UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MAR 3 0 2001

MEMORANDUM

TO: Greg Woods
Chief Operating Officer
Student Financial Assistance

FROM: Lorraine Lewis Lorraine Lewis

SUBJECT: FINAL AUDIT REPORT
Audit of the Illinois Student Assistance Commission's Administration of the Federal Family Education Loan Program Federal and Operating Funds
Control Number ED-OIG/A05-A0028

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 Program Federal and Operating Funds.

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 Dowd, Regional Inspector General for Audit, at 312-886-6503.

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

Attachment

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MAR 30 2001

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 final report (Control Number ED-OIG/A05-A0028) entitled, *The Illinois Student Assistance Commission's Administration of the Federal Family Education Loan Program Federal and Operating Funds*. The report incorporates the comments you provided in response to the draft audit report. 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
7th and D Streets, SW
Washington, D.C. 20202

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 the 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.

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

Sincerely,

Lorraine Lewis

Lorraine Lewis

Attachment

The Illinois Student Assistance Commission's Administration of the Federal Family Education Loan Program Federal and Operating Funds

FINAL AUDIT REPORT

ED-OIG/A05-A0028
March 2001

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, Illinois

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.

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

Except for the findings discussed in this report, the Illinois Student Assistance Commission (ISAC) complied with the Higher Education Act of 1965 (HEA), as amended, while establishing and maintaining its Federal and Operating Funds during the period July 1, 1998 through June 30, 1999. We identified six findings that affect the balances of the funds:

- ISAC did not follow Office of Management and Budget (OMB) Circular A-87 cost principles in developing its cost allocation plans, as required by Title 34 Code of Federal Regulations (CFR) §682.418 (c). ISAC also did not follow its allocation plans in distributing shared salary cost to its three major functions. Using ISAC's data, we estimate that ISAC overcharged the Federal Family Education Loan (FFEL) programs about $1,871,000 during the period July 1, 1996 through June 30, 1999.

- ISAC transferred $1,524,248 from the Federal Fund to the Operating Fund for unused employee vacation and sick pay. The HEA and implementing regulations do not include funding this liability as an authorized use of the Federal Fund.

- ISAC has not recognized the Federal Government's ownership interest in the building and land that ISAC occupies.

- ISAC transferred $419,122 in supplemental preclaims assistance (SPA) payments from the Federal Fund to the Operating Fund. The amendments to the HEA require SPA payments remain in the Federal Fund.

- ISAC paid $2,677 in late filing fees from the Federal Fund. The amendments to the HEA do not include this expense as an authorized use of the Federal Fund.

- ISAC understated the complement of the reinsurance percentage owed to the Federal Fund from post-default collections. An ISAC official agreed, recalculated the complement from October 1998 through July 2000, and transferred $172,103 to the Federal Fund.

We noted the following issues that warrant Student Financial Assistance's (SFA) attention: (1) the accuracy of ISAC's National Student Loan Data System (NSLDS) data used for calculating account maintenance fees and loan processing and issuance fees paid to ISAC, (2) ISAC's procedures for depositing SFA's share of post-default collections in the Federal Fund, and (3) ISAC's procedures for charging terminal leave costs to the FFEL programs.

We recommend that the Chief Operating Officer (COO) for SFA require ISAC to return $4,297,000 including imputed interest to the FFEL programs and recognize or reimburse the Federal Government's ownership interest in its building and land.

We provided ISAC a draft report. ISAC did not agree with findings one through three and generally agreed with findings four through six. We paraphrased ISAC's comments after each finding and also included them in their entirety as an Attachment.

AUDIT RESULTS

During the period July 1, 1998 through June 30, 1999 (State FY 1999), except as discussed below, ISAC complied with the HEA, as amended, while establishing and maintaining its Federal Fund and Operating Fund. ISAC elected to transfer $13,000,000 from the Federal Fund to the Operating Fund. ISAC's accounting of this transaction complied with the HEA and ISAC will begin repayment of those funds in State FY 2003. ISAC also complied with the Federal regulations on prohibited uses of assets. We identified six findings that affect the balances of the funds.

Finding No. 1 – ISAC's Cost Allocation Practices Result in Overcharges to the FFEL Programs

ISAC did not follow OMB Circular A-87 cost principles in developing its cost allocation plans and did not follow its allocation plans in distributing shared salary costs to its three major functions. ISAC did not charge salary costs to the FFEL programs based on each employee's actual activity. Using ISAC's data, we estimate that ISAC overcharged the FFEL programs about $1,871,000 during State FYs 1997 through 1999. As a result, the balances of the Federal Fund and Operating Fund are understated.

ISAC allocates shared expenses between its three main functions: the FFEL programs, State student aid programs, and the Illinois Designated Account Purchase Program (IDAPP), a secondary market. Title 34 CFR §682.418 (c) states that each guaranty agency that shares costs with any other program, agency, or organization shall develop a cost allocation plan consistent with the requirements described in OMB Circular A-87. The regulation also requires a guaranty agency to submit its cost allocation plan for the Secretary's approval if specifically requested by the Secretary.

To evaluate ISAC's cost allocation plan, we reviewed the allocation of shared salary expense. OMB Circular A-87 [Attachment B (11) (h) *Support of salaries and wages*] states that for employees who work on multiple activities or cost objectives, salaries will be supported by personnel activity reports or equivalent documentation unless a statistical sampling system is used. Personnel activity reports must reflect an after-the-fact distribution of each employee's actual activity, account for the total activity for which each employee is compensated, be prepared at least monthly, and be signed by the employee. Budget estimates determined before the services are performed do not qualify as support, but may be used for interim accounting purposes.

For each year we reviewed, we found that ISAC did not adjust its salary budget estimates to reflect actual activity, and did not charge the FFEL programs based on after-the-fact distributions for employees whose salaries were split between two or more activities. According to ISAC officials, the accounting system does not have the capacity to split an employee's salary between two or more funds. As a result, ISAC must arbitrarily charge salary expense to the three major functions in an attempt to approximate the results of the cost allocation plan. ISAC officials also stated there is a risk that the State student aid programs exceed State appropriations year after year, and some of the State student aid program expenses are most likely allocated to other functions.

Consultants hired by ISAC (in State FY 1997) have previously recommended improvements needed to bring ISAC's cost allocation plan into compliance with OMB Circular A-87. ISAC continues to lack the required after-the-fact support for shared salaries; therefore, ISAC cannot adjust its budget estimates to reflect actual activity.

For State FY 1997, ISAC based its cost allocation plan on time on task surveys completed by ISAC managers for each employee at the end of State FY 1996. The surveys documented the percentage of time each employee spent on the FFEL programs, State student aid programs, or IDAPP activities in State FY 1996. ISAC did not adjust the plan or salary expense charged to the FFEL programs for actual activity in State FY 1997. ISAC's total salary expense for State FY 1997 was $16,520,262. It charged 56.39 percent to the FFEL programs. We reviewed time on task surveys completed at the end of State FY 1997. Based on the actual time certified during the year, the FFEL programs should have been allocated no more than 49.7 percent of the total salary expense. As a result, ISAC overcharged the FFEL programs by about $1,105,000 in State FY 1997.

ISAC's total salary expense for State FY 1998 was $17,280,432. The FFEL program paid 54.47 percent of this amount. At the end of State FY 1998, ISAC did not have adequate after-the-fact support for each employee's activity. As a result, ISAC did not have sufficient documentation to determine the amount of salary expense that should have been charged to the FFEL programs in State FY 1998. We compared the State FY 1998 time allocations, which were the basis for the State FY 1999 cost allocation plan, to the actual salary expense charged to the FFEL programs in State FY 1998. Based on the State FY 1999 cost allocation plan (which was the best available resource), the FFEL program should have been charged only 52.13 percent of the State FY 1998 salary expense. ISAC overcharged the FFEL programs by about $404,000.

