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# Federal Student Aid's Performance as a Performance-Based Organization

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## FINAL AUDIT REPORT



**ED-OIG/A19H0008**  
**December 2008**

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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  
Washington, DC

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## **NOTICE**

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**UNITED STATES DEPARTMENT OF EDUCATION**  
**OFFICE OF INSPECTOR GENERAL**

THE INSPECTOR GENERAL

December 11, 2008

**Memorandum**

**TO:** Kent D. Talbert  
Delegated Responsibilities of the Under Secretary

**FROM:** Jerry G. Bridges /s/  
Acting Inspector General

**SUBJECT:** Final Audit Report  
Federal Student Aid's Performance as a Performance-Based Organization  
Control Number ED-OIG/A19H0008

Attached is the subject final audit report that covers the results of our review of Federal Student Aid's (FSA) performance as a performance-based organization. We received FSA's comments and its corrective action plan for each of the recommendations in our draft report.

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). Department 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.

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 given us during this review. If you have any questions, please call Michele Weaver-Dugan at (202) 245-6941.

Enclosure

cc: James Manning, Acting Chief Operating Officer, FSA  
Marge White, Audit Liaison Officer (ALO), Internal Audits, FSA  
Phil Link, Director, Executive Secretariat

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## EXECUTIVE SUMMARY

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The objective of our audit was to determine if Federal Student Aid (FSA) is meeting its responsibilities under Title I, Part D of the Higher Education Act (HEA), as amended, related to planning and reporting, systems integration, and cost reduction. In response to the growing complexity, increasing demand, and the likelihood for fraud, waste, and abuse associated with student financial assistance programs, Congress amended the HEA in 1998 to create a performance-based organization (PBO) to manage and administer student financial assistance programs authorized under Title IV of the HEA. As the designated PBO, FSA operates without the constraints of certain rules and regulations for the purpose of achieving specific measurable goals and objectives.

With regard to the scope of our audit, we found FSA is not meeting its responsibilities under Title I, Part D of the HEA. We found that FSA has not completely fulfilled its planning and reporting responsibilities, as required, and its planning and reporting processes are not always effective or efficient. Specifically, FSA did not issue its first Five-Year Performance Plan (Five-Year Plan) until 2004 and did not prepare one in 2005. We found none of the strategic objectives to be measurable or quantifiable in FSA's Fiscal Year (FY) 2004-2008 plan. In comparing the Five-Year Plans to the Annual Performance Plans (Annual Plans), we found a weak correlation between the documents and found it difficult to determine what action items from the Annual Plans were necessary for FSA to achieve its Five-Year Plan goals. We also found FSA's FY 2004 to 2006 Annual Performance Reports (Annual Reports) did not always provide required information, including: 1) clear information on how FSA met the Five-Year Plan goals; 2) performance requirements under the Government Performance and Results Act of 1993 (GPRA); 3) evaluation ratings of the Chief Operating Officer (COO) and senior managers, including bonus amounts; and 4) recommendations for legislative and regulatory changes. As a result, FSA has not clearly informed Congress, the Secretary, or the public about its progress toward achieving its purposes as established by the HEA.

We also found FSA's progress in integrating its student financial assistance systems is significantly hindered. We found the development of two out of three major systems integration initiatives, which FSA planned to complete by 2008, have been canceled. FSA expects to release only the first of two phases of the third initiative in 2008. Due to the failure of its system integration efforts, FSA has been unable to realize the expected benefits of the initiatives and has hindered its progress in meeting the requirements of the HEA.

In addition, we found FSA's progress towards the reduction of program administration costs is uncertain. Specifically, we found FSA did not establish measurable strategic goals in the area of cost reduction until its FY 2006 Five-Year Plan, and these measures will not be reported on until FY 2008. We also found anticipated cost savings from three of four major system initiatives identified in FY 2004-2006 Annual Reports are not expected until FY 2008 and beyond. Further, we found the scope of work for two of the four system initiatives was significantly reduced and separate acquisitions of unknown cost are planned to complete these initiatives. The transition of the third initiative has been delayed, causing FSA to incur unexpected costs. Due to the limitations noted, it is difficult to determine FSA's progress in reducing its costs. As a result,

Congress, the Secretary, and the public cannot determine if FSA has reduced its program costs since becoming a PBO in 1998.

To correct the weaknesses identified, we recommended that the Under Secretary ensure the Acting COO takes action to, among other things:

- Implement controls to ensure Five-Year Plans include measurable and quantifiable strategic objectives, Annual Plans correlate with Five-Year Plans, and Annual Reports clearly convey the extent of meeting specific goals and objectives;
- Ensure staff responsible for planning and reporting on FSA's performance are familiar with GPRA requirements;
- Provide the most recently available rating and bonus information for the COO and each of the senior managers in the Annual Reports;
- Identify recommendations for legislative and regulatory changes in each Annual Report;
- Establish procedures and controls to ensure the feasibility of major system integration efforts;
- Report savings from major system initiatives to facilitate tracking of planned savings to actual savings; and
- Include appropriate transition clauses in all future contracts to avoid unnecessary transition costs.

In its response to the draft audit report, FSA stated, in general, it agreed with many of the comments in the report, and provided a corrective action plan to address each of the recommendations. FSA noted disagreement with Finding 1, generally concurred with Finding 2, and provided comments but did not specifically state whether or not it concurred with Finding 3. The comments are summarized at the end of each finding. No changes were made to the report as a result of FSA's response. The full text of FSA's response is included as an Attachment to this report.

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## BACKGROUND

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Federal Student Aid (FSA) manages and administers student financial assistance programs authorized under Title IV of the Higher Education Act (HEA), as amended. These programs include the William D. Ford Federal Direct Loan Program, the Federal Family Education Loan Program (FFEL), the Federal Pell Grant Program, and campus-based programs. In response to the growing complexity, increasing demand, and the likelihood for fraud, waste, and abuse associated with the student financial assistance programs, Congress amended the HEA in 1998 to create a performance-based organization (PBO) to manage and administer student financial assistance programs authorized under Title IV of the HEA. As the designated PBO, FSA operates without the constraints of certain rules and regulations for the purpose of achieving specific measurable goals and objectives.

As defined in Title I, Part D of the HEA, the purposes of FSA as a PBO are to:

- improve service to students and other participants in the student financial assistance programs;
- reduce the costs of administering the programs;
- increase the accountability of responsible officials;
- provide greater flexibility in management of operational functions;
- integrate information systems;
- implement an open, common, integrated delivery system; and
- develop and maintain a system that contains complete, accurate, and timely data to insure program integrity.

The HEA also requires the appointment of a Chief Operating Officer (COO), establishment of a fair and equitable system for measuring staff performance, and development of annual performance agreements for the COO and other senior managers. In exchange for increased accountability, the legislation allows for the payment of performance bonuses to the COO and senior managers, the hiring of an unlimited number of senior managers, and the appointment of up to 25 excepted service personnel to administer the functions of the PBO.

FSA's enabling legislation requires several annual reporting requirements to inform Congress and the public of the progress that FSA is making toward achieving its intended purposes and goals. The COO and Secretary must (1) agree on and publicly release each year a five-year performance plan that includes measurable goals and objectives as well as the action steps necessary to achieve a modernized student financial assistance delivery system, and (2) provide an annual report to Congress that describes the results achieved relative to the PBO's goals and objectives.

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## AUDIT RESULTS

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With regard to the scope of our audit, we found FSA is not meeting its responsibilities under Title I, Part D of the HEA, as amended. Specifically, we found: (1) FSA has not always fulfilled its planning and reporting responsibilities, (2) FSA's progress in integrating its student financial assistance systems is significantly hindered, and (3) FSA's progress towards the reduction of program administration costs is uncertain. As a result, FSA has not clearly informed Congress, the Secretary, or the public about its progress toward achieving its purposes as established by law; FSA has been unable to realize benefits associated with systems integration and has hindered its progress in meeting related requirements; and Congress, the Secretary, and the public cannot determine if FSA has reduced its program administration costs since becoming a PBO in 1998.

