memorandum, dated July 1, 1999, also reported concerns with FSA's lack of written policies and procedures, changes to program logic, and continuity of operations for the invoice preparation process. FSA had not implemented changes to address these concerns from the prior OIG Action Memorandum.

FAR Subparts 4.801 and 4.803, “Government Contract Files, ” prescribe requirements for maintenance of contract files as follows:

The head of each office performing contracting, contract administration, or paying functions shall establish files containing the records of all contractual actions. The documentation in the files...shall be sufficient to constitute a complete history of the transaction for the purpose of – (1) Providing a complete background as a basis for informed decisions at each step in the acquisition process; (2) Supporting actions taken; and (3) Providing information for reviews and investigations. Examples of records normally contained in the paying office contract file are: (1) Copy of the contract and any modifications; (2) Bills, invoices, vouchers, and supporting documents; (3) Record of payments or receipts; and (4) Other pertinent documents.

Office of Management and Budget Circular A-130, “Management of Federal Information Resources, ” states,

[A]gencies are to conduct Information Management Planning to [r]ecord, preserve, and make accessible sufficient information to ensure the management and accountability of agency programs, and to protect the legal and financial rights of the Federal Government... An agency should ensure that records management programs provide adequate and proper documentation of agency activities; and the ability to access records regardless of form or medium.

Departmental Directive, OCIO [Office of the Chief Information Officer] : 1-103, “Departmental Records and Information Management Program, ” states,

Records are broadly defined by statute and regulation to include all recorded information, regardless of medium or format, made or received by the Department and its agents under Federal law or in connection with the transaction of public business. Records serve a number of broader purposes, including longer-term administrative and program planning needs; evidence of Department activity; use by other Programs in the Department; use by other Federal and/or state and local agencies; protection of the legal and financial rights of the Government and its citizens; effective oversight by Congress and other authorized agencies; and the retention of an official record for historical purposes.

Departmental Directive OCFO:1-101, “Federal Managers’ Financial Integrity Act Management/Reporting on Internal Controls, ” states,

...[P]rincipal Officers will establish and maintain cost-effective systems of internal control so that they can provide reasonable assurance that their systems are operating in a manner to accomplish the goals of the Department and the objectives of internal control.

The attachment to this directive further identifies types of control activities as shown below:

- System software controls are established to provide control over the acquisition, implementation, and maintenance of all system software including the operating system, data-based management systems, telecommunications, security software, and utility programs.
- The PO [Principal Office] establishes procedures to ensure proper and effective service continuity for its computerized operations.
- The PO establishes controls designed to help ensure completeness and validity of all transactions during the application process.
- The PO establishes controls designed to help ensure accuracy and validity of all transactions during the application process.
- The PO establishes procedures to help ensure the integrity of processing and data files.

### **Collection Data Was Not Adequately Maintained and Archived**

The Department did not adequately maintain and archive computer-generated data to support payments made to contractors. FSA did not maintain all Debt Management Collection System (DMCS) computer-generated data and Access database files used to calculate invoice amounts for the original period of our review, October 2001 through September 2002. DMCS is the Department's system for recording payments against borrowers' accounts. An FSA management analyst developed procedures that retrieved collection data from DMCS and loaded this data into Access databases. CSB staff used the Access databases to calculate commissions, fees, and adjustments. CSB's monthly invoice procedures specified that staff make a backup copy of the entire set of database files prior to beginning the monthly processing. While CSB staff maintained some of this data on personal computers, there were no procedures that defined the retention period for data retrieved from DMCS and data in the Access databases, or a central location to maintain the information. As such, FSA staff could not provide 6 months of summary commission data, 5 months of detail commission data, 1 month of rehabilitation data, and 1 month of consolidation import data for the 12-month period we requested.

Since our review, FSA stated that it now saves summary and detail computer generated data files from DMCS. However, written policies and procedures had not been developed to ensure that a complete record of contractors' collection data was maintained and archived to allow FSA to reevaluate contractors' compliance with Federal laws, regulations, and contractual requirements, and to determine if proper payments were made for commissions, fees, and incentive bonuses.

