



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

DATE: September 26, 2008

CPA-08-02

SUBJECT: Required Examination-Level Attestation Reports for Lenders Participating in the Federal Family Education Loan (FFEL) Program that Request Special Allowance Payments at the 9.5 Percent Minimum Return Rate for FFEL Program Loans Acquired with Funds Derived from Eligible Tax-Exempt Financing Sources

Dear Certified Public Accountant:

This letter pertains only to audits of lenders participating in the Federal Family Education Loan (FFEL) Program that are requesting special allowance payments (SAP) at a 9.5 percent minimum return rate for FFEL program loans acquired with funds derived from tax-exempt financing sources under 20 U.S.C. § 1087-1(b)(2)(B)(i)(2006), in accordance with U.S. Department of Education (ED) Dear Colleague Letter (DCL) FP-07-01, dated January 23, 2007. (Lenders who are not eligible to request SAP at the 9.5 percent minimum return rate for such loans are not subject to the provisions of this letter.)

In accordance with the comprehensive resolution of issues related to proper billing of SAP at the 9.5 percent minimum return rate described in ED DCL FP-07-01 (<http://ifap.ed.gov/dpcletters/attachments/FP0701.pdf>), dated January 23, 2007, and a letter addressed to individual lenders (a copy of which is attached to the DCL), lenders that seek to receive SAP at the 9.5 percent minimum return rate must submit with any billing the lender's certification that:

- (i) the lender has internal controls in place to monitor and ensure the accuracy of the claim for the 9.5 percent billings, and
- (ii) as part of the lender's regular annual audit, their independent auditor will attest to the effectiveness of these controls and the accuracy of the 9.5 percent billings.

The lender is also required to disclose to their independent auditors, and to their audit committee, all significant deficiencies in the design and operation of the internal controls that could adversely affect the accuracy of the information presented in the SAP billing, as well as any fraud, regardless of materiality, that involves management or any other employee connected to the information contained in the SAP billing.

The purpose of this Dear CPA letter is to provide guidance and procedures for auditors to conduct an examination-level attestation engagement to render an opinion on the accuracy of 9.5 SAP billings and the effectiveness of internal controls relating to them. This Dear CPA letter is applicable for certain lender audits, described above, for lender fiscal years ending in 2008 and later. As indicated below, it also applies to the 2007 quarterly 9.5 percent SAP supplemental billings submitted by the lender to ED in 2008.

To continue to bill loans at the 9.5 percent minimum return rate, lenders were required to submit a special purpose audit to identify loans eligible for SAP billing at the 9.5 percent minimum return rate as of the quarter ended December 31, 2006. Subsequent to ED's acceptance of the lender's special purpose audit, lenders were to submit separate supplemental 9.5 percent SAP billings for quarters ending March 31, 2007, June 30, 2007, September 30, 2007, etc., thereafter. The earliest possible supplemental 9.5 percent SAP billing that could require the lender's certification prescribed by the attachment to DCL FP-07-01 is the billing for the quarter ended March 31, 2007. The attestation reports required by this Dear CPA Letter must be submitted together with the lender's annual audit report for their fiscal year 2008 covering all quarters for which the lender has submitted initial supplemental 9.5 SAP billings to ED (or with the lender's annual audit report for the subsequent fiscal year if such supplemental billings are submitted later than in lender fiscal year 2008).

After the lender has submitted and ED has accepted the initial supplemental 9.5 percent SAP billings, the lender uses the regular SAP billing process to bill for 9.5 percent SAP, submits the required certification for 9.5 percent eligible loans for each quarter billed, and submits the attestation reports required by this Dear CPA letter with the lender's annual audit report for those fiscal years.

Those lenders that are eligible to bill loans at the 9.5 percent minimum return rate for quarters subsequent to December 31, 2006, are entities that are subject to the requirements of OMB Circular A-133. Circular A-133 provides for a financial and compliance audit, conducted in accordance with its requirements. However, §.235 of OMB Circular A-133 allows entities that only administer one Federal program to fulfill the audit requirements of Circular A-133 by submitting a program specific audit conducted in accordance with ED's *Lender Audit Guide*.

