

September 2010

# STUDENT LOANS

## Federal Web-based Tool on Private Loans Would Pose Implementation Challenges and May Be Unnecessary



GAO

Accountability \* Integrity \* Reliability

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## Abbreviations

FFEL      Federal Family Education Loan

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United States Government Accountability Office  
Washington, DC 20548

September 29, 2010

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

Student loans play a key role in ensuring postsecondary access for millions of students each year. In fiscal year 2009, students and their families borrowed \$90 billion in federal student loans to help pay the cost of postsecondary education. Traditionally, these loans have been available through two programs: the William D. Ford Federal Direct Loan Program (Direct Loan), in which the federal government provides loans directly to students through their schools, and the Federal Family Education Loan Program (FFEL), in which private lenders provide loans guaranteed by the federal government. However, the Health Care and Education Reconciliation Act of 2010 terminated the authority to make new FFEL loans after June 30, 2010, and all federally guaranteed loans are now originated under the Direct Loan Program.<sup>1</sup>

While private lenders no longer provide federally guaranteed student loans, they may continue to provide private loans—estimated at nearly \$12 billion in 2008-2009—which are not federally subsidized. Although federal loans comprise the majority of loans used to defray educational expenses, private student loans serve as a source of supplemental or alternative funding. For example, in 2007-2008, an estimated 14 percent of undergraduates obtained private student loans. Unlike federal loans,

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<sup>1</sup>Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, title II, § 2201, 124 Stat. 1029, 1074 (Mar. 30, 2010).

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which have statutorily fixed interest rates and flexible repayment terms, interest rates for private loans vary based upon factors such as a borrower's credit score. These loans typically offer borrowers fewer protections and benefits than federal loans. Given the variety of options available, some observers have questioned whether borrowers have sufficient information to help them make informed decisions about student loans.

In this report, we respond to a mandate in the Higher Education Opportunity Act<sup>2</sup> requiring GAO to study the feasibility of developing a national clearinghouse of federal and private student loans on the Department of Education's (Education) Web site. We addressed the following questions: (1) What are some options for establishing a tool on Education's Web site that provides real-time information on federal and private student loans, and what is the perceived need for such a tool? (2) What challenges would Education need to address in implementing such a tool?

We briefed your staff on the results of our analysis on August 25 and 26, 2010, and this report formally conveys the information provided during the briefing (see app. I for briefing slides). In summary, we found:

- Education has a range of options for providing prospective borrowers with a Web-based tool containing real-time information—such as interest rates and loan terms—on federal and private student loans, but such a tool may be unnecessary. Providing information on private student loans also may not align with Education's role in administering and promoting federal student aid.
- To implement such a tool, Education would have to address several challenges—including securing a high rate of lender participation and ensuring completeness, accuracy, and objectivity of information presented—to avoid the appearance of bias or endorsement. Furthermore, minimizing costs to the federal government would be challenging because developing a tool would require a considerable investment, and many stakeholders ruled out a system funded by lenders.

While it would be feasible for Education to establish a student loan tool on its Web site, the need for such a new source of information is

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<sup>2</sup>Pub. L. No. 110-315, title XI, § 1123, 122 Stat. 3078, 3506 (Aug. 14, 2008).

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questionable. Since all federal student loans are now originated through the Direct Loan Program, students no longer have to choose a lender for federal loans. In addition, information on both federal and private loans is already available from resources such as financial aid offices and existing Web-based loan comparison tools. Furthermore, any perceived need for a federal tool must be weighed against the investment required of Education and the considerable challenges inherent in implementation.

To identify options for establishing a tool on Education's Web site and challenges to implementation, we interviewed officials from Education, the Federal Trade Commission, the Securities and Exchange Commission, and the Federal Reserve Board. We also conducted semi-structured interviews with representatives from four privately operated, Web-based student loan comparison tools; three organizations that represent student loan borrowers; five higher education associations; seven private lenders, including three that provide loan servicing and one affiliated with a guaranty agency; one guaranty agency with no lender affiliation; and FICO. We also interviewed financial aid officials from five schools and a group of students from one school. We selected this nongeneralizable sample to represent a mix of 2-year and 4-year public and private (not-for-profit and for-profit) institutions in various geographic locations. In addition, we reviewed the content and structure of four Web-based student loan comparison tools to gain a better understanding of various approaches Education could pursue. We also reviewed relevant guidance, federal laws, and regulations.

