
Federal Student Aid's Controls Over Loan Purchases Under the Ensuring Continued Access to Student Loans Act of 2008

FINAL AUDIT REPORT



ED-OIG A03J0005
July 2010

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U.S. Department of Education
Office of Inspector General
Philadelphia, PA

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services, Washington, DC

July 2, 2010

MEMORANDUM

TO: William J. Taggart
Chief Operating Officer, Federal Student Aid
Lead Action Official

Daniel T. Madzelan
Delegated the Authority to Perform the Functions of
Assistant Secretary for Postsecondary Education

FROM: Keith West /s/
Assistant Inspector General for Audit

SUBJECT: Final Audit Report
Federal Student Aid's Controls Over Loan Purchases Under the Ensuring
Continued Access to Student Loans Act of 2008
Control Number ED-OIG/A03J0005

Attached is the subject final audit report that covers the results of our review of Federal Student Aid's (FSA) Controls Over Loan Purchases Under the Ensuring Continued Access to Student Loans Act of 2008. An electronic copy has been provided to your Audit Liaison Officers. We received FSA's comments and its corrective action plan for each of the recommendations in our draft report.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your offices will be monitored and tracked through the U.S. Department of Education's (Department) Audit Accountability and Resolution Tracking System. Department policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 days of the issuance of this report. The CAP should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report.

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

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We appreciate the cooperation given us during this review. If you have any questions, please call Bernard Tadley, Regional Inspector General for Audit, at 215-656-6279.

Enclosure

Electronic cc:

Marge White, Audit Liaison Officer, Federal Student Aid

Janie Funkhouser, Audit Liaison Officer, Office of Postsecondary Education

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Acronyms/Abbreviations Used in this Report

A-123	Office of Management and Budget Circular A-123, <i>Management's Responsibility for Internal Control</i>
ACS	Affiliated Computer Services, Incorporated
COO	Chief Operating Officer
Department	U.S. Department of Education
ECASLA	Ensuring Continued Access to Student Loans Act of 2008
FFEL	Federal Family Education Loan
FMS	Financial Management Systems
FSA	Federal Student Aid
GAO	United States Government Accountability Office
HEA	Higher Education Act of 1965, as amended
MLSA	Master Loan Sales Agreement
MPA	Master Participation Agreement
NOI	Notice of Intent to Participate
NSLDS	National Student Loan Data System
PPFR	Participation Purchase Funding Request
Standards	GAO's <i>Standards for Internal Control in the Federal Government</i>

EXECUTIVE SUMMARY

The objective of our audit was to determine whether Federal Student Aid (FSA) established and implemented adequate controls and system edits to ensure that the U.S. Department of Education (Department) did not purchase ineligible loans under the Loan Purchase Commitment Program or purchase participation interests in ineligible loans under the Loan Participation Purchase Program. These programs were created by the Department under authority provided in the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA). Our audit covered the Department's purchase of 2008-2009 academic year loans and participation interests in such loans during the period August 1, 2008, through December 31, 2008.

Based on our review of controls and system edits implemented by FSA and its contractor, Affiliated Computer Services, Incorporated (ACS),¹ we concluded that FSA established and implemented adequate controls and system edits to reasonably ensure that the Department did not purchase ineligible loans under the Loan Purchase Commitment Program. Conversely, FSA's controls and system edits were not adequate to reasonably ensure that the Department did not purchase participation interests in ineligible loans under the Loan Participation Purchase Program. However, the inadequate controls and system edits we identified had a minimal impact on the number and amount of ineligible loans in which the Department purchased participation interests.

We found significant weaknesses in the system edits that were in place to reasonably ensure that lenders participating in the Loan Participation Purchase Program complied with the loan eligibility requirements. Specifically, FSA did not ensure that the loans in which it purchased a participation interest –

1. Were made for eligible loan periods;
2. Were submitted as “New” loan records only once;
3. Had a cumulative amount of disbursements, net of cumulative reductions (e.g. cancellations, borrower payments), equal to the outstanding borrower principal balance on the loan and equal to or less than the original loan amount;
4. Had eligible first and anticipated final disbursement dates; and
5. Had interest rates that did not exceed allowable limits.

The weaknesses found resulted in the Department purchasing participation interests in 2,328 ineligible loans, totaling \$7,106,139 (about .055 percent and .057 percent, respectively, of the number and amount of loans in which the Department purchased participation interests during the audit period). In addition, the Department overpaid a total of \$26,530 for participation

¹ ACS serviced the Federal Family Education Loan Program loans purchased by the Department.

interests in eight loans, with a total principal balance outstanding of \$29,009, because sponsors reported unsupported disbursement amounts on Participation Purchase Funding Request (PPFR) Loan Schedules (the “PPFR Loan Schedule”).² When the Department purchased a participation interest in an ineligible loan, the lender obtained short-term liquidity from the Department equal to the purchase price of the ineligible loan.

During the audit, we informed FSA of our preliminary findings concerning its system edits. Effective June 14, 2009, FSA implemented revised system edits concerning “first disbursement dates,” “anticipated final disbursement dates,” and “actual interest rates.” We determined that FSA’s revised system edits addressed the weaknesses we identified regarding the first disbursement dates and loan interest rates, and partially addressed the weaknesses we identified regarding the anticipated final disbursement dates.

We recommend that the Chief Operating Officer (COO) for FSA ensure that –

1. A “Net Disbursement Report”³ system edits, and other controls are implemented for the Loan Participation Purchase Program for 2009-2010 academic year loans to address the weaknesses we identified; and
2. The Department did not purchase loans under the Loan Purchase Commitment Program from the Loan Participation Purchase Program for 2008-2009 academic year loans that had –
 - a. Ineligible loan periods;
 - b. Cumulative disbursements, net of cumulative reductions, in excess of the loan’s outstanding borrower principal balance or original loan amount; or
 - c. Ineligible first or anticipated final disbursement dates.

A draft of this report was provided to FSA. In its response, FSA concurred with all but one of our recommendations. FSA proposed an alternative corrective action to address the objective of the recommendation. We agreed and revised our recommendation. FSA’s comments are summarized at the end of the recommendations and a copy of the complete response is included as an enclosure to this report.

² The 8 loans were part of our sample of 25 loans randomly selected from the universe of 4,919 loans with more than one “New” loan record that the Department purchased participation interests in during the audit period. The 4,919 loans with more than one “New” loan record were about .117 percent of all loans in which the Department purchased a participation interest during the audit period.

³ The “Net Disbursement Report” would identify inconsistencies between a loan’s cumulative disbursements, net of cumulative reductions, the outstanding principal balance, and the original loan amount.

BACKGROUND

ECASLA provided the Department with new authority to address concerns about the availability of Federal Family Education Loan (FFEL) Program loans for the 2008-2009 academic year.⁴ ECASLA added Section 459A to the Higher Education Act of 1965, as amended (HEA), which authorized the Department to purchase or enter into forward commitments to purchase FFEL Program loans made under Sections 428 (subsidized Stafford loans), 428B (PLUS loans), and 428H (unsubsidized Stafford loans) of the HEA. The purchasing of loans was intended to encourage lenders to provide students and parents access to Stafford and PLUS loans for the 2008-2009 academic year. Under the loan purchase authority, the Department established the Loan Participation Purchase Program and the Loan Purchase Commitment Program.

Loan Participation Purchase Program

In addition to the Department, the entities involved in the Loan Participation Purchase Program included:

- Sponsors – A sponsor is an eligible FFEL Program lender or holder of eligible FFEL Program loans. A sponsor may be a secondary market or beneficial holder under an eligible lender trustee agreement.⁵ A sponsor sells participation interests in loans to the Department through a custodian.
- Custodians – A custodian is an eligible lender that is a national or state chartered bank that is not affiliated with the sponsor or eligible lender trustee. A custodian is granted the legal title to the loans for which a participation interest is sold to the Department.
- Originating lenders – This is the lender that originates the loan. In some instances, a sponsor may acquire and sell participation interests in loans that were originated by another lender. In these instances, both the sponsor and originating lender must submit a Notice of Intent to Participate (NOI) to the Department.