For its State FY 1999 cost allocation plan, ISAC utilized two types of employee certifications completed in State FY 1998. ISAC's managers completed a six-month certification that identified employees as direct or indirect. The programs they worked on were not identified. ISAC defined direct as employees who spent 100 percent of their effort on one activity. For these employees, ISAC's managers completed a second six-month certification identifying the function the employee supported. For employees defined as indirect, ISAC did not record the percentage of time spent on different activities. ISAC's employee certifications for its indirect employees did not support its salary expense allocations among the three main functions. ISAC either left indirect employee salaries in the indirect cost pool, which was allocated on the basis of total direct time, or charged portions of these salaries among its three main functions. ISAC did not maintain support for splitting the employees' salaries among the three main functions. ISAC officials stated that in some cases they only obtained verbal input to support those allocations.

ISAC stopped completing employee certifications during State FY 1999. Therefore, ISAC did not have sufficient documentation for us to determine the amount of salary expense that should have been charged to the FFEL programs in State FY 1999. ISAC did not adjust its State FY 1999 budget estimates to reflect actual activity. The only adjustments ISAC made were to ensure that it did not exceed its budgeted salary expense in each fund approved in the State of Illinois FY 1999 appropriations bill. State FY 1999 cost allocations were in some cases based on certifications for employees who were no longer employed at ISAC in State FY 1999. We found that the actual salary expense paid by the FFEL programs exceeded the amount calculated using the cost allocation plan by about $362,000 during State FY 1999 (the Federal Fund by $90,000 and the Operating Fund by $272,000). ISAC's cost allocation plans did not meet the requirements of OMB Circular A-87 and ISAC did not follow its cost allocation plan to determine the amount of salary expense charged to the FFEL programs.

Due to the lack of adequate support for shared salary expense, $1,871,000 is an estimate of the amount ISAC overcharged the FFEL programs during State FYs 1997 through 1999 ($1,105,000 + $404,000 + $362,000). Using this estimate and the 5 percent U.S. Treasury Current Value of Funds Rate (CVFR), we calculated that the Federal Fund lost about $271,000 and the Operating Fund lost about $24,000 in imputed interest through September 30, 2000.

We also noted that ISAC's cost allocation plans for State FYs 2000 and 2001 do not meet the requirements of OMB Circular A-87 because shared salary expense continues to be allocated based on budget estimates. ISAC's State FY 2000 cost allocation plan followed the same structure as State FY 1999. Beginning in State FY 2001, ISAC plans to use the results of a statistical sampling study completed by a consultant in December 1999, to allocate most salary expenses. OMB Circular A-87 states that if a statistical sampling system is used, the sampling universe must include all of the employees' salaries that will be allocated using the sample results, the entire time period involved must be covered by the sample, and the results must be statistically valid and applied to the period being sampled. Therefore a study completed in December 1999 cannot be the basis for State FY 2001 cost allocations. ISAC also plans to use other allocation methods that are based on the previous year's information that are not adjusted for after-the-fact personnel activity reports or equivalent documentation. As a result, ISAC will not have sufficient support to allocate salaries expense among its three major functions in accordance with OMB Circular A-87.

Recommendations

We recommend that the COO for SFA require ISAC to:

1.1. Return $1,870,000 to the Federal Fund. This amount includes:

(a) $1,599,000 in salary expenses the Federal Fund overpaid in State FYs 1999, 1998 and 1997, and

(b) Imputed interest of $271,000.

1.2. Return to the Federal Fund interest on the $1,599,000 after September 30, 2000. This interest should be computed using the CVFR applied to the $1,599,000 through the date this issue is resolved.

1.3. Return $296,000 to the Operating Fund. This amount includes:

(a) $272,000 in salary expenses the Operating Fund overpaid in State FY 1999, and

(b) Imputed interest of $24,000.

1.4. Identify and return any amounts to the Operating Fund for salary expenses overpaid in State FY 2000.

1.5. Revise its State FY 2002 cost allocation plan to meet the requirements of OMB Circular A-87. Include procedures to adjust budgeted salary expenses paid by funds to reflect actual activity.

1.6. Submit the State FY 2002 and all future cost allocation plans for SFA's review and approval.

ISAC Comments – ISAC acknowledged that its cost allocation plans for State FYs 1997 - 1999 did not fully comply with OMB Circular A-87 and that it subsequently lapsed into noncompliance in documenting its plan in State FY 2001. However, ISAC disagreed with our estimate that its noncompliance with OMB Circular A-87 resulted in overcharges of salary expense to the FFEL programs for the three years we reviewed. ISAC stated that it could have charged up to $1,221,000 more to the FFEL programs. ISAC also questioned whether OMB Circular A-87 applied prior to State FY 1998.

ISAC stated it had additional information regarding its cost allocation plan and identified additional salary expense that had not been provided during the audit. ISAC attributed its failure to provide this information during the audit to a vacancy in a key position and the geographical separation of its budgeting and accounting functions.

ISAC stated that it statistically evaluated time-on-task surveys that covered certain departments for a portion of State FY 1998 to develop an estimate of the proportion of salary expense that was allocable to the FFEL programs. These proportions were applied to the total salaries for State FYs 1997 and 1998 to derive the salary expense allocable to the FFEL programs. For FY 1999, ISAC stated that it completed quarterly time on task surveys. It evaluated these surveys in a similar manner to estimate the allocable amount for State FY 1999. Based on these calculations, ISAC stated that it could have charged up to $1,221,000 more to the FFEL programs.

ISAC stated that it created a new position that includes responsibilities related to its cost allocation plan and expects to be fully compliant with OMB Circular A-87 requirements for State FY 2002.

OIG Response - We reviewed ISAC's response and related supporting documents. We have not changed our position. ISAC did not follow OMB Circular A-87 in preparing its cost allocation plan for salary expense. As a result, there is a risk that the FFEL programs were overcharged during the years we reviewed and subsequent years. However, both the amounts that we presented in the report and the amounts that ISAC presented in its response are estimates. The documentation needed to determine the actual amount of shared salary expense allocable to the FFEL programs was not developed during the periods in question and was therefore not available for review. While SFA will need to determine the amount to be returned to the Federal Fund, resolution of this finding should emphasize developing an acceptable cost allocation plan for all categories of shared expenses for future periods. We did revise our estimates to reflect the additional salary expense ISAC identified in its response.

Because both ISAC's and our calculations of the amounts of salary expense allocable to the FFEL programs during State FYs 1997 through 1999 are estimates, neither is likely to be the same as the amount that would have been derived from an acceptable system during the actual periods. Our estimate was based on available certifications/cost allocation plans prepared by ISAC during the periods in question. ISAC's estimate was based on statistically evaluating time studies prepared by a contractor and extrapolating the results to periods not covered by the time studies. The amounts that ISAC presented as allocable to the FFEL programs in its response were calculated using the upper bounds of the confidence intervals at the 95 percent confidence level. We did not attempt to evaluate the accuracy of ISAC's statistical calculations, but we did review them to determine the midpoint and lower bounds of ISAC's estimate. Considering both the upper and lower bounds of ISAC's estimate brings it closer to our estimate. The results are summarized below.

State FY	Actual Salary Expense Charged	OIG Salary Expense Estimate	ISAC Salary Expense Estimate		
			Lower	Midpoint	Upper
1997[1]	$9,315,000	$8,211,000	$8,761,000	$9,228,000	$9,696,000
1998	9,412,000	9,008,000	9,164,000	9,653,000	10,142,000
1999	10,154,000	9,792,000	9,716,000	9,991,000	10,265,000
Total	$28,881,000	$27,011,000	$27,641,000	$28,872,000	$30,103,000

ISAC also questioned whether OMB Circular A-87 applied to periods prior to State FY 1998 based on the date it was first cited in the FFEL regulations. OMB Circular A-87 was the applicable cost principles for the entire period reviewed. As ISAC pointed out in its response, it is subject to the requirements of OMB Circular A-128, Audits of State and Local Governments, which references and incorporates the requirements of OMB Circular A-87. OMB Circular A-87 states that it establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and agreements with State and local governments. The effective date of the current recompilation is September 1, 1995.

