



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

SEP 25 2001

MEMORANDUM

TO: Greg Woods  
Chief Operating Officer  
Student Financial Assistance

FROM:   
Thomas A. Carter  
Assistant Inspector General for Audit Services

SUBJECT: FINAL AUDIT REPORT  
Audit of the Michigan Guaranty Agency's Administration of the Federal Family  
Education Loan Program Federal and Operating Funds  
Control Number ED-OIG/A05-B0007

Attached is our subject report presenting our findings and recommendations resulting from our audit of the Michigan Guaranty Agency'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



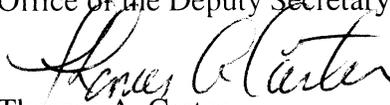
UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

**MEMORANDUM**

SEP 25 2001

**TO:** William D. Hansen  
Deputy Secretary  
Office of the Deputy Secretary

**FROM:**   
Thomas A. Carter  
Assistant Inspector General for Audit Services

**SUBJECT:** FINAL AUDIT REPORT  
*Audit of the Michigan Guaranty Agency's Administration of the Federal  
Family Education Loan Program Federal and Operating Funds*  
Control Number ED-OIG/A05-B0007

Attached is a copy of the final audit report referenced above. We are furnishing this report to you because it may contain information of interest to you. No response on your part is necessary.

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.

If you have any questions, please contact Richard Dowd, Regional Inspector General for Audit at 312-886-6503.

Attachment



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

**MEMORANDUM**

SEP 25 2001

**TO:** Terry Abbott  
Chief of Staff  
Office of the Secretary

**FROM:**   
Thomas A. Carter  
Assistant Inspector General for Audit Services

**SUBJECT:** FINAL AUDIT REPORT  
*Audit of the Michigan Guaranty Agency's Administration of the Federal Family Education Loan Program Federal and Operating Funds*  
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If you have any questions, please contact Richard Dowd, Regional Inspector General for Audit at 312-886-6503.

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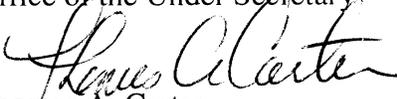
UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

**MEMORANDUM**

SEP 25 2001

**TO:** Eugene W. Hickok  
Under Secretary  
Office of the Under Secretary

**FROM:**   
Thomas A. Carter  
Assistant Inspector General for Audit Services

**SUBJECT:** FINAL AUDIT REPORT  
*Audit of the Michigan Guaranty Agency's Administration of the Federal  
Family Education Loan Program Federal and Operating Funds*  
Control Number ED-OIG/A05-B0007

Attached is a copy of the final audit report referenced above. We are furnishing this report to you because it may contain information of interest to you. No response on your part is necessary.

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If you have any questions, please contact Richard Dowd, Regional Inspector General for Audit at 312-886-6503.

Attachment



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

SEP 25 2001

Mr. H. Jack Nelson  
Executive Director  
Michigan Higher Education Assistance Authority  
P.O. Box 30047  
Lansing, Michigan 48909-7547

Dear Mr. Nelson:

Enclosed is our final report (Control Number ED-OIG/A05-B0007) entitled, *The Michigan Guaranty Agency'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  
7<sup>th</sup> 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,

Thomas A. Carter

Assistant Inspector General for Audit Services

Attachment

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The Michigan Guaranty Agency's  
Administration of the Federal Family Education Loan Program  
Federal and Operating Funds

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**FINAL AUDIT REPORT**



**ED-OIG/A05-B0007**  
**September 2001**

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Our mission is to promote the efficiency,  
effectiveness, and integrity of the  
Department's programs and operations



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

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# **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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*Control Number ED-OIG/A05-B0007*

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## EXECUTIVE SUMMARY

Except for the findings discussed in this report, the Michigan Guaranty Agency (MGA) complied with the Higher Education Act of 1965 (HEA), as amended, while establishing and maintaining its Federal Family Education Loan (FFEL) program Federal and Operating Funds during the period October 1, 1998 through September 30, 1999. We identified three findings that affect the balances of the funds:

