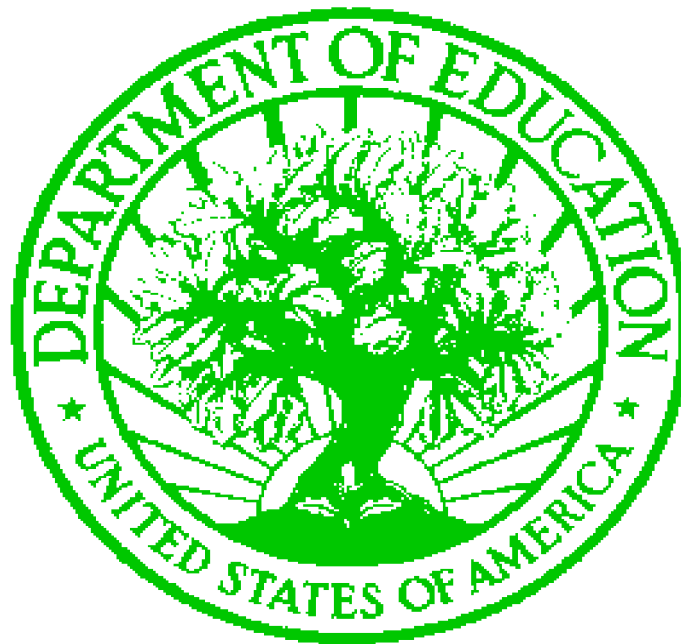


AUDIT GUIDE

COMPLIANCE AUDITS (ATTESTATION ENGAGEMENTS) FOR LENDERS AND LENDER SERVICERS PARTICIPATING IN THE FEDERAL FAMILY EDUCATION LOAN PROGRAM



**U.S. DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL**

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

December 1996

LS-97-01

Dear Colleague:

This letter transmits the U.S. Department of Education's Audit Guide, *Compliance Audits (Attestation Engagements) for Lenders and Lender Servicers Participating in the Federal Family Education Loan Program*. This guide supersedes the March 1995 Lender Audit Guide.

Section 428(b)(1)(U) of the Higher Education Act of 1965, as amended, (HEA) and Section 682.305(c) of Title 34 of the Code of Federal Regulations (CFR) require all lenders participating in the Federal Family Education Loan (FFEL) Program to have an annual compliance audit performed by a non-federal auditor. A participating lender is any lender who originates or holds FFEL Program loans. Lenders that participate in the FFEL Program frequently engage servicer organizations (servicers) to perform certain functions relating to the administration of that program. Section 487(c)(1)(C) of the HEA and 34 CFR 682.416(e) requires servicers to have an annual compliance audit performed of the servicer's administration of the FFEL Program.

All compliance audits (attestation engagements) conducted to satisfy the annual compliance audit requirements, except for audits of lenders or servicers that are nonprofit or governmental organizations, must be done in accordance with this guide. Lenders or servicers that are nonprofit or governmental organizations have the option of obtaining an audit (attestation engagement) in accordance with this guide or obtaining an audit in accordance with the Office of Management and Budget (OMB) Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions* and OMB Circular A-128, *Audits of State and Local Governments*, (or successor circulars), respectively. However it is highly recommended that auditors consult this Guide to identify the compliance requirements to be tested in an A-133 or A-128 audit of FFEL Program lenders or servicers. It should be noted that the Single Audit Act of 1984 has been amended by the Single Audit Act Amendments of 1996 and is effective for fiscal years beginning after June 30, 1996. It is the intention of the OMB to combine the audit requirements under Circulars A-133 and A-128, revise Circular A-133 to also be applicable to state and local governments, and then rescind OMB Circular A-128.

Engagement Periods and Reporting Deadlines

The following are the engagement periods and related due dates for the lender and servicer compliance reports.

Lenders: The first report submission required to be filed by a lender was for the lender's first fiscal year that began after July 23, 1992. Except for lenders who originated and/or held FFEL Program loans totaling \$5 million or less (Dear Colleague Letter 95-L-183 [September 14, 1995]), lenders were required to complete and submit the audits, if required (see Submission Requirements below), by September 30, 1995.

The Omnibus Consolidated Appropriations Act of 1997 (Public Law 104-208) providing fiscal year 1997 (October 1, 1996-September 30, 1997) appropriations for the Department of Education includes a provision prohibiting the Department of Education from using funds made available under that act to enforce the lender compliance audit requirement against lenders with loan portfolios equal to or less than \$5 million. This provision of the appropriations bill does not eliminate the requirement that lenders with this volume of FFEL Program loans complete an annual compliance audit for all the fiscal years subject to the audit requirement, rather it simply delays the date by which the audits must be completed. In light of possible further legislative action by Congress, the Department of Education has decided to again postpone the deadline for completion and, if necessary, submission of the audit until June 30, 1998 for any audit period in which the lender originated and/or held FFEL Program loans totaling \$5 million or less.

Subsequent audits are required annually and are to be completed and submitted to the Department of Education within six months after the close of the lender's fiscal year.

Servicers: The servicer audit requirement (attestation engagement) applies to any servicer's fiscal year in which the servicer administered or serviced any aspect of the FFEL Programs. The implementing regulation (34 CFR 682.416) requires annual servicer compliance audits beginning with the servicer's first full fiscal year that began on or after July 1, 1994. The initial audits due are of a servicer's fiscal year 1995.

Servicers with fiscal years ending June 30 through October 31 have the option of having an annual audit for fiscal years 1995 and 1996 or a combined audit for the two years. The initial audits for servicers with fiscal years ending November 1 through December 31 are required for their fiscal year 1995. The initial audits for servicers with fiscal years ending January 1 through June 29 are required for their fiscal year 1996. The initial compliance audit report for all servicers should be completed and submitted to the Department of Education by May 31, 1997.

Servicers who, prior to issuance of this guide, had independent practitioners perform audits of their fiscal years 1995 or 1996 in support of the lender audit requirement may submit those audits to ED as meeting their servicer audit requirement for those fiscal years provided those audits: (1) were performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States; standards established by the American Institute of Certified Public Accountants; and the March 1995 Lender Audit Guide, *Compliance Audits (Attestation*

Engagements) of the Federal Family Education Loan Program at Participating Lenders issued by the U.S. Department of Education, Office of Inspector General, and (2) addressed all compliance requirements and applicable assertions contained in Section II of the March 1995 Lender Audit Guide.

Subsequent annual servicer audits are required to be completed and submitted to the address below within six months after the close of the servicer's fiscal year.

Effective Date of this Guide

Application of this guide is effective immediately for servicer audits. For lender audits, application of this guide is effective for fiscal years ending on or after December 31, 1996. Earlier application is permitted but not required.

Submission Requirements

The following lenders and servicers are required to submit the full lender or servicer reporting package identified in Section IV of the Guide.

1. Lenders that originate and/or hold FFEL Program loans totaling \$10 million or more in a fiscal year
2. Other lenders whose reports identify findings of noncompliance
3. All servicers

These lenders or servicers should submit the full reporting package to the Department of Education at the following address:

Guarantor and Lender Oversight Staff
U.S. Department of Education
600 Independence Avenue, SW
Room 4624, ROB-3
Washington, D.C. 20202-5132

Lenders that originate or hold more than \$5 million but less than \$10 million in FFEL Program loans and whose reports do not disclose findings of noncompliance, should hold the reports for a period of five years and must submit them only if requested. The Guarantor and Lender Oversight Staff intends to request a random sample of these reports to be submitted. In addition, these reports may be requested by staff performing program reviews or other audit work to assist in planning such work and to avoid duplicating the work performed by the non-federal auditor.

Copies of the guide can be obtained by calling the Federal Student Aid Information Center at 1-800-4-FEDAID. Questions pertaining to the guide should be faxed to the Office of Inspector General at (202)205-8238. We look forward to working with you to implement the compliance audit requirements for FFEL Program lenders and lender servicers.

Sincerely,

/S/

Thomas R. Bloom

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SECTION I

PLANNING AND OTHER CONSIDERATIONS

PURPOSE OF THE GUIDE

This Guide helps lender¹ or lender servicer² [servicer(s)] managements prepare written assertions about the entity's compliance (and, for servicers, about the entity's internal control over compliance with) specified U.S. Department of Education (ED) Federal Family Education Loan (FFEL) Program requirements. It also helps practitioners engaged to examine and report on management's written assertions.

AUTHORIZATION

Section 428(b)(1)(U) of the Higher Education Act of 1965, as amended, (HEA) requires that each participating lender have a compliance audit of its FFEL Program. The FFEL Program (formerly the Guaranteed Student Loan Program) includes the Federal Stafford Loan Program, both subsidized and unsubsidized,³ the Federal Supplemental Loans for Students (SLS) Program, the Federal PLUS Program, and the Federal Consolidation Loan Program.

Lenders frequently hire servicers to administer FFEL Program functions. Section 487(c)(1)(C) of the HEA requires annual compliance audits of servicers that contract with eligible lenders to administer or service any aspect of the Student Financial Assistance (SFA) Programs. The SFA Programs include the FFEL Program. Section 682.416(e) of Title 34 of the Code of Federal Regulations (34 CFR), requires an annual servicer compliance audit unless:

- a. The servicer contracts with only one lender⁴; *and*
- b. The audit of that lender's FFEL Programs involves every aspect⁵ of the servicer's administration of those FFEL Programs.

¹Lender is defined in Appendix C.

²Servicer is defined in Appendix C.

³See definition in Appendix C.

⁴Applies at the individual lender identification number (ID) level.

⁵For the purpose of making this determination, the term "every aspect" means all the functions addressed in the compliance requirements specified in this Guide. Therefore, a separate audit would be required of the servicer if the lender's audit is narrow in scope and does not cover all of the functions addressed in the compliance requirements specified in this Guide that are performed by the servicer for their lender client.

Sections 428(b)(1)(U) and 487(c)(1)(C) of the HEA require that the audits be performed by a qualified, independent organization or person in accordance with the U.S. General Accounting Office's (GAO) *Government Auditing Standards*, issued by the Comptroller General of the United States. The regulations implementing the audit requirements specify that procedures for the audits will be available in an audit guide developed by the ED Office of Inspector General [34 CFR 682.305(c)(2)(iii) and 682.416(e)].

Required Reports

An overall objective of ED in implementing the statutory and regulatory audit requirements is to gain assurance that:

- a. the *Lender's Interest and Special Allowance Request and Reports* (ED Form 799s) are materially correct and in conformity with identified laws and regulations; *and*
- b. the lender or servicer has complied with—and, as of the assertion date, the servicer has effective control over compliance with—the identified statutory and regulatory provisions applicable to its participation in or administration of the FFEL Program.

The reports required by this Guide provide assurance to ED program managers that management's assertions relative to the matters specified in this Guide are fairly stated, in all material respects. Thus, the Guide addresses the statutory and regulatory audit requirements by requiring an examination-level attestation engagement performed in accordance with the American Institute of Certified Public Accountant's (AICPA's) Statement on Standards for Attestation Engagements (SSAE) No. 3, *Compliance Attestation* (AICPA, *Professional Standards*, vol. 1, AT sec. 500), as amended⁶ and the general, fieldwork, and reporting standards in *Government Auditing Standards* relative to:

- (1) the lender or servicer management's written assertions about the entity's compliance with certain requirements involving their participation in or administration of the FFEL Program; *and*
- (2) the servicer management's written assertion about the effectiveness of its internal control structure over compliance with those specified compliance requirements.

This Guide requires certain other management and practitioner communications as part of the engagement (see the "Reporting" section herein). The "Practitioner Qualification and Responsibilities" section herein describes the general, fieldwork, and reporting standards that must be followed.

⁶Footnote 1 of SSAE No. 4, *Agreed-Upon Procedures Engagements* (AICPA, *Professional Standards*, vol. 1, AT sec 600), provides details of SSAE No. 4's amendments of SSAE No. 3.

USE OF THIS GUIDE

This Guide must be used by all lenders or servicers that participate in or administer any aspect of the FFEL Program, with two exceptions:

- (1) Lenders or servicers that may be covered under the Single Audit Act of 1984⁷ and Office of Management and Budget (OMB) Circular A-128, *Audits of State and Local Governments*; and
- (2) Lenders or servicers satisfying the audit requirement with an audit in accordance with OMB Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions*.

For these lenders or servicers, this Guide identifies the programmatic compliance requirements that should be addressed by the audit.

This Guide is divided into four sections.

Section I provides general information about engagement requirements, addresses the purpose of the Guide, the scope of required engagements, management and practitioner responsibilities, reporting, effective dates, examination periods and due dates.

Section II specifies the requirements about which lender and servicer management must assert compliance and suggests, to the practitioner, procedures for examining and reporting on management's assertions ("standard engagement").

Section III explains when an alternative (or combined) engagement may be performed and establishes the required assertions for management, agreed-upon procedures for the practitioner, and other matters.

Section IV sets forth and illustrates management and practitioner reporting requirements.

ENGAGEMENT SCOPE

Lender Engagements

Lenders frequently engage servicers to administer certain of the lenders' FFEL Program functions (for example, managing initial applications, disbursements, and loan status; preparing ED Form 799s;

⁷The Single Audit Act of 1984 was amended by the Single Audit Act Amendments of 1996 and is effective for fiscal years beginning after June 30, 1996. We understand OMB intends to combine the audit requirements under Circulars A-133 and A-128. It is expected that OMB will revise Circular A-133 to also be applicable to state and local governments and then rescind OMB Circular A-128. Management and Practitioners should be alert to changes in relevant statutes and OMB requirements and apply the provisions contained therein accordingly.

servicing loans in repayment; or other services). The nature of management's written assertions and, thus, the scope of a lender engagement, will vary depending whether—

- (1) The functions addressed by assertions in Section II of this Guide are carried out in whole or in part by one or more servicers; *and*
- (2) The servicer(s) obtains and provides an audit/attestation report that meets certain requirements identified in Section III.

Management should determine whether the entity performs the functions addressed in Section II, whether it can make all or part of the required management assertions, and which of the following engagements is required.

■ ***Standard Engagement*** - When the lender services all, or all except an immaterial part, of its own FFEL Program loan portfolio, lender management must make all of the applicable assertions required in Section II of this Guide and a standard (examination-level) engagement should be performed.

■ ***Alternative Engagement*** - When all of the lender's FFEL Program loan portfolio is serviced by one or more servicers and the lender elects to use the alternative engagement, the lender's management is required to make the assertions contained in Section III, rather than those in Section II, in which case management is required to engage a practitioner to perform an agreed-upon procedures attestation engagement.

■ ***Combined Engagement*** - When part of the FFEL Program loan portfolio is serviced by the lender and part is serviced by one or more servicers and the lender elects to use the combined engagement, the lender's management is required to make the applicable assertions in Section II *and* the additional assertions in Section III. Management is required to engage the practitioner to perform the standard (examination-level) engagement on the Section II assertions and the agreed-upon procedures engagement required by Section III.

Multiple Lenders or Lender IDs. Some lenders submit information to ED under multiple lender IDs. This Guide allows management to submit separate reports for each lender ID or to combine its lender IDs into one or more reports. Similarly, lenders that issue consolidated financial statements may combine lender IDs into one or more reports. However, management's written assertions (and, thus, the practitioner's report) must include all lenders and lender IDs that either held or originated loans during the year. A complete listing of lender IDs covered by the assertions must be provided in the report submission.

Servicer Engagements

If a servicer does not perform, for its lender client, all of the functions addressed by a single assertion, that assertion may be modified but must clearly distinguish responsibilities of the lender and the servicer so that their respective written assertions address only the functions each performs.

Contracting With More Than One Lender. Servicers generally perform different services for different lenders. This Guide allows a servicer with more than one lender client to submit a single, organization-wide report that covers each compliance function addressed in Section II for each lender *if* the servicer management’s written assertions outline the compliance functions the servicer performs for each of its clients.

Servicer’s Internal Control Over Compliance. In addition to examining the servicer management’s assertions about the specified compliance requirements specified in Section II, this Guide also requires that servicer management engage the practitioner to examine and report on the servicer management’s assertion about the effectiveness of the servicer’s internal control over compliance with those specified compliance requirements (internal control assertion) in accordance with the AICPA’s Statement on Standards for Attestation Engagements (SSAE) No. 3, *Compliance Attestation* (AICPA, *Professional Standards*, vol. 1, AT sec. 500), as amended; the general, fieldwork and reporting standards in *Government Auditing Standards*; and this Guide. Management and practitioners should be aware that the required assertions and accompanying report on internal control over compliance required in this Guide differs from and is not a substitute for a report issued under AICPA Statement on Auditing Standards (SAS) No. 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA, *Professional Standards*, vol.1, AU sec.324).

Reporting Criteria. Management is responsible for the effectiveness of the servicer’s internal control over compliance with the specified requirements and for evaluating its effectiveness using reasonable criteria. As discussed in paragraph 6 of SSAE No. 3, practitioners are allowed to accept an engagement to examine management’s assertion about the effectiveness of the servicer’s internal control over compliance only if management uses reasonable criteria. This Guide recognizes *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as reasonable criteria for management’s internal control assertion and related practitioner reporting.

Practitioners engaged to examine a servicer management’s assertion about the effectiveness of the servicer’s internal control over compliance with the specified compliance requirements identified in Section II of this Guide are required to obtain an understanding of the relevant portions of the servicer’s internal control over compliance and to test and evaluate the design and operating effectiveness of the servicer’s internal control over compliance with the specified compliance requirements. Paragraph 6 of SSAE No. 3 says SSAE No.2, *Reporting on an Entity’s Internal Control Structure Over Financial Reporting* (AICPA, *Professional Standards*, vol. 1, AT 400), may be helpful to a practitioner engaged to examine management’s internal control assertion.

