

## **MEMORANDUM**

**TO:** Greg Woods  
Chief Operating Officer  
Student Financial Assistance

**FROM:** Lorraine Lewis

**SUBJECT:** FINAL AUDIT REPORT  
Audit of the Illinois Student Assistance Commission's  
Administration of the Federal Family Education Loan Programs  
Control Number ED-OIG/A05-90002

Attached is our subject report presenting our findings and recommendations resulting from our audit of the Illinois Student Assistance Commission's administration of the Federal Family Education Loan programs.

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

If you have any questions or wish to discuss the contents of this report, please contact Richard J. Dowd, Regional Inspector General for Audit, Chicago, Illinois at 312-886-6503.

Please refer to the above audit control number in all correspondence relating to this report.

Attachment

**Control Number ED-OIG/A05-90002**

Mr. Larry E. Matejka  
Executive Director  
Illinois Student Assistance Commission  
500 West Monroe Street, Third Floor  
Springfield, Illinois 62704

Dear Mr. Matejka:

Enclosed is our report entitled *Audit of the Illinois Student Assistance Commission's Administration of the Federal Family Education Loan Programs*. We discussed the contents of this report with your directors and Chief Program Officer on August 18, 1999. The report incorporates the comments made during that discussion and those provided in response to our finding point sheets. If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Departmental action on the audit:

Greg Woods, Chief Operating Officer  
Student Financial Assistance  
U.S. Department of Education  
Regional Office Building, Room 4004  
7<sup>th</sup> and D Streets, S.W.  
Washington, D.C. 20202-5132

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

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

Mr. Larry E. Matejka  
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If you have any questions or wish to discuss the contents of this report, please contact Richard J. Dowd, Regional Inspector General for Audit, Chicago, Illinois at 312-886-6503. Please refer to the audit control number in all correspondence relating to this report.

Sincerely,

Lorraine Lewis

Enclosure

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AUDIT OF THE ILLINOIS STUDENT ASSISTANCE  
COMMISSION'S ADMINISTRATION OF THE FEDERAL  
FAMILY EDUCATION LOAN PROGRAMS

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**FINAL AUDIT REPORT**



**Control Number ED-OIG/A05-90002**  
**December 1999**

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Office of Inspector General  
Chicago, Illinois

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## **NOTICE**

Statements that financial and/or managerial practices need improvement or recommendations that costs questioned be refunded or unsupported costs be adequately supported, and recommendations for the better use of funds, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations on these matters will be made by the appropriate U.S. 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, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

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# Executive Summary

Our audit disclosed that the Illinois Student Assistance Commission (ISAC) generally administered the Federal Family Education Loan (FFEL) programs according to federal laws and regulations. Our review of 59 randomly selected claims (from a universe of 22,173) disclosed only one significant instance of noncompliance and identified two potential weaknesses in ISAC's system of management controls. Consequently, we did not expand our review beyond our initial probe sample. We recommend that Student Financial Assistance instruct ISAC to remit \$17,084 of reinsurance paid for a loan that a lender failed to convert to repayment timely. To reduce the risk of ISAC improperly paying future claims and ensure ISAC has adequate documentation to support its reinsurance requests, we recommend Student Financial Assistance instruct ISAC to (1) revise its claims review procedures and (2) strengthen its management controls over its computerized imaging process. ISAC generally concurred with our findings and recommendations. For additional information on ISAC; the FFEL programs; our objectives, scope, and methodology; and ISAC's management controls, see Appendices A, B, and C, respectively.

## Audit Results

### **Enhance Claims Review Procedures to Ensure Lenders' Certifications Are Fully Supported by Payment and Collection Histories**

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#### **ISAC Improperly Paid a \$17,084 Claim to a Lender That Failed to Convert the Loan to Repayment Timely**

We randomly selected a sample of 59 claims from a universe of 22,173 claims and reviewed the claim packets to ensure the lender adhered to all applicable due diligence requirements. (See **Appendix B** for a detailed description of our sample selection methodology.) We found that ISAC improperly paid a claim for \$17,084 for a loan that the lender failed to convert timely to repayment.

Based on the records the lender submitted to ISAC and maintained in ISAC's file, the borrower's last day of school was May 8, 1996. The borrower's six-month grace period should have ended about November 8, 1996. The lender claimed, however, that it did not know the borrower had left school until it received a Student Status Confirmation Report from ISAC on July 3, 1997. The lender then established a first payment due date of August 4, 1997, even though other information in the file clearly showed that the school informed the lender on October 10, 1996, that the borrower had left school. The lender should have established a first payment due date no later than December 23, 1996, and started its collection activities shortly thereafter. Instead, the lender did not begin its collection activities until August 19, 1997, a gap of 239 days.

