

MEMORANDUM

DATE: September 24, 1998

TO: Dr. David A. Longanecker
Assistant Secretary for Postsecondary Education

FROM: Richard J. Dowd
Regional Inspector General
for Audit, Chicago, Illinois

SUBJECT: *Audit of the Guarantor and Lender Oversight Service's Oversight of Lenders Participating in the Federal Family Education Loan Program*, Control Number: A0570015)

Attached is our Management Information Report that informs you of the results of our audit of the Guarantor and Lender Oversight Service's (GLOS) oversight of lenders. Please let us know what actions, if any, you plan to take as a result of the issue we describe.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act. Copies of this report have been provided to the offices shown on the distribution list enclosed in the report.

We appreciate the cooperation given us during our review. If you have any questions concerning this report, please call me at 312-886-8647.

ATTACHMENT

Audit of the Guarantor and Lender Oversight Service's
Oversight of Lenders Participating in the Federal Family
Education Loan Program

MANAGEMENT INFORMATION REPORT



Control Number A05-70015
September 1998

Our mission is to promote the efficient
and effective use of taxpayer dollars
in support of American education



U.S. Department of Education
Office of Inspector General
Chicago, IL

NOTICE

Statements that management practices need improvement, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determination of corrective action to be taken will be made by appropriate Department of Education officials. This report may be released to members of the press and general public under the Freedom of Information Act.

Summary

The purpose of this Management Information Report is to provide the results of our audit of the sufficiency of the Guarantor and Lender Oversight Service's (GLOS) oversight of lenders participating in the Federal Family Education Loan (FFEL) program. In general, we found that GLOS has controls in place to ensure that the required lender audits are completed. Our audit disclosed that nearly all lenders with outstanding loan portfolios equal to or greater than \$10 million are audited by Independent Public Accountants (IPA).

We also found that GLOS management has developed and disseminated to all its review staff a detailed lender review guide. As part of each lender review, GLOS review specialists are:

1. Completing all applicable steps in the guide;
2. Documenting their work; and
3. Reviewing the audit report issued by the IPA if one is available.

However, we did find significant overlap among IPA audits, GLOS reviews, and guaranty agency reviews. GLOS managers believe that overlap with IPAs is necessary because they question the quality of IPA audits.

To reduce the overlap and increase the resources available to manage other areas of the FFEL program, we recommend that:

1. GLOS compare specific data on the results of its lender reviews to the results of IPA audits;
2. If the comparison discloses significant differences, immediately refer the IPA audit to the Office of Inspector General (OIG) for quality control review;
3. GLOS require guaranty agencies to report comparable data regarding their lender reviews; and
4. As part of the continuing dialog between the Office of Postsecondary Education (OPE) and the OIG, meet quarterly to assess the results of the comparisons and develop appropriate corrective actions.

**Audit Requirement
Meant to Provide
Reasonable
Assurance of
Lender
Compliance**

Section 428(b)(1)(U)(iii) of the Higher Education Act of 1965, as amended, requires all lenders participating in the FFEL program to have an annual compliance audit. In Dear Colleague Letter 95-L-176, the Department provided that the deadline for completion and submission of the initial audit completed according to this requirement would be September 30, 1995. However, the acts providing fiscal years 1996 and 1997 appropriations for the Department (Pub. L. 104-134 and 104-208) included provisions prohibiting the Department from using funds made available under the acts to enforce the lender compliance audit requirement against lenders with loan portfolios equal to or less than \$5 million. Though the provisions did not eliminate the audit requirement for lenders with this volume of FFEL program loans, the provisions did delay the date by which the audits must be completed. Therefore, the Department currently requires only lenders originating and/or holding loans totaling \$5 million or more to have audits completed annually. Those lenders originating and/or holding \$10 million or more and other lenders whose audit reports disclose findings of noncompliance must submit their independent audit reports to the Department by September 30. Lenders originating and/or holding FFEL program loans totaling \$5 million but less than \$10 million for any audit period need not submit the report to the Department unless requested to do so. We noted that GLOS has controls in place to ensure that the required audits are completed. We also found that nearly all lenders with outstanding loan portfolios equal to or greater than \$10 million complied with the requirement and submitted audit reports to the Department.

