
REVIEW OF COLLECTION ACTIVITIES AT UNGER AND ASSOCIATES

FINAL AUDIT REPORT



Audit Control Number ED-OIG/A06-90011
February 2000

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and effective use of taxpayer dollars
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U.S Department of Education
Office of Inspector General
Dallas, Texas

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. Determinations of corrective action to be taken will be made by 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, if requested, 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

THE INSPECTOR GENERAL

FEB - 8 2000

Control Number ED-OIG/A06-90011

William H. Eschrich, Chapter 11, Trustee
Unger Estate
Unger and Associates, Inc.
P. O. Box 794733
Dallas, Texas 85379-4733

Dear Mr. Eschrich:

This is our audit report, *Review of Collection Activities at Unger and Associates*. The report incorporates the comments you provided in response to a draft report which was provided to you. 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 U.S. Department of Education official, who will consider them before taking final Departmental action on the audit:

Mr. Greg Woods, Chief Operating Officer
Student Financial Assistance
ROB-3, Room 4004
7th and D Streets, SW
Washington, DC 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, we request receipt of your comments within 30 days.

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

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

Sincerely,

A handwritten signature in cursive script that reads "Lorraine Lewis".

Lorraine Lewis

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EXECUTIVE SUMMARY

Unger and Associates (Unger), a collection agency headquartered in Plano, Texas, stopped remitting collections of Federal Perkins Loans to most of its client schools beginning in early 1998. Unger provided records that showed as of June 1999 that it owed a balance of \$833,897 in Federal Perkins Loan collections to 177 schools (one school listed had a negative balance). At least \$13,039 of the \$833,897 was collected for three schools that closed. An Unger official stated that the funds were used for general operating expenses. We were unable to confirm the accuracy of the amount collected or how it was used due to the condition of Unger records. Further, Unger was unwilling to provide a management representation letter attesting to the validity of the records and information provided to us (see the Objectives, Scope, and Methodology section of this report for details and limitations). We also noted that Unger has not submitted compliance audit reports and audited financial statements to the Department. Unger filed for Chapter 11 bankruptcy in June 1999, after our audit began.

Unger is 1 of 17 collection contractors used by the Department's Debt Collection Service (DCS). We did not review Unger's compliance with the DCS contract because Unger did not receive payments directly from debtors under this contract. However, Unger's weak financial condition and lack of compliance may affect its performance under the DCS contract.

Our draft audit report, issued on October 1, 1999, noted that Unger's records listed 189 schools that were owed \$744,235 in Federal Perkins Loan collections as of April 1999. On October 19, 1999, the Department filed a claim with the bankruptcy court for the total \$744,235 that Unger owed the schools. On December 8, 1999, the Department filed an amended claim with the bankruptcy court increasing the amount to \$833,897. The \$833,897 represents Federal Perkins Loan collections owed schools through June 11, 1999, shortly after Unger filed for bankruptcy. Our final report includes this updated amount. After our draft report was issued, the bankruptcy court appointed a trustee to administer Unger. The trustee told us that negotiations were underway to sell Unger and that he would advise the new owner that submitting the past-due compliance audits should be a priority. A copy of the trustee's response to our draft report is included as an appendix. We have revised our recommendations to reflect these subsequent events.

We recommend that the Chief Operating Officer for Student Financial Assistance:

1. Require Unger to submit past-due compliance audits through Unger's fiscal year ended December 31, 1998.

2. Take appropriate administrative action against the Unger owners who failed to:
a) remit the \$833,897 that is owed to schools, and b) submit compliance audit reports and audited financial statements. Administrative action should be taken to the extent consistent with the Bankruptcy Code, 11 U.S.C. 362(b)(4).
3. Closely monitor Unger's performance under the DCS contract in light of Unger's failure to remit amounts collected under the school contracts, weak financial condition, failure to comply with compliance audit and financial statement reporting requirements, and refusal to provide a management representation letter for this audit.
4. Monitor the pending sale of Unger and take action to ensure the Department and schools receive their appropriate share of any sale proceeds based on bankruptcy claims filed (i.e., at a minimum \$833,897).

AUDIT RESULTS

Our audit was conducted in response to complaints from schools that Unger was not remitting Federal Perkins Loan collections and was unresponsive to requests for information. Federal Perkins Loan collection agencies such as Unger meet the definition of a third-party servicer and are subject to Federal audit requirements and can be held liable for the misuse of loan funds collected on behalf of institutions. We found that Unger began experiencing financial problems in early 1998 and soon thereafter stopped remitting loan collections to most of its client schools. Records provided by Unger as of June 1999 list 177 schools with a balance owed of \$833,897.

