



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

400 MARYLAND AVENUE, S.W.
WASHINGTON, DC 20202-1500



February 2, 2006

Control Number ED-OIG/A05F0013

Theresa S. Shaw, Chief Operating Officer
Federal Student Aid
U.S. Department of Education
830 First Street, NE, Union Center Plaza, Room 112G1
Washington, D.C. 20202

Dear Ms. Shaw:

This Final Audit Report, titled *Federal Student Aid's Internal Control over Initial Exceptional Performance Applications*, presents the results of our audit. The objective of our audit was to assess the adequacy of Federal Student Aid's (FSA) internal control over its initial approval of lenders' or servicers' requests for Exceptional Performance (EP) designation. The audit period covered applicants' requests that became effective during the period January 1, 2003, through April 30, 2005.

BACKGROUND

Section 428I of the Higher Education Act of 1965, as amended (HEA), authorizes the Secretary of the U.S. Department of Education (Department) to recognize lenders and servicers for an exceptional level of performance in servicing Federal Family Education Loan (FFEL) program loans. Lenders and servicers designated for EP may receive 100 percent reimbursement on all claims submitted for insurance during the 12-month period following the date they receive notification of the designation. Without this EP designation, only 98 percent of the unpaid principal balance of a loan would be guaranteed if the loan were first disbursed on or after October 1, 1993.

Under 34 C.F.R. § 682.415(a)(2), to apply for EP designation, a lender or servicer must submit to the Secretary a written request. The written request must include, among other items, a copy of an annual audit report and an audit of the entity's loan portfolio that yields a compliance performance rating of 97 percent or higher for all due diligence requirements applicable to each loan. The lender or servicer must maintain an overall compliance performance percentage of 97

or higher with respect to (1) converting FFEL program loans to repayment, (2) collecting delinquent loans, and (3) filing claims with the guaranty agency in a timely manner.

Financial Partners Services (FP) designated a single resource in the headquarters office to serve as the coordinator for all requests for EP designation. The EP coordinator serves as the point of contact for new applicants. To review a request for EP designation, the EP coordinator performs an initial review to ensure the request includes all required documentation. After the initial review, the EP coordinator sends the request to a regional FP office. A regional office team conducts a review of the applicant following steps defined by FP management and provides a report recommending approval or denial to the EP coordinator. The EP coordinator reviews the regional office's report and recommendation, discusses the review with the FP's General Manager, and provides a final recommendation to FSA's Chief Operating Officer and the Office of Postsecondary Education's Assistant Secretary, who make the final decision on the lender's or servicer's request.

As of April 30, 2005, there were 12 lenders and servicers that received the EP designation. Six lenders with the EP designation ranked in the top 100 holders of FFEL program loans as of September 30, 2004.

AUDIT RESULTS

FSA did not always ensure that a lender or servicer included in its request for EP designation an annual audit that met the requirements of 34 C.F.R. § 682.415(a)(2)(i)(E) to cover a period that ended no more than 90 days prior to the submittal date. Of the 12 approved requests, 2 did not include such an audit. In addition, FSA did not always maintain records that were sufficient to adequately document the EP review and approval process. Except for these two findings, FSA's internal control over the initial approval of lenders' and servicers' requests for EP designation was generally adequate.

A draft of this report was provided to FSA. In its response, FSA concurred with all of our findings and recommendations. We summarized FSA's response after each finding and provided a copy of FSA's complete response as an attachment to this report.

Finding No. 1 FSA Needs to Ensure Applicants Comply with the 90-day Requirement for Annual Audits

Under 34 C.F.R. § 682.415(a)(2)(iii)(A), all applicants must submit a compliance audit that yields a compliance rating of 97 percent or higher with due diligence requirements. The entity may submit its application no later than 90 days after the end of the audit period. All 12 approved applicants met this requirement.