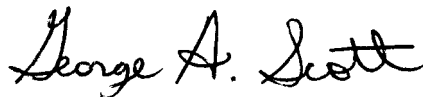
We conducted this performance audit from November 2009 to August 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions 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.

We provided a draft copy of this report to Education for review and comment. In written comments, Education agreed with our findings. Education also provided technical comments, which we incorporated as appropriate. Education's comments appear in appendix II.

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We are sending copies of this report to relevant congressional committees, the Secretary of Education, and other interested parties. In addition, this report will be available at no charge on GAO's Web site at [www.gao.gov](http://www.gao.gov).

If you or your staff have any questions about this report, please contact me at (202) 512-7215 or [scottg@gao.gov](mailto:scottg@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff members who made key contributions to this report are listed in appendix III.



George A. Scott  
Director, Education, Workforce, and  
Income Security Issues

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# Appendix I: Briefing Slides

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## **Student Loans: Federal Web-based Tool on Private Loans Would Pose Implementation Challenges and May Be Unnecessary**

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**Briefings for the Senate Committee on  
Health, Education, Labor, and Pensions  
and the House Committee  
on Education and Labor**

**August 2010**

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## Overview

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- Research Objectives
- Scope and Methodology
- Summary of Findings
- Background
- Findings
- Concluding Observations





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## Research Objectives

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In response to a mandate in the Higher Education Opportunity Act\* requiring GAO to study the feasibility of developing a national clearinghouse of federal and private student loans on the Department of Education's (Education) Web site, we addressed the following questions:

1. What are some options for establishing a tool on Education's Web site that provides real-time information on federal and private student loans, and what is the perceived need for such a tool?
2. What challenges would Education need to address in implementing such a tool?

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\*Pub. L. No. 110-315, title XI, § 1123, 122 Stat. 3078, 3506 (Aug. 14, 2008).



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## Scope and Methodology

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To address our research objectives, we interviewed:

- Officials from Education, the Federal Trade Commission, the Securities and Exchange Commission, and the Federal Reserve Board.
  - Representatives of 7 private lenders, including 3 that provide loan servicing and 1 affiliated with a guaranty agency; and representatives of 1 guaranty agency with no lender affiliation.
  - Financial aid officials from 5 schools, and a group of students at one school. We selected this nongeneralizable sample to represent a mix of 2-year and 4-year public and private (not-for-profit and for-profit) institutions in various geographic locations.
  - Representatives of organizations that represent student loan borrowers; higher education associations; trade associations that represent lenders, servicers, and guaranty agencies; 4 Web-based student loan comparison tools; and FICO.
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## Scope and Methodology (cont.)

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In addition, we:

- reviewed 4 Web-based student loan comparison tools;
- reviewed relevant federal laws, regulations, and guidance; and
- conducted our work from November 2009 to August 2010, in accordance with generally accepted government auditing standards.



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## Summary of Findings

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- Education has a range of options for providing prospective borrowers with a Web-based tool containing real-time information—such as interest rates and loan terms—on federal and private student loans, but such a tool may be unnecessary.
  - Education would have to address several challenges to implement such a tool, including:
    - securing lender participation;
    - ensuring completeness, accuracy, and objectivity of information presented; and
    - minimizing costs to the government.
-

## Background



# The Federal Government Is Students' Primary Source of Education Loans

- During fiscal year 2009, the federal government provided \$90 billion in federal student loans to almost 11 million students and their families.
- Federal loans include Stafford Loans (subsidized and unsubsidized) to students and PLUS Loans to parents and graduate students.
- Historically, these loans have been available under two programs:
  - the William D. Ford Federal Direct Loan Program (Direct Loan), under which the government originates the loans directly, and
  - the Federal Family Education Loan Program (FFEL), under which private lenders originated loans guaranteed by the government.
- As of July 1, 2010, all Stafford and PLUS Loans are originated through the Direct Loan Program.\*

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



**Background**

**Federal Student Loans Have Fixed Interest Rates Set by Statute**

Loans disbursed 7/1/2010 to 6/30/2011	Borrower eligibility	Annual loan limits*	Interest rates
<b>Stafford</b> (subsidized and unsubsidized)	Students must be enrolled at least half-time. Subsidized loans require demonstration of financial need.	<b>Dependent undergraduates</b> \$5,500 - \$7,500 <b>Independent undergraduates</b> \$9,500 - \$12,500 <b>Graduate students</b> \$20,500	<b>Subsidized</b> Fixed 4.5% <b>Unsubsidized</b> Fixed 6.8%
<b>PLUS</b>	Parents of dependent undergraduate students or graduate students who are enrolled at least half-time. Borrowers cannot have a negative credit history.	Cost of attendance minus any other financial aid received.	Fixed 7.9%

Source: Department of Education.  
 \*Limits vary depending on student's year in school.