According to Title 34 Code of Federal Regulations (34 CFR) 682.406(a)(1) and (3), ISAC is entitled to reinsurance payments on a loan only if the lender exercised due diligence in making, disbursing, and servicing the loan. The lender must provide accurate collection and payment histories with the default claim showing that the lender exercised due diligence in collecting the loan through collection efforts meeting the requirements of 34 CFR 682.411. For the purposes of this section, the lender must establish the due date of the first payment no later than 45 days following the end of the grace period and file a default claim by the 270<sup>th</sup> day of delinquency. At no point may the lender permit a gap in collection activity of more than 45 days. If a gap of 46 days or more occurs, or the lender fails



to file the claim by the 270<sup>th</sup> day of delinquency, the agency should reject the claim and cancel the loan guarantee. The cancellation is effective from the date of the earliest unexcused violation.

**ISAC's Account Analysts  
Do Not Thoroughly Review  
All Claim Packets**

We concluded that the error rate did not justify expanding our sample to identify the full extent of the problem. However, the improper payment demonstrates a weakness in ISAC's claim review procedures. ISAC's account analysts do not thoroughly review all claim packets. Instead, ISAC relies on the lenders' certifications that the claims are legitimate, the lenders have completed all the necessary due diligence, and the lenders' collection and payment histories support the certifications. ISAC requires the lender to submit a Request for Preclaim Assistance and Claim Reimbursement form, which includes all pertinent loan information (including any payments the borrower made). As proof of due diligence, ISAC requires the lender to certify and sign a Due Diligence/Cure Checklist stating it performed the required due diligence activities. ISAC also requires the lender to submit its entire collection and payment histories (usually computer printouts). However, ISAC's account analysts do not routinely review collection and payment histories and compare that information to activities the lender reported on the Request for Preclaim Assistance and Claim Reimbursement form and Due Diligence/Cure Checklist.

**Risks Transferred to ED**

ISAC's claims review policy transfers the potential risks inherent in the reduced claim file review to ED. Relying on the lenders' certifications does not provide ED reasonable assurances that claims are legitimate and the lender completed all required due diligence. Any claims that ISAC might erroneously pay would only be detected through limited tests during subsequent audits and program reviews.

***RECOMMENDATIONS***

We recommend Student Financial Assistance instruct ISAC to:

1. Remit \$17,084 of reinsurance paid for the loan that the lender failed to convert to repayment timely; and
2. Enhance its claims review procedures and ensure that account analysts, at a minimum, make sure the information on the Due Diligence/Cure Checklist and Request for Preclaims Assistance and Claim Reimbursement form are supported by the lenders' collection and payment histories. ISAC could limit the review to the loan's conversion to repayment and the latest 180-day period of delinquency.

***Auditee Comments***

In ISAC's response to our point sheet regarding the incorrectly paid claim, ISAC stated that the lender indicated it did err in completing the Due Diligence/Cure Checklist, and the student's last day of attendance was May 8, 1996. However, ISAC did not agree that its account analysts should thoroughly review all the lenders' collection and payment histories. ISAC officials told us that they:

...do require all lenders to provide their collection history by having the lender recap its collection activities that are required under regulation and certify thereto on the Due Diligence/Cure Checklist; this checklist is thoroughly reviewed by the Claims Analysts [account analysts].

***Auditor's Response***

We made minor changes to this finding based on ISAC's comments.

## **Strengthen Controls Over Imaging to Ensure Complete and Accurate Copies of Claim Packets**

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### **ISAC Did Not Have All the Documents Lenders Submitted With Their Request for Claim Reimbursement**

Our review of 59 claims from a universe of 22,173 claims that ISAC paid between October 1, 1997, and September 30, 1998, disclosed that ISAC was missing pages from 9 claim packets. Six claim packets were missing pages from the collection or payment histories from the latest 180-day period of delinquency. Three other claim packets were missing collection histories (one was also missing the payment history) prior to the latest 180 days of delinquency.

According to 34 CFR 682.406 (a)(3), a guaranty agency is entitled to reinsurance payments on a loan only if the lender provided accurate collection and payment histories. The histories must be sufficient to support guarantor review for claim payment and show that the lender exercised due diligence in collecting the loan meeting the requirements of 34 CFR 682.411. The Guaranty Agency Common Manual, which ISAC has adopted, requires lenders to submit the following nine items of documentation so the guaranty agency can determine the claim's validity:

1. Guarantor's Claim Form;
2. Original Application and Promissory Note;
3. Assignment of Promissory Note;
4. Evidence of Disbursement;
5. Out-of-School Date Information;
6. Repayment Disclosure;
7. Deferment/Forbearance Documentation;
8. Collection History; and
9. Complete Payment History.