Whether the lender procures a complete Circular A-133 financial and compliance audit, or (if allowed under §.235 of OMB Circular A-133) a program specific audit conducted in accordance with the *Lender Audit Guide*, if the lender is eligible to and bills loans at the 9.5 percent minimum return rate, that audit must be supplemented by procedures and reporting in accordance with this Dear CPA Letter. This additional work and reporting is required by the attachment to DCL FP-07-01, and the additional expense for it is the responsibility of the lender. In performing the examination-level attestation engagement required by this Dear CPA Letter, the attestation procedures may be coordinated or integrated with procedures for the *OMB Circular A-133* or *Lender Audit Guide* audits.

Background

Per the attachment to DCL FP-07-01, lenders must submit the following certification with applicable billings, executed and signed by the chief executive officer (CEO) and chief financial officer (CFO):

We, _____, [CEO name] CEO and _____ [CFO name], CFO of _____ [company name] hereby certify that we have reviewed the billing for special allowance payments under the Federal Family Education Loan Program submitted to the Department of Education by _____ [company name] on _____ [date] for the quarter ending _____ [date]. We certify that we have internal controls in place to monitor and ensure the accuracy of the

claim presented in this bill, and that as part of our regular annual audit, our independent auditor will attest to the effectiveness of these controls and the accuracy of the billing. Based on our review, we certify that the billing requests special allowance payment at the 9.5 percent minimum return rate only on loans that are first-generation or second-generation loans obtained from an eligible source, as described in the Department's Dear Colleague Letter [FP-07-01] dated January 23, 2007, and no others. We have disclosed to our independent auditors and to the audit committee¹ all significant deficiencies in the design and operation of the internal controls that could adversely affect the accuracy of the information presented herein, as well as any fraud, whether or not material, that involves management or any other employee connected to the information contained in this bill.

Requirements

This Dear CPA Letter requires an examination-level attestation engagement performed in accordance with *Government Auditing Standards*, attestation standards established by the American Institute of Certified Public Accountants, and the certification required to be submitted under DCL FP-07-01, to express an opinion on the accuracy of billings and the effectiveness of internal control relating to their preparation that must be made in writing to the auditor by lender management and signed by the lender's CEO and CFO (see Attachment 1 for the specific assertions).

Description of Applicable Compliance Requirements

Special Allowance:

ED pays a special allowance to the lender on the average daily outstanding balance of eligible FFEL loans. ED computes the special allowance payable to the lender based upon the average daily balance computed by the lender. The amount of each quarterly special allowance payment will vary according to the type of FFEL program loan, the date the loan was disbursed, the loan period, the loan interest rate, and the loan status. The lender reports in Part III of the *Lender's Interest and Special Allowance Request and Report* (LaRS/799) the average daily principal balance of loans in each category qualifying for the special allowance payment. ED computes the payment due to the lender during processing of the LaRS [See 34 CFR Sections 682.304 through 682.305].

Special Allowance and Tax-Exempt Obligations:

The special allowance rate payable on loans made or purchased from funds derived from tax-exempt obligations depends on the specific source of funds used to acquire the loan, whether specified events occurred after its acquisition, the date the loan was acquired, the rate payable on the loan when it was acquired, and the characteristics of the lender that acquired the loan. [See Section 438 of HEA (20 USC 1087-1); 34 CFR Section 682.302]

¹ If the entity has not established an audit committee, substitute the director(s), trustee(s) or other authority with responsibility for review of the entity's annual financial statements.

Limitations on the 9.5 Percent Minimum Return Rate Loans:

The Higher Education Reconciliation Act of 2005 (HERA) and Taxpayer-Teacher Protection Act of 2004 amended the HEA. As a result of these amendments, the 9.5 percent minimum return rate does not apply to loans that are:

1. Financed by a tax-exempt obligation described in 34 CFR Section 682.302(e)(2)(i) that, after September 30, 2004, has matured or been refunded, retired, or defeased;
2. Refinanced after September 30, 2004, with funds obtained from a source other than funds described in 34 CFR Section 682.302(e)(2)(i) ;
3. Sold or transferred to any other holder after September 30, 2004.
4. Made or purchased on or after February 8, 2006; or
5. Not earning special allowance at the 9.5 percent minimum return rate as of February 8, 2006.

[See Section 438(b)(2)(B)(vi) of HEA (20 USC 1087-1(b)(2)(B)(vi)); 34 CFR Sections 682.302(e)(2), (3) and (4); DCL FP-06-01, dated March 2006].