**Background**



**Private Loans Are a Secondary Source of Funding for Students**

- While private lenders no longer originate federally guaranteed student loans through the FFEL Program, they continue to provide private loans—which are not federally subsidized—as a supplement or an alternative to federal student loans.
- An estimated 14 percent of undergraduate students obtained private loans in 2007-2008.\*
- However, data suggest that borrowers' use of private student loans has recently decreased.
  - According to preliminary data from the College Board, borrowers obtained an estimated \$11.9 billion in private student loans in 2008-2009, a 50 percent reduction from the prior academic year.
  - Tightening credit markets and recent increases in federal loan limits may explain some of the decline.

\*GAO analysis of Education's 2008 National Postsecondary Student Aid Study.

## Background



# Lenders Apply Underwriting Criteria to Determine Borrower Eligibility for Private Loans

- Lenders may use a variety of factors—or underwriting criteria—to determine borrower eligibility for private loans and to set interest rates and terms.
  - Factors may include a borrower’s credit score, program length (e.g., 2-year versus 4-year), type of school, school graduation rates, and school cohort default rates.
- The inclusion of different factors, and their relative importance in making loan decisions, vary by lender.
- Lenders consider information about their underwriting practices to be proprietary.\*

\*For more information, see GAO, *Higher Education: Factors Lenders Consider in Making Lending Decisions for Private Education Loans*, GAO-10-86R (Washington, D.C.: Nov. 17, 2009).





**Background**

**Federal and Private Loans Differ in Important Ways**

	<b>Federal loans</b>	<b>Private loans</b>
<b>Borrower eligibility</b>	At least half-time enrollment in an eligible program; PLUS loan borrowers must not have an adverse credit history	Enrollment in an eligible program; risk-based; determined based on factors such as a borrower’s credit history, school choice, and presence of co-signer
<b>Interest rates</b>	Fixed, set by statute*	Usually variable; determined based on borrower characteristics and market-rates
<b>Repayment options</b>	Flexible options, including postponing repayment	Few, if any, flexibilities
<b>Federal oversight</b>	Department of Education	FTC and banking regulators

Source: Department of Education and Federal Trade Commission.

\*Stafford loans disbursed between October 1, 1992 and June 30, 2006 had variable rates, adjusted annually. The federal government pays the interest on subsidized Stafford loans while the borrower is in school and during a 6-month grace period. In contrast, borrowers are responsible for paying all interest on unsubsidized Stafford and PLUS loans.

## Background



# Prospective Borrowers May Turn to Several Different Sources of Information to Help Them Evaluate Their Student Loan Options

- Education's Web site provides information on federal student loans and financial literacy topics related to evaluating loan options.
- Prospective borrowers may also seek guidance from schools' financial aid offices, some of which maintain lists of specific lenders the institution recommends—known as preferred lender lists.
- Several private organizations have developed Web-based tools that allow prospective borrowers to shop for private loans by comparing interest rates, fees, and terms offered by participating lenders. These tools vary in the number and type of lenders that participate.
- As a result of amendments to the Truth in Lending Act, lenders are now required to provide prospective borrowers with private loan disclosures—including information on loan rates and terms—and inform them that they may qualify for federal student aid. These disclosures were required starting in February 2010.\*

\*The Higher Education Opportunity Act amended the Truth in Lending Act. See 15 U.S.C. § 1638(e).

**Finding 1: Student Loan Tool—Options**



**Education Has a Range of Options for Providing Real-Time Information on Student Loans**

- With the elimination of loan originations under FFEL and the move to the Direct Loan program, borrowers will no longer have to choose a lender for their federal loans.
- Education could include information about federal loans in any tool it might establish that provides real-time information about private loans.
  - Could highlight federal loan options and encourage borrowers to exhaust federal loans before obtaining private loans.

