
Review of Federal Student Aid's Monitoring of Guaranty Agency Compliance with the Establishment of the Federal Fund and the Operating Fund

FINAL INSPECTION REPORT



**ED-OIG/I13H0001
September 2007**

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U.S. Department of Education
Office of Inspector General
Washington, DC

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Evaluation and Inspection Services

September 7, 2007

Memorandum

TO: Lawrence Warder
Acting Chief Operating Officer
Federal Student Aid

FROM: George A. Rippey /s/
Acting Assistant Inspector General for Audit

SUBJECT: Final Inspection Report
Review of Federal Student Aid's Monitoring of Guaranty Agency Compliance
with the Establishment of the Federal Fund and the Operating Fund
Control Number ED-OIG/I13H0001

Attached is the final inspection report that covers the results of our review of Federal Student Aid's Monitoring of Guaranty Agency Compliance with the Establishment of the Federal Fund and Operating Fund. We received your comments to our draft report on August 14, 2007. A copy of your responses to the draft report in their entirety is attached.

We also received your draft corrective action plan (CAP) with your response. Corrective actions proposed (resolution phase) and implemented (closure phase) will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS).

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

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

We appreciate the cooperation given us during this review. If you or your staff have any questions, please contact W. Christian Vierling, Director, Evaluation and Inspection Services at 202-245-6964.

Enclosure

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EXECUTIVE SUMMARY

This report provides the results of our *Review of Federal Student Aid's Monitoring of Guaranty Agency Compliance with the Establishment of the Federal Fund and the Operating Fund*. Our inspection objective was to determine the adequacy of Federal Student Aid's (FSA's) support for its conclusions concerning the establishment of the Federal Fund and the Operating Fund at the 27 guaranty agencies not audited by the Office of Inspector General (OIG).¹

FSA provided us with all of the documentation it used to draw its conclusion that the Federal and Operating Funds were established in compliance with the Higher Education Act of 1965, as amended by the Higher Education Amendments of 1998 (enacted on October 7, 1998) (HEA) and regulations. We found that the work performed by FSA on the 27 guaranty agencies not audited by OIG provides no assurance that the Federal and Operating Funds were established in compliance with the HEA. Specifically, we identified the following issues:

- A. FSA's documentation indicates that the liquid assets of the Federal Fund were established incorrectly at 16 of the 27 guaranty agencies.² Furthermore, FSA's documentation for the other 11 guaranty agencies does not contain enough information to draw conclusions on the establishment of the Federal and Operating Funds.
- B. The work originally performed by Financial Partner Services (FPS)³ and reviewed by the Corrective Action Plan (CAP) Verification Leads⁴ was not sufficient to assess usage fees for non-liquid assets, as required by the regulations, at 22 of the 27 guaranty agencies. For 20 of the 27 guaranty agencies there was no evidence of review for questionable purchases.
- C. FPS management assigned CAP Verification Leads to assess the sufficiency of their own prior FPS program reviews.
- D. FPS' actions show a lack of consideration for the monitoring standard from the Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government*.

¹ The 2003 OIG Audit, *Oversight Issues Related to Guaranty Agencies' Administration of the Federal Family Education Loan Program Federal and Operating Funds*, presented conclusions based on the issues identified in OIG audits at nine guaranty agencies.

² Our conclusions are based solely on the documentation used by FSA to draw its conclusions regarding the establishment of the Federal and Operating Funds. We did not perform inspections or audits of the 27 guaranty agencies.

³ During the time period covered by this inspection, FPS was the division within FSA that was responsible for the oversight of the guaranty agencies. The Financial Partner Eligibility and Oversight division is currently responsible for the oversight of the guaranty agencies.

⁴ In 2005, FPS Guarantor and Lender Review Specialists (CAP Verification Leads) examined review reports, work papers, and documentation to determine whether the Federal and Operating Funds were sufficiently reviewed and addressed during a prior FPS program review.

We recommend that the Chief Operating Officer for FSA –

1. Perform onsite program reviews to examine supporting records for the establishment of the Federal and Operating Funds at the 27 guaranty agencies not previously reviewed by OIG to ensure that the funds were established in accordance with the HEA, as amended, including the requirement for the use of the cash basis of accounting.
2. Ensure that the program reviewers have the requisite accounting knowledge to sufficiently evaluate the establishment of the Federal and Operating Funds.
3. Ensure that adequate resources are devoted to perform the program reviews, *e.g.*, adequate staff days and travel funds.
4. In performing the program reviews, identify, quantify, and report as erroneous payments any lost revenue to the Federal Fund that resulted from the incorrect assessment of usage fees.
5. In performing the program reviews, identify any improper purchases made by guaranty agencies prior to the establishment of the Federal and Operating Funds, and require full repayment to the Federal Fund.

On July 3, 2007, we provided FSA with a copy of our draft report for comment. FSA provided its comments to the report on August 14, 2007. FSA did not disagree with our inspection results and concurred with all of our recommendations. We included our response to FSA's comments in the Report Section titled FSA Comments. A copy of FSA's comments, in their entirety, is attached to this report.

BACKGROUND

The Higher Education Act of 1965, as amended by the Higher Education Amendments of 1998 (enacted on October 7, 1998) (HEA) required each guaranty agency to establish a Federal Fund and an Operating Fund within 60 days of enactment. The final date for establishing these funds was December 6, 1998. All funds, securities, and other liquid assets of the guaranty agency's Federal Family Education Loan (FFEL) program reserve fund (Reserve Fund) were to be transferred to the Federal Fund, which is the property of the Federal Government.

The HEA required a guaranty agency to deposit revenue from specified sources into the Federal Fund and also specified the limited uses of Federal Fund assets. The HEA also specified deposits into the Operating Fund and the general uses of Operating Fund assets. Except for funds transferred from the Federal Fund, the Operating Fund is the property of the guaranty agency. If the Operating Fund contains transferred funds owed to the Federal Fund, those funds may be used only as permitted by the regulations, which prohibit certain uses of the funds. The Department issued interim guidance in January and November 1999, and published regulations relating to the Federal and Operating Funds on October 29, 1999.

Federal Student Aid's (FSA's) Financial Partners Services (FPS) conducted technical assistance site visits at guaranty agencies in fiscal year (FY) 2000 and program reviews during FYs 2001 and 2002. The technical assistance site visits provided assistance to the guaranty agencies in establishing and maintaining the Federal and Operating Funds. The program reviews then tested the guaranty agencies' compliance with the HEA and regulations in these areas.