In addition to the compliance audit required under 34 C.F.R. § 682.415(a)(2)(iii)(A), lender or servicer applicants must also submit one of three additional annual audits specified in 34 C.F.R. § 682.415(a)(2)(i)(E):

A copy of an annual financial audit performed in accordance with the Audit Guide developed by the U.S. Department of Education, Office of Inspector General, or one of the following as appropriate:

(1) A lender may submit a copy of an annual audit required under §682.305(c), if the audit period ends no more than 90 days prior to the date the lender submits its request for designation.

(2) A servicer may submit a copy of the annual financial audit, as defined, completed and submitted under 34 CFR 682.416(e), if the audit period ends no more than 90 days prior to the date the servicer submits its request for designation.

Two applicants, Wells Fargo and Great Lakes Educational Loan Services, Inc. (Great Lakes), chose to submit an annual audit required under paragraph (2) of the Department's regulations rather than "an annual financial audit performed in accordance with the Audit Guide developed by the U.S. Department of Education, Office of Inspector General." Contrary to regulatory requirements, the audit periods for these two annual audits ended more than 90 days prior to the dates the applications were submitted: Wells Fargo's annual audit covered a period (year ended December 31, 2002) that was 441 days prior to the submittal date of its request (March 16, 2004); and Great Lakes' annual audit covered a period (year ended September 30, 2003) that was 197 days prior to the submittal date of its request (April 14, 2004).

FSA has not ensured that all staff completing reviews of requests for EP designation have a clear understanding of this 90-day requirement. In addition, FSA has not clearly established who has responsibility for ensuring that an applicant's annual audit period satisfied the requirement set forth in 34 C.F.R. § 682.415(a)(2)(i)(E). For Great Lakes, the regional office reviewing the request did not determine whether the annual audit met the 90-day requirement because it assumed the EP coordinator reviewed the request for timeliness before sending it to the region. For Wells Fargo, the regional office reviewing the request asked the EP coordinator if the annual audit met the 90-day requirement. The regional office understood the EP coordinator's response to mean that the 90-day requirement did not apply to Wells Fargo's request.

Because FSA did not ensure Wells Fargo and Great Lakes adhered to the requirement in 34 C.F.R. § 682.415(a)(2)(i)(E)(2), FSA may have approved two applicants that it would not have approved if FSA had more current audit information. If the applicants were not eligible for the EP designation, their guaranty agencies were reimbursing them two percent more for defaulted claims than they should have paid, unnecessarily reducing the guaranty agencies' federal funds.

Recommendation

We recommend that the Chief Operating Officer for FSA

- 1.1 Ensure that requests for EP designation are not approved if the applicant does not comply with the 90-day requirement of 34 C.F.R. § 682.415(a)(2)(i)(E).

FSA Comments

FSA concurred with our finding and recommendation.

Our draft report included two additional recommendations, asking FSA to (1.2) obtain the annual audit reports completed subsequent to the report submitted with Wells Fargo's and Great Lakes's requests for EP designation to verify the reports did not include information that would have precluded granting of the EP designation, and (1.3) take appropriate action if the annual audit reports included information that should have resulted in the requests for EP designation being rejected. In its comments, FSA indicated that it had reviewed the applicable annual audits and determined that they contained no findings or information that would have precluded the EP designation for Wells Fargo and Great Lakes.

OIG Response

We have reviewed the audit reports that FSA used to resolve our draft recommendations 1.2 and 1.3. We agree that the appropriate corrective action has been taken, and we have deleted recommendations 1.2 and 1.3 from this final report.

Finding No. 2 FSA Needs to Ensure Documentation is Maintained of the Review and Approval Process

FSA did not effectively manage records documenting its review and approval of requests for EP designation: it did not adequately track requests for EP designation and document its review of each request, and it did not maintain an official file for each applicant that contained all the records pertaining to the request for EP designation.

Tracking and Documenting

FSA's procedures include steps to record in a database the receipt of a request for EP designation and the dates certain tasks were completed. However, the database did not include any information on requests submitted by Student Assistance Foundation, Iowa Student Loan Liquidity Corporation, and Affiliated Computer Services, Inc., Education Services.