The HERA provides an exemption for restrictions 4 and 5 (above) to small lenders until December 31, 2010. A “HERA small lender” is a loan holder that on February 8, 2006, and during the quarter for which the special allowance is paid:

- Was a unit of state or local government or a private nonprofit entity;
- Was not owned or controlled by, or under common ownership with, a for-profit entity; and
- Held directly or through any subsidiary, affiliate, or trustee, a total unpaid balance of principal equal to or less than \$100 million on loans for which special allowances were paid under section 438(b)(2)(B) in the most recent quarterly payment prior to September 30, 2005 [See Section 438(b)(2)(B)(vii) of HEA (20 USC 1087-1(b)(2)(B)(vii)); 34 CFR Section 682.302(e)(5); DCL FP-06-01].

As a result, loans made or purchased by a HERA small lender from eligible sources of funds between February 8, 2006 and December 31, 2010 can qualify for the 9.5 percent minimum return rate.

Lender’s Interest and Special Allowance Request and Reports:

Billings for SAP are made by lenders via the *Lender’s Interest and Special Allowance Request and Reports* (LaRS/799) filed using the Lender Reporting Systems. Loans are listed individually on this report. Two character alphabetic SAP category codes are assigned to categories of loans. Per applicable instructions, all loans billed for the 9.5 percent minimum return rate for FFEL program loans acquired with funds derived from eligible tax-exempt financing sources, are identified with codes that have “X” as the first alphabetic character.

Termination of Special Allowance Payments on a Loan:

The lender is required to terminate the SAP on loan balances when a date-specific event described in 34 CFR section 682.302(d) occurs, and the loan is no longer eligible for the payment. These date-specific events are described in detail in 34 CFR Section 682.302(d) and include the following:

- The date a borrower's loan is repaid;
- The date a borrower's loan check is returned uncashed to the lender;
- The date the lender receives payment on a claim for loss on the loan;
- The date the loan ceases to be guaranteed or ceases to be eligible for reinsurance, regardless of whether the lender has filed a claim for loss on the loan with the guarantor;
- The 60th day after the borrower's default on the loan, unless the lender files a claim for loss on the loan with the guarantor together with all the required documentation on or before the 60th day;
- The 120th day after disbursement if the loan check has not been cashed on or before that date or if the loan proceeds disbursed by EFT have not been released from the restricted account maintained by the school on or before that date;
- The 30th day after the date the lender received a returned claim from the guaranty agency due solely to inadequate documentation on a loan submitted by the regulatory deadline for loss on the loan (unless the lender files a claim for loss on the loan with the guarantor, together with the required documentation prior to the 30th day); or
- The date on which the lender determines the loan is legally unenforceable based on receipt of an identity theft report under 34 CFR section 682.208(b)(3).

Minimum Required Procedures and Tests

Obtain Management Assertions

The auditor must obtain the written assertions from management contained in Attachment 1.

In addition to written representations from lender management required under applicable attestation standards, the auditor must also obtain a representation that management has disclosed all known fraud, whether or not material, that involves management or any other employee connected to billings for SAP.

Accuracy of Billings:

For the purpose of rendering an opinion on the accuracy of billings at the 9.5 percent minimum rate of return, the following procedures must be performed by the auditor:

1. For loans included in Part III of the LaRS/799 reports submitted during the audit period for SAP at the 9.5 percent minimum return rate for loans, test that the

lender is reporting such loans by the proper year, quarter, interest rate, and special allowance category. [These loans are loans identified with two character alphabetic SAP category codes with “X” as the first character.]

2. Test that the lender is accurately reporting for the 9.5 percent floor (i.e., minimum SAP) only those loans that—
 - (a) were identified as a result of the special purpose audit conducted under the methodology prescribed in DCL FP-07-06, or
 - (b) if made or acquired by a HERA small lender between December 31, 2006, and December 31, 2010, were made or purchased with funds obtained from repayments, sales, or interest or SAP on loans that were established by the special purpose audit to be first-generation loans, as that term is used in DCL FP 07-01 (for loans made or acquired after December 31, 2006, a lender’s records should indicate the funding source (e.g., 34 CFR section 682.302(c)(3)(i)(A) through (E)) from which these loans derive eligibility for the 9.5 percent minimum rate of return),
 - (c) were not subject to the disqualifying events specified in HEA and 34 CFR sections 682.302(e)(2) and (3), or the date-specific events specified in 34 Section 682.302(d).
3. Test the accuracy of the average daily balance calculations as defined in 34 CFR Section 682.304(d) by recalculating amounts or by reasonableness tests.

Effectiveness of Internal Control over Billings:

The auditor must evaluate the effectiveness of the lender’s internal control and test and evaluate the operating effectiveness of the controls in place to ensure that billings for SAP at the 9.5 percent minimum rate of return are accurate and conform to the compliance requirements listed above.