Under the Loan Participation Purchase Program, the Department purchased participation interests in eligible loans made for the 2008-2009 academic year that were held by an eligible lender or holder of FFEL Program loans approved as a sponsor under a Master Participation

⁴ ECASLA (Public Law 110-227) was enacted on May 7, 2008. Public Law 110-350, enacted on October 7, 2008, extended the Department's loan purchase authority to loans for the 2009-2010 academic year. The Department offered a separate Loan Participation Purchase Program and Loan Purchase Commitment Program for 2009-2010 academic year loans.

⁵ A beneficial holder does not meet the HEA criteria to participate in FFEL Programs. However, a beneficial holder may participate in FFEL Programs through an agreement with an eligible lender to serve as its trustee.

Agreement (MPA).⁶ Each sponsor was required to file an NOI with the Department and enter into a MPA with the Department and a third-party custodian acceptable to the Department. The date the Department received the sponsor's NOI filing generally determined the eligibility of the loans for which the sponsor sold participation interests. With the filing of the NOI, the sponsor was vested with the option to sell participation interests in and "put" eligible loans to the Department for purchase (i.e., sell the loans to the Department under the Loan Purchase Commitment Program). The participation interest purchased by the Department entitled it to a 100 percent beneficial ownership interest in the principal portion of the loans and the right to receive a yield on such loans equal to the commercial paper rate plus one-half percent.

In order to sell participation interests to the Department, sponsors were required to provide a PPFR Loan Schedule that detailed the loans for which a participation interest was being offered for sale to the Department. During the audit period, the Department purchased participation interests in 4.2 million loans with disbursements totaling \$12.5 billion, from 21 sponsors.⁷ For the entire duration of the Loan Participation Purchase Program for loans made for the 2008-2009 academic year, the Department purchased more than \$33.3 billion in participation interests of FFEL Program loans from 24 sponsors.

The Department held the participation interest in a loan until no later than October 15, 2009. To redeem the participation interest, the sponsor had to use funds obtained from private sources, or it sold the underlying loan to the Department under the Loan Purchase Commitment Program.

Loan Purchase Commitment Program

Under the Loan Purchase Commitment Program, the Department purchased from sellers (i.e., lenders or beneficial holders) eligible loans made for the 2008-2009 academic year. In order to participate in this program, each seller was required to file a NOI and enter into a Master Loan Sales Agreement (MLSA) with the Department. The date the Department received the seller's NOI filing generally determined the eligibility of the loans that the seller sold to the Department. Under the provisions of the MLSA, the Department purchased a loan at a price that was the sum of the outstanding principal balance of the loan, plus the total accrued but unpaid interest owed on the loan by the borrower, plus a reimbursement of the one percent lender fee, and \$75 (per loan). Sellers wishing to sell eligible fully disbursed loans to the Department were required to provide a 45-Day Notice of Intent to Sell loans under this program and complete the sale on or before October 15, 2009. During the audit period, the Department purchased 62.7 thousand loans, totaling \$192 million from 5 sellers.⁸ For the entire duration of the Loan Purchase Commitment Program for loans made for the 2008-2009 academic year, the

⁶ Our references to the MPA in this audit report are to the version issued by the Department on July 25, 2008, as an attachment to its Loan Purchase Programs Electronic Announcement #8. Portions of the MPA were included as an Appendix to a notice published in the Federal Register on July 1, 2008 (73 FR 37422).

⁷ The data reviewed were the records included on the weekly PPFR Loan Schedules.

⁸ The data reviewed were the records included on the Loan Detail Schedules.

Department purchased about 11.6 million loans, totaling about \$48.5 billion, from 72 sellers.⁹

FSA used a contractor, ACS, to service the FFEL Program loans purchased by the Department. In order to sell loans to the Department, sellers submitted to ACS a Loan Transfer/Conversion File, which included required loan records for loans scheduled to be sold to the Department. FSA required ACS to perform loan eligibility and data integrity edits on the Loan Transfer/Conversion File's loan records to ensure the file included only loans eligible for the Loan Purchase Commitment Program.

AUDIT RESULTS

Based on our review of controls and system edits implemented by FSA and its contractor, ACS, we concluded that FSA established and implemented adequate controls and system edits to reasonably ensure that the Department did not purchase ineligible loans under the Loan Purchase Commitment Program. Conversely, we found that FSA did not establish and implement adequate controls and system edits to reasonably ensure that the Department did not purchase participation interests in ineligible loans under the Loan Participation Purchase Program. However, the inadequate controls and system edits we identified had a minimal impact on the number and amount of ineligible loans in which the Department purchased participation interests. Our audit covered the Department's purchase of 2008-2009 academic year loans and participation interests in such loans during the period August 1, 2008, through December 31, 2008.

FINDING: FSA Did Not Have Adequate Controls and System Edits in Place to Reasonably Ensure that the Department Did Not Purchase Participation Interests in Ineligible Loans

FSA did not establish and implement adequate controls and system edits to reasonably ensure that sponsors complied with the Loan Participation Purchase Program loan eligibility requirements. Specifically, we found the following significant weaknesses –

1. FSA did not establish a system edit to ensure the PPFR Loan Schedule included only loans made for eligible loan periods.
2. FSA did not establish a system edit to ensure it would accept only one "New" loan record for each loan.

⁹ Of the \$48.5 billion in loans purchased by the Department, under the Loan Purchase Commitment Program, over \$31.2 billion were purchased from the Loan Participation Purchase Program.

3. FSA did not establish a control procedure to determine whether: (a) the cumulative amount of disbursements, net of cumulative reductions, for a loan did not equal the outstanding borrower principal balance on the loan, and (b) the cumulative amount of disbursements, net of cumulative reductions, for a loan did not exceed the original loan amount.
4. For the period August 1, 2008, through June 13, 2009, FSA's "First Disbursement Date" edit did not ensure that the loans listed on the PPFR Loan Schedule met the first disbursement date eligibility requirements when a null was encountered in the First Disbursement Date data field.¹⁰
5. For the period August 1, 2008, through June 13, 2009, FSA's "Anticipated Final Disbursement Date" edit did not ensure that the loans listed on the PPFR Loan Schedule met the final disbursement date eligibility requirements when a null was encountered in the Anticipated Final Disbursement Date data field. Also, because the "Anticipated Final Disbursement Date" edit was a "soft" edit, it did not reject individual loans that it had identified with an ineligible anticipated final disbursement date.¹¹
6. For the period August 1, 2008, through June 13, 2009, FSA's "Actual Interest Rate" edit did not review the interest rates of Unsubsidized Stafford and Graduate/Professional PLUS loans listed on the PPFR Loan Schedule to ensure that the interest rates did not exceed the maximum rates permitted under the HEA.

During the audit, we informed FSA of our preliminary findings concerning its system edits. Effective June 14, 2009, FSA implemented revised "First Disbursement Date," "Anticipated Final Disbursement Date," and "Actual Interest Rate" system edits. We determined that FSA's revised system edits addressed the weaknesses we identified regarding the first disbursement date data field and loan interest rates and partially addressed the weaknesses we identified regarding the anticipated final disbursement date data field.

We found that, during the audit period, the Department purchased participation interests in 2,328 ineligible loans, totaling \$7,106,139. In addition, the Department overpaid a total of \$26,530 for participation interests in eight loans, with a total principal balance outstanding of \$29,009, because sponsors reported unsupported disbursement amounts on PPFR Loan Schedules. When the Department purchased a participation interest in an ineligible loan, the lender obtained short-term liquidity from the Department, equal to the purchase price of the ineligible loan. Implementing adequate system edits to ensure sponsors' compliance with the provisions of the Loan Participation Purchase Program is important to protect the Federal interest.

The Office of Management and Budget Circular A-123, *Management's Responsibility for Internal Control*, (A-123) and the United States Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (Standards) require Federal managers to develop and maintain effective internal control. Specifically, A-123 states –

¹⁰ A null represents missing or unknown information, for example a field consisting of zero or left blank.