According to the audit guide, the purpose of the audit requirement is to gain assurance that (1) the lender's ED Form 799s are materially correct and in conformity with applicable laws and regulations, and (2) the lender has complied with the statutory and regulatory provisions applicable to its participation in or administration of the FFEL program. Further, the reports required should provide the Department's program managers with assurance that lender management's assertions relative to the matters specified in the audit guide are fairly stated in all material respects.

**GLOS and
Gurantor Reviews
of Lenders Overlap
with IPA Audits**

Despite the assurances that the lender audit requirement should be providing, we found significant overlap between IPA audits and the reviews conducted by GLOS and guaranty agencies. Using fiscal years 1995 and 1996 data that GLOS provided, we noted that 495 lenders should have submitted audit reports to the Department because they had portfolios of \$10 million or more. Using fiscal years 1995 through 1997 data that GLOS provided, we found that 220 of the 789 reviews guaranty agencies completed overlapped

IPA audits. We also found that 68 of the 406 reviews GLOS completed overlapped with IPA audits.

GLOS' lender review guide (we were told that the revised guaranty agency lender review guide will be very similar to GLOS' lender review guide) and our review of a sample of GLOS' lender review files indicate that GLOS routinely obtains a copy of the IPA audit report as part of each lender review. However, we found that GLOS review specialists do not use those reports to focus or restrict the scope of their reviews. Instead, review specialists adhere to the guide, generally complete all applicable steps, and document their work in the form of work papers on each review.

By completing all applicable steps regardless of the results of the IPA audit, GLOS is duplicating some of the work that the IPAs are required to perform. If GLOS management and staff believed they could use the IPAs' results to focus or streamline reviews, review specialists would be available to work on other high priority projects. We recognize that some overlap might be necessary until GLOS' concerns are resolved. However, given the number of GLOS reviews conducted for fiscal years 1995 and 1996, and our observations that each review, at a minimum, takes approximately one staff month to complete, relying on IPA audit results could provide GLOS management with about 3 staff years annually for other priorities.

GLOS management and review specialists do not believe they can use IPA audits to focus their reviews. Our audit disclosed a number of potential reasons for GLOS' concerns. First, the IPAs' work could be substandard. The OIG's non-federal audit team's initial quality control reviews disclosed that not all IPA work was conducted according to the guide or government auditing standards. Second, the audit guide might need to be revised. Both OPE and the OIG have recognized this possibility and are taking steps to improve the lender audit guide. Third, GLOS management and review specialists expect more than the reasonable assurance lender audits are intended to provide. We were told that GLOS reviews disclosed problems that IPA audit reports did not, even though GLOS and the IPA reviewed the same lender for the same time period. However, GLOS reviews can be very detailed. Review specialists pursue and report on every potential instance of noncompliance. IPAs, on the other hand, base the extent of their testing on materiality. We believe that a combination of these reasons is causing the overlap.

GLOS and the guaranty agencies are best positioned to gather data on the differences between the results of IPA audits and lender reviews completed by GLOS and the guaranty agencies. GLOS routinely obtains IPA audit reports as part of its lender reviews. Also, GLOS issues review guidance to the guarantors who conduct lender reviews. Both GLOS and the guarantors, as the last step of each lender review, could, with minimal effort, compare the results of their reviews with the results disclosed in the IPA audit reports.