* * * * *

The procedures and tests described in this Dear CPA letter are minimum requirements. The practitioner should also perform any additional tests or procedures they deem necessary to render the required opinions. These minimum requirements are supplementary to the tests and procedures pertaining to Circular A-133 or (if applicable) Lender Audit Guide audits. Tests and procedures under those audits alone will not suffice to meet the requirements for the attestations required by this Dear CPA letter. However, in performing the attestation engagement required by this Dear CPA letter, these procedures may be coordinated or integrated with procedures for Circular A-133 or Lender Audit Guide audits.

Reporting

An examination level opinion on compliance and an examination level opinion on the effectiveness of internal controls are required. All instances of noncompliance must be reported in a Schedule of Findings. With respect to internal controls, all significant deficiencies or material weaknesses in internal control must be reported.

The following attachments provide illustrative examples of the management assertions and practitioner reports required by this Dear CPA letter. This letter requires that a copy of management's written assertions, addressed to the audit firm, on the lender's letterhead and signed by both the CEO and CFO, must be included in the reporting package. The auditor must retain the original as part of the audit documentation.

Attachment 1 – Lender Management Assertions

Attachment 2 – Examination Level Opinion on Compliance

Attachment 3 – Examination Level Opinion on the Effectiveness of Internal Controls

Findings of noncompliance and significant deficiencies or material weaknesses in internal control should be reported in a schedule of findings and questioned costs that consists solely of findings presented with details comparable to the details required for presenting audit findings in single audits performed in accordance with OMB Circular A-133. Each audit finding must include a reference number to allow for reference during the report resolution process by ED.

As noted above, the report package should be submitted together with the lender's annual audit report.

If any fraud or any other illegal act is detected, the auditor must report it immediately to the ED Office of Inspector General, Investigation Services (OIG/IS), by phone or fax at the numbers shown below, before further extending audit steps and procedures:

Assistant Inspector General for Investigations
U. S. Department of Education
400 Maryland Avenue, SW
Washington, D.C. 20202-1510
Phone: (202) 245-6966
Fax: (202) 245-6990

The auditor must promptly prepare a separate written report as instructed by ED-OIG Investigations Services, and must submit the report to the address provided above, either within 30 days after the fraud or illegal act was discovered or within a time frame agreed to by our Investigations Services and the auditor.

Contact for Questions

Questions about this letter may be directed to Hugh Monaghan, Director, Non-Federal Audits, by e-mail to hugh.monaghan@ed.gov, or by fax to Mr. Monaghan at 215-656-6397.

Sincerely,

/s/

Keith West

Assistant Inspector General for Audit

Lender Management Assertions
[On the Letterhead of the Lender]

TO: [Name of Audit Firm]

We make the following assertions in relation to the *Special Allowance Billing and Payments Attestation Report Required For Lenders Participating in the Federal Family Education Loan Program and Requesting Special Allowance Payments at the 9.5 Percent Minimum Return Rate* submitted to the U.S. Department of Education as required for our organization being paid SAP at the 9.5 percent minimum return rate for FFEL program funds derived from eligible tax-exempt financing sources.

1. Accuracy of Billings

Assertion For Lenders That Are Not Small Lenders As Defined By HERA:

Loans included in Part III of the Lender's Interest and Special Allowance Request and Reports (LaRS/799) submitted by [the Lender] during the year ended [mm/dd/yyyy] for billings for special allowance payments for the [number of] quarter(s) for the period beginning mm/dd/yyyy and ending mm/dd/yyyy at the 9.5 percent minimum return rate were only for loans that are first-generation or second generation loans obtained from an eligible source, as described in the Department's DCL FP-07-01, identified in the special purpose audit and no others. Such billings were (1) eligible for the special allowance payments, (2) accurately reported by the proper year, quarter, interest rate, and special allowance category, and (3) accurately reported the average daily balance.

Assertion For Lenders That Are Small Lenders As Defined By HERA

Loans included in Part III of the Lender's Interest and Special Allowance Request and Reports (LaRS/799) submitted by [the Lender] during the year ended [mm/dd/yyyy] for billings for special allowance payments for the [number of] quarter(s) for the period beginning mm/dd/yyyy and ending mm/dd/yyyy at the 9.5 percent minimum return rate were only for loans that are first-generation or second generation loans obtained from an eligible source, as described in the Department's DCL FP-07-01 and any new loans were originated from the proceeds of the eligible loans identified in the special purpose audit. Such billings were (1) eligible for the special allowance payments and (2) accurately reported by the proper year, quarter, interest rate, and special allowance category.