¹¹ "Soft" edits identified an entire PPFR Loan Schedule or individual loans that failed to meet the criteria of the edit. However, "soft" edits did not delay funding of the PPFR Loan Schedule.

Internal control also needs to be in place over information systems – general and application control. . . . Application control should be designed to ensure that transactions are properly authorized and processed accurately and that the data is valid and complete. Controls should be established at an application’s interfaces to verify inputs and outputs, such as edit checks.

In addition, the GAO’s Standards states, “Controls should be installed . . . to ensure that all inputs are received and are valid and outputs are correct and properly distributed. An example is computerized edit checks built into the system to review the format, existence, and reasonableness of data.”

FSA Purchased Participation Interests in Loans Made for Ineligible Loan Periods

During the audit period, the Department purchased participation interests, totaling \$12,451,957,671, in 4,180,218 loans. We analyzed the universe of loans and identified 2,328 ineligible loans in which the Department purchased participation interests, totaling \$7,106,139 (about .055 percent and .057 percent, respectively, of the number and amount of loans in which the Department purchased participation interests during the audit period).

In order to be eligible for the Loan Participation Purchase Program, each loan must be made for a loan period that includes or begins on or after July 1, 2008. (Section 3 of the MPA, Definition of “Eligible Loan”) The 2,328 loans we identified were for loan periods that did not include, or begin on or after July 1, 2008.

As part of the PPFR, sponsors submitted Loan Schedules that listed the loans for which participation interests were offered for sale to the Department. The Loan Schedule file layout and submission procedures were included in the Department’s “Loan Purchase Programs Electronic Announcement #16: Revised Document Submission Process for Request for Funding (updated September 25, 2008).” The Loan Schedule file layout in Electronic Announcement #16 did not include a data field for the loan period end date.¹²

FSA ran validation and edit checks against the PPFR Loan Schedule to ensure it included only loans eligible for the Loan Participation Purchase Program. Because the PPFR Loan Schedule file layout did not include a data field for the loan period end date, FSA could not establish a system edit that reviewed the loan period beginning and ending dates to determine whether the file listed only loans for loan periods that included, or began on or after July 1, 2008.

Without a system edit to determine whether the loans included on the PPFR Loan Schedule were made for eligible loan periods, the Department purchased and may continue to purchase participation interests in ineligible loans.

¹² Effective June 14, 2009, under “Loan Purchase Programs Electronic Announcement #62: Loan Purchase Participation Program - Revised Loan Schedule and Eligibility Edits Announcement (updated May 15, 2009),” FSA revised the Loan Schedule layout to include a data field for the loan period end date. However, the edits described in Electronic Announcement #62 do not include a review to determine that each loan’s loan period falls within the eligible parameters.

FSA Purchased Participation Interests in Loans that Had More Than One “New” Loan Record

We analyzed the universe of “New” loan records for 4,174,963 loans, with disbursement amounts greater than zero, totaling \$11,105,672,275, that the Department purchased participation interests in during the audit period. From this universe, we identified 4,919 loans that had more than one “New” loan record; these loans had disbursements totaling \$20,421,178. Additional analysis revealed that 4,899 of the 4,919 loans had two “New” loan records and 20 had more than two “New” loan records.

The PPFR Loan Schedule file layout included a data field, titled Data Flag, which was required to be completed, to identify: (1) whether the loan data was for a new loan, (2) whether there was an update to a previously submitted loan, or (3) that there was no change to a previously submitted loan. Consequently, each loan should have had only one “New” loan record.

We reviewed the PPFR Loan Schedule records, the Month-End Loan Schedule records,¹³ and information on the loans contained in the National Student Loan Data System (NSLDS)¹⁴ for a random sample of 25 loans selected from the 4,919 loans we identified with more than one “New” loan record. All 25 of the loans (the “Duplicate Loan Sample”) had two “New” loan records. Based on the PPFR Loan Schedules, the Department purchased participation interests in the 25 loans that had disbursements totaling \$115,499. We found that –

- For 21 of the 25 loans, the sponsor had misclassified one of the two “New” loan records. One of the “New” loan records should have been classified as an “Updated” record.¹⁴ There were no duplicate payments associated with these 21 “New” loan records.
- For 4 of the 25 loans, one of the two “New” loan records was a duplicate record that the sponsor should not have submitted.¹⁵ Total disbursements, net of reductions, for the four loans was \$18,001, of which \$8,084 was associated with the duplicate records (see Table 4).

FSA did not establish a system edit to determine whether a “New” loan record had been previously submitted for a loan. As a result, FSA could not ensure that sponsors had completed the PPFR Loan Schedule’s Data Flag field correctly and that it did not purchase participation interests in loans for amounts that it had previously purchased.

Loans that are ineligible for the Participation Program include loans in which the Department has previously purchased a participation interest, whether or not that interest has been redeemed. (Section 3 of the MPA, Definition of “Eligible Loan”)

¹³ Collections on and reductions to loans in which the Department purchased a participation interest were reported on the Month-End Loan Schedule.

¹⁴ NSLDS is the Department’s central database for student aid.

¹⁵ Based upon our sample, we are 90 percent confident that of the 4,919 loans we identified with more than one “New” loan record: (1) the number of loans with misclassified “New” loan records range from 3,301 loans (67.1 percent) to 4,639 loans (94.3 percent), and (2) the number of loans with duplicate “New” loan records range from 280 loans (5.7 percent) to 1,618 loans (32.9 percent).

Without a system edit to ensure that a loan can only be submitted as a “New” loan once, sponsors may continue to incorrectly code the PPFR Loan Schedule’s Data Flag field and the Department may purchase participation interests in ineligible loans.

FSA Did Not Ensure that the Participation Interest Purchase Amount for a Loan Did Not Exceed the Value of the Loan

Original Loan Amount and Outstanding Principal Balance

FSA did not establish a control procedure to determine whether: (a) the cumulative amount of disbursements, net of cumulative reductions, for a loan did not equal the outstanding borrower principal balance on the loan, and (b) the cumulative amount of disbursements, net of cumulative reductions, for a loan did not exceed the original loan amount.

We found that for 8 of the 25 loans in our Duplicate Loan Sample either the outstanding principal balance or the original loan amount was reported incorrectly on the PPFR Loan Schedule.¹⁶ For two of the eight loans, a sponsor under-reported the outstanding principal balance of the loans on the PPFR Loan Schedule (see Table 1).

Table 1 - Duplicate Loan Sample Outstanding Principal Balance Review Results			
Sample Loan ID	Outstanding Principal Balance Reported on the PPFR Loan Schedule	Outstanding Principal Balance that Should Have Been Reported on the PPFR Loan Schedule According to NSLDS Records	Amount of the Outstanding Principal Balance Under-Reported on the PPFR Loan Schedule
1	\$4,000	\$8,000	\$4,000
2	\$5,666	\$8,500	\$2,834
Totals	\$9,666	\$16,500	\$6,834

For six of the eight loans, sponsors reported incorrect original loan amounts on the PPFR Loan Schedule. For four of the six loans, the original loan amounts were under-reported, and for two of the six loans, the original loan amounts were over-reported (see Table 2).

¹⁶ Based upon our sample, we are 90 percent confident that of the 4,919 loans we identified with more than one “New” loan record, the number of loans with incorrect principal balances and/or original loan amounts reported range from 841 loans (17.1 percent) to 2,474 loans (50.3 percent).