In its response to the draft audit report, FSA stated, in general, it agreed with many of the comments in the report, and provided a corrective action plan to address each of the recommendations. FSA noted disagreement with Finding 1, generally concurred with Finding 2, and provided comments but did not specifically state whether or not it concurred with Finding 3. The comments are summarized at the end of each finding. No changes were made to the report as a result of FSA's response. The full text of FSA's response is included as an Attachment to this report.

### **FINDING NO. 1 – FSA Did Not Always Fulfill Its Planning and Reporting Responsibilities**

FSA needs to improve its planning and reporting of PBO activities. We determined that FSA has not completely fulfilled its planning and reporting responsibilities under Title I, Part D of the HEA, and its planning and reporting processes are not always effective or efficient.

#### Five-Year Performance Plans

The HEA requires FSA to develop a Five-Year Performance Plan (Five-Year Plan) annually. Although established as a PBO in 1998, FSA did not issue its first Five-Year Plan until 2004.<sup>1</sup> Our review of the Fiscal Year (FY) 2004-2008 plan noted it contained five strategic objectives outlining FSA's general goals over the term of the plan. It also contained tactical goals which offered descriptive procedures for obtaining the strategic objectives. However, similar to what the Government Accountability Office (GAO) reported in October 2004,<sup>2</sup> we found none of the strategic objectives to be measurable or quantifiable. We also found 14 of the 38 (37 percent) tactical goals to be immeasurable, and none of the tactical goals was directly linked to specific strategic objectives.

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<sup>1</sup> FSA prepared a draft Five-Year Plan for FY 2000-2004 dated November 30, 1999.

<sup>2</sup> GAO, *Office of Federal Student Aid: Better Strategic and Human Capital Planning Would Help Sustain Management Progress*, GAO-05-31, October 2004.



We noted FSA did not prepare a Five-Year Plan in FY 2005, as required. Our review of FSA's 2006-2010 plan noted some improvements from FY 2004, as tactical goals were linked to specific strategic objectives, and performance standards were established that would enable FSA to measure its success in achieving identified goals.

### Annual Performance Plans

Although not required by the HEA, FSA also develops an Annual Performance Plan (Annual Plan), which provides a more detailed discussion of procedures to complete the goals identified in the Five-Year Plan. FSA officials stated the Annual Plan essentially "gives birth" to the Annual Report, and also feeds into the Five-Year Plan. FSA officials stated that everything FSA does comes from the Annual Plan, and these items should tie back to the Five-Year Plan. The Annual Plan includes the project number, responsible area, responsible general managers, why FSA is doing the project, how FSA will know it was successful in completing the project (success measure), and the target completion date.

In comparing the Five-Year Plans to the Annual Plans, we noted a weak correlation between documents. The Annual Plans from FYs 2004 through 2006 provided action items for the strategic objectives identified in the 2004 Five-Year Plan. Because the 2004 Five-Year Plan did not identify which tactical goals related to the strategic objectives, we found it difficult to determine what action items from the Annual Plans were necessary for FSA to achieve its tactical goals. We found a stronger correlation between FSA's 2006 Five-Year Plan and the FY 2006 Annual Plan because the Five-Year Plan linked its short-term tactical goals to its specific long-term strategic objectives.

### Annual Performance Reports

FSA is also required by the HEA to prepare an Annual Performance Report (Annual Report). We reviewed FSA's Annual Reports for FYs 2004 to 2006 and found the reports did not always meet the requirements of the HEA. Specifically, we noted the reports did not provide:

- Clear information that conveyed to what extent the PBO met Five-Year Plan goals and objectives;<sup>3</sup>
- Performance requirements applicable to the PBO under the Government Performance and Results Act of 1993 (GPRA);
- Evaluation ratings of the performance of the COO and senior managers, including the amounts of the bonus compensation awarded to these individuals; and
- Recommendations for legislative and regulatory changes.

We also noted the Annual Report format changed each year, making it difficult to follow progress from one year to the next, and that statements made in the reports tended to be broad in nature, making it difficult to determine exactly where FSA was in achieving its goals.

According to FSA officials, the Annual Report discusses progress made and goals accomplished with regard to the Annual Plan. However, we noted accomplishments mentioned in the reports did not always correlate to stated quantitative success measures or goals that were identified in

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<sup>3</sup> Only the FY 2006 report included this information.

the related Annual Plan and/or Five-Year Plan. Only 60 percent of FY 2004 accomplishments related to systems integration and cost reduction were found to correlate with the FY 2004 Annual Plan and/or related Five-Year Plan, and 88 percent of accomplishments in the FY 2005 Annual Report were found to correlate with related plans. Ninety-six percent of FY 2006 Annual Report accomplishments were found to correlate with the respective Annual Plan and/or Five-Year Plan.

Conversely, we noted that not many action items and success measures per the Annual Plan were included in the Annual Report. We judgmentally selected 47 out of 274 action items (17 percent) with 100 out of 315 associated success measures (32 percent), as relating to systems integration and cost reduction, from FY 2004-2006 Annual Plans and traced them to the corresponding Annual Report. Only 3 of 14 selected action items (21 percent) and 3 of 24 selected success measures (13 percent) were included in FY 2004; 10 of 25 selected action items (40 percent) and 18 of 55 selected success measures (33 percent) were reported in the FY 2006 Annual Report.<sup>4</sup>

We also reviewed documentation available to support accomplishments noted in the Annual Reports related to systems integration and cost reduction efforts. FSA could not initially support 24 of 38 (63 percent) accomplishments in the FY 2004-2006 reports. In response to our request, FSA provided additional documentation that supported 16 additional accomplishments. Ultimately, we were not provided with information to support 8 of the 38 (21 percent) accomplishments.

We found that items noted as being canceled and items that were not successfully completed were not mentioned in the reports. In general, the FY 2004 and 2006 reports tended not to note any problems that had been encountered.

Section 141 (c)(1) of the HEA, as amended, states,

(A) In general- Each year, the Secretary and Chief Operating Officer shall agree on, and make available to the public, a performance plan for the PBO for the succeeding 5 years that establishes measurable goals and objectives for the organization.

Section 141 (c)(2) of the HEA states,

Each year, the Chief Operating Officer shall prepare and submit to Congress, through the Secretary, an annual report on the performance of the PBO, including an evaluation of the extent to which the PBO met the goals and objectives contained in the 5-year performance plan.... The annual report shall include the following....:

(B) Financial and performance requirements applicable to the PBO under the Chief Financial Officer Act of 1990 and the Government Performance and Results Act of 1993...

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<sup>4</sup> The FY 2005 Annual Report included an appendix to the report entitled, "FY 2005 Tactical Accomplishments," which listed action items in a manner that attempted to approximate the details of the FY 2005 Annual Plan. It reported items that were considered completed and those that were outstanding, allowing the reader to more easily track progress associated with FSA's plans.

(D) The evaluation rating of the performance of the Chief Operating Officer and senior managers...including the amounts of bonus compensation awarded to these individuals.

(E) Recommendations for legislative and regulatory changes to improve service to students and their families, and to improve program efficiency and integrity....

Section 1116 of the *Government Performance and Results Act of 1993* requires an annual performance report and states,

(d) Each report shall-

- (1) review the success of achieving the performance goals of the fiscal year;
- (2) evaluate the performance plan for the current fiscal year relative to the performance achieved toward the performance goals in the fiscal year covered by the report;
- (3) explain and describe, where a performance goal has not been met...
  - (A) why the goal was not met;
  - (B) those plans and schedules for achieving the established performance goal; and
  - (C) if the performance goal is impractical or infeasible, why that is the case and what action is recommended....