In July 2003, the Office of Inspector General (OIG) issued an audit report on the results of nine OIG audits of guaranty agencies' compliance with the HEA requirements for the establishment and operation of the Federal and Operating Funds held by the guaranty agencies.⁵ The audit showed that of the nine guaranty agencies reviewed, FPS had completed program reviews at eight; however, FPS had not identified any of the significant findings reported by OIG. The audit concluded that the Department needed to improve its monitoring of guaranty agencies and recommended that the Department review the 27 guaranty agencies OIG did not audit to test their establishment of the Federal and Operating Funds.

In the Corrective Action Plan (CAP) agreed to by OIG and FSA,⁶ FSA planned to review 18 of the 27 guaranty agencies during FY 2004 and planned to review the remaining 9 agencies during the following review cycle. Rather than following the CAP, in 2005 FSA assigned staff to serve as CAP Verification Leads⁷ and instructed them to "[e]xamine review reports, work papers, and

⁵ For the purposes of this report, the 2003 OIG Audit, *Oversight Issues Related to Guaranty Agencies Administration of the Federal Family Education Loan Program Federal and Operating Funds* (ED-OIG/A05-D0010, July 2003) will be referred to as the 2003 OIG Audit.

⁶ OIG agreement with a CAP indicates that OIG agrees that the proposed CAP, if implemented, should address or adequately respond to audit or inspection findings and recommendations.

⁷ The Regional FPS Directors assigned Guarantor and Lender Review Specialists as the CAP Verification Leads. During interviews we were informed that Regional Directors usually assigned the liaison for the guaranty agency or the team lead for the Financial Review as the CAP Verification Lead for that specific guaranty agency.

documentation to determine whether the 7 areas [referred to as CAP Elements⁸] identified on the CAP Verification Cover Sheet have been sufficiently reviewed and addressed during a prior FP[S] Funds, Full-Scope or other Program Review.”⁹ The CAP Verification Leads filled out a separate sheet (CAP Element Sheet) for each CAP Element describing the documents reviewed and the work performed to determine whether the CAP Element had been addressed during a prior FPS program review. For CAP Element 1 (CAP 1): “Establishment of the Federal Fund,” FSA concluded that the Federal and Operating Funds at all 27 guaranty agencies had been sufficiently examined during a prior FPS program review and that no additional work was required.

⁸ The seven CAP Elements were: 1) Establishment of the Federal Fund; 2) Deposit of Supplemental Preclaim Assistance into the Federal Fund After 10/1/98; 3) Use of Federal Funds; 4) Cost Allocation Plans; 5) Conflict of Interest - Pre & Post Default Collections; 6) Conflict of Interest - Agency Board Members, Officials, and Employees; and 7) Standards of Conduct.

⁹ For the purposes of this report, FPS program reviews include the following: 1) Technical Assistance Review; 2) Financial or Funds Review; and 3) Comprehensive or Full-Scope Program Review.

INSPECTION RESULTS

FINDING – The Work Performed by FSA on the 27 Guaranty Agencies Not Audited by OIG Provides No Assurance That the Federal and Operating Funds Were Established in Compliance with the HEA

Our inspection objective was to determine the adequacy of FSA’s support for its conclusions concerning the establishment of the Federal Fund and the Operating Fund at the 27 guaranty agencies not audited by OIG. FSA provided us with all of the documentation used to draw its conclusion that the Federal and Operating Funds were established in compliance with the HEA and regulations. During our inspection, we found that the work performed by FSA on those 27 guaranty agencies provides no assurance that the Federal and Operating Funds were established in compliance with the HEA. Specifically, we identified the following issues:

- A. The CAP documentation indicates that the liquid assets of the Federal Fund were established incorrectly at 16 of the 27 guaranty agencies.¹⁰ Furthermore, the CAP documentation for the other 11 guaranty agencies does not contain enough information to draw conclusions on the establishment of the Federal and Operating Funds.
- B. The work originally performed by FPS and reviewed by the CAP Verification Leads was not sufficient to assess usage fees for non-liquid assets as required by the regulations at 22 of the 27 guaranty agencies. For 20 of the 27 guaranty agencies there was no evidence of review for questionable purchases.
- C. FPS management assigned CAP Verification Leads to assess the sufficiency of their own prior FPS program reviews.
- D. FPS’ actions show a lack of consideration for the monitoring standard from the Government Accountability Office’s (GAO’s) *Standards for Internal Control in the Federal Government*.

ISSUE A – The CAP Documentation Indicates That the Liquid Assets of the Federal Fund Were Established Incorrectly at 16 of the 27 Guaranty Agencies. Furthermore, the CAP Documentation for the Other 11 Guaranty Agencies Does Not Contain Enough Information to Draw Conclusions on the Establishment of the Federal and Operating Funds.

The documentation provided to us by FPS regarding CAP 1: “Establishment of the Federal Fund” does not support the CAP Verification Leads’ conclusions that the liquid assets of the Federal Fund were established in compliance with the HEA.

¹⁰ Our conclusions are based solely on the documentation used by FPS to draw its conclusions regarding the establishment of the Federal and Operating Funds. We did not perform inspections or audits of the 27 guaranty agencies.

The CAP Verification Leads confirmed that they only determined whether the establishment of the Federal and Operating Funds was addressed during prior FPS program reviews, not whether the prior work was sufficient to determine compliance with the requirements for establishing the Federal and Operating Funds. The 2003 OIG Audit determined, however, that the FPS program reviews at eight of the nine audited guaranty agencies were insufficient to identify problems with the establishment of the Federal and Operating Funds.

CAP Documentation Indicates That the Liquid Assets of the Federal Fund Were Established Incorrectly.

The regulations at 34 CFR § 682.410(a)(3)¹¹ require that deposits and payments to the Reserve Fund be charged using the cash basis of accounting prior to October 1, 1998.¹² The HEA provides that the opening balance of the Federal Fund was to consist of “all funds, securities and other liquid assets” from the Reserve Fund. Accruals as of September 30, 1998, should not exist because the Reserve Fund was based on cash accounting.¹³ The guaranty agency CAP files, however, indicate that 16 of the 27 guaranty agencies used accruals for accounting purposes in establishing the liquid assets of the Federal and Operating Funds.

A previous OIG audit, *California Student Aid Commission’s [CSAC’s] Administration of the Federal Family Education Loan Program Federal and Operating Funds*, found that “CSAC reduced the [Reserve Fund] balance by \$7.4 million for EDFUND and other FFEL-related administrative expenses that were accrued, but not yet paid from reserve funds.” For the 16 guaranty agencies that used accruals, we found no evidence that all accruals were removed to determine the cash balance of the Federal Fund on October 1, 1998, and, where accrual accounting was used, that the detail of the accruals was examined to determine the appropriateness of assignment to the Federal Fund. Without examining the detail of what the guaranty agencies were proposing as future uses of Federal Fund resources, it would be inappropriate for FSA to accept the beginning balance on an accrual basis.