Sample Loan ID	Original Loan Amount Reported on the PPFR Loan Schedule	Original Loan Amount that Should Have Been Reported on the PPFR Loan Schedule According to NSLDS Records	Original Loan Amount Under-Reported (U) or Over-Reported (O) on the PPFR Loan Schedule
1	\$2,250	\$4,500	\$2,250 (U)
2	\$3,667	\$5,500	\$1,833 (U)
3	\$2,250	\$4,500	\$2,250 (U)
4	\$1,750	\$3,500	\$1,750 (U)
5	\$1,500	\$0 ¹⁷	\$1,500 (O)
6	\$3,500	\$0 ¹⁷	\$3,500 (O)
Totals	\$14,917	\$18,000	\$3,083 (U)

We also selected a random sample of 25 loans that had disbursements totaling \$97,078, from the universe of 4,175,250 loans with one “New” loan record that had disbursements totaling \$12,431,532,159, in which the Department purchased participation interests during our audit period (the “Non-Duplicate Loan Sample”).¹⁸ We reviewed the PPFR Loan Schedule records and information on the loans contained in NSLDS for our Non-Duplicate Loan Sample and found that for 3 of the 25 loans either the outstanding principal balance or the original loan amount was reported incorrectly on the PPFR Loan Schedule.¹⁹ For one of the three loans, a sponsor over-reported the original loan amount on the PPFR Loan Schedule by \$4,250. The original loan amount that was reported was \$8,500; the original loan amount that should have been reported was \$4,250. For two of the three loans, sponsors over-reported the outstanding principal balances of the loans on the PPFR Loan Schedule (see Table 3). However, the participation interests purchased by the Department did not exceed the value of the loans for all 25 loans in our Non-Duplicate Loan Sample.

¹⁷ According to NSLDS records, the loan was cancelled. The original loan amount should have been reported on the PPFR Loan Schedule as the original principal amount of the loan, net of cancellations, as of the PPFR Loan Schedule creation date.

¹⁸ We tested the Non-Duplicate Loan Sample to determine whether the Department purchased participation interests in loans that exceeded the value of the loans.

¹⁹ Based upon our sample, we are 90 percent confident that of the 4,175,250 loans we identified with one “New” loan record, the number of loans with incorrect principal balances and/or original loan amounts reported range from 141,959 loans (3.4 percent) to 1,177,421 loans (28.2 percent).

Table 3 - Non-Duplicate Loan Sample Outstanding Principal Balance Review Results			
Sample Loan ID	Outstanding Principal Balance Reported on the PPFR Loan Schedule	Outstanding Principal Balance that Should Have Been Reported on the PPFR Loan Schedule According to NSLDS Records	Amount of the Outstanding Principal Balance Over-Reported on the PPFR Loan Schedule
1	\$1,000	\$0	\$1,000
2	\$1,750	\$0	\$1,750
Totals	\$2,750	\$0	\$2,750

Cumulative Disbursement Amounts

For 8 of the 25 loans in our Duplicate Loan Sample, the Department purchased participation interests, totaling \$26,530, for more than the outstanding principal balances on the loans (see Table 4).²⁰ For all eight of the loans, the overpayments resulted from sponsors reporting unsupported disbursement amounts (that is, amounts on the PPFR Loan Schedule did not agree to information on the loans contained in NSLDS). For four of the eight loans the overpayments, totaling \$8,084, resulted from sponsors reporting the same disbursement twice on the PPFR Loan Schedules.

²⁰ Based upon our sample, we are 90 percent confident that of the 4,919 loans we identified with more than one “New” loan record, the number of loans with disbursement amounts greater than the outstanding principal balances range from 841 loans (17.1 percent) to 2,474 loans (50.3 percent).

Sample Loan ID	Total Disbursements Net of Reductions	Principal Balance Outstanding According to NSLDS Records	Unsupported Disbursements Including Duplicate Disbursement Amounts (D)
1	\$4,500	\$2,250	\$2,250
2	\$4,500	\$2,250	\$2,250 (D)
3	\$5,501	\$3,667	\$1,834 (D)
4	\$4,500	\$2,250	\$2,250 (D)
5	\$2,000	\$1,000	\$1,000
6	\$5,000	\$3,000	\$2,000
7	\$26,038	\$12,842	\$13,196
8	\$3,500	\$1,750	\$1,750 (D)
Totals	\$55,539	\$29,009	\$26,530

In accordance with the MPA, Section 4(c), the Department purchases the participation interest from the sponsor for “a purchase price equal to the Principal Balance of the related Eligible Loans.” Also, Section 10(a), “Representations and Warranties of the Sponsor, the Eligible Lender Trustee and Custodian,” states –

The Sponsor, and to the extent expressly required below, the Eligible Lender Trustee (if applicable), represents and warrants to the Department and the Custodian, as of the date the Adoption Agreement is executed and as of each Purchase Date:

.....

- (xiv) The consideration received by the Sponsor upon the sale of the Participation Interests constitutes fair consideration and reasonably equivalent value for such Participation Interests

Without a control procedure in place to identify loans in which the cumulative amount of disbursements, net of cumulative reductions, does not equal the outstanding principal balance or exceed the original amount of the loan, the Department may continue to purchase participation interests in loans for amounts that exceed the value of the loans.

FSA's First Disbursement Date Edit Did Not Ensure the Eligibility of the Loans Listed on the PPFR Loan Schedule

The "First Disbursement Date" edit that FSA ran against the PPFR Loan Schedule for loans in which participation interests were being offered for sale to the Department did not ensure that the date of the first disbursement for the loans met the eligibility requirements. We identified 8,573 loans in which the Department purchased participation interests, totaling \$18,139,156, which did not have a first disbursement date reported on the PPFR Loan Schedule.

In order to be eligible for the Loan Participation Purchase Program each loan's first disbursement must have been made on or after May 1, 2008, but no later than July 1, 2009. (Section 3 of the MPA, Definition of "Eligible Loan")

FSA's "First Disbursement Date" edit was a "hard" edit. For the First Disbursement Date data field, a "hard" edit resulted in the rejection of individual loans that failed to meet the criteria of the edit. In cases where an individual loan transaction was rejected, the PPFR amount was reduced by the amount of that loan. The error on the individual loan transaction was required to be corrected and resubmitted to the Department on the next PPFR Loan Schedule.

FSA's "First Disbursement Date" edit identified and rejected individual loans listed on the PPFR Loan Schedule file for which the date entered in the First Disbursement Date data field was not on or after May 1, 2008, but no later than July 1, 2009. However, the "First Disbursement Date" edit was flawed. The edit was written so that when a null was encountered in the First Disbursement Date data field, the edit substituted the "system date" (the date on which the PPFR Loan Schedule edits were run) for the null and then checked to determine whether the "system date" was on or after May 1, 2008, and was no later than July 1, 2009. As a result, FSA did not ensure that the loans listed on the PPFR Loan Schedule, which had a null entered in the First Disbursement Date data field, met the first disbursement date eligibility requirements, and that it did not purchase participation interests in ineligible loans.

On June 1, 2009, we reported the flaw in the "First Disbursement Date" edit to FSA. On June 2, 2009, an FSA Analyst explained that FSA was already aware of the problem. The FSA Analyst stated –

You are correct that [the "First Disbursement Date"] edit 11 is flawed. It should never have used SYSDATE where a null value was reported. . . . We identified the immediate extent of the issue and . . . contacted the servicers who originated the files. Those servicers have provided explanations for their mistakes, and are updating their . . . files to include the First Disbursement Date. FMS [Financial Management Systems] is implementing a correction to the edit on June 14.

We determined that effective June 14, 2009, FSA revised the "First Disbursement Date" edit to also identify and reject loans listed on the PPFR Loan Schedule when a null is reported in the First Disbursement Date data field.

FSA's Anticipated Final Disbursement Date Edit Did Not Ensure the Eligibility of the Loans Listed on the PPFR Loan Schedule

The "Anticipated Final Disbursement Date" edit that FSA ran against the PPFR Loan Schedule for loans in which participation interests were being offered for sale to the Department did not ensure that the anticipated final disbursement date for the loans met the eligibility requirements when a null was encountered in the Anticipated Final Disbursement Date data field. We identified 12 loans in which the Department purchased participation interests, totaling \$36,680, which did not have an anticipated final disbursement date reported on the PPFR Loan Schedule.