### **Manual and Automated Invoice Processes Were Not Documented**

The Department did not document manual and automated invoice processes for calculating commissions, fees, refunds, adjustments, and bonuses. Collections data maintained in DMCS



was entered in consolidation, rehabilitation, refund, and invoice Access databases and used to create invoices. In addition to several different databases, CSB's invoice process also consisted of a series of computer programs, and manual and automated adjustments. These programs evaluated contractors' compliance with laws, regulations, and task order terms to determine whether proper payments and amounts had been recorded to borrowers' accounts. The invoice database was then used to calculate commissions and fees on properly consolidated and rehabilitated accounts. FSA staff also used the invoice database to calculate incentives for eligible contractors at the end of every four-month performance evaluation period. CSB staff responsible for performing invoice processing did not have sufficient knowledge of all the functions performed by the databases and computer programs to adequately develop written procedures. CSB staff relied on staff in several other offices for programming support and to provide collection data needed to calculate invoice amounts.

The 1999 Action Memorandum noted that FSA did not have written policies and procedures over the invoice process. Since that time, FSA developed written procedures for retrieving collection data, however, the procedures did not include automated functions and calculations that were being performed within the computer programs and databases.

Written procedures are necessary for proper internal control and to provide an objective basis for evaluating whether calculations are being performed correctly. Should the Access databases become damaged or unavailable, the Department would not be able to recreate the process to determine the amounts due to the contractors.

### **Procedures Were Not Developed for Reviewing Changes and Validating Program Logic**

FSA did not have a process for reviewing changes to program logic and obtaining independent verification and validation of the invoice processing operation. In order to properly analyze borrower accounts, the management analyst developed computer programs and databases to evaluate contractors' compliance with specific criteria. In the 1999 Action Memorandum, OIG recommended that FSA establish a review process to monitor changes to the program logic. In response to the prior review, FSA reported that the management analyst would obtain approval from the Assistant COR prior to implementing changes to the programs and databases. FSA did not develop written policies and procedures for authorizing and approving changes to computer programs used in the invoice process.

FSA stated that no written procedures had been developed to authorize changes because only one change had been made to the program to date. FSA stated that its process would be to use electronic mail whenever changes are necessary, but this process had not been documented. FSA has not had an independent verification and validation performed of the invoice preparation process to ensure that the programs and databases are operating as intended.

In July 2003, CSB began using a new program for determining invoice amounts for loan consolidations. The new program no longer uses an Access database to calculate the fees due the contractors for the loan consolidations portion of the invoice. When this new program was implemented, CSB staff reviewed a sample of consolidations from June 2003 and stated

commissions paid were appropriate. However, an independent evaluation of the entire invoice preparation process has not been conducted to ensure all commissions and fees paid were appropriate.

Without effective controls for authorization and approval of computer program changes, FSA is not able to prevent and detect unintentional changes that could affect invoice amounts. Documentation of computer program changes also serves as a historical record that may be needed to assess prior amounts paid to contractors. For the period September 2000 through March 2004, FSA paid \$346.6 million to the current PCA contractors through this system. An error in one or more of the formulas or programs used to calculate invoice amounts could result in significant improper payments. Without independent verification and validation of the invoice preparation process, FSA does not have assurance that the contractors are being paid appropriate amounts.

### **Procedures Were Not Developed to Ensure Continuity of Operations**

FSA did not develop procedures to ensure continuity of operations over the invoice preparation process. We found six FSA staff located in various offices performing separate parts of the invoice process. A management analyst developed and designed computer programs and databases used to evaluate contractors' compliance, and an information technology specialist developed the refund database. These staff performed the initial steps in the invoice preparation process. Several staff in CSB used the results of the programming and Access databases to complete the invoice preparation processes. An FSA staff member who maintained the CPCS performance measures also provided data to CSB staff to calculate incentive bonuses. FSA did not have written procedures to identify backup staff that could perform these processes in the event current staff are not available. Subsequent to our review, CSB stated that it had assigned backup staff to perform the part of the invoice process related to loan consolidations. Additional procedures are still needed to strengthen FSA's controls over other parts of the invoice process.