FSA’s CAP files clearly indicate that Guaranty Agency A¹⁴ incorrectly used accrual accounting to establish the Federal Fund. Despite the fact that FPS did not test accounts during the Technical Assistance visit, the CAP Verification Lead explicitly used the Technical Assistance Trip Report for this guaranty agency to support the conclusion that the Federal and Operating

¹¹ All regulatory citations are to the July 1, 2000 volume.

¹² The regulation at 34 CFR § 682.410(a)(3) establishes that the Reserve Fund is accounted for using the cash basis of accounting: “*Accounting basis.* Except as approved by the Secretary, a guaranty agency . . . shall deduct the items listed in paragraph (a)(2) of this section from its [R]eserve [F]und upon their payment, without any accrual for accounting purposes.”

¹³ According to the Financial Accounting Standards Board, “Accrual accounting attempts to record the financial effects on an entity of transactions and other events and circumstances that have cash consequences for the entity in the periods in which those transactions, events, and circumstances occur rather than only in periods in which cash is received or paid by the entity.” Accruals that are recorded as assets represent future rights to resources and accruals that are recorded as liabilities represent future uses of resources. Accruals represent the future inflow or outflow of resources from an entity.

¹⁴ Because we did not perform inspections or audits of the 27 guaranty agencies, we do not specifically name any guaranty agencies covered by this inspection report.

Funds had been established correctly. The CAP Verification Lead used the following quote from the Technical Assistance Trip Report to support the conclusion in the CAP Element Sheet:

The opening fund balance for the Federal account was \$82,284,990 (cash balance \$38,252,064). The opening fund balance for the Operating account was \$1,651,708 (cash balance \$16,659,109). The difference was used to settle obligations during the 60 day period following enactment. These obligations included Collections due ED [Department], Accounts Payable, etc.). The Restricted/Recall obligation was accrued for \$28,881,803. These opening balances were as of October 1, 1998. The interest accumulated on the Federal Fund as of 9/30/99 was \$342,764.

In this case, both the Federal and Operating Funds were established using accrual accounting. The statute provides that all liquid assets as of October 1, 1998, were the property of the Federal government. The Technical Assistance Trip Report indicates, however, that as of October 1, 1998, the guaranty agency used cash from the Reserve Fund to pay \$16 million in obligations instead of depositing that cash into the Federal Fund as of October 1, 1998, as required by the HEA. There is no indication that the guaranty agency borrowed the funds from the Federal Fund, as provided for in the HEA, and there is no explanation for why \$16 million in cash was deposited into the Operating Fund and not the Federal Fund as required.

The Financial Review Report for Guaranty Agency B also indicates that the Federal Fund was established incorrectly using accrual accounting:

Total assets transferred to the FSLRF [Federal Student Loan Reserve Fund] were \$32,879,618 consisting of cash and equivalents of \$25,040,329, total receivables of \$4,680,654 and investments in U.S. Government Securities \$2,859,342. Total liabilities transferred were \$23,890,057 and total fund balances transferred were \$8,989,561.

There is no documentation in the guaranty agency CAP file to support that FPS program reviewers performed any analysis of the liabilities to ensure that the liabilities were only for permitted expenses of the Federal Fund.

The CAP files for the other 14 guaranty agencies in this category also clearly indicated that they had incorrectly used accrual accounting to establish the Federal Fund. The documentation provided to us and used by FPS to draw the conclusion in 2005 that the Federal and Operating Funds were established correctly did not provide enough information for us to determine the nature of the accruals. Furthermore, the CAP Verification Leads were unable to explain why accruals were used to determine the opening balance or how adjustments were used to correct the opening balances.

Because the 16 guaranty agencies in this category may have established the Federal Fund incorrectly, the Federal Fund at each guaranty agency may be understated. During the previous OIG audits of nine guaranty agencies, OIG found that the beginning balances of the Federal Fund were understated by over \$17.8 million. During the FPS program reviews of the 27 guaranty agencies included in our inspection, FPS only quantified approximately \$1.1 million in findings related to the establishment of the Federal and Operating Funds.

The Documentation Is Insufficient to Draw Conclusions Regarding the Sufficiency of Prior FPS Program Reviews of the Establishment of the Federal and Operating Funds.

The guaranty agency CAP files for the remaining 11 guaranty agencies did not contain sufficient information for the CAP Verification Lead to have drawn a valid conclusion on the sufficiency of prior FPS program reviews concerning the establishment of the Federal and Operating Funds. For four of these guaranty agencies, the CAP Verification Leads concluded on the CAP 1 Element Sheet that the Federal Fund was sufficiently addressed during a prior FPS program review. The methodology section, however, on all four of these CAP 1 Element Sheets states:

Attempted to locate review reports, element worksheets and back-up detail/documentation on Accorde [Accorde contains the electronic, imaged file documents]. Not all documents could be located as they were not properly input at inception of imaging project.

For two of these four, the opening balance of the Federal Fund was not discussed in any of the documentation used by the CAP Verification Leads to draw conclusions on the establishment of the Federal and Operating Funds.

Though the CAP Verification Leads for the remaining seven guaranty agency CAP files were able to access FPS program review reports and work papers, the CAP files did not provide sufficient information to draw a conclusion on the establishment of the Federal and Operating Funds. There is no indication in any of these guaranty agency files that FPS sufficiently reviewed the Federal and Operating Funds during a prior FPS program review.

In the CAP file for Guaranty Agency C, we determined that the opening balance of the Federal Fund was not discussed in any of the documentation used by the CAP Verification Lead. Of the documentation provided in the CAP file, the Financial Review Report describes the Federal Fund without reference to the beginning balance in 1998:

During the course of this review, we were able to tie the ED1130 [ED Form 1130: Revised Guaranty Agency Quarterly/Annual Report] numbers for fund balance, income, and expenses to the audited financial statements for September 30, 1999. A sample of expenditures from the fund was reviewed; all expenditures were for costs properly allocated to the Federal Fund. The agency has not borrowed from the fund.

Two of the seven CAP files report that the Federal Fund was established on a cash basis; however, FPS' documentation for Guaranty Agency D contained unexplained adjustments and the documentation for Guaranty Agency E showed an account receivable on the opening balance of the Federal Fund. In both of these cases, there is not enough information to conclude whether these Funds were established correctly.

The last four files do not provide enough information to determine the procedures the guaranty agency used to establish the Federal and Operating Funds. We were unable to determine whether the Funds were established on an accrual or a cash basis. There is also no information

in the files indicating whether FPS sufficiently reviewed the Federal and Operating Funds during a prior FPS program review.

CAP Verification Leads Only Verified Whether the Establishment of the Federal and Operating Funds Had Been Addressed During Prior FPS Program Reviews, Not Whether the Work Was Sufficient or Whether the Funds Were Established in Accordance With the HEA.