Severity of Control Deficiencies. As internal controls vary among servicers, this Guide does not provide suggested procedures for testing the design and operating effectiveness of the servicer’s internal control over compliance with the specified requirements. A servicer should have internal control that gives the servicer reasonable assurance that it is complying with the specified compliance requirements identified in Section II of this Guide. For purposes of management and practitioner reporting, the severity of control deficiencies relates to whether the servicer’s internal control provides reasonable assurance of

material compliance with the specified requirements. A deficiency in which the servicer's internal control over compliance fails to provide reasonable assurance of material compliance with the specified requirements should be considered a *significant deficiency*. The subsection "*Materiality*" herein discusses materiality of noncompliance.

Comparison of Information in ED Form 799

The ED Form 799s required to be tested must be copies of the ED Form 799s submitted by the lender [servicer] and processed by ED. Accordingly, as part of the engagement planning, the information in parts II, III and IV of the ED Form 799s to be tested should be compared to information in the Lender Pay History Search report for each quarter. Appendix D explains how to obtain the Lender Pay History Search report. [Note: Because ED Form 799s are required to be submitted to ED after the end of each quarter, the period of loan activity covered by the attestation engagement--that is, loan activity reported in ED Form 799s *submitted* during the lender's fiscal year--will not be the same as the lender's full fiscal year activity.]

MANAGEMENT RESPONSIBILITIES AND ASSERTIONS

Among other management responsibilities discussed in this Guide, management is responsible for:

- a. identifying the applicable compliance requirements,
- b. establishing and maintaining effective internal control over compliance,
- c. evaluating and monitoring compliance and the effectiveness of internal control over compliance,
- d. providing the practitioner with assertion(s) about the lender's or servicer's compliance with the specified compliance requirements and the effectiveness of the servicer's internal control structure over compliance, and
- e. providing the practitioner with their written representations about all other matters in paragraph 70 of SSAE No. 3.

Management refusal to provide the practitioner with the required assertions may subject the entity to administrative actions by ED.

PRACTITIONER QUALIFICATIONS AND RESPONSIBILITIES

Following is a discussion of the standards practitioners must follow and guidance on applying those standards in the engagements required by this Guide.

Qualifications and General Standards. Sections 428(b)(1)(U) and 487(c)(1)(C) of the HEA require that the FFEL Program compliance audits of each lender and servicer be conducted by a qualified, independent organization or person in accordance with standards established by the Comptroller General. This Guide requires that the engagement be performed by a certified public accountant (“practitioner”) that meets the general standards of qualification, independence, due professional care and quality control contained in Chapter 3 of *Government Auditing Standards*, including the requirements relating to continuing professional education. In part, those standards require that practitioners and audit firms comply with the applicable provisions of the public accountancy laws and rules of the jurisdictions in which they are licensed and where the engagement is being conducted. If the lender or servicer is located in a state outside the home state of the practitioner, and the practitioner performs substantial field work in the lender's or servicer's state, this Guide requires the practitioner document his or her compliance with the licensing requirements of the public accountancy laws of that state. This Guide does not impose additional licensing requirements beyond those established by the individual State Boards of Accountancy.

Internal auditors of a lender [servicer] are not independent of the entity while auditing within it and, therefore, they cannot perform the majority of field work and their reports cannot satisfy the reporting requirements of this Guide. For examination-level engagements—like the standard engagement discussed in Section II of this Guide—paragraph 43 of SSAE No. 3 says a practitioner should consider the guidance in Statement on Auditing Standards (SAS) No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec 322), “when addressing the competence and objectivity of internal auditors, the nature, timing, and extent of work to be performed, and other related matters.” In accordance with paragraphs 24 and 25 of SSAE No. 4, the agreed-upon procedures required by the alternative or combined engagement discussed in Section III must be performed entirely by the independent practitioner.

Fieldwork and Reporting Standards. This Guide requires the practitioner to follow the fieldwork and reporting standards for financial-related audits contained in Chapters 4 and 5, respectively, of the *Government Auditing Standards*, and to perform and report on the engagement in accordance with SSAE No. 3. Failure to follow standards may result in a referral to the AICPA and the cognizant State Board of Accountancy and an action to prohibit the practitioner from being engaged to fulfill federal program reporting requirements. (See also the “*Engagement Quality*” subsection herein).

Engagement Scope. As discussed in the “Engagement Scope” section herein, the nature of the lender or servicer management's written assertions and the scope of the practitioner's engagement may vary if the lender contracts with servicers. **All applicable assertions required of management by this Guide must be addressed by the practitioner's report.**

Engagement Letter. This Guide requires that the practitioner prepare a letter of engagement to communicate to the lender or servicer the nature of the examination-level attestation engagement. The letter must include, at a minimum, the following:

- a. A statement that the engagement is to be performed in accordance with the general, fieldwork, and reporting standards contained in *Government Auditing Standards*, the American Institute of Certified Public Accountant’s (AICPA’s) Statement on Standards for Attestation Engagements (SSAE) No. 3, *Compliance Attestation*, as amended and this Guide.
- b. A description of the scope of the engagement and related reporting that meets the requirements of this Guide.
- c. A statement that both parties understand that the U.S. Department of Education intends to use the practitioner's report to help carry out its responsibilities for oversight of the FFEL Program.
- d. A provision that the practitioner is required to provide the Secretary of Education, the ED Inspector General, and the GAO, or their representatives, access to working papers or related documents to review the engagement. Access to working papers includes making necessary photocopies. Practitioners can refer to Interpretation No. 2 of SAS No. 41, *Working Papers*, titled “providing Access to or Photocopies of Working Papers to a Regulator” (AICPA, Professional Standards, vol.1, AU sec 9339) for guidance. Information regarding confidential commercial information that may be contained in working papers and Freedom of Information Act disclosure is provided in the “*Working Papers*” subsection herein and in Appendix F.

Although not a mandatory requirement, this Guide suggests that practitioners also include a statement in the engagement letter that describes the practitioner’s responsibility to communicate and report fraudulent acts or indications of such acts directly to the ED Office of Inspector General.

Obtaining Management Representations. Paragraph 11a of SSAE No. 3 says, in part, a practitioner may perform an examination engagement if management makes written assertions about the entity’s compliance with the specified requirements. Management's written assertions are the basis for the practitioner's testing and, therefore, are an integral part of the engagement. The nature of the written assertions made by the lender or servicer management (and, thus, the scope of the practitioner’s engagement) may vary depending on the extent to which a lender has contracted with the servicer to perform certain compliance functions. Because lenders and servicers are not required to make such specific written assertions to ED, such assertions should be obtained from management in a representation letter to the practitioner. In addition to the specific assertions identified in the Guide, as applicable, management must also provide, in the letter, written representations about the matters in paragraph 70 of SSAE No. 3. **This Guide requires that management provide all written assertions and representations required by the Guide.** If management omits any of the required assertions or representations, the practitioner should consider the guidance of paragraphs 61 and 71 of SSAE No. 3 about restrictions on the scope of the engagement.

Inherent Risk. Paragraph 32 of SSAE No. 3 requires that, in assessing inherent risk, the practitioner “should consider factors relevant to compliance engagements, such as. . . prior experience with the entity’s compliance [and] the potential impact of noncompliance.” In addition, paragraph 48 of SSAE No. 3 says that for engagements involving compliance with regulatory requirements, “the practitioner’s procedures should include reviewing reports of significant examinations and related communications between regulatory

agencies and the entity and, when appropriate, making inquiries of the regulatory agencies, including inquiries about examinations in progress.” Accordingly, this Guide requires the practitioner to consider known material findings and recommendations and material noncompliance identified in prior audits, guaranty agency reviews, and ED program reviews related to the FFEL Program. (See also the “*Follow-up on Audit Resolution Matters*” subsection herein.)

Matters Requiring Immediate Action. This Guide requires practitioners to design and perform procedures to provide reasonable assurance of detecting significant illegal acts and to report directly to the ED Office of Inspector General any fraudulent act or indication of such acts. In addition, paragraph 30 of SSAE No. 3 says that an examination-level engagement includes “designing the examination to detect both intentional and unintentional noncompliance that is material to management’s assertion.” Accordingly, practitioners should be aware of fraud or high risk areas and recognize basic weaknesses in internal controls. See Appendix E for a list of high risk indicators or conditions a practitioner may encounter while performing the compliance engagement.

As described in Paragraph 4.16 of *Government Auditing Standards*, if the practitioner becomes aware of fraud or indications of fraud, the practitioner should exercise due professional care to avoid any actions that would compromise the protection of an individual's rights and the integrity of any official inquiries. Upon discovery of a fraudulent act or indication of such an act related to Federal programs, this Guide requires the practitioner to immediately contact the ED Office of Inspector General, Investigation Services, by phone or fax on the numbers shown in Appendix A before extending audit steps and procedures. In addition, the practitioner must promptly prepare a separate written report concerning fraudulent acts or indications of such acts and include all information described in Section IV on reporting findings. This report should be submitted to the ED Office of Inspector General, Investigation Services, within 30 days after the date of discovery of the act or within the time frame agreed to by the practitioner and the ED Office of Inspector General, Investigation Services. The practitioner shall submit this report to the Assistant Inspector General for Investigations at the address shown in Appendix A.

As practitioners are required to report fraudulent acts or indications of such acts directly to the ED Office of Inspector General, this Guide suggests that practitioners include a statement in the engagement letter that describes the practitioner’s responsibility to communicate and report on such acts.

For supplemental guidance, see Chapters 4 and 5 of *Government Auditing Standards*. In addition, practitioners may wish to consult SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors or Irregularities*, and SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317).

Materiality. Management's assertions relate to each of the specified compliance matters in Section II of this Guide. In part, the practitioner should consider the materiality of management's assertions in the context of the magnitude of loan origination fees, total interest, or total special allowance earned during the year or the portfolio balances at the end of the year as separately reported in the ED Form 799 and if applicable for servicer engagements, in relation to each of the individual services performed by the service organization. Materiality for purposes of compliance assertions differs from materiality for financial reporting purposes.

Accordingly, materiality relates to each separate management assertion about compliance. Paragraph 35 of SSAE No. 3 provides guidance on the practitioner's consideration of materiality.

This Guide requires a supplemental report of all servicer noncompliance and all noncompliance identified in the agreed-upon procedures engagements—regardless of materiality—titled “Schedule of Findings and Questioned Amounts by Compliance Requirement” (see the “Reporting” section herein).

Due Care and Professional Skepticism. Paragraph 3.26 of *Government Auditing Standards* states that due professional care should be used in conducting the audit and in preparing related reports. Paragraph 37 of SSAE No. 3 requires that the practitioner “exercise (a) due care in planning, performing, and evaluating the results of his or her examination procedures and (b) the proper degree of professional skepticism to achieve reasonable assurance that material noncompliance will be detected.” This Guide cautions practitioners against ignoring basic weaknesses in internal controls, performing audit steps mechanically (auditing form over substance), and accepting explanation for audit exceptions without question.

Consideration of Internal Control. Paragraphs 44-46 of SSAE No. 3 provide guidance on the consideration of internal control over compliance in an examination-level attestation engagement. Paragraph 44 of SSAE No. 3 says “the practitioner should obtain an understanding of relevant portions of the internal control structure over compliance sufficient to plan the engagement and to assess control risk for compliance with the specified requirements,” which for this engagement are specified in Section II of this Guide. The documentation requirements referred to in the subsection “*Working Papers*” herein apply equally to the practitioner’s consideration of the lender’s or servicer’s internal control over compliance and assessment of control risk. Therefore, the practitioner must document his or her consideration of the lender's or servicer’s internal control over compliance and assessment of control risk in the working papers.

Obtaining Sufficient Evidence and Sampling. The examination procedures suggested in this Guide are not all of those that the practitioner may determine are necessary to provide reasonable assurance of detecting material noncompliance, nor are they intended to supplant the practitioner’s judgement of the work required. Suggested procedures described may not cover all circumstances or conditions encountered. Practitioners should refer to guidance about “Obtaining Sufficient Evidence” in paragraphs 47 and 48 of SSAE No. 3. Further, as internal controls vary among servicers, the Guide does not suggest procedures for an examination of a servicer management’s assertion about the servicer’s internal control over compliance with the specified requirements.

Although this Guide requires no specific or minimum sample size or sampling methodology, it does require samples be selected in such a way to be representative of the population and period under audit (in the case of servicers, also representative of the lender clients serviced and the functions performed by the servicer for those lender clients that are contained in the compliance requirement tested). Paragraph 47 of SSAE No. 3 suggests that, in examination-level engagements, practitioners consider the guidance in the AICPA’s *Professional Standards*, vol. 1, AU sec. 350, *Audit Sampling*.

Working Papers. Paragraphs 71 through 75 of SSAE No. 1, *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AT sec. 100), and paragraphs 4.34 through 4.38 of *Government Auditing Standards* address working papers. SSAE No. 1 paragraph 71 says working papers “ordinarily should indicate that (a)

the work was adequately planned and supervised and that (b) evidential matter was obtained to provide a reasonable basis for the conclusion or conclusions expressed in the practitioner's report." Paragraph 4.35 of *Government Auditing Standards* say further that the practitioner's working papers should "contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditor's significant conclusions and judgements."

Lenders, servicers or practitioners who deem any of the working paper information to be "confidential commercial information" should take appropriate steps to so designate that information. Such designation may protect its confidentiality if, at a future point of time, a request is made for disclosure of this information under the Freedom of Information Act (FOIA). "Confidential commercial information" means records that may contain material exempt from release under Exemption 4 of the FOIA (pertaining to trade secrets and commercial or financial information that is privileged or confidential) because disclosure could reasonably be expected to cause substantial competitive harm. Further information regarding the designation of such documents and ED Office of Inspector General procedures upon receipt of an FOIA request are contained in Appendix F.

Engagement Quality. The ED Office of Inspector General has implemented procedures for evaluating work performed by non-Federal practitioners. As part of this evaluation, the practitioner shall make working papers available upon request to the cognizant Regional Inspector General for Audit (RIGA) [see Appendix A] or other representatives of the Secretary. To facilitate these requests, the management's reporting package should include an information sheet identifying the name, address, and telephone number of the partner on the engagement (see Appendix B, Example 1). Working paper reviews will normally take place at the practitioner's office.

Whenever an evaluation of a report or working papers discloses inadequacies, the practitioner may be asked to take corrective action. If ED determines that the report and working papers are substandard or contain significant inadequacies, referral to the AICPA and the cognizant State Board of Accountancy will be considered. ED may also initiate action to debar the practitioner from further participation in Federal programs.

In addition, certain State Boards of Accountancy have requested that the ED Office of Inspector General send them copies of correspondence detailing deficiencies noted during its reviews. This includes the licensee's home state and the state(s) where the engagement was conducted, if different. This is for information only and is not a referral for disciplinary action. Notification to the State Board is concurrent with notification to the licensee.

REPORTING

Management's assertions and the independent accountant's reports issued pursuant to this Guide are a primary tool used by program managers in meeting their stewardship responsibilities in overseeing these loan programs and assuring the integrity of the funds and the reporting process. The areas of noncompliance noted in management's assertions and the independent accountant's reports must be acted upon by ED

program managers. To be of value, these reports must contain adequate information to give reported matters perspective and to allow the managers to take necessary corrective action.

Management Reporting Responsibilities

Management Assertions. If the lender or servicer did not materially comply with one or more of the compliance requirements, management should modify its assertions to disclose the noncompliance.

Effects of Waivers. In certain instances the Secretary grants waivers of specific compliance requirements due to extenuating circumstances (e.g., natural disasters, etc.). These waivers deem the holder of the covered loans harmless for failing to comply with prescribed compliance requirements and often impose conditions or limitations for the waiver to apply. If a waiver exists, management need not assess its compliance with the waived requirements. However, management should disclose any existing waivers in its representation letter to the practitioner and should modify its written assertions by appending the parenthetical “(giving effect to applicable waivers)” to the phrase “complied with” in each of management’s affected written assertions.

Corrective Action Plan. To help ED resolve noncompliance and deficiencies in internal control over compliance, a lender or servicer must develop and submit a corrective action plan. The corrective action plan is an essential part of the report requirement for the FFEL Program, is prepared by the lender or servicer management and presented on the entity’s letterhead and includes the name, title, and telephone number of the responsible lender or servicer official. In the plan, management:

- a. Describe the corrective action taken or planned in response to findings identified in the practitioner’s report; *and*
- b. Comment on the status of corrective action taken on the prior two years’ findings for all audits, program reviews and guaranty agency reviews.

See Appendix B Example 7 for a suggested plan format.

Communication to Lenders. When a lender chooses to use the alternative or combined engagement method, the lender’s management should arrange with the servicer’s management to obtain: (a) a copy of the report on the practitioner’s examination of the servicer’s management’s written assertions, and (b)(i) a copy of each of the applicable servicer’s “Schedule of Findings and Questioned Amounts by Compliance Requirement” prepared by the practitioner related to the FFEL Program compliance requirement functions the lender had contracted the servicer to perform; or (ii) a separate communication from the servicer management to the lender stating there were no findings related to any of the FFEL Program compliance functions for which the lender has contracted the servicer to perform. The separate communication from the servicer management to that lender can be attached to the report.