Unger was unwilling to provide us with a management representation letter attesting to the validity of the information provided. This limited our ability to perform the audit as described in the Objectives, Scope and Methodology section of the report. Unger filed for Chapter 11 bankruptcy in the Eastern District of Texas on June 11, 1999.

The Federal Perkins Loan Program provides low-interest loans to financially needy students attending institutions of higher education to help them pay their educational costs. Institutions are responsible for administering the program, including servicing and collecting loans. An institution may contract with another entity to perform these functions but remains responsible for ensuring compliance with all billing and collection requirements and for safeguarding of all funds collected by the contractor (34 CFR 674.48(d)). The regulation provides that funds be safeguarded by requiring all contractors to maintain a fidelity bond or comparable insurance.

Unger had individual contracts with each institution that included provisions for bond coverage. However, the amount of bond coverage for an institution may not be sufficient to cover the total loss. An official of the bonding company used by Unger told us that the coverage was limited to an annual total of between \$5,000 and \$35,000 for each state regardless of the number of institutions or claims in a state. Some contracts included provisions that required Unger to obtain additional insurance coverage. For example, the contract with one university included up to \$2 million of insurance coverage. Each institution that is owed collection payments by Unger may file a claim with the bonding or insurance company for any losses.

Additionally, creditors had until October 14, 1999, and the Government had until December 8, 1999 to file a proof of claim in the Eastern District of Texas bankruptcy court. Unger provided records as of June 11, 1999, that listed 177 schools with a balance owed of \$833,897. One of the 177 schools had a negative balance owed. The Department filed a claim in the bankruptcy court by the required deadline for the total \$833,897 that was owed the schools. We determined that \$13,039 of the \$833,897 was owed to three schools that had closed.

An Unger official stated that the amounts collected were used for general operating expenses. However, we were unable to confirm either the accuracy of the amount collected or how the funds were used because of the disarray of the records. The records were located in a large warehouse building in numerous boxes. An Unger official told us that he was unsure of the location of specific records and invited us to search the boxes for any records we required.

Unger officials cited several reasons for its financial problems. For example, Unger incurred unusual expenses involved in its attempt to convert to a new computer system in January 1998. In addition, a lack of revenue occurred because of a delay in receiving assignments of accounts under the October 1997 DCS contract. An official also told us that Unger had obtained a \$5.5 million loan in December 1997. The official stated that \$3.3 million of the loan was used to purchase Unger stock held by two other entities and \$2.2 million was used to pay current debts. According to the Unger officials, the computer system problem, a lack of revenue from loan assignments, and the purchase of outstanding stock with the loan proceeds all contributed to Unger's current financial problems.

Unger's financial condition may affect its performance on the DCS contract. An Unger official told us that there was a recent incident where Unger's DCS contract workers were not paid on time because there were insufficient funds in the bank account. Although the employees were ultimately paid, this resulted in the resignation of seven of the employees (17 percent of Unger's DCS contract workforce).

Unger has not completed any compliance audits as required of third-party servicers by 34 CFR 668.23(c). Also, Unger has never submitted audited financial statements to the Department. Annual audited financial statements are required of third-party servicers who have contracts with lenders or guaranty agencies [34 CFR 668.23(d)(5)]. Unger had contracts with six different guaranty agencies for varying periods of time beginning in January 1995 and ending in January or February 1998.

RECOMMENDATIONS

We recommend that the Chief Operating Officer for Student Financial Assistance:

1. Require Unger to submit past-due compliance audits through Unger's fiscal year ended December 31, 1998.
2. Take appropriate administrative action against the Unger owners who failed to: a) remit the \$833,897 that is owed to schools, and b) submit compliance audit reports and audited financial statements. Administrative action should be taken to the extent consistent with the Bankruptcy Code, 11 U.S.C. 362(b)(4).
3. Closely monitor Unger's performance under the DCS contract in light of Unger's failure to remit amounts collected under the school contracts, weak financial condition, failure to comply with compliance audit and financial statement reporting requirements, and refusal to provide a management representation letter for this audit.
4. Monitor the pending sale of Unger and take action to ensure the Department and schools receive their appropriate share of any sale proceeds based on bankruptcy claims filed (i.e., at a minimum \$833,897).