- During the establishment of its Federal and Operating Funds, MGA transferred a Federal Reserve Fund receivable to the Operating Fund. Section 422A (a) of the HEA required each guaranty agency to deposit all funds, securities, and other liquid assets from the Federal Reserve Fund into a Federal Fund by December 6, 1998. Therefore, MGA understated the Federal Fund by \$612,400 and the Federal Fund lost about \$81,000 in imputed interest.
- MGA understated its interest liability to the Federal Fund due to MGA's delayed deposit of the Federal Fund's share of post-default collections. Section 422A (b) of the HEA required each guaranty agency to invest all funds deposited in the Federal Fund and specified that the Federal Fund's earnings are the sole property of the Federal Government. Although MGA repaid some imputed interest, we estimated MGA owes the Federal Fund about \$377,000 in additional imputed interest.
- The Federal Fund lost about \$30,000 of imputed interest while supplemental preclaims assistance (SPA), a Federal Fund asset, remained in the Operating Fund. Section 422A (c) (4) of the HEA required guaranty agencies to deposit all SPA payments into the Federal Fund.

We also noted an issue that warrants Student Financial Assistance's (SFA) attention. MGA allocated shared expenses, but had no cost allocation plan. According to 34 C.F.R. § 682.418 (c) (1998), if a guaranty agency shares costs with any other program, agency, or organization, it must develop a cost allocation plan consistent with the requirements of Office of Management and Budget (OMB) Circular A-87.

We recommend that the Chief Operating Officer (COO) for SFA require MGA to return \$1,100,400 to the Federal Fund and any additional imputed interest accruing after April 30, 2001.

We provided MGA a draft report. MGA agreed with Findings 1 and 3, and transferred the recommended recovery amounts to the Federal Fund on August 23, 2001. MGA did not agree with our recommendation in Finding 2. We paraphrased MGA's comments after each finding and also included them in their entirety as an Attachment.

## AUDIT RESULTS

During the period October 1, 1998 through September 30, 1999 (FY 1999), except as discussed below, MGA complied with the HEA, as amended, while establishing and maintaining its FFEL program Federal and Operating Funds. We identified three findings that affect the balances of the funds. MGA elected not to transfer funds from the Federal Fund to the Operating Fund under § 422A (f) of the HEA; therefore, MGA was not required to adhere to the prohibited uses of assets regulations. Also, MGA's Federal Fund had no fixed assets in FY 1999; so, usage fees were not due from the Operating Fund.

### **Finding 1 – Unauthorized Transfer to the Operating Fund**

During the establishment of its Federal and Operating Funds, MGA transferred a Federal Reserve Fund receivable to the Operating Fund. Effective October 1, 1998, MGA transferred most Federal Reserve Fund assets to its new Federal Fund. However, it did not transfer a \$612,400 receivable due from the State Treasury to the Federal Fund. The \$612,400 represented collection fees the State Treasury overcharged MGA plus accrued interest on a Federal Reserve Fund U.S. Treasury Bill maintained by the State Treasury in a trust fund. MGA transferred this asset to the Operating Fund. During FYs 1999 and 2000, MGA received payment from the State Treasury and deposited the funds into the Operating Fund.

Section 422A (a) of the HEA required each guaranty agency to deposit all funds, securities, and other liquid assets from the Federal Reserve Fund into a Federal Fund by December 6, 1998. Sections 422A (b) and (e) also required that deposited funds be invested, and specified that the Federal Fund and its earnings are the property of the Federal Government. SFA issued interim guidance in January and November 1999, and published regulations relating to the Federal and Operating Funds on October 29, 1999. In administering Federal funds, a guaranty agency must exercise the level of care required of a fiduciary charged with investing the money of others. 34 C.F.R. § 682.419 (a) (2000); 34 C.F.R. § 682.410 (a) (5) (1998).

MGA officials stated that they exercised professional judgment during the establishment of the Federal and Operating Funds and considered the receivable to be an Operating Fund asset. MGA officials also mentioned that MGA's independent auditors agreed with MGA's handling of this accounting transaction.

The Federal Fund also lost interest income while the asset was in the Operating Fund. Using the U.S. Treasury Current Value of Funds Rate (CVFR), we calculated imputed interest totaling about \$81,000 through April 30, 2001.

