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United States Government Accountability Office
Washington, DC 20548

September 30, 2009

Congressional Committees

Subject: Federal Student Loans: Audits and Reviews of the Federal Family Education Loan and Federal Direct Loan Programs

This letter formally transmits the enclosed briefing slides in response to section 1119 of Pub. L. No. 110-315, the Higher Education Opportunity Act. This act mandated GAO study the financial and compliance audits and reviews required or conducted for the Federal Family Education Loan and Federal Direct Loan Programs. On August 6 and 7, 2009, we briefed the staff of your respective committees on the types of audits, reviews, agreed-upon procedures, and reconciliations that are required or conducted for these programs. At your request, we have incorporated additional information on the agreed-upon procedures engagements required by the Ensuring Continued Access to Student Loans Act and the reconciliations performed by the Department of Education's Office of Federal Student Aid. We obtained comments from the Department of Education and have incorporated changes in the enclosed documents, as appropriate. In a forthcoming report, we will provide an assessment of whether these audits and reviews as designed provide comparable coverage of the two loan programs. That report will also discuss how the Department of Education ensures that these audits and reviews comply with statutory and regulatory requirements and how the Department uses them to oversee these loan programs.

We are sending copies of this letter to the appropriate congressional committees. We are also sending a copy to the Secretary of Education. The letter will be available at no charge on GAO's Web site at <http://www.gao.gov>. Should you or your staff have any questions concerning this letter, please contact me at 202-512-9095 or at dalykl@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this letter. Key contributors were Jack Warner, Assistant Director; Barry Grinnell; Chau Dinh; and Jennifer Dent.

Kay L. Daly
Director
Financial Management and Assurance

Enclosure - 1

List of Committees

The Honorable Tom Harkin
Chairman

The Honorable Michael B. Enzi
Ranking Member
Committee on Health, Education, Labor and Pensions
United States Senate

The Honorable George Miller
Chairman

The Honorable John P. Kline
Ranking Member
Committee on Education and Labor
House of Representatives

Federal Student Loans

Audits and Reviews of the Federal Family Education Loan and Federal Direct Loan Programs

**Briefing for Staff of
the Senate Committee on Health, Education,
Labor, and Pensions and
the House Committee on Education and Labor**

Overview

- Background
 - Objective
 - Scope and Methodology
 - Preliminary Observations
 - Types and Frequency of Audits and Reviews
 - Summary of Department of Education (Education) Audits, Reviews, Agreed-Upon Procedures, and Reconciliations of the Federal Family Education Loan (FFEL) and Federal Direct Loan (DL) programs (see Table 1)
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Background

- The Higher Education Act (HEA) of 1965, as amended, authorizes Education to provide assistance to postsecondary education students with programs such as the FFEL and DL programs.
 - In fiscal year 2008, Education guaranteed approximately \$52.9 billion in new net loans to about 6 million recipients under the FFEL program and made approximately \$21.8 billion in new net loans to about 3 million recipients under the DL program.
 - The Higher Education Opportunity Act of 2008 (HEOA), Pub. L. No. 110-315, revised and reauthorized HEA programs.
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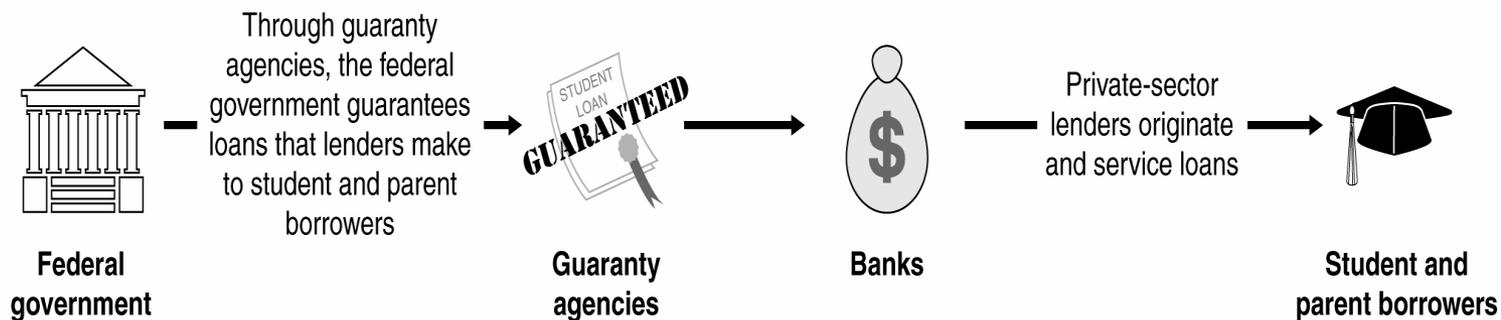
Background (cont.)