The CAP procedures instructed the CAP Verification Leads to “[e]xamine the review reports, work papers, and documentation to determine whether the 7 areas identified on the CAP Verification Cover Sheet have been **sufficiently** reviewed and addressed during a prior FP[S] Funds, Full-Scope or other Program Review.” (Emphasis added.)

The methodology sections for all 27 CAP 1 Element Sheets indicate that the CAP Verification Leads simply reviewed information in previous FPS program review reports. Furthermore, the CAP Verification Leads relied on FPS program reviews that the 2003 OIG Audit found were insufficient to identify problems with the establishment of the Federal and Operating Funds.

Interviews with the CAP Verification Leads confirmed that they all only determined whether the Federal and Operating Funds were addressed during a prior FPS program review, not whether the prior reviews were sufficient or whether the establishment was in compliance with the HEA and regulations. A CAP Verification Lead stated that his role was not to determine “how well [the prior work] was done, just that it was done.” Furthermore, another CAP Verification Lead stated he was mainly putting data together for the Regional Directors and OIG. This CAP Verification Lead explained that he did not analyze or evaluate the documentation.

Because CAP Verification Leads did not do new or additional work on the establishment of the Federal and Operating Funds and relied on prior FPS program review reports deemed insufficient by the 2003 OIG Audit, they were not in a position to draw a conclusion on the sufficiency of the work or to determine that the Federal and Operating Funds were established in compliance with the HEA. Therefore, FPS used its resources on work that was not responsive to the 2003 OIG Audit’s findings and recommendations and the work did not contribute to the determination that the Federal and Operating Funds were established correctly at the 27 guaranty agencies.

ISSUE B – The Work Originally Performed by FPS and Reviewed by the CAP Verification Leads Was Not Sufficient to Assess Usage Fees for Non-Liquid Assets as Required by the Regulations at 22 of the 27 Guaranty Agencies. For 20 of the 27 Guaranty Agencies There Was No Evidence of Review for Questionable Purchases.

The FPS Assessment of Usage Fees Was Not Sufficient.

A CAP Verification Lead informed us that a few guaranty agencies made a “good faith effort” to pay usage fees prior to July 1, 2000. FPS, however, only required guaranty agencies to pay usage fees after this date. This action allowed guaranty agencies to use Federal assets for 21 months without compensating the Federal government. Once FPS required guaranty agencies to

pay usage fees, it failed to recognize the fair market value for assets and only required guaranty agencies to pay usage fees based on the depreciated value of the assets.¹⁵

In many of these cases, the equipment had depreciated below what FPS considered a nominal value¹⁶ by July 1, 2000. FPS did not require the guaranty agencies to pay usage fees when this occurred, even though they continued to use this equipment. In addition, FPS instructed guaranty agencies to disaggregate classes of assets and only charged usage fees on individual assets with a depreciated value greater than \$5,000. This further reduced the usage fees paid by guaranty agencies.

FPS program reviewers did not calculate usage fees for Federal non-liquid assets based on the fair market value for the use of the equipment. Instead, at 22 of the 27 guaranty agencies, FPS program reviewers only assessed usage fees for items with a depreciated book value greater than \$5,000 as of July 1, 2000. The General Manager for FPS drafted a "Dear Partner Letter," dated May 17, 2001, to "provide guidance to the guaranty agencies concerning the determination and payment of usage fees on non-liquid assets purchased in whole or in part with Federal reserve funds." The letter states that effective July 1, 2000, the "Department [had] determined that any tangible asset with a net fair value of \$5,000 or less after June 30, 2000 will be considered to have nominal value and will be exempt from payment of a usage fee (net book value may be used to establish net fair value)." There is no evidence that this draft letter was ever formalized or approved by Department officials authorized to determine Department policy or that it was provided to the guaranty agencies. FPS program reviewers, however, appear to have adhered to the guidelines of this draft letter and did not require guaranty agencies to pay usage fees prior to July 1, 2000. This practice allowed guaranty agencies to use assets purchased with Reserve Funds for 21 months without compensating the Federal Fund and never required guaranty agencies to pay usage fees on fully depreciated assets that were still in use.

In one example, an FPS program reviewer instructed Guaranty Agency F to disaggregate equipment on its asset inventory. The FPS program reviewer wrote that there "[a]ppear to be numerous items lumped together. These need to be split apart in order to determine if individual items/book value exceeds \$5,000 on 7/1/2000." Disaggregating the inventory and only requiring usage fees to be paid based on the book value as opposed to fair usage value allowed the guaranty agency to pay lower usage fees.

In another example, an FPS program reviewer concluded during the Financial Review of Guaranty Agency A that "according to the Department's guidance, [Guaranty Agency A] may have overpaid its good faith usage fees to date" because the guaranty agency paid "usage fees on items until the book value [was] -0-." Again, FPS based its decisions on the book value of assets as opposed to the fair usage value.

¹⁵ 34 CFR § 682.420 provides instruction on how to value non-liquid assets, how revenue from non-liquid assets must be applied to the Federal Fund, and how usage fees must be paid to the Federal Fund. All usage fees are to be based on the net fair value of the asset.

¹⁶ FPS internally established nominal value at \$5,000. One of the CAP Verification Leads explained that in his role as a Guarantor and Lender Review Specialist he recommended that usage fees not be calculated for assets with a book value of less than \$5,000. This CAP Verification Lead explained that he based nominal value on the guidelines from the Office of Management and Budget (OMB) Circular A-87. The \$5,000 nominal value in OMB Circular A-87, however, is not related to usage fees.

In our final example, an FPS program reviewer also did not require Guaranty Agency G to pay usage fees on a server purchased in 1997. The FPS reviewer initially “felt that it still had some value,” but the agency explained that using Generally Accepted Accounting Principles, the server’s book value had depreciated to a nominal value. Although the guaranty agency still used the server, FPS did not require it to pay usage fees for this item, which illustrates FPS’ use of the book value rather than the fair usage value.

The Department’s practice of considering tangible assets with a book value of \$5,000 or less, as of July 1, 2000, to have nominal value and to be exempt from payment of a usage fee does not comply with 34 CFR § 682.420, which states that usage fees are to be based on the net fair value of *use* and should be applied to the Federal Fund effective October 1, 1998.

The 2003 OIG Audit described a similar finding regarding FPS’ calculation of usage fees:

Guaranty agencies have not properly documented federal assets or consistently calculated and paid usage fees. The Department has not specified how federal ownership of assets should be recorded or how usage fees should be calculated. OIG audits reported that two guaranty agencies did not adequately identify federal assets, two guaranty agencies developed their own usage fee calculation, and one guaranty agency did not pay usage fees to its Federal Fund.

FPS’ actions with regard to usage fees resulted in guaranty agencies paying less than required by the regulations, resulting in improper payments.