**Finding 1: Student Loan Tool—Options**

**Education Has a Range of Options for Providing Real-Time Information on Student Loans (cont.)**

**Option 1: Comprehensive List of Private Lenders**

- Would provide borrowers with a directory of current private lenders and their contact information.
- May include a simple search feature narrowing the list by borrower characteristics, like school type and location, and lender characteristics, such as geographic region covered.



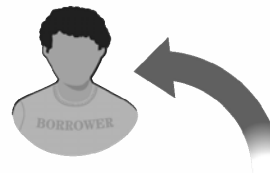
	Address	Contact Information
<b>Lender A</b>	1001 Finance Center Suite 201 Boston, MA 02125	Phone (233) 555-2224 Fax (233) 555-2223 Email loanofficer@lendera.net
<b>Lender B</b>	1120 Lender Way Suite 723 Portland, ME 04103	Phone (811) 555-5565 Fax (811) 555-5545 Email studentloans@lenderb.com
<b>Lender C</b>	1001 Private Loan Cir. 25th Floor, Dallas, TX 75283	Phone (374) 555-1120 Fax (374) 555-1006 Email loaninfo@lenderc.net

**Finding 1: Student Loan Tool—Options**

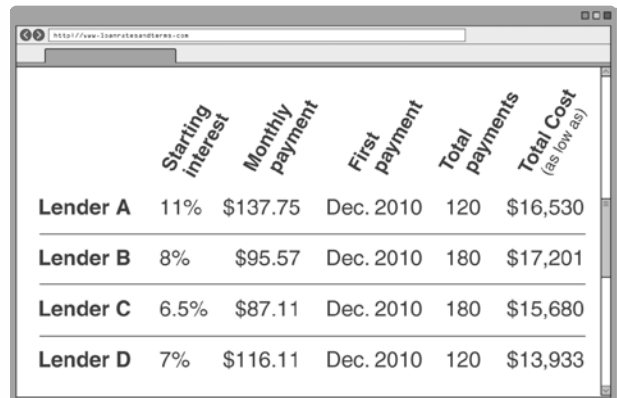
**Education Has a Range of Options for Providing Real-Time Information on Student Loans (cont.)**

**Option 2: Tool with General Rates and Terms for Private Loans**

- Could display a range of available interest rates in various formats, as well as such terms as total cost, repayment period, fees, monthly payment, and future benefits.
- May facilitate comparison shopping by providing borrowers with specific information on loan products from multiple lenders.



Basic information on loan rates and terms



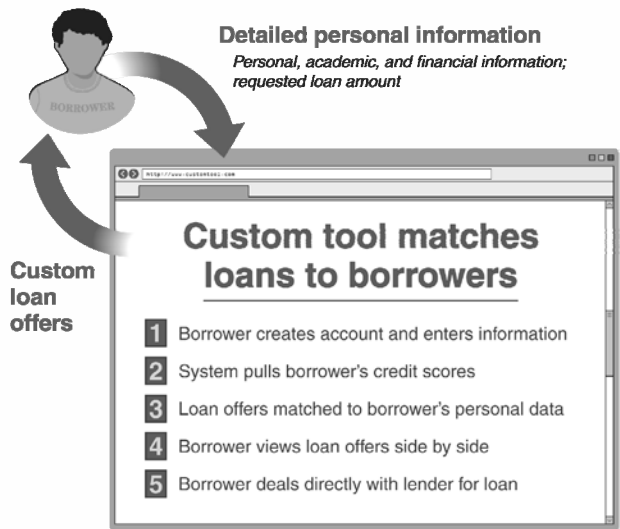
	Starting interest	Monthly payment	First payment	Total payments	Total Cost (as low as)
Lender A	11%	\$137.75	Dec. 2010	120	\$16,530
Lender B	8%	\$95.57	Dec. 2010	180	\$17,201
Lender C	6.5%	\$87.11	Dec. 2010	180	\$15,680
Lender D	7%	\$116.11	Dec. 2010	120	\$13,933

**Finding 1: Student Loan Tool—Options**

**Education Has a Range of Options for Providing Real-Time Information on Student Loans (cont.)**

**Option 3: Customized Tool That Helps Match Borrowers to Private Loans**

- Could match borrowers' unique characteristics to lender-specific criteria.
- Would likely require lenders to provide underwriting criteria on an ongoing basis.
- Could request borrowers to enter personally identifiable information and would likely need to obtain a borrower's credit score.