ISAC's noncompliance with OMB Circular A-87 continues in State FY 2001. The time remaining to achieve compliance with OMB Circular A-87 for State FY 2002 is limited. State FY 2002 begins July 1, 2001. While the audit tested ISAC's cost allocation plan by reviewing shared salary expense, all shared costs need to be addressed in ISAC's full cost allocation plan. If SFA adopts the recommendation to require ISAC to submit its cost allocation plan for approval, the remaining time will be further limited.

Finding No. 2 – ISAC Made an Unauthorized Transfer from the Federal Fund to the Operating Fund for Unused Vacation and Sick Pay

ISAC transferred $1,524,248 from the Federal Fund to the Operating Fund for unused employee vacation and sick pay. The HEA and the implementing regulations do not identify funding this liability as an authorized use of the Federal Fund. In addition, ISAC's basis of accounting did not recognize the expense or liability for unused employee vacation or sick pay in the Federal Student Loan Reserve Fund until it was used.

[1] Comparing the OIG Salary Expense Estimate and ISAC Salary Expense Estimate Upper to the Actual Salary Expense for State FY 1997 will result in a $1,000 difference from the amounts cited in the report and ISAC's response. The differences are due to rounding.

ISAC calculated that $1,524,248[2] of its unused employee vacation and sick pay was attributable to the FFEL programs as of September 30, 1998, and transferred that amount from the Federal Fund to the Operating Fund effective October 1, 1998. ISAC officials stated that they considered the transaction a residual equity transfer. ISAC did not record the amount as an expense or a liability in the Federal Fund.

Section 422A (d) of the HEA and 34 CFR §682.419 (c) list the authorized uses of the Federal Fund and payments for unused employee vacation and sick pay are not included. ISAC uses a modified accrual basis of accounting that recognizes unused employee vacation and sick pay in the General Long Term Obligations Account Group. ISAC does not record an expense in individual funds for vacation and sick pay employees earn until it is used. ISAC's transfer was an unauthorized use of Federal funds and inconsistent with its own accounting methods.

The Federal Fund also lost interest income when ISAC transferred the $1,524,248 to the Operating Fund. Using the 5 percent CVFR, we calculated imputed interest totaling $146,086 through September 30, 2000.

Recommendations

We recommend that the COO for SFA require ISAC to:

2.1. Return $1,670,334 to the Federal Fund. This amount includes:

(a) The $1,524,248 it transferred from the Federal Fund to the Operating Fund on October 1, 1998, and

(b) Imputed interest of $146,086.

2.2. Return to the Federal Fund interest income earned on any of the $1,524,248 remaining in the Operating Fund after September 30, 2000. This interest should be computed using the CVFR, calculated through the date this issue is resolved.

ISAC Comments - ISAC disagreed with Finding No. 2. ISAC stated that the transfer was a residual equity transfer in the establishment of the Federal and Operating Funds. ISAC also stated that Governmental Accounting Standards Board (GASB) Statement No. 16 required ISAC to recognize its full liability for unused leave in the General Long Term Debt Accounts Group and that only the current year's usage is recorded in the respective funds. ISAC stated that it must follow the GASB Statements and that OMB Circular A-87 requirements related to

[2] We did not verify the accuracy of this amount. However, ISAC calculated the amount based on its unsupported cost allocation discussed in Finding 1.

compensated absences cannot be applied to a state guaranty agency.

OIG Response - We reviewed ISAC's comments; but we have not changed our position. The transfer of $1,524,248 was not an authorized use of the Federal Fund and in addition, did not comply with OMB Circular A-87. ISAC correctly stated GASB requirements for financial statement presentation of the liability related to compensated absences. However, OMB Circular A-87 is the applicable criteria for determining allowable costs chargeable to agreements between state and Federal agencies.

ISAC's published financial statements for the years 1998 and 1999 state: "Expenditures are recognized in the accounting period in which the liability is incurred, except that accumulated unpaid vacation, sick pay and other employee benefits are recognized when they normally would be liquidated with expendable available financial resources." ISAC uses the cash basis of accounting for vacation and sick pay.

OMB Circular A-87 recognizes compensation paid to employees during authorized absences as an allowable cost and states that the accounting basis for the cost must be consistently followed. If the cash basis of accounting is used, the cost of leave is recognized in the period it is used and paid for. If accrual accounting is used, allowable leave costs are the lesser of the amount accrued or funded. Under either basis, OMB Circular A-87 limits the allowable amount chargeable to the Federal source to the amount actually paid or funded during the period. This would be the amount ISAC paid for vacation and sick absences during the period.

ISAC did not record an expense for accumulated unpaid vacation and sick pay in its Federal Student Loan Reserve Fund before the 1998 amendments, or in its Operating Fund as of October 1, 1998. The transfer is not consistent with ISAC's basis of accounting for compensated absences. ISAC made an unauthorized transfer of funds and should return $1,524,248 to the Federal Fund plus imputed interest.

Finding No. 3 – ISAC Has Not Recognized the Federal Government's Ownership Interest in the Building and Land ISAC Occupies

ISAC has not recognized the Federal Government's ownership interest in the building and land that ISAC occupies. Section 422A (e) of the HEA and 34 CFR §682.420 (a), state that any nonliquid asset developed or purchased with Federal reserve funds is the property of the United States, prorated based on the percentage of the asset purchased with Federal funds.

The State of Illinois (State) entered into an installment purchase agreement with the NBD Trust Company of Illinois on March 1, 1992 to acquire the building and land ISAC occupies. The State will own the building and land at the completion of the installment purchase on June 30, 2013. The State instructed ISAC to pay the semi-annual installment purchase payments. ISAC allocated the payments between the FFEL programs, State student aid programs, and IDAPP based on the percentage of the total square footage occupied by each function. The Federal Student Loan Reserve Fund paid the FFEL programs' portion of the payments from July 1, 1993 to September 30, 1998, totaling $1,901,591 in principal and $4,275,228 in interest. The $1,901,591 represents 7.96 percent of the $23,900,000 principal portion of the installment purchase agreement. After ISAC established the Federal Fund and Operating Fund on October 1, 1998, it paid the FFEL programs' portion of the payments from the Operating Fund. ISAC did not record the portion of the building and land paid from the Federal Student Loan Reserve Fund as a Federal Fund asset because it does not recognize the Federal Government's ownership interest.

Effective July 1, 2000, 34 CFR §682.420 (c) (1) (i) required guaranty agencies that use the Federal portion of a nonliquid asset in their activities to deposit a usage fee based on net fair value into the Federal Fund. Because ISAC does not recognize the Federal Government's ownership interest in the building and land, it has not deposited a usage fee in the Federal Fund.

Recommendations

We recommend that the COO for SFA require ISAC to:

3.1. Reimburse SFA for the Federal Government's interest in the building and land;

or

3.2. Recognize the Federal Government's ownership interest in the building and land and pay the required usage fee.

ISAC Comments - ISAC did not agree that the Federal Government has an ownership interest in the building and land it occupies. ISAC confirmed that the State of Illinois' Department of Central Management Services (CMS) entered into a capital lease agreement with NBD Trust Company of Illinois and instructed ISAC to allocate the semi-annual lease payments to its three major programs based on square footage occupied. ISAC views the payments as rent, not capital lease payments.

OIG Response - ISAC's comments did not cause us to change our position. According to the HEA, the prorated percentage of the building and land purchased with Federal funds is the property of the United States. ISAC paid the FFEL program's share of the building and lease payments from the Federal Student Loan Reserve Fund until September 1998. Therefore, ISAC should recognize the Federal Government's interest in those assets.

Finding No. 4 – ISAC Transferred SPA Payments Intended for the Federal Fund to the Operating Fund

ISAC transferred $419,122 from the Federal Fund to the Operating Fund. This equaled the amount of supplemental preclaims assistance (SPA) ISAC deposited in the Federal Fund from October 1998 to March 1999. The 1998 amendments to the HEA replaced SPA with a Default Aversion Fee (DAF). According to Section 422A (c) (4) of the HEA, a guaranty agency shall deposit all payments received for supplemental preclaims activity performed prior to October 7, 1998, into the Federal Fund. The HEA allowed guaranty agencies to calculate and transfer DAF from the Federal Fund to the Operating Fund monthly.