Recommendations

GLOS could further efforts to provide improved fiscal management of the FFEL program by:

1. Comparing GLOS lender review results with the results of the IPA audit. The comparative data could include (a) the scope of GLOS' review and IPA audit, (b) whether the lender was required to submit the audit report, (c) the nature of the differences in results, (d) the type of audit engagement, (e) whether the lender used a loan servicer, and (f) any other factor GLOS believes might have influenced the review or audit.
2. Referring the IPA audit immediately to the OIG non-Federal audit team for quality control review if GLOS' comparison discloses significant differences.
3. Requiring guarantors to report comparable data regarding guarantor lender reviews.
4. As part of the continuing dialog between OPE and OIG on audit quality, meeting quarterly to assess the results of GLOS and guarantor comparisons and develop appropriate corrective action for lender audits.

Audit Objective, Scope, and Methodology

The objective of our audit was to evaluate GLOS' oversight of lenders and determine whether controls were sufficient to provide reasonable assurance that the lenders were complying with federal regulations. The objective included IPA audits, GLOS' lender reviews, and guaranty agencies' lender reviews. A secondary objective was to ensure that these three types of oversight activities did not result in duplication. To achieve our objectives, we collected information on the universe of lenders participating in the FFEL program, lender audit reports, guaranty agency reviews of lenders conducted for fiscal years 1995 through 1997, and GLOS reviews of lenders conducted during fiscal years 1995 through 1997. The data that GLOS provided is the only data available (both to us and GLOS). Though we did not verify the accuracy of

data, we did assess the reasonableness of the data. We reviewed the files from (a) 6 of 12 lender reviews conducted by one GLOS region between October 1, 1994 and September 30, 1997, and (b) 5 of 164 lender reviews conducted by another region over the same period. We selected our sample from data GLOS provided us, limiting our universe to those reviews that were not part of GLOS' origination fee project. We also interviewed officials from OPE and OIG, and managers and staff from two GLOS field offices. Finally, we accompanied GLOS staff on two lender reviews.

We conducted our field work at GLOS' offices in Washington, DC, New York, NY, and Dallas, TX from November 5, 1997 through March 11, 1998. We conducted additional analyses at our Chicago office from March 12 through July 15, 1998.

We conducted our audit according to government auditing standards applicable to the scope of review described.

**Management
Controls Statement**

As part of our audit of GLOS' oversight of lenders participating in the FFEL program, we conducted a limited assessment of the management controls, policies, procedures, and practices applicable to GLOS' oversight of lenders. We performed our limited assessment to determine the level of control risk for determining the nature, extent, and timing of our tests to accomplish the audit objectives. For the purpose of this audit, we classified the significant controls into the following categories:

- < Use of IPA lender audits;
- < Use of Guaranty agency reviews of lenders; and
- < Procedures followed during GLOS reviews of lenders.

Because of inherent limitations, a study and evaluation made for the limited purpose described would not necessarily disclose all material weaknesses in GLOS' management controls structure. Our assessment did not disclose any material management control weaknesses that affected GLOS' ability to oversee lenders. However, our assessment did disclose overlapping coverage between lender audits and reviews, which, if corrected, would increase the resources available to strengthen GLOS' management controls.

**REPORT DISTRIBUTION LIST
CONTROL NUMBER A0570015**

Action Official/Auditee

No. of Copies

Dr. David A. Longanecker
Assistant Secretary for Postsecondary Education
Office of Postsecondary Education
U. S. Department of Education

Other ED Officials

Deputy Assistant Secretary for Student Financial Assistance Programs	1
Director, Guarantor and Lender Oversight Service	1
Director, Accounting and Financial Management Service, OPE	Electronic Copy
Supervisor, Post Audit Group Office of the Chief Financial Officer	1
Office of Public Affairs	1

ED-OIG Officials

Inspector General	Electronic Copy
Deputy Inspector General	Electronic Copy
Director, Planning, Analysis, and Management Services	Electronic Copy
Assistant Inspector General for Audit	Electronic Copy
Assistant Inspector General for Investigations	Electronic Copy
Assistant Inspectors General for Operations	Electronic Copies (2)
Director , Advisory and Assistance, SFA	Electronic Copy
Director, PAMS	Electronic Copy
Regional Inspectors General for Audit	Electronic Copies (7)