

OFFICE OF INSPECTOR GENERAL'S MANAGEMENT CHALLENGES FOR FISCAL YEAR 2010

The Office of Inspector General (OIG) works to promote efficiency, effectiveness and integrity in the programs and operations of the U.S. Department of Education (Department). Through our audits, inspections, investigations and other reviews, we continue to identify areas of concern within the Department's programs and operations and recommend actions the Department should take to address these weaknesses.

The *Reports Consolidation Act of 2000* requires OIG annually to identify and summarize the top management challenges facing the Department and provide information on the Department's progress in addressing those challenges. In recent years, we have focused our Management Challenges reports on six operational areas that our work identified as most vulnerable to waste, fraud and abuse: (1) student financial assistance programs; (2) information technology (IT) security and management; (3) grantee monitoring and oversight; (4) grant and contract awards, performance and monitoring; (5) data reliability; and (6) human resources. While our previous Management Challenges reports have noted some progress by the Department in addressing these challenges, with passage of the *American Recovery and Reinvestment Act of 2009 (Recovery Act)* and the *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)*, there is an immediate need for the Department to increase its efforts to ensure that Federal education programs are operating effectively, efficiently and as required by statute. It is with that goal in mind that we focus this report on three overall challenges that impact virtually every operational aspect of the Department: (1) the *Recovery Act*; (2) student financial assistance programs/*ECASLA*; and (3) information security and management.

The Department has voiced its commitment to tackling these challenges and addressing the underlying problem of internal controls. "Internal controls" are plans, methods and procedures an entity employs to provide reasonable assurance that it meets its goals and achieves its objectives while minimizing operational problems and risks. By establishing effective internal controls, the Department can be an effective steward of the billions of taxpayer dollars supporting its programs and operations. America's students and taxpayers deserve nothing less.

Challenge: Implementing the *Recovery Act*

The *Recovery Act* was signed into law on February 17, 2009, and includes approximately \$98.2 billion in new funding for federal education programs and operations. This includes funding for programs within the *Elementary and Secondary Education Act of 1965, as amended (ESEA)*; the *Higher Education Act of 1965, as amended (HEA)*; the *Individuals with Disabilities Education Act of 2004, as amended*; and the *Rehabilitation Act of 1973*. With 55 state and territorial educational agencies, more than 16,000 school districts and thousands of schools, colleges and universities potentially eligible to receive these funds, the Department faces a formidable challenge in ensuring that *Recovery Act* funds reach the intended recipients and achieve the desired results. To do so, the Department must: (1) provide effective oversight and monitoring of its grantees and subrecipients; (2) ensure that the information reported to the Department and by the Department is accurate and reliable; and (3) make certain it has knowledgeable staff on board to successfully carry out and manage its programs and operations. While our specific *Recovery Act* work is underway,

previous OIG audits, inspections and investigations have uncovered problems in these three areas, making each a significant challenge for the Department.

Grantee and Subrecipient Oversight and Monitoring

Ineffective monitoring and oversight can have a significant impact on a grantee's ability to meet statutory requirements and ensure critical education funds reach the intended recipients. Recent OIG audits, inspections and investigations have uncovered problems with program control and oversight of a number of grantees, almost all of which are eligible to receive *Recovery Act* funds. Further complicating this issue is the requirement that grantees receiving *Recovery Act* funds closely monitor subrecipients' use of and account for the funds. Our previous audit and investigation work identified a number of weaknesses in grantee oversight and monitoring of its subrecipients. For example, some state educational agencies' (SEA) subrecipient monitoring efforts lacked a fiscal oversight component, while other SEAs were found to conduct on-site program monitoring of subrecipients infrequently. Other grantees were found to rely too heavily on local educational agency single audits, which often times are too late for early detection of inappropriate use of funds. In addition, preliminary *Recovery Act* work has shown that some grantees are relying on existing monitoring procedures that do not appear adequate to ensure their subrecipients use of and accounting for *Recovery Act* funds appropriately, and do not cover new program funding, including dollars from the *Recovery Act's* State Fiscal Stabilization Fund. These factors make it a challenge for the Department to ensure that adequate and timely monitoring of *Recovery Act* funds is taking place at both the SEA and subrecipient levels.