Practitioner Reporting Responsibilities

Attestation Reports. Paragraphs 61-69 of SSAE No. 3 provide overall guidance on report modification. In part, paragraph 61 of SSAE No. 3 says the practitioner should modify his or her report if “there is material noncompliance with the specified requirements.” Paragraph 63 of SSAE No. 3 says, “if management discloses the noncompliance and appropriately modifies its assertion about the entity's compliance with the specified requirements, the practitioner should modify the opinion paragraph by including a reference to the noncompliance and add an explanatory paragraph (after the opinion paragraph) that emphasizes the noncompliance.” Paragraph 27 of SSAE No. 4 requires that a practitioner “report all findings from application of agreed-upon procedures” regardless of materiality. Other requirements for reporting findings of agreed-upon procedures are set forth in Section IV.

Control Deficiencies.

For Lenders: Although lender managements are not currently required to make specific assertions about or engage a practitioner to examine and report on the lender management's assertions about the effectiveness of the lender's internal control over compliance, the practitioner examining the lender management's assertions about the compliance requirements identified in this Guide may become aware of significant deficiencies in the lender's internal control over compliance. (For example, in addition to when a practitioner performs procedures to test management's assertions about compliance, significant deficiencies in the lender's internal control over compliance may come to the practitioner's attention when (a) reviewing prior audits, guaranty agency reviews or program reviews related to the FFEL Program; or (b) when the practitioner performs procedures to gain an understanding of the lender's internal control over compliance.)

Paragraph 46 of SSAE No. 3 says that a practitioner's responsibility to communicate these deficiencies in an examination of management's assertion about an entity's compliance with specified requirements is similar to the auditor's responsibility described in SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325). However, this Guide requires all communications of significant deficiencies to be in writing. Therefore, if during the examination-level engagement the practitioner becomes aware of significant deficiencies in the lender's internal control over compliance, this Guide requires the practitioner to provide a copy of any written report or communication from the practitioner to the lender in the practitioner's reporting package. (See Section IV, “Required Practitioner's Reports.”)

For Servicers: Servicer managements are required to engage a practitioner to examine and report on the servicer management's assertions about the effectiveness of the servicer's internal control over compliance with the specified compliance requirements. If the examination of servicer management's internal control assertions disclose conditions that, individually or in combination, result in one or more significant deficiencies, the practitioner should modify the report using an approach similar to that suggested in paragraphs 51-53 of SSAE No. 2 for reporting of material weaknesses in internal control over financial reporting. See Example 3 in Section IV, Appendix B for an illustrative practitioner's report on the servicer management's assertion about the effectiveness of the servicer's internal control over compliance with the specified requirements.

Schedule of Findings and Questions Amounts by Compliance Requirement. This Guide requires a supplemental schedule(s) of noncompliance titled “Schedule of Findings and Questioned Amounts by Compliance Requirement.”⁸ As discussed in paragraph 36 of SSAE No. 3, a supplemental report should not change the practitioner’s judgements about materiality in planning and performing the engagement or in forming an opinion on management’s assertions.

⁸For example, ED Forms 799, Individual Record Review, Loan Origination Fees etc.

The only instances of noncompliance that may be omitted from the Schedule are those that were detected and corrected by the lender's or servicer's internal control over compliance and associated liabilities were repaid by the lender or servicer in a timely manner.⁹

Accordingly, the Schedule(s) must include, for

lenders (examination-level engagements), all instances of noncompliance, by compliance requirement, that are material individually or in the aggregate and that are identified by the lender in its assertions or by the practitioner during his or her engagement.

servicers(all engagements), all instances of noncompliance, by compliance requirement, whether material or not, that are identified by the servicer in its assertions or by the practitioner during his or her engagement. However, in addition to instances of noncompliance that were detected and corrected, and associated liabilities repaid in a timely manner as described in footnote 9 herein,¹⁰ the following instances of immaterial noncompliance may also be omitted from the servicer's Schedule:

- (a) Immaterial noncompliance, determined to be isolated and nonrecurring whose questioned amounts (known or likely) do not exceed \$10,000 or in which the outstanding loan principal balance of the specific loans affected does not exceed \$25,000 or 5% of the total outstanding loan principal balance of the individual lender's total loan portfolio serviced, whichever is less.

lenders(agreed-upon procedures engagement), all instances of noncompliance, by compliance requirement, whether material or not, that are identified:

- (a) By the lender in its assertions or by the practitioner during his or her engagement, *and*
- (b) In the servicer practitioner's report(s) or in any of the servicer practitioner's "Schedule of Findings and Questioned Amounts by Compliance Requirement" that addresses a FFEL Program compliance requirement function for which the lender has contracted the servicer to perform.

Noncompliance must be included in the Schedule even if corrective action was taken by the lender [servicer] after the examination period.

⁹Unless otherwise specified by statutory/regulatory authority, the term "timely manner" means as soon as possible in the course of business. Practitioners should use professional judgement and should also make the determination in relation to the activity involved. For example, since ED Form 799's are filed on a quarterly basis, noncompliance related to the classification of loans reported on the 799 filed in the second quarter would not have to be reported if the entity's internal control over compliance detected and corrected (properly reclassified the loans and made any adjustments accordingly) the noncompliance by the time the entity filed the next 799 in the third quarter.

¹⁰See footnote 9 herein.

For each instance of noncompliance, the following information must be presented in the Schedule, *if applicable*:

- a. All lender IDs that comprise the population from which the sample was selected.
- b. Sampling methodology.
- c. The number of units and dollar value of the population.
- d. The number of units and dollar value of the selected sample.
- e. The number of units and dollar value of the instances of noncompliance.

For the agreed-upon procedures engagement, in addition to any of the items identified in a to e above that may be applicable, the Schedule must also include the population of applicable transactions administered by the servicer for each lender in the population.

Follow-up on Audit Resolution Matters: Paragraph 4.10 of *Government Auditing Standards* requires practitioners to:

- (1) Follow-up on known material findings and recommendations from previous audits to determine whether timely and appropriate corrective action has been taken; *and*
- (2) Report the status of uncorrected material findings and recommendations from prior audits.

This Guide requires practitioners to report on the status of material findings and any related recommendations to management in the prior two year's related examinations or audits performed by the practitioner or by other practitioners that are related to the lender's or servicer's participation in the FFEL Program. Practitioners do not have to report on the specific status of findings or recommendations from guaranty agency reviews, ED program reviews or other engagements which were not examinations or audits (opinion-level engagements). An illustrative report is shown in Appendix B, Example 6 of this Guide.

SUBMISSION REQUIREMENTS

The practitioner's reports should be submitted to the lender's or servicer's governing body (for example, the Board of Directors) and/or president, as appropriate. Management should prepare a full reporting package which includes (a) an information sheet that includes the period addressed by the enclosed practitioner's reports (see Appendix B, Example 1) and identifies servicer performed FFEL Program compliance requirement functions, and (b) management's corrective action plan (see Appendix B, Example 7).

The package should be submitted to ED in accordance with the instructions contained in the Dear Colleague Letter that transmitted this Guide, or any Dear Colleague Letter that subsequently amends those instructions and should be sent to:

Guarantor and Lender Oversight Staff
U.S. Department of Education
600 Independence Avenue, SW
Room 4616, ROB-3
Washington, D.C. 20202-5132

Further guidance on reporting requirements is contained in Section IV of this Guide.

The Secretary has the authority under 432(g) of the HEA and 34 CFR Part 682, Subpart G to impose a civil penalty against a lender or servicer and/or limit, suspend, or terminate a lender's or servicer's participation in the FFEL Program for failure to comply with Federal requirements.

EFFECTIVE DATES, ENGAGEMENT PERIODS AND REPORTING DEADLINES

Effective Dates

This Guide is effective immediately for servicer audits. For lender audits, this Guide is effective for fiscal years ending on or after December 31, 1996. Earlier application of this Guide is permitted but not required.

Engagement Periods and Reporting Deadlines

The following are the engagement periods and related due dates for the lender and servicer compliance reports. Management's failure to meet these due dates may result in administrative sanctions as described in 34 CFR Part 682 Subpart G.

<i>Lender</i> reports covering each full fiscal year ending: July 23, 1993 - March 31, 1995 ¹	Must be submitted: By September 30, 1995 ²
April 1, 1995 and thereafter	Within six months following <i>lender's</i> fiscal year-end ²

Servicer reports
covering
each full fiscal year ending:
June 30, 1995 - October 31, 1996^{1,3}

Must be submitted:

By May 31, 1997

November 1, 1996 and thereafter

Within six months following
servicer's fiscal year-end

¹ Entities with two full fiscal years ending in this period may submit separate reports covering each fiscal year *or* a single report covering the two-year period.

² The submission date is extended to June 30, 1998 for any period in which the lender originated or held FFEL Program loans totaling \$5 million or less.

³ For fiscal years ending in this period, servicers who had independent practitioners perform audits of their fiscal years 1995 or 1996 in support of the lender audit requirement may submit those audits to ED as meeting their servicer audit requirement for those fiscal years provided those audits: (1) were performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States; standards established by the American Institute of Certified Public Accountants; and the March 1995 Lender Audit Guide, *Compliance Audits (Attestation Engagements) of the Federal Family Education Loan Program at Participating Lenders* issued by the U.S. Department of Education, Office of Inspector General and (2) addressed all compliance requirements and applicable assertions contained in Section II of the March 1995 Lender Audit Guide.

FUTURE REVISIONS

It is the practitioner's responsibility to ensure he/she is using the most current version of this Guide. ED periodically revises the FFEL Program compliance requirements and the ED Office of Inspector General plans to issue revisions to this Guide to reflect changes. Until the Guide is revised, inconsistencies may exist between the Guide and the FFEL Program laws or regulations. Practitioners should follow the FFEL Program laws or regulations in effect for the period being examined and modify their procedures to test the FFEL Program compliance requirements accordingly.

The practitioner is also responsible for monitoring relevant changes in *Government Auditing Standards*, AICPA Statements on Standards for Attestation Engagements, and generally accepted auditing standards and considering their implications on the engagement.

Technical questions about applying the Guide and suggestions for improving future Guides should be sent to:

U.S. Department of Education
Office of Inspector General
Non-Federal Audit Team
600 Independence Avenue, SW, Mail-Stop 1510

Washington, D.C. 20202-1510
Fax: (202)205-8238

SECTION II

STANDARD ENGAGEMENT

INTRODUCTION

This section:

- sets forth the minimum standards that are the subject of management's written compliance assertions;
- describes related regulatory requirements; and
- provides guidance on the general approach the practitioner should consider in designing and carrying out procedures in his or her examination of management's written assertions.

The first nine assertions relate to ED Form 799s. The last three assertions supplement the assertions about the accuracy of the ED Form 799s by focusing on specific aspects of due diligence. (Note: To ensure consistent reporting, the period of loan activity tested under compliance requirements 10, 11, and 12 concerning collections, claims and cures should be aligned with the testing of the 799s submitted during the lender's fiscal year.)

As discussed in Section I, the examination procedures suggested in this Guide are not intended to be a complete set of procedures to satisfy the engagement objectives, may not cover all circumstances or conditions encountered, do not supplant the practitioner's judgement of the work required, and do not include suggested procedures for examination of a servicer management's assertion about the servicer's internal control over compliance with the specified requirements.

Paragraph 39 of SSAE No. 3 says that a practitioner should "obtain an understanding of the requirements specified in management's assertion about compliance," including relevant laws, regulations, and contracts.¹ Accordingly, among other sources, the practitioner should obtain from management, read and/or have available:

¹Paragraph 39 says further: To obtain such an understanding, a practitioner should consider the following: (a) Laws, regulations, rules, contracts, and grants that pertain to the specified compliance requirements, including published requirements; (b) Knowledge about the specified requirements obtained through prior engagements and regulatory reports; (c) Knowledge about the specified compliance requirements obtained through discussion with appropriate individuals within the entity (for example, the chief financial officer, internal auditors, legal counsel, compliance officer, or grant or contract administrators); and (d) Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals outside the entity (for example, a regulator or third-party specialist).

- (a) 34 CFR Section 682²
- (b) The Lender Search Report(s) (See Appendix D)
- (c) The ED Form 799s/servicer billings submitted/prepared during the fiscal year
- (d) The summary and detailed loan records and supporting loan documents
- (e) Student Status Confirmation Reports/Notification of change information
- (f) Servicer's contract(s) with lending institutions
- (g) Dear Colleague Letter 94-L-171/94-G-263 - Subject - Rebates of excess interest (windfall profits)
- (h) Dear Colleague Letter 96-L-186/96-G-287 - Subject - Clarification and interpretative guidance on certain provisions in the FFEL Program regulations published on December 18, 1992. (Note: To help ensure consistent implementation of the regulations, ED issued a series of follow-up letters to clarify the answers contained in the DCL. Three of the letters were dated March 14, 1996; April 24, 1996; and May 31, 1996.)³

COMPLIANCE REQUIREMENTS, MANAGEMENT ASSERTIONS, AND SUGGESTED Procedures for Examining Compliance FOR LENDERS AND SERVICERS

1. ED FORM 799

Compliance Requirements - Support for ED Forms 799

For lenders to receive payments of interest benefits and special allowance, quarterly reports must be submitted to ED on ED Form 799. Loan origination fees collected on new loans are also reported on this form. The loan origination fee due ED is either remitted to ED or is offset by deducting it from the interest and special allowance benefits due for the quarter. In addition, other information on the portfolio under the FFEL Program is required to be reported to assist ED in proper management of the FFEL Program.

²Copies of the Code of Federal Regulations can be obtained by contacting the Superintendent of Documents, U.S. Government Printing Office, Washington D.C. 20402 at (202)512-1800 or a Compilation of Student Financial Aid Regulations can be obtained by calling 1-800-4-FEDAID.

³Copies of ED's Dear Colleague Letters or Clarification letters can be obtained by (1)calling 1-800-4-FEDAID or (202)401-2412 or (2)by faxing requests to (202)-205-0657.

The ED Form 799 is a six-part form.

Part I identifies the lender by name and ID and if the lender uses a servicer to prepare the form, the servicer's name and address. It also requires that an official representative of the lender [or servicer, if applicable] certify that the computations in the report are correct and proper.

Parts II, III, and IV contain information necessary for ED to collect lender and origination fees and pay interest and special allowance to the lender. The resulting net amount is either a payment to the lender or a payment to ED.

Parts V and VI contain information regarding the changes to the guaranteed loan balances during the quarter and the analysis of the status of ending balances of all applicable accounts, including past due accounts.

The information reported on ED Form 799 is subject to levels of edit checks for data reasonability during ED's processing of the payment request. In some cases the form will be rejected and returned to the lender [servicer] for correction. In other cases, ED notifies the lender [servicer] that its submission failed to pass these edits and instructs it to determine if the errors resulted in an incorrect payment of interest benefits or special allowance. The lender [servicer] is further instructed by ED to make applicable adjustments to the affected loan balances on the next quarterly report. The lender [servicer] is required to keep records necessary to support the amounts reported on ED Form 799. [34 CFR 682.305(a) and 682.414(a)(3)(K)].

Management Assertion

Lender Assertion

The loan information (loan types, interest rate, beginning and ending principal loan balances, and loan status (past due, in grace, in deferment) reported in Parts II, III, IV, V, and VI of the ED Form 799s submitted by [ABC Lender-ID #] during the year ended [m/d/y] agrees with [ABC Lender's-ID # (identify the summary records, such as the general or subsidiary ledgers)].

Servicer Assertion

The loan information (loan types, interest rate, beginning and ending principal loan balances, and loan status (past due, in grace, in deferment) reported in Parts II, III, IV, V, and VI of either the ED Form 799s prepared by [XYZ Servicer] and submitted to ED on behalf of our lender clients or the billing information prepared by [XYZ Servicer] and submitted to our lender clients during the year ended [m/d/y] agrees with [XYZ Servicer's (identify summary records/ledgers)] and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements that such information be in agreement.

Suggested Procedures for Examining Compliance

- a. For Lenders - Compare the ED Form 799s to the Lender Search Report to ensure that they are the same as the forms submitted to ED.

For Servicers - On a sample basis, compare the ED Form 799s prepared by the servicer and submitted to ED on behalf of their lender clients to the Lender Search Report to ensure that they are the same as the forms submitted to ED.

- b. For Lenders - Trace loan information reported on the ED Form 799s to the summary records/ledgers.

For Servicers - For the sample of the ED Form 799s prepared by the servicer and submitted to ED on behalf of their lender clients, trace the loan information reported to the servicer's summary system records/ledgers.

- c. Servicer Billings - For a sample of lender client billings, summarize and agree the information reported on the billing information prepared by the servicer and submitted to their lender clients for their preparation of the 799s, to the servicer's summary system records/ledgers.

2. INDIVIDUAL RECORD REVIEW

Compliance Requirements - Loan Documentation

A lender (or a servicer that is under contract with a lender to perform any activity for which the records in 34 CFR 682.414(a)(3)(ii) are relevant) is required to maintain current, complete and accurate records of each loan that it holds, or in the case of a servicer, is under contract to administer on behalf of the lender. These loan records (files) form the basis for the information contained in the ED Form 799. The records must be maintained in a system that allows ready identification of each loan's status. As stated in the regulations, except for the loan application and the promissory note, these records may be stored on microfilm, optical disk, or other machine-readable format.

The required documents are identified in 34 CFR 682.414(a)(3)(ii) and are listed below.

