September 16, 2010

FINAL MANAGEMENT INFORMATION REPORT

To: William J. Taggart
Chief Operating Officer
Federal Student Aid

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

Subject: Federal Student Aid's Efforts to Ensure the Effective Processing of Student Loans Under the Direct Loan Program
Control Number ED-OIG/X19K0008

The purpose of this **Final Management Information Report** is to provide the U.S. Department of Education (Department), Federal Student Aid (FSA), with information that may be beneficial to ensuring a smooth transition of Federal Family Education Loan Program (FFEL) schools to the William D. Ford Federal Direct Loan Program (Direct Loan). The objective of our review was to assess the status of FSA's efforts to ensure the Common Origination and Disbursement (COD) system can effectively process 100 percent of student loan volume[1] under the Direct Loan program as a result of the SAFRA Act (SAFRA), which was part of the Health Care and Education Reconciliation Act enacted March 30, 2010, P.L. 111-152. Because of the new requirements resulting from SAFRA, we performed this review to assess FSA's efforts in 1) executing appropriate modifications to the COD contract given the anticipated increase in Direct Loan volume; 2) providing technical assistance to impacted schools, and 3) preparing contingency plans if the COD system cannot effectively handle the increased loan volume, especially during the peak loan origination period. With respect to the scope of our review, we found FSA took actions intended to ensure the effective processing of student loans as a result of the 100 percent transition to the Direct Loan program.

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

BACKGROUND

FSA was created as a result of the Higher Education Amendments of 1998. FSA's mission includes ensuring that all eligible individuals benefit from federally funded or federally guaranteed financial assistance for education beyond high school. To this end, FSA administers

[1] Stafford, PLUS and Consolidation loans

the Federal student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended.

In Fiscal Year (FY) 2009, FSA delivered or supported the delivery of approximately $113 billion in new aid to almost 13 million postsecondary students and their families through the Title IV programs, which include the Direct Loan and FFEL programs.

- The Direct Loan program lends funds directly to students through participating postsecondary institutions, with funds borrowed from the United States Treasury. In FY 2009, the Department originated 7.3 million Direct Loans.

- FFEL funds are provided by private and non-profit lenders, insured by loan guaranty agencies, and are reinsured by the Federal Government. In FY 2009, FFEL lenders originated 14.6 million FFEL loans.

FSA relies on contractors to provide the information technology systems that support the operation of the Direct Loan program, as well as operational and maintenance assistance and technical assistance to postsecondary institutions. One of the key systems is the COD system. This system processes, stores, and reconciles data from several FSA programs, including the Direct Loan program. The COD system was designed to provide a consistent process for requesting, reporting, and reconciling Direct Loans. The COD contractor provides system operation and maintenance, as well as a call center and technical support.

On March 30, 2010, the President signed the Health Care and Education Reconciliation Act which included the SAFRA Act. SAFRA required that all new Federal Stafford, PLUS and Consolidation loans be made through the Direct Loan program beginning July 1, 2010. It also appropriated $50 million to the Department for FY 2010 to provide technical assistance to institutions of higher education that were already participating or seeking to participate in the Direct Loan program.

This review built upon work conducted during our recent audit of the Department's Oversight of the Direct Loan Program.[2] In the related report, we noted that FSA took actions to estimate the impact of significant changes on Direct Loan origination and servicing demands as a result of student loan market conditions and authorities granted to the Department under the Ensuring Continued Access to Student Loan Act (ECASLA), P.L. 110-227. FSA's response to potential volume increases included modifying existing contracts and awarding new contracts. Our report also noted that FSA appeared to have access to sufficient resources to assist schools with the transition to the Direct Loan program. Because of FSA's reliance on vendor provided assistance to successfully meet the demands of increased program volume, we suggested FSA ensure effective contract monitoring practices were in place as well as provisions for appropriate system testing to ensure affected systems will perform adequately under increasing processing requirements.

[2] ED-OIG/X19I0006; issued November 24, 2009.