The FPS Review of Questionable Purchases Was Not Sufficient.

In 20 of the 27 guaranty agency CAP files, there is no evidence that the CAP Verification Lead or a prior FPS program reviewer examined purchases prior to October 1, 1998, to ensure that guaranty agencies were not improperly using Reserve Funds prior to the establishment of the Federal and Operating Funds.

Two guaranty agency CAP files included charts containing questionable equipment purchases;¹⁷ however, there is no evidence that FPS program reviewers evaluated the purchases for appropriateness. Instead of using Reserve Funds for necessary and reasonable costs, these purchases indicate that the guaranty agencies may have timed the execution of purchases in order to use Reserve Fund assets before the Federal Funds were established.¹⁸

The CAP file for Guaranty Agency F does not provide an explanation for why the guaranty agency exhibited a significant increase in its monthly spending prior to the establishment of the Federal Fund. Between February 1988 and August 1998, the guaranty agency never spent over

¹⁷ Without the benefit of performing an audit of these purchases, we cannot be certain that these purchases were improper.

¹⁸ The OIG audit, *California Student Aid Commission’s Administration of the Federal Family Education Loan Program Federal and Operating Funds* (ED-OIG/A09-C0013, 2003) found that “CSAC used reserve fund assets to pay EDFUND for about \$5.1 million of equipment, software, and equipment-related services purchased in September 1998. Our review of three EDFUND purchase agreements, which accounted for \$4.5 million of the \$5.1 million in purchases, found that the purchased equipment, software, and services were for administration of the FFEL program after September 30, 1998.”

\$100,000 on equipment in a single month. During September 1998, however, the guaranty agency spent \$344,523 on equipment.¹⁹ Only 4 of the 83 items purchased had an individual purchase price over \$5,000; as a result, FPS only charged usage fees for these 4 items of equipment.

Guaranty Agency H exhibited questionable spending activity during the month before the establishment of the Federal Fund (September 1998) that should have received additional scrutiny from FPS. According to the Non-Liquid Assets Spreadsheets, which only identified individual assets with a depreciated book value over \$5,000 as of July 1, 2000, the guaranty agency spent at least \$1,008,526 on equipment in September 1998. Furthermore, on the day before the establishment, the guaranty agency spent at least \$790,539 on equipment.²⁰ FPS required the agency to pay usage fees on the equipment identified in the Non-Liquid Assets Spreadsheet. FPS, however, did not require the guaranty agency to pay usage fees on equipment it may have purchased that had depreciated to a book value of \$5,000 by July 1, 2000.

Because FPS reviewers did not evaluate the appropriateness of purchases prior to the establishment of the Federal Fund, guaranty agencies may have inappropriately used Reserve Funds resulting in a lower beginning balance of the Federal Fund.

ISSUE C – FPS Management Assigned CAP Verification Leads to Assess the Sufficiency of Their Own Prior FPS Program Reviews.

FPS assigned CAP verification work to staff that were involved with previous FPS program reviews. Twenty-five of the 27 CAP 1 Element Sheets were prepared by CAP Verification Leads who participated in the Financial Review of the guaranty agency; in 19 cases, the CAP Verification Leads also served as the lead during the Financial Review. Additionally, 17 of the CAP 1 Element Sheets were prepared by CAP Verification Leads who participated in the Technical Assistance Review of the guaranty agency.

CAP Verification Leads informed us that they were assigned to perform the CAP verification work for each guaranty agency because they either served as the liaison for the guaranty agency or they served as the lead during the Financial Review of the guaranty agency. It appears that when FPS management delegated the CAP verification workload, it did not consider that many of the CAP Verification Leads would be in the position of assessing the sufficiency of their own work.

ISSUE D – FPS’ Actions Show a Lack of Consideration for the Monitoring Standard from the GAO’s *Standards for Internal Control in the Federal Government*.

According to the GAO’s *Standards for Internal Control in the Federal Government*, the monitoring internal control standard states that “[i]nternal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.” The standard further states that:

¹⁹ The guaranty agency spent \$344,523 on 31 printers, 22 computers, 8 computer monitors, 7 power units, computer equipment, computer disk storage, a scanner, a binding machine, a telecommunications device, and other equipment.

²⁰ The guaranty agency spent at least \$790,539 on equipment such as photocopy machines, enterprise cards, test equipment, furniture, telecommunications equipment, a router, an auto dialer, a server, and an electric generator.

Managers are to (1) promptly evaluate findings from audits and other reviews, including those showing deficiencies and recommendations reported by auditors and others who evaluate agencies' operations, (2) determine proper actions in response to findings and recommendations from audits and reviews, and (3) complete, within established timeframes, all actions that correct or otherwise resolve the matters brought to management's attention.

In 2004, FPS presented a CAP to OIG that provided for FPS to conduct new program reviews at the 27 guaranty agencies not previously audited by OIG. OIG subsequently agreed to the CAP as written in the Audit Accountability and Resolution Tracking System (AARTS). As of March 9, 2005, FSA had not started the program reviews agreed to by OIG. On that date, the Inspector General sent a Memorandum to the Chief Operating Officer of FSA sharing his concerns regarding the process used to estimate "erroneous payments for the student financial assistance programs." The memorandum stated:

My office conducted a series of audits that identified systemic problems in the student loan programs. While the sustained liabilities for our nine guaranty agency federal/operating fund audits were included in the most recent assessment, there are no liabilities for the remaining 27 guaranty agencies that were to be reviewed by FSA as part of the agreed-upon corrective actions.

After the memo was issued, FSA worked with OIG to develop areas of concern (seven CAP Elements) in April 2005.

During the May 26, 2005 congressional hearing held before the House Committee on Government Reform ("Federal Student Loan Programs: Are They Meeting the Needs of Students and Schools?" Serial Number 109-31. U.S. Government Printing Office.), the Chief Operating Officer of FSA responded to Representative William Lacy Clay's inquiry into whether FSA had plans to review the additional guaranty agencies not audited by OIG:

We have a work plan to do program reviews and audits of schools, lenders, and guaranty agencies, the servicers that participate in the programs. Yes, we are focusing in on the guaranty agencies, and our oversight of them, and doing onsite reviews. I do not recall off the top of my head the specific nine that you are referencing. But yes, we do have plans for not only this year, but in 2006 to do onsite reviews at guaranty agencies, as well as other participants in the program.

Representative Clay responded:

Well, I would hope so. Because the fact that [OIG] uncovered \$164 million in abuse in an audit of only a quarter of the guaranty agencies^[21] suggests to me that it would be worthwhile to take a deeper look.