Because of internal systems problems, ISAC could not calculate the appropriate amount of DAF during State FY 1999. From October 1998 through March 1999, ISAC transferred $419,122 to the Operating Fund. According to ISAC officials, the amount of DAF that ISAC would have been eligible to claim exceeded the amount it transferred. ISAC officials stated that the transfers had no negative financial impact on the Federal Fund. They did not provide any support for this statement. Using the 5 percent CVFR, the monthly transfers earned about $38,895 in interest through September 30, 2000.

Recommendations

We recommend that the COO for SFA require ISAC to:

4.1. Return $458,017 to the Federal Fund. This amount includes:

(a) $419,122 in SPA payments transferred to the Operating Fund, and

(b) Imputed interest of $38,895.

4.2. Return to the Federal Fund interest on the $419,122 after September 30, 2000. This interest should be computed using the CVFR applied to the $419,122 through the date this issue is resolved.

ISAC Comments - ISAC agreed with recommendation 4.1(a) but suggested eliminating recommendations 4.1(b) and 4.2. ISAC concurred that its Federal Fund received SPA payments and that it then transferred those SPA payments to the Operating Fund. ISAC repeated its opinion that the amount of DAF the Operating Fund could have received during FY 1999, if ISAC's information systems were capable of calculating DAF, would have been significantly more than the SPA payments it transferred to the Operating Fund.

OIG Response - The deficiencies in ISAC's information systems did not justify the transfer of Federal funds to the Operating Fund. While Federal funds remained in the Operating Fund, the Federal Fund lost imputed interest. ISAC did not present any justification for retaining the imputed interest in the Operating Fund.

Finding No. 5 – ISAC's Charge to the Federal Fund for Late Filing Fees Was Not an Authorized Use of Federal Funds

ISAC paid its late filing fees from its Federal Fund during State FY 1999. Section 422A (d) of the HEA does not include late filing fees as an authorized use of the Federal Fund.

SFA charged ISAC late filing fees during State FY 1999 because ISAC filed several Form 1130s and Form 1189s beyond their deadlines. ISAC charged a total of $2,677 in late filing fees to the Federal Fund instead of the Operating Fund. As a result, the Federal Fund lost $2,677 and interest it would have earned on those funds.

Recommendations

We recommend that the COO for SFA require ISAC to:

5.1. Return $2,677 to the Federal Fund for late filing fees the Federal Fund paid.

5.2. Return to the Federal Fund any interest the $2,677 would have earned using the applicable CVFR through the date this issue is resolved.

ISAC Comments - ISAC agreed with the finding, but only returned $2,677 to the Federal Fund.

OIG Response - ISAC did not address recommendation 5.2. We continue to recommend that SFA require ISAC return to the Federal Fund any interest the $2,677 earned while those funds remained in the Operating Fund.

Finding No. 6 – ISAC Understated the Complement of Reinsurance Percentage from Post-Default Collections

ISAC understated the complement of the reinsurance percentage owed to the Federal Fund from post-default collections. The complement of the reinsurance percentage is a portion of SFA's share of collections that the 1998 amendments to the HEA require ISAC to deposit into the Federal Fund.

Section 422A (c) (2) of the HEA requires guaranty agencies to deposit into the Federal Fund, from amounts collected on a defaulted loan, an amount equal to the complement of the reinsurance percentage in effect when ISAC received the reinsurance payment on the loan. ISAC deposited all post-default collections into its Operating Fund. Once a month, after ISAC completed Form 1189, it transferred SFA's share of post-default collections plus interest into the Federal Fund. Our testing of ISAC's calculations for December 1998 revealed that ISAC: (1) did not transfer the complement of the reinsurance percentage into the Federal Fund for loans in two reinsurance categories and (2) understated the complement of the reinsurance percentage for loans in another category. As a result, ISAC understated the amount due to the Federal Fund for December 1998 by $11,277.

We discussed our results with an ISAC official. He agreed with our finding and recalculated the complement of the reinsurance percentage owed to the Federal Fund from October 1998 through July 2000 and transferred $172,103 to the Federal Fund. ISAC also modified its procedures to ensure that the Federal Fund receives the appropriate complement of the reinsurance percentage for all reinsurance categories. We concurred with ISAC's actions and considered the matter resolved.

ISAC Comment - ISAC provided additional information to explain its current and future accounting procedures for the complement of reinsurance.

OTHER MATTERS

We noted three additional issues that warrant SFA's attention. These issues were either beyond the scope of the current audit or ongoing at the conclusion of our field work. We did not fully develop them as findings. The issues are: the accuracy of ISAC's NSLDS data, ISAC's procedures for depositing SFA's share of post-default collections in the Federal Fund, and ISAC's procedures for charging terminal leave costs to the FFEL programs.

Accuracy of ISAC's NSLDS Data - ISAC's data in NSLDS: (1) understated the amount of ISAC's net guaranteed loans and (2) may have included a significant percentage of inaccurate loan balances. The reliability of NSLDS data is important because under the 1998 amendments to the HEA, SFA calculates and pays each guaranty agency loan processing and issuance fees, and account maintenance fees using NSLDS data. The amount of ISAC's net guaranteed loans as of September 30, 1999, as reported in NSLDS, was less than the amount ISAC reported on its quarterly/annual Form 1130 for that period.

ISAC's Procedures for Depositing SFA's Share of Post-Default Collections - As of July 1, 2000, ISAC was not depositing SFA's share of post-default collections into the Federal Fund within 48 hours of receipt as required by 34 CFR §682.419 (b) (6). A Dear Colleague Letter, dated July 18, 2000, permitted guaranty agencies to submit a request to SFA Financial Partners for an exemption from this requirement. In a letter to the regional SFA Financial Partners office dated August 30, 2000, ISAC explained the circumstances related to ISAC's non-compliance. ISAC requested approval to (1) deposit post-default collections into the Operating Fund after they clear a State holding account and (2) transfer SFA's share plus associated interest to the Federal Fund monthly. SFA Financial Partners denied this request on October 4, 2000, and gave ISAC until December 1, 2000, to comply with the requirements of 34 CFR §682.419 (b) (6). SFA Financial Partners and ISAC were negotiating the resolution of this issue at the end of our field work.

ISAC's Procedures for Charging Terminal Leave Costs to the FFEL Programs - During our review of ISAC's cost allocation plan, we also noted that ISAC's method for charging terminal leave costs to its various functions is inconsistent with the requirements of OMB Circular A-87. When employees terminate their employment, ISAC recognizes salary expense for 100 percent of their terminal leave costs in the same fund that was charged for their salary expense. As we reported in Finding No. 1, ISAC's charges for employees' salaries do not follow its cost allocation plan. ISAC's accounting system only allows payment of an employee's salary by one fund even if ISAC's cost allocation plan splits the time between multiple cost objectives. OMB Circular A-87 [Attachment B (11) (d) (3) *Fringe Benefits*] states that a terminated or retired employee's leave is allowable in the year of payment provided the expense is allocated as a general administrative expense to all activities of the governmental unit or component.

ISAC Comments - ISAC provided additional information for the first two issues. We also received confirmation from SFA that it has reached an agreement with ISAC to grant a temporary exception from the 48-hour rule until September 1, 2001. For the third issue, ISAC explained its accounting system prevents it from properly allocating terminal leave costs. However, ISAC plans to address terminal leave cost allocations in future cost allocation plans.

BACKGROUND

The 1998 amendments to the HEA of 1965, enacted on October 7, 1998, required each guaranty agency to establish a Federal Fund and an Operating Fund within 60 days. The final date for establishing these funds was December 6, 1998. Unless otherwise specified, the 1998 amendments to the HEA were effective October 1, 1998. SFA issued interim guidance in January and November 1999, and published regulations relating to the Federal and Operating Funds on October 29, 1999.