In order to be eligible for the Loan Participation Purchase Program, each FFEL Program loan, if not fully disbursed on the purchase date, must be scheduled to be fully disbursed no later than September 30, 2009. (Section 3 of the MPA, Definition of "Eligible Loan")

FSA's "Anticipated Final Disbursement Date" edit was a "soft" edit. "Soft" edits identified an entire PPFR Loan Schedule or individual loans that failed to meet the criteria of the edit. "Soft" edits did not delay funding. However, the error was required to be corrected and resubmitted to the Department on the next PPFR Loan Schedule.

FSA's "Anticipated Final Disbursement Date" edit identified individual loans listed on the PPFR Loan Schedule file for which the date entered in the Anticipated Final Disbursement Date data field was after September 30, 2009. However, the "Anticipated Final Disbursement Date" edit was flawed. The edit was written so that when a null was encountered in the Anticipated Final Disbursement Date data field, the null was identified as an acceptable date. Also, because the "Anticipated Final Disbursement Date" edit was a "soft" edit, it did not reject individual loans that it had identified with an Anticipated Final Disbursement Date later than September 30, 2009. As a result, FSA did not ensure that the loans listed on the PPFR Loan Schedule, which had a null entered in the Anticipated Final Disbursement Date data field, met the final disbursement date eligibility requirements, and that it did not purchase participation interests in ineligible loans.

We determined that effective June 14, 2009, FSA revised the "Anticipated Final Disbursement Date" edit to identify loans listed on the PPFR Loan Schedule when a null or a date later than September 30, 2009, is reported in the Anticipated Final Disbursement Date data field. However, FSA did not revise the edit to a "hard" edit, which would reject the loans.

FSA's Actual Interest Rate Edit Did Not Include Unsubsidized Stafford Loans and Graduate/Professional Student PLUS Loans

The "Actual Interest Rate" edit that FSA ran against the PPFR Loan Schedule did not test whether the interest rates of Unsubsidized Stafford loans and Graduate/Professional student PLUS loans listed on the PPFR Loan Schedule did not exceed the maximum rates permitted under the HEA for such loans.

The applicable rate requirements, according to Section 427A(l) of the HEA, for Stafford and PLUS loans are displayed in the following table.

Table 5 - Stafford and PLUS Loan Rate Requirements Under the HEA			
Loan Type	Grade Level	First Disbursement Date	
		July 1, 2006 Through June 30, 2008	July 1, 2008 Through June 30, 2009
Subsidized Stafford Loans	Undergraduate	6.8%	6.0%
	Graduate	6.8%	6.8%
Unsubsidized Stafford Loans	Undergraduate	6.8%	6.8%
	Graduate	6.8%	6.8%
PLUS Loans (Parent or Graduate/Professional)	All	8.5%	8.5%

The “Actual Interest Rate” edit did verify that the interest rates of Subsidized Stafford loans and PLUS loans for parents listed on the PPFR Loan Schedule did not exceed 6.8 percent and 8.5 percent, respectively. However, the edit was not written to include Unsubsidized Stafford loans and Graduate/Professional PLUS loans.

In order to be eligible for the Loan Participation Purchase Program each loan must bear interest at a stated rate equal to the maximum rate permitted under the HEA for such loan.
(Section 3 of the MPA, Definition of “Eligible Loan”)

We ran queries to determine whether the interest rate of any of the loans that the Department purchased a participation interest in during the audit period did not bear interest at the applicable rate under the HEA. Based upon the result of the queries, we determined that during this period the Department did not purchase a participation interest in a loan that did not bear interest at the applicable rate under the HEA.

We determined that effective June 14, 2009, FSA revised the “Actual Interest Rate” edit to verify whether the interest rates of Subsidized and Unsubsidized Stafford loans, PLUS loans for parents, and Graduate/Professional student PLUS loans listed on the PPFR Loan Schedule did not exceed the maximum rates permitted under the HEA for such loans.

Recommendations:

We recommend that the COO for FSA –

- 1.1 Ensure that a “hard” system edit is implemented that will reject a loan made for a loan period that does not include or begin on or after July 1, 2009, for the Loan Participation Purchase Program for 2009-2010 academic year loans.
- 1.2 Ensure that all the 2008-2009 academic year loans, made for loan periods that do not include or begin on or after July 1, 2008, in which the Department held a participation interest were redeemed by the sponsor and not purchased by the Department under the Loan Purchase Commitment Program.
- 1.3 Ensure that a report is implemented that will identify loans with more than one “New” loan record and require the sponsors to redeem any duplicate purchases of participation interests in such loans.
- 1.4 Identify all the 2009-2010 academic year loans that have more than one “New” loan record and require the sponsors to identify and redeem any duplicate purchases of participation interests in such loans.
- 1.5 Ensure that a “Net Disbursement Report” is implemented that will identify loans reported on the PPFR Loan Schedule in which the cumulative amount of disbursements, net of cumulative reductions, do not equal the outstanding principal balance of the loan and/or exceed the original loan amount.
- 1.6 Identify all the 2009-2010 academic year loans for which the Department purchased a participation interest, where the purchase price of the participation interest, net of cumulative reductions, exceeded the value (i.e., the original loan amount or outstanding principal balance) of the loan and require the sponsor to redeem the participation interest in excess of the value of the loan.
- 1.7 Ensure that all 2008-2009 academic year loans, in which the cumulative purchase amount for the participation interest, net of cumulative reductions, exceeded the principal balance outstanding and/or the original loan amount, were redeemed by the sponsor or not purchased by the Department under the Loan Purchase Commitment Program at prices in excess of the value of the loans.
- 1.8 Ensure that for “New” loan records the “Anticipated Final Disbursement Date” edit is revised from a “soft” edit to a “hard” edit.
- 1.9 Identify purchases by the Department for participation interests in 2009-2010 academic year loans with an Anticipated Final Disbursement date after September 30, 2010, and require sponsors to redeem the participation interests in these loans.
- 1.10 Ensure that all 2008-2009 academic year loans, with an Anticipated Final Disbursement Date after September 30, 2009, in which the Department held a participation interest,

were redeemed by the sponsor and not purchased by the Department under the Loan Purchase Commitment Program.

FSA's Response:

FSA concurred with all the recommendations, except for Recommendation 1.3. FSA concurred with the objective of this recommendation; however, it did not concur with the approach recommended. FSA explained that it had determined that a "hard" system edit that will only allow a loan to be submitted as a "New" loan record once impaired FMS performance when PPFR Loan Schedules were processed.

FSA proposed an alternative approach to address the objective of this recommendation. FSA stated that in place of a "hard" edit it has developed a report to identify when a loan had been submitted as a "New" loan record multiple times. The report was scheduled for implementation on June 20, 2010.²¹ Exceptions noted will be reported to the custodians/sponsors with instructions to redeem any duplicate purchases of participation interests.

OIG's Reply:

We believe that FSA's proposed alternative corrective action should satisfy the objective of Recommendation 1.3, and we have revised our recommendation.

OTHER MATTERS

FSA Purchased Loans That Had No Remaining Principal Balance Outstanding

We identified two loans that had no remaining principal balance outstanding at the time the Department purchased the loans under the Loan Purchase Commitment Program. The Department purchased the loans for a total of \$221.²²

FSA's contractor, ACS, serviced the FFEL Program loans sold to the Department. ACS ran an edit against the Loan Transfer/Conversion File, submitted by sellers, which identified and rejected loans scheduled to be sold to the Department that had no remaining principal balance outstanding. The edit reviewed loans at the "account level" and not the "loan level." As a result, for a borrower with multiple loans, if one or more loans had a remaining principal balance, and

²¹ FSA's official response to Recommendation 1.3, dated June 2, 2010, stated that the report was scheduled for implementation on June 13, 2010. On June 15, 2010, FSA explained that it had the revised the report implementation date to June 20, 2010.

²² The total purchase price of \$221 includes \$71 for the reimbursement of the one percent loan fees previously paid by the lender to the Department plus \$150 (the fixed amount of the \$75 paid for each loan that was purchased by the Department).

one or more loans had no remaining principal balance, the loans with no remaining principal balance were not identified as ineligible. Consequently, FSA could not ensure that it did not purchase ineligible loans.

