
July 2010

FEDERAL STUDENT LOAN PROGRAMS

Opportunities Exist to Improve Audit Requirements and Oversight Procedures





Highlights of GAO-10-668, a report to congressional committees

Why GAO Did This Study

The Higher Education Opportunity Act of 2008, Pub. L. No. 110-315, mandated GAO to study the financial and compliance audits and reviews required or conducted for the Federal Family Education Loan (FFEL) program and the Federal Direct Student Loan (DL) program. The Department of Education's (Education) Office of Federal Student Aid is responsible for administering these programs. This report focuses on

- (1) identifying differences and similarities in audit requirements and oversight procedures for the FFEL and DL programs, including anticipated changes to selected oversight activities and
- (2) describing how the Office of Federal Student Aid's policies and procedures are designed to monitor audits and reviews. To do so, GAO interviewed Education and inspector general officials and reviewed numerous audit guides, agency procedures, checklists, and audit tracking systems.

What GAO Recommends

GAO recommends that the Education Inspector General update the OIG *Lender Audit Guide* to include all appropriate regulatory requirements for audits of ongoing FFEL participants. GAO also recommends that the Secretary of Education develop and implement policies and procedures requiring Office of Federal Student Aid review of audited financial statements for lender servicers. The Education Office of Inspector General and Education agreed with GAO's recommendations.

[View GAO-10-668 or key components.](#)
For more information, contact Kay Daly at (202) 512-9095 or dalykl@gao.gov.

July 2010

FEDERAL STUDENT LOAN PROGRAMS

Opportunities Exist to Improve Audit Requirements and Oversight Procedures

What GAO Found

GAO identified differences and similarities in audit requirements and oversight procedures for the two programs. Differences include the following:

- The FFEL and DL programs generally had different audit requirements stemming primarily from divergent program structures. The FFEL program relied on lenders, guaranty agencies—which administer federal government loan guarantees to lenders—and other entities that were subject to statutory and regulatory audit requirements. The DL program did not have as many audit requirements because DL loans are provided by the federal government, and fewer external entities are involved.
- GAO found differences in audit requirements for nonprofit and for-profit lenders. Certain applicable audit objectives included in Office of Management and Budget (OMB) requirements for compliance audits of nonprofit lenders were not included in the Department of Education Office of Inspector General (OIG) *Lender Audit Guide* for compliance audits of for-profit lenders. As a result, audits of lenders performed in accordance with the OIG *Lender Audit Guide* were at risk of omitting compliance testing for a key audit objective.

Similarities in audit requirements and oversight procedures include these:

- Schools were subject to annual financial statement and compliance audits under both programs.
- The functions performed by the DL servicer, with which Education contracts to administer certain functions of the DL program, were similar to functions performed by lenders, guaranty agencies, and their servicers in the FFEL program. GAO's analysis found that objectives addressed by FFEL participant compliance audits were similar to the objectives addressed through oversight procedures for the DL servicer, such as Education's review of the servicer's monthly performance metrics.

The passage of the Health Care and Education Reconciliation Act of 2010 terminated the authority to make new FFEL loans after June 30, 2010.

Borrowers who would have been eligible to obtain new FFEL loans could receive loans under the DL program.

Regarding Office of Federal Student Aid's monitoring activities, staff were to use financial statement audits to oversee the financial condition of the schools and guaranty agencies that participate in the student loan programs. Compliance audits of schools, lenders, guaranty agencies, and their third-party servicers help Education ensure that these participants comply with applicable statutes, regulations, and program requirements. The Office of Federal Student Aid was required to track findings in these audit reports. GAO found that third-party servicers for lenders in the FFEL program did not submit their audited financial statements to Education as required. Education lacked a policy and specific procedures to ensure receipt and review of these audited financial statements. Without such reviews, the Office of Federal Student Aid might not be informed of a third-party servicer's unfavorable audit opinion or significant reported findings that could affect program operations.

Contents

Letter		1
Background		3
FFEL and DL Audit Requirements and Oversight Procedures		
Generally Differed with Divergent Program Structures, and		
Certain Audit Guidance Was Inconsistent with Regulations		7
Federal Student Aid Had Policies and Procedures Designed to		
Monitor Audits, but Certain Audit Reports Were Not Required to		
Be Reviewed		14
Conclusions		20
Recommendations for Executive Action		20
Agency Comments and Our Evaluation		21
Appendix I	Summary of FFEL and DL Program Audits and Reviews	23
Appendix II	Objectives, Scope, and Methodology	26
Appendix III	Comments from the Department of Education Office of Inspector General	29
Appendix IV	Comments from the Department of Education Office of Federal Student Aid	30
Appendix V	GAO Contact and Staff Acknowledgments	32
Tables		
Table 1: FFEL Participants during Fiscal Year 2009		5
Table 2: DL Participants during Fiscal Year 2009		5
Table 3: Education Audits, Reviews, Agreed-Upon Procedures, and Reconciliations of the Federal Family Education Loan (FFEL) and William D. Ford Federal Direct Loan (DL) Programs as of August 31, 2009		23

Figures

Figure 1: FFEL and DL Loans Outstanding as of September 30, 2008 and 2009	4
Figure 2: Overview of Audit and Review Requirements for the FFEL and DL Programs	8
Figure 3: Program Compliance Office's Oversight Responsibilities for Audits of the FFEL and DL Programs	15
Figure 4: School Eligibility Channel and Financial Partners Processes for Monitoring Receipt, Acceptability, and Resolving Required Audits	17

Abbreviations

AUP	Agreed-Upon Procedures
CFO	Chief Financial Officer
DL	William D. Ford Federal Direct Loan
ECASLA	Ensuring Continued Access to Student Loans Act
Education	Department of Education
FFEL	Federal Family Education Loan
Financial Partners	Financial Partner Eligibility and Oversight
FSA	Office of Federal Student Aid
GA	Guaranty Agency
GAGAS	Generally Accepted Government Auditing Standards
HCERA	Health Care and Education Reconciliation Act of 2010
HEA	Higher Education Act of 1965
HEOA	Higher Education Opportunity Act of 2008
IPA	Independent Public Accountant
IPM	Integrated Partner Management
NSLDS	National Student Loan Data System
OIG	Office of Inspector General
OMB	Office of Management and Budget
PEPS	Postsecondary Education Participants System
SAP	Special Allowance Payments

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



**United States Government Accountability Office
Washington, DC 20548**

July 21, 2010

Congressional Committees

In fiscal year 2009, the Department of Education (Education) provided or oversaw the provision of over \$90 billion in federal student loans to almost 11 million postsecondary students and their families under the Higher Education Act of 1965 (HEA).¹ Of that amount, Education guaranteed² \$62.5 billion in loans from nonfederal lenders to 7.7 million borrowers under the Federal Family Education Loan (FFEL) program and disbursed \$23.7 billion in loans to 2.9 million borrowers under the William D. Ford Federal Direct Loan (DL) program. These two loan programs have different operating structures that involve various participants.

Education's Office of Federal Student Aid (Federal Student Aid), led by its Chief Operating Officer, is responsible for overall program administration and oversight of the FFEL and DL programs. As part of its oversight, Federal Student Aid is required to review and resolve audits of entities that participate in the operation of these programs. Schools, lenders, guaranty agencies,³ and other program participants are subject to audits and reviews focused on financial statements, internal controls, and compliance with laws and program regulations.