FFEL and DL Program Participants

- FFEL
 - U.S. Government
 - Schools
 - Lenders
 - Secondary Markets
 - Guaranty Agencies
 - Third-Party Servicers
 - Borrowers
- DL
 - U.S. Government
 - Schools
 - Third-Party Servicers
 - Borrowers

Background (cont.)

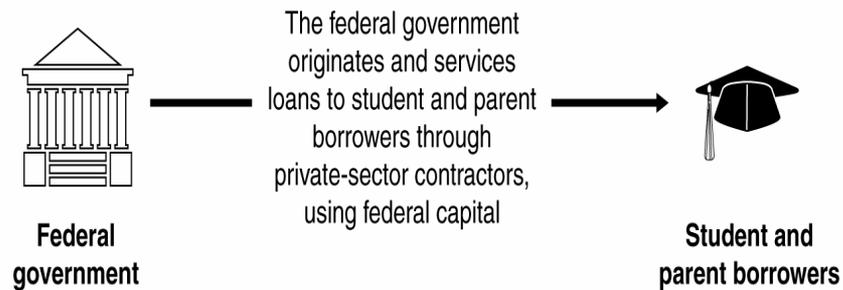
Overview of FFEL Program



Source: GAO.

Background (cont.)

Overview of DL Program

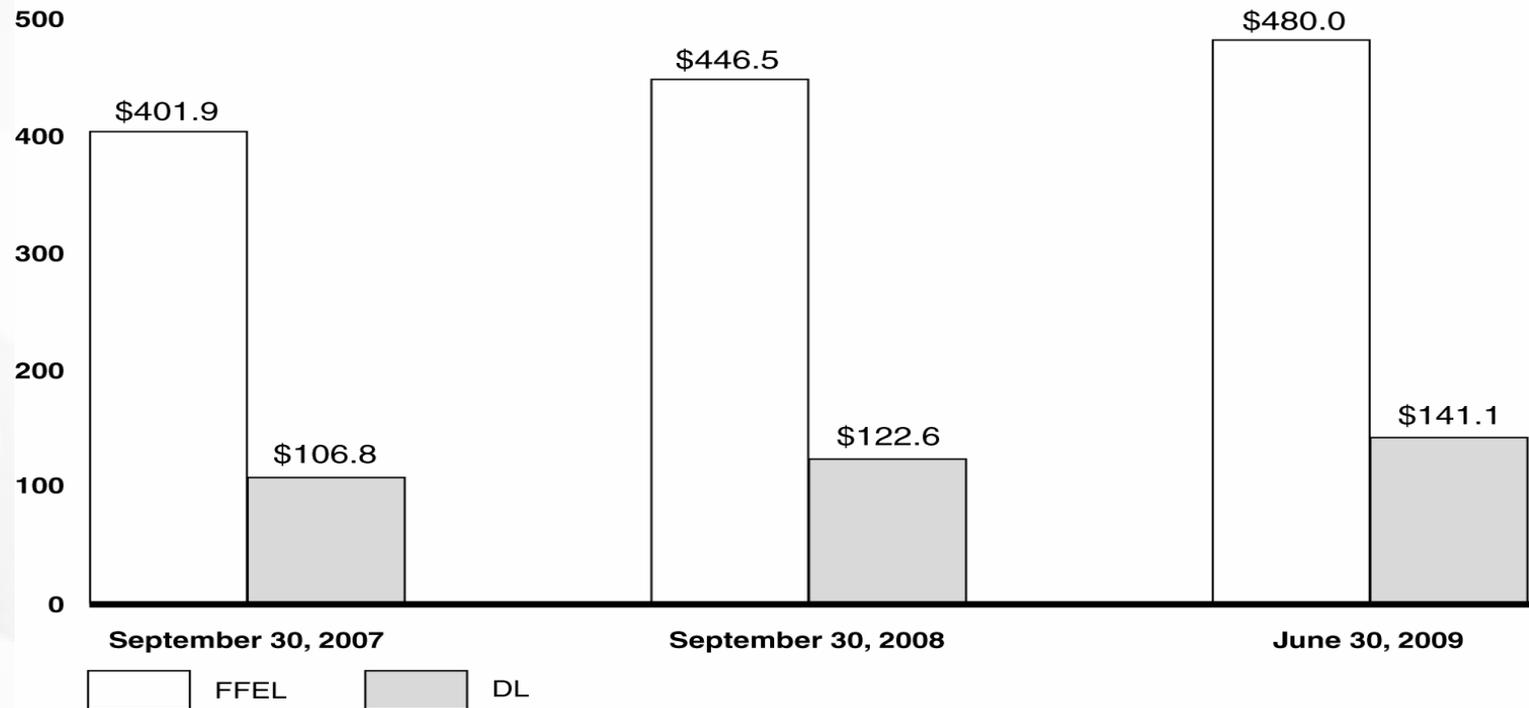


Source: GAO.

Background (cont.)

Loans Outstanding

Dollars in billions



Source: Department of Education's National Student Loan Data System.

Note: Loan totals include accrued interest.

Objective

- Section 1119 of the HEOA mandated that GAO study the financial and compliance audits and reviews required or conducted for the federal student loan programs under parts B (FFEL) and D (DL) of Title IV of the HEA.
- Our objective for this briefing was to identify the types of audits, reviews, agreed-upon procedures, and reconciliations required or conducted for the FFEL and DL programs.

Scope and Methodology

We categorized audits and reviews that are required or conducted as follows:

- Required audits, reviews, and agreed-upon procedures are those required by statutes, regulations, or contract terms. These include audits performed by independent public accountants and reviews performed by guaranty agency staff.
- Discretionary audits, reviews, and reconciliations are those conducted but not required by statutes, regulations, or contract terms that help enforce statutes, regulations, and contract terms. These include audits and reviews performed by Education's Office of Federal Student Aid (FSA) and Office of Inspector General (OIG).

Scope and Methodology (cont.)