OBSERVATIONS

With respect to the scope of our review, we found FSA took actions intended to ensure the effective processing of student loans as a result of the 100 percent transition to the Direct Loan program. Specifically, we found FSA executed contract modifications that expanded the COD contract's loan origination tier pricing structure[3] to accommodate the projected origination volume for FY 2010 and beyond, and subsequently ordered sufficient processing capacity in relation to the anticipated FY 2010 COD origination volume. The contract also contains requirements for the contractor to process unexpected increases in origination volume. In addition, we concluded that FSA is providing appropriate technical assistance to impacted schools and has reasonable plans in place to accommodate schools that experience challenges in successfully transitioning to the Direct Loan program. Lastly, we noted that FSA has a COD contingency plan in place that documents related disaster recovery procedures intended to assist in resuming critical data processing support with the least amount of delay in the event of disruption of data processing operations. However, FSA is completely reliant on the COD system to originate loans. Origination operations cannot be transferred elsewhere in the event the COD system experiences difficulties in processing increased loan volume, which would likely result in delays.

Section 1 – Execution of Appropriate Contract Modifications

We determined that FSA executed contract modifications that expanded the COD contract's loan origination tier pricing structure to accommodate the projected origination volume for FY 2010 and beyond, and subsequently ordered sufficient processing capacity in relation to the anticipated FY 2010 COD origination volume. The contract also contains requirements for the contractor to process unexpected increases in origination volume.

Our review found that both FSA and the COD contractor prepared estimates of COD originations for FY 2010 to reflect the changes in the Direct Loan program as a result of SAFRA. The COD contractor projection of 30.3 million originations was slightly below the 33.5 million originations projected by FSA.

FSA officials stated that they accepted the COD contractor's projections because they were more current and based on actual COD origination volume to date. As part of a technical assessment of the Direct Loan origination process, the Office of Inspector General's (OIG) Computer Assisted Assessment Techniques Division analyzed the contractor's FY 2010 COD origination projections for accuracy and reasonableness. It determined the COD contractor's projection was supported and appeared to have a reasonable basis for the methodology used.

[3] Under the COD contract the Department commits to a level of service each FY based on the number of projected originations. The related pricing structure for FY 2010 includes a base of 14,045,400 originations and additional pricing tiers based on incremental increases of 1,872,720 originations.

During work conducted as part of our audit of the Department's Oversight of the Direct Loan Program,[4] FSA officials had indicated that the COD system could process 100 percent of FFEL loan volume. However, the COD's tier pricing structure was limited to 24 million originations, which FSA felt was sufficient to handle any immediate increase in Direct Loan originations at that time. We found that FSA subsequently modified the COD system contract in February 2010 to expand the pricing structure to Tier 11 (up to 34.6 million originations) through FY 2015, which would be an adequate structure to accommodate either the COD contractor's projections or FSA's original projection.

FSA notified the contractor of its selection of Tier 9 (30.9 million originations) through an email dated April 21, 2010 and formalized this direction through a contract modification executed in June 2010. FSA staff stated that it reviews the number of COD originations on a daily basis to ensure it has ordered the appropriate tier level. A new tier level can be ordered at any time if necessary. FSA staff stated that although it has funding to accommodate pricing at the Tier 10 level (32.8 million originations), it did not order this tier because it did not want to pay a higher price than necessary for origination services. We noted the applicable contract modification includes a provision that FSA would not be billed at a higher rate for origination levels that exceed the ordered tier level until the originations are greater than 20 percent of the next tier's incremental increase in origination volume.

With regard to general operational capability, we found the COD contract, as modified through March 1, 2010, includes clauses identifying the contractor's responsibility to: a) support and maintain the COD infrastructure necessary to support the origination and disbursement of Direct Loans; and b) monitor the utilization of system technical capacity to identify and address any shortfalls that may affect system performance.

Specifically, the COD contract, Section C.4.1, "COD Infrastructure Support," states

> The Contractor shall support and maintain the infrastructure necessary to support the origination and disbursement of Direct Loans… . Infrastructure consists of the COD Data Center, COD Operations Center, and Customer Service Center.

Additionally, the COD contract Section C.4.5.1, "Performance Monitoring and Capacity Planning," states

> … The Contractor shall regularly monitor the utilization of system technical capacity in order to identify and address any projected shortfalls that may affect system performance. Capacity monitoring includes system utilization of CPU [Central Processing Unit], memory and physical storage.

FSA officials agreed that these clauses require the contractor to process unexpected increases in origination volumes.