In March 2010, the Health Care and Education Reconciliation Act of 2010 (HCERA) terminated the authority to make new FFEL loans after June 30, 2010.⁴ Instead, borrowers who would have been eligible to receive FFEL loans could receive loans made by Education under the DL program. However, FFEL loans outstanding after that date will continue under the same structure with Federal Student Aid oversight for possibly 30 years,

¹Department of Education, Federal Student Aid, *FY 2009 Annual Report*, (Washington, D.C., November 2009).

²The federal government assumes the responsibility for payment of a borrower's debt that is owed to a lender in instances of the borrower's default, death, permanent disability, or in limited circumstances, bankruptcy.

³Guaranty agencies are state or nonprofit entities that perform certain FFEL program oversight and administrative functions, including federal government guarantees of FFEL loan repayment to lenders.

⁴Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, title II, § 2201, 124 Stat. 1029, 1074 (Mar. 30, 2010).

depending on the repayment plan.⁵ Accordingly, Federal Student Aid officials expect the audits and reviews of the FFEL program to remain part of that oversight.

To identify how audits and reviews compare between the programs as well as how Education uses these audits and reviews, the Higher Education Opportunity Act (HEOA) of 2008,⁶ which revised and reauthorized the HEA programs, mandated that GAO study the financial statement and compliance audits and reviews required or conducted⁷ as part of the management of FFEL and DL programs. In response to this mandate, on September 30, 2009, we issued a report⁸ that identified the audits and reviews for the FFEL and DL programs. For a summary of this information, see appendix I. To complete our response to this mandate, this report focuses on (1) identifying differences and similarities in audit requirements and oversight procedures⁹ for the FFEL and DL programs including anticipated changes to selected Federal Student Aid oversight activities and (2) describing how Federal Student Aid's policies and procedures are designed to monitor audits and reviews.

To achieve the first objective, we analyzed audit requirements and oversight procedures under both programs. For those audits and reviews applicable to both programs, we compared the relevant audit guides to assess whether the requirements were similar. We did not evaluate the quality of the design of audit requirements or oversight procedures or the extent to which the audit requirements or oversight procedures were implemented. The scope of our work did not include program reviews conducted by guaranty agencies and other Federal Student Aid reviews because the review objectives were unique to each review. To address our

⁵FFEL and DL borrowers are not required to begin repayment until graduation or withdrawal from school. The repayment period could range from 10 to 30 years.

⁶Pub. L. No. 110-315, 122 Stat. 3078 (Aug. 14, 2008).

⁷Required audits and reviews are those required by statutes and regulations, and, for purposes of this report, include attestation and agreed-upon procedure engagements. Conducted audits and reviews are discretionary and not required by statutes and regulations.

⁸GAO, *Federal Student Loans: Audits and Reviews of the Federal Family Education Loan and Federal Direct Loan Programs*, GAO-09-992R (Washington D.C.: Sept. 30, 2009).

⁹For the purposes of this report, oversight procedures refer to Federal Student Aid's monthly review of performance metrics as well as other procedures, including reconciliations.

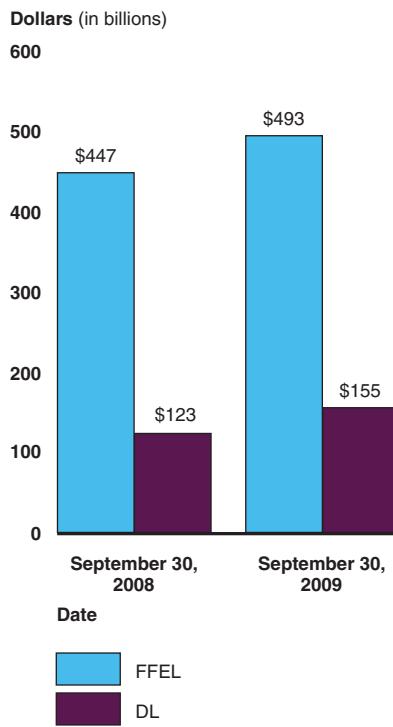
second objective, we analyzed Federal Student Aid's policies and procedures, observed systems demonstrations, and interviewed Federal Student Aid officials to obtain an understanding of the agency's processes for monitoring receipt, acceptability, and resolution of required audits and reviews. We did not confirm whether the processes were implemented as designed. See appendix II for additional information about our scope and methodology.

We conducted this performance audit at Federal Student Aid offices in Washington, D.C., from August 2009 to July 2010 in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The FFEL and DL programs have substantially different structures but both provide student loans to help students meet the costs of obtaining a postsecondary education. FFEL loans are provided by nonfederal lenders and repayment is guaranteed by the federal government. Under the DL program, the federal government provides loans to students and their families, using federal capital. Figure 1 shows the FFEL and DL program loan volume outstanding as of September 30, 2008 and 2009.

Figure 1: FFEL and DL Loans Outstanding as of September 30, 2008 and 2009



Source: Department of Education.

Note: Loan totals include accrued interest. GAO presentation of National Student Loan Data System data, unaudited.

Overview of the FFEL Program

In the FFEL program, student loans are made by nonfederal lenders, which can be for-profit or nonprofit entities. Lenders are protected against borrower defaults by federal government guarantees that are administered by guaranty agencies. Guaranty agencies are state or nonprofit entities that also perform other administrative and oversight functions under the FFEL program. For example, guaranty agencies provide counseling to borrowers regarding delinquent loan repayment and initiate collections on defaulted loans.

Generally, lenders provide the FFEL loan proceeds to a student's school, which then credits the student's account and disburses the residual amount,¹⁰ if any, to the student. Schools, lenders, and guaranty agencies

¹⁰The residual amount is the amount of loan proceeds remaining after the school collects tuition, fees and, if applicable, room and board.

often employ third-party servicers to perform functions related to the administration of the FFEL program. For example, a lender may hire a servicer to process borrower payments. Table 1 details the number of FFEL participants.

Table 1: FFEL Participants during Fiscal Year 2009

Participant	Number of participants
Schools	4,555 ^a
Third-party servicers for schools	270 ^b
Lenders	2,786
Secondary markets ^c	48
Guaranty agencies	33
Third-party servicers for lenders and guaranty agencies	38
Borrowers with outstanding loans	25 million

Source: Federal Student Aid.

Note: The data are unaudited.

^aIncludes 1,048 schools that participate in both the FFEL and DL programs.

^bIncludes school servicers that participate in the FFEL and DL programs.

^cOriginating lenders often sell their student loans to secondary markets, thereby obtaining additional capital to make new student loans.

Overview of the DL Program

In the DL program, student loans are fully funded by the federal government, which provides the loan proceeds to the student's school. The school then credits the student's account and disburses any residual amount to the student. Schools sometimes contract with third-party servicers to assist in administering the operations of the DL program. In addition, Education contracts with a servicer (DL servicer) to administer certain aspects of the DL program, such as payment processing. The number of participants in the DL program is detailed in table 2.

Table 2: DL Participants during Fiscal Year 2009

Participant	Number of participants
Schools	2,011 ^a
Third-party servicers for schools	270 ^b
DL servicer	1
Borrowers with outstanding loans	9 million

Source: Federal Student Aid.

Notes: The data are unaudited.

^aIncludes 1,048 schools that participate in both the FFEL and DL programs.

^bIncludes school servicers that participate in the FFEL and DL programs.

Under HCERA, no new FFEL loans may be made after June 30, 2010. Borrowers who may have been eligible to obtain new FFEL loans prior to the passage of HCERA could receive loans under the DL program. Accordingly, the number of DL borrowers is expected to increase with the expansion of the program. Education has awarded contracts to four additional DL servicers to begin servicing direct loans by August 31, 2010.