### **ISAC Might Not Have Adequate Documentation to Support Its Request for Reinsurance**

Without a complete and accurate computer image of the claim packet, ISAC might not have adequate documentation to support its request for reinsurance or support that the lender serviced the claim properly. When we asked for support for the nine claims, ISAC needed to contact the lender to obtain the missing documents.

Strengthen Controls Over Imaging to Ensure Complete and Accurate Copies of Claim Packets

**ISAC's Management Controls for Imaging Do Not Ensure Complete and Accurate Computer Images of Claim Packets**

ISAC's imaging policies and procedures do not ensure that ISAC maintains complete and accurate computer images of original claim packets. After it images a claim packet, ISAC destroys the paper documents, leaving the computer image as its only evidence of its right to reinsurance.

ISAC's imaging personnel only check to make sure the first five documents are imaged correctly. These main documents include the Request for Preclaims Assistance and Claim Reimbursement form and the Due Diligence/Cure Checklist. ISAC's imaging personnel do not review the rest of the claim packet to ensure all of the collection and payment histories, including those covering the loan's conversion to repayment and latest 180-day period of delinquency, are imaged. These procedures do not ensure ISAC has an imaged copy of all the documentation the lender submitted.

We spoke with representatives from two other guaranty agencies. We learned their imaging personnel ensure that every paper document is imaged prior to destruction.

***RECOMMENDATIONS***

We recommend Student Financial Assistance instruct ISAC to improve management controls over imaging to ensure it keeps a complete and accurate computer image of all the documentation the lender submitted to support its request for claim reimbursement.

***Auditee Comments***

ISAC stated that it believes that the lender submitted the pages correctly but, through clerical or machine malfunction, ISAC did not image the missing pages. ISAC did not believe it needed to maintain an exact image of the entire claim packet the lender submitted. Instead, ISAC believes that ensuring it has the Request for Preclaims Assistance and Claim Reimbursement form and Due Diligence/Cure Checklist (which contains the lender's certified recap of the collection history) is sufficient evidence to support its right to reinsurance and that the lender serviced the account according to the regulations.

Strengthen Controls Over Imaging to Ensure Complete and Accurate Copies of Claim Packets

***Auditor's Response***

We still believe ISAC needs to maintain an imaged copy of the entire claim packet the lender submitted.

## Background

### Federal Family Education Loan Programs and Guaranty Agencies

Title IV of the Higher Education Act of 1965, as amended, authorizes several FFEL programs. These programs include the Federal: (1) Stafford Loan, which encourages making loans to eligible undergraduate, graduate, and professional students; (2) Supplemental Loans for Students, in effect for periods of enrollment beginning prior to July 1, 1994, which encouraged making loans to eligible graduate, professional, independent undergraduate, and certain dependent undergraduate students; (3) PLUS, which encourages making loans to parents of eligible, dependent undergraduate students; and (4) Consolidation Loan, which encourages making loans to eligible borrowers for the purpose of consolidating their payment obligations.

A guaranty agency guarantees a lender against losses due to borrower default on FFEL loans, and ED reinsures the agency for all or part of the default claims the agency pays to lenders. As part of the claim process, a guaranty agency reviews claim packets to determine that the lender exercised due diligence in collecting loans. The collection efforts must meet the requirements of 34 CFR 682.411 and ED Dear Guaranty Agency Director letter 88-G-138 dated March 11, 1988. All regulatory citations in this report are to the compilations dated December 31, 1997.

### Description of ISAC

In 1957, the Illinois General Assembly created ISAC (originally called the Illinois State Scholarship Commission) to provide all Illinois residents access to higher education. ISAC is a State agency backed by the faith and credit of the State of Illinois and has three different locations (Springfield, Chicago, and Deerfield, Illinois). Its main operations are in Deerfield, Illinois.

ISAC guarantees loans for qualified borrowers for use at any approved institution of higher learning, provided the borrower is eligible for a loan under the Higher Education Act of 1965. All approved lenders must execute an ISAC Lender Agreement prior to participating in the FFEL program through ISAC. The lenders must have received ED approval prior to executing a Lender Agreement. ISAC

## Appendix A - Background

will cancel a guarantee if the lender fails to comply with Federal regulations or ISAC's rules or procedures.