## Recommendations

We recommend that the COO for SFA require MGA to

1.1. Return \$693,400 to the Federal Fund. This amount includes:

- (a) The \$612,400 it transferred to the Operating Fund, and
- (b) Imputed interest of \$81,000.

1.2. Return to the Federal Fund interest income earned on the \$612,400 after April 30, 2001. This interest should be computed using the applicable CVFR through the date this finding is resolved.

**MGA Comments** – MGA agreed with our audit finding and recommendations. On August 23, 2001, MGA transferred \$705,322 from the Operating Fund to the Federal Fund. The amount included \$612,400 plus \$92,922 in imputed interest earned up to the time of the transfer.

## Finding 2 – MGA Understated Interest Owed the Federal Fund

MGA understated its interest liability to the Federal Fund by about \$377,000. From October 1998 through June 2000, MGA deposited post-default collections into the Operating Fund. Post-default collections remained in the Operating Fund for a range of 56 to 273 days before MGA deposited the Federal share in the Federal Fund each month. MGA transferred \$52,569 from the Operating Fund to the Federal Fund on August 3, 2000, based on its calculation of interest that Federal funds earned while they remained in the Operating Fund. However, MGA did not consider all Federal funds deposited in the Operating Fund or the entire period those funds remained in the Operating Fund.

Section 422A (c) (2) of the HEA required that the Federal share of post-default collections be deposited in the Federal Fund. Section 422A (b) also required that deposited funds be invested and specified that the earnings are the sole property of the Federal Government. In administering Federal funds, a guaranty agency must exercise the level of care required of a fiduciary charged with investing the money of others. 34 C.F.R. § 682.419 (a) (2000); 34 C.F.R. § 682.410 (a) (5) (1998). Consistent with this fiduciary obligation, 34 C.F.R. § 682.419 (b) (6) (2000) specified that, a guaranty agency must deposit the Federal share of default collections into its Federal Fund within 48 hours of receipt. Guidance issued by the U.S. Department of Education (Department) instructed guaranty agencies that they must deposit into the Federal Fund any investment income earned on the Federal

share of collections between October 1, 1998 and September 1, 2000. Dear Colleague Letter G-00-328 (July 18, 2000).

Using the 5 percent CVFR, we recalculated the amount of imputed interest due to the Federal share of post-default collections while it remained in the Operating Fund. For example, the Federal share of collections that MGA deposited into the Operating Fund during October 1998 totaled \$2,339,028. MGA transferred most of the Federal share into the Federal Fund on December 18, 1998 and the remainder in March and October 1999. We estimated the Federal Fund lost about \$21,651 while its share remained in the Operating Fund. For the same period, MGA calculated interest of \$1,999, leaving an additional \$19,652 in interest owed the Federal Fund. MGA's calculation considered only collections the State Treasury received (\$1,107,057) from October 7<sup>th</sup> through October 31<sup>st</sup>, instead of total collections over the entire time the funds remained in a non-Federal account (average of 203 days).

Following the same process for all the months involved, we estimated that MGA owes the Federal Fund about \$377,000 more in imputed interest. We estimated the amount because MGA does not have the data to calculate the actual imputed interest earned.

### **Recommendation**

We recommend that the COO for SFA require MGA to

2. Return \$377,000 to the Federal Fund for imputed interest Federal funds earned while they remained in the Operating Fund.

**MGA Comments** – Past guidance is currently under advisement at the senior level within the Department. Until the Department makes a final determination on whether to enforce the guidance or amend it, MGA will not take action on the audit finding and recommendation.

**OIG Response** – MGA's comments did not cause us to change our position. The guaranty agencies' fiduciary responsibility with respect to Federal funds, the law, and the Department's guidance all require guaranty agencies to deposit investment income earned on the Federal Government's share of collections into the Federal Fund.

### **Finding 3 – MGA Did Not Transfer Imputed Interest SPA Earned While in the Operating Fund**

The Federal Fund lost about \$30,000 of imputed interest while supplemental preclaims assistance (SPA), a Federal Fund asset, remained in the Operating Fund. From December 1998 to May 1999,

MGA transferred \$369,287 in SPA from the Federal Fund to the Operating Fund. MGA returned the \$369,287 to its Federal Fund on August 31, 2000, but did not return imputed interest.