Overview of Audit Guidance

Audits required under FFEL or DL are performed in accordance with guidance issued by the Office of Management and Budget (OMB) or the applicable Department of Education Office of Inspector General (OIG) audit guide. States, local government entities, and nonprofit entities are generally required to have their audits performed in accordance with OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Institutions*,¹¹ although, if federal student assistance is the only federal program in which the entity participates, OMB Circular No. A-133 gives the entity the option of using the program-specific audit guide issued by the OIG in place of the guidance produced under the Circular. For-profit entities are required to have their audits performed in accordance with the applicable OIG audit guide.

¹¹OMB Circular No. A-133 provides guidance for implementing the requirements of the Single Audit Act, 31 U.S.C. §§ 7501-7507. The Single Audit Act requires states, local governments, and nonprofit organizations expending \$500,000 or more in federal awards in a year to obtain an audit in accordance with the requirements set forth in the act.

FFEL and DL Audit Requirements and Oversight Procedures Generally Differed with Divergent Program Structures, and Certain Audit Guidance Was Inconsistent with Regulations

Audit Requirements Generally Differed for the FFEL and DL Programs

The FFEL and DL programs generally have different audit requirements stemming mainly from different program structures. The FFEL program relies on lenders, guaranty agencies, and other entities that are subject to statutory, regulatory, and contractual audit requirements. The DL program does not have as many of these audit requirements because DL loans are provided by the federal government, and fewer external entities are involved. The audit requirements set out under the FFEL and DL programs are similar with regard to schools and their servicers, which are participants in both programs. We noted that certain for-profit lender audit guidance was inconsistent with regulations. Finally, oversight procedures for the DL servicer were designed to assess the DL servicer's performance in servicing loans in the program. Different oversight procedures are planned for four additional DL servicers expected to begin servicing direct loans by August 31, 2010.

The FFEL and DL programs have different statutory and regulatory requirements for audits and program reviews, with more audit requirements in place for the FFEL program, which involves more participants external to the government. For instance, because the FFEL program relies on thousands of nonprofit and for-profit lenders, there are regulatory requirements for compliance audits and program reviews of those lenders. Such requirements do not apply to the DL program, which provides student loans through a single lender—the federal government. Similarly, required agreed-upon procedures¹² engagements for the Ensuring Continued Access to Student Loans Act (ECASLA)¹³ and audits of 9.5% Special Allowance Payments¹⁴ are only applicable to lenders in the FFEL program. Figure 2 summarizes the audit and review requirements for

¹² Agreed-upon procedures are engagements in which an auditor is engaged to issue a report of findings based on specific procedures that the auditor and parties specified by the auditee agree are appropriate.

¹³ Pub. L. No. 110-227, 122 Stat. 740 (May 7, 2008). ECASLA provided Education with the authority to purchase or enter into commitments to purchase FFEL loans from lenders and secondary markets to help ensure that federally guaranteed loans are available for all eligible borrowers.

¹⁴ Under the 9.5% Special Allowance Payment authority, the federal government guarantees lenders a 9.5 percent minimum rate of return to encourage lenders to make 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).

the FFEL and DL programs, and appendix I includes more details about these activities.

Figure 2: Overview of Audit and Review Requirements for the FFEL and DL Programs

Required audits and reviews	FFEL	DL
Schools		
Annual financial statement audit	■	■
Annual compliance audit	■	■
Biennial program review by guaranty agencies	■	▲
Monthly DL reconciliation	◆	■
Third-party servicers for schools		
Annual compliance audit	■	■
Lenders		
Annual compliance audit	■	●
Biennial program review by guaranty agencies	■	▲
Annual special allowance payment audit	■	▲
ECASLA agreed-upon procedures engagement	■	▲
Third-party servicers for lenders		
Annual financial statement audit	■	●
Annual compliance audit	■	●
Guaranty agencies		
Annual financial statement audit	■	●
Annual compliance audit	■	●
Third-party servicers for guaranty agencies		
Annual financial statement audit	■	●
Annual compliance audit	■	●

■ Applicable to the program

▲ Biennial program reviews of schools and lenders performed by guaranty agencies do not apply to DL because guaranty agencies participate only in the FFEL program. Annual special allowance payment audits and ECASLA agreed-upon procedures engagements for nonfederal lenders do not apply to DL because these lenders participate only in the FFEL program.

◆ This reconciliation of funds received from Education for DL program student loans to amounts it disburses to students does not apply to the FFEL program because FFEL loans are not funded by the federal government.

● Certain functions performed by the DL servicer for the DL program are performed for the FFEL program by lenders, guaranty agencies, and their servicers, which are not participants in the DL program. The DL servicer is subject to oversight procedures designed to monitor its performance.

Source: GAO analysis of applicable laws, regulations, and contracts for the FFEL and DL programs (see app. I).

Note: Other audits and reviews may be performed for both programs at the discretion of the Education OIG or Federal Student Aid.

Both Programs Had Similarities in Audit Requirements for Schools and Their Servicers

While our analysis showed audit requirements generally differed, schools under both programs had similar requirements to have annual financial statement audits performed by independent public accountants (IPA).¹⁵ School financial statement audits focus on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. These financial statement audits are to be performed in accordance with GAGAS.¹⁶ GAGAS also requires IPAs to report on the results of certain tests performed on internal controls over financial reporting and compliance with certain provisions of laws, regulations, and program requirements. Financial statement audit reports provide Education with information about the financial condition of participants, any significant internal control deficiencies,¹⁷ and instances of noncompliance. Third-party servicers employed by schools to aid in the administration of their federal loans are not generally required to have financial statement audits under either the FFEL or DL programs.

Both programs also require schools and school servicers to have annual compliance audits performed by IPAs.¹⁸ The audits focus on whether these participants comply with applicable statutes, regulations, and program requirements. For example, school compliance audits for both programs

¹⁵34 C.F.R. § 668.23.

¹⁶Financial statement audits performed under the Single Audit Act are performed in accordance with GAGAS and guidance issued by the Office of Management and Budget, and financial statement audits performed under an OIG-issued audit guide are to be performed in accordance with GAGAS and generally accepted auditing standards.

¹⁷A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

¹⁸34 C.F.R. § 668.23 requires that school servicers have an annual compliance audit performed of the servicer's administration of federal student assistance programs—including both FFEL and DL—of each school at which the servicer has a contract, unless the servicer contracts with only one participating school and the audit of that school's participation involves every aspect of the servicer's administration of those programs. Compliance audits performed under the Single Audit Act are performed in accordance with GAGAS and guidance issued by the Office of Management and Budget, and compliance audits performed under an OIG-issued audit guide are performed in accordance with GAGAS and the American Institute of Certified Public Accountants attestation standards.

are designed to test whether schools perform student eligibility validation.¹⁹ These audits are to determine whether a school has verified that certain student requirements, such as citizenship and financial need, have been met. In addition, schools participating in the student loan programs are required to follow specified criteria for applying loan proceeds to students' accounts and disbursing residual amounts to students within established time frames. To illustrate, for students borrowing from the FFEL or DL programs, schools should not credit a registered student's account more than 10 days before the first day of classes. For both programs, compliance with these requirements is monitored through the annual compliance audit.

If performed properly, the required audits for FFEL and DL participants should address federal and borrower interests. Audits address federal fiscal interests if they are designed to help protect the government from financial loss and address borrower interests if they are designed to help ensure that qualified individuals (1) have access to federal student loans and (2) are protected from financial loss. For instance, auditors assess whether schools that participate in either program complied with refund requirements.²⁰ Refund requirements for both programs include the proper return of program funds in the case of unearned tuition and other charges for a student who received federal student aid if the student did not register, dropped out, was expelled, or otherwise failed to complete the period of enrollment. Proper refunds to the lender or federal government reduce the outstanding loan amount, thus protecting federal and borrower interests.