²¹ OIG's audits of the nine guaranty agencies disclosed (1) \$48.3 million in cash funds not transferred to the Federal Fund, (2) \$10.9 million in assets owned by the Federal Fund, (3) \$1.7 million in unsupported labor expenses charged to the Federal Fund, and (4) \$103.0 million in excess reserve funds not recalled by the Department, for a total of approximately \$164 million in monetary findings.

On July 26, 2005, the Inspector General sent a Memorandum to the Chief Financial Officer and provided a copy to the Chief Operating Officer of FSA. This memorandum conveyed, in part, the Inspector General's disagreement with FSA's decision to "reverse its corrective action plan and to not attempt to recover potentially millions in Federal assets" by not reviewing the guaranty agencies' establishment of the Federal and Operating Funds. Instead of following the CAP agreed to by OIG, FSA decided in August 2005, to examine prior FPS program reviews, work papers, and related documentation, as opposed to conducting new program reviews of the establishment of the Federal and Operating Funds.

FPS did not follow the CAP that was agreed to by OIG, as required by OMB Circular A-50: *Audit Followup*.²² The actions taken by FPS in response to the 2003 OIG Audit violate the monitoring internal control standard because the actions would not ultimately resolve the matters brought to the attention of FPS management and did not appear to take into account the deficiencies identified in the 2003 OIG Audit. Specifically, the methodology used by FPS was flawed, FPS assigned CAP Verification Leads to assess the sufficiency of their own prior FPS program reviews, there was a lack of clear direction or involvement from FSA headquarters management, and not all CAP Verification Leads had the requisite knowledge of accounting to effectively determine the accuracy of the establishment of the Federal and Operating Funds.

Rather than following the CAP as originally proposed and agreed to by OIG as responsive to the audit report, FPS chose to look only at prior FPS program review reports and some work papers. OIG, however, had already determined that prior FPS program reviews were insufficient to identify problems with the establishment of the Federal and Operating Funds. The OIG audits found that although FPS program reviews had objectives similar to OIG audits, the FPS program reviews did not identify significant findings. The OIG audits found that the nine audited guaranty agencies understated the beginning balances of the Federal Fund by over \$17.8 million; FPS, however, did not identify these errors.

Although the CAP Verification Leads were instructed to evaluate whether the work performed during prior FPS program reviews was sufficient, all of the CAP Verification Leads we interviewed said that their work was limited to determining whether the establishment of the Federal and Operating Funds had been addressed in some manner during prior FPS program reviews. We found that the documentation used to support their work would not substantiate a conclusion regarding the sufficiency of the establishment of the Federal and Operating Funds.

Additionally, the CAP Verification Leads were instructed to use the *Financial Partners Guaranty Agency Review Guide (Interim)*, revised May 5, 2005, and the 2001 *Financial Partners Guaranty Agency Funds Review Guide* to examine the CAP Elements for sufficiency. The *Financial Partners Guaranty Agency Review Guide (Interim)*, revised May 5, 2005, does not address the establishment of the Federal and Operating Funds. The Regional project person for the CAP verification work confirmed that for CAP Element 1, the CAP Verification Leads should have used the entire 2001 *Financial Partners Funds Review Guide*, which did address the establishment of the Federal and Operating Funds. None of the CAP Verification Leads, however, stated that they had used this guide during their examination of the Federal Fund.

²² OMB Circular A-50: *Audit Followup* requires the audit organization and agency management to agree on the actions to be taken on reported findings and recommendations. In cases where the agency management officials disagree with an audit recommendation, the matter shall be resolved by the followup official.

The CAP Verification Leads were assigned to assess the sufficiency of their own prior FPS program reviews. Headquarters management should have taken this issue into consideration if it was interested in evaluating the quality of performance under the internal control standard for monitoring, particularly since the 2003 OIG Audit found that the previous FPS program reviews were inadequate.

From our interviews with the CAP Verification Leads and the Regional Directors, there appears to have been only minimal involvement from FSA headquarters management. CAP Verification Leads expressed varying levels of frustration with the lack of information from headquarters during this work and previous program reviews. Additionally, one CAP Verification Lead explained that there was no formal training for this work and that the instructions were provided through telephone calls and emails.

Once the work was completed in the Regional offices and signed off by the Regional Directors, there was little further review of the work. The Regional project person, the individual who provided the work to headquarters, only tracked the CAP files to determine whether each Region successfully uploaded the CAP documentation onto their shared drive. The State Agency Liaison Officer stated that when the CAP verification work was complete, he did a “spot check, especially in the areas where they identified additional work.” The role of the Director of Partner Services Group was to ensure that the Regional Directors signed off on the work and to determine whether the work satisfied the CAP. The Director stated that she did a “ cursory review” by looking at a sample of the documents, but did not go “line by line.” Without a thorough review, it would not be possible for the Director of Partner Services Group to determine whether the work satisfied the CAP or whether the CAP Verification Leads followed the instructions. Additionally, the work was not evaluated to ensure consistency in coverage or documentation among the Regions and CAP Verification Leads.

Most FPS program reviewers did not have the accounting background necessary to review financial documents related to the establishment of the Federal Fund. A CAP Verification Lead admitted that he would have needed more of an accounting background during the prior FPS program reviews to address accruals. Additionally, another CAP Verification Lead stated that only a few FPS program reviewers have an accounting background. The CAP Verification Lead stated that it is essential for program reviewers to be program experts, not accountants. The Director of Partner Services Group was concerned that the program reviewers do not have the accounting expertise necessary to perform an in-depth review of the establishment of the Federal and Operating Funds. The FFEL program, however, is a complicated financial and accounting intensive program. To ensure program compliance, a program reviewer would need a background in accounting.

This Inspection Reinforces Findings In a Prior OIG Audit Regarding Weak Internal Controls in FPS.

The 2006 OIG audit, *Review of Financial Partners’ Monitoring and Oversight of Guaranty Agencies, Lenders, and Servicers*, identified significant weaknesses in FPS’ internal controls. OIG found that FSA had a weak control environment for monitoring and oversight and that FPS “[e]mphasized partnership over compliance in dealing with guaranty agencies, lenders, and servicers in its mission statement on selected actions.” Our inspection reinforces that FPS

emphasized partnership with the guaranty agency over compliance with Federal Regulations in prior program reviews.

During the Technical Assistance Review for Guaranty Agency I, the FPS program reviewers emphasized their role as partners in their dealings with this guaranty agency. FPS reviewers stated in the Technical Assistance Trip Report: “We were provided with everything we asked for, but the staff seemed to be skeptical of our role as a partner.” Also, during an interview, a CAP Verification Lead said that her role as a liaison for the guaranty agency is to be the “guaranty agency’s legs within the Department.”