All funds, securities and other liquid assets of the guaranty agency's FFEL programs reserve fund were to be transferred to the Federal Fund, which is the property of the Federal Government. The HEA required a guaranty agency to deposit revenue from specified sources into the Federal Fund and also specified the uses of Federal Fund assets. The HEA also specified deposits into the Operating Fund and the general uses of Operating Fund assets. Except for funds transferred from the Federal Fund, the Operating Fund is the property of the guaranty agency. If the Operating Fund contains funds transferred from the Federal Fund, it may be used only as permitted by the regulations, which prohibit certain uses of reserve funds.

In 1957, Illinois created the Illinois State Scholarship Commission to provide all Illinois residents access to higher education. In State FY 1990, the name changed to ISAC. ISAC is a State agency backed by the full faith and credit of the State of Illinois and has three locations (Springfield, Chicago, and Deerfield, Illinois). One of its functions is as a guaranty agency for the FFEL programs. Its main operations are in Deerfield, Illinois.

In 1977, Illinois created IDAPP, and the Executive Director of ISAC became responsible for this secondary market. In addition to the FFEL programs and secondary market, ISAC administers 11 other State grant and scholarship programs.

ISAC is regulated by State legislation and the Illinois State Treasury holds ISAC's cash. State law and an error in the appropriations bill delayed the separation of the Federal and Operating Funds until July 1, 2000. Although the State did not approve the separation by December 6, 1998, ISAC separated all accounting of FFEL funds into a Federal Fund and Operating Fund in its general ledger as of October 1, 1998. ISAC allocated monthly interest revenue the shared cash account received between the Federal and Operating Funds based on their ending cash balances in the general ledger.

AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY

The purpose of our audit was to determine whether ISAC complied with the HEA and regulations governing the establishment and operations of the Federal and Operating Funds. Specifically, we evaluated the areas of (1) initial establishment of the two funds, (2) continued operations of the two funds, (3) the Operating Fund's compliance with conflict of interest regulations, (4) ownership of nonliquid assets and usage fees paid, and (5) reasonableness of the cost allocation plan.

To accomplish our objectives, we reviewed (1) State FY 1999 accounting transactions relevant to the establishment of the Federal and Operating Funds, (2) accounting transactions that occurred during State FY 1999 related to the transfer of funds from the Federal Fund to the Operating Fund, (3) accounting records and/or legal documentation for the building, land and other Federal Fund assets, (4) ISAC's cost allocation plans for State fiscal years 1997 through 1999, (5) State FYs 1999 and 2001 transactions for the distribution of post-default collections, and (6) transactions related to the distribution of State FY 1999 account maintenance fees and SPA. We reviewed ISAC's financial and single audit reports for the years ended June 30, 1998 and 1999, to determine whether there were significant findings related to our audit. We reviewed the working papers of the independent public accountant that performed those audits. We also interviewed various ISAC personnel and SFA officials.

To achieve our audit objectives, we relied on the accuracy of ISAC's automated general ledger system, Fundware. To assess the reliability of this data, we relied on the work completed by the independent public accountant and completed additional tests. Based on these tests and assessments, we concluded the data were sufficiently reliable to be used in meeting our objectives.

We conducted our field work from June 19, 2000 through October 6, 2000. We performed the majority of our field work at ISAC's main location in Deerfield, Illinois. We performed our audit in accordance with government auditing standards appropriate to the scope of review described above.

STATEMENT ON MANAGEMENT CONTROLS

As part of our audit, we made an assessment of ISAC's management control structure, policies, procedures, and practices applicable to ISAC's administration of the FFEL programs. The purpose of our assessment was to assess the level of control risk, that is, the risk that material errors, irregularities, or illegal acts may occur. We performed the control risk assessment to assist us in determining the nature, extent, and timing of the substantive tests needed to accomplish our audit objectives.

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

- Establishment of the Federal and Operating Funds
- Maintenance of the Federal and Operating Funds
- Ownership of fixed assets used to administer the FFEL programs
- Transfers of assets from the Federal Fund to the Operating Fund
- Transactions involving the Federal Reserve Fund prior to the establishment of the Federal and Operating Funds which significantly impacted the opening balances of those funds

Due to inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the control structure. However, we identified weaknesses in ISAC's controls over the establishment and maintenance of its Federal and Operating Funds. We describe the weaknesses in Findings 1 and 6. We are not recommending corrective action regarding control weaknesses in Findings 2 through 5 because ISAC will not establish the Federal and Operating Funds again.

Illinois Student Assistance Commission

March 12, 2001

Mr. Richard Dowd
Regional Inspector General for Audit
Department of Education – Office of the Inspector General
111 N. Canal, Suite 940
Chicago, IL 60606

Dear Mr. Dowd:

ISAC has reviewed the ***Draft Audit Report*** which presents the results of your audit of the Illinois Student Assistance Commission's Administration of the Federal Family Education Loan Program Federal and Operating Funds during the period July 1, 1998 through June 30, 1999.

Attached, please find our responses to the findings outlined in the ***Draft Audit Report***. I trust that the information contained in these responses and the additional supporting documentation will sufficiently address the issues identified in the draft audit findings.

ISAC is committed to effectively administering the Federal Family Education Loan Program in accordance with the laws and regulations which govern the program. If you have further questions or need additional information regarding our audit responses, please do not hesitate to contact Ms. Theresa Morgan, ISAC Deputy Chief Financial Officer at 217-782-8742 or Mr. Scott Taylor, Assistant Director, Budget & Finance at 217-785-0730.

Sincerely,

Larry E. Matejka

Larry E. Matejka
Executive Director

Attachment

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500 West Monroe • Springfield, IL 62704-1876 • 217-782-6767
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ILLINOIS STUDENT ASSISTANCE COMMISSION

Subject: Audit Finding Number 1

Finding

ISAC's Cost Allocation Practices Result in Overcharges to the FFEL Programs.

Response

Disagree

ISAC contends that it did not overcharge salary costs related to the FFEL programs during the three years analyzed. ISAC accepts full responsibility for not providing the auditors with complete information during the audit process regarding our cost allocation plan and process. We regret unintentionally providing less-than-complete data to the auditors. The primary reason for this oversight is the splitting of the cost allocation function between ISAC's Comptroller and the Deputy Chief Financial Officer (Budget and Finance Department). During the audit process, the latter position was vacant, and given this position's responsibilities related to cost allocation, it was unfair to assume the Comptroller had a complete comprehension of the design and implementation of ISAC's cost allocation plan from both a budget development and accounting implementation perspective. This problem was exacerbated by the budget development function being centered in the Springfield office and the accounting implementation function being centered in the Deerfield office.

ISAC's response to the audit finding differs among fiscal years, because the level at which it applied the principles set forth in A-87 was different in each of the three fiscal years cited. ISAC does believe that its response to this audit shows a willingness to comply with A-87, and, most importantly, an improvement in each of these years. ISAC was faced with many constraints in implementing A-87 due to a required, but inflexible State accounting system. ISAC has spent significant resources over the past three years to adjust our budget development and accounting processes, and we are continuing to refine these processes. Further, we believe that data being provided in this response will show full compliance for FY1999 with the requirement of charging the FFEL programs based on after-the-fact distributions for employees whose salaries were split between two or more activities. Finally, as further evidence of our commitment to continually improving the design, implementation, and documentation of our cost allocation plan according to the letter of A-87, ISAC would like to point out that ISAC has created an Assistant Director position in our Budget and Finance Department with significant responsibilities related to this area.