The management analyst who developed the software that determines invoice amounts is the only staff member familiar with all aspects of the process. This issue was also noted in the 1999 Action Memorandum. During our review, FSA stated that it had identified staff in other offices with computer programming knowledge that could serve as backups to provide computer-generated files. However, there were no written agreements to document this decision, or any training and familiarization provided to ensure that staff would be available to perform these functions. As previously stated, sufficient written documentation did not exist to allow recreation of the invoice preparation process in the event the computer programs and Access databases are not available. Without appropriate backup staff assigned and trained, and sufficient documentation of the functions of the programs and databases used, invoice processing operations could be disrupted if staff currently responsible are not available to perform these functions, or if the computer programs or Access databases are damaged or not available. As a result, payment amounts could not be calculated, possibly resulting in hardship to the contractors.

### **Recommendations :**

We recommend that FSA's Chief Operating Officer:

- 2.1 Develop and implement policies and procedures to provide assurance that collection data used to determine invoice amounts is retained and archived to support payments made to contractors.
- 2.2 Develop and implement policies and procedures to adequately document databases and computer programs that are used in the automated and computer generated invoice process.
- 2.3 Ensure that computer program changes are documented, authorized, and approved prior to implementation.
- 2.4 Assign and train alternate staff to perform invoice processing functions to ensure that operations will continue when other staff are not available.
- 2.5 Conduct an independent verification and validation of the computer-based invoice process to evaluate whether it appropriately determines compliance with laws, regulations, and contractual requirements, and calculates invoice amounts.

### **FSA Response and OIG Comments:**

In its response to the draft report, FSA stated that it maintains paper copies of records to support invoice payments and requested that this fact be clarified in the report.

OIG's position remains unchanged. The finding above stated that FSA did not maintain adequate computer-generated data to support payments to the contractors. As such, FSA cannot recalculate or recreate the payments made to the contractor. Voluminous paper reports would not allow FSA to effectively recalculate payments and validate that the invoice payment system was working properly.

FSA agreed with all five recommendations for this finding.

## **OBJECTIVE, SCOPE AND METHODOLOGY**

The objective of this review was to assess the accuracy of the calculations in the invoice payment process and determine if appropriate amounts were paid to PCA contractors. Because FSA did not adequately maintain computer files used to prepare invoices, we could not achieve our original objective. Our audit was limited to a review of the incentive payments made, and a review of internal controls over the invoice preparation process. We reviewed applicable laws

and regulations, Office of Management and Budget Circulars, Department policies and procedures, terms of the solicitation, task orders, and the statement of work. We also reviewed information from the former CO's contract files, including the solicitation for task order proposals, individual task orders, invoices, performance evaluation data, and other supporting documentation. We also interviewed staff in FSA and OCFO, including the former and current CO, and Assistant COR responsible for monitoring and administering PCA task orders, and staff who developed and participated in the invoice preparation process.

We obtained and performed a limited evaluation of computer-generated data files from the DMCS and the Access databases used in determining invoice amounts. Because FSA did not maintain complete computer files used to prepare invoices, we could not fully assess the accuracy of the calculations or the appropriateness of invoice amounts during our scope period.

We initially reviewed payments made to PCA contractors during the period October 1, 2001, through September 30, 2002. We expanded our scope to include a review of incentive payments made to contractors from the first incentive period, August 2001, through April 2004.

We relied on computer-processed data obtained from the Department's DMCS, Contracts and Purchasing Support System (CPSS), and Financial Management Support System (FMSS) to determine payments made to contractors. To test the accuracy of incentive bonuses, invoice payments, and contract values, we compared reports from CPSS with reports of payments from the Department's FMSS, monthly invoices submitted by the contractors, and duplicated selected computer processes. Based on these tests and assessments, we determined that the computer-processed data was not reliable for meeting our initial audit objective. As a result, we limited our objective to reviewing incentive payments and evaluating internal controls, and determined that computer-processed data was reliable for meeting our modified objective.

We conducted fieldwork at the Department of Education offices in Washington, DC, during the period February 2003 through October 2004. We held an exit conference with Department management and staff on October 4, 2004. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the modified scope of the review described above.

## **STATEMENT ON INTERNAL CONTROLS**

We have made a study and evaluation of the internal control structure of FSA's process for preparing invoices for amounts due to PCA contractors in effect February 2003 through October 2004. Our study and evaluation was conducted in accordance with Government Auditing Standards. For the purpose of this report, we assessed and classified the significant internal control structure into the following categories:

- Written policies and procedures,
- Invoice preparation processing, and

- Retention of computer generated data files.