FSA management cited timing and a lack of resources as reasons for not preparing a Five-Year Plan for FY 2005.

Regarding Annual Report GPRA requirements, FSA management stated that the FY 2006 Annual Report contained the status of certain projects, and referred readers to the Annual Performance Plan Report, posted on a website at [www.federalstudentaid.ed.gov](http://www.federalstudentaid.ed.gov), for additional information. Management was not entirely familiar with the GPRA requirement on reporting on canceled initiatives, but stated that such data is made available to the public. We reviewed this website and found that an Annual Performance Plan Report was not provided. In addition, FY 2006 was the first time performance standards and measurable baselines were established, making it difficult for FSA to meet GPRA reporting requirements in prior years.

Information to be included in the Annual Reports was determined by FSA's Executive Management Team (EMT), which consisted of the COO and senior management officials. We noted that highlights from the Annual Report also served as the COO's accomplishment statement and justification for the COO's bonus, as well as the justification for Secretarial approval of senior official bonuses.

FSA management stated the decision not to include individual evaluation ratings and bonuses awarded in the Annual Reports was made by FSA's COO. We noted that the COO never actually received a rating of record, just a bonus. Therefore, FSA would not be able to include

an evaluation rating for her. We also noted that FSA could find the evaluations for only 3 out of 12 of its EMT members for FY 2005, and there was confusion determining exactly who was on the EMT in any given year, all of which could make it difficult to include as required in the Annual Report.

Regarding recommendations for legislative and regulatory changes, FSA officials stated that FSA is an advisory body when it comes to policy. FSA's Policy Liaison and Implementation office is in constant communication with the Office of Postsecondary Education (OPE), which handles policy matters. However, we happened to note that in at least one report prior to FY 2004, FSA had included recommendations that it was making to OPE.

As a result of the issues noted above, FSA has not clearly or fully informed Congress, the Secretary, or the public about its progress toward achieving its purposes as established by the HEA. Policymaking, spending decisions and program oversight are handicapped by a lack of disclosure. To the extent the Secretary relied upon information presented in the Annual Reports, he/she may not have had complete information upon which to base the COO and senior official bonus decisions.

For example, we noted that serious problems with systems integration efforts were not disclosed in the FY 2005 Annual Report. The report gave no indication that anything was wrong with the ADvance effort, even though a cure notice had been issued to the contractor at the end of the fiscal year due to serious performance concerns. The only thing noted in the report was that the ADvance contract had been awarded during the year. FSA's FY 2005 report included a section on possible future effects of existing events and conditions, where performance problems could have been noted and observations made that the difficulties encountered could cause a delay on integration efforts. In fact, only four months later, the development portion of the ADvance initiative was canceled.

The FY 2005 Annual Report simply noted that the Common Services for Borrowers (CSB) initiative continued to be implemented, and that the implementation plans established in the Annual Plan were 99.8% complete, even though the attached chart noted that two of the seven planned activities had been canceled – migration of the Direct Loan Servicing System and retirement of the Direct Loan Consolidation System – and one item was carried over to the FY 2007 performance plan. Nothing was mentioned about the problems encountered during the year that led to FSA modifying its go-live date in April 2005.

The FY 2006 Annual Report again mentioned nothing about the problems on the ADvance contract. The narrative noted that FSA continued to identify requirements, and the table of benchmarks noted targets were not met for ADvance, but did not provide any specifics as to why, other than there was a change in acquisition strategy. Continued design of CSB was noted, along with a statement in the table that the target was not met due to delays in meeting established timelines. However, the brief explanations provided do not appear to adequately explain the reasons for delays in meeting established targets.

While the information presented in these reports was not necessarily untrue, it was misleading and did not fully disclose the status of the major integration efforts. As a result, when the integration efforts subsequently failed, it was likely a surprise to outside parties. Without full

disclosure in accordance with GPRA requirements, information presented can be misleading and not provide for appropriate accountability.

Subsequent to the completion of our fieldwork, FSA issued its FY 2007 Annual Report. Our limited review of the report noted some improvements over prior reports. Specifically, we noted a more consistent reporting format, recently available information on performance ratings and bonuses, and topic areas for legislative and regulatory changes.

## **Recommendations**

We recommend that the Under Secretary ensure the Acting COO takes action to:

- 1.1 Effectively utilize resources by reissuing the same Five-Year Plan annually when no significant changes are necessary, and include an addendum noting changes from the previous year's Five-Year Plan.
- 1.2 Implement controls to ensure Five-Year Performance Plans include strategic objectives that are measurable and quantifiable, with goals linked to specific objectives, Annual Performance Plans correlate with Five Year Performance Plans, and Annual Performance Reports clearly convey the extent of meeting specific goals and objectives, as required.
- 1.3 Include a section in the Annual Report on major obstacles faced during the fiscal year, along with a list of significant activities that have been canceled. Explain why each of these activities was canceled and the plans/schedule for completing them in the future.
- 1.4 Implement a consistent reporting format to afford readers with a means to easily track progress from year to year.
- 1.5 Ensure staff responsible for planning and reporting on FSA's performance are familiar with GPRA requirements.
- 1.6 Provide the most recently available information related to individual performance ratings and bonuses for the COO and each of the senior managers in the Annual Reports.
- 1.7 Identify recommendations for legislative and regulatory changes in each Annual Report, or indicate that there are none.

In addition, we recommend that the Under Secretary:

- 1.8 Ensure the COO receives an actual rating of record, based upon the overall PBO performance.

## **FSA Comments**

While FSA acknowledged that the development of a comprehensive strategic and tactical planning, tracking, and reporting structure for FSA has been evolutionary, FSA disagreed that it was not meeting its responsibilities as outlined under the PBO legislation. FSA stated it has worked with OIG [Office of Inspector General] to continually refine both the Five-Year Plan and

the Annual Report. FSA also stated that OIG has reviewed and ultimately approved every Five-Year Plan and Annual Report produced during the time in question. In addition, since 2005, FSA stated every accomplishment listed in the Management's Discussion and Analysis [MD&A] section of the Annual Report was audited, verified and approved by an OIG auditor and extensive supporting documentation was provided to support every accomplishment.

### **OIG Response**

FSA is correct that OIG reviewed and commented on FSA's Five-Year Plan and Annual Reports as part of the Department's Executive Secretariat Document Clearance process. However, OIG did not approve the plans and reports in that process. OIG did meet and discuss with FSA how FSA could address OIG comments, but the decision to incorporate or respond to OIG comments, as well as responsibility for the contents of the plans and reports, remained with the Department. Several of the issues noted in the finding were identified by OIG as part of the review and comment process. As stated in the finding, OIG continues to believe FSA reports do not meet all of the requirements of the HEA.

In addition, the OIG contractor that audited FSA's consolidated and combined financial statements did not audit and verify FSA's accomplishments in the Annual Reports included in our review. As noted in the Report of Independent Auditors included in FSA's FY 2005 and 2006 Annual Reports, the audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information presented in the MD&A is not a required part of the basic financial statements, but is supplementary information required by the Office of Management and Budget. Certain limited procedures were performed on this information, consisting primarily of inquiries of management regarding the methods of measurement and presentation of information. However, the information was not audited and no opinion was expressed on it.

### **FINDING NO. 2 – FSA's Progress in Integrating Its Student Financial Assistance Systems Is Significantly Hindered**

Since 2004, FSA has not made significant progress in completing activities designed to integrate its student financial assistance systems. In October 2004, GAO reported that while FSA continued to take actions toward better integrating systems supporting its student financial assistance programs, FSA remained several years from operating in a fully integrated information systems environment. GAO noted FSA had begun three major systems integration initiatives, which it planned to complete by 2008. We found FSA has since canceled the development portions of two of the major systems integration initiatives, CSB and ADvance,<sup>5</sup> and expects to release only the first of two phases of the Integrated Partner Management (IPM) initiative in 2008.