Certain Audit Guidance for FFEL Lenders Did Not Incorporate All Requirements

As noted previously, HCERA terminated the authority to make new FFEL loans after June 30, 2010. However, FFEL loans outstanding after that date will continue under the same structure with Federal Student Aid oversight for many years, depending on the repayment plan. Accordingly, we identified and reviewed audit objectives and related guidance and found one area where the guidance for compliance audits of for-profit and

¹⁹These tests are described at Department of Education, Office of Inspector General, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers* (January 2000), II-13 and Office of Management and Budget, OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* Compliance Supplement, Part 5, *Student Financial Assistance Programs* (March 2009), 5-3-8.

²⁰See 34 C.F.R. § 668.22.

nonprofit FFEL lenders differed. FFEL lenders can be for-profit or nonprofit and, in some cases, can be the schools themselves.²¹ For-profit lenders are required to have their audits performed in accordance with the OIG *Lender Audit Guide*. Nonprofit lenders are generally required to have their audits performed in accordance with OMB Circular No. A-133, although the Single Audit Act²² and OMB Circular No. A-133 allow lenders to elect to have their audits performed using the OIG audit guide if federal student assistance is the only federal program in which the lender participates.

Certain compliance objectives included in OMB Circular No. A-133 for nonprofit lenders were not included in the OIG *Lender Audit Guide* used to audit for-profit lenders and the nonprofit lenders that elect to undergo an audit under the OIG guide instead of OMB Circular No. A-133. These objectives address the compliance testing for regulatory requirements of the programs. One of these omitted objectives remains applicable after the passage and implementation of HCERA. Specifically, the following OMB Circular No. A-133 audit objective was not in the OIG *Lender Audit Guide* required for audits of for-profit lenders, including for-profit schools that make or originate FFEL loans:

“School lenders proceeds: Determine whether schools that made FFEL loans use borrower interest payments, Education special allowance payments, interest subsidies, and any proceeds from the sale of loans to supplement needs-based grants for its students, as required.”

This audit objective is designed to assess whether school lenders appropriately comply with regulations²³ affecting significant amounts of proceeds from loans. The OIG *Lender Audit Guide* has been supplemented with several amendments for specific changes to audit requirements, but has not been comprehensively updated since December 1996 and, as amended, did not address this audit objective. OIG officials told us they plan to update the OIG *Lender Audit Guide* to appropriately address this omission.

²¹Under the Higher Education Reconciliation Act of 2005, Pub. L. No. 109-171, title VIII, § 8011, 120 Stat. 4, 165 (Feb. 8, 2006), only those schools that made FFEL loans prior to April 1, 2006 are allowed to continue as a school lender.

²²31 U.S.C. § 7502.

²³34 C.F.R. § 682.601(a).

Education Has Designed Procedures for Oversight of the DL Servicer

The functions performed by the DL servicer are similar to certain functions performed by lenders, guaranty agencies, and their servicers in the FFEL program. The DL servicer is not required to have an independent auditor perform financial and compliance audits similar to those required of guaranty agencies, guaranty agency servicers, and lender servicers in the FFEL program. Instead, Federal Student Aid directly oversees the DL servicer's performance as a federal contractor through monthly reviews of performance metrics as well as other procedures, including monthly reconciliations of loan balances recorded by the DL servicer to those in Federal Student Aid records.²⁴ Federal Student Aid officials are to review reports generated by the Independent Quality Control Unit, a component of the DL servicer that performs analysis to help ensure that the DL servicer's performance metrics are correctly calculated and accurately reported and that corrective actions from prior audits are implemented. These oversight procedures are designed to assess and evaluate the DL servicer's performance in servicing loans in the DL program.²⁵

Our analysis showed that the objectives of the oversight procedures to be performed by Federal Student Aid over the DL servicer share some similarities with the objectives being addressed by audits of FFEL lenders, guaranty agencies, and their servicers. For example, both FFEL lenders and the DL servicer are to update student records to reflect changes in a student's status—such as student enrollment, which affects the repayment of the loan. For FFEL lenders, the performance of this function is to be evaluated in the annual compliance audit of lenders performed by IPAs. For the DL servicer, this function is to be evaluated through the oversight procedures performed by Federal Student Aid staff, including monthly reviews of performance metrics that monitor the DL servicer's performance. For example, Federal Student Aid is to monitor whether the DL servicer meets the 2-day standard for completing student status updates and the 98 percent standard for status update accuracy. Other examples of similar functions monitored by compliance audits in the FFEL program and by oversight procedures in the DL program include timely

²⁴The Federal Acquisition Regulation and various procurement laws that it implements, together with the terms and conditions of the DL servicer contract, set forth the servicer's obligations and Federal Student Aid's general contract management requirements. For example, Federal Acquisition Regulation § 37.503 calls for developing appropriate performance standards so that agency requirements can be met.

²⁵These oversight procedures do not provide the same level of independent oversight and assurance regarding the DL servicer's compliance with applicable program requirements as compliance audits performed by IPAs.

and accurate application of loan payments to borrower accounts and timely review and processing of loan discharge claims.²⁶

Different Oversight Procedures Apply to Additional DL Servicers

In 2009, Federal Student Aid awarded contracts to four additional servicers to address increased direct loan volume stemming from changed student loan market conditions and potential further volume increases.²⁷ HCERA, passed in March of 2010, terminated the authority to make new FFEL loans after June 30, 2010, which, according to Federal Student Aid officials, will add substantially to Federal Student Aid's direct loan volume and DL servicing needs. The new servicers, expected to begin servicing direct loans by August 31, 2010, are subject to oversight procedures that differ from the current DL servicer. According to Federal Student Aid's contract monitoring plan, these activities will include transaction analysis and reconciliations as well as internal control and program compliance reviews. For example, according to the contract monitoring plan, Federal Student Aid staff are expected to perform periodic transaction analysis at the borrower account level to determine the servicing accuracy of transactions. Federal Student Aid officials and DL servicer are to discuss issues identified through transaction analysis and the status of corrective actions at weekly operational meetings. In addition, the monitoring plan states that program compliance reviews are to be conducted as needed, at least annually, to determine if servicing is in compliance with requirements. According to Federal Student Aid officials, guidance for some of these oversight procedures is under development.

The contract monitoring plan also calls for the additional DL servicers to be subject to internal control examinations performed by IPAs in

²⁶Loans received under the student loan programs can be cancelled under limited circumstances such as a student's death or disability, or may qualify for discharge under conditions such as school closures or false certification from the school.

²⁷The unit pricing provisions of the contracts allow Federal Student Aid to be prepared for servicing an indeterminable volume of direct loans. Each of the contracts provides for payment based on the number of borrowers processed and has a \$5 million minimum award for the initial 5-year term.

accordance with Statement on Auditing Standards No. 70.²⁸ Each additional DL servicer is to provide Federal Student Aid with an IPA report on the examination of its operational controls semiannually and on the examination of its information technology controls annually. These examinations are in addition to Education's annual review of internal controls required by OMB Circular No. A-123.²⁹ In addition, the contracts call for the additional DL servicers to be subject to performance measures focused on default prevention and surveys of borrower satisfaction, school satisfaction, and Federal Student Aid staff satisfaction with servicer performance. These performance measures are to be used to compare the additional DL servicers' relative performance as one factor in determining the allocation of direct loans to them for servicing. Education officials expect to have these oversight procedures in place by the time the additional DL servicers begin servicing direct loans.