According to a Senior Advisor for FSA's Business Operations Group and an ACS Director of Business Development, ACS revised the edit to identify and reject loans listed on the Loan Transfer/Conversion File with no principal balance outstanding at the "loan level" in November 2008.²³

We suggest that FSA require sponsors to redeem the \$221 for the two loans purchased by the Department that had no principal balance outstanding.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether FSA established and implemented adequate controls and system edits to ensure that the Department did not purchase ineligible loans or purchase participation interests in ineligible loans. Our audit covered the Department's purchase of 2008-2009 academic year loans and participation interests in such loans during the period August 1, 2008, through December 31, 2008.

To accomplish our objective, we performed the following procedures –

- Interviewed FSA officials, and reviewed FSA's policies and procedures to gain an understanding of the internal controls applicable to processes relating to –
 1. Processing the NOI, the MPA, and the MLSA.
 2. Purchasing participation interests in FFEL Program loans under the Loan Participation Purchase Program including loan eligibility system edits and all required documentation that must be submitted to the Department.
 3. Purchasing FFEL Program loans under the Loan Purchase Commitment Program including loan eligibility system edits performed by ACS and all required documentation that must be submitted to the Department.
- Reviewed selected provisions of the HEA, regulations, A-123, the GAO's Standards, and FSA's ECASLA guidance.

²³ Our review did not identify any loans sold to the Department from November 1, 2008, through December 31, 2008, that had no remaining principal balance outstanding.

- Reviewed “Agreed Upon Procedures Attestation Engagement Guide for Ensuring Continued Access to Student Loans Act of 2008 Loan Participation Program” audits submitted to FSA by lenders, as of December 31, 2008.

Additional Information

On June 17, 2009, four companies were awarded contracts to service student loans held by the Department, including loans sold to the Department through the Loan Purchase Commitment Program authorized under ECASLA. These contractors will service the FFEL Program loans held by the Department in a manner similar to that of ACS. However, our review did not include any loans serviced by the Department’s four new loan servicers and the impact these servicers may have on the ECASLA program’s control environment. The four new servicers are –

- AES/PHEAA in Harrisburg, Pennsylvania
- Great Lakes Education Loan Services, Inc., in Madison, Wisconsin
- Nelnet, Inc., in Lincoln, Nebraska
- Sallie Mae Corporation in Reston, Virginia

Loan Participation Purchase Program

To achieve our audit objective, we relied, in part, on the computer-processed data in FSA’s Excel spreadsheet “Daily Rolling Disbursement Report,” dated January 5, 2009. For each PPFR submitted to the Department, the “Daily Rolling Disbursement Report” listed the PPFR Reference Number, the Custodian Name and Identification Number, the Sponsor Name and Identification Number, the Requested Purchase Price, the Expected Payment Date, the Actual Payment Date confirmed by Treasury, and the Amount Paid.

We verified the completeness of the data by comparing the total amount paid according to the “Daily Rolling Disbursement Report” to the total amount paid according to the Department’s corresponding general ledger account. We verified the authenticity of the data by comparing the “Daily Rolling Disbursement Report” records for 12 PPFRs randomly selected from the universe of 121 PPFRs included in FSA’s Excel spreadsheet “Daily Rolling Disbursement Report,” dated January 5, 2009, to the PPFRs and the “Government Wide Accounting System Report on PPFRs paid by Treasury,” during our audit period. Based on our preliminary assessment, we concluded that the computer-processed data included in FSA’s Excel spreadsheet “Daily Rolling Disbursement Report,” dated January 5, 2009, were sufficiently reliable for the purpose of our audit.

We used the data in the “Daily Rolling Disbursement Report” as our sampling universe for testing whether –

1. FSA had obtained sponsors’ required Loan Participation Purchase Program eligibility documents. We reviewed the eligibility documents for 10 sponsors. The 10 sponsors reviewed submitted 12 PPFRs, totaling \$719,185,247. The 12 PPFRs were randomly selected from the universe of 121 PPFRs, submitted by 21 sponsors, totaling \$12,451,957,671, which were paid during our audit period. The eligibility documents

reviewed included the NOI, MPA, Officer's Certification, and Opinion of Counsel for each of the 10 sponsors.

2. FSA had obtained sponsors' required Loan Participation Purchase Program sales documents. We reviewed the sales documents for 12 PPFRs, totaling \$719,185,247, which were randomly selected from the universe of 121 PPFRs, totaling \$12,451,957,671, which were paid during our audit period. The sales documents reviewed included the Class A Participation Certificate, PPFR, Loan Schedule Data File, and Security Release Certificate for each of the 12 randomly selected PPFRs.

We also relied, in part, on the computer-processed data in FSA's PPFR Loan Schedules that detail the loans that the Department purchased participation interests in. We verified the completeness of the data by comparing the total participation interests purchased by the Department, during our audit period, according to the PPFR Loan Schedules to the total purchased according to the Department's corresponding general ledger account.²⁴ We verified the reliability of the data by comparing the PPFR Loan Schedules' loan records for loans selected during our loan eligibility testing to the records in the NSLDS. Based on our preliminary assessment we concluded that the computer-processed data included in FSA's PPFR Loan Schedules' records for the loans that the Department purchased participation interests in during our audit period were sufficiently reliable for the purpose of our audit.

We queried the PPFR Loan Schedules' loan records to test whether the loans complied with the Loan Participation Purchase Program loan eligibility requirements. We queried the loan records to identify –

1. Records where the original lender was not the same as the sponsor. We performed additional procedures, described below, on this group of loans to determine whether the original lenders submitted a NOI to the Department.
2. Records for academic years other than 2008-2009, where the loan period begin date was before July 1, 2008, the first disbursement date was before July 1, 2008, and the anticipated final disbursement date was before July 1, 2008. We performed additional procedures, described below, on this group of loans, to determine if the Department purchased participation interests in loans for loan periods that did not include, or begin on or after July 1, 2008.
3. Records with interest rates falling outside of permissible ranges based upon statutory interest rates, where the loan type was Stafford and the interest rates were not within the specified parameters of 0.065 to 0.068 or 0.0575 to 0.06. Also, records where the loan

²⁴ During our audit period, the Department purchased participation interests in 4,180,218 FFEL Program loans that had disbursements totaling \$12,451,957,671, from 21 sponsors.

type was PLUS and the interest rates were not within the specified parameters of 0.0825 to 0.085 or 0.0575 to 0.06.²⁵

4. Loans with two or more “New” loan records. We performed additional procedures, described below, on this group of loans, to determine if the Department purchased participation interests in loans in which it had previously purchased a participation interest.
5. Loans with one “New” loan record. We performed additional procedures, described below, on this group of loans to determine whether the Department purchased participation interests in loans that exceeded the value of the loans.
6. Records where the first disbursement date was not reported.
7. Records where the anticipated final disbursement date was not reported.
8. Records where the loan status was cancelled, the disbursement amount was greater than zero, the total reduction amount was zero, and the total loan proceeds amount was zero.²⁶ We performed additional procedures, described below, on this group of loans, to determine if participation interests in cancelled loans were redeemed by the Sponsor.

We used the results of Query 1 above as our sampling universe for testing whether FSA had obtained NOIs for the original lender when the original lender was not the same as the sponsor as follows –

1. We identified 146 unique original lender/sponsor combinations that had a total disbursement amount of \$8,339,805,573.
2. We reviewed the disbursement data and stratified it into three strata as follows –

Table 6 - Stratified Disbursement Data			
Strata	Disbursed Amount	Original Lender/Sponsor Count	Dollar Amount
1	\$0 - \$50,000	134	\$ 561,361,932
2	\$50,001 - \$1,000,000	11	\$2,413,515,910
3	>\$1,000,000	1	\$5,364,927,731

3. We randomly selected for review 15 original lender/sponsor combinations that had disbursements totaling \$6,459,067,447. From Strata 1, we randomly selected 8 original lender/sponsor combinations that had a total disbursement amount of \$7,246,303; from

²⁵ Interest rate ranges reflect the ranges under the HEA for such loans and permissible interest rate reductions for Eligible Borrower Benefits under the MPA and /or interest rate limitations under the Service Members Civil Relief Act.