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

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

Our assessment disclosed the following conditions in FSA's internal control structure over the invoice preparation process for PCA contractors, which, in our opinion, result in more than a relatively low risk that errors, irregularities and other inefficiencies may occur resulting in inefficient and/or ineffective performance.

- Incentive payments to PCA contractors were not consistent with task order terms,
- PCA collection data was not adequately maintained or archived,
- Manual and automated invoice preparation processes were not documented,
- Procedures were not developed for reviewing changes to program logic, and
- Procedures were not developed to ensure continuity of operations.

These weaknesses and their effects are fully discussed in the AUDIT RESULTS section of this report.

## **ADMINISTRATIVE MATTERS**

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System. Department 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 finding and recommendation 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.

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report represent the opinions of the Office of the 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. § 522), 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 provided to us during this review. Should you have any questions concerning this report, please call Michele Weaver-Dugan at (202) 245-6941. Please refer to the control number in all correspondence related to the report.

Sincerely,

Helen Lew /s/  
Assistant Inspector General for Audit Services

Attachment



**F E D E R A L  
S T U D E N T A I D**  
*We Help Put America Through School*

CHIEF OPERATING OFFICER

FEB - 2005

**TO:** Helen Lew  
Assistant Inspector General for Audit Services  
Office of Inspector General (OIG)

**FROM:** Theresa S. Shaw *TSS*  
Chief Operating Officer

**SUBJECT:** Draft Audit Report Control Number ED-OIG/A19-D0005  
"Unauthorized Incentives Paid to Private Collection Agency (PCA)  
Contractors"

Thank you for the opportunity to review and comment on Draft Audit Report Control Number ED-OIG/A19-D0005. Our response was coordinated with the Office of the Chief Financial Officer. Please note, although we agree with the major findings and the recommendations in this Draft Audit Report, we continue to disagree with the OIG's interpretation of certain facts. The attached report summarizes our response and details our suggested changes to the final audit report.

If you have any questions, you may contact the Contracting Officer's Representative, Rich Galloway, at 202-377-3611 or the Contracting Officer, Roscoe Price, at 202-377-3609.

Attachment

**OIG Finding 1—Incentive Payments to PCA Contractors Were Not Consistent with Task Order Terms.**

We agree with the overall finding that certain incentive payments were not consistent with task order terms. However, we believe that by combining the two task order pools, the OIG has mischaracterized the inconsistency. In the small business pool, ED paid only one bonus, rather than the three specified in the task orders. Additionally, ED paid this bonus at a percentage that was lower than the one specified in the task orders. Although Clause H.4 of the task orders gives ED the right to modify the bonus payment plan at any time, we agree that we did not adequately document this change in the bonus payment plan at the time. The Contracting Officer has now modified the small business pool task orders to reflect the revised bonus payment plan.

We request that the OIG revise the statement under Finding 1 that reads, “the Department paid incentive bonuses to four PCA contractors, rather than three contractors as specified in the task order contracts.” As explained above, there are two separate pools of task orders each of which specified that the Department would pay bonuses to the top three PCAs. Thus, it would be accurate to say “the Department paid incentive bonuses to four PCA contractors, rather than *six* contractors as specified in the task order contracts.” Alternatively, it would also be accurate to say, “the Department paid incentive bonuses to *only one* PCA contractor *in the small business pool*, rather than three contractors as specified in the task order contracts.”

We request that the OIG delete or revise the statement under Finding 1 that reads, “The small business was not one of the three top-performing contractors and therefore did not qualify for the bonus payments.” As noted above, each small business that received a bonus had the highest Competitive Performance and Continuous Surveillance (CPCS) rating in the small business pool and did indeed qualify for the bonus payments. If we were to agree with the OIG’s interpretation that the bonuses should be based on the top CPCS performance ratings in both pools together, then the small business’s CPCS scores would still place it among the top three in every CPCS period. (However, we believe it is inappropriate to equate small business CPCS scores with those in the unrestricted pool since these represent two separate rating systems with contractors competing solely against other contractors that received task orders under the same competition.)