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<sup>5</sup> This effort commenced in FY 2004 as the Front End Business Integration (FEBI) initiative. FEBI was renamed ADvance in March 2005, with the overall goal unchanged.

System integration is an important purpose for FSA's creation as a PBO. Section 141 (a)(2) of the HEA, as amended, states the purposes of the PBO are...

- (E) to integrate the information systems supporting the Federal student financial assistance programs;
- (F) to implement an open, common, integrated system for the delivery of student financial assistance under Title IV....

### ADvance

The ADvance initiative was intended to support the end-to-end needs of the customer by bringing together the front-end operations of the student aid process. ADvance was to align FSA's business processes with its strategic objectives, and ultimately re-engineer the front-end student aid application processes, disbursement processes, funds management, and customer service functions into a single integrated business solution. The ADvance contract was awarded on February 1, 2005, and FSA officials described it as two-fold. The first portion of the contract was to keep the following legacy systems supporting front-end operations running: Central Processing System, Common Origination and Disbursement, Public Inquiry Call Center, Editorial Services, Ombudsman Support, Ombudsman Case Tracking System, and Student Aid Internet Gateway. The second portion of the contract dealt with development and planning efforts to integrate the legacy systems under a unified platform.

In September 2005, seven months after contract award, FSA formally documented concerns in a cure notice and cited contractor performance which it believed endangered the satisfactory start up of the ADvance solution. On February 1, 2006, FSA and the contractor bilaterally agreed to modify the contract to, among other things: 1) accept existing development related work products "as is;" and 2) stop development work and related efforts under the contract if an ongoing effort to negotiate a separate agreement to restart all or part of this work was not reached by April 12, 2006. FSA officials stated that no separate agreement was reached, and on April 13, 2006, the decision to halt development work was formalized. According to FSA officials, this divided the contract so the contractor's primary responsibility was with the continued operations of the legacy systems. As a result, FSA canceled items from its FY 2006 Annual Performance Plan to implement the ADvance solution, which required identifying resources to support transition, completing the detailed business requirements and high-level design, and developing the detailed implementation approach. Currently, the legacy systems are running as seven independent systems, six of which had already been under the operation of the ADvance contractor. The ADvance contract, as modified, expires January 31, 2015, if all option years are exercised.

FSA officials stated they were meeting with the contractor approximately three times per week and saw little to no progress being made to integrate the systems. As a result, FSA began to question whether the systems could be integrated with the contractor in place. After the cure notice was issued, the contractor responded and admitted there had been delay in the development effort, but claimed that any delay was excusable. In its response, the contractor asserted the fault for any delay lay primarily with FSA and admitted only minimal responsibility for the lack of progress. Due to FSA's concerns with the contractor's response, including the lack of accountability, the decision was made to cancel further development work.

## CSB

Through the CSB initiative, FSA planned to improve and simplify back-end services related to the management of student aid obligations by combining the borrower-related functions of Direct Loan Servicing, Loan Consolidation, Conditional Disability Discharge Tracking, and Debt Management Collection into a single integrated solution. The CSB contract was awarded on November 20, 2003, to develop a vehicle that fulfilled core business objectives in areas such as data management, payment and transaction processing, and delinquency and program management.

As with ADvance, difficulties were experienced with the effort to achieve the envisioned integrated end-state system. FSA officials stated a modification to the CSB contract was executed on April 29, 2005, because of performance concerns, which in part established go-live dates for various phase releases and penalties for missing these dates. Further difficulties towards the achievement of the desired end state ultimately resulted in a contract modification on May 29, 2007, which formalized a “De-scoping Settlement Agreement.” This modification descope all uncompleted CSB transition software development work and stated the contractor had no further contractual obligation with respect to the CSB end-state system other than current production systems and business operations. To date, these four legacy systems have been consolidated under one vendor, but remain as four independent systems. The CSB contract, as modified, expires November 19, 2013, if all option years are exercised.

FSA officials stated that the prime contractor for the CSB initiative had difficulties managing its subcontractors, which included the contractors for the legacy systems being integrated, due to differences in distinct business cultures. They stated the contractor failed to meet delivery dates and fell behind schedule, which they believed was due to both a lack of coordinated effort between the prime and subcontractors and a failure to understand the complexities of the software lifecycle development process. FSA officials also noted the implementation schedule was aggressive, and had the contractor proposed (and FSA accepted) a more realistic timeline, the initiative might have worked. In addition, FSA officials said the contractor accused FSA of providing inadequate guidance on system requirements.

## IPM

IPM is intended to integrate common functions within the partner management business systems in order to provide a streamlined and consolidated solution to managing partner interactions and support the delivery of Title IV funds from both a cost and customer satisfaction perspective. FSA plans to address some of the deficiencies in its current stove-piped system architecture, characterized by multiple partner entry points, redundant data entry, redundant data storage, and excessive file exchange activities by replacing the following legacy systems: Application for Approval to Participate in Federal Student Financial Aid Programs, eZ-Audit, Electronic Records Management, Postsecondary Education Participants System, and the Participation Management portion of the Student Aid Internet Gateway. Expected benefits include operational efficiencies and overall cost savings. FSA anticipated receiving funding for this initiative in 2005 and implementing the entire initiative in 2008. However, the funding was not received until 2006, delaying full implementation until 2009.



With the CSB and ADvance initiatives, FSA expected to streamline, consolidate, and reengineer common functions to deliver significant improvements in managing student aid obligations from both a cost and borrower satisfaction perspective. Due to the failure of its integration efforts, FSA has been unable to realize these benefits and has hindered its progress in meeting the requirements of the HEA.

Subsequent to canceling two of its major integration efforts, FSA developed the Enterprise Development Support Services (EDSS) Model to use a more in-depth approach to analyze FSA's business vision and needs, and determine how best to achieve those needs. Under EDSS, FSA intends to move away from a "single vendor" environment by "pre-qualifying" vendors for tasks within service categories, such as development and operations and maintenance support. FSA plans to award indefinite delivery/indefinite quantity contracts to pre-qualified vendors based around the defined functional segments of work.

The former FSA Chief Information Officer (CIO) stated that one lesson learned from the CSB and ADvance initiatives was that FSA did not obtain the best services in each of the many service categories using a single procurement. She affirmed that although EDSS differs contractually from the previous initiatives, the primary business objective remains the same – creating a seamless experience for the customer on both the front-end and back-end. The former FSA CIO added the visions for CSB and ADvance are still intact at the enterprise level, but the technical strategy has changed. Furthermore, she said the integration of the legacy systems will depend on the quality of the systems themselves and it is likely some new systems will be built.

## **Recommendations**

We recommend that the Under Secretary ensure the Acting COO takes action to:

- 2.1 Establish procedures and controls to ensure the feasibility of major system integration efforts, as well as offerors' proposed technical solutions.
- 2.2 Engage industry consultants, when necessary, to assist in the above noted processes.

## **FSA Comments**

FSA generally concurred with the finding and provided a corrective action plan for each of the recommendations.

## **FINDING NO. 3 – FSA's Progress Towards the Reduction of Program Administration Costs is Uncertain**

Several factors have hindered the ability to measure FSA's progress towards the reduction of costs of administering its programs. Due to limitations noted with earlier efforts to establish cost reduction metrics, FSA will not have measurable results to report until FY 2008. In addition, anticipated cost savings from three of four major system initiatives identified in FY 2004 – FY 2006 annual reports are not expected until FY 2008 and beyond. FSA does not plan to report on individual progress towards anticipated cost reductions by initiative, limiting the ability to determine whether planned savings were actually achieved. Further, our review noted the scope

of work for two of the four system initiatives was significantly reduced and separate acquisitions of unknown cost are now planned to complete these initiatives. The transition of the third initiative has been delayed, causing FSA to incur unexpected costs.