- a. A copy of the loan application
- b. A copy of the signed promissory note, including the repayment instrument
- c. The repayment schedule
- d. A record of each disbursement of loan proceeds
- e. A payment history showing the date and amount of each payment received from or on behalf of the borrower and the amount of each payment that was attributed to principal, interest, late charges, and other costs.

The following documents are required when the applicable condition exists:

- f. Notices of changes in a borrower's address and status as at least a half-time student (**Note:** The

practitioner should look for these notices only if he or she becomes aware that the borrower moved or changed status.)

- g. Evidence of the borrower's eligibility for a deferment
- h. The documents required for the exercise of forbearance
- i. Documentation of the assignment of the loan
- j. A collection history showing the date and subject of each communication between the lender [servicer] and the borrower or endorser relating to collection of a delinquent loan; each communication other than regular reports by the lender [servicer] showing that an account is current, between the lender [servicer] and a credit bureau regarding the loan; each effort to locate a borrower whose address is unknown at any time; and each request by the lender [servicer] for preclaims assistance on the loan
- k. Any other records to document the validity of a claim or the accuracy of reports

Note: Original Loan Applications and Promissory Notes. When loan documentation required to be originals (loan applications and promissory notes) is transferred to a purchaser in a loan sale or transferred to and held by a guaranty agency or trustee on behalf of the lender, this Guide permits the practitioner to perform alternative procedures to obtaining access to and reviewing the original documents. The alternative procedures could include but are not necessarily limited to: (1) reviewing a copy or image of the original document maintained by the lender, servicer, or guaranty agency; (2) obtaining a copy of the original loan document from the purchaser, guaranty agency or trustee and comparing it to the lender's document; (3) obtaining a letter certifying that the document provided to the practitioner is a true copy of the original document; and/or (4) reviewing loan sale documentation (see Compliance Requirement #7).

Practitioners should use professional judgement in determining the adequacy and type of procedures to be performed, including procedures for gaining access to the original documents if so determined. (For example, a practitioner may determine that it is necessary to gain access to the original documents because of indications of noncompliance, ineffective internal controls, or lack of controls. Under such circumstances, this Guide requires the lender to work with the purchaser, guaranty agency or trustee to make arrangements for their practitioner to obtain access to the original loan documentation.

If alternative procedures cannot be performed, the practitioner should modify the standard report if there is a restriction on the scope of the engagement. Practitioners must document in the working papers the procedures performed. (See "Working Papers" in Section I of this Guide.)

Management Assertion

Lender Assertion

[ABC Lender-ID #] supported loans reported in the ED Form 799s submitted during the year ended [m/d/y] with loan records that included all applicable documents listed in Section II, Compliance Requirement 2,

of the Audit Guide.

Servicer Assertion

[XYZ Servicer] supported loans reported in either the ED Form 799s prepared by [XYZ Servicer] and submitted to ED on behalf of our lender clients or the billing information prepared by [XYZ Servicer] and submitted to our lender clients during the year ended [m/d/y] with—and as of [m/d/y], XYZ Servicer] had effective internal control over compliance requirements for supporting loans with—loan records that include all applicable documents listed in Section II, Compliance Requirement 2, of the Audit Guide that our lender clients have contracted with [XYZ Servicer] to store.

(If a lender has not contracted with the servicer to maintain the original loan application and promissory notes, the lender would be responsible for making the assertion about maintenance of documents for which it has not contracted the servicer to store.)

Suggested Procedures for Examining Compliance

- a. Trace loan information from summary records/ledgers to detailed loan records.
- b. Test a sample of individual loan files to determine if the required documents are maintained by the lender [servicer] and the information recorded in the detailed loan record agrees with the information in these documents.
- c. For Servicers - For the sample selected above read the servicer's contracts to identify any exceptions for maintaining the required documents (for example, original loan applications and promissory notes).

Note: If the practitioner intends to use the same sample to test Parts II, III and IV of the ED Form 799s, changes in loan status should be noted during the testing.

3. LOAN ORIGINATION FEES

Compliance Requirements - Payment of Loan Origination Fees

A lender may charge subsidized Stafford loan borrowers a loan origination fee not to exceed the maximum rate specified by statute. For SLS and PLUS loans originated after October 1, 1992, the lender **must** charge the borrower a loan origination fee. From October 1, 1992 through June 30, 1994 borrowers of Unsubsidized Stafford loans were required to pay a combined origination fee and insurance premium. For all Unsubsidized Stafford loans first disbursed on or after July 1, 1994 for periods of enrollment that either include that date or begin after that date, the origination fee paid to the Secretary by a lender is reduced to 3 percent of the principal amount of the loan. The maximum guarantee fee (insurance premium) that a guaranty agency can charge a lender and the lender can pass along to the borrower was reduced from 3 percent to 1 percent for loans first disbursed on or after July 1, 1994 for periods of enrollment that include that date or begin after that date. The lender is required to deduct the origination fee, and other approved

fees, from the loan proceeds of a Subsidized Stafford loan, with the fees deducted on a *pro rata* basis for loans disbursed in multiple installments.

The amount of origination fees is reported in Part II of ED Form 799. Adjustments for prior periods are combined and reported as a separate line item. (Any adjustments within the quarter will be shown in the net amount of loans disbursed within the same quarter being reported.) Typically, prior period adjustments are loan cancellations. In determining the total amount of a lender's quarterly payment, ED deducts the amount of origination fees from the amount of interest and special allowance benefits. However, some lenders with loan origination volume that is disproportionate to their loan holdings may have origination fees that exceed the amount of interest benefits. This results in an amount owed to ED for the quarter. See 34 CFR 682.305(a)(3) for more information.

Management Assertion

Lender Assertion

During the year ended [m/d/y, ABC Lender] (a) completely reported, classified and computed, in accordance with ED Form 799 instructions, the loan origination information reported in Part II of the ED Form 799s submitted during that period and (b) paid to ED loan origination fees in excess of interest and special allowance.

Servicer Assertion

During the year ended [m/d/y, XYZ Servicer] completely reported, classified and computed, in accordance with ED Form 799 instructions—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with ED Form 799 instructions for classifying and computing—the loan origination information reported in Part II in either the ED Form 799s prepared by [XYZ Servicer] and submitted to ED on behalf of our lender clients or the billing information prepared by [XYZ Servicer] and submitted to our lender clients. During the year ended [m/d/y, XYZ Servicer] paid ED—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements for payment to ED of—origination fees in excess of interest and special allowance.

(If a lender has not contracted with the servicer to pay any loan origination fees in excess of interest and special allowance to ED on their behalf, the lender would be responsible for making the assertion regarding payments to ED.)

Suggested Procedures for Examining Compliance

- a. From the loan disbursement records, select a sample of loans and trace the loan and origination fee to the quarterly ED Form 799 or billing information, as applicable. The sample should include loans originated in each quarter.
- b. Test whether loan origination fees are computed in accordance with the ED Form 799 instructions by recalculating those amounts or by application of reasonableness tests.
- c. Test reported prior period adjustments for proper recording.

- d. If loan origination fees exceeded the lender's interest and special allowance payment, review documentation to verify that the lender paid the origination fees to ED. If the servicer is responsible for paying the origination fees to ED on behalf of their lender clients (per contract), review documentation (for example, record of payments) to verify that the origination fees were paid to ED.

4. INTEREST BENEFITS

Compliance Requirements - Eligibility, Proper Rate and Proper Calculations

ED pays the lender interest benefits on eligible FFEL Program loans (subsidized Stafford and certain consolidated loans)⁴ on behalf of a qualified borrower during certain loan statuses. These statuses include the in-school loan period, the grace period, and any authorized deferment period (34 CFR 682.300). Generally, ED's obligation to pay interest benefits to a lender ceases when the eligible borrower enters repayment status and does not qualify for deferment. Interest benefits to the lender also begin or terminate with certain other day-specific events enumerated in 34 CFR 682.300(b)(2) and (c). (See Compliance Requirement 8 for further discussion of conversion to repayment status).

The information needed to calculate interest benefits is reported in Part III of ED Form 799. Applicable loan interest rates are provided in Section 427A(a)-(i) of the HEA. Interest benefits due the lender may be calculated by using either the Average Daily Balance or Actual Accrual methods as defined in 34 CFR 682.304(b) and (c). Adjustments for prior periods must be reported as separate line items.

Note: Practitioners should be aware that they may not be able to rely on the interest rate stated on the promissory note as it could be wrong (for example, because the guaranty agency's computer system guaranteed a loan at the wrong rate) or because rates may have changed due to a conversion to the variable interest rate.

Management Assertion

Lender Assertion

Loans included in Part III of ED Form 799s submitted by [ABC Lender-ID #] during the year ended [m/d/y] were (1) in a status eligible for interest benefits, (2) assigned the correct interest rate in accordance with Section 427A(a)-(i) of the HEA, as amended, and (3) classified in the correct interest rate category on the ED Form 799s in accordance with ED Form 799 instructions. Ending principal amounts, the average daily balances and the interest amounts were calculated in accordance with the ED Form 799 instructions.

Servicer Assertion

⁴The Secretary pays interest benefits on consolidated loans if the loan application was received by the lender on or after January 1, 1993 but not later than August 9, 1993, or if the consolidation application was received by the lender on or after August 10, 1993 and only if all of the underlying loans consolidated are subsidized Stafford loans.

Loans included in Part III of either the ED Form 799s prepared by [XYZ Servicer] and submitted to ED on behalf of our lender clients or the billing information prepared by [XYZ Servicer] and submitted to our lender clients during the year ended [m/d/y] were—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements that loans are—(1) in a status eligible for interest benefits, (2) assigned the correct interest rate in accordance with Section 427A(a)-(i) of the HEA, as amended, and (3) classified in the correct interest rate category in accordance with ED Form 799 instructions. Ending principal amounts, average daily balances, and interest amounts were calculated in accordance with—and as of [m/d/y, XYZ Servicer] had effective internal controls over compliance with requirements for calculation in accordance with—the ED Form 799 instructions.

Suggested Procedures for Examining Compliance

- a. Test that the loans are assigned the correct interest rate in accordance with Section 427A(a)-(i) of the HEA and are reported in the correct interest rate category.
- b. Test that the lender [servicer] begins and ends billing ED for interest benefits on the appropriate day for loans documented as in-school, in-grace, or in authorized deferment. **(Note: The practitioner may want to perform this step in conjunction with the procedures to test Compliance Requirement 8.)**
- c. Review loan records, disbursement records, or other documentation to verify that interest is not billed for periods after the dates specified in 34 CFR 682.300(b)(2) or for interest not covered under 34 CFR 682.300(c).⁵
- d. For consolidated loans that are billed for interest benefits, review the history files and verify that the loan consolidated only subsidized Stafford loans as required or that the consolidation loan application was received by the lender on or after January 1, 1993 but not later than August 9, 1993. [34 CFR 682.300(a)]
- e. Test the accuracy of the average daily balance or actual accrual calculations as defined in 34 CFR 682.304(b) and (c) by recalculating amounts or by reasonableness tests.
- f. Test reported prior period adjustments for proper recording of interest rate and category and whether the correct principal and billing days were used.

5. SPECIAL ALLOWANCE PAYMENTS

Compliance Requirements - Eligibility and Proper Calculation of Average Daily Balance

Pertains to subsidized Stafford loans and some categories of Consolidated loans (see procedure d). For loans disbursed on/after 10/1/92, regulations allow lenders to bill ED for interest, however, once the lender knows the loan is unconsummated, all the interest paid by ED for those loans must be returned to ED.

In addition to interest benefits, ED pays a compensating special allowance to the lender on the average unpaid daily loan principal balance. The average loan principal, including any appropriate capitalized interest, is to be calculated using the Average Daily Balance method as defined in 34 CFR 682.304(d). The lender [servicer] does not compute the special allowance payment. The lender [servicer] reports in Part IV of ED Form 799 the average daily balance of those loans qualifying for the payment, in each category. ED computes the payment due the lender during processing of the ED Form 799. (34 CFR 682.304-305)

Adjustments for prior periods due to differences between what should have been reported in prior quarters, and what was originally reported in prior quarters, are reported as separate line items. [Note: The Higher Education Technical Amendments of 1993 (Public Law 103-208) (enacted December 20, 1993) required lenders to convert fixed rate loans for which excess interest was required to be rebated to borrowers or ED to annual variable rate loans. Certain lenders (those that did not previously apply rebates or that reversed previously applied rebates) were required to calculate quarterly variable interest rates for each of the quarters prior to the annual variable rate conversion and rebate the excess interest paid for those quarters to the borrower or ED. An issue has recently been identified whereby some lenders may be billing ED for special allowance payments based on the recalculated quarterly variable interest rates, for periods prior to the conversion of loans to the annual variable rate. Per Q&A 20 in *Dear Colleague Letter 94-L-171/94-G-263*, this is not permitted.

A loan loses reinsurance coverage and interest and special allowance payment benefits due to violations of due diligence requirements. To reinstate the loan, it has to be "cured." A loan can be cured by obtaining a new signed repayment agreement and/or receipt of one full payment from the borrower. See Appendix D of 34 CFR 682 for more information on cures.

The lender [servicer] is required to terminate the special allowance requests on loan balances when a day-specific event occurs and the loan is no longer eligible for the payment. These day-specific events are described in 34 CFR 682.302(d).

Management Assertion

Lender Assertion

Loans included in Part IV of ED Form 799s submitted by [ABC Lender-ID #] during the year ended [m/d/y] were (1) in a status eligible for special allowance and (2) properly categorized on the ED Form 799 in accordance with the instructions. Ending principal balances, average daily balances and adjustments for differences in average daily balances were calculated in accordance with the instructions.

Servicer Assertion

Loans included in Part IV of either the ED Form 799s prepared by [XYZ Servicer] and submitted to ED on behalf of our lender clients or the billing information prepared by [XYZ Servicer] and submitted to our lender clients during the year ended [m/d/y] were—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements that loans are—(1) in a status eligible for special allowance and (2) properly categorized on the ED Form 799 in accordance with the ED Form 799 instructions. Ending principal balances, average daily balances, and adjustments for differences in average daily balances were calculated in accordance with—and as of [m/d/y, XYZ Servicer] had effective internal controls over

compliance with requirements for calculation in accordance with—the ED Form 799 instructions.

Suggested Procedures for Examining Compliance

- a. Test that the lender [servicer] reports loans by the proper time period and special allowance category as defined in the ED Form 799 instructions.
- b. Test that the lender [servicer] is terminating special allowance requests on loan balances when a day-specific event specified in 34 CFR 682.302(d) occurs, as documented in the borrower's file.
- c. Test the accuracy of the average daily balance calculations as defined in 34 CFR 682.304(b) by recalculating amounts or by reasonableness tests.
- d. Test reported prior period adjustments for proper recording of interest rate and category, and whether the correct principal and billing days were used. Assure that the lender [servicer] has not claimed the additional special allowance payments for quarters prior to the conversion of fixed rate loans subject to rebate of excess interest to annual variable rates.
- e. Test a sample of loans included in the average daily balances to determine that the average daily balances do not include the following categories of loans: (Note: Loans with due diligence/timely filing violations, loans paid-in-full and loans without reinsurance may be eligible for special allowance for the period during a quarter prior to the terminating event.)
 - Nonsubsidized⁶ Stafford loans (unless made before October 1, 1981)
 - Unconsummated loans (cancellations)⁷
 - Loans with future disbursements
 - Loans with due diligence/timely filing violations (sufficient to cause loss of guaranty)
 - Loans paid in full
 - Loans without reinsurance
 - Loans beyond the date of sale

6. LOAN PORTFOLIO ANALYSIS

Compliance Requirements - Accurate Loan Principal Balances

The lender's outstanding loan principal balances for each type of loan at the end of the quarter are presented in Parts V and VI of the ED Form 799. This summary of the ending balances is required each

⁶See definition in Appendix C.

⁷Pertains to all FFEL loans. For loans disbursed on/after 10/1/92, regulations allow lenders to bill ED for special allowance, however, once the lender knows the loan is unconsummated, all special allowance paid by ED for those loans must be returned to ED.

time a lender [servicer] submits the form. All loans are included even if they do not qualify for the interest benefit or special allowance payment, except that loans on which the guarantee was voided are not included in Part VI, unless they were cured. Part VI also contains information about the delinquent status of loans in the lender's FFEL portfolio. See 34 CFR 682.414(a)(3)(ii) for more information.

Management Assertion

Lender Assertion

In Parts V and VI of the ED Form 799s submitted during the year ended [m/d/y, ABC Lender] properly classified and accurately reported loan principal balances in accordance with the ED Form 799 instructions and included all outstanding loans (except those for which the guaranty was voided are not included in Part VI).

Servicer Assertion

In Parts V and VI of the ED Form 799s prepared by [XYZ Servicer] and submitted to ED on behalf of our lender clients or the billing information prepared by [XYZ Servicer] and submitted to our lender clients during the year ended [m/d/y, XYZ Servicer] properly classified and accurately reported—and, as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements to properly classify and report—loan principal balances in accordance with the ED Form 799 instructions and included all outstanding loans (except those for which the guaranty was voided are not included in Part VI).

Suggested Procedures for Examining Compliance

- a. Review the classification of loan type and status as reported by the lender [servicer]. Test a sample of loans to determine whether the loans were properly classified.
- b. Test completeness by tracing a sample of loans from individual loan records to ED Form 799s or billing information, as applicable. Only loans with a valid guarantee should be reported.