The Department's Progress. *The Department has expressed its commitment to improving oversight of its grantees and subrecipients. As an example, the Department has been working closely with the Michigan Department of Education and Detroit Public Schools to aggressively address significant financial and performance problems which left the school system on the verge of collapse. The Department's plan includes provisions for a structurally balanced budget, accountability and systemic controls and deficit elimination. With regard to the Recovery Act, the Department has issued a number of policy guidance documents and fact sheets to assist grantees in implementing Recovery Act programs. It is also developing a technical assistance plan and training curricula for grantees that will include administrative requirements for implementation of federal grants and will convey the importance of complying with those requirements. The Department also intends to conduct outreach efforts, such as conferences, workshops and Webinars, to provide additional technical assistance to Recovery Act grantees.*

Data Reliability

The Department, its grantees and subrecipients must have controls in place and effectively operate to ensure that accurate, reliable data is reported. This is particularly important with regard to *Recovery Act* funds, as recipients must submit regular reports detailing the projects and activities funded with those dollars. They are also required to submit quarterly reports, which include new data elements that must be submitted within 10 days of the close of each fiscal quarter. Our preliminary *Recovery Act* work has determined that some SEAs are planning to use existing data systems to collect, compile and report *Recovery Act* data, but had not yet modified their systems to reflect new reporting requirements. Also, some SEAs expressed concern that they had not received adequate guidance, or that their

states might not have enough staff and funding resources to meet all of the new reporting requirements and timelines. In addition, the *Recovery Act* requires that all fund recipients register in the Central Contractor Registration database, which means the Department must ensure that all of these recipients are registered in time to meet reporting requirements. As previous OIG work has identified issues of noncompliance with data collection and reporting requirements, it will be a challenge for the Department to ensure that data received from *Recovery Act* fund recipients is accurate, reliable and complete.

The Department's Progress. *The Department has collected data and has developed a risk-assessment model for technical assistance that will allow its staff to provide more guidance to states and other grantees that are at increased risk for problems. Department staff has also been using conference calls with states to provide targeted technical assistance to meet each state's specific needs. The Department established a Metrics and Monitoring Team that is charged with ensuring transparency, accountability and oversight of Recovery Act dollars. The team meets weekly to coordinate oversight efforts and develop new reports that are required for posting on the Recovery.gov Web site.*

Human Resources

Like most federal agencies, the Department will see a significant percentage of its workforce eligible for retirement in 2010. Compounding the situation is the immediate demand for staff to address the requirements of the *Recovery Act*. Prior OIG work in the area of grants monitoring has shown that staff handled a large number of grants and were not able to closely monitor all necessary activities. Human resources is a challenge that the Department must immediately address, as current staff will be further stretched to monitor the unprecedented levels of new funding available to state and local governments and other entities under the *Recovery Act*.

The Department's Progress. *The Department has devoted significant resources to implement requirements related to the Recovery Act. Teams have been formed to issue guidance and provide technical assistance and outreach on various topics to ensure Recovery Act fund recipients are aware of their responsibilities, all at a time when a number of critical positions have not yet been filled due to the change in administration. While efforts to date have been significant, Department staff may not be able to maintain the current pace without additional resources as its Recovery Act efforts move from implementation to monitoring.*

Challenge: Student Financial Assistance Programs/ECASLA

The federal student financial assistance programs involve more than 6,200 postsecondary institutions, more than 2,900 lenders, 35 guaranty agencies and many third party servicers. In 1998 and in response to the growing complexity, increased demand and the likelihood for waste, fraud and abuse associated with the student financial assistance programs, Congress established a Performance Based Organization (PBO) in the Department to manage and administer the student financial assistance programs authorized under Title IV of the *HEA*. In the decade since becoming the PBO, the Federal Student Aid (FSA) office's responsibilities have increased as the programs have grown substantially. In 2009, FSA disbursed \$18.4 billion in Pell Grants averaging approximately \$2,973 to 6.2 million students. In fulfilling its program responsibilities, FSA directly manages or oversees almost \$622 billion in outstanding loans, representing over 111 million student loans to more than