For two applicants whose information was included in the database, not all fields were completed. For both applicants, the field for the date that National Student Loan Data System queries were completed was blank. For one applicant, the field for claims paid was blank. This work was completed but not documented in the database.

In addition, the database did not include fields to document the completion date for three steps included in FP's procedures:

- Email sent to guarantors to notify them of the request and to obtain information;
- Copies of the request sent to Office of the General Counsel, Office of Postsecondary Education, FSA, and the Application Coordinator; and
- Letter to the applicant acknowledging receipt of the request.

These fields are needed to establish a record of FSA's compliance with its procedures. We verified that the first step listed above was completed. According to FP's EP coordinator, the second step was performed for the first few applications but FP management decided to discontinue the procedure, and the third step was performed for the first applicant verbally and in writing for subsequent applicants, but the EP coordinator was unable to provide documentation of the notice for all applicants.

Official File

FSA does not maintain an official file for each request for EP designation. Documentation of the request and of FP's review process was found at both FSA headquarters and regional offices. The contents of the files maintained at headquarters and the regional offices did not contain consistent types of information for all applicants.

Departmental Directive OCIO:1-103, *Departmental Records and Information Management Program* (December 16, 2002), provided policy, guidance, and direction for implementing the records and information management program in the Department. The directive states

It is the policy of the Department of Education to manage records effectively throughout their life cycle, in order to facilitate accomplishment of programmatic and administrative missions, to preserve official departmental records in accordance with applicable statutory and regulatory requirements, and to ensure appropriate access to information by Department officials and the public. This policy should be implemented through adequate and proper documentation of all Department organizations, functions, policy decisions, procedures, and essential transactions, in a manner that promotes accountability, establishes a historical record, and protects the legal and financial rights of the Government and the privacy of individuals.

* * * * *

[The Department] shall manage records throughout their life cycle that includes the following components:

- (1) Records creation/collection – An official record shall be created to appropriately document all Department functions, policies, decisions, procedures and essential transactions. Program offices shall develop record-keeping requirements for all official Department records for which they are responsible.. [sic]
- (2) Records maintenance and use – Record filing, indexing and storage systems shall be designed and documented to the extent appropriate and necessary, to maximize the usefulness of the records and allow retrieval throughout their life cycle.

FSA's procedures did not address the maintenance of documentation for the review of requests for EP designation; FSA did not effectively manage its records, because its staff did not always

adhere to established procedures; and the database used to document completion of review tasks does not contain fields necessary to maintain an adequate record of its review procedures.

If FSA's documentation is inadequate, FSA runs the risk of not being in compliance with EP requirements in 34 C.F.R. § 682.415 and with Departmental Directive OCIO:1-103. Non-compliance could occur as a result of FSA's inconsistent review of requests, failure to update its tracking database consistently for all requests, inadequate tracking database fields, and inconsistent documentation and maintenance of official files for applicants.

Recommendations

We recommend that the Chief Operating Officer for FSA

- 2.1 Ensure that FP staff follow established procedures for documenting the review and approval of requests for EP designation;
- 2.2 Ensure that FP staff use and update the tracking database for all requests for EP designation, to ensure that the database includes all required information for each request received; and
- 2.3 Establish procedures for the maintenance of one official file for each request for EP designation and defining minimum documentation requirements for each official file.

FSA Comments

FSA concurred with our finding and recommendations.

OTHER MATTERS

One of the four FP regional offices (Eastern) was not using a correct definition of "submittal date." The regional office defined "submittal date" as the date on the application's cover letter, but "submittal date" is defined in Dear Colleague Letter FP-04-04 (March 2004) as the "date that a complete application is received by FSA." In its comments, FSA indicated it is taking steps to ensure that all FP offices use a consistent definition of "submittal date."

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to assess the adequacy of FSA's internal control over its initial approval of lenders' or servicers' requests for EP designation. We reviewed FSA's internal control over approving lenders' or servicers' requests for EP designation, as it existed for requests that became effective during the period January 1, 2003, through April 30, 2005. Our

audit only covered the initial approval process. It did not include renewal or revocation decisions.