**Finding 1: Student Loan Tool—Options**

**Options for Providing Real-Time Information on Student Loans Vary in Design and Complexity**

<b>Key features</b>	<b>List of private lenders</b>	<b>General rates and terms</b>	<b>Customized tool</b>
Could highlight federal student loan options	●	●	●
Provides listing of lenders and contact information	●	●	●
Could include sort capability based on basic borrower information	●	●	●
Facilitates comparison shopping by displaying loan terms and rates		●	●
Collects borrowers' personally identifiable information and obtains credit score			●
Matches individual borrowers to loan products for which they are eligible			●

Source: GAO analysis.



**Finding 1: Student Loan Tool—Need**

**A Federal Tool Could Serve as a Trusted Resource for Borrowers**

- Students and several stakeholders we interviewed said a federal tool may be perceived by potential borrowers as more neutral and trustworthy than private sector tools.
- Officials from two schools stated that a federal tool could be used to help borrowers better understand loan options and educate them about common loan terminology, requirements, and responsibilities.
  - Students and most stakeholders we interviewed generally agreed that financial literacy is a challenge for borrowers.





## Finding 1: Student Loan Tool—Need

### **Several Stakeholders Questioned Whether a Federal Tool Would Add Value beyond Currently Available Resources**

- Several lenders and higher education associations stated that existing Web-based loan comparison tools provide a useful service to help borrowers assess their private loan options and questioned whether a tool on Education’s Web site would be duplicative.
- Education officials noted that schools are often students’ primary source of information and already provide students various informational resources on options for financing their education.

**Finding 1: Student Loan Tool—Need**



**Recent Legislative Changes Have Increased Transparency of Information about Private and Federal Student Loans**

- Education officials and two lenders said the new Truth in Lending Act disclosure forms provide a transparent and uniform way for borrowers to compare private loans.
  - Borrowers receive the first of three disclosures when they apply or receive a solicitation for a private student loan.
- Education officials and several other stakeholders anticipate that originating all federal loans through the Direct Loan program will lessen the confusion some students have had about the differences between federal and private loans, since private lenders will no longer make federal loans.

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**Finding 1: Student Loan Tool—Education’s Role**



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**Providing Information on Private Loans May Not Align with Education’s Role**

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- Education administers federal student aid and has no regulatory authority over private student loans.
  - Education cannot endorse particular private lenders or loan products.
  - In addition, Education officials expressed concern that:
    - Providing private loan information could encourage use of those loans, which do not have the same protections and benefits as federal loans.
    - In a customized tool, the department would be placed at unnecessary risk by having to protect borrowers’ personally identifiable information for a purpose over which Education has no regulatory authority.
-

**Finding 2: Implementation—Lender Participation**



**Most Stakeholders Said Securing Widespread Lender Participation Could Be a Considerable Challenge**

- Education officials and many other stakeholders said the department would need a high level of lender participation in order to be unbiased and avoid the appearance of endorsement.
  - Education officials and a few stakeholders said a comprehensive tool would need to include national and smaller lenders, such as credit unions, state-based organizations, and schools.
  - Representatives of two loan comparison tools cited challenges they faced in securing lenders' participation.
  
- Most lenders we spoke with said they would be unlikely to participate in a federal tool or would have to carefully evaluate the option.
  - All lenders expressed concern about a customized model that would require them to provide loan underwriting criteria to Education. However, about half of stakeholders said providing customized information would be more useful than the other options.

**Finding 2: Implementation—Information Management**



**Most Stakeholders Said Education Would Face Challenges in Ensuring the Completeness and Accuracy of Information Presented**

- Education officials and several other stakeholders said that the agency could not ensure that the loan rates and terms lenders would provide are the most current.
  - The market is fluid; interest rates may change frequently and lenders often enter or exit the market.
  - Many stakeholders, including representatives of two existing loan comparison tools, said that it would be particularly difficult to maintain accurate information in a tool that provides customized loan options.
- Education officials expressed concern that the department’s credibility could be damaged if it could not guarantee that borrowers received lenders’ advertised rates and terms.