Section 141 (a)(2)(B) of the HEA, as amended, establishes the reduction of program administration costs as a purpose of the PBO.

Cost Reduction Strategic Goals

In October 2004, GAO noted that while FSA had developed a cost model that had addressed previously noted problems and limitations, the model was still not fully functional. As a result, GAO concluded that FSA was still unable to demonstrate that it reduced the cost of administering its programs. Our review noted that FSA’s Five-Year Plan for FY 2004-2008 did not establish measurable goals in the area of cost reduction. FSA did not complete a Five-Year Plan for FY 2005-2009, as such no measurable strategic goals were established. FSA did establish measurable strategic goals in the area of cost reduction in its FY 2006-2010 Five-Year plan. However, within this plan there are no specific cost reduction success measures that will be reported on until FY 2008.

FSA’s Five-Year Plan for FY 2006-2010 included four cost reduction performance measures. As shown in Table 1 below, the FY 2006 success measure was baseline development, with measurable unit cost reduction standards established for FY 2008 and FY 2010.

**Table 1 – Cost Reduction Performance Measures and Related Standards**

<b>Performance Measure</b>	<b>FY 2006 Standard</b>	<b>FY 2008 Standard</b>	<b>FY 2010 Standard</b>
Reduce electronic FAFSA <sup>6</sup> direct unit costs	Develop Baseline	20% Reduction	25% Reduction
Reduce origination and disbursement direct unit costs	Develop Baseline	10% Reduction	15% Reduction
Reduce direct loan servicing direct unit costs	Develop Baseline	12% Reduction	12% Reduction
Reduce collections direct unit costs	Develop Baseline	14% Reduction	14% Reduction

FSA first reported on specific program administration unit costs in its FY 2006 Annual Report. This report identified baseline unit costs in each of the four areas from Table 1 above. We noted that FSA reported these unit baselines as FY 2006 actual results when the related data was from FY 2005 operations. In addition, while the FFEL program is FSA’s largest program, there is no related cost reduction measure identified for FFEL.

Cost Reductions from System Initiatives

FSA’s Annual Reports from FY 2004 through FY 2006 identified four significant system initiatives with anticipated cost reductions of almost \$1.7 billion. As shown in Table 2, three of the four initiatives are not expected to begin realizing cost reductions until FY 2008 or beyond.

<sup>6</sup> Free Application for Federal Student Aid

Two of the four acquisitions have recently experienced significant reductions in scope and additional acquisitions are being planned to meet the original system integration objectives. Another initiative has experienced significant delays in transitioning to a new contractor and has caused FSA to incur unexpected costs. We also noted that while anticipated cost reductions from these initiatives were reported separately in FSA’s Annual Reports, FSA does not plan to report on progress towards actual cost reductions by initiative. Any reductions in cost will be reflected through the unit costs associated with the four performance measures identified above.

**Table 2 – Initiatives With Reported Cost Reductions**

<b>Initiatives</b>	<b>Reported Anticipated Cost Reductions (in millions)</b>	<b>Anticipated Cost Reductions Begin</b>	<b>Unanticipated Scope Reduction or Delay in Implementation</b>
Advance	\$500	FY 2009	Yes
CSB	\$1,000	FY 2004	Yes
IPM	\$5	FY 2008	No
Virtual Data Center (VDC)	\$150	FY 2008	Yes
<b>Total</b>	<b>\$1,655</b>		

Additional details relating to the initiatives, as pertaining to anticipated cost reductions, are presented below.

*ADvance*

The ADvance initiative was intended to support the end-to-end needs of the customer by bringing together the front-end operations of the student aid process. In its FY 2005 Annual Report, FSA estimated the initiative would save \$500 million over the life of the contract. Implementation of this initiative was planned for FY 2008. Documentation supporting the anticipated savings showed that cost savings were not expected to be realized until contract year four (February 2008 – January 2009). Anticipated savings were calculated through establishment of baseline estimates for contract costs for the continued operation of various front-end legacy systems under the prior system of contracts in comparison to estimated ADvance contract costs. FSA officials stated that since the contract was reduced in scope, they were no longer actively tracking actual ADvance costs and comparing them to anticipated costs of continued operation of the legacy systems under the prior method.

Contract awards related to the integration portion of the ADvance contract are estimated to be made in late June 2008.<sup>7</sup> The maximum cumulative dollar ceiling value of all contracts to be awarded is \$300,000,000.

*CSB*

The CSB initiative was intended to consolidate back-end systems for Direct Loan Servicing, Consolidation, and Collections into a single integrated solution. In its FY 2004 Annual Report, FSA estimated the initiative would save over \$1 billion over the life of the contract, with implementation originally planned to begin in FY 2005. Anticipated savings were calculated through establishment of baseline estimates for contract and other costs associated

<sup>7</sup> Five indefinite delivery indefinite quantity (IDIQ) contracts were subsequently awarded on September 25, 2008.

with the continued operation of various back-end legacy systems in comparison to estimated contract and other costs associated with the operation under the CSB contractor.

FSA officials indicated that although the integration effort was de-scoped, they continued to compare actual costs incurred under CSB to estimated costs under prior contracts. FSA officials believed they would fully realize the anticipated savings due to the reduced costs of the CSB contract to continue operation of the legacy systems when compared to the estimated costs under the prior contracts.

Contract awards related to the integration portion of the CSB contract are estimated to be made in late June 2008. The maximum cumulative dollar ceiling value of all contracts to be awarded is \$300,000,000.<sup>8</sup>

### *IPM*

IPM is intended to modernize and replace legacy systems associated with management functions such as enrollment, eligibility, and oversight. In its FY 2006 Annual Report, FSA estimated the initiative would save \$5.4 million over the life of the contract. The estimate of cost reduction included factors such as cost benefits from retiring legacy systems and work hour reductions from the increased automation of operational processes. Cost reductions were not expected to be realized until implementation of the first phase, scheduled for 2008.

### *VDC*

The VDC includes computer systems that support and operate the delivery of Title IV student aid. It operates as a hub connecting several data and processing centers into a single servicing operation. The VDC contract was re-competed and awarded to a new contractor on September 1, 2006. In its FY 2006 Annual Report, FSA stated the new VDC contract would save \$150 million over the contract term. The cost reduction estimate was based on a forward projection of current VDC contract prices compared to the terms of the new VDC contract. Cost reductions were not expected to be realized until contract period 2 during FY 2008. FSA officials stated they planned to track actual costs under the new contract and compare them to anticipated costs under the prior agreements once the transition period ended and the new contractor was responsible for operation and maintenance.

We found the transition of the VDC has been delayed. FSA officials stated the transition of the VDC to the incoming contractor was expected to be completed by September 30, 2007. However, due to delays, the VDC transition did not occur until June 22, 2008. Overall, we determined FSA has incurred additional costs of approximately \$22.2 million as a result of the delayed transition and parallel operations of both contractors' facilities, and could incur up to an additional \$15.4 million in costs associated with an extension to the incumbent contract.