32 million borrowers. Further, with the significant disruptions in the credit markets, in early 2008, lenders in the Federal Family Education Loan (FFEL) Program expressed concerns that there would be insufficient private capital to fund FFEL loans to meet the demands of Stafford and PLUS loan borrowers. To address these concerns, Congress passed the *ECASLA*, which provided the Department with the authority to purchase or enter into forward commitments to purchase student loans from lenders to ensure that loans are available for all students. Colleges and universities also expanded participation in the William D. Ford Federal Direct Loan (Direct Loan) program due to uncertainty over FFEL availability. Prior to 2008, the Direct Loan program has accounted for about 20 percent of new student loan volume. However, the Direct Loan program's new loan volume is expected to increase to about 60 percent for the 2009–2010 academic year, and the administration has proposed a transition to 100 percent direct lending for the 2010–2011 academic year.

In order to fulfill all of its responsibilities as a PBO, as well as sufficiently administer the Title IV and *ECASLA* programs, FSA must: (1) have a system of effective internal controls in place; (2) provide sufficient oversight and monitoring of Title IV program participants; (3) provide effective contract monitoring to ensure that it receives quality goods and services from its vendors; and (4) make certain it has knowledgeable staff on board to successfully carry out and manage its programs and operations. Our specific *ECASLA*-related work is ongoing, but previous OIG efforts found that FSA does not have sufficient capacity or resources necessary to provide effective oversight for all aspects of the student financial assistance programs, leaving programs vulnerable to waste, fraud and abuse.

Internal Controls

Establishing effective internal controls has long been a challenge for Federal Student Aid, and three recent OIG reports show that problems in this area continue. First, an OIG audit that sought to determine whether FSA was meeting its responsibilities as a PBO in three key areas found that FSA had not done so, and as a result, the Congress, the Secretary and the public have not been clearly informed about FSA's progress toward achieving its purposes as a PBO or whether it has reduced its program costs since becoming a PBO more than a decade ago. Second, an OIG review of FSA's oversight of GAs, lenders and loan servicers found that improvements were needed in each of the five areas of internal control: control environment, risk assessment, information and communications, control activities and monitoring. This was a follow-up report to a 2006 audit that contained similar findings, many of which had not been fully addressed. Third, OIG performed an inspection of FSA's Enterprise Risk Management Group, an effort initiated by FSA in 2006 with the goal of developing risk assessments and providing a more strategic view of future risks. The OIG inspection found that FSA had not fully implemented enterprise risk management, leaving its programs vulnerable to waste, fraud and abuse. Based on these findings, the passage of *ECASLA* and the expansion of the Direct Loan Program, it is vital that FSA leaders take on this challenge and implement effective internal controls.

The Department's Progress. *FSA has agreed to improve the management of its programs. It is restructuring and improving its chief compliance officer organization for the oversight of the FFEL Program. FSA is also in the process of implementing the authorities provided by ECASLA for the Loan Participation/Purchase programs, and establishing internal controls to provide for accountability and monitoring and ensure compliance with the requirements of the law.*

Participant Oversight and Monitoring

FSA has always faced a significant challenge in conducting effective monitoring and oversight of the thousands of entities participating in its programs. Recent OIG efforts have revealed cases of lenders violating the inducement provision of the *HEA* or overbilling the Department for loans under the 9.5 percent special allowance payment (SAP); guaranty agencies that did not comply with *HEA* requirements regarding the Federal Fund and Operating Fund; and schools that did not comply with Title IV requirements for institutional and program eligibility, the 90-10 rule and other criteria. With *ECASLA*, the need for FSA to conduct effective oversight and monitoring has only intensified. FSA estimated that about 75 percent of FFEL new loan volume for the 2008–2009 academic year would be financed through *ECASLA* programs, and significant increases in student loan volume were expected in the Direct Loan program. FSA must make improvements in oversight and monitoring to ensure that the entities participating in the federal student financial assistance programs are adhering to statutory, regulatory and program requirements. Still another challenge facing both FSA and schools participating in the Title IV programs involves identity verification of students receiving federal student financial assistance. FSA does not yet require schools to verify the identity of students receiving aid, which leaves the programs vulnerable to identity theft and other fraudulent schemes, particularly distance education programs.