7. LOAN SALES, PURCHASES AND TRANSFERS

Compliance Requirements - Reporting of Sales, Purchases and Transfers

Loan sales, purchases and transfers between eligible lenders [servicers] entail special portfolio management risks and therefore require special controls. The lenders [servicers] must exercise due care in ensuring that gaps in servicing do not occur, possibly affecting the reinsurance of the loan. The lenders [servicers] must provide notice, either jointly or separately, of the transfer of the loan to the borrower and the purchasing lender must notify the guaranty agency of the loan transfer. In addition, within 90 days of its acquisition of the loan, the purchasing lender shall report to at least one national credit bureau the information required in 34 CFR 682.208(b)(1)(ii)-(v). Finally, the seller must ensure that all of the required loan documentation is transferred to the purchaser, including accurate payment histories.

If an originating lender sells or otherwise transfers a loan to a new holder, ED will hold the originating lender liable for the payment of the origination fees and will not pay interest benefits or special allowance to the new

holder or pay reinsurance to the guaranty agency until the origination fees are paid to the Secretary. See 34 CFR 682.305(a)(4).

The lender [servicer] is required to maintain accurate records of each loan, including records of loan sales, purchases or transfers. See 34 CFR 682.414 (a)(3)(ii).

Management Assertion

Lender Assertion

Loan purchases and sales during the year ended [m/d/y] were recorded by [ABC Lender-ID #] in accordance with the purchase/sales agreements with respect to the start/end date of eligibility for interest, special allowance and responsibility for payment of loan origination fees. Loan origination fees for which we were responsible were paid to ED in accordance with the agreements. For loans transferred to [ABC Lender-ID #] during the year ended [m/d/y], all applicable ED Form 799 loan data, including beginning balances were recorded completely and accurately into the lender's loan servicing systems.

Servicer Assertion

Loan purchases and sales made on behalf of our lender clients during the year ended [m/d/y], were recorded by [XYZ Servicer] in accordance with—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance for recording loan purchases/sales in accordance with—the [identify the applicable documents such as purchase/sales agreements or the instructions ABC Lender provided to XYZ Servicer] with respect to the start/end date of eligibility for interest, special allowance and responsibility for payment of loan origination fees. During the year ended [m/d/y, XYZ Servicer] paid ED—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements for payment to ED of—loan origination fees for which we were responsible for paying on behalf of our lender clients in accordance with the agreements. During the year ended [m/d/y, XYZ Servicer] recorded completely and accurately in the servicer's loan servicing systems—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements to record completely and accurately in the servicer's loan servicing systems—all applicable ED Form 799 loan data for loans transferred, including beginning balances.

Suggested Procedures for Examining Compliance

- a. For a sample of loans, trace principal amount of loans sold reported on the ED Form 799/billings to the bills of sale.
- b. Review a sample of the loan purchase/sales agreements [or if applicable, lender instructions provided to the servicer] and ascertain the terms of the agreements as to day of sale, transfer of funds and responsibility for loan origination fees. Test that the sale/purchase was conducted in accordance with these terms and the day-specific event was properly noted in the lender's [servicer's] records as to the start/end date of eligibility for interest benefits and special allowance.
- c. For loan sales that occurred within the quarter in which the loan was disbursed, determine that the lender or servicer, on behalf of its lender clients, reported the origination fee liability to ED. **(Note the practitioner may want to perform this step in conjunction with the procedures to test Compliance**

Requirement 3).

- d. Select a sample of loans that were transferred to the lender [servicer] during the examination engagement period and verify that all applicable ED Form 799 loan data, including beginning balances, was entered completely and accurately into the lender's [servicer's] system. Verify that all required supporting loan documentation was obtained and maintained (unless not contracted to store). **(Note the practitioner may want to perform this step in conjunction with the procedures to test Compliance Requirement 2).**

8. STUDENT STATUS CHANGES

Compliance Requirements - Recording of Student Status Changes

Guaranty agencies are responsible for ensuring that schools complete and submit the Student Status Confirmation Report (SSCR). The guaranty agency forwards the SSCR or other notification of change information to the lender [servicer]. The frequency and timing of forwarding such information may vary among guaranty agencies. Some guaranty agencies forward the SSCR or other notification of change information to the lender on a monthly basis. In addition, on an interim basis, schools will forward notification of change information directly to the lender [servicer].

The lenders [servicers] must use the data promptly to make proper and timely adjustments to each loan. The billing for interest benefits and special allowance payments relies on the timely and proper processing of student status information, including timely conversion to repayment status. The conversion of a loan to repayment status is subject to a number of conditions as defined in 34 CFR 682.209. Typically, subsidized and unsubsidized Stafford loan borrowers begin repayment six months after reaching less than half-time enrollment. PLUS, SLS and Consolidated loans go into repayment on the day the loan is disbursed, or if multiply-disbursed, on the day the loan is fully disbursed. The first payment of principal is due within 60 days of the date the loan is fully disbursed. For purposes of this requirement, *prompt* means adjustments are made in time to satisfy the time requirements outlined in 34 CFR 682.209 for converting and beginning collections of loans. **(Note: Practitioners should be aware that late or improper conversion to repayment status is a concern to ED and has been an area of weakness ED has found to exist when performing their file reviews at lenders.)**

The Higher Education Amendments of 1992 changed the method of determining when a Stafford loan enters repayment from month-specific to date-specific. This change also effectively made date-specific the beginning and ending of a borrower's grace period. However, because of the systems changes many lenders and guaranty agencies are required to make to comply with this provision, ED decided not to enforce the use of date-specific grace period and repayment start dates until the implementation of the student status confirmation report system required by 34 CFR 682.401(b)(20). Therefore, lenders could continue to use month-specific dates for determining student separation dates (i.e., the last day of the month in which the borrower ceased to be enrolled as at least a half-time student at an eligible school) until the guaranty agencies implemented the student status confirmation system report system required by 34 CFR 682.401(b)(20).

Lenders who converted to the date-specific method could continue with that method. The use of day specific grace periods and repayment start dates should be implemented in accordance with Dear Colleague Letter 96-L-186/96-G-287. See Dear Colleague Letter 96-L-186/96-G-287 question and answer 18 for more information.

Management Assertion

Lender Assertion

Upon receipt of Student Status Confirmation Reports or other notification of change information during the year ended [m/d/y, ABC Lender] accurately updated loan records for changes to student status, including conversion to payment status in accordance with 34 CFR 682.401 (b)(20) and 34 CFR 682.209, respectively.

Servicer Assertion

Upon receipt of Student Status Confirmation Reports or other notification of change information for loans serviced during the year ended [m/d/y, XYZ Servicer] accurately updated—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements to accurately update—loan records for changes to student status, including conversion to payment status in accordance with 34 CFR 682.401 (b)(20) and 34 CFR 682.209, respectively.

Suggested Procedures for Examining Compliance

- a. Trace a sample of loans from the SSCRs (or other notification of change information) received from guaranty agencies during the period to loan records to determine if changes to student status as reported by guaranty agencies were made accurately and promptly. (Note: Change information may be received and maintained in machine-readable format.)
- b. Determine whether conversions to repayment status were made in accordance with 34 CFR 682.209.
- c. Obtain and review the error reports (manifests, in school discrepancy reports, or out-of school status reports), if any, generated by the lender [servicer] which identify discrepancies between the SSCRs received from guaranty agencies and the lender's [servicer's] records. For a sample of loans, trace student status data to any interim status reports or other notification of change information which may have been received directly from the schools.

9. PAYMENT PROCESSING

Compliance Requirements - Payment Processing

Borrowers may prepay at any time without a penalty. The lender [servicer] may credit the entire prepayment first to any accrued late charges or collection costs, and then to any outstanding interest and then to outstanding principal. Unless the borrower requests otherwise, if the prepayment equals or exceeds the established monthly payment amount, the lender [servicer] shall apply the prepayment to future installments

and advance the next payment due date. The lender [servicer] must (1) inform the borrower in advance that any additional full payment amounts submitted without instructions as to their handling will be applied to future scheduled payments with the borrower's next scheduled payment due date advanced, or (2) provide a notification after the payments are received stating that the payments have been so applied and the date of the borrower's next scheduled payment due date. See 34 CFR 682.209(b) for more information.

Management Assertion

Lender Assertion

During the year ended [m/d/y, ABC Lender]: (a) calculated interest and principal in accordance with 34 CFR 682.304 and (b) applied (i) loan payments effective with the day of receipt and (ii) prepayments in accordance with 34 CFR 682.209(b) or the documented specific request of the borrower.

Servicer Assertion

For loans serviced during the year ended [m/d/y, XYZ Servicer]: (a) calculated—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements to calculate—interest and principal in accordance with 34 CFR 682.304 and (b) applied—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements to apply—(i) loan payments effective with the day of receipt and (ii) prepayments in accordance with 34 CFR 682.209(b) or the documented specific request of the borrower.

Suggested Procedures for Examining Compliance

- a. Test whether the lender [servicer] applies the borrower payments and prepayments to loan records effective with the day of receipt.
- b. Test that application of principal and interest are appropriately calculated and that the correct amount is applied to the individual borrower loan balance.
- c. Test if prepayments were allocated in accordance with the requirements set forth in 34 CFR 682.209(b) and/or if applicable, borrower instructions.

10. DUE DILIGENCE BY LENDERS OR SERVICERS IN THE COLLECTION OF DELINQUENT LOANS

Compliance Requirement - Due Diligence in Collecting FFEL Program Loans

Lenders [servicers] are required to follow specific collection activities and meet specific claim filing deadlines on delinquent loans (34 CFR 682.411). There are two different sets of due diligence regulations that a lender [servicer] may be following for loans included in their portfolios. Lenders [servicers] were allowed to continue using the November 1986 regulations on loans that were included in their portfolios both prior to and after issuance of the December 1992 regulations. The practitioner should consult with the lender [or

servicer] and review Dear Colleague Letter 96-L-186/96-G-287 as to the applicability of the 1986 and 1992 regulations for the loans tested. **[Note: In addition, Dear Colleague Letter 96-L-186/96-G-287 stipulates July 1, 1996 as the deadline for fully implementing and enforcing certain provisions of the December 18, 1992 regulations that were subject to delayed enforcement.]**

Failure to comply with the federal due diligence regulations results in the loss of reinsurance for the guaranty agency and the lender's right to receive interest and special allowance.

General Information

Lenders [servicers] are required to maintain complete and accurate records of each loan that it holds. In determining whether the lender [servicer] met the due diligence compliance requirements pertaining to collection of delinquent loans the documentation maintained should include:

- ▶ Copies of collection letters sent to the borrower or endorser, or the loan collection history. Information on file should identify the date and subject of each communication (for example, documentation of a telephone contact, written notice, collection letter, etc.). between the lender [servicer] and the borrower or endorser, regarding delinquent loan collection. [If letters are system-generated, the organization is only required to maintain samples of each letter with the system history identifying which letter was sent on what date.]
- ▶ Any other loan portfolio documents that provide evidence that the due diligence requirements were met.

[The loan records may be stored on microfilm, optical disk, or other machine readable formats]

December 1992 Regulations

Delinquency - Delinquency on a loan begins on the first day after the due date of the first missed payment which is not made later. If a payment is made late, the first day of delinquency is the day after the due date of the next missed payment which is not later made. A payment that is within \$5.00 of the amount normally required to advance the due date may nevertheless advance the due date if the lender's procedures allow for that advancement.

1 to 10 Days Delinquent: One written notice or collection letter should be sent to the borrower. (Except in the case where a loan is brought into this period by a payment on the loan, expiration of an authorized deferment or forbearance period, or the lender's [servicer's] receipt from the drawee of a dishonored check submitted as a payment on the loan.)

11 to 180 Days Delinquent: (11-240 days delinquent for a loan repayable in installments less frequent than monthly.) Unless exempted as set forth in 34 CFR 682.411 (d)(4), during this period the lender [servicer] shall engage in the following: At least four diligent telephone efforts* [34 CFR 682.411 (l)] - one must be prior to 90 days and one must be on or after 90 days; at least four collection letters - at least two letters

of which must warn the borrower that if the loan is not paid the lender [servicer] will assign the loan to the guaranty agency that, in turn, will report the default to all national credit bureaus, and that the agency may institute proceedings to offset the borrower's state and federal tax refunds, to garnish the borrower's wages, and bring suit to compel loan repayment. Dear Colleague Letter 96 - L - 186/96 - G - 287 question and answer 50 states that although the timing of the required collection letters is left to the discretion of the lender, "the Secretary intends that the two most forceful letters should be sent late in the delinquency cycle, when they are likely to have the greatest effect on the borrower." Therefore a lender may choose to send one or more of the required collection letters during these periods, provided the timing and forcefulness of the lender's collection letters meet the Secretary's stated intention.

Following the lender's [servicer's] receipt of a payment on the loan or a correct address for the borrower, the lender's [servicer's] receipt from the drawee of a dishonored check received as a payment on the loan, the lender's [servicer's] receipt of a correct telephone number for the borrower, or the expiration of an authorized deferment or forbearance period, the lender [servicer] is required to engage in only:

Less than 91 Days Delinquent (121 days)	91-120 Days Delinquent (121-180)
Two (2) diligent* telephone efforts	One (1) diligent* telephone effort
Upon receipt of loan payment, correct address or telephone number, or returned check, or expiration of the deferment or forbearance	

Note: The days in parenthesis represent the requirements for loan installments made less frequently than monthly.

* Diligent efforts for telephone contact are defined as:

- ▶ a successful effort to contact the borrower by telephone;
- ▶ at least two unsuccessful attempts to contact the borrower by telephone at a number that the lender reasonably believes to be the borrower's correct telephone number; or
- ▶ an unsuccessful effort to ascertain the borrower's correct telephone number, including but not limited to, a directory assistance inquiry as to the borrower's telephone number and a diligent effort to contact each reference, relative, and individual identified in the most recent loan application for that borrower that the lender holds. The lender [servicer] may contact a school official other than the financial aid administrator who reasonably may be expected to know the borrower's address.

Delinquent 151 Days or More (the 211th day for loans payable in installments less frequent than monthly): The final demand letter should be sent to the borrower requiring repayment of the loan in full and notifying the borrower that a default will be reported to a national credit bureau. The lender [servicer] shall allow the borrower at least 30 days after the date the letter is mailed to respond to the final demand letter and to bring the loan out of default before filing a default claim on the loan.

Loan Endorsers

During the delinquency period (1-180 days; 240 days if installments less frequent than monthly) the lender [servicer] shall—

- ▶ make a diligent effort to contact the endorser by telephone.
- ▶ send the endorser on the loan **two** letters advising the endorser of the delinquent status of the loan and urging the endorser to make the required payments on the loan.

At least one letter must warn the endorser that if the loan is not paid, the lender will assign the loan to the guaranty agency that, in turn, will report the default to all national credit bureaus. In addition, the letter should state that the agency may institute proceedings to offset the endorser's State and Federal income tax refunds, garnish the endorser's wages, and bring suit against the endorser to compel loan repayment.

- ▶ on or after the 151st day of delinquency (the 211th day for loans payable in installments less frequent than monthly) send a final demand letter to the endorser requiring repayment of the loan in full and notifying each one that a default will be reported to a national credit bureau. The lender shall allow the borrower at least 30 days after the date the letter is mailed to respond to the final demand letter and to bring the loan out of default before filing a default claim on the loan.

Skip Tracing Requirements: Unless the final demand letter specified in “Delinquent 151 Days or More” section above has already been sent, the lender [servicer] shall begin to attempt diligently to locate the borrower through the use of normal commercial skip-tracing techniques within 10 days of its receipt of information indicating that it does not know the borrower's current address. These efforts must include, but are not limited to, making a diligent effort to contact each endorser, relative, reference, and individual and entity identified in the borrower's loan file. For this purpose, a lender's [servicer's] contact with a school official who might reasonably be expected to know the borrower's address may be with someone other than the financial aid administrator identified on the loan application.

These efforts must be completed by the date of default with no gap of more than 45 days between attempts to contact those individuals or entities. Upon receipt of information indicating that it does not know the borrower's current address, the lender shall discontinue the collection efforts described in the paragraphs above skip tracing requirements.

If the lender [servicer] is unable to ascertain the borrower's current address despite its performance of the activities described in the first paragraph above, the lender [servicer] is excused thereafter from performance of the collection activities unless it receives communication indicating the borrower's address before the 151st day of delinquency (the 211th day for loans payable in less frequent installments than monthly).

Skip Tracing For Loan Endorsers: Unless the final demand letter specified in “ Delinquent 151 Days or More” section above has already been sent, upon receiving information indicating that it does not know the endorser's current address or telephone number, the lender [servicer] must diligently attempt to locate the endorser through the use of normal commercial skip-tracing techniques. This effort **must** include an inquiry

to directory assistance.

Preclaims Assistance: The lender [servicer] shall request preclaims assistance from the loan guaranty agency within 10 days before or after the date the agency established that it would first provide assistance.

November 1986 Regulations

Delinquency - For purposes of this section, delinquency on a loan begins on the first day after the due date of the first missed payment not later made. If a payment is made late, the first day of delinquency is the day after the due date of the next missed payment not later made.

1 to 30 Days Delinquent: Two written notices or collection letters should be sent to the borrower (unless the borrower's address is unknown).

31 to 60 Days Delinquent: Multiple phone attempts should be made or two letters sent if unable to contact the borrower by phone. Letters include references to consequences of default, credit bureau reporting, and law suit.