FSA officials indicated several factors contributed to delays in establishing and reporting measurable cost reduction strategic goals and measures. These factors included concerns raised

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<sup>8</sup> These are the same awards as noted under the ADvance initiative. Five IDIQ contracts were subsequently awarded on September 25, 2008.

by GAO relating to FSA's initial efforts in FY 1998 to develop unit cost measures which led to a revision in its approach.<sup>9</sup> FSA officials stated that the current activity based cost model was implemented in FY 2004 in response to these concerns, and time was required for FSA operational components to review the reported costs and related metrics prior to concurring and including them in FSA's strategic plans. FSA officials also stated it was likely that actual unit cost data reported will be from the previous year, as the current year data will not yet be final at the time the annual reports are prepared. With regard to the lack of an apparent cost reduction goal for the FFEL program, FSA indicated the primary driver for measures to include in the Five-Year Plan was the inclusion of measures that closely mapped with the information systems where FSA was making its largest investments. FSA noted that a majority of its costs were accounted for in the four outputs chosen. FSA also stated its preferred goal was to look at the reduction of costs globally as opposed to on a project-by-project basis.

FSA's progress in recognizing cost reductions associated with significant systems initiatives has been hampered for several reasons.<sup>10</sup> FSA officials stated several factors contributed to the delays and additional costs associated with the VDC transition. First, officials said a high speed data transfer solution was proposed by the incoming contractor and accepted by FSA, but the incumbent contractor found it to be unacceptable because the solution imposed a risk to its production environment. As a result, the incumbent contractor created an alternative transfer solution, requiring additional equipment to be purchased.

FSA officials stated additional software licenses were needed in order to operate the software at both contractors' facilities. Since the licenses were in the incumbent contractor's name only and not meant for distribution elsewhere, permission was required from the software vendors. The officials said FSA needed to obtain 27 dual-license agreements. Some vendors negotiated the dual-usage licenses at no-cost, but others saw it as an opportunity to generate revenue.

In addition, the officials said the transition clause in the incumbent contract was general and did not require the contractor to transition easily. One official said approximately one-month after the contract award, the incumbent contractor began evading FSA.

FSA officials said as a result of delays created by the issues noted above, the incoming contractor proposed to move FSA's mainframes in mid-November 2007, but that date was too close to the testing in preparation of the FAFSA peak processing season. The officials said if the mainframes were transitioned during mid-November, FSA would not be able to adequately test the results of the move and the risk of error would be too great. FSA officials stated as a result, the mainframes could not begin to transition until after FAFSA peak processing, which ends in late February or early March 2008. These delays created the need for a contract extension with the incumbent contractor, and a request for equitable adjustment from the new contractor to cover unanticipated costs.

The former FSA CIO said FSA was very conservative with the projected \$150 million savings from the VDC recompute. She said while the savings may be lower than what was previously

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<sup>9</sup> GAO-02-255, *Federal Student Aid – Additional Management Improvements Would Clarify Strategic Direction and Enhance Accountability*, April 2002.

<sup>10</sup> Information related to reasons for delays in recognizing initial planned cost savings associated with the ADvance and CSB initiatives is noted in Finding No. 2.

expected, FSA will still realize cost savings because the savings will come from the long-term operations and maintenance costs with the incoming contractor.

Overall, due to the limitations noted, it is difficult to determine FSA's progress in reducing its costs. Data that can be compared to recently established baselines will not be reported until FY 2008, measures that FSA has selected to report out on may not adequately reflect costs associated with all of the major programs administered by FSA, and cost reductions associated with major system initiatives may not be recognized due to significant modifications to plans associated with the original savings projections. In addition, FSA's plans to include cost reductions associated with individual system initiatives only in overall unit cost measures will likely make it difficult to determine whether any of the planned savings were actually recognized. Congress, the Secretary, and the public cannot determine if FSA has reduced its program costs since becoming a PBO in 1998.

### **Recommendations**

We recommend that the Under Secretary ensure the Acting COO takes action to:

- 3.1 Include a cost reduction measure in FSA's strategic plans and annual reports that adequately captures administration costs associated with the FFEL program.
- 3.2 Include a disclosure in FSA's annual reports that clearly explains the actual reported unit costs are the prior year's costs.
- 3.3 Report savings from major system initiatives on an aggregate and individual basis to facilitate tracking of planned savings to actual savings.
- 3.4 Include appropriate transition clauses in all future contracts to ensure the timely cooperation of incumbent contractors and avoid unnecessary transition costs.

### **FSA Comments**

FSA did not state whether it concurred with the finding, but provided a corrective action plan for each of the recommendations. FSA stated the measurement of cost reduction takes time, and that it is incorrect to infer from this that cost reductions are not being achieved. FSA also stated that while it acknowledges that changes have been made to the CSB, Advance, IPM, and VDC contracts, changes in contract scope do not necessarily result in the loss of projected cost reductions.

With regard to the FFEL program, FSA stated it is not appropriate to expect FSA to exert influence over the cost of this program nor is it reasonable to judge FSA based on reductions in the cost of this program. The primary costs to the government are lender and guaranty agency subsidies, which can be reduced only through changes to the authorizing legislation and the regulations. FSA stated that because of this, the administrative costs of the FFEL program are generally limited to eligibility determination and oversight and monitoring of FFEL participants, and as a result, on a unit cost basis, these costs are relatively minor in comparison to the administrative costs of other programs. FSA also stated that while it will identify a FFEL cost standard, in its opinion, a more important standard to measure is FSA's performance in

conducting oversight of these program participants. FSA said it is currently identifying possible standards to address this need and will incorporate them in its next update to the Five-Year Plan.

### **OIG Response**

In the finding, OIG did not conclude that cost reductions are not being achieved or that changes in contract scope would result in the loss of projected cost reductions. OIG noted several factors have hindered the ability to measure FSA's progress towards the reduction of costs of administering its programs. These include the cost reduction measures that FSA selected to report out on may not adequately reflect costs associated with all of the major programs administered by FSA, and the anticipated cost reductions associated with major system initiatives may not be recognized due to significant modifications to plans associated with the original savings projections. In addition, FSA's plans to include reductions associated with individual system initiatives only in overall unit cost measures will likely make it difficult to determine whether any of the planned savings were actually recognized. Due to these limitations, OIG concluded it was difficult to determine FSA's progress in reducing its program administration costs.

OIG is aware that the primary costs of the FFEL program are the subsidy payments made to lenders and guaranty agencies to originate, guarantee and service loans, and OIG never stated or implied that FSA should exert influence on the statutory definition of those costs. OIG also recognizes that part of FSA's administrative costs of the FFEL program are for eligibility determination and oversight and monitoring. However, there are other significant administrative contract costs for information technology systems necessary for FSA to operate the FFEL program. The administrative costs of the contracts are under FSA's control. For example, FSA incurs costs for the Lender Reporting System (LARS), Guaranty Agency Financial Reporting (Form 2000), and the National Student Loan Data System (NSLDS). These systems are critical for the financial management operation of the FFEL program, such as collecting information on outstanding amounts, types, and statuses of loans, and for processing payments to lenders and guaranty agencies.

OIG does not agree that oversight standards are sufficient as a primary response to the HEA's mandate to reduce administrative costs. The mandate in Section 141 (a)(2)(B) of the HEA does not exclude the FFEL program. FSA needs to fully identify the FFEL program's administrative costs and plan efforts to reduce those costs. To improve program integrity, OIG fully supports FSA's intent to identify and develop standards to measure performance in conducting oversight of FFEL program participants, and incorporate them in the next update of its Five-Year Plan to supplement administrative cost reduction standards for the FFEL program.

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## OBJECTIVE, SCOPE, AND METHODOLOGY

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The objective of our audit was to determine if FSA is meeting its responsibilities under Title I, Part D of the HEA, as amended, related to planning and reporting, systems integration, and cost reduction. To accomplish our objective, we gained an understanding of internal control applicable to FSA's responsibilities under the HEA. We reviewed applicable laws and regulations, policies and procedures, and GAO *Standards for Internal Control in the Federal Government*. We reviewed GAO audit reports and OIG inspection reports that discussed FSA's performance as a PBO. We performed an analysis of information from Annual Performance Plans, Five-Year Performance Plans, and Annual Performance Reports for FYs 2004 through 2006. We also performed a limited review of the FY 2007 Annual Performance Report.