According to its computerized records, ISAC paid lenders for 22,173 claims (for which ED paid ISAC reinsurance) from October 1, 1997, through September 30, 1998. The total amount of all claims was \$125,075,481. Lenders submitted claims for the following reasons:

<b>Reason</b>	<b>Number of Claims</b>	<b>Amount of Claims</b>
Slow Pay (Default)	19,902	\$110,222,320
Bankruptcy	1,325	\$7,892,993
Disability	542	\$4,298,658
Death	370	\$2,523,639
Closed School	22	\$73,278
False Certification	4	\$12,307
Others	8	\$52,286
<b>Total</b>	<b>22,173</b>	<b>\$125,075,481</b>

## Objectives, Scope, and Methodology

### Objectives and Scope

The objective of our audit was to determine whether ISAC complied with federal laws and regulations governing the FFEL programs during the period October 1, 1997, through September 30, 1998. Specifically, we wanted to ensure ISAC adhered to laws and regulations relating to ED's payment to ISAC of reinsurance on lender claims. We focused on ISAC's claim review and approval procedures and the adequacy of ISAC's supporting documentation for claims paid.

### Methodology

To accomplish our audit objective, we talked to ED officials, key ISAC officials and staff, and representatives from the State of Illinois' Auditor General's office and its special assistant auditors. We also reviewed written policies and procedures, reports on reviews and audits of ISAC conducted by other entities, and claim packets that lenders submitted. We reviewed 59 claims selected from ISAC's universe of claims paid to lenders from October 1, 1997, to September 30, 1998.

### Sampling and Claim Review Methodology

To select claims for review, we first defined the sampling unit, universe, and sampling frame. We analyzed the sampling frame and identified certain characteristics that we used to stratify our universe. We first divided our sampling frame by why (slow pay/default, bankruptcy, disability, death, closed school, false certification, and other) the lender submitted the claim. Next we divided our slow pay claims universe into 8 different strata based on the number of claims each lender submitted. We identified 6 lenders that submitted 1,000 or more claims during the audit period. We considered each its own strata. We divided the remaining lenders' claims into 2 strata.

We randomly selected 52 slow pay claims, 15 from the first strata, 5 from each of the next 5 strata, 9 from the 7<sup>th</sup> strata, and 3 from the 8<sup>th</sup> strata. We also randomly selected 2 claims each from the bankruptcy, disability, and death strata, and 1 claim each from the closed school and false certification strata. (Note: ISAC incorrectly entered the reason for the false certification claim we selected;



## **Appendix B - Purpose, Objectives, Scope, and Methodology**

therefore, we eliminated that claim from our review.) We used a random number generator to select a sample for each strata.

For our review of the claims, we developed a spreadsheet to capture the information we collected through our review of ISAC's claim files and data on ISAC's computer system. The spreadsheet helped us determine whether the lender exercised due diligence in servicing the loan, included all required documentation, and filed the claim timely.

### **Reliability of Computer-Processed Data**

To achieve our audit objectives, we extensively relied on computer-processed data in ISAC's Illinois Guaranteed Loan Program Student Databases. We assessed the reliability of this data, including relevant general and application controls, and found them to be adequate. We tested the accuracy, authenticity, and completeness of the data by comparing source records to computer data and duplicating selected computer processes. Based on these assessments and tests, we concluded that the data are sufficiently reliable for use in meeting this audit's objectives.

We performed field work at ISAC in Deerfield, Illinois from November 16, 1998, through March 25, 1999. We completed additional work in our Chicago office from March 29 through July 1, 1999. We performed our audit according to Government Auditing Standards appropriate to the limited scope of audit described.

## Statement on Management Controls

### Statement on Management Controls

As part of our review, we assessed ISAC's system of management controls, including policies, procedures, and practices applicable to its administration of the FFEL programs. We performed our assessment to determine the level of control risk for determining the nature, extent, and timing of our tests to accomplish the audit objectives.

To make our assessment, we identified significant controls and classified them into the following three categories:

- C Receipt of Claim Request from Lender
- C Review and Approval of the Claim Packet
- C Voucher Preparation and Payment of the Claim

Because of inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in ISAC's management controls. However, our assessment disclosed two management control weaknesses that could adversely affect ISAC's ability to administer the FFEL programs. Our limited scope audit identified weaknesses in controls specifically related to ISAC's review of lenders' requests for claim payment and ISAC's maintenance of supporting documentation (See **Audit Results** for an explanation of the two weaknesses).

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CONTROL NUMBER ED-OIG/A05-90002**

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