To identify the types of audits, reviews, agreed-upon procedures, and reconciliations required or conducted for the FFEL and DL programs, we:

- researched laws and regulations;
 - reviewed audit and review guides, including:
 - Education FSA Review Guides, Policies, and Procedures;
 - OIG Audit Guides;
 - Office of Management and Budget (OMB) Circular No. A-133 and Compliance Supplements; and
 - OIG Ensuring Continued Access to Student Loans Act (ECASLA) Agreed-Upon Procedures Guides
 - interviewed knowledgeable officials from Education including FSA and the OIG; and
 - reviewed lists of audit reports from systems used by FSA to track report filings and audit findings.
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Scope and Methodology (cont.)

We conducted our work from March 2009 to August 2009 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for our work.

Types and Frequency of Audits and Reviews

We identified the following required audits, reviews, and agreed-upon-procedures:

- Financial statement audits performed annually to provide reasonable assurance that school, guaranty agency, and third party servicer financial statements are free of material misstatement.
- Compliance audits performed annually to assess school, lender, secondary market entity, guaranty agency, and third party servicer compliance with applicable statutes, regulations, and program requirements.
- ECASLA agreed-upon procedures engagements required to assess participant compliance with the provisions of the ECASLA programs.¹

¹The three ECASLA programs allow Education to buy certain loans from lenders to ensure funds are available for the FFEL program. The frequency of agreed-upon procedure engagements varies among the programs.