Additionally, in 13 of the Financial Review Reports at the 27 guaranty agencies, FPS program reviewers used language that emphasizes their partnership with the guaranty agencies regarding a finding on collections interest. FPS expressed regret in each report that it was “unable to rescind the requirement that interest on the Federal share of collections be remitted to the Federal Fund effective October 1, 1998.” These statements emphasize that FPS views its relationship with the guaranty agencies in terms of valuing partnership rather than guaranty agency compliance.

RECOMMENDATIONS

We recommend that the Chief Operating Officer for FSA –

1. Perform onsite program reviews to examine supporting records for the establishment of the Federal and Operating Funds at the 27 guaranty agencies not previously reviewed by OIG to ensure that the funds were established in accordance with the HEA, as amended, including the requirement for the use of the cash basis of accounting.
2. Ensure that the program reviewers have the requisite accounting knowledge to sufficiently evaluate the establishment of the Federal and Operating Funds.
3. Ensure that adequate resources are devoted to perform the program reviews, *e.g.*, adequate staff days and travel funds.
4. In performing the program reviews, identify, quantify, and report as erroneous payments any lost revenue to the Federal Fund that resulted from the incorrect assessment of usage fees.
5. In performing the program reviews, identify any improper purchases made by guaranty agencies prior to the establishment of the Federal and Operating Funds, and require full repayment to the Federal Fund.

FSA COMMENTS

On July 3, 2007, we provided FSA with a copy of our draft report for comment. FSA provided its comments to the report on August 14, 2007. FSA did not disagree with our inspection results and concurred with all of our recommendations. A copy of FSA's comments, in their entirety, is attached to this report.

Recommendation 1 - Perform onsite program reviews to examine supporting records for the establishment of the Federal and Operating Funds at the 27 guaranty agencies not previously reviewed by OIG to ensure that the funds were established in accordance with the HEA, as amended, including the requirement for the use of the cash basis of accounting.

FSA Comments

To the extent data is available, Federal Student Aid will ensure that independent onsite reviews of the establishment of the Federal and Operating Funds will be performed at the remaining 27 guaranty agencies not reviewed by OIG. FSA also stated that to ensure the program review processes are sufficient, FSA will require guidance from the OIG.

OIG Response

The work previously done by our office showed that the beginning balance of the Federal Fund at the nine guaranty agencies our office audited was understated by over \$17.8 million. All of the audits identified problems with the establishment of the Federal Fund. If FSA had adequately responded to the original audit recommendations, any funds not belonging to the Operating Fund at the 27 guaranty agencies not audited by our office could have been returned to the Federal Fund. Should guaranty agency accounting records not be available due to FSA's lack of action on the original recommendations and the amount of time that has passed since those recommendations were made, FSA should develop an alternative method to determine any amounts to be returned to the Federal Fund at the 27 guaranty agencies not audited by OIG. If an alternative method cannot be developed, FSA should determine what reporting is required under the Federal Managers Financial Integrity Act or Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Internal Control.

FSA must take ownership of the corrective actions it will be taking in response to this inspection. To the extent that FSA knows of general weaknesses in its program review abilities and processes, it should take corrective action independently. OIG will, as it has in the past, provide advice and comments on specific actions concerning the program reviews to be conducted of the Federal and Operating Funds at the 27 guaranty agencies we did not audit.

Recommendation 2 - Ensure that the program reviewers have the requisite accounting knowledge to sufficiently evaluate the establishment of the Federal and Operating Funds.

FSA Comments

FSA will ensure that individuals with the requisite accounting knowledge perform the recommended reviews. FSA also stated that to ensure the reviewers have the requisite accounting knowledge of these types of reviews, an independent, external firm with the required accounting experience will be required.

OIG Response

This recommendation was based on an acknowledgement by Financial Partners management that staff did not have the requisite accounting knowledge to perform the program reviews. In addition to hiring an outside firm to perform the program reviews, FSA should take steps to develop in-house capacity and the skills to perform not only this type of program review, but other guaranty agency, lender, and servicer reviews in the future. As we noted in the report, the FFEL program is a complicated financial and accounting intensive program. Therefore, to ensure program compliance, a program reviewer should have a sufficient background in accounting. FSA should also ensure that the external firm that performs this work has the essential program knowledge to confirm that the Federal and Operating Funds were established in accordance with the HEA, as amended.

Recommendation 3 - Ensure that adequate resources are devoted to perform the program reviews, *e.g.*, adequate staff days and travel funds.

FSA Comments

FSA agreed to implement the recommendation.

Recommendation 4 - In performing the program reviews, identify, quantify, and report as erroneous payments any lost revenue to the Federal Fund that resulted from the incorrect assessment of usage fees.

FSA Comments

The reviews will include the determination of the appropriateness of usage fees and purchases, if needed. The Department, with the OIG's approval, has entered into usage fee settlements with many of the guaranty agencies considered in the scope of these reviews. The results of the reviews will include, as appropriate, identification of liabilities in accordance with FSA established procedures.

OIG Response

The appropriateness of usage fees must be evaluated at all 27 guaranty agencies. FSA's method of establishing usage fees for non-liquid assets other than real estate did not follow the requirement in the regulations that stated usage fees be based on the fair market value for all assets purchased using federal funds. OIG does not approve of or make Department management decisions. Our office provided advice and comments on proposed settlement agreements related to the disposition of real property purchased with federal reserve funds at a small number of guaranty agencies. OIG did not approve decisions on these settlements.

FSA's comments did not address the portion of our recommendation related to reporting of improper payments. In conducting reviews of usage fees, FSA should

report not only liabilities assessed, but also improper payments in the form of lost revenue to an agency's Federal Fund. There may be circumstances where FSA cannot assess and collect a liability due to improper assessment of usage fees. Nevertheless, improper payments should be reported pursuant to OMB Circulars A-123, Management's Responsibility for Internal Control, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments, and A-136, Financial Reporting Requirements, even if a liability cannot be assessed.

Recommendation 5 - In performing the program reviews, identify any improper purchases made by guaranty agencies prior to the establishment of the Federal and Operating Funds, and require full repayment to the Federal Fund.

FSA Comments

FSA will ensure that the reviews will include the determination of the appropriateness of purchases, if needed. The results of the reviews will include, as appropriate, identification of liabilities in accordance with FSA established procedures.

OIG Response

FSA must evaluate the appropriateness of purchases at each of the 27 guaranty agencies not audited by OIG. An audit previously done by our office identified \$7.4 million spent prior to the establishment of the Federal and Operating Funds as improper administrative expenses at one guaranty agency. Without testing the appropriateness of purchases at each guaranty agency, FSA has no assurance that federal funds were not misused. In addition to identifying liabilities, FSA also needs to require repayment of any liabilities identified.