Federal Student Aid Had Policies and Procedures Designed to Monitor Audits, but Certain Audit Reports Were Not Required to Be Reviewed

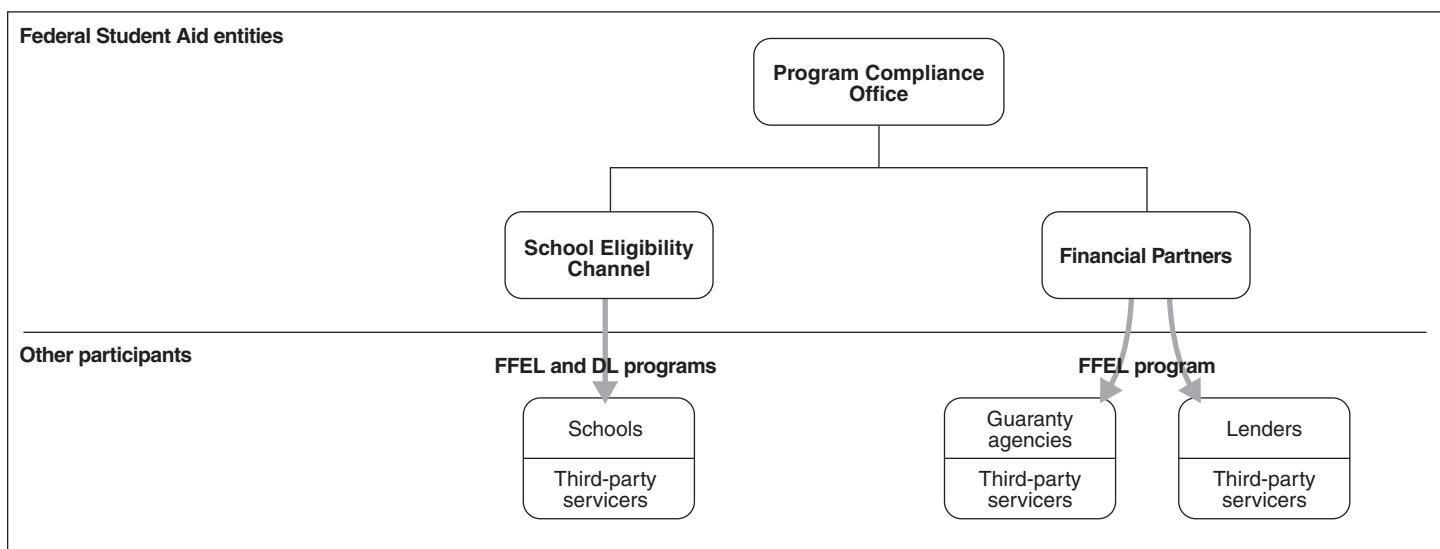
FFEL and DL participants submit required audits to Federal Student Aid. Components of Federal Student Aid's Program Compliance office, including the School Eligibility Channel and Financial Partner Eligibility and Oversight (Financial Partners) are responsible for providing oversight by ensuring that the audits performed comply with statutory and regulatory requirements. The School Eligibility Channel is responsible for providing oversight of audits of schools and school servicers that participate in the FFEL and DL programs. Financial Partners is responsible for the oversight of audits of lenders, guaranty agencies, and

²⁸Statement on Auditing Standards No. 70, *Service Organizations*, is the authoritative guidance that allows service organizations to disclose their control activities and processes to their customers and their customers' auditors in a uniform reporting format. The issuance of a service auditor's report prepared in accordance with Statement on Auditing Standards No. 70 signifies that a service organization has had its control objectives and control activities examined by an independent accounting and auditing firm. The service auditor's report includes valuable information regarding the service organization's controls and the effectiveness of those controls.

²⁹Office of Management and Budget, *Management's Responsibility for Internal Control*, Circular No. A-123 (Washington, D.C., Dec. 21, 2004). OMB Circular No. A-123 prescribes requirements for executive agencies to conduct annual assessments of their systems of internal control and provides specific requirements for the 24 major departments and agencies covered under the Chief Financial Officers Act of 1990 to follow in conducting management's annual assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The procedures and systems of the additional DL servicers will be included in Education's annual assessment of the effectiveness of its internal control over financial reporting.

their servicers participating in the FFEL program. These activities are to be accomplished through audit resolution and program review processes. Figure 3 depicts the respective oversight responsibilities of the School Eligibility Channel and Financial Partners.

Figure 3: Program Compliance Office's Oversight Responsibilities for Audits of the FFEL and DL Programs



Source: GAO analysis of Department of Education data.

Note: The data are from Federal Student Aid process descriptions and interviews with Education officials.

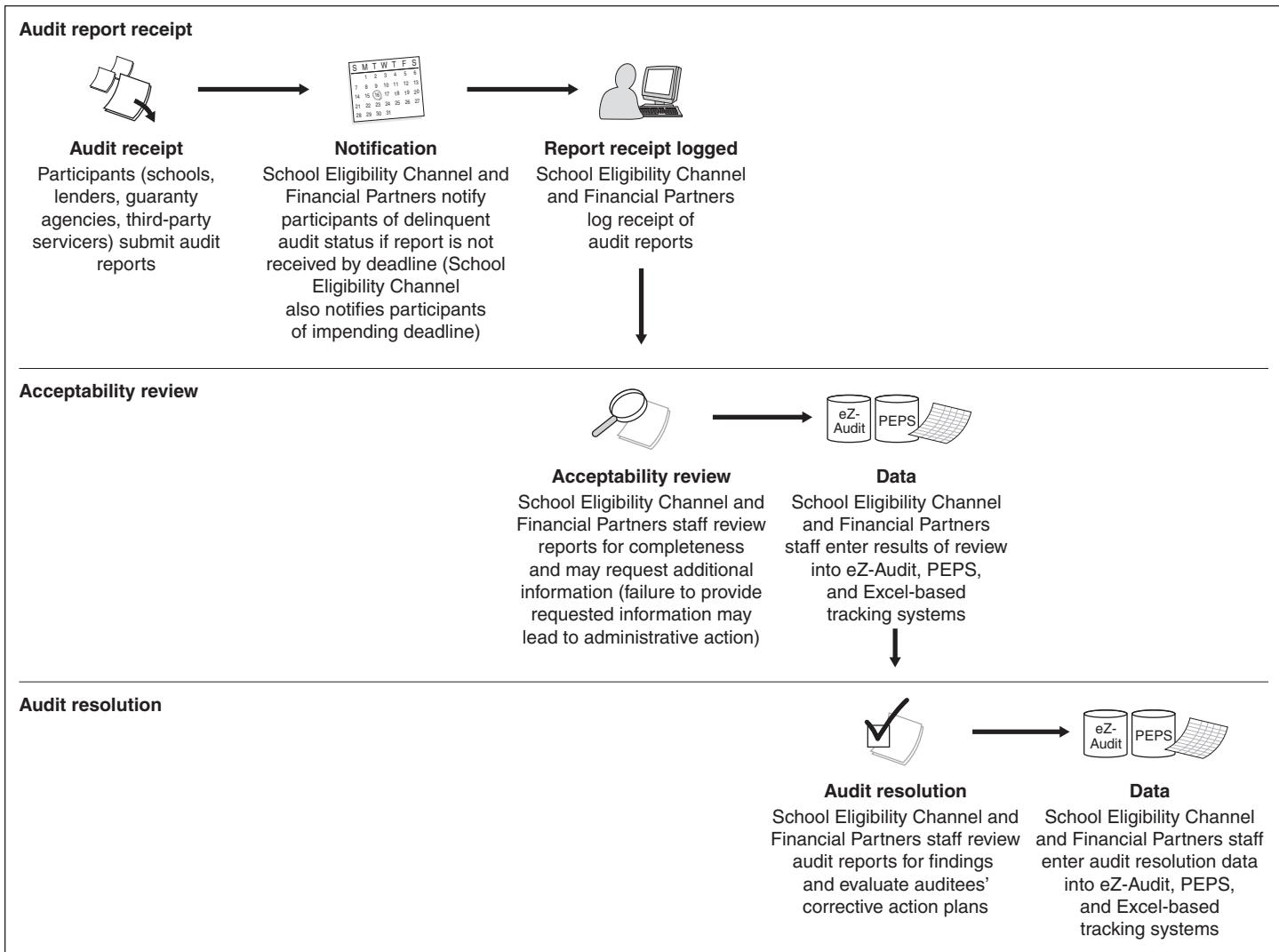
The School Eligibility Channel and Financial Partners are responsible for logging receipt of the audit report, performing an acceptability review, and taking steps to resolve the audit.³⁰ According to policies and procedures, Federal Student Aid staff track findings contained in audit reports and use them to oversee the programs by monitoring whether corrective actions are taken. Tracking systems used by the School Eligibility Channel and Financial Partners include the Postsecondary Education Participants