For FY1997, ISAC maintains we followed A-87 cost principles in developing and implementing a cost allocation plan. We did not, however, follow the letter of A-87. ISAC feels it is appropriate to note that Title 34 CFR 682.418 cited in the audit did not become effective until July 1, 1997, which was after the conclusion of FY1997. Prior to the creation of Title 34 CFR 682.418, ISAC was implicitly required to follow the general cost principles of A-87 because it was subject to OMB Circular A-128, Audits of State and Local Governments. ISAC, however, was not explicitly required to follow A-87 to the letter until the creation of Title 34 CFR 682.418. As a result, the only cost allocation data available for FY1997 only generally follow A-87 principles, and ISAC maintains these data are not the best indicator of the amount it could have charged the FFEL programs in FY1997. The OIG applied the FY1999 cost allocation plan given to them to determine the amount ISAC could have charged the FFEL programs in FY1998. Therefore, ISAC is proposing using the FY1998 cost allocation plan presented in this response as the best indicator of the amount ISAC could have charged the FFEL programs in FY1997.

When the 1996 regulations, which explicitly indicated that guaranty agencies would be subject to A-87, were first published in November of 1996, ISAC began its plans to implement the requirements prescribed by A-87. We hired a consultant to assist us in our efforts to comply, but ISAC agrees we did not follow detailed principles set forth in A-87 to the letter when developing, documenting, and implementing our cost allocation plan for FY1998. This was partially due to the newness of the increased detail required by the regulation as well as limitations in the State of Illinois accounting system, which ISAC must use. Again, ISAC maintains that we have been diligently working to continually improve the development, implementation, and documentation of our cost allocation plan according to the letter of A-87.

Although ISAC agrees we failed to fully document our cost allocation plan in FY1998, we also maintain that we do have substantial documentation, which shows the distribution of salaries for employees whose activities are split between two or more funds during FY1998. ISAC contracted with Coopers and Lybrand to conduct a time-on-task survey during FY1998. Again, ISAC claims full responsibility for not providing these data to the auditors previously, but feels strongly that these data must be considered when estimating the salary costs attributable to FFEL program functions in FY1998. Although the survey was only conducted once, and thus does not allow for seasonal changes in activity, ISAC maintains that results from the survey are better indicators of personnel time devoted to FFEL program activities than the FY1999 cost allocation plan cited by the auditors.

ISAC also respectfully disputes several points in the OIG methodology used to determine the proportion of salary charges allocable to the FFEL programs, regardless of the survey methodology used to determine the observed proportions. First, ISAC maintains that survey data have limits when being used to determine the proportion of time an employee spends on activities related to more than one fund. Even when survey sampling meets statistically valid standards as prescribed by A-87, the potential exists for the observed proportion to vary from the actual proportion. ISAC contends that when survey proportions are used to determine allocable costs, confidence intervals for the observed proportions need to be constructed to determine the upper bound of salary expenses which are allocable to a particular fund. ISAC proposes constructing these confidence intervals by using a normal approximation to the binomial distribution. We maintain that it is appropriate to apply the binomial distribution because from the perspective of the OIG, ISAC employees either worked on FFELP-related activities or they did not.

For purposes of the response to this audit, ISAC also proposes using an objective measure for one cost center, specifically its Information Services (IS) Division. One reason ISAC is able to excel at providing service to students using FFEL programs with relatively few employees is its reliance on data processing systems to achieve "economies of scale." ISAC maintains that salary costs for indirect employees in our IS Division should be allocated according to the overall cost of data processing, which we view as a much more objective measure than survey data.

In the future, ISAC will work to increase the number of employees whose contribution to activities related to each particular fund can be measured using more objective data than survey data. By using a more objective measure for the IS Division, as well as determining appropriate objective measures for employees in other cost centers in the future, ISAC would reduce the width of the confidence interval used to determine the upper bound of allocable costs to the FFEL programs.

ISAC also respectfully disputes the portion of the OIG methodology, which treats all employees alike, and does not weight the proportion contributed by each employee by his or her salary. In the application of the OIG methodology, an employee making $50,000 per year is treated the same as an employee making $25,000. ISAC also contends that vacant positions should be excluded from the analysis because vacancies do not affect salary needs. OIG's methodology includes vacant positions when computing proportions. ISAC maintains that the fact that one of our cost centers, specifically IDAPP, consistently has a disproportionate number of vacant positions skews the observed proportion in a manner that unfairly reduces the proportion of salary costs allocable to FFEL programs. Finally, ISAC maintains that the observed proportions from survey data should be allocated by department, i.e., cost center, rather than using an overall average for every indirect employee.

Using the following methodology, ISAC determined a different proportion of salary costs that could have been allocated to the FFEL programs in FY1998. The proportions gathered in the FY1998 time-on-task survey were applied to indirect employees, except indirect employees in the IS Division. Direct employees received a proportion of one for the appropriate fund. Each of these proportions was then weighted by the employee's salary. Indirect employees whose departments were not surveyed due to the random nature of the sampling were assigned the overall proportion computed using the survey results. Vacant positions were excluded from the analysis because vacancies have no salary costs.

Further, confidence intervals for the observed proportions were constructed using a normal approximation to the binomial distribution to determine the upper bound of the salary expenses ISAC could have charged to FFELP. As stated above, using binomial results is appropriate because, from the perspective of the OIG, ISAC employees either worked on FFELP-related activities or they did not. The results from this analysis indicated that ISAC could have charged up to 58.69 percent of salary expenses to FFELP in FY1998.

ISAC must admit that we failed to note $303,196 in non-FFEL salary expense for FY1998 for the auditors, but we feel strongly that this amount should be considered when calculating the proportion of salary costs allocated to the federal fund in FY1998. ISAC paid a total of $17,280,432 in salary expense in FY1998. Approximately 54.5 percent, or $9,412,000 was charged to the FFEL programs. Using the 58.69 percent calculated proportion, ISAC estimates we could have charged the FFEL programs approximately an additional $730,000 in FY1998.

ISAC also maintains that this methodology is a better indicator of the proportion of salary costs ISAC could have allocated to the FFEL programs in FY1997. ISAC must also admit that we failed to note $581,671 in non-FFEL salary expense for FY1997 for the auditors, but, again, we feel strongly that this amount should be considered when calculating the proportion of salary costs allocated to the federal fund in FY1997. ISAC paid a total of $16,520,264 in salary expense in FY1997. Approximately 56.4 percent, or $9,315,437 was charged to the FFEL programs. Using the 58.69 percent proportion calculated for FY1998, ISAC could have charged up to $9,713,915 to FFELP. Therefore, ISAC estimates it could have charged the FFEL programs approximately an additional $380,000 in salary expenses in FY1997.

In FY1999, ISAC did complete time-on-task surveys quarterly, and thus these survey results do account for seasonal variance in activity. Although the OIG stated that these surveys could not be used to allocate salary expenses in the FY2001 cost allocation plan, ISAC contends that they do provide an appropriate measure of fund activity, which occurred in FY1999. Using the methodology stated previously, ISAC contends that up to 54.65 percent of salary expense could have been charged to the FFEL programs in FY1999. Using this proportion, ISAC estimates that it could have charged the FFEL programs by up an additional $111,000 in FY1999.

In summary, ISAC would like to once again acknowledge that we inadvertently failed to provide the auditors with important salary-related data for FY1997 and FY1998, as well as the extensive supporting data we used for designing and implementing our cost allocation plan in FY1998 and FY1999. We further acknowledge that we have failed to document our cost allocation process fully according to the methodology prescribed to the letter in A-87, but we would like to reiterate our commitment to rectifying this oversight. ISAC believes it has made substantial progress towards full compliance during each of the three years cited in the audit. We understand that, largely due to the resignation of our Deputy CFO in August of 2000, we have lapsed into noncompliance with the letter of A-87 in documenting our cost allocation plan in FY2001. We do, however, intend to make a good-faith effort to develop data to document our salary charges to the FFEL programs in this fiscal year. Further, with the creation of the Assistant Director position in BFD with substantial job responsibilities in the area of cost allocation, ISAC expects to be fully compliant with the letter of A-87 in designing, documenting, and implementing its cost allocation plan for FY2002 and beyond.

Even though ISAC accepts responsibility for not being fully compliant with A-87, we have aggressive plans to become compliant. We also contend that, using the extensive data in conjunction with the methodology described previously, we did not overcharge the proportion of salary allocable to the FFEL programs during the time period studied.