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[4] See Footnote 2.

Section 2 – Technical Assistance Provided to Impacted Postsecondary Institutions

We concluded FSA is providing appropriate on-going technical assistance to schools and has reasonable plans in place to accommodate schools that experience difficulties in transitioning to the Direct Loan program. FSA has provided technical assistance through training opportunities and other activities conducted by its Transition Team and technical assistance contractor. FSA is also actively monitoring schools transitioning to the Direct Loan program to assess their related progress and initiate follow-up activities where deemed necessary.

Training Opportunities

FSA incorporated several training opportunities and learning resources on its Training for Financial Aid Professionals website. We noted several webinars and training workshops designed to assist schools in their transition to the Direct Loan program. Learning resources included topics such as Direct Loan reconciliation, tools, and reports; awarding and reporting Direct Loans made at foreign schools; and using the COD website and other FSA software to process Direct Loans. The webinars and workshops were provided between May and July 2010 or offered as self-paced training. FSA also held 15 conferences across the country between February and April 2010, which featured information about the Direct Loan program, the systems used to administer the program, and issues for schools to consider when implementing the Direct Loan program.

Transition Team and Technical Assistance Contractor

In the summer of 2009, FSA created a Transition Team to assist schools in implementing the Direct Loan program. The team identified schools that were expected to have an increased risk of transition difficulty based on several factors, including those that lacked previous experience with COD, required heightened cash monitoring, required conversions of legacy systems, and were identified as small private institutions. FSA's internal tracking report identified a total of 340 schools that met those criteria. FSA indicated that each of these schools was assigned a point of contact on the Transition Team to directly resolve implementation issues.

Additionally, FSA acquired the services of a technical assistance contractor through the execution of a task order in April 2010. The technical assistance contractor is required to provide services such as consulting activities and support and must develop a tracking system for the status of each school site support deployment. This task order also requires the contractor to provide a "Virtual Financial Aid Office" to assist schools that fall behind in the transition process or have insufficient staff to effectively transition.

FSA's Transition Team may approve telephone or on-site support from its technical assistance contractor to help a school in its transition process. On-site support may last from two to three days to greater than a week. Related activities could include items such as validating the school's selected software solution and developing reconciliation procedures. FSA's Transition Team estimated that no more than 120 schools would likely need on-site assistance, based upon information the team has compiled from working with all of the schools. As of July 8, 2010, the technical assistance contractor reported it had received a total of 14 requests for telephone support and 7 requests for on-site support. The contractor's monthly status report through June 2010 identified just one school as potentially unable to originate Direct Loans until after mid-August 2010. In response, the contractor identified a risk mitigation plan that included the development of an implementation project plan and deployment of additional support resources to further assist the school in its transition.

Transition Monitoring

FSA's Business Operations staff is actively tracking the number of schools that have transitioned to the Direct Loan program along with those that have not. FSA's Direct Loan Transition Report as of July 29, 2010 showed that FSA projected 2,575 domestic schools would need to transition to the Direct Loan program through December 2010 and that 1,884 of these schools (73 percent) had fully transitioned to the Direct Loan program since April 2010. FSA officials stated that on average approximately 30 domestic schools transition to the Direct Loan program per day and that these schools are reporting the transition process to be easier than expected.

The report also indicated that 136 of the 473 foreign schools (29 percent) needing to transition had fully transitioned to the Direct Loan program since July 2010. FSA officials stated that there were several reasons why they were not concerned about this. FSA explained that it was not possible for foreign schools to be fully transitioned before July 1, 2010 because of statutory requirements that did not allow them to participate in the program prior to that date. In addition, FSA officials indicated that only about 25 percent of foreign schools actually generate a significant amount of loan volume and that some of the schools operate on a different award year and may not have a need to process any Direct Loans during the current award year.

FSA officials indicated that they have taken steps to assist schools that showed limited activity in the transition process. This included providing programmatic information necessary to originate Direct Loans to domestic schools that did not submit their intent to participate in the Direct Loan program by April 2010, and contacting domestic schools that had not shown Direct Loan related activity by July 2010. FSA further indicated it plans to contact senior officials at domestic schools it considers to be non-responsive. FSA stated that during June 2010 it began actively communicating with foreign schools that had not submitted amended Program Participation Agreements and that it was conducting additional follow-up as part of its ongoing monitoring efforts.