### Planning and Reporting Processes

We conducted interviews with FSA officials to gain an understanding of the planning and reporting processes required under the HEA. We reviewed all accomplishments identified in FY 2004-2006 Annual Reports as relating to systems integration or cost reduction and traced them to the corresponding Annual Plan. We also reviewed documentation provided by FSA staff to support completion of these projects. We judgmentally selected 47 out of 274 action items (17 percent) with 100 out of 315 associated success measures (32 percent) as relating to systems integration and cost reduction from FY 2004-2006 Annual Plans and traced them to the corresponding Annual Report. Further, we reviewed performance agreements for the COO and senior managers on the EMT, including annual ratings and awarded bonuses.

We relied on computer-processed data maintained in the Project Performance Measurement System (PPMS) representing the completion status of projects from the FY 2004 to 2006 Annual Plans. We verified the accuracy of the reported completion status from PPMS against supporting documentation provided. Based on our testing, we determined the data was sufficiently reliable for the purpose of our audit.

### Systems Integration

Our review included an analysis of data relating to FSA's systems integration strategic objective from FY 2004 through 2006. We held discussions with FSA management and staff responsible for the ADvance, CSB, and IPM initiatives regarding integration efforts and accomplishments. We also reviewed contract file documentation for the ADvance, CSB, and IPM initiatives.

### Cost Reduction

We held discussions with FSA management and staff knowledgeable about the activity-based costing system and development of FSA's unit cost baselines. In addition, we held discussions with FSA staff regarding statements of cost savings for the ADvance, CSB, IPM, and VDC initiatives in the FYs 2005 and 2006 Annual Performance Reports. We also reviewed documentation of the cost savings for these four systems initiatives.



The fieldwork for our audit was conducted at Department offices in Washington, DC, during the period March 2007 through January 2008. We held an exit conference with FSA management and staff on April 23, 2008. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.



SEP 18 2008

Ms. Michele Weaver-Dugan, Director  
Operations Internal Audit Team  
U.S. Department of Education  
Office of Inspector General  
400 Maryland Avenue, SW  
Washington, DC 20202-1510

RE: Audit Control Number ED-OIG/A19H0008

Dear Ms. Weaver-Dugan:

Thank you for providing us the opportunity to review and respond to your Draft Audit Report entitled "Federal Student Aid's Performance as a Performance-Based Organization." The Under Secretary has asked me to respond on her behalf.

In general, while Federal Student Aid agrees with many of the comments and looks forward to working with your office to implement a corrective action plan, the report fails to recognize these issues:

- The development of a comprehensive strategic and tactical planning and reporting structure for Federal Student Aid has evolved over the past four years. Today, a comprehensive collection of processes and programs, some mandated and several that are not, provide management with an effective infrastructure to manage the organization's planning and reporting responsibilities;
- While Federal Student Aid has reevaluated components of its integration strategy, its Target State Vision remains the same and progress continues on our multi-year sequencing plan to bring us closer to that integrated vision; and
- From the development of processes to measure unit costs to the identification of appropriate standards to accurately gauge meaningful cost control to the compilation of sufficient results necessary to compare cost movement, the measurement of cost reduction takes time. However, it is incorrect to infer from this that cost reductions are not being achieved. In addition, changes to contract scope do not necessarily result in the loss of projected cost reductions.

In the discussion that follows, we have addressed some of your comments and specific concerns.

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## **Finding No. 1**

While we acknowledge that the development of a comprehensive strategic and tactical planning, tracking and reporting structure for Federal Student Aid has been evolutionary, we disagree that Federal Student Aid is not meeting its responsibilities as outlined under the PBO legislation. Federal Student Aid has worked with your office to continually refine both the Five-Year Plan and the Annual Report. While there may be differences in interpretations of how and what constitutes compliance with the legislation (such as the utility of including short-term tactical plans or performance standards in a long-term strategy document or how to report senior management compensation), your office has reviewed and ultimately approved every Five-Year Plan and Annual Report produced during the time in question.

The result is a process that we believe is successful and by your own admission has improved. In fact, in removing the student financial assistance programs from their High Risk List, the GAO reported in 2005 that “Education has demonstrated a strong commitment to addressing risks; developed and implemented corrective action plans; and, through its annual planning and reporting processes, monitored the effectiveness and sustainability of its corrective measures.”

More importantly, Federal Student Aid has worked to develop complementary planning and reporting processes to augment apparent gaps in the mandated procedures. Our performance management initiatives are wide-ranging and influence every aspect of our business. Today, Federal Student Aid produces a comprehensive suite of strategic and tactical planning, tracking and reporting processes that are used by senior-level management as well as rank-and-file employees for budgeting, planning, monitoring, control and reporting.

The **Five-Year Plan** outlines Federal Student Aid’s strategic direction and provides long-term guidance in achieving organizational objectives. The Five-Year Plan aligns with Federal Student Aid’s annual, tactical business-level planning, tracking and implementation processes including the Annual Performance Plan.

Federal Student Aid’s **Annual Performance Plan** establishes specific tactical initiatives to achieve organizational strategic objectives outlined in the Five-Year Plan. Timelines, milestones and status are reported in the Annual Performance Plan and evaluated on a monthly basis to ensure their alignment with current business needs, the allocation of resources and capital, policy considerations, and statutory and regulatory requirements.

The **Annual Report** provides the mechanism for reporting the organization’s annual performance results, including the organization’s audited financial statements, a summary of the organization’s progress in meeting tactical goals established in the Annual Performance Plan and detailed results of the organization’s success in meeting



performance standards established in the Five-Year Plan. These documents—the Five-Year Plan, the Annual Performance Plan and the Annual Report—form the foundation of Federal Student Aid’s strategic planning, tactical implementation and reporting processes.

Federal Student Aid also produces weekly and monthly project planning and reporting activities detailing the scope, schedule, cost, quality and overall status of key initiatives. Federal Student Aid’s budget management process and our unit-cost model provide cost identification, control and management. Federal Student Aid also tracks and reports enterprise-wide operational, human capital and performance metrics through a series of dashboard tracking reports.

In addition to annual planning and reporting, Federal Student Aid's performance management is supported by several teams throughout the enterprise that help us to meet our five core objectives. The groups described below each play an integral part in ensuring Federal Student Aid performs effectively and efficiently.

- **Project Management Office**

The Project Management Office, established in FY 2003, is a central point of oversight for identified projects. Through the Project Management Office, we integrate project activities within Federal Student Aid, linking them to strategic objectives, priorities and available resources. It supports project managers by establishing enterprise project management standards of practice, advising on systems integration strategy, sharing information across projects during the full life cycle of the projects through our Enterprise Change Management (ECM) Group and providing relevant reports and data to management.

- **Enterprise Risk Management**

Federal Student Aid has also established an Enterprise Risk Management (ERM) function to provide strategic direction in assessing, monitoring and managing risk across the organization. The ERM Group is responsible for development and implementation of an enterprise risk management program at Federal Student Aid. This program provides a strategic view of downstream risk potentials and enables senior management to better anticipate, analyze and manage risks inherent in the federal student financial assistance programs and develop strategies to address these risks. The ERM Group also performs internal reviews, conducts risk assessments and provides internal audit tracking and resolution services for the organization.

This collection of processes and programs provide management with an effective infrastructure to manage the organization’s strategic and tactical planning and reporting functions. While we continually strive to improve the alignment between these planning,

tracking and reporting functions, we believe they fulfill Federal Student Aid's responsibility for planning and reporting of PBO activities and complies with Title I, Part D of the HEA, as amended.