61-150 Days Delinquent: Multiple phone attempts should be made or one letter sent during each 30-day period if unable to contact the borrower by phone. The letter must be as forceful as the letters described in the 31-60 day period.

151-180 Days Delinquent: A final demand letter should be sent (unless the borrower's address is unknown). The lender [servicer] should allow at least 30 days for the borrower to respond before filing a default claim on the loan or reporting that default to a credit bureau.

Skip Tracing Requirements: The lender [servicer] shall begin to diligently attempt to locate the borrower through the use of normal commercial skip-tracing techniques within 10 days of its receipt of information indicating that it does not know the borrower's current address. These efforts must include, but are not limited to, making a diligent effort to contact each endorser, relative, reference, and any other individual and entity identified in the borrower's loan file.

Preclaims Assistance: The lender [servicer] shall request preclaims assistance from the loan guaranty agency within 10 days of the date the agency established that it would first provide assistance.

Management Assertion

Lender Assertion

During the year ended [m/d/y, ABC Lender] complied with the due diligence requirements for collection of delinquent loans, including the requirements for skip-tracing or preclaims assistance set forth in 34 CFR 682.411 (c)-(m).

Servicer Assertion

For loans serviced during the year ended [m/d/y, XYZ Servicer] complied with—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with—the due diligence requirements for collection of delinquent loans, including the requirements for skip-tracing or preclaims assistance set forth in 34 CFR 682.411 (c)-(m).

Suggested Procedures for Examining Compliance

(Note: The practitioner may want to perform these procedures in conjunction with the procedures to test Compliance Requirement 2 - Individual Record Review.)

- a. Obtain and review the lender's [servicer's] written collection procedures. If applicable, obtain the sample collection letters and list of system codes for collection efforts.
- b. From the delinquency report, select a sample of loans. Determine by inquiry of the lender [servicer] as to the applicability of the 1992 regulations or the 1986 regulations for the loans sampled. Verify the calculation of delinquency periods.

Loans Covered by the 1992 Regulations

- c. For loans that were delinquent from 1 to 10 days, determine if the lender's [servicer's] records document that the required written notice or collection letter was sent to the borrower. Verify the letter informed the borrower of the delinquency and urged the borrower to make payments sufficient to eliminate delinquency.
- d. For loans that were delinquent between 11 to 180 days (11 to 240 for loans repayable in installments less frequently than monthly) determine if the lender's [servicer's] records document that the required telephone efforts were made and/or collection letters were sent to the borrowers. Verify that at least two of the letters warned the borrower of possible assignment of the loan to the guaranty agency, reporting the default to all national credit bureaus, offset of income tax refunds to garnish wages and suit.
- e. For loans that were delinquent more than 150 days (the 211th day for loans payable in installments less frequent than monthly) determine if the lender's [servicer's] records document that the final demand letter requiring repayment of the loan in full and notifying the borrower that a default will be reported to a national credit bureau was sent to the borrower.
- f. Loan Endorser Procedures: For a sample of loans delinquent from 1-180 days (240 days for loans repayable in installments less frequently than monthly) determine if the lender's [servicer's] records document that the lender [servicer] made a diligent effort to contact the endorser by phone, sent the required letters and final demand letter, if applicable, in accordance with requirements.
- g. Skip-Tracing Procedures: From the sample of delinquent loans where a final demand letter was not sent to the borrower, determine if the lender's [servicer's] records document that the lender [servicer] attempted to contact each endorser, relative, reference, individual and entity identified in the borrower's loan file within 10 days of receipt of information indicating that it did not know the borrower's current address. Determine if these efforts were completed by the date of default with no gap of more than 45 days between attempts. Determine if the lender's [servicer's] efforts for loan endorsers included an inquiry to directory assistance.

- h. Preclaims Assistance Procedures: Obtain and review the agreement the guaranty agency has with the lender that establishes the time period for preclaims assistance. From the population of delinquent or defaulted loans determine the loans where required preclaims assistance from the loan guaranty agency should have been requested by the lender [servicer]. For a sample of the loans, determine if the lender's [servicer's] records document that preclaims assistance was requested within 10 days before or after the established time period.

Loans Covered by the 1986 Regulations

- c. For loans that were delinquent from 1 to 30 days, determine if the lender's [servicer's] records document that the required number of written notices or collection letters were sent to the borrowers.
- d. For loans that were delinquent between 31 to 60 days, determine if the lender's [servicer's] records document that multiple telephone efforts were made to contact the borrower or at least two letters were sent to the borrower if the lender [servicer] was unable to contact the borrower by phone.
- e. For loans that were delinquent between 61 to 150 days, determine if the lender's [servicer's] records document that multiple telephone efforts were made to contact the borrower or at least one letter was sent to the borrower if the lender [servicer] was unable to contact the borrower by phone.
- f. For loans that were delinquent 151-180 days, determine if the lender's [servicer's] records document that a final demand letter was sent to the borrower.
- g. Skip-Tracing Procedures: From the sample of delinquent loans, determine if the lender's [servicer's] records document that the lender [servicer] attempted to contact each endorser, relative, reference, individual and entity identified in the borrower's loan file within 10 days of receipt of information indicating that it did not know the borrower's current address.
- h. Preclaims Assistance Procedures: Obtain and review the agreement the guaranty agency has with the lender that establishes the time period for preclaims assistance. From the population of delinquent or defaulted loans determine the loans where required preclaims assistance from the loan guaranty agency should have been requested by the lender [servicer]. For each of those loans, determine if the lender's [servicer's] records document that preclaims assistance was requested within 10 days of the established time period.

11. DUE DILIGENCE - TIMELY CLAIM FILINGS BY LENDERS OR SERVICERS

Compliance Requirement - Timely Filing of Claims

Lenders [servicers] are required to timely file claims with the guaranty agency for payment of death, disability, closed schools, false certification, bankruptcy and default claims. Each type of claim has a separate timely filing requirement.

- * Death or disability claims must be filed within 60 days of the date on which the lender [servicer] determines that a borrower has died or is totally and permanently disabled [34 CFR 682.402(g)(2)(i)].
- * Closed school claims must be filed no later than 60 days after the borrower submits to the lender/servicer the written request and sworn statement described in 34 CFR 682.402(d) or after the lender/servicer is notified to file a claim by the Secretary, the Secretary's designee, or the guaranty agency [34 CFR 682.402(g)(2)(ii)].
- * False certification claims must be filed no later than 60 days after the borrower submits to the lender [servicer] the written request and sworn statement described in 34 CFR 682.402(e) or after the lender/servicer is notified to file a claim by the Secretary, the Secretary's designee, or the guaranty agency [34 CFR 682.402(g)(2)(iii)].
- * Bankruptcy claims must be filed within: (1) 30 days after the date on which the lender [servicer] receives notice of the first meeting of creditors unless, in the case of a proceeding under Chapter 7, the notice states that the borrower has no assets [34 CFR 682.402(g)(2)(iv)(A)]; or (2) 15 days after the lender [servicer] is served with a complaint or motion to have the loan determined to be dischargeable on grounds of undue hardship, or, if the lender [servicer] secures an extension of time within which an answer may be filed, 25 days before the expiration of that extended period, whichever is later [34 CFR 682.402(g)(2)(iv)(B)]; or (3) 30 days after the lender [servicer] receives a notice from the court stating that a Chapter 7 no-asset case has been converted to an asset case [34 CFR 682.402(f)(4)].
- * Default claims must be filed with the guaranty agency by the lender/servicer within 90 days of default [34 CFR 682.406(a)(5)].

The lender/servicer is required to maintain records necessary to document the validity of a claim against a loan guarantee [34 CFR 682.404(g)(1) and 34 CFR 682.414(a)(3)(ii)]. Items to be filed by the lender [servicer] with the guaranty agency include:

- ▶ The original promissory note.
- ▶ The loan application.
- ▶ In the case of a death claim, those documents that formed the basis for the determination of death as described in 34 CFR 682.402(b).
- ▶ In the case of a disability claim, a copy of the certification of disability described in 34 CFR 682.402(c)(2).
- ▶ In the case of a closed school claim the documentation described in 34 CFR 682.402(d)(3), or any other documentation as the Secretary may require.
- ▶ In the case of a false certification claim, the documentation described in 34 CFR 682.402(e)(3).
- ▶ In the case of a bankruptcy claim: Evidence that a bankruptcy petition has been filed, all pertinent documents sent to or received from the bankruptcy court by the lender, and an assignment to the guaranty agency of any proof of claim filed by the lender regarding the loan; **AND** a statement of any facts of which the lender is aware that may form the basis for an objection or exception to the discharge of the borrower's loan obligation in bankruptcy and all documents supporting those facts [34 CFR 682.402(g)(1)(v)].

Management Assertion

Lender Assertion

During the year ended [m/d/y, ABC Lender] complied with deadlines for timely filing of claims with the guaranty agency concerning death, disability, false certification, closed schools, or bankruptcy contained in 34 CFR 682.402(b), (c), (d), (e) and (f) and for default claims contained in 34 CFR 682.406(a)(5). During the year ended [m/d/y, ABC Lender] properly categorized amounts pertaining to claims in the ED Form 799.

Servicer Assertion

For loans serviced during the year ended [m/d/y, XYZ Servicer] complied with—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with—deadlines for timely filing of claims with the guaranty agency concerning death, disability, false certification, closed schools, or bankruptcy contained in 34 CFR 682.402(b), (c), (d), (e) and (f) and for default claims contained in 34 CFR 682.406(a)(5). For loans serviced during the year ended [m/d/y, XYZ Servicer] accurately categorized—and as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements for accurately categorizing—amounts pertaining to claims in the ED Form 799.

Suggested Procedures for Examining Compliance

- a. Select a sample from all loans on which a death, disability, closed school, false certification, bankruptcy or default claim was filed and determine if the lender's [servicer's] records document that a claim was filed in a timely manner with the guaranty agency.
- b. Select a sample of claims rejected during the period covered by management's assertion and determine whether the lender [servicer] either resubmitted the claim timely or recategorized the loan to an uninsured loan on the ED Form 799.

12. CURES

Compliance Requirement - Curing Due Diligence/Timely Filing Violations

A lender/servicer may "cure" a violation of collection due diligence requirements or the 90-day deadline for the filing of default claims, in order to reinstate the loan guarantee, and the lender's right to interest and special allowance. Guaranty Agency Director Letter, 88-G-138, "Policy for Waiving the Secretary's Right To Recover or Refuse to Pay, Interest Benefits, Special Allowance, and Reinsurance on Stafford, and Consolidation Program Loans Involving Lenders' Violations of Federal Regulations Pertaining to Due Diligence in Collection or Timely Filing of Claims" is applicable to due diligence violations on loans for which the first day of delinquency occurred on or after March 10, 1987 (the effective date of the November 10, 1986 due diligence regulations) and to timely filing violations occurring on or after December 26, 1986 whether or not the affected loans have been submitted as claims to the guaranty agency.

A violation with respect to the due diligence requirements in 34 CFR 682.411 means the failure to timely

complete a required diligent phone contact effort, the failure to timely send a required letter (including request for preclaims assistance), or the failure to timely engage in a required skip-tracing activity.

Under 34 CFR 682.200, default on a FFEL Program loan occurs when a borrower fails to make a payment when due, provided this failure persists for 180 days for loans payable in monthly installments, or for 240 days for loans payable in less frequent installments. The 90 day filing period applicable to FFEL Program default claims is set forth in 34 CFR 682.406(a)(5). The 90 day filing period begins at the end of the 180/240 day default period.

When reviewing loans that have been cured, the practitioner should determine what cure applies to the loans.

Retrospective period - One or more due diligence violations occurring during the period March 10, 1987 - April 30, 1988.

Prospective period - Due diligence violations occurring on or after May 1, 1988.

The following guidance only pertains to the prospective period as most loans tested by the practitioner should fall into that category. The practitioner should refer to 34 CFR Part 682 Appendix D for detailed information on the retrospective period.

Cures for Due Diligence Violations

- A. If a lender/servicer fails to perform one activity when required but is no more than five days late in performing that activity (for transfers no more than 20 days late) the violation is excused.
- B. If one or two activities are omitted or performed more than five days late (for transfer, more than 20 days late) and the gap is no greater than 45 days (for transfers, no greater than 60 days) the violation(s) is excused. However, the lender/servicer must complete all required activities before the claim filing deadline. Interest and special allowance will be limited to 90 days if the missed activities are not performed before day 270. If the preclaim is not completed by day 240, then interest and special allowance will not be paid for the most recent 180 days prior to default. A preclaim must be in effect 30 days before a claim will be paid. No additional interest will be paid for this period.
- C. 3 Activities - If three activities were omitted or performed more than five days late (for transfers, more than 20 days late) and the gap is no greater than 45 days (for transfers, no greater than 60 days) the lender/servicer must locate the borrower and:
 - Step 1. Within 15 days of location send a new Repayment Agreement to the borrower that complies with the 10-year repayment limitations set out in 34 CFR 682.209(a)(7) and a strongly worded collection letter.
 - Step 2. If the borrower does not respond within 15-20 days of Step 1, attempt to contact the borrower by phone.
 - Step 3. If the borrower does not respond within 5-10 days of Step 2, again attempt to contact the

- borrower by telephone.
- Step 4. If the borrower does not respond within 5-10 days of Step 3, send a forceful collection letter requesting entire balance of the loan.
- Step 5. If the borrower does not respond within 30 days of Step 4, file the claim within 60 days of Step 4. Principal, Interest, and Special Allowance will be paid only to the date of the first unexcused violation.

If the borrower returns the signed agreement or sends a payment, consider the borrower current. Principal will be paid. Interest and Special Allowance will not be paid from the earliest unexcused violation to reinstatement.

Note: As a cure may be obtained through the receipt of a signed new repayment agreement or one full payment, some lenders [servicers] may choose to substitute the following “more than 3 activities” process for the “3 activities” process.

D. More than 3 Activities - If more than three activities were omitted or performed more than 5 days late (for transfers, more than 20 days late) or if there is a gap of 46 days or more and at least one violation (for transfers, 61 days or more) the lender [servicer] must—

1. locate the borrower
2. obtain a new repayment agreement OR obtain one full payment (evidence must be retained). The borrower is current if either action above occurs and interest and special allowance resumes

Cure for Timely Filing Violations

Same procedures as for "C. - 3 Activities" above.

Management Assertion

Lender Assertion

For loans with timely-filing violations or due-diligence violations that were cured during the year ended [m/d/y, ABC Lender] documented that it performed the cure procedures required by 34 CFR 682 Appendix D [Bulletin 88-G-138]. For loans on which a cure was required but that were not cured during the year ended [m/d/y, ABC Lender] properly categorized the loans in the ED Form 799 submitted to ED.

Servicer Assertion

For loans with timely-filing violations or due-diligence violations that were cured during the year ended [m/d/y, XYZ Servicer] documented that it performed—and, as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements to perform—cure procedures required by 34 CFR 682 Appendix D [Bulletin 88-G-138]. For loans on which a cure was required but that were not cured during the year ended [m/d/y, XYZ Servicer] properly categorized—and, as of [m/d/y, XYZ Servicer] had effective internal control over compliance with requirements to properly categorize—the loans in the ED Form 799 prepared and submitted to ED on behalf of our lender clients or the billing information prepared by [XYZ Servicer] and submitted to our lender clients.

Suggested Procedures for Examining Compliance

- a. For a sample of "cured" loans identified in Part V of the ED form 799s [or servicer billing information] verify that the lender's [servicer's] records document that it performed the required cure procedures described in 34 CFR Part 682 Appendix D section I.C; and D or E.
- b. For cured loans on which the lender [servicer] obtained a new repayment agreement, verify that the new repayment agreement complies with the ten-year repayment limitations set out in 34 CFR 682.209(a)(7).
- c. For cured loans on which the lender [servicer] obtained one full payment, obtain the copy of the full payment check and/or other documentation maintained by the lender [servicer] and verify that the full payment complies with the terms of the most current repayment schedule and that the curing payment was valid [34 CFR Part 682 Appendix D section I.A]. For example, NSF checks are an invalid form of cure; payments must be made by the borrower or a party on behalf of the borrower having no financial interest in the loan.
- d. Verify that the lender [servicer] accurately adjusted its ED Form 799 to rebate interest and/or special allowance, if any, during non-reinsured periods. (Note: The practitioner may want to perform this step in conjunction with the procedures to test Compliance Requirement 5.)
- e. Verify that the lender [servicer] properly categorized loans for which a cure was required but which were NOT cured on either the ED Form 799 or if applicable the billing information.

SECTION III

ALTERNATIVE AND COMBINED ENGAGEMENTS FOR CERTAIN LENDERS USING SERVICERS

When a lender uses servicers to service all or part of its FFEL Program loan portfolio, the lender's management may or may not be able to make all of the assertions required in Section II of this Guide. In those situations, ED will accept as meeting the lender audit requirement an independent accountant's report(s) based on an alternative or combined engagement as discussed in this section. This section provides guidance on when the alternative or combined engagement would be acceptable and the requirements for such an engagement.

Please note that when the circumstances exist that would allow the alternative or combined engagement to be used, ED is not mandating such an engagement. If the lender wants a standard engagement and is able to make the required assertions, it is free to make that choice.

PREREQUISITE FOR ALTERNATIVE (OR COMBINED) ENGAGEMENT

A prerequisite for the alternative or combined engagement is that the lender obtains from the servicer(s) an audit/attestation report that meets the requirements described in this section. If a report meeting these requirements cannot be obtained from the servicer, a standard engagement is required, with the lender's practitioner performing examination procedures at the servicer, if necessary.