**Finding 2: Implementation—Information Management**



**Most Stakeholders Said Education Would Face Challenges in Ensuring the Objectivity of Information Presented**

- Several stakeholders said the wide variety of interest rates (e.g., fixed vs. variable) and loan terms makes it difficult to present information in a way that facilitates objective comparison.
- Four lenders and a few other stakeholders said the way the tool displays loan information (e.g., sorted alphabetically, by interest rate) could influence which loans look preferable.
  - Research on survey development has shown people are more likely to only look at the first few items on a list and can be overwhelmed if presented with too many choices.
  - One financial aid official said the first lender listed on the school's preferred lender list received the highest loan volume.



## Finding 2: Implementation—Costs

### **Most Stakeholders Said Funding a Federal Student Loan Tool Would Be Costly**

- Education officials said developing a tool and keeping information current would require a considerable investment in staff and technology resources, regardless of the tool's complexity. For example, the agency would have to cover the cost of contracting to develop a tool and build a secure system to house it.
- Education officials and two lenders noted that constantly evolving loan rates and terms would make the tool expensive to maintain.
- In a customized tool, Education would incur a cost for obtaining each borrower's credit score, according to agency officials and several stakeholders.



## Finding 2: Implementation—Costs

### Most Stakeholders Said Funding a Federal Student Loan Tool Would Be Costly (cont.)

- Education officials and many stakeholders ruled out a system funded by lenders.
  - For example, most lenders said that charging fees could shut out smaller lenders that do not have the volume to justify the expense.
- A few stakeholders said schools would object to paying for a loan tool on Education’s Web site.
  - For example, one school financial aid official said that many small schools could not afford the service.





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## Concluding Observations

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- Providing real-time information to help borrowers make informed decisions about federal and private student loans is a laudable goal.
  - While it would be feasible for Education to establish a student loan tool on its Web site, the need for such a new source of information is questionable.
    - Originating all federal student loans through the Direct Loan program eliminates the need for students to choose a lender for federal loans.
    - Information on federal and private loans is available through existing resources, including financial aid offices and several Web-based loan comparison tools.
  - Finally, any perceived need must be weighed against the investment required for Education to establish such a tool and the considerable challenges inherent in its implementation.
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# Appendix II: Comments from the Department of Education



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF POSTSECONDARY EDUCATION

THE ASSISTANT SECRETARY

SEP 17 2010

George A. Scott  
Director, Education, Workforce,  
and Income Security Issues  
United States Government Accountability Office  
Washington, DC 20548

Dear Mr. Scott:

Thank you for giving the U.S. Department of Education (Department) the opportunity to review and comment on the Government Accountability Office (GAO) draft report entitled "STUDENT LOANS: Federal Web-based Tool on Private Loans Would Pose Implementation Challenges and May Be Unnecessary" (GAO-10-990). Your letter includes these findings:

- Education has a range of options for providing prospective borrowers with a Web-based tool containing real-time information—such as interest rates and loan terms—on federal and private student loans, but such a tool may be unnecessary. Providing information on private student loans also may not align with Education's role in administering and promoting federal student aid.
- To implement such a tool, Education would have to address several challenges—including securing a high rate of lender participation and ensuring completeness, accuracy, and objectivity of information presented—to avoid the appearance of bias or endorsement. Furthermore, minimizing costs to the federal government would be challenging because developing a tool would require a considerable investment, and many stakeholders ruled out a system funded by lenders.

The Department agrees with your findings but has technical comments (see enclosure). The Department remains committed to continuing to increase college access, quality, and completion. As you note, student loans play a key role in ensuring postsecondary access for millions of students every year. In this regard, we appreciate your research and analysis related to the feasibility and usefulness of a Web-based informational tool on federal and private student loans.

Sincerely,

A handwritten signature in dark ink, appearing to read "Eduardo M. Ochoa".

Eduardo M. Ochoa

Enclosure

1990 K ST. N.W., WASHINGTON, DC 20006  
www.ed.gov

*The Department of Education's mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.*

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO contact

George A. Scott (202) 512-7215 or [scottg@gao.gov](mailto:scottg@gao.gov)

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## Staff Acknowledgments

Debra Prescott (Assistant Director) and Rebecca Woiwode (Analyst-in-Charge) managed this assignment. Jennifer Cook, Paola Bobadilla, and Tranchau (Kris) Nguyen made significant contributions in all facets of the work. In addition, Jean McSween and Patrick Dudley provided methodological support; James M. Rebbe provided legal assistance; Susan Aschoff provided writing assistance; and James Bennett and Mimi Nguyen provided graphics for the report.

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