SUBSEQUENT EVENTS

Our draft audit report was issued on October 1, 1999. On October 19, 1999, the Department filed a claim with the bankruptcy court for the total \$744,235 that Unger owed the schools as of April 1999. On December 8, 1999, the Department filed an amended claim with the bankruptcy court increasing the amount to \$833,897. The \$833,897 represents Federal Perkins Loan collections owed schools through June 11, 1999, shortly after Unger filed for bankruptcy. Our final report includes this updated amount. After our draft report was issued, the bankruptcy court appointed a trustee to administer the Unger estate. The trustee told us that negotiations were underway to sell Unger. The trustee responded to our draft report by stating that he would advise the new owners that submitting the past-due compliance audits should be a priority. A copy of the trustee's response is included as an appendix to this report. We have revised our recommendations to reflect these subsequent events.

BACKGROUND

Unger and Associates, Inc. began operating as a collection agency in 1985. It currently is headquartered in Plano, Texas, with additional offices in Westmont, Illinois, and Houston, Texas. According to Unger officials, the Plano office currently collects Federal Perkins Loans and non-Federal debt under direct contracts with over 150 institutions. The Illinois office operates the Department's DCS contract, and the Houston office collects funds under contract with the U.S. Department of the Treasury's Financial Management Services. Unger's portfolio of loans under direct contract with institutions amounted to \$28.5 million as of July 14, 1999. The DCS and Treasury contracts are performance-based with Unger receiving additional referrals and bonus monies based on collections and debt resolutions. The DCS contract requires all debtor payments be sent to another Department contractor. Unger is 1 of the 17 collection contractors used by DCS. As of July 1999, Unger held approximately \$259 million on 59,533 accounts under the DCS contract.

Unger started downsizing its operations in early 1998 due to increasing financial problems. The downsizing resulted in a move of its headquarters from Dallas to Plano, Texas. In addition, all of Unger's employees were transferred to an employment agency and Unger contracts with the employment agency for workers. As a result, many of the same people continue to work at Unger. Unger filed for Chapter 11 bankruptcy in the Eastern District of Texas on June 11, 1999 (Case number 9941872).

OBJECTIVES, SCOPE, AND METHODOLOGY

We began our audit after receiving complaints from several schools that Unger had stopped remitting collections on Federal Perkins Loan assignments and was unresponsive to the schools' requests for information. The objectives of our audit were to determine the amount of unpaid collections and the status of Unger's operations.

To accomplish our objectives, we obtained background information about Unger and interviewed officers and staff that worked for the corporation. We also reviewed Unger's corporate financial statements, records of collections, bank statements, and cancelled checks. We also interviewed officials of 14 institutions and 6 guaranty agencies that used Unger to collect loans.

Our ability to perform the audit was limited. Specifically, we obtained computerized data from Unger, but we were unable to test the reliability of the information due to previous downsizing of the corporation and the condition of records. Also, Unger failed to provide us with a management representation letter. Such a letter acknowledges that management has responsibility for the fair presentation of records and reports, and asserts that the auditors have been provided with complete and accurate records. It also states that, to the best of management's knowledge, there have been no irregularities or violations of law or regulation in connection with issues covered in the audit scope. The failure of Unger to sign a management representation prevents us from completing a required audit step and causes us to qualify any conclusions we have drawn on the basis of the data made available to us. Further, we were not able to perform an assessment of management controls because key staff that performed management control functions no longer worked for Unger and records were not readily available and in disarray.

Our audit focused on current operations. However, we did perform a limited review of financial data made available for the period beginning January 1, 1996, through April 27, 1999. Fieldwork was conducted at Unger's headquarters in Plano, Texas, from April 27 through June 15, 1999. Except for those limitations explained in the preceding paragraph, our audit was conducted in accordance with generally accepted government auditing standards appropriate to the scope described above.

APPENDIX I

William H. Eschrich, Chapter 11, Trustee
Unger Estate
P.O. Box 794733
Dallas, Texas 85379-4733

December 6, 1999

Ms. Marilyn Peck
United States Department of Education
Office of Inspector General
1999 Bryan Street, Harwood Center, Suite 2630
Dallas, Texas 75201-6817

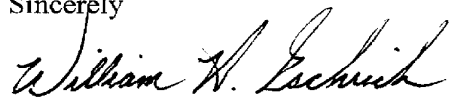
Dear Ms. Peck,

Please consider this letter to be in response to the audit conducted by the OIG on the Unger Estate. The Trustee was asked to respond to item number 3.

Per your conversation with me today, it was decided that it would be in the best interest of the OIG and the new owners of the company to have the new owners do the compliance audit. I will make it known to the new owners that this is a priority.

Thank you for your patience in this matter. It has been a pleasure working with you and your staff. Please do not hesitate to let me know if we can be of any assistance to you.

Sincerely

A handwritten signature in cursive script that reads "William H. Eschrich".

William H. Eschrich
Chapter 11, Trustee

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