³⁰Federal Student Aid considers an audit to be resolved when audits without findings are received or, for audits with findings, corrective action plans are in place for minor findings and corrective action has been taken for major findings.

System (PEPS), eZ-Audit, and various Excel-based tracking sheets.³¹ Figure 4 depicts the process used by Federal Student Aid components for reviewing audit reports.

³¹PEPS is a database used by Education to maintain eligibility, certification, financial, default rate, review, and audit data about participants. eZ-Audit is a Web-based, paperless system used for submission of financial statement and compliance audits to the School Eligibility Channel.

Figure 4: School Eligibility Channel and Financial Partners Processes for Monitoring Receipt, Acceptability, and Resolving Required Audits



Source: GAO analysis of Department of Education data.

Note: The data are from Education policies and procedures and interviews with Education officials.

Some processes described in figure 4 are designed differently depending on the type of participant. Specifically, according to Federal Student Aid policies and procedures, schools are required to submit audit reports—both financial statement and compliance audits—to Federal Student Aid electronically via the eZ-Audit system. Other participants, including

lenders, guaranty agencies, and their servicers, are expected to submit reports in paper or electronic form. For audits performed in accordance with OMB Circular No. A-133, Federal Student Aid staff are to obtain the audit reports from the Federal Audit Clearinghouse Web site, a governmentwide audit information repository. Federal Student Aid staff are to perform acceptability reviews on the audit reports using checklists that address issues such as whether all required reporting elements are included. The School Eligibility Channel uses contractors to assist with the acceptability review of school audit reports. After the acceptability review is completed, Federal Student Aid policies and procedures require staff to review the submitted audit report and notify the participant that the audit has been accepted or explain steps required for satisfactory audit resolution. Statutes and regulations provide authority for Federal Student Aid to perform a program review³² as a method of program oversight of participants. Regulations also authorize Federal Student Aid to initiate administrative hearings that can lead to sanctions, including the suspension of the participant from the program.³³ Federal Student Aid staff are to enter resolution information into eZ-Audit or PEPS once an audit is resolved. Similar processes are to be used for biennial program reviews of schools and lenders performed by guaranty agencies.³⁴

Special allowance payment audits and ECASLA agreed-upon procedure reports, also required from participating lenders, are subject to similar report review procedures.³⁵ Federal Student Aid procedures called for using acceptability review checklists and Excel-based tracking sheets designed specifically for these kinds of reports to ensure completeness of the reports and to track the status and ensure the resolution of reported findings. For these reports, findings resolution could include adjusting special allowance payments made to lenders or coordinating with the lender to remove ineligible loans from an ECASLA portfolio.

³²Program reviews conducted by Federal Student Aid of schools, lenders, guaranty agencies, or third-party servicers are risk-based and address specific operating conditions. Accordingly, the objectives and scope may vary from review to review.

³³See 34 C.F.R. § 668.82(c) (schools and their servicers); 34 C.F.R. § 682.413(c) (guaranty agencies and their servicers); and 34 C.F.R. § 682.705 (lenders and their servicers).

³⁴Guaranty agencies perform biennial program reviews of FFEL schools and lenders. These program reviews supplement the program oversight provided by the annual compliance audits, which have similar objectives.

³⁵Secondary markets that participate in the ECASLA program have the same reporting requirements as lenders.

Financial Partners has acknowledged that inefficiencies exist with the current tracking system. For example, Financial Partners staff must manually enter the receipt of the compliance audit reports in Excel-based tracking sheets, while the receipt of the school audit reports are automatically logged through eZ-Audit electronic submission. Further, PEPS does not allow Financial Partners to readily identify those lenders required to submit annual compliance audits. Accordingly, Financial Partners staff must analyze database information to identify these lenders. Further, because PEPS does not track all audit information that is important to Financial Partners, staff supplement their use of PEPS with Excel-based tracking sheets. To address these inefficiencies, Education is in the process of designing a new system—referred to as Integrated Partner Management (IPM)—that will replace the existing systems and, among other things, provide the capability to track audit findings. According to Education officials, IPM is currently in the requirements phase, which is expected to be completed in July 2010, with implementation in phases in 2012.

Gap Noted in Receipt and Review of Certain Audit Reports

We noted a gap in Education's policies and procedures regarding review of audited financial statements for lender servicers. Education regulations³⁶ require lender servicers that participate in the FFEL program to submit audited financial statements³⁷ to Education annually. However, our review found that lender servicers did not submit their audited financial statements to Education. Federal Student Aid did not have procedures in place to review these financial statement audit reports and therefore did not conduct any follow-up to ensure that the audit reports were received and reviewed. Federal Student Aid officials told us they consider the risk to the government of not receiving these servicers' audited financial statements to be low because lenders are ultimately responsible for the loans and have the responsibility to ensure that their servicers are financially capable. By not requiring the review of the audited financial statements of lender servicers, Federal Student Aid runs the risk of missing significant findings disclosed in these reports. Such findings could relate to control weaknesses over information security and financial reporting that may not be addressed in the annual compliance audits that Federal Student Aid staff review.

³⁶34 C.F.R. § 668.23(d)(5).

³⁷Audited financial statements include an independent auditor's opinion which presents the results of the audit, including findings and conclusions.

Further, Federal Student Aid staff might not be informed if a lender servicer received other than an unqualified audit opinion. Concerns such as these might indicate potential problems regarding the servicer's ability to continue program operations effectively. In addition, because one servicer may service multiple lenders, the risk to the government and borrowers increases should one of these servicers be in violation of any provision of federal regulations. According to GAO's *Internal Control Management and Evaluation Tool*,³⁸ agencies should obtain and report to managers any relevant external information that may affect the achievement of its missions, goals, and objectives. Unless Federal Student Aid receives and reviews these financial statement audit reports, it may not be fully aware of risks to the government and borrowers, and its ability to properly oversee the FFEL program could be impaired.