Section 3 – Contingency Plans

We found that FSA has a contingency plan in place for the COD system that documents the disaster recovery procedures intended to assist in resuming critical data processing support with the least amount of delay in the event of disruption of data processing operations. However, FSA's COD contingency plan does not address a situation where the system would be unable to process loans due to increased origination demand. FSA officials indicated that they are completely reliant on the COD system to originate loans and categorized COD as a single point of failure because it is the only system that can originate Direct Loans. Origination operations cannot be transferred elsewhere in the event the COD system cannot handle an increase in loan volume or peak processing periods. There will likely be a delay in origination processing if this occurs.

A draft of this report was provided to FSA for comment. After reviewing the draft, FSA notified OIG that it did not have any comments.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the review was to assess the status of FSA's efforts to ensure the COD system can effectively process 100 percent of student loan volume[5] under the Direct Loan program as a result of SAFRA requirements. To meet this objective, we specifically assessed FSA's efforts in 1) executing appropriate modifications to the COD contract given the anticipated increase in Direct Loan volume; 2) providing technical assistance to impacted schools, and 3) preparing contingency plans if the COD system cannot effectively handle the increased loan volume, especially during the peak loan origination period. Accordingly, we reviewed applicable Federal laws and regulations and policies and procedures. We reviewed a prior OIG management information report related to Direct Loan program systems and compliance monitoring, as well as an OIG technical assessment review of the Direct Loan program origination process. We reviewed the origination projections related to the 100 percent Direct Loan transition that were prepared by both FSA and the COD contractor. We also conducted interviews with applicable FSA management and staff and evaluated relevant documentation to assess FSA's actions with regard to COD system processing capabilities. Additional information on the scope and methodology is presented below.

Contract Monitoring

We met with FSA contracting staff to identify contractual actions taken to increase the COD system capacity in response to anticipated volume increases. We reviewed contract documentation intended to ensure that the COD system can absorb the anticipated increased volume and that a pricing structure adequate for the increased volume was established. We also reviewed the schedule of deliverables in the COD system contract to identify and review any key deliverables related to the capacity of the COD system.

Technical Assistance

We met with officials from FSA Business Operations to gain an understanding of the plans and actions taken to provide postsecondary institutions with technical assistance as they transition to the Direct Loan program. We reviewed contract documentation related to the task order awarded for Direct Loan Readiness Transition Support. We obtained the transition support contractor's weekly Project Status Tracking Reports through July 8, 2010 as well as the monthly status report through June 30, 2010 and reviewed the reports for any identified issues, risks, and actions taken to mitigate these events. We reviewed announcements for current and future training activities and learning resources made available to impacted schools. We also obtained FSA's Direct Loan Transition Reports to identify the number of domestic and foreign schools that have fully transitioned to the Direct Loan program as of July 29, 2010.

[5] See Footnote 1.

Contingency Plans

We met with FSA contracting officials to discuss FSA's contingency plans in the event the COD system would not be able to effectively process peak loan volume. We also reviewed the COD Contingency Plan.

The scope of this review was limited to FSA's efforts to ensure the effective processing of student loans as a result of the 100 percent transition to the Direct Loan program required by SAFRA. We specifically reviewed the actions taken by FSA as a result of SAFRA's enactment on March 30, 2010. The fieldwork for our review was conducted at Department offices in Washington, D.C., during the period May 2010 through July 2010. An exit conference with Department officials was held on July 8, 2010.

We conducted our work in accordance with the OIG quality standards for Management Information Reports.

If you have any questions, please call Sean Dawson, Assistant Director, Operations Internal Audit Team, at (202) 245-6268.

cc: Dawn Dawson, Audit Liaison Officer, FSA

Attachment

Attachment

Acronyms/Abbreviations Used in this Report

COD	Common Origination and Disbursement
Department	U.S. Department of Education
Direct Loan	William D. Ford Federal Direct Loan Program
ECASLA	Ensuring Continued Access to Student Loan Act
FFEL	Federal Family Education Loan Program
FSA	Federal Student Aid
FY	Fiscal Year
OIG	Office of Inspector General