Types and Frequency of Audits and Reviews (cont.)

- Special Allowance audits annually performed to assess the accuracy of lender billings for the 9.5 percent special allowance payments.²
- Guaranty agency biennial program reviews of lenders with a high volume of guarantees and of schools whose students collectively have a default rate exceeding 20 percent to enforce federal, state, and guaranty agency requirements.

Education conducts additional discretionary audits and reviews:

- FSA conducts reviews of specific program issues relating to schools, lenders, secondary market entities, guaranty agencies, and third-party servicers based on risk assessments and other compelling factors that may indicate a review is appropriate.
- OIG conducts audits, investigations, and inspections of Education programs and operations based on risk assessments.

²Under the 9.5 percent Special Allowance Program, the federal government guarantees lenders a 9.5 percent minimum rate of return on certain FFEL loans. GAO previously reported on these loans in *Federal Family Education Loan Program: Statutory and Regulatory Changes Could Avert Billions in Unnecessary Federal Subsidy Payments*, GAO-04-1070 (Washington, D.C.: Sept. 20, 2004).

Types and Frequency of Audits and Reviews (cont.)

Further, audits and reviews of Education as a whole, though not focused specifically on FFEL and DL, provide audit and review coverage of these programs:

- annual financial statement audits under the Chief Financial Officers (CFO) Act, as amended (31 U.S.C. section 3515),
- annual internal control assessment under OMB Circular No. A-123, and
- annual information security assessment under the Federal Information Security Management Act.

Types and Frequency of Audits and Reviews (cont.)

In addition to the audits and reviews, FSA performs monthly reconciliations as part of its continuing oversight of contractors and schools associated with the DL, FFEL, and ECASLA programs. Per FSA, these reconciliations are an integral part of Education's internal control activities and help ensure that loan disbursements, receipts, and transfers are made and recorded in Education and other program participants' records accurately and timely.

See Table 1 for a Summary of Department of Education Audits, Reviews, Agreed-Upon Procedures, and Reconciliations of the FFEL and DL Programs.

Table 1

Education Audits, Reviews, Agreed-Upon Procedures, and Reconciliations of the FFEL and DL Programs as of August 31, 2009