The Department's Progress. *FSA has agreed to develop and implement consistent oversight procedures of the entities participating in the federal student financial assistance programs. As an example, in response to our audit work on 9.5 percent SAP, the Department has required all lenders wishing to bill at the 9.5 percent SAP rate to undergo audits to determine the eligibility of loans for payments at the 9.5 percent rate. With ECASLA, FSA has conducted outreach efforts to inform industry participants of ECASLA-related programs and operations, and developed testing and certification requirements for industry participants with the advice of OIG. Additionally, FSA has executed Lender of Last Resort Agreements with 30 guaranty agencies. To increase the capacity of the Direct Loan Program, FSA has expanded the capacity of the Common Origination and Disbursement system used to originate Direct Loans. To handle the increased need for servicing Direct Loans and loans purchased under the ECASLA-related programs, FSA contracted with four additional entities to service loans. In addition, as part of its corrective action to the recommendations made in our 2007 inspection report on guaranty agency compliance with the establishment of a Federal Fund and Operating Fund at each agency, FSA contracted for program reviews at 22 guaranty agencies. FSA hired contractors to carry out these efforts. These program reviews identified more than \$33 million in potential recoveries to the Federal Fund. Finally, FSA is aware of the issues involving identity verification of students receiving federal student financial assistance and may discuss the issue at its next negotiated rulemaking session.*

Contract Awards, Monitoring and Performance

In 2005, the Secretary of Education delegated authority to the Chief Operating Officer in FSA to procure property and services in the performance of functions managed by FSA as a PBO. Since that time, more than 50 percent of the contracts entered into and paid by the Department are done so by and through FSA. A 2007 audit by OIG found that FSA's contract monitoring process did not always ensure contractors adhered to contract requirements and FSA received the products and services intended. We found that FSA

staff did not always ensure appropriate review and approval of invoices, appropriately communicate acceptance/rejection of deliverables, issue modifications for contract changes and appropriately issue or sign necessary appointment letters. This occurred because of resource limitations and because FSA staff was not always familiar with applicable policies and procedures. FSA must expand its oversight and monitoring to new contractors, such as the four new contractors hired to service loans.

The Department's Progress. In 2008 FSA hired consultants to review its acquisition processes and make recommendations for improvement. In addition, FSA revised its Contracting Officer's Representative Training Program to incorporate more stringent certification, training and recordkeeping requirements.

Human Resources

Due to the complexities of the student financial assistance programs, FSA personnel must have the necessary skills and training for effective program monitoring and oversight. During the course of our 2007 inspection report on guaranty agency compliance with the establishment of the Federal and the Operating Funds, Department officials acknowledged that FSA did not have sufficient staff with the qualifications and knowledge needed to monitor guaranty agencies, lenders and other participants. Further, our 2009 audit of FSA's oversight of guaranty agencies, lenders and loan servicers noted that staff resources were not sufficient to adequately provide oversight of those participants, and core competencies had not been developed to ensure proper qualifications for staff conducting program reviews. We also found that FSA staff did not complete adequate training related to their duties. FSA must take the steps necessary to ensure it has knowledgeable staff so it has the capacity to successfully carry out the student financial assistance programs.

The Department's Progress. To address the human resource weaknesses identified in recent OIG audit and inspection reports, FSA has contracted for services, including program reviews. In addition, FSA agreed with OIG recommendations that it ensure that its staff have the requisite knowledge to sufficiently evaluate programs; that it dedicate sufficient staff resources to provide oversight of the FFEL program; and that it develop core competencies and implement mandatory training for responsible staff.