We request that the OIG delete or revise the statement under Finding 1 that reads, “We also noted one instance in which two contractors were paid the highest bonus rate, when only one contractor was eligible for that rate.” Based on the Contracting Officer’s reading of section B.3(d) of the task order, it was determined that both contractors were entitled to the higher bonus rate. The OIG further notes that the performance statistics for the period in question ranked one contractor above the other. The Contracting Officer determined that the two top performers were “statistically equivalent” and essentially tied for the number one position. The Contracting Officer determined it was fair and consistent with the task order to give both contractors a bonus.



The Contracting Officer also determined that the task orders require payment of a 5% bonus to both contractors if both finished in first place. The Contracting Officer is the ED official responsible for interpreting the terms of the task order. Under the Contracting Officer's determination, it is not the case that "only one contractor was eligible for that rate."

The OIG properly faults the Department for the lack of adequate documentation of these decisions. Although the Contracting Officer recorded the decisions in an e-mail message, the documentation was misfiled and cannot be recovered. The Contracting Officer has since modified the task orders to clarify and define what constitutes a tie and how that eventually will be handled. Copies of those modifications are filed in the official contract file.

We request that the OIG delete or revise the statement under Finding 1 that reads, "FSA received no additional services for paying the second place contractor additional funds." We do not agree that FSA did not receive an additional benefit. Two contractors performing at the top level of performance resulted in increased collections and account resolutions. This was a substantial benefit to FSA that merited an appropriate bonus. Further, there was no contractor in second place, since as noted above, the Contracting Officer determined that both contractors were in first place.

### **OIG Recommendations, Finding 1**

*1.1 Ensure that incentive bonuses paid to contractors are consistent with the terms of the PCA task orders and are based on appropriate bonus rates.*

**FSA Response**—We agree with this recommendation. Bonus payments are now consistent with the task order terms as modified by the Contracting Officer. The Contracting Officer's Representative will submit any future proposed changes to the Contracting Officer to incorporate into task order modifications.

*1.2 Ensure that appropriate actions are taken to document decisions, and if appropriate, to modify the task orders, when decisions are made that impact the terms and conditions.*

**FSA Response**—We agree with this recommendation. As noted, the Contracting Officer has now modified the task orders to reflect previous modifications in the bonus payment plan. Any further changes will be reflected in future task order modifications. The Contracting Officer will place supporting documentation for modifications in the contract file as required by Office of the Chief Financial Officer procedures.

*1.3 Ensure that contractors are informed of any changes in the performance incentive plan.*

**FSA Response**—We agree with this recommendation. Although the government has the unilateral right to change the bonus payment plan, we intend to exercise that right by issuing task order modifications.

**OIG Finding 2—Internal Controls Over the Invoice Preparation Process Need Improvement.**

We agree with this finding, however, we believe a clarification is necessary. The OIG correctly notes that FSA did not always retain electronic copies of database files. While we do not question that electronic copies of records should be maintained, the wording in the OIG report leads the reader to conclude that no records were available to support invoice payments. However, as the OIG acknowledged in the exit interview, FSA did maintain paper copies of records. We request that this be clarified in the report.

**OIG Recommendations, Finding 2**

2.1 Develop and implement policies and procedures to provide assurance that collection data used to determine invoice amounts is retained and archived to support payments made to contractors.

**FSA Response**—We agree with this recommendation. FSA is retaining data used to determine invoice amounts and will incorporate appropriate requirements into its written procedures.

2.2 Develop and implement policies and procedures to adequately document databases and computer programs that are used in the automated and computer generated invoice process.

**FSA Response**—We agree with this recommendation. FSA is retaining data used to determine invoice amounts and will incorporate appropriate requirements into its written procedures.

2.3 Ensure that computer program changes are documented, authorized, and approved prior to implementation.

**FSA Response**—We agree with this recommendation. FSA will develop and implement written procedures for documenting, authorizing and approving computer program changes related to the PCA invoice process.

2.4 Assign and train alternate staff to perform invoice processing functions to ensure that operations will continue when other staff are not available.

**FSA Response**—We agree with this recommendation. FSA has assigned alternate staff for all invoice processing functions and is continuing to train them.

- 2.5 Conduct an independent verification and validation of the computer-based invoice process to evaluate whether it appropriately determines compliance with laws, regulations, and contractual requirements, and calculates invoice amounts.

**FSA Response**—We agree with this recommendation. FSA will conduct an independent verification and validation of the computer-based invoice process for PCA task orders.

cc: Chief Financial Officer