ISAC maintains that:

- during FY1997, we potentially undercharged salary related to FFEL programs by up to approximately $380,000;

- during FY1998, we potentially undercharged salary related to FFEL programs by up to approximately $730,000; and,

- during FY1999, we potentially undercharged salary related to FFEL programs by up to approximately $111,000.

Therefore, ISAC contends that we potentially undercharged the Federal Fund by up to approximately $1,221,000 between FY1997 and FY1999.

ILLINOIS STUDENT ASSISTANCE COMMISSION

Subject: Audit Finding Number 2

Finding Title

ISAC Made an Unauthorized Transfer from the Federal Fund to the Operating Fund for Unused Vacation and Sick Pay.

Response

Disagree

We assert that ISAC did not make an unauthorized transfer from the Federal Fund to the Operating Fund for unused vacation and sick pay and that the issue is not one of an unauthorized use of the Federal Fund, but rather involves the distribution of assets and corresponding liabilities (residual equity transfer) in the establishment of the Federal Fund, the Operating Fund and the Federal Recall Fund.

It is also important to note that ISAC uses a modified accural basis of accounting, **not a cash basis of accounting.** Therefore, ISAC assigned $1,524,248 from the Student Loan Fund (the one fund which existed prior to establishment of the three funds required to implement the new guaranty agency financing structure) to the Operating Fund (at the time of its establishment on October 1, 1998), the equivalent of the Federal Family Education Loan Program's portion of accumulated vacation and sick pay as of September 30, 1998. This was done to accurately reflect the distribution of assets and corresponding liabilities in establishing the funds. This was a liability which was incurred prior to the establishment of the Operating Fund. We believe that the audit finding cite of Section 422A (d) of the 1998 amendments to the HEA and 34 CRF 682.419 does not apply to this situation. We believe the authorized uses of the Federal Fund outlined in 422A (d) apply to post-fund creation activities and expenditures and not to the establishment of the fund itself.

In addition, as noted in the audit exit interview conducted on Friday, March 9, ISAC followed generally accepted accounting procedures per GASB 16, Accounting for Compensated absences, which indicates "because all governmental entities are required to report accrual-based compensated absences liabilities, the GASB expanded the scope of this project (GASB 16) to establish accrual-based compensated absences standards for all entities, regardless of the reporting model, or fund type used for financial reporting."

Per GASB 16, a liability for compensated absences that is attributable to services already rendered and that is not contingent on a specific event that is outside the control of the employer and employee should be accrued as employees earn the rights to the benefits. While governments must recognize their full liability for compensated absences that have been earned but not yet taken by employees, only the current year's usage of compensated absences are booked in the respective funds. GASB requires booking the balance of the total liability in the General Long Term Debt Accounts Group for governmental funds. Therefore, a liability did indeed exist for the leave which accrued prior to 10/01/98 and, thus, the accrual basis of accounting for this leave could be used as outlined in OMB Circular A-87. As a state agency, ISAC must conform to the GASB standards. In this instance, A-87 cannot be applied to a state guaranty agency in its strictest sense, but must be applied using the required accounting standards for the agency.

With the creation of the operating fund on 10/01/98, all administrative costs including compensated absences are to be paid only from the Operating Fund. These costs accrued under and would have previously been payable from the Student Loan Fund. Thus, it is reasonable and within generally accepted accounting principles to transfer an amount to the Operating Fund sufficient to fund this existing liability. To do other than this would create an inequitable division of the assets and liabilities of the original Student Loan Fund with the Operating Fund assuming responsibility for liabilities related to accrued leave, but not receiving the corresponding assets associated with the activities conducted prior to 10/01/98. Further, the transfer of the resources to the Operating Fund does not equate to expense recognition, but, merely, the distribution of the assets on the date the new funding model was established.

ILLINOIS STUDENT ASSISTANCE COMMISSION

Subject: Audit Finding Number 3

Finding Title

ISAC Has Not Recognized the Federal Government's Ownership Interest in the Building and Land ISAC Occupies.

Response

Disagree

ISAC contends that we are in compliance with the regulations of Section 422A (e) of the 1998 Amendment to the HEA of 1965, 34 CFR 682.420 (a) and 682.420 (c)(1)(i), the objections of the auditors to the contrary notwithstanding. If there exists a disagreement in this regard, we respectfully refer the auditors as well as other Department of Education officials to the State of Illinois' Department of Central Management Services (CMS) staff; Carole Fox, Manager, Bureau of Property Management at 217-785-0562 or Mr. Steve Seiple, Chief Legal Counsel at 217-782-9669. CMS is the administrative agent for the State in handling all matters relating to property used by State agencies including the Illinois Student Assistance Commission. In addition, you may also contact Ms. Karen Salas, ISAC General Counsel at 847-948-8500, extension 3111.

The State of Illinois through CMS (not ISAC, the guaranty agency) entered into a capital lease agreement with NBD Trust Company of Illinois. This agreement, dated March 1, 1992, provided for ISAC's use of the land and building located at 1755 Lake Cook Road, Deerfield. The State of Illinois, operating through CMS, dictates the release of payments made by ISAC for its occupancy. This directive and the manner in which it is carried forth (at the behest of CMS) is fully compliant with the terms of State law.

As per instructions from CMS, ISAC allocates the semi-annual lease payments to its three major programs, the Federal Family Education Loan Program, Scholarship & Grant Programs and Illinois Designated Account Purchase Program based on square footage occupied. These allocations are occupancy charges (rent) allocated to each of the programs for administration. These are not capital lease payments for each of the programs. At the completion of the capital lease agreement, it is the State of Illinois that will own the building, not ISAC, and it is the State of Illinois which will determine the continued best use of the property.

The occupancy charges collected by ISAC from the three programs are deposited semi-annually into a State of Illinois controlled account at the fiscal agent (formerly National City Bank and currently LaSalle Bank). The fiscal agent in turn pays the semi-annual lease payments to the bondholders.

GASB requires that for governmental fund types, fixed assets (including Land and Building) be recorded in the Fixed Assets Accounts Group, not in the expending funds. ISAC did not book Land and Building in the General Fund. Although it is reflected in the fixed assets accounts group as an asset and as a liability, this is part of the State's comprehensive financial statement reflecting State of Illinois assets. Upon completion of the capital lease payment the Land and Building will be owned by the State of Illinois, not by the programs or agency that pays occupancy costs.

ILLINOIS STUDENT ASSISTANCE COMMISSION

Subject: Audit Finding Number 4

Finding Title

ISAC Transferred SPA Payments Intended for the Federal Fund to the Operating Fund.

Response

Concur with finding, but with modified resolution.

We concur that ISAC transferred SPA payments from the Federal Fund to the Operating Fund from October 1998 through March 1999.

Although ISAC was eligible to receive Default Aversion Fees beginning in October, 1998, we did not transfer funds for this purpose from October 1998 through March 1999. Due to the short timeframe between the establishment of the Default Aversion fee approach and the effective implementation date, ISAC's information systems did not include the functionality required to support the new approach to reimbursement beginning October 1, 1998. Rather than attempt to bill for the fees through an interim and more unreliable method, ISAC decided to forego collection of the Default Aversion Fees (which was noted in the State of Illinois Compliance Audit for the two years ended June 30, 1999). During this time ISAC continued to perform all default aversion/default prevention activities.

Given the data that we had available at the time, we are confident that the Default Aversion Fees collected would have been significantly more than the SPA payments. The net effect of this is that the federal fund balance will permanently remain higher than it would have been had we transferred funds to support default aversion fees. Therefore, we believe that an appropriate and more than equitable resolution to this finding is to transfer the $419,122 (the amount of the SPA payments) back to the Federal Fund, but not be responsible for imputed interest.

ILLINOIS STUDENT ASSISTANCE COMMISSION

Subject: Audit Finding Number 5

Finding Title

ISAC's Charge to the Federal Fund for Late Filing Fees Was Not an Authorized Use of Federal Funds.