²⁶ Reductions are reductions in the outstanding loan principal balance due to cancellations and school refunds. Loan proceeds are proceeds from loan sales to third parties and proceeds from redemptions by the sponsor.

Strata 2 we randomly selected 6 original lender/sponsor combinations that had a total disbursement amount of \$1,086,893,413; and from Strata 3 we selected the one original lender/sponsor combination that had a total disbursement amount of \$5,364,927,731.

4. For each of the 15 randomly selected original lenders/sponsor combinations we reviewed the NOI of the original lender.

We used the results of Query 2 above (99,447 loan records that had disbursements totaling \$285,257,710) as our universe for testing whether the Department purchased participation interests in loans for loan periods that did not include, or begin on or after, July 1, 2008. We queried NSLDS to obtain each loan's loan period end date. Using the loan period end dates from NSLDS, we identified all loans with a loan period end date prior to July 1, 2008.

We used the results of Query 4 above as our sampling universe for testing whether the Department purchased participation interests in loans in which it had previously purchased a participation interest. We randomly selected for review 25 loans from the universe of 4,919 loans, which had more than one "New" loan record, with disbursements totaling \$20,421,178. The 25 randomly selected loans had disbursements totaling \$115,499. We reviewed the PPFR Loan Schedule records, the Month-End Loan Schedule records, and information on the loans contained in NSLDS for each of the 25 randomly selected loans.

We used the results of Query 5 above as our sampling universe for testing whether the Department purchased participation interests in loans that exceeded the value of the loans. We randomly selected for review 25 loans from the universe of 4,175,250 loans, which had one "New" loan record, with disbursements totaling \$12,431,532,159. The 25 randomly selected loans had disbursements totaling \$97,078. We reviewed the PPFR Loan Schedule records for our audit period and information on the loans contained in NSLDS for each of the 25 randomly selected loans.

We used the results of Query 8 above as our sampling universe for testing whether the Department's participation interests in cancelled loans were redeemed by sponsors. We randomly selected for review 25 loans from the universe of 10,873 loans, with disbursements totaling \$33,458,960, that each had a cancelled status, with total disbursements greater than zero, loan proceeds totaling zero, and reductions totaling zero. The 25 randomly selected loans had disbursements totaling \$73,807. We reviewed the PPFR Loan Schedules records for our audit period, the Month-End Loan Schedule records for our audit period, and information on the loans contained in NSLDS for each of the 25 randomly selected loans.²⁷

Loan Purchase Commitment Program

To achieve our audit objective, we relied, in part, on the computer-processed data in FSA's Excel spreadsheet "Master Loan Sales Agreement Activity Report," dated January 28, 2009. For each sale the "Master Loan Sales Agreement Activity Report" included the Lender, the Lender's NOI and MLSA receipt dates, the 45-Day Notice of Intent to Sell receipt date, the 45-Day Notice of

²⁷ The participation interests were redeemed by the sponsors for all 25 loans.

Intent to Sell loan count and amount, the Bill of Sale loan count and amount and the Bill of Sale Consummation date.

We verified the completeness of the data by comparing the total amount paid, during our audit period, according to the “Master Loan Sales Agreement Activity Report” to the total amount paid according to the Department’s corresponding general ledger account.²⁸ We verified the authenticity of the data by comparing the “Master Loan Sales Agreement Activity Report” records for all sales during our audit period to supporting documentation in the 45-Day Notice of Intent to Sell, Projected Loan Summary Schedule of Loans, Final Loan Summary Schedule of Loans, Bill of Sale, and the Bill of Sale Email Confirmation of Payment. Based on our preliminary assessment, we concluded that the computer-processed data included in FSA’s Excel spreadsheet “Master Loan Sales Agreement Activity Report,” dated January 28, 2009, were sufficiently reliable for the purpose of our audit.

We used the data in the “Master Loan Sales Agreement Activity Report” for testing whether FSA obtained required Loan Purchase Program—

1. Eligibility documents for the universe of five lenders that sold loans to the Department. Records reviewed included the NOI, MLSA, Officer’s Certification, and Opinion of Counsel for each of the five lenders that sold loans to the Department during our audit period.
2. Sales documents for the universe of nine sales of FFEL Program loans to the Department. Records reviewed included the 45-Day Notice of Intent to Sell, Projected Loan Summary Schedule of Loans, Bill of Sale and Final Loan Schedule Summary for the universe of nine sales of FFEL loans to the Department during our audit period.

We also relied, in part, on the computer-processed data in FSA’s Loan Detail Schedules’ records for the loans that the Department purchased during our audit period. We verified the completeness of the data by comparing the total loans purchased by the Department, during our audit period, according to the Loan Detail Schedules to the total purchased according to the Department’s corresponding general ledger account. We verified the authenticity of the data by comparing the Loan Detail Schedules’ loan records for 50 loans, totaling \$151,039, randomly selected from the universe of 62,279 loans, totaling \$191,956,123, to the records in the NSLDS. Based on our preliminary assessment we concluded that the computer-processed data included in FSA’s Loan Detail Schedules’ records for the loans that the Department purchased during our audit period were sufficiently reliable for the purpose of our audit.

For the 50 loans randomly selected above we tested whether the loans’ promissory notes were on file with FSA’s loan servicer, ACS.

We queried the Loan Detail Schedules’ loan records to test whether the loans complied with the ECASLA Loan Purchase Commitment Program loan eligibility rules and provisions and with the loan eligibility terms of the MLSA. We queried the loan records as follows –

²⁸ During our audit period, the Department purchased 62,279 FFEL Program loans, with a total purchase price of \$191,956,123, from 5 sellers.

1. Records where the original lender was not the same as the seller. We then performed procedures to determine whether the original lenders had submitted NOIs.
2. Records for ineligible loan types, where the loan type was not Stafford and PLUS.
3. Records with interest rates falling outside of permissible ranges based upon statutory interest rates, where the loan type was Stafford and the interest rates were not within the specified parameters of 0.065 to 0.068 or 0.0575 to 0.06. Also, records where the loan type was PLUS and the interest rates were not within the specified parameters of 0.0825 to 0.085 or 0.0575 to 0.06.²⁹
4. Records where the outstanding loan principal balance was equal to zero.

We reviewed and assessed FSA's internal controls significant to our audit objective. Our review disclosed significant weaknesses in FSA's internal controls over the Loan Participation Purchase Program for the period, August 1, 2008, through December 31, 2008. Specifically, FSA did not establish and implement adequate controls and system edits to ensure that the Department did not purchase participation interests in ineligible loans. These weaknesses and their effects are fully described in the Audit Results section of this report.

We conducted fieldwork at FSA's offices in Washington, D.C., and at our offices from January 2009, through February 2010. We provided our audit results to FSA staff during an exit conference conducted on January 20, 2010. We conducted this performance audit 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.

Enclosure

²⁹ Interest rate ranges reflect the rate requirements under the HEA for such loans and permissible interest rate reductions for Eligible Borrower Benefits under the MPA and/or interest rate limitations under the Service Members Civil Relief Act.

Enclosure – FSA’s Comments



CHIEF OPERATING OFFICER

June 2, 2010

TO: Mr. Keith K. West
Assistant Inspector General for Audit
Office of Inspector General

FROM: William J. Taggart /s/
Chief Operating Officer

SUBJECT: Draft Audit Report – “Federal Student Aid’s Controls over Loan Purchases under the Ensuring Continued Access to Student Loans Act of 2008,” Control Number ED-OIG/A03-J0005.

Thank you for providing us with an opportunity to respond to the Office of Inspector General’s (OIG) Draft Audit Report, “Federal Student Aid’s Controls Over Loan Purchases under the Ensuring Continued Access to Student Loans Act (ECASLA) of 2008,” dated April 28, 2010.