Section 422A (c) (4) of the HEA required guaranty agencies to deposit all SPA payments into the Federal Fund. Section 422A (b) also required that deposited funds be invested and specified that the earnings are the sole property of the Federal Government. In administering Federal funds, a guaranty agency must exercise the level of care required of a fiduciary charged with investing the money of others. 34 C.F.R. § 682.419 (a) (2000); 34 C.F.R. § 682.410 (a) (5) (1998).

MGA officials determined that they had complied with the HEA and met their fiduciary responsibility when they transferred the SPA payments from the Operating Fund to the Federal Fund. Using the 5 percent CVFR, the Federal Fund lost about \$30,000 in imputed interest through August 2000.

### **Recommendation**

We recommend that the COO for SFA require MGA to

3. Return \$30,000 to the Federal Fund for imputed interest SPA earned while in the Operating Fund.

**MGA Comments** – MGA agreed with our audit finding and recommendation. On August 23, 2001, MGA transferred \$29,683 from the Operating Fund to the Federal Fund.

### **OTHER MATTERS**

We noted an additional issue that warrants SFA's attention. We did not fully develop the issue as a finding due to its immaterial effect. MGA allocated shared expenses, but had no cost allocation plan. According to 34 C.F.R. § 682.418 (c) (1998), if a guaranty agency shares costs with any other program, agency, or organization, it must develop a cost allocation plan in accordance with the requirements of OMB Circular A-87. MGA's allocated expenses were primarily personnel and building rental costs. Total allocated costs represented about 7 percent of MGA's administrative expenses in FY 1999.

To comply with Federal regulations, MGA should develop a cost allocation plan, maintain supporting documentation for salaries and fringe benefits, and update its square footage calculations used to allocate building rent in accordance with OMB Circular A-87.

## **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 program 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.

MGA is a component of the Michigan Higher Education Assistance Authority and was established by Act 77 of the Public Acts of 1960. MGA is the guaranty agency for the FFEL program in Michigan.

## **AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY**

The purpose of our audit was to determine whether MGA 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 prohibited uses of assets 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) FY 1999 accounting transactions relevant to the establishment of the Federal and Operating Funds, (2) accounting transactions that occurred during FY 1999 related to the transfer of funds from the Federal Fund to the Operating Fund, (3) supporting documentation for MGA's shared operating expenses in FY 1999, (4) FYs 1999 and 2000 transactions for the distribution of post-default collections, and (5) transactions related to the distribution of FY 1999 account maintenance fees, default aversion fees, and SPA. We reviewed MGA's financial reports for the years ended September 30, 1998 and 1999 and its OMB Circular A-133 reports for the years ended September 30, 1997 and 1998, 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 MGA personnel and SFA officials.

To achieve our audit objectives, we relied on the accuracy of MGA's automated general ledger system, Micro Information Product. 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 January 8, 2001 through June 8, 2001. We performed the majority of our field work at MGA's location in Lansing, Michigan. 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 MGA's management control structure, policies, procedures, and practices applicable to MGA's administration of the FFEL program. 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:

- S Establishment of the Federal and Operating Funds
- S Maintenance of the Federal and Operating Funds
- S Ownership of fixed assets used to administer the FFEL program
- S Transfers of assets from the Federal Fund to the Operating Fund
- S 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 MGA's controls over the establishment and maintenance of its Federal and Operating Funds. We describe the weaknesses in the Audit Results and the Other Matters sections. We are not recommending corrective action regarding control weaknesses in Findings 1 through 3 because MGA will not establish the Federal and Operating Funds again.