Conclusions

Significant federal resources are committed to providing loans so that students' educational goals can be achieved. Effectively overseeing the FFEL and DL programs is critical to minimize the risks to taxpayers and borrowers. Although no new FFEL loans will be made after June 30, 2010, FFEL loans unpaid at that time will remain under Federal Student Aid's oversight for possibly 30 years. Improvements are needed in the audit guidance and review procedures for the FFEL program. The gaps we noted in the OIG *Lender Audit Guide* used to audit lenders and in Federal Student Aid's policies and procedures regarding its review of audited financial statements for lender servicers expose the program to unnecessary risk. As Education moves forward to administer the expanded DL program, maintaining and enhancing its oversight procedures will help ensure that federal and borrower interests continue to be protected.

Recommendations for Executive Action

To help address any gaps in the guidance for audits FFEL lenders perform in accordance with the OIG *Lender Audit Guide*, we recommend that the Education Inspector General update the OIG *Lender Audit Guide* to include all appropriate regulatory audit requirements.

To ensure that Education properly oversees the ongoing servicing of outstanding FFEL student loans and mitigates risks related to lender

³⁸GAO, *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: August 2001).

servicers, we recommend that the Secretary of Education direct the Chief Operating Officer of the Office of Federal Student Aid to develop and implement policies and procedures requiring Federal Student Aid review of audited financial statements for lender servicers.

Agency Comments and Our Evaluation

In written comments on a draft of this report, the Education Office of Inspector General and Federal Student Aid agreed with our recommendations. These comments are reprinted in their entirety in appendixes III and IV, respectively. Regarding our recommendation to update the OIG *Lender Audit Guide*, the Education Inspector General concurred that the guide needs to be made current with all compliance requirements and anticipates updating and issuing a revised guide by December 2010. Regarding our recommendation to develop and implement policies and procedures requiring the review of lender servicer audited financial statements, the Chief Operating Officer of Federal Student Aid acknowledged the need to update the OIG *Lender Audit Guide* and existing processes and procedures to require lender servicers to prepare and submit audited financial statements, and stated that Federal Student Aid will review the audited financial statements. Education also provided technical comments, which we incorporated in this report, as appropriate.

We are sending copies of this report to the Secretary of Education, the Inspector General of Education, and other interested parties. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

Please contact me on (202) 512-9095 if you or your staff have any questions about this report. Contact points for our Office of Congressional Relations and Office of Public Affairs can be found on the last page of this report. Other major contributors to this report are listed in appendix V.



Kay L. Daly
Director, Financial Management and Assurance

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

Appendix I: Summary of FFEL and DL Program Audits and Reviews

The following information is from GAO, *Federal Student Loans: Audits and Reviews of the Federal Family Education Loan and Federal Direct Loan Programs, GAO-09-992R* (Washington D.C.: Sept. 30, 2009), enclosure, p. 16.

Table 3: Education Audits, Reviews, Agreed-Upon Procedures, and Reconciliations of the Federal Family Education Loan (FFEL) and William D. Ford Federal Direct Loan (DL) Programs as of August 31, 2009

Auditee and Type of Audit/Review	Objective	Frequency ^a	Performed by	Authority	FFEL	DL
Type of Required Audit/Review						
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 ^b
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 ^b	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 ^b
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 ^b
Program reviews	Enforce federal, state, and guaranty agency requirements.	Biennially	GA	34 CFR 682.410(c)	Required	Not Applicable ^b
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 ^b
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 ^b

**Appendix I: Summary of FFEL and DL
Program Audits and Reviews**

Auditee and Type of Audit/Review	Objective	Frequency^a	Performed by	Authority	FFEL	DL
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 ^c	IPA	Section 8 of the Master Participation Agreement	Required	Not Applicable ^b
	2) Assess custodian compliance with the provisions of the Master Participation Agreement.	Annually	IPA	Section 8 of the Master Participation Agreement	Required	Not Applicable ^b
Agreed-upon procedures engagements	1) Assess lender and secondary market compliance with provisions of the Asset-Backed Commercial Paper Conduit Put Program – Putability ^d and Eligibility. ^e	Once to determine putability ^d Quarterly for eligibility ^e	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 ^b
	2) Assess conduit administrator compliance with provisions of the Put Agreement.	Annually	IPA	Section 20 of the Put Agreement	Required	Not Applicable ^b
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 ^b
Compliance	Assess entity compliance with applicable statutes, regulations, and program requirements.	Annually	IPA	34 CFR 682.410(b)	Required	Not Applicable ^b
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 ^b
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						
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

**Appendix I: Summary of FFEL and DL
Program Audits and Reviews**

Auditee and Type of Audit/Review	Objective	Frequency^a	Performed by	Authority	FFEL	DL
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						
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

Source: GAO.

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

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

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

^dPutability -- 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."

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

Appendix II: Objectives, Scope, and Methodology

To address the first objective, we reviewed our September 30, 2009, report¹ to determine the extent to which the audit and review requirements were applicable to both the Federal Family Education Loan and the William D. Ford Federal Direct Loan (DL) program participants in order to identify similarities and differences. We obtained and reviewed relevant audit guides to determine if the audit objectives addressed statutory and regulatory requirements to be met by the programs' participants.² For the DL program, we also interviewed knowledgeable officials regarding the Department of Education's (Education) procedures to oversee the performance of the DL servicer, and we reviewed the relevant oversight procedures. For nonprofit and for-profit schools and lenders, we analyzed Office of Management and Budget (OMB) Circular No. A-133 and the Education Office of Inspector General (OIG) audit guides to determine if they addressed similar objectives. To assess whether the audits as designed addressed federal and borrower interests, respectively, we determined if the audits are designed to help protect the government from financial loss, and help ensure that qualified individuals have access to federal student loans and are protected from financial loss. For example, we determined if the audit guides focused on determining whether the students and lenders met eligibility requirements to participate in these programs. We interviewed officials from Education's Office of Federal Student Aid (Federal Student Aid) and the OIG, including the Acting Director of Financial Partner Eligibility and Oversight (Financial Partners), the General Manager of the School Eligibility Channel, and the Deputy Assistant Inspector General for Audit, to obtain clarification and explanations for any discrepancies identified during our review of documentation. The scope of our audit did not include testing that the

¹GAO, *Federal Student Loans: Audits and Reviews of the Federal Family Education Loan and Federal Direct Loan Programs*, GAO-09-992R (Washington D.C.: Sept. 30, 2009).

²Key audit guides that we reviewed included Department of Education, Office of Inspector General, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers* (January 2000) and amendments (August 30, 2007 and September 27, 2007); Department of Education, Office of Inspector General, *Compliance Audits (Attestation Engagements) for Lenders and Lender Servicers Participating in the Federal Family Education Loan Program* (December 1996) and amendment (March 27, 2008); Department of Education, Office of Inspector General, *Audits of Guaranty Agency Servicers Participating in the Federal Family Education Loan Program* (March 2000); Office of Management and Budget, OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* Compliance Supplement, Part 4, Department of Education (March 2009); and Office of Management and Budget, OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* Compliance Supplement, Part 5, *Student Financial Assistance Programs* (March 2009).

audit guides were used by the auditors as intended. In addition, our work did not include program reviews conducted by guaranty agencies and other Federal Student Aid reviews because (1) in some cases, these reviews had similar objectives to the audits that we did include in our study and (2) in other cases, the reviews were risk-based and addressed specific operating conditions, and therefore these objectives were unique to each review.