Challenge: Information Security and Management

The *Federal Information Security Management Act (FISMA)* requires each federal agency to develop, document and implement an agencywide program to provide information security and develop a comprehensive framework to protect the government's information, operations and assets. To ensure the adequacy and effectiveness of information security controls, Igs conduct annual independent evaluations of the agencies' information security programs and report the results to the Office of Management and Budget. OIG work conducted since 2004 has revealed numerous system security internal control weaknesses, all of which increase the risk for inappropriate disclosure or unauthorized use of sensitive and personally identifiable information (PII). The Department's challenges in the area of IT security and management involve the *Recovery Act*, oversight and monitoring of its multimillion-dollar IT contracts; addressing cybersecurity threats; and administering its IT capital investment portfolio. It is vital that the Department addresses these challenges to ensure that its IT and information security projects are appropriately managed so they meet their technical and functional goals on time and on budget.

Recovery Act Funds

Through the *Recovery Act*, an additional \$98.2 billion will flow through the Department's systems. These systems must simultaneously administer and process transactions for the *Recovery Act* as well as existing programs. As a result, it is essential that the Department implement and maintain appropriate systems security controls over IT assets used to administer *Recovery Act* funds.

The Department's Progress. *The Department has agreed to improve its managerial, operational and technical security controls to adequately protect its data. While we are currently conducting work related to the Recovery Act, previous FISMA-related reports identified critical risks and vulnerabilities in the Department's systems. Our findings have provided management with key recommendations for tightening of security awareness and incident handling, ensuring adequate maintenance of the Department's systems and damage assessment.*

Contract Awards, Monitoring and Performance

In 2007, the Department awarded a 10-year, nearly \$500 million contract to a single vendor to acquire IT network services and improve all services provided to the Department customers and to lower costs to the Department through IT integration. While OIG is currently reviewing this contract, previous OIG work revealed that improvement was needed in the Department's IT contract management. A 2007 OIG audit of the previous IT network services contract revealed a number of weaknesses, including that the Department did not provide effective performance incentives or disincentives to allow for timely enforcement of an acceptable level of performance, and that contract modifications were not fully evaluated to consider whether a reduction in cost was appropriate for the reduced level of effort required by the contractor to meet acceptable levels of performance. We also found that the Department's controls did not ensure the contractor provided the quality and services required by the contract. As a result, the Department paid for a quality or level of services it did not receive.

The Department's Progress. *The Department agreed to take action on a number of the recommendations made in our 2007 IT audit, which included: ensuring that future performance-based contracts include appropriate incentives and disincentives to motivate contractor performance; providing a correlation between performance and payments to the contractor; and assuring minimum quality levels for all critical services. It also agreed to require contractors to provide the Department with alternatives to address unsatisfactory contractor performance and allow for execution of option years for achievement of satisfactory performance levels if such continuation is in the best interest of the Department. The Department also agreed to develop and implement an internal contract-deliverables tracking system.*

Ongoing Cybersecurity Threats

The nature of the ongoing cybersecurity threat has shifted. Historically the threat was from the outside "hacker" conducting attacks to compromise systems for bragging rights or use of resources. Now the primary threat is from criminal elements, including organized crime and even terrorist organizations. The threat vector most commonly used by these parties is to influence regular users to go to malicious Web sites or open malicious files and

compromise the computer. The consequences of security incidents from these threats can include disclosure of sensitive information and PII, lost staff hours, damaged or altered records, extensive financial damage and the loss of the public's confidence in its government.

The Department's Progress. *The Department is making progress in establishing policies to protect sensitive information and PII and has implemented enhanced security monitoring to protect users' computers within the Department's network. More needs to be done, however, to reduce the threats posed by external business partners who have remote access to Department systems. For example, while the Department is working hard to implement two-factor authentication within the Department's network, little progress has been made on strengthening remote access from business partners.*

IT Capital Investment Portfolio

The Department's IT capital investment portfolio for FY 2009 was \$656.9 million and for FY 2010 is expected to be \$920.8 million, with many resource-intensive projects pending. It is critical that the Department have a sound IT investment management control process that can ensure that technology investments are appropriately evaluated, selected, justified and supported. This oversight and monitoring process must address IT investments as an agency-wide portfolio.

The Department's Progress. *The Department has recently strengthened the IT capital investment program by expanding membership of two of its review groups, the Investment Review Board and the Planning and Investment Review Working Group. The Department continues its efforts to strengthen individual business cases and to map proposed investments to an agencywide enterprise architecture strategy.*