Prior work by our office has shown that FSA's established procedures to identify liabilities were not adequate to protect the federal interest. FSA should carefully review any established procedures it currently uses to identify liabilities to ensure that all liabilities are not only identified, but repaid to the Federal Fund.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our inspection was to determine the adequacy of FSA's support for its conclusions concerning the establishment of the Federal Fund and the Operating Fund at the 27 guaranty agencies not audited by OIG. The OIG audited nine guaranty agencies and reported the results in the 2003 OIG Audit, *Oversight Issues Related to Guaranty Agencies Administration of the Federal Family Education Loan Program Federal and Operating Funds*.

We began our fieldwork on November 8, 2006, and we conducted an exit conference on April 17, 2007. We reviewed the HEA, applicable regulations, and Dear Colleague Letters.

We interviewed FPS staff at headquarters and conducted phone interviews with FPS staff from its Regional offices. Additionally, we interviewed all available FPS officials who served as the CAP Verification Leads for the reviews of the 27 guaranty agencies.

We reviewed the CAP verification work papers and the supporting documentation the CAP Verification Leads used for their reviews of the establishment of the Federal and Operating Funds at each of the 27 guaranty agencies. FSA's CAP completion package contains seven elements related to specific areas of concern identified by OIG in prior audits of nine guaranty agencies' establishment and operation of the Federal and Operating Funds. The scope of CAP Element 1, titled "Establishment of the Federal Fund," directly relates to the objective of this inspection, while the other six CAP elements are related to the operation of the Federal and Operating Funds after the establishment. As a result, we limited our review to the documentation and supporting work papers related to CAP Element 1.

To determine the liabilities from previous FPS program review reports, we identified findings specifically related to the establishment or beginning balance of the Federal and Operating Funds at the 27 guaranty agencies included in our inspection. We added the total amount of liabilities quantified by FPS and found that FPS quantified \$1,117,910 in findings at 27 guaranty agencies.

To determine the liabilities from the 2003 OIG Audit, we reviewed the audit findings and added the liabilities related to the understatement of the beginning balance of the Federal Fund. The 2003 OIG Audit found that "[f]our guaranty agencies understated the beginning balances of the Federal Funds by over \$15.2 million" and that "[t]hree guaranty agencies understated the beginning balances of the Federal Funds by over \$2.6 million." These understatements totaled over \$17.8 million.

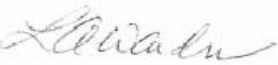
Our inspection was performed in accordance with the *2005 President's Council on Integrity and Efficiency Quality Standards for Inspections* appropriate to the scope of the inspection described above.

ATTACHMENT: FSA RESPONSE TO DRAFT INSPECTION REPORT



DATE: August 13, 2007

TO: George A. Rippey
Acting Assistant Inspector General for Audit
Office of Inspector General

FROM: Lawrence A. Warder 
Acting Chief Operating Officer
Federal Student Aid

SUBJECT: Draft Inspection Report – "Review of Federal Student Aid's Monitoring of Guaranty Agency Compliance with the Establishment of the Federal Fund and the Operating Fund", Control Number ED-OIG/I13H0001

Thank you for providing us with an opportunity to respond to recommendations made in the Office of Inspector General's (OIG) Draft Inspection Report, "Review of Federal Student Aid's Monitoring of Guaranty Agency Compliance with the Establishment of the Federal Fund and the Operating Fund," Control Number ED-OIG/I13H0001, dated July 3, 2007.

We agree that onsite reviews of the establishment of the Federal and Operating Funds should be conducted at the remaining 27 guaranty agencies not reviewed by the OIG. The objective of these reviews will ensure that the funds were established in accordance with the Higher Education Act of 1965, as amended by the Higher Education Amendments of 1998, and regulations. The reviews will include the determination of the appropriateness of usage fees and purchases, if needed. The Department, with the OIG's approval, has entered into usage fee settlement agreements with many of the guaranty agencies considered in the scope of these reviews.

As recommended in the OIG report, the reviewers must be proficient in the requisite accounting knowledge to sufficiently evaluate the establishment of the funds. To ensure that the reviewers have the requisite accounting knowledge for these types of reviews, an independent, external firm with the required accounting experience will be required to perform the work. To ensure that the program review processes are sufficient, Federal Student Aid will require guidance from the OIG.

Our response to the finding and each of the recommendations are included in the attachment. Thank you again for the opportunity to review and comment on this report.

Attachment

cc: W. Christian Vierling, Director, Evaluation and Inspection Services

830 First St. N.E., Washington, DC 20202
www.FederalStudentAid.ed.gov
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Attachment

Draft Inspection Report – "Review of Federal Student Aid's Monitoring of Guaranty Agency Compliance with the Establishment of the Federal Fund and the Operating Fund," Control Number ED-OIG/I13H0001

Finding No. 1 – The Work Performed by FSA on the 27 Guaranty Agencies Not Audited by OIG Provides No Assurance that the Federal and Operating Funds Were Established in Compliance with the HEA.

Recommendation 1.1:

Perform onsite program reviews to examine supporting records for the establishment of the Federal and Operating Funds at the 27 guaranty agencies not previously reviewed by OIG to ensure that the funds were established in accordance with the HEA, as amended, including the requirement for the use of the cash basis of accounting.

Federal Student Aid's Response:

To the extent data is available, Federal Student Aid will ensure that independent onsite reviews of the establishment of the Federal and Operating Funds will be performed at the remaining 27 guaranty agencies not reviewed by OIG.

Recommendation 1.2:

Ensure that the program reviewers have the requisite accounting knowledge to sufficiently evaluate the establishment of the Federal and Operating Funds.

Federal Student Aid's Response:

Federal Student Aid will ensure that individuals with the requisite accounting knowledge perform the recommended reviews.

Recommendation 1.3:

Ensure that adequate resources are devoted to perform the program reviews, e.g., adequate staff days and travel funds.

Federal Student Aid's Response:

Federal Student Aid will ensure that adequate resources will be devoted to the reviews.

Recommendation 1.4:

In performing the program reviews, identify quantify, and report as erroneous payments any lost revenue to the Federal Fund that resulted from the incorrect assessment of usage fees.

Federal Student Aid's Response:

The reviews will include the determination of the appropriateness of usage fees and purchases, if needed. The Department, with the OIG's approval, has entered into usage fee settlements with many of the guaranty agencies considered in the scope of these reviews. The results of the reviews will include, as appropriate, identification of liabilities in accordance with Federal Student Aid established procedures.

Recommendation 1.5:

In performing the program reviews, identify any improper purchases made by guaranty agencies prior to the establishment of the Federal and Operating Funds, and require full repayment to the Federal Fund.

Federal Student Aid's Response:

Federal Student Aid will ensure that the reviews will include the determination of the appropriateness of purchases, if needed. The results of the reviews will include, as appropriate, identification of liabilities in accordance with Federal Student Aid established procedures.