Response

Concur

ISAC acknowledges that the assignment of the de minimus costs associated with the late filing of its monthly (1189) and quarterly (1130) reports does not appear to be an authorized use of the Federal Fund. The total amount of $2,677 has been transferred to the Federal Fund.

It is important to note that ISAC has implemented procedures which will subsequently prevent the assessment of the late filing fees in question. In the event that an anomalous event prevents the timely filing of such reports, ISAC is in agreement that such fees should be paid from the Operating Fund.

ILLINOIS STUDENT ASSISTANCE COMMISSION

Subject: Audit Finding Number 6

Finding Title

ISAC Understated the Complement of Reinsurance Percentage from Post-Default Collections.

Response

Concur

During the OIG's audit, ISAC found errors in the spreadsheet formula that was used to calculate the complement of reinsurance on certain categories of loans and also found that it had omitted by mistake to calculate complements on certain other categories of loans. These data entry errors were corrected and the total amount of $172,103 was transferred to the federal fund at that time. In addition, ISAC has modified its procedures to include a cross-check of the spreadsheet formulas to ensure the transfer of appropriate complement of reinsurance percentage for all reinsurance categories.

Upon implementation of the Odyssey system (a new system that ISAC is developing to support post default collections and accounting functions), the complement portion of reinsurance will be automatically calculated by the system.

ILLINOIS STUDENT ASSISTANCE COMMISSION

Subject: Other Matters

Response

Accuracy of ISAC's NSLDS Data

With regard to the accuracy of ISAC's NSLDS data, an *NSLDS Data Integrity Improvement Plan* has recently been submitted to the Department of Education which should address the issues outlined in the draft audit report. A copy of this report is attached.

48 Hour Rule

As noted in the draft audit report, ISAC is still engaged in discussion with Region V representatives of the Department of Education to resolve state statutory obstacles related to technical compliance with 34 CFR 682.419(b)(6). A copy of ISAC's most recent correspondence to Region V on this issue is attached.

Terminal Leave Costs

As noted in ISAC's response to draft audit finding #1 (cost allocation), the systemic obstacles inherent in the state's accounting and disbursements procedures precludes a perfect division of costs (accrued sick and vacation pay) upon an employee's termination. We do assert, however, that the aggregate effect of all such terminations in any given fiscal year (and, for that matter, over the course of several fiscal years) does result in the correct allocation of costs to the funds supporting the functions of the employee in question. In order to fully address the auditor's concerns, however, ISAC will address this issue directly in current and future cost allocation plans.

NSLDS Data Integrity Alert Improvement Plan as of 11/15/2000

Item	ISAC Analysis	Plan of Action
Non-current balances on Lender held loans. 466,326 loans affected Impacts payment of fees	Over half of the loans affected are pre-conversion loans (made prior to1982) and are loans made prior to ISAC's current guaranty computer system. The original system only stored data on the most recent loan so upon conversion to the current system, the only data available was for the most recent loan. Unfortunately, due to this lack of data, the data reported by lenders on these early loans do not match the data available in the system for the borrower. The other portion of the affected loans is unreported balances by lenders. These loans have either never been reported on by the lender or have not been reported on during the last 180 days.	-Data clean up efforts on pre-conversion loans. We are attempting to create the loan record with key identifiers so that we can load the loan onto our guaranty system. We can then begin to work on matching loans through our standard lender manifest process. -Utilize the new loan status code of "PM" (presumed paid) when available after January 2001 to more accurately report the status of older loans that have never been reported on during the lender manifest process. - Twice a year ISAC generates and sends an Unreported Loans Report to lenders. This report is provided to make lenders aware and prompt them into action concerning specific loans they hold that need balance and status information. The second report to be sent in 2000 is scheduled to be mailed in November, 2000.
Loans not in NSLDS with errors. 59,249 loans affected Impacts payment of fees	17,000 of the affected loans have been identified as missing key data elements such as loan status date or loan guaranty date. The analysis on the remaining loans has not presented specific data errors or trends.	-Data clean up regarding specific key data elements. ISAC is actively completing efforts to add the key data elements to the loan record when they are known. -An October 17, 2000 request was made to NSLDS staff to provide reports and assistance on those loans that do not present specific data errors.
Non-current balance on GA held loans 43,569 loans affected. Impacts student eligibility	Per NSLDS specifications, we report the loan balance date as of month end on GA held loans.	-An October 17 request was made to NSLDS staff to provide loan detail on these loans to determine where errors may be occurring.
Underlying loans for CL not Coded as PC 25,667 loans affected. Impacts student eligibility	Probable that our guaranty system incorrectly reported loan status at the time we guaranteed the loan consolidation request.	-ISAC requesting internal extract of guaranty system to identify consolidation loans with underlying loans reported as paid in full not paid by consolidation. -Underlying loans will be corrected to reflect proper loan status.

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Non-Reporting of refunds. Number of loans affected unknown. Impacts student eligibility	Initially the required data elements to properly report this information were not available on our guaranty system. We can confirm that lenders can report this information via the lender manifest process.	-Modifications have been made to guaranty system to capture the required data elements from lender manifest reporting process. -Modifications need to be made to the monthly extract to provide this information into NSLDS via the regular reporting process.
Use of 999999 as school code. 45, 403 affected loans 1,076 affected loans in FY'98 Cohort default rate Impacts cohort default rates	Per NSLDS specifications, a value of 999999 is a valid value only for those loans made prior to 1/1/84. ISAC's data only reflects 226 loans made after 1/1/84 with 999999 as school code value.	-An October 17, 2000 request was made to NSLDS staff to provide examples of loans made after 1/1/84 and carry a school code value of 999999. -A interdependency with proper reporting of date entered repayment errors has been identified. This is item 9 on this plan. Correction of this item may also result in the proper reporting of school code for the 1,076 loans in the FY98 Cohort Default Rate.
Date of Loan Status< Date entered repayment 15,432 loans affected Impacts cohort default rates	Analysis indicates that most of these affected loans are loans on which lenders have never reported.	-Modifications need to be made to our method of calculating the Date Entered Repayment. -Apply correct calculation to affected loans.
Date of GA Principal/Interest Collection< DER 14,539 loans affected Impacts cohort default rates	Analysis indicates that most of these affected loans are loans on which lenders have never reported.	-Modifications need to be made to our method of calculating the Date Entered Repayment on these loans. -Apply correct dates to loans.
Forward moving Date Entered Repayment 14,295 loans affected Impacts cohort default rates	Analysis indicates that most of these affected loans are loans on which lenders have never reported.	-Modifications need to be made to our method of calculating the Date Entered Repayment on these loans. -Apply correct dates to loans.
Date Deferment Starts<Date Entered Repayment 13,558 loans affected Impacts cohort default rates	Our lenders via the lender manifest process are providing this data. Lenders are reporting dates of deferment start < than their reported Date Entered Repayment.	-Initiating discussions with staff to determine best resolution approach.
Non-Reporting of Supplemental Insurance Payments. Number of loans affected unknown.	Acknowledge that ISAC is unable to capture and report this information due to the limitations of our existing claim system.	- Implementation of the claim portion of ISAC's new post guaranty system (Odyssey) will correct this reporting deficiency. Anticipated effective date – Fall 2001.
Non-Reporting of GA Bankruptcy Claim Refunds. Number of loans affected unknown.	Acknowledge that ISAC is unable to report this information due to the limitations of our existing claims system.	- Implementation of the claim portion of ISAC's new post guaranty system (Odyssey) will correct this reporting deficiency. Anticipated effective date – Fall 2001.

Item	ISAC Analysis	Plan of Action
Rolled up loans 5,001 affected loans	Need additional information to perform analysis.	- Request was made to NSLDS staff on October 17, 2000 to provide reports and assistance on these loans.
Amount of Guaranty > maximum allowed by academic level. 8,693 loans affected	These are pre-conversion loans. See explanation for item #1. These loans only create one aggregate total which serves as the guaranty total. We currently are unable to provide guaranty total by loan.	- Through a data cleanup effort on pre-conversion loans, we are attempting to create individual loan records with the appropriate guaranty totals.

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