MICHIGAN HIGHER EDUCATION ASSISTANCE AUTHORITY



JOHN EMERSON, Director  
DOUGLAS B. ROBERTS, State Treasurer

OFFICE OF FISCAL AFFAIRS  
P.O. Box 30047, Lansing, Michigan 48909  
Phone: (517) 373-8823 FAX: (517) 373-1741

September 5, 2001

ROBERT W. BLACKSTOCK  
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HOWARD WEAVER  
FRED E. WHITTE

DOUGLAS B. ROBERTS  
Executive Director

Ms. Laura DiVincenzo, CPA, CIA  
U.S. Department of Education  
Office of the Inspector General Western Area  
111 North Canal Street  
Suite 940  
Chicago, Illinois 60606-7204

Dear Ms. DiVincenzo:

Enclosed please find the Michigan Guaranty Agency's response to the OIG draft audit report dated August 2001. Please feel free to contact me or Dennis Reilly if you have any questions or need additional information.

Sincerely,

A handwritten signature in cursive script that reads "Gary E. Harvey".

Gary E. Harvey, C.P.A.  
Director

Enclosures

**Finding 1 – Unauthorized Transfer to the Operating Fund**

**Recommendations**

We recommend that the COO for SFA require MGA to

1.1. Return \$693,400 to the Federal Fund. This amount includes:

(a) The \$612,400 it transferred to the Operating Fund, and

(b) Imputed interest of \$81,000

1.2 Return to the Federal Fund interest income earned on the \$612,400 after April 30, 2001. This interest should be computed using the applicable CVFR through the date this finding is resolved.

**Agency Response**

The Michigan Guaranty Agency concurs with the audit finding and recommendations. As a result, the Agency made the necessary transfers of funds on August 23, 2001.

**Finding 2 – MGA Understated Interest Owed the Federal Fund**

**Recommendation**

We recommend that the COO for SFA require MGA to

2. Return \$377,000 to the Federal Fund for imputed interest Federal funds earned while they remained in the Operating Fund.

**Agency Response**

The U.S. Department of Education's (the "Department") past guidance on the issue of "retroactive interest on the Secretary's share of collections" is currently under advisement in the Department. The Department is not enforcing such a Finding pending the outcome of a guidance review at the senior level within the Department. (See attached.) Until the Department makes a final determination on whether to enforce the guidance or amend it, it would not be prudent for the Michigan Guaranty Agency to take any action on the audit Finding and Recommendation.

**Finding 3 – MGA Did Not Transfer Imputed Interest SPA Earned While in the Operating Fund**

**Recommendation**

We recommend that the COO for SFA require MGA to

3. Return \$30,000 to the Federal Fund for imputed interest SPA earned while in the Operating Fund.

**Agency Response**

The Michigan Guaranty Agency concurs with the audit finding and recommendation. As a result, the Agency made the necessary transfer of funds on August 23, 2001.



UNITED STATES DEPARTMENT OF EDUCATION  
THE OFFICE OF STUDENT FINANCIAL ASSISTANCE  
WASHINGTON, D.C. 20202-\_\_\_\_\_

September 4, 2001

Mr. Brett Lief, President  
NCHELP  
1100 Connecticut Ave, Suite 1100  
Washington, D.C. 20036

Dear Brett:

You've asked for clarification as to the Department's position on the issue referred to by the community as "retroactive interest on the Secretary's share of collections."

As you know, the Department issued a Dear Guaranty Agency Director letter on July 18, 2000. Although some guarantors have followed the guidance in that letter, other guarantors assert a portion of the guidance to be unlawful and have not complied with the payment of interest outlined in the letter. Some guarantors are reportedly considering litigation if the matter cannot ultimately be resolved. Late last year settlement discussions occurred between the Department and the aggrieved guarantors, but were unsuccessful. Shortly thereafter, there was a change in the Administration. The Department's new senior leadership is aware that some guarantors have asked that the guidance be reviewed and amended, and the issue is currently under advisement at the senior level.

In the interim, it is the Department's position that the prior July 18, 2000 guidance is still controlling. When we find instances of non-compliance, we are citing it as a Finding. However, while this guidance is under review at the senior level of the Department, we are not taking action at this time to enforce such a Finding and we have been stating that as part of the Finding. Depending on the outcome of the pending guidance review, we will then either begin enforcing the guidance or will amend it.

I hope this answers your question.

Sincerely,

A handwritten signature in black ink, appearing to read "John A. Reeves".

John A. Reeves  
General Manager, Financial Partners

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