Federal Student Aid (FSA) is committed to the implementation of a strong internal control environment. FSA has taken many actions to establish, assess, and improve its controls for the Loan Purchase Commitment Program and Loan Participation Commitment Program.

We are proud to observe that you “concluded that FSA established and implemented adequate controls and system edits to reasonably ensure that the Department did not purchase ineligible loans under the Loan Purchase Commitment Program.” This is a significant achievement given the size and complexity of the program and accelerated timeframe for implementation. As you noted in your report, “the Department purchased about 11.6 million loans, totaling about \$48.5 billion, from 72 sellers” under this program for the 2008-09 academic year.

For the Loan Participation Commitment Program, you identified weaknesses where controls could be improved. The report notes that “the weaknesses found resulted in the Department’s purchasing participation interests in 2,328 ineligible loans, totaling \$7,106,139 (about .055 percent and .057 percent, respectively of the number and amount of loans in which the Department purchased Participation Interests during the audit period”. During the audit period,

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the Department purchased participation interests in 4.2 million loans for \$12.5 billion. We appreciate your attention to detail in citing both the number of loans and dollar value of loans affected by each issue relative to the population.

We take these findings very seriously and, with one exception, have either already implemented your recommendations or are in the process of doing so. The one exception is recommendation 3. For this recommendation we concur with the intent, but not the specific approach outlined. As noted below, we considered and system-tested the “hard” edit recommended and determined that running and enforcing the edit impaired FMS performance.

Our response to each of the recommendations follows:

Recommendation 1: Ensure that a “hard” system edit is implemented that will reject a loan made for a loan period that does not include or begin on or after July 1, 2009, for the Loan Participation Purchase Program for the 2009-2010 academic year.

Response: We concur with this recommendation and have completed action items to implement a “hard” system edit. On June 14, 2009, Financial Management System (FMS) Change Request (CR) No. 1346 was implemented in Release No. 7.030 imposing a “hard” edit on loan period.

Recommendation 2: Ensure that all the 2008-09 academic year loans made for loan periods that do not include or begin on or after July 1, 2008, in which the Department held a participation interest were redeemed by the sponsor and not purchased by the Department under the Loan Purchase Commitment Program.

Response: We concur with this recommendation and have completed action items to ensure that 2008-09 loans made for loan periods that do not include or begin on or after July 1, 2008, in which the Department held a participation interest, were not purchased by the Department. Specifically, loan eligibility edits were applied against all loans purchased by the Department at the time of sale/conversion under the Loan Purchase Commitment Program. These edits are independent from those executed on loans participated within the Loan Participation Purchase Program. The loan eligibility edit in the validation of the loan transfer conversion file confirms that the loan either ‘begins after or includes July 1, 2008’ for ECASLA 2008-09 or ‘begins after or includes July 1, 2009’ for ECASLA 2009-10.

Recommendation 3: Ensure that a hard system edit is implemented that will only allow a loan to be submitted as a “new” loan record once.

Response: While we concur with the intent of the recommendation (i.e., to ensure each first disbursement is funded only once), we do not concur with the approach recommended. FSA considered and tested implementation of a hard system edit, but concluded that running and enforcing a hard edit when processing Participation Purchase Funding Request (PPFR) loan schedules would impair FMS system performance.

To achieve the intent of the recommendation and to remediate the underlying issue, a report has been developed to identify exceptions. This report will be implemented in CR No. 1498

scheduled for implementation on June 13, 2010, with FMS Release No. 7.034. Exceptions noted will be communicated to the custodians / sponsors with instructions to redeem.

Recommendation 4: Identify all the 2009-10 academic year loans that have more than one “new” loan record and require the sponsors to identify and redeem any duplicate purchases of participation interests in such loans.

Response: We concur with the recommendation and have developed a report to identify 2009-10 loans that have more than one “new” loan record. This report will be implemented in CR No. 1498 scheduled for implementation on June 13, 2010 with FMS Release No. 7.034. Exceptions noted will be communicated to the custodians / sponsors with instructions to redeem.

Recommendation 5: Ensure that a “Net Disbursement Report” is implemented that will identify loans reported on the PPFR Loan Schedule in which the cumulative amount of disbursements, net of cumulative reductions, do not equal the outstanding principal balance of the loan and/or exceed the original loan amount.

Response: We concur with the recommendation and will implement a “Net Disbursement Report” on June 13, 2010, in CR No. 1498 with FMS Release No. 7.034.

Recommendation 6: Identify all the 2009-2010 academic year loans for which the Department purchased a participation interest, where the purchase price of the participation interest, net of cumulative reductions, exceeded the value (i.e., the original loan amount or outstanding principal balance) of the loan and require the sponsor to redeem the participation interest in excess of the value of the loan.

Response: We concur with the recommendation and will implement functionality to query weekly loan schedules to identify conditions where the “Participation Interest Loans Paid were more than the Outstanding Principal or Original Loan Amount”. Federal Student Aid CFO Funds Control and Accounting Operations Branch will provide the results to custodian/sponsors for review and action. Custodian/sponsor will be required to redeem interests in excess of collateral, as applicable. This functionality will be implemented with CR No. 1498 in FMS Release No. 7.034.

Recommendation 7: Ensure that all 2008-09 academic year loans, in which the cumulative purchase amount for the participation interest, net of cumulative reductions, exceeded the principal balance outstanding and/or the original loan amount, were redeemed by the sponsor or not purchased by the Department under the Loan Purchase Commitment Program.

Response: We concur with this recommendation and have completed action items to ensure all 2008-09 academic year loans, in which the cumulative purchase amount for the participation interest, net of cumulative reductions, exceeded the principal balance outstanding and/or the original loan amount, were not purchased by the Department. Specifically, loan eligibility edits were applied against all loans purchased by the Department at the time of sale/conversion under the 2008-09 Loan Purchase Commitment Program. These edits are independent from those executed on loans participated within the Loan Participation Purchase Program.

Recommendation 8: Ensure that for “new” loan records the “Anticipated Final Disbursement Date” edit is revised from a “soft” edit to a “hard” edit.

Response: We concur with this recommendation will revise edit #12 from a “soft” edit to a “hard” edit on June 28, 2010 in CR# 1497.

Recommendation 9: Identify purchases by the Department for participation interests in 2009-2010 academic year loans with an Anticipated Final Disbursement date after September 30, 2010, and require sponsors to redeem the participation interests in these loans.

Response: We concur with this recommendation and have developed corrective action plans to identify applicable purchases and require redemption. Implementation of the hard edit described above in the response to recommendation 8 will reject all future funding requests with an Anticipated Final Disbursement date greater than September 30, 2010. For PPFR loan schedules processed before the hard edit is put in place, FMS will establish and execute a query to identify any 2009-10 loans with an Anticipated Final Disbursement date after September 30, 2010, and implement procedures to notify custodians/sponsors, instructing them to redeem such loans.

Recommendation 10: Ensure that all 2008-09 academic year loans with an Anticipated Final Disbursement Date after September 30, 2009, in which the Department held a participation interest were redeemed by the sponsor and not purchased by the Department under the Loan Purchase Commitment Program.

Response: We concur with this recommendation and have completed action items to ensure that 2008-09 loans made with an Anticipated Final Disbursement Date after September 30, 2009, in which the Department held a participation interest were not purchased by the Department. Specifically, loan eligibility edits were applied against all loans purchased by the Department at the time of sale/conversion under the Loan Purchase Commitment Program. These edits are independent from those executed on loans participated within the Loan Participation Purchase Program. The loan eligibility edit used by Business Operations in the validation of the loan transfer conversion file verifies that the Last Disbursement Date is ‘on or before September 30, 2009’ for ECASLA 2008-09.

Once again, thank you for your recommendations and the opportunity to review and respond to the report.

cc: Bernard Tadley, Regional Inspector General for Audit
Daniel Madzellan, Office of Postsecondary Education