ADDITIONAL REQUIREMENTS

Alternative Engagement

When all of the lender's FFEL Program loan portfolio is serviced by one or more servicers that perform the functions governed by the compliance requirements identified in Section II of this Guide, and the lender is not able to make any of the required assertions for a standard engagement, the lender could engage a practitioner to perform an agreed-upon procedures attestation engagement relative to the lender management's assertions required by this section (see the "Management Assertions and Agreed-Upon Procedures" section herein).

Combined Engagement

When the lender services part of its FFEL Program loan portfolio and part is serviced by one or more servicers (and it is not immaterial), the lender could engage a practitioner to:

- a. Perform an examination-level attestation engagement (standard engagement) on the lender management's assertions applicable to the portion of the FFEL Program loan portfolio serviced

by the lender, and

- b. Perform an agreed-upon procedures attestation engagement (alternative engagement) on the lender management's assertions discussed herein for the portion of the FFEL Program loan portfolio serviced by the servicer.

SERVICER AUDIT/ATTESTATION REPORT REQUIREMENTS

A servicer's independent accountant's audit/attestation report must meet all of the following requirements to be acceptable for use as a basis for an alternative or combined engagement.

1. The audit/attestation engagement must be conducted in accordance with the standards for financial-related audits in *Government Auditing Standards*, and the report must include an independent accountant's opinion with respect to the servicer's compliance with the specified compliance requirements identified in Section II of this Guide that pertain to the functions carried out by the service organization. This can be the practitioner's direct opinion on compliance or an opinion on management's assertions about compliance. If the latter, the service organization management's assertions should be the same as or similar to the assertions identified in Section II for a standard attestation engagement of a lender. The guidance in Section I of this Guide and Section IV, should be adapted as appropriate.
2. The scope of the audit/attestation engagement can be service organization-wide or can be limited to certain lenders' portfolios, in which case, only those lenders whose portfolios are covered by the servicer audit/attestation report can use the report as a basis for an alternative or combined engagement.
3. The period covered by the audit/attestation engagement must: 1) cover at least the same length of period as the lender's reporting period (generally 12 months except if the lender elects a two-year initial report), and 2) end within 6 months of the lender's reporting period. However, to be of use, the report should be available in time for the lender's audit to be completed in a timely manner.
4. The audit/attestation report must specify what lenders, functions, and compliance requirements are covered.
5. If the report discloses noncompliance (in either management's assertions, the independent accountant's report, or supplemental schedule), the practitioner's audit/attestation report or supplemental schedule must disclose whether the findings address FFEL Program compliance requirement functions for which the lender has contracted the servicer to perform. (Note: If there were no findings related to the FFEL Program compliance functions for which the lender has contracted the servicer to perform, a separate communication from the servicer to the lender should so state. See Section I, "*Management's Reporting Responsibilities.*")
6. The supplemental schedule titled, "Schedule of Findings and Questioned Amounts by Compliance

Requirement,” must contain all the required attributes and elements identified in Appendix B, Example 4 of this Guide.

MANAGEMENT ASSERTIONS AND AGREED-UPON PROCEDURES

When the lender elects to use the alternative engagement, lender management must prepare the written assertions, and must engage a practitioner to perform the agreed-upon procedures, that follow. These assertions and agreed-upon procedures are also required in a combined engagement (together with the standard report).

1. COMPILATION OF BILLING INFORMATION

Compliance Requirement - Compilation of Billing Information from Servicer

The services provided by servicers vary from lender to lender. In some cases the servicer prepares the ED Form 799 for the lender based on the servicer records. In other cases the servicer provides information from which the lender prepares the ED Form 799. This would always be the case when the lender uses more than one servicer and/or services part of its own portfolio. The lender would then need to combine the information from the servicer(s) and the portfolio that it services to prepare the ED Form 799.

Management Assertion (applicable when the lender prepares the ED Form 799)

The information included in the ED Form 799s submitted to ED during the year ended [m/d/y] pertaining to loans serviced by the servicer(s) agrees with the billing information provided by the servicer(s).

Agreed-Upon Procedure To Be Performed by the Lender Practitioner

- a. Compare and agree the loan information (as adjusted) reported in the ED Form 799s submitted to ED during the year to the billing information provided by the servicer(s).

Management Assertion (applicable when the service organization prepares the ED Form 799)

The ED Form 799s submitted to ED during the year were prepared by (insert name or servicer).

Agreed-Upon Procedure To Be Performed by the Lender Practitioner

- b. Review the submissions of billing information (and lender/servicer contract, if necessary) from the servicer to the lender to determine whether it included a servicer-prepared ED Form 799.

2. SERVICE ORGANIZATION AUDIT/ATTESTATION REPORT

Compliance Requirement - Servicer Audit/Attestation Report Meets Requirements for Alternative Engagement

A servicer's report must meet the servicer's audit/attestation report requirements identified on page III-2 of this Guide.

Management Assertion

The servicer's audit/attestation report meets the requirements in Section III of the Audit Guide for the alternative method engagement.

Agreed-Upon Procedure to be Performed by the Lender Practitioner

- a. Obtain and read all servicer(s) audit/attestation report(s) obtained by the lender to satisfy the alternative engagement approach and ascertain that the report(s):
 - Include a statement that the audit/attestation engagement was conducted in accordance with *Government Auditing Standards*.
 - Expresses an opinion on compliance, or management's assertions on compliance, with the applicable compliance requirements in Section II of the Audit Guide.
 - Sets forth the scope of the audit/attestation engagement (organization-wide or limited to certain lenders).
 - Covers the same length of period as the lender's reporting period (generally 12 months except if the lender elects a two-year initial report), ending within 6 months of the end of the lender's reporting period.
 - Identifies what lenders, functions, and compliance requirements are covered by the audit/attestation report.
 - Discloses whether the findings address the FFEL Program compliance requirement functions for which the lender has contracted the servicer to perform; *and*

The supplemental schedule titled, "Schedule of Findings and Questioned Amounts by Compliance Requirement" contains all the required attributes and elements identified in Appendix B, Example 4 of this Guide.

3. SERVICER REPORT FINDINGS

Compliance Requirement - Lender Discloses All Noncompliance Included in Servicer Audit/Attestation Reports or in Separate Servicer Communications

This compliance requirement is self-explanatory.

Management Assertion

All instances of noncompliance reported in the servicer audit/attestation report, including any in the “Schedule of Findings and Questioned Amounts by Compliance Requirement,” that relate to a FFEL Program compliance requirement function for which the lender has contracted the servicer to perform are disclosed below [in a representation letter to DEF Practitioner].

Agreed-Upon Procedures to be Performed by the Lender Practitioner

- a. Review a copy of the servicer(s) audit/attestation report(s), including any “Schedule of Findings and Questioned Amounts by Compliance Requirement,” transmitted to the lender from the servicer that reports noncompliance (material and immaterial) at the servicer. Confirm with the servicer that there has been no additional communication to the lender relating to noncompliance other than those of which the practitioner is aware.
- b. Review any contract the lender has with a servicer(s) to determine the FFEL Program compliance requirements the lender has contracted with the servicer(s) to perform.
- c. Report all findings of noncompliance identified in the report(s) that address any FFEL Program compliance requirement function for which the lender has contracted the servicer(s) to perform and include as an element, the population of the lender’s applicable transactions administered by the servicer. (See Appendix B, Example 4)

SECTION IV

REPORTING

REPORTING PACKAGE FOR LENDERS AND SERVICERS

The following required management and practitioner reports comprise the lender's or servicer's full reporting package.

Required Lender Reports

1. Information Sheet (Example 1)
2. Corrective Action Plan - This plan is to be developed by the lender and should describe the corrective action taken or planned in response to the findings identified by the practitioner. The plan should also include comments on the corrective action taken on prior year findings resulting from audits, guaranty agency reviews, and ED program reviews that effect the current examination objective. (Example 7)

Required Servicer Reports

1. Information Sheet (Example 1)
2. Corrective Action Plan - This plan is to be developed by the servicer and should describe the corrective action taken or planned in response to the findings identified by the practitioner. The plan should also include comments on the corrective action taken on prior year findings resulting from audits, lender reviews, and ED program reviews that effect the current examination objective. (Example 7)

Required Practitioner Reports

The following comprise the practitioner's reporting package to the lender or servicer, as applicable.

1. A) Standard Lender Engagement: Report on the practitioner's examination of lender management's written assertions about lender's compliance with specified requirements. (Example 2)
B) Servicer Engagement: Report on the practitioner's examination of servicer management's written assertions about servicer's compliance with—and effectiveness of servicer's internal control over compliance with—specified requirements. (Example 3)
C) Lender - Alternative Engagement: A report based on an agreed-upon procedures attestation engagement on the lender's assertions identified in Section III of this Guide. (Example 5)

- D) Combined Engagement: (i) Report on the practitioner's examination of lender management's written assertions about lender's compliance with specified requirements. (Example 2) for that portion of the FFEL Program loan portfolio serviced by the lender; and (ii) report based on an agreed-upon procedures attestation engagement on the lender's assertions identified in Section III relative to the portion of the lender's FFEL Program loan portfolio serviced by a third-party servicer(s).
2. A schedule of findings and questioned amounts by compliance requirement, including material noncompliance found by the practitioner or disclosed in management's assertions. (Each noncompliance finding should contain the elements in Example 4.)
 3. A copy of written communications from the practitioner to the lender's management of any internal control deficiencies noted. (See Reporting Considerations in Section I.)
 4. The practitioner's comments on prior audit resolution matters. The report should disclose the status of material findings and recommendations (uncorrected) from the prior two year's related examinations or audits performed by the practitioner or by other practitioners that are related to the lender's or servicer's participation in the FFEL Program. (Example 6)
 5. If a separate report on illegal acts that could result in criminal prosecution was submitted in accordance with the instructions in Section I of this Guide, it should be included as part of the reporting package.

REGIONAL INSPECTORS GENERAL FOR AUDIT

Offices

States Covered

Regional Inspector General for Audit
U.S. Department of Education/OIG
3535 Market Street, Room 16280
Philadelphia, Pennsylvania 19104
Phone: 215-596-0262
FAX: 215-596-0124

Connecticut, Delaware, District of Columbia,
Maine, Maryland, Massachusetts, New
Hampshire, New Jersey, New York,
Pennsylvania, Puerto Rico, Rhode Island,
Vermont, Virgin Islands, Virginia, West
Virginia

Regional Inspector General for Audit
U.S. Department of Education/OIG
1200 Main Tower, Room 2130
Dallas, Texas 75202
Phone: 214-767-3826
FAX: 214-729-2024

Alabama, Arizona, Arkansas, California,
Florida, Georgia, Guam, Hawaii, Kentucky,
Louisiana, Mississippi, Nevada, New Mexico,
North Carolina, Oklahoma, South Carolina,
Tennessee, Texas

Regional Inspector General for Audit
U.S. Department of Education/OIG
Executive Hills North 2nd Floor
10220 N. Executive Hills Boulevard
Kansas City, Missouri 64153
Phone: 816-880-4024
FAX: 816-891-0815

Alaska, Colorado, Idaho, Illinois, Indiana,
Iowa, Kansas, Michigan, Minnesota, Missouri,
Montana, Nebraska, North Dakota, Ohio,
Oregon, South Dakota, Utah, Washington,
Wisconsin, Wyoming

ASSISTANT INSPECTOR GENERAL FOR INVESTIGATIONS

Assistant Inspector General for Investigations
U. S. Department of Education/OIG
600 Independence Ave., SW
Room 4122, MES
Washington, D.C. 20202-1510
Phone: 202-205-8762
FAX: 202-205-9449

(All states for Matters Requiring Immediate
Action; see Section I, "Practitioner
Qualifications and Responsibilities" subsection
"Matters Requiring Immediate Action.")

ILLUSTRATIVE INFORMATION SHEET
(Prepared by Lender or Servicer Management)

(Note: This Information Sheet is prepared by the lender or servicer management, as applicable, for the information of ED and is not considered part of the scope of the practitioner's engagement.)

PARTNER: _____
CPA FIRM'S NAME: _____
ADDRESS: _____

TEL. NO. _____
FAX. NO. _____

LENDER OR SERVICER AUDITED: _____
PERIOD AUDITED: _____
LENDER OR SERVICER'S ADDRESS: _____
ENTITY'S ID NUMBER: _____
TEL. NO. (____) ____-_____
FAX. NO. (____) ____-_____

Program Examined: FFEL 84.032 √

Lender:

[ABC Lender-ID #] utilizes a FFEL Servicer - (name and address). The following are all the FFEL Program compliance requirement functions provided by this Servicer as at [m/d/y]:

- | | |
|--|------------------|
| 1. Prepare and submit ED Form 799s to ED | 4. Skip Tracing |
| 2. Record Student Status Changes | 5. Claim Filings |
| 3. Collections | 6. ETC . . . |

(Note: Use as many lines as necessary for the above data. Provide the above data for each servicer utilized.)

Servicer:

(1) The following are all the FFEL Program compliance requirement functions performed by XYZ Servicer for our lender clients as at [m/d/y]:

- | | |
|--|------------------|
| 1. Prepare and submit ED Form 799s to ED | 4. Skip Tracing |
| 2. Record Student Status Changes | 5. Claim Filings |
| 3. Collections | 6. ETC . . . |

(Note: Use as many lines as necessary for the above data.)

(2) The following is a listing of our lender clients as at [m/d/y]:

Lender ID

111111
222222
333333
444444

(Note: Use as many lines as necessary for the above data.)

(3) The following pertain to our financial statement audit:

(Note: This Guide does not require Servicers to demonstrate financial responsibility as described in 34 CFR 682.416 (b), however ED requests that Servicers provide the following information pertaining to their financial statement audits on this schedule.)

- a. Last Period Audited: _____
- b. Prepared in Accordance With: (for example, accrual basis in accordance with GAAP)
- c. Performed in Accordance with: (for example, GAAS)
- d. Type/Entity: (for example, Separate Financial Statement Audit of XYZ or Consolidated Financial Statement Audit of [UVW])

**ILLUSTRATIVE REPORT ON LENDER MANAGEMENT'S ASSERTIONS ABOUT
COMPLIANCE WITH SPECIFIED FFEL PROGRAM REQUIREMENTS**

Independent Accountant's Report

[Addressee]

We have examined management's assertions, included in its representation letter¹ dated [date], that [ABC Lender] complied with [list specified compliance requirements or attach in accompanying schedule], relative to the [ABC Lender's] participation in the Federal Family Education Loan Program during the year ended [date]. As discussed in that representation letter, management is responsible for [ABC Lender's] compliance with those requirements. Our responsibility is to express an opinion on management's assertions about [ABC Lender's] compliance based on our examination.

Our examination was made in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States; standards established by the American Institute of Certified Public Accountants; and the 1996 Audit Guide, *Compliance Audits (Attestation Engagements) for Lenders and Lender Servicers Participating in the Federal Family Education Loan Program* (the Guide), issued by the U.S. Department of Education, Office of Inspector General; and, accordingly, included examining, on a test basis, evidence about [ABC Lender's] compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on [ABC Lender's] compliance with specified requirements.

In our opinion, management's assertions that [ABC Lender] complied with the aforementioned requirements for the year ended [date] are fairly stated, in all material respects.²

This report is intended solely for the information of the audit committee, management, and the U.S. Department of Education. However, this report is a matter of public record and its distribution is not limited.

[Signature]

[Date]

¹ Paragraphs 54 and 55 of SSAE No. 3 explain how the practitioner should report if, alternatively, management presents its written assertions in a separate report.

² Paragraph 61 of SSAE No. 3 says "the practitioner should modify [the standard report] if any of the following conditions exists:

- There is material noncompliance with specified requirements.
- There is a matter involving a material uncertainty.
- There is a restriction on the scope of the engagement.
- The practitioner decides to refer to the report of another practitioner as the basis, in part, for the practitioner's report."

Paragraphs 62 through 68 of SSAE No. 3 give practitioners guidance when an examination of management's assertions about an entity's compliance with specified requirements discloses material noncompliance.

**ILLUSTRATIVE REPORT ON SERVICER MANAGEMENT'S ASSERTIONS
ABOUT COMPLIANCE WITH AND INTERNAL CONTROL OVER
COMPLIANCE WITH SPECIFIED FFEL PROGRAM REQUIREMENTS**

Independent Accountant's Report

[Addressee]

We have examined management's assertions, included in its representation letter³ dated [date], that [XYZ Servicer] complied with [list specified compliance requirements or attach in accompanying schedule] relative to [XYZ Servicer's] administration of the Federal Family Education Loan Program on behalf of its lender clients [list lender ID numbers or attach in accompanying schedule] during the year ended [date] and about the effectiveness of [XYZ Servicer's] internal control over compliance with the aforementioned compliance requirements as of [date]. As discussed in that representation letter, management is responsible for [XYZ Servicer's] compliance with—and the effectiveness of the [XYZ Servicer's] internal control over compliance with—those requirements. Our responsibility is to express an opinion on management's assertions about [XYZ Servicer's] compliance with—and the effectiveness of [XYZ Servicer's] internal control over compliance with—the specified compliance requirements based on our examination.