AUDITEE and TYPE of REQUIRED AUDIT/REVIEW	Objective	Frequency ¹	Performed by	Authority	FFEL	DL
Schools						
Financial statements	Provide reasonable assurance that entity financial statements are free of material misstatement.	Annually	Independent Public Accountant (IPA)	20 U.S.C. 1094(c)(1)(A) and 34 CFR Section 668.23(b)	Required	Required
Compliance	Assess entity compliance with applicable statutes, regulations, and program requirements.	Annually	IPA	20 U.S.C. 1094(c)(1)(A) and 34 CFR Section 668.23(b)	Required	Required
Program reviews	Enforce federal, state, and guaranty agency requirements for schools having a student loan default rate exceeding 20 percent.	Biennially	Guaranty Agency (GA)	34 CFR 682.410(c)	Required	Not Applicable ²
Direct loan reconciliation	Assess whether funds drawn down by each school equal the amount disbursed to students.	Monthly with year-end closeout	Federal Student Aid (FSA)	34 CFR 685.102(b) and 20 U.S.C. 1087e	Not Applicable ²	Required
Lenders						
Compliance	Assess: (1) accuracy of origination fee, interest, and special allowance payments and (2) compliance with applicable statutes, regulations, and program requirements.	Annually	IPA	20 U.S.C. 1078(b)(1)(U) and 34 CFR 682.305(c)	Required	Not Applicable ²
Special allowance audits	Assess the accuracy of billings for the 9.5 percent special allowance payments.	Annually	IPA	20 U.S.C. 1078(b)(1)(U)	Required	Not Applicable ²
Program reviews	Enforce federal, state, and guaranty agency requirements.	Biennially	GA	34 CFR 682.410(c)	Required	Not Applicable ²
Secondary Markets						
Compliance	Assess entity compliance with applicable statutes, regulations, and program requirements.	At least once a year	IPA	20 U.S.C.A. 1094(c)(1)(D)	Required	Not Applicable ²
Lenders and Secondary Markets - Ensuring Continued Access to Student Loans Act (ECASLA)						
Agreed-upon procedures engagements	Assess lender and secondary market compliance with the provisions of the Loan Purchase Commitment Program.	Once, for all loans sold each quarter	IPA	Section 5 of the Master Loan Sales Agreement	Required	Not Applicable ²
Agreed-upon procedures engagements	1) Assess lender and secondary market compliance with the provisions of the Loan Participation Program.	Based on loan volume and error rate ³	IPA	Section 8 of the Master Participation Agreement	Required	Not Applicable ²
	2) Assess custodian compliance with the provisions of the Master Participation Agreement.	Annually	IPA	Section 8 of the Master Participation Agreement	Required	Not Applicable ²
Agreed-upon procedures engagements	1) Assess lender and secondary market compliance with provisions of the Asset-Backed Commercial Paper Conduit Put Program -- Putability ⁴ and Eligibility. ⁵	Once to determine putability ⁴ Quarterly for eligibility ⁵	IPA	Section 20 of the Put Agreement, Section 8 of the Student Loan Purchase Agreement, and Article 1 of the Funding Note Purchase Agreement	Required	Not Applicable ²
	2) Assess conduit administrator compliance with provisions of the Put Agreement.	Annually	IPA	Section 20 of the Put Agreement	Required	Not Applicable ²
Guaranty Agencies						
Financial statements	Provide reasonable assurance that entity financial statements are free of material misstatement.	Annually	IPA	34 CFR 682.410(b)	Required	Not Applicable ²
Compliance	Assess entity compliance with applicable statutes, regulations, and program requirements.	Annually	IPA	34 CFR 682.410(b)	Required	Not Applicable ²
Third-Party Servicers						
Financial statements of servicers for lenders and guaranty agencies	Provide reasonable assurance that entity financial statements are free of material misstatement.	Annually	IPA	34 CFR 668.23(d)(5)	Required	Not Applicable ²
Compliance	Assess entity compliance with applicable statutes, regulations, and program requirements.	Annually	IPA	FFEL third-party servicers: 20 U.S.C. 1094 (c)(1)(c) and 34 CFR 682.416(e); School third-party servicers: 34 CFR 668.23	Required	Required
TYPE of DISCRETIONARY AUDIT/REVIEW	Objective	Frequency	Performed by	Authority	FFEL	DL
FSA Reviews	Address specific program issues and follow-up on prior audit findings.	Based on risk	FSA	Lenders: 34 CFR 682.414(c); Guaranty Agencies: 34 CFR 668.24; Schools: 20 U.S.C. 1099c; and Servicers: 34 CFR 682.416(c)	Discretionary	Discretionary
OIG audits	Audit, investigate, and inspect student loan programs and operations.	Based on risk	OIG	Inspector General Act of 1978 and 5 U.S.C. app.	Discretionary	Discretionary
RECONCILIATIONS OF ACCOUNTS	Objective	Frequency	Performed by	Authority	FFEL	DL
Reconciliations	Help ensure that loan disbursements, receipts, and transfers are made and recorded in Education and other program participants' records accurately and timely.	Monthly	FSA	OMB Circular A-123, OMB Circular A-136, the CFO Act of 1990, and ECASLA Agreements	Discretionary	Discretionary

1. Exceptions to these frequencies are based on factors such as loan volume and the servicer's relationship with program participants.

2. Certain audits, reviews, and reconciliations are not applicable because of the structure, operations, and participants of the FFEL and DL programs differ.

3. Every one, three, or six months. The error rate is the rate of ineligible loans identified in the previous engagement.

4. Putability -- Under this program, Education agrees to purchase loans that meet specific criteria from lenders, at the lender's discretion. The review is conducted once to ensure that loans are "putable."

5. Eligibility -- Under this program, "putable" loans are reviewed quarterly to ensure that they continue to meet specific criteria.

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