To address the second objective, we focused on the design of the processes Education uses to oversee the programs and to ensure compliance with statutory and regulatory requirements for the timely submission of audit reports. We reviewed applicable statutes and regulations and Federal Student Aid policies and procedures, including process flow diagrams and audit acceptability checklists.³ To further our understanding of the design of Education's processes for overseeing these programs and ensuring compliance, we observed systems demonstrations that included automated and Excel-based systems used to track receipt of audits and related findings. During these demonstrations, we observed actual steps taken by staff in order to review, and if necessary resolve, the audit. We obtained and reviewed supporting documentation referenced during these demonstrations, such as audit acceptability checklists and copies of Excel-based tracking sheets, used by staff to determine the sufficiency of the audit report's content and to ensure the timeliness of audit submissions, respectively. We interviewed officials from Federal Student Aid and OIG, including the Acting Director of Financial Partners, the General Manager of the School Eligibility Channel, and the Deputy Assistant Inspector General for Audit, to obtain clarification and explanations for any discrepancies identified during our review of documentation and the demonstrations. We focused on describing the processes Education has designed to ensure that applicable requirements are being met. While the scope of our audit did not include testing the

³Department of Education, Federal Student Aid, *Compliance Audit Procedures* (March 2009); Department of Education, Federal Student Aid, *Compliance Audit Procedures* (August 2008); Department of Education, Federal Student Aid, *Financial Analysis Procedures* (August 2008); Department of Education, Federal Student Aid, *eZ-Audit Compliance Audit Analysis: A-133 Submissions* (May 2008); Department of Education, Federal Student Aid, *eZ-Audit Compliance Audit Analysis: Proprietary School-SFA Audit Guide Submissions* (May 2008); Department of Education, Federal Student Aid, *Step-by-Step Guide to Using eZ-Audit Financial Statement Analysis: A-133 Submissions* (May 2008); and Department of Education, Federal Student Aid, *Step-by-Step Guide to Using eZ-Audit Financial Statement Analysis: Proprietary Submissions* (May 2008).

implementation of these processes including controls, as appropriate, we noted any design deficiencies.

We requested comments on a draft of this report from Education. We received written comments from the Education Inspector General and the Chief Operating Officer of Federal Student Aid (reprinted in their entirety in appendixes III and IV, respectively). We conducted this performance audit at Federal Student Aid offices in Washington, D.C., from August 2009 to July 2010 in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix III: Comments from the Department of Education Office of Inspector General



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

JUL 15 2010

Ms. Kay L. Daly
Director, Financial Management and Assurance
Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Ms. Daly:

Thank you for giving us the opportunity to comment on the draft report entitled *Federal Student Loan Programs – Opportunities Exist to Improve Audit Requirements and Oversight Procedures*. Our comments are limited to the recommendation pertaining to the Office of Inspector General (OIG).

As stated in the draft report, the current OIG Lender Audit Guide (*Compliance Audits / Attestation Engagements for Lenders and Lender Servicers Participating in the Federal Family Education Loan Program [FFEL]– December 1996*) does not incorporate all compliance requirements. Although we have supplemented the Guide with several amendments for specific changes to audit requirements, we concur that it needs to be made current with all compliance requirements. We anticipate that we will update and issue the revised Guide by December 2010.

Although we are aware of the need for an updated Lender Audit Guide, over the last several years we have used our limited resources related to guidance for lenders in the FFEL Program by focusing our work on emerging areas of risks in that Program. We did issue a special purpose guide to conduct audits of the 9.5 percent special allowance payments to assure those billings were allowable. The audits that were conducted found that nearly 90 percent of all the 9.5 percent special allowance payments were not eligible.

We also issued seven audit guides covering various aspects of the Ensuring Access to Student Loans Act (ECASLA) programs. We believed this to be of primary concern because ECASLA provided financing for \$47.6 billion or 88 percent of the total 2009-10 FFEL Program loans.

If you have any additional questions, please contact Kevin Winicker, Acting Director for Non-Federal Audits at (202) 245-6982 or kevin.winicker@ed.gov.

Sincerely,

Kathleen S. Tighe
Inspector General

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.

Appendix IV: Comments from the Department of Education Office of Federal Student Aid



Ms. Kay L. Daly
Director
Financial Management and Assurance
United States Government Accountability Office
Washington, DC 20548

JUL 15 2010

Dear Ms. Daly:

Thank you for providing the U.S. Department of Education (the Department) with the opportunity to respond to the recommendation made in the U.S. Government Accountability Office's (GAO's) draft report entitled, "*Federal Student Loan Programs: Opportunities Exist to Improve Audit Requirements and Oversight Procedures*" (GAO-10-668).

The Higher Education Opportunity Act, P.L. 110-315, included a mandate for GAO to study the financial and compliance audits and reviews required or conducted for the Federal Family Education Loan (FFEL) and William D. Ford Direct Loan (DL) Programs. GAO was asked to provide (1) an assessment of whether the audits and reviews as designed provide comparable coverage of the two loan programs, (2) discuss how the Department ensures that these audits and reviews comply with statutory and regulatory requirements, and (3) describe how the Department uses them to oversee these loan programs. The draft report focuses on (1) identifying differences and similarities in audit requirements and oversight procedures for the FFEL and DL Programs, including anticipated changes to selected oversight activities and (2) describing how Federal Student Aid's (FSA's) policies and procedures are designed to monitor audits and reviews.

As a result of its study, GAO acknowledges that FSA has designed procedures for the oversight of the servicers that service loans originated under the DL Program. GAO also makes two recommendations to the Department regarding oversight of the FFEL Program. The first recommendation is that the Department's Office of Inspector General (OIG) update the OIG *Lender Audit Guide* to include all appropriate regulatory requirements for audits of ongoing FFEL participants. The OIG will address this recommendation in a separate response. The second recommendation is that FSA develop and implement policies and procedures requiring FSA review of audited financial statements for lender servicers. Our response to this recommendation follows. In addition to this response, we are including, as an appendix to this letter, clarifications we propose to the draft report.

830 First St. N.E., Washington, DC 20202
www.FederalStudentAid.ed.gov
1-800-4-FED-AID

FEDERAL STUDENT AID ■ START HERE. GO FURTHER.

**Appendix IV: Comments from the Department
of Education Office of Federal Student Aid**

Recommendation: *To ensure that Education properly oversees the ongoing servicing of outstanding FFEL student loans and mitigates risks related to lender servicers, we recommend that the Secretary of Education direct the Chief Operating Officer of the Office of Federal Student Aid to develop and implement policies and procedures requiring Federal Student Aid review of audited financial statements for lender servicers.*

We agree with this recommendation. As GAO notes in the draft report, 34 C.F.R. 668.23 (d)(5) requires that third-party servicers that enter into a contract with a lender to administer any aspect of the lender's programs must submit annually an audited financial statement. This regulation also states that the financial statements must be prepared on an accrual basis in accordance with generally accepted accounting principles and audited by an independent auditor in accordance with generally accepted government auditing standards and other guidance contained in audit guides issued by the OIG. The current OIG *Lender Audit Guide*, which also covers lender servicers, does not contain guidance regarding lender servicer audited financial statements and, as a result, lender servicers have not been providing audited financial statements to the Department. FSA will work with the OIG to update the *OIG Lender Audit Guide* to include guidance to lender servicers regarding preparation and submission of audited financial statements. FSA will incorporate a review of the audited financial statements into the process and procedures that are currently in place for the review and resolution of compliance audits.

We appreciate the opportunity to respond to the GAO draft report. If you have any questions regarding our response, please contact me or Marge White of my staff at 202-377-3022.

Sincerely,



William J. Taggart
Chief Operating Officer

Enclosure

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Kay L. Daly, (202) 512-9095 or dalykl@gao.gov

Staff Acknowledgments

In addition to the contact named above, significant contributions to this report were made by Jack Warner (Assistant Director), Jennifer Dent, Chau Dinh, P. Barry Grinnell, and Danietta Williams. Francine DelVecchio and Jason Kirwan also made key contributions.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