Our examination was made in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States; standards established by the American Institute of Certified Public Accountants; and the 1996 Audit Guide, *Compliance Audits for Lenders and Lender Servicers Participating in the Federal Family Education Loan (FFEL) Program* (the Guide), issued by the U.S. Department of Education, Office of Inspector General; and, accordingly, included obtaining an understanding of the internal control over compliance with the specified compliance requirements; testing and evaluating the design and operating effectiveness of internal control over compliance; examining, on a test basis, evidence about [XYZ Servicer's] compliance with those requirements; and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on [XYZ Servicer's] compliance with specified requirements.

Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Also projections of any evaluation of the internal control over compliance with the specified requirements to future periods are subject to the risk that internal control over compliance may become inadequate because of changes in conditions, or that the degree of compliance with control policies or procedures may deteriorate.

In our opinion, management's assertions that [XYZ Servicer] complied with the aforementioned requirements for the year ended [date] and that [XYZ Servicer] maintained an effective internal control over compliance with the aforementioned compliance requirements as of [date] are fairly stated, in all material respects.¹

This report is intended solely for the information of the audit committee, management, and the U.S. Department of Education. However, this report is a matter of public record and its distribution is not limited.

[Signature]

[Date]

APPENDIX B

³See footnote 1 herein.

¹See footnote 2 herein.

ILLUSTRATIVE SCHEDULE OF FINDINGS AND QUESTIONED AMOUNTS BY COMPLIANCE REQUIREMENT

As discussed in Section I, management's assertions and the practitioner's issued reports are a primary tool used by program managers in meeting their stewardship responsibilities in overseeing these loan programs and assuring the integrity of the funds and the reporting process. To assist ED, practitioners are required to prepare a separate schedule for each FFEL Program compliance requirement tested during their engagement. For example, ED Forms 799, Individual Record Review, Loan Origination Fees etc. The Schedule of Findings and Questioned Amounts must include the information outlined below, where applicable. *Government Auditing Standards* states that well-developed findings generally consist of the following attributes:

1. Statement of condition - the nature of the deficiencies, for example, a regulation not being followed.
2. Criteria - what the entity should be doing, for example, the specific regulation, a prudent management practice, or an internal control procedure.
3. Effect - what happened as a result of the condition; this should be quantified in terms of dollar value in all possible instances and described as thoroughly as possible.
4. Cause - why the condition exists, for example, the entity was unaware of the regulation or internal control was not a high priority of the entity.
5. Recommendation - what the entity should do to correct the condition; normally addresses the cause, e.g., develop procedures to implement regulation or specific actions to follow established procedures. If corrective action is not necessary, the practitioner must describe the reason.

The practitioner must attempt to identify the condition, criteria, effect, and cause to provide sufficient information to ED officials to permit timely and proper audit resolution. These findings may also serve as a basis for ED to conduct further work. In addition, findings identified in all servicer and agreed-upon procedures engagements should clearly be identified or classified as material or immaterial.

In describing the condition and effect, the practitioner must provide, if applicable, the following:

1. All Lender IDs that comprise the population from which the sample was selected.
2. Sampling methodology
3. The number of units and dollar value of the population.
4. The number of units and dollar value of the selected sample.
5. The number of units and dollar value of the instances of noncompliance.
6. The population of applicable transactions administered by the servicer for each lender in the population (pertains to agreed-upon procedures engagements).

ILLUSTRATIVE

**REPORT ON AGREED-UPON PROCEDURES
ATTESTATION ENGAGEMENT UNDER ALTERNATIVE METHOD²**

Independent Accountant's Report

[Addressee]

We have performed the procedures included in Section III of the 1996 Audit Guide, *Compliance Audits for Lenders and Lender Servicers Participating in the Federal Family Education Loan (FFEL) Program* (the Guide), issued by the U.S. Department of Education, Office of Inspector General, which were agreed to by the [ABC Lender] and U.S. Department of Education solely to assist the users in evaluating management's assertions included in its representation letter dated [date], which are presented [below/in the accompanying summary to this report], relative to compliance with certain U.S. Department of Education reporting requirements applicable to the [ABC Lender's] participation in the Federal Family Education Loan Program during the year ended [date]. This agreed-upon procedures engagement was performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States and standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described in the Guide either for the purpose for which this report has been requested or for any other purpose.

[Include paragraph to enumerate procedures and findings.]

These agreed-upon procedures are substantially less in scope than an examination, the objective of which is the expression of an opinion on whether management's assertions are fairly presented. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information of the audit committee, management, and the U.S. Department of Education, and should not be used by those who did not participate in determining the procedures. However, this report is a matter of public record and its distribution is not limited.

[Signature]

[Date]

The practitioner should follow the guidance in paragraphs 24-28 of SSAE No. 3, if conditions exist where the report should be modified.

**ILLUSTRATIVE PRACTITIONER'S COMMENTS ON
PRIOR YEAR'S AUDIT/EXAMINATION RESOLUTION MATTERS
RELATING TO THE FFEL PROGRAM**

The lender [servicer] has not taken corrective action on findings from prior audits/examinations:

Finding No. 1:

In an audit [examination] performed by the [*Identify Entity, for example, ED/OIG or HIJ Audit Firm*] dated [m/d/y] and titled [name of audit/examination], in fifty of 200 loans reviewed, the lender billed the U.S. Department of Education for interest after the loans were sold. The Department was over billed by \$125,000.

Status:

As of [m/d/y], the lender has not made a refund to the U.S. Department of Education or an adjustment to the ED Form 799.

ILLUSTRATIVE

**CORRECTIVE ACTION PLAN
(Prepared by Lender or Servicer Management)**

The Corrective Action Plan (CAP) is to be prepared by the lender or servicer on the lender's or servicer's letterhead, as applicable. The following is a suggested format to assist the lender or servicer in the preparation of the CAP:

Name of Lender or Servicer:
Official Who Prepared Plan:
Phone Number:
Audit Period:
Practitioner/Firm:

a. Comments on Findings and Recommendations

The lender or servicer, as applicable should provide a statement of concurrence or nonconcurrence with each finding and recommendation. If the lender or servicer, as applicable does not agree with a finding, specific information/documentation should be provided by the lender or servicer, as applicable to support its position. If the documentation is voluminous, an appendix may be attached to the submission.

b. Actions Taken or Planned

The lender or servicer, as applicable should detail actions taken or planned to correct deficiencies identified in the audit report. To expedite the resolution process, appropriate documentation must be submitted for actions taken, when requested. For planned actions, lenders or servicers, as applicable must provide projected dates for completion of major tasks. Officials responsible for completing the proposed actions should be identified. If the lender or servicer, as applicable believes a corrective action is not required, a statement describing the reasons should be included.

c. Status of Corrective Actions on Prior Findings

For all audits, program reviews and guaranty agency reviews for the previous two years, the lender or servicer, as applicable must comment on all prior findings and whether corrective action has been completed. The lender or servicer, as applicable should provide a report on the status of corrective actions taken on prior findings that remain open. An update should be included on dates for completion of major tasks and responsible officials for any actions not completed.

DEFINITIONS

LENDER

The term "eligible lender" is defined in section 435(d) of the Higher Education Act of 1965, as amended, as follows:

(d) ELIGIBLE LENDER.--

(1) IN GENERAL.-- . . . , the term "eligible lender" means--

(A) a National or State chartered bank, a mutual savings bank, a savings and loan association, a stock savings bank, or a credit union which--

(I) is subject to examination and supervision by an agency of the United States or of the State in which its principal place of operation is established, and

(ii) does not have as its primary consumer credit function the making or holding of loans made to students under this part unless (I) it is a bank which is wholly owned by a State, or a bank which is subject to examination and supervision by an agency of the United States, makes student loans as a trustee pursuant to an express trust, operated as a lender under this part prior to January 1, 1975, and which meets the requirements of this provision prior to the enactment of the Higher Education Amendments of 1992, or (II) it is a single wholly owned subsidiary of a bank holding company which does not have as its primary consumer credit function the making or holding of loans made to students under this part;

(B) a pension fund as defined in the Employee Retirement Income Security Act;

(C) an insurance company which is subject to examination and supervision by an agency of the United States or a State;

(D) in any State, a single agency of the State or a single nonprofit private agency designated by the State;

(E) an eligible institution which meets the requirements of paragraphs (2) through (5) of this subsection;

(F) for purposes only of purchasing and holding loans made by other lenders under this part, the Student Loan Marketing Association or an agency of any State functioning as a secondary market;

(G) for purposes of making loans under sections 428A(d), 428B(d), 428C, and 439(q), the Student Loan Marketing Association;

(H) for purposes of making loans under section 428(h) and 428(j), a guaranty agency;

(I) a Rural Rehabilitation Corporation, or its successor agency, which has received Federal funds under Public Law 499, Eighty-first Congress [64 Stat.98 (1950)]; and

(J) for purpose of making loans under section 428C, any nonprofit private agency functioning in any State as a secondary market.

SERVICER

The term "third-party servicer" is defined in section 682.200 subpart B - General Provisions of the 34 CFR, as follows:

Third-Party servicer. Any State or private, profit or nonprofit organization or any individual that enters into a contract with a lender or guaranty agency to administer, through either manual or automated processing, any aspect of the lender's or guaranty agency's FFEL Programs required by any statutory provision of or applicable to Title IV of the HEA, any regulatory provision prescribed under that statutory authority, or any applicable special arrangement, agreement, or limitation entered into under the authority of statutes applicable to Title IV of the HEA that governs the FFEL Program, including any applicable function described in the definition of third-party servicer in 34 CFR Section 668; originating, guaranteeing, monitoring, processing, servicing, or collecting loans; claims submission; or billing for interest and special allowance.

NONSUBSIDIZED STAFFORD LOAN

A Stafford loan made prior to October 1, 1992 that does not qualify for interest benefits under 34 CFR 682.301(b) or special allowance payments under 34 CFR 682.302.

UNSUBSIDIZED STAFFORD LOAN

A loan made after October 1, 1992 authorized under section 428H of the Act for borrowers who do not qualify for interest benefits under 34 CFR 682.301(b).

LENDER PAY HISTORY SEARCH INSTRUCTIONS

Lender Pay History Searches, also known as Lender Search Reports, are available from the Department of Education's contractor, E-Systems, Inc. The Lender Pay History Search, or Lender Search Report, is a quarterly report which shows the interest benefits, special allowances and origination fees reported by the lender on the ED Form 799. The report also shows the detailed information reported by the lender on the ED Form 799 regarding interest benefits, special allowances and origination fees. Instructions for obtaining the Lender Pay History Searches were contained in GSL/Perkins Bulletin 93-031, dated 6-25-93, which is reproduced below.

6-25-93

GSL/Perkins Bulletin
(93-031)

NOTICE!

Lender Pay History Searches...

Guaranty Agencies and auditors should submit requests, in writing, for 799 Interest Payment Lender Pay History Searches to the following address:

U. S. Department of Education
Interest Payment Processing
P.O. Box 4134
Greenville, Texas 75403-4134

The request must include the lender's name, six-digit lender ID number and where the Pay History Search is to be mailed. The request should include which year and quarter ending is required. If all years are needed, the request should indicate as such.

If you have any questions, please call (903) 408-4500.

Thanks for your cooperation.

Customer Service Center
E-Systems, Inc. - Greenville Division
1-800-435-7709

HIGH RISK INDICATORS

The following list identifies some high risk indicators and/or conditions that the practitioner may encounter while testing the various compliance areas in the lender or servicer audits. If the practitioner should become aware of illegal acts or indications of such acts, the IPA should follow guidance contained in Section 1 of the *Guide*. (Note: The following list is being provided for information purposes. The practitioner is not required to perform test procedures for each of high risk indicators and/or conditions that follow.)

Conditions which may impact origination fees

1. Origination fees not submitted or transmitted.
2. Sale or transfer of loans within the quarter in which the loan is disbursed. The originating lender did not pay fees.
3. Lack of documentation to verify amounts disbursed or actual dates of disbursements.

Conditions which may impact interest benefits and special allowance

1. Disbursement checks not cashed.
2. Errors in calculating average daily principal balances for interest and special allowance.
3. Borrowers who received loans not eligible for interest benefits are included in the billing.
4. Undisbursed portions of multiple disbursed loans are included in the balances for interest and special allowance computations.
5. Disbursements in excess of loan amounts guaranteed included in billing.
6. Sold loans not removed from the balances for billing interest and special allowance effective on the date sale proceeds were received.
7. Improperly applied prepayments.
8. Billing for interest on a Stafford loan when borrowers cease to be eligible for an authorized deferment.
9. Failure to convert loans to repayment or late conversion to repayment.
10. Stafford loan checks disbursed directly to the borrower instead of the school (exception: borrowers attending foreign schools).
11. Disbursement of funds prior to issuance of a guarantee for the loan.
12. Loans in deferment not included for interest benefits.
13. Conversion of loans to repayment prior to the end of the borrower's grace period or post-deferment grace period (exception: borrower requests in writing that his or her grace period be terminated early).
14. Borrowers in forbearance status included in the billings.
15. Insufficient documentation on file to substantiate deferment eligibility.
16. Inability to substantiate right to interest and special allowance because of a failure to comply with record retention requirements.
17. Use of incorrect interest rates.
18. Double billing. Reporting full balance of loan portfolio in two Categories.
19. Billing for special allowance on denied/rejected claims due to timely filing violations/due diligence violations.
20. Loans in repayment not included in billing.
21. Large number of adjustments to interest and special allowance billings (e.g., over bill one quarterly period and offset against the next quarterly period while earning interest on the funds).
22. Lender's failure to delay billing for interest on first disbursements of Stafford loans.

General

1. Ineffective controls over the integrity of the software program and access to FFEL Program data.
2. Inadequate controls over the validity, accuracy, and completeness of processed data.
3. Inadequate documentation.
4. Inadequate or no written policies and procedures for administering functions related to the FFEL Program.
5. Lack of segregation of duties.
6. Large fluctuations in the portfolio levels of the lender as reported in their interest and special allowance billings.
7. Billing under more than one lender I.D. (i.e., having more than one account and billing for the same portfolio under both I.D.'s).
8. Lender computer system designed to update increases to portfolio balances as they occur, but does not update decreases to portfolio balances in a timely manner; thus, the lender collects more interest and special allowance.
9. Complaints received from the guaranty agency regarding a lender indicate potential fraud.
10. Social security numbers either duplicate or erroneous.
11. Large number of typed loan applications on file with same characteristics.
12. Lender with high number of "never enrolled" students.
13. Key management turnover.
14. High default rates.
15. Poor accounting records.
16. Numerous student complaints filed with Better Business Bureau and State agencies.
17. Presence of attorney at entrance conference and other meetings.
18. Officials/attorneys/consultants restrict access of information to auditors and demand to sit in with audit staff during field work.
19. Key staff are convicted felons.
20. Delinquent audit reports, reports never submitted to ED.
21. OSFA program reviews indicate numerous program violations.

Due Diligence Red Flags

1. Number of telephone contact entries on a specific day exceed the number of telephone calls.
2. Entries for telephone contacts are significantly higher on a specific day.
3. Computerized telephone or autodialer systems experience nonfunctional periods, yet telephone contact entries are documented.

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

NOTIFICATION TO SUBMITTERS OF
CONFIDENTIAL
COMMERCIAL INFORMATION

You have been or may be asked to submit to the Office of Inspector General (OIG), U.S. Department of Education, information in connection with an investigation, audit, inspection or other inquiry pursuant to the Inspector General Act of 1978, as amended, 5 U.S.C. app. 3, sec. 1 et seq. This is to notify you that if you deem any of this information to be “confidential commercial information,” you may take steps to so designate that information to protect its confidentiality if at a future point in time a request is made for disclosure of this information under the Freedom of Information Act (FOIA).

“Confidential commercial information” means records that may contain material exempt from release under Exemption 4 of the FOIA (pertaining to trade secrets and commercial or financial information that is privileged or confidential), because disclosure could reasonably be expected to cause substantial competitive harm.

You may use any reasonable method you believe appropriate and which is acceptable to the OIG to indicate which documents and information you deem to fall into the category of “confidential commercial information.” Please be as specific as possible in segregating the information that you consider to be “confidential commercial information” from any other information you are providing to the OIG. This may be done before such information is provided to the OIG if feasible, but only if it will not delay or interfere with production of the information or delay or interfere with the OIG's investigation, audit, inspection or other inquiry. Otherwise, you may so designate this information within a reasonable period of time after the information is provided to the OIG.

If an FOIA request is received by the OIG for information you have designated as “confidential commercial information,” the OIG is nevertheless required by law to make its own independent determination of whether the FOIA requires disclosure of the information or whether it should be withheld pursuant to Exemption (b)(4) or any other exemption of the FOIA. If the OIG determines that it may be required to disclose pursuant to the FOIA that information you have designated or other information that the OIG has reason to believe could reasonably be expected to cause substantial competitive harm, to the extent permitted by law, we will make a good faith effort to notify you and provide you with a reasonable opportunity to object to such disclosure and to state all grounds upon which you oppose disclosure. We will give careful consideration to all specified grounds for nondisclosure prior to making our final decision.

If we nonetheless believe that disclosure is required, we will provide you with a statement explaining why your objections were not sustained and specifying a disclosure date. To the extent permitted by law, this statement will be provided to you in a reasonable number of days prior to the specified disclosure date. Furthermore, if disclosure of the designated information is denied pursuant to an exemption under the FOIA and an administrative or judicial appeal is taken by the FOIA requester, we will make a good faith effort to notify you promptly.

The procedures outlined in this notice are intended only to improve the internal management of the OIG and are not intended to create any right or benefit, substantive or procedural, enforceable at law by a party against the United States, its agencies, its officers, or any person.