The following discussion addresses some of the specific comments under Finding No. 1:

- We acknowledge that it took too long to establish Federal Student Aid's first official Five-Year Plan. However, we also agree with you in questioning the value to the organization and the taxpayer of updating a Five-Year Plan on an annual basis. Per your suggestion, we attempted, albeit unsuccessfully, to change the requirement when Congress recently reauthorized the Higher Education Act. We concur with your suggestion to reissue the document during those years when there are no updates to report.
- You noted and we acknowledge the 2004 Five-Year Plan and the 2004 and 2005 Annual Reports failed to include several key components such as tactical goals, goals that were linked to strategic objectives, performance standards and the organization's results in meeting those standards, and a "weak correlation" between the Five-Year Plan and the corresponding Annual Plans. However we believe, and judging by your acknowledgement of improvements, many of these issues were satisfactorily addressed with revisions identified by both your office and ours and incorporated into the 2006 Five-Year Plan, the 2006 and 2007 Annual Plans and the 2006 and 2007 Annual Reports.
- You noted that "not many action items and success measures per the Annual Plan were included in the Annual Report." While this is true, Federal Student Aid maintains a different interpretation of the correlation between these two documents. The Annual Plan spells out in specific detail (over 300 line items in FY 2008) the actual projects to be accomplished during the year and the organization's progress in completing those projects. While the Annual Report references the Annual Plan for specific progress made by the organization in completing the stated action items, the Annual Report is presented in summary form providing a high-level overview of the organization's progress in achieving the objectives outlined in the Five-Year Plan and the corresponding action items from the Annual Performance Plan.
- In 2005, Federal Student Aid combined two redundant annual reporting requirements combining the Annual Report and the Annual Performance and Accountability Report into a single document satisfying both requirements. The result was that the Annual Report was now subject to the Department's annual financial audit. As a result, every accomplishment listed in the Management's Discussion and Analysis section of the Annual Report was audited, verified and approved by your auditor. As part of this process, extensive supporting documentation was supplied to your auditor for every accomplishment listed in the Management's Discussion and Analysis section of the Annual Report. We are happy to provide this information to your office as well in the future.



## **Finding No. 2**

Federal Student Aid generally concurs with your finding regarding the three integration efforts referenced in the audit, Common Services for Borrowers (CSB), Advance and Integrated Partner Management (IPM). However, while some of our integration initiatives have been revised, Federal Student Aid's overall target state vision for system and process integration remains unchanged and we continue to develop and support efforts to achieve it.

Through CSB, Advance and IPM, we were successful in reducing many of the operating costs of our legacy operations. (See our response to Finding 3 below for additional details). However, what we discovered was that large contracts requiring multiple business capabilities, and supporting a complex and multi-faceted business process, do not provide Federal Student Aid the best solution providers from the marketplace. In addition, the lack of post-award competition led to price, quality and innovation issues preventing Federal Student Aid from being able to quickly transition services, potentially putting our business at risk.

In order to increase the competitive environment, increase our product quality, and reduce the risk of a single point of failure, Federal Student Aid decided to adopt a strategy where multi-vendor contract vehicles for core business capabilities will replace single large contracts. In addition, large contracts for system development will be replaced with smaller task orders for component-based development. For example, Federal Student Aid now plans to develop the functions of Advance in several components and under several separate task orders, thereby reducing risk and increasing overall competition and quality.

In addition, we believe it is important to note that the concept of integration has changed since the inception of the PBO in 1998. At that time, integration generally aimed at consolidating sets of business functions onto a single platform whenever practical. Since that time, concepts of integration have evolved with the introduction of Web services, service-oriented architecture and other technological advances.

Federal Student Aid has not confined its integration strategy to development efforts aimed at consolidating computer systems. Federal Student Aid understands system integration to encompass infrastructure, business application development and supporting processes. Our integration efforts today extend far beyond the office of Chief Information Officer and require the redeployment of physical, human and financial assets to support enterprise integration efforts. Federal Student Aid has made progress towards integration of all support systems and activities required to deliver the Title IV programs. This understanding of integration aligns with the changes in organizational planning, business modeling and technological advancements established over the last decade.

During the coming years, Federal Student Aid will continue to pursue system and business process integration measures that will lower our overall costs while improving program integrity and system security, as well as the quality and accessibility of our

products and services. As we pursue integration initiatives, we will continuously reevaluate existing strategies, as necessary, and explore new and innovative approaches and technology to help us achieve our goals. Projects such as Advance and CSB will continue forward, but with different development and contracting strategies that will allow Federal Student Aid to incrementally enable functions with new technology rather than perform only large-scale system replacements. It is important to reiterate that while Federal Student Aid has reevaluated components of its strategy to achieve its integration efforts, its Target State Vision remains the same and progress continues on our multi-year sequencing plan by focusing on major initiatives and activities that bring us closer to that vision.

### **Finding No. 3**

From the development of processes to measure unit costs to the identification of appropriate standards to accurately gauge meaningful cost control to the compilation of sufficient results necessary to compare cost movement, the measurement of cost reduction takes time. However, it is incorrect to infer from this that cost reductions are not being achieved. In addition, changes to contract scope do not necessarily result in the loss of projected cost reductions.

While your office correctly noted that performance standards published in the FY 2006-2010 Five-Year Plan only provide targets identified for FY 2006, 2008 and 2010, it is incorrect to interpret this to mean that no cost reductions will occur or be reported until 2008. On the contrary, actual results indicate that cost reductions have been realized and are published annually in the Annual Report. In fact, Federal Student Aid reported (in the FY 2007 Annual Report) unit cost reductions that, in every case but one, were lower than the baseline. In the one case where unit costs rose, (the unit cost of servicing a Direct Loan borrower), the increase was attributed to a decrease in servicing volume. We anticipate unit costs for this standard will be reduced dramatically this year and for the foreseeable future due to the significant increase in Direct Loan volume.

With regard to cost reductions from systems initiatives, we acknowledge that changes have been made to the contracts in question (CSB, Advance, IPM and VDC). However, changes in contract scope do not necessarily result in the loss of projected cost reductions. For example, in 2007, Federal Student Aid changed the scope of the CSB contract. This change did not impact the Department's original cost reduction estimates and, in fact, resulted in even greater savings. More importantly, this change did not in any way impact service levels to students. Changes to the Advance, IPM and the VDC contracts will also result in savings to the Department, although in some cases they may be less than originally projected.

With regard to the Federal Family Education Loan (FFEL) Program, it is not appropriate to expect Federal Student Aid to exert influence over the cost of this program nor is it reasonable to judge Federal Student Aid based on reductions in the cost of this program. Federal Student Aid has very little influence over FFEL costs. In fact, operational and programmatic costs are borne primarily by private entities such as lenders, servicers and



guaranty agencies. The primary costs to the government are lender and guaranty agency subsidies, which can only be reduced through changes to the authorizing legislation and the regulations. Because of this, the administrative costs of the FFEL program are generally limited to eligibility determination and oversight and monitoring of FFEL participants. As a result, on a unit cost basis, these costs are relatively minor in comparison to the administrative costs of some of our other programs such as the Direct Loan Program. While we will identify a FFEL cost standard, in our opinion, a more important standard to measure is Federal Student Aid's performance in conducting oversight of these program participants. We are currently identifying possible standards to address this need and will incorporate them in our next update to the Five-Year Plan.

Finally, because of the time it takes to calculate annual unit costs coupled with Congressionally mandated deadlines for submission of the Annual Report, we are unable to report current year unit costs. While we regret our original reporting of these costs may have been misinterpreted by some, beginning with the FY 2007 Annual Report, we have begun clearly footnoting the years being reported.

Enclosed is a corrective action plan addressing each of your findings and recommendations. Thank you for providing us the opportunity to respond to your report and we look forward to working with your office to implement these changes.

Best regards,

Lawrence A. Warder  
Acting Chief Operating Officer  
Federal Student Aid