2. Effectiveness of Internal Control Over Billings

For the year ending [mm/dd/yy],[the Lender] had effective internal control to provide reasonable assurance that, loans billed for special allowance payments at the 9.5 percent minimum return rate were (1) eligible for special allowance at such rate and (2) accurately reported by the proper year, quarter, interest rate, and special allowance category.

Signature of Lender CEO

Signature of Lender CFO

Name of Lender CEO

Name of Lender CFO

Date Signed _____

Date Signed _____

**ILLUSTRATIVE REPORT ON THE EXAMINATION OF
LENDER MANAGEMENT'S COMPLIANCE WITH REQUIREMENTS
FOR LOANS BILLED FOR SPECIAL ALLOWANCE PAYMENTS
AT THE 9.5 PERCENT MINIMUM RETURN RATE**

Independent Accountant's Report

To: [Lender]

We have examined the [Lender's] compliance with requirements that loans billed for special allowance payments at the 9.5 percent minimum rate were (1) eligible for special allowance payments at such rate and (2) accurately reported by the proper year, quarter, interest rate, and special allowance category on LaRS/799 Reports *during the year ended [date] for billings for special allowance payments for the [number of] quarter(s) for the period beginning mm/dd/yyyy and ending [date].*

Management is responsible for [Lender's] compliance with those requirements. Our responsibility is to express an opinion on [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; attestation standards established by the American Institute of Certified Public Accountants; ED Dear Colleague Letter FP-01, dated January 23, 2007; and ED Dear CPA Letter 08-02, dated September 26, 2008 and, accordingly, included examining, on a test basis, evidence about the entity'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 of the Lender's compliance with the specified requirements.

Our examination disclosed noncompliance with [compliance requirement(s)] applicable to [Lender] during the [period] ended [date]. The accompanying *Schedule of Findings and Questioned Costs* sets forth results indicating non-compliance with U.S. Department of Education requirements based on the conduct of these procedures. We considered these instances of noncompliance in forming our opinion. [Note: If noncompliance is not found, the report must be appropriately modified.]

In our opinion [Lender] complied, in all respects, with the aforementioned requirements for the year ended [date]. [Note: If significant deficiencies are found, the report must be appropriately modified.]

This report is intended solely for the information and use of the U.S. Department of Education and the management of [Lender] and is not intended to be and should not be used by anyone other than these specified parties.

[CPA Firm Signature]

[Date]

**ILLUSTRATIVE REPORT ON THE EXAMINATION OF LENDER MANAGEMENT'S
EFFECTIVENESS OF INTERNAL CONTROL OVER COMPLIANCE WITH
REQUIREMENTS FOR LOANS BILLED FOR SPECIAL ALLOWANCE PAYMENTS
AT THE 9.5 PERCENT MINIMUM RETURN RATE**

We have examined the effectiveness of [Lender's] internal control over compliance with requirements for loans billed for special allowance payments at the 9.5 percent minimum return rate that the loans were (1) eligible for special allowance at such rate and (2) accurately reported by the proper year, quarter, interest rate, and special allowance category for the year ended [date]. [Lender's] management is responsible for maintaining effective internal control over compliance with the requirements for loans billed at the 9.5 percent minimum return rate. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

Our examination was made in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, attestation standards established by the American Institute of Certified Public Accountants, U.S. Department of Education (ED) Dear Colleague Letter FP-01, dated January 23, 2007; and ED Dear CPA Letter 08-02, dated September 26, 2008 and, accordingly, included obtaining an understanding of internal control over compliance with requirements for loans billed for special allowance at the 9.5 percent minimum return rate, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over compliance with requirements for loans billed for special allowance payments at the 9.5 percent minimum return rate to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, [Lender] maintained, in all material respects, effective internal control over compliance with requirements that loans billed for special allowance payments at the 9.5 percent minimum return rate were (1) eligible for special allowance at such rate and (2) accurately reported by the proper year, quarter, interest rate, and special allowance category. [Note: If significant deficiencies are found, the report must be appropriately modified.]

This report is intended solely for the information and use of the U.S. Department of Education and the management of [Lender] and is not intended to be and should not be used by anyone other than these specified parties.

[CPA Firm Signature]

[Date]