To achieve our objective, we

1. Reviewed written procedures related to receiving and reviewing initial EP applications;
2. Discussed the initial EP application review process with responsible personnel located at FP headquarters and four regional offices;
3. Reviewed FP's files related to the receipt, review, and approval decisions for all 12 approved EP applications.

We conducted our audit at FP's offices in Washington, DC; Chicago, Illinois; Dallas, Texas; and New York, New York. We held telephone conferences with FP's offices in San Francisco, California, and Boston, Massachusetts. We conducted our audit work from March through August 2005. We conducted the audit in accordance with generally accepted government auditing standards appropriate to the scope of the audit described above.


ADMINISTRATIVE MATTERS

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). ED policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 days of the issuance of this report. The CAP should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report. An electronic copy of this report has been provided to your Audit Liaison Officer.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

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

We appreciate the cooperation your staff showed us during our audit. If you have any questions, please call Richard J. Dowd, Regional Inspector General for Audit, or Gary D. Whitman, Assistant Regional Inspector General for Audit, at 312-886-6503.

Sincerely,

Helen Lew
Assistant Inspector General for Audit

Attachment



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ATTACHMENT

CHIEF OPERATING OFFICER

TO: Richard J. Dowd
Regional Inspector General for Audit
Office of Inspector General

DEC 20 2005

FROM: Theresa S. Shaw *TSS*
Chief Operating Officer

SUBJECT: Draft Audit Report
Federal Student Aid's Internal Control over Initial Exceptional
Performance Applications
ED-OIG/A05-F0013

Thank you for providing Federal Student Aid with an opportunity to comment on the Office of Inspector General's (OIG) Draft Audit Report dated November 8, 2005. Our response to the findings and recommendations follow.

Finding No. 1 – FSA Needs to Ensure Applicants Comply with the 90-day Requirement for Annual Audits.

Recommendation 1.1 – Ensure that requests for Exceptional Performer (EP) designation are not approved if the applicant does not comply with the 90-day requirement of 34 C.F.R. § 682.415(a)(2)(i)(E).

Financial Partners Services (FPS) is updating its procedures for reviewing new EP applications to ensure that an application will not be approved if it does not meet the 90-day requirement. This action will be completed by December 31, 2005.

Recommendation 1.2 – Obtain the annual audit reports completed subsequent to the report submitted with Wells Fargo's and GLHEC's requests for EP designation to verify the reports did not include information that would have precluded granting of the EP designation.

Recommendation 1.3 – Take appropriate action if the annual audit reports included information that should have resulted in the requests for EP designation being rejected.

FPS has reviewed annual audits for Wells Fargo and GLHEC and has ensured that they comply with 34 C.F.R. § 682.415(a)(2)(i)(E). There were no findings or information that would have precluded the EP designation.

Finding No. 2 – FSA Needs to Ensure Documentation is Maintained of the Review and Approval Process.

Recommendation 2.1 – Ensure that FPS staff follows established procedures for documenting the review and approval of request for EP designation.

Recommendation 2.2 – Ensure that FPS staff use and update the tracking database for all requests for EP designation to ensure that the database includes all required information for each request received.

Recommendation 2.3 – Establish procedures for the maintenance of one official file for each request for EP designation and defining minimum documentation requirements for each official file.

FPS is enhancing its procedures for documenting the review and approval of EP applications to ensure that all FPS offices are consistently following established procedures and that one official file is maintained for each request for EP designation. FPS is also in the process of enhancing its tracking database to include all necessary fields for accurate tracking. Once these enhancements are complete, all missing data elements will be entered. These actions will be completed by March 31, 2006.

Other Matters – Correct Definition of “Submittal Date”.

Federal Student Aid has taken steps to ensure that all FPS offices are using a consistent definition of “submittal date.” The definition will also be clarified in the enhanced documented procedures for reviewing new EP applications.

If you have questions concerning our response to the Draft Audit Report, please contact Katrina Turner at 202-377-3311.

cc: Pat Howard