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ABSTRACT

This report discusses the continuing concerns of the U.S. General Accounting Office (GAO) in regard to the Department of Education's management and oversight of postsecondary student financial aid programs, especially the Federal Family Education Loan, the Ford Direct Loan, and the Federal Pell Grant Programs. GAO commends the department for its actions over the last several years to reduce waste, fraud, abuse and mismanagement in these programs, but believes that the department needs to take further action, specifically toward improving program management and information systems. The report points out that complicated, cumbersome processes still hinder the operation of federal student loan programs, that program structures remain flawed, and that program management concerns continue to persist. It concludes that the Department of Education needs to continue its ongoing efforts to improve gatekeeping, integrate its information systems, ensure the accuracy and validity of student loan data, and continue its efforts to improve financial management. A list of related GAO reports is included. (MDM)

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Student Financial Aid

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GAO United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

February 1997

The President of the Senate
The Speaker of the House of Representatives

In 1990, the General Accounting Office began a special effort to review and report on the federal program areas its work identified as high risk because of vulnerabilities to waste, fraud, abuse, and mismanagement. This effort, which was supported by the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight, brought much-needed focus on problems that were costing the government billions of dollars.

In December 1992, GAO issued a series of reports on the fundamental causes of problems in high-risk areas and, in a second series in February 1995, it reported on the status of efforts to improve those areas. This, GAO's third series of reports, provides the current status of designated high-risk areas.

This report discusses GAO's continuing concerns about the Department of Education's management and oversight of postsecondary student financial aid programs, especially the Federal Family Education Loan, the Ford Direct Loan, and the Federal Pell Grant Programs. GAO commends the Department for its actions over the last few years in response to many recommendations made by others and GAO. Many of these actions have likely played a major role in reducing the number of student loan defaults and the default rate. GAO believes, however, that the Department needs to take further action, specifically toward improving program management and information systems.

Copies of this report series are being sent to the President, the congressional leadership, all other Members of the Congress, the Director of the Office of Management and Budget, and the heads of major departments and agencies.

James F. Hinchman
Acting Comptroller General
of the United States

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Overview

Our previous high-risk reports[1] have identified vulnerabilities in the Department of Education's student financial aid programs, specifically the Federal Family Education Loan Program (FFELP)[2] and the Federal Pell Grant Program. Although federal student aid programs have succeeded in giving students access to money for postsecondary education, the Department has been less successful at protecting the financial interests of the U.S. taxpayers, according to our reviews. In addition, long-standing management problems, we believe, could hamper the Department's implementation and administration of the Ford Direct Loan Program (FDLP).[3] Although the Department has acted to correct many problems and improve program controls, vulnerabilities remain.

Problems

In fiscal year 1995, the federal government paid out over $2.5 billion to make good its guarantee on defaulted student loans. In

[1] High-Risk Series: Guaranteed Student Loans (GAO/HR-93-2, Dec. 1992) and High-Risk Series: Student Financial Aid (GAO/HR-95-10, Feb. 1995).

[2] FFELP was formerly called the Guaranteed and Stafford Student Loan Programs.

[3] FDLP was formerly called the Federal Direct Student Loan Program.

addition, inadequate Department oversight has contributed to abuses on the part of some schools participating in federal student aid programs. These abuses included instances in which schools received Pell grant funds for students who never applied for the grants nor enrolled in or attended the schools. In one instance, a chain of proprietary schools falsified student records and misrepresented the quality of its educational programs to increase its revenues from students receiving Pell grants.

Underlying problems with the student aid programs' structure and management, on which we have previously reported, include the following:

- FFELP's structure was overly complex, and participants had little or no incentive to prevent loan defaults.
- Lenders and state agencies that guaranteed the loans against default (guaranty agencies) bore little or no financial risk. The federal government bore nearly all the risk.
- Many schools participating in the programs did not meet federal standards and requirements, providing poor training to their students, whose skills were then insufficient to get the jobs required to enable them to repay their loans.

- The Department did not fully implement adequate controls to minimize its losses and to correct a number of long-standing management problems.

The Congress addressed many of these problems through amendments in 1992 and 1993 to title IV of the Higher Education Act of 1965, as amended (HEA). The Department has acted to address these problems and their causes; however, these actions have not completely resolved the underlying problems.

Progress

Partly to help strengthen the Department's internal controls, the 1992 and 1993 amendments

- required that financial and compliance audits of guaranty agencies be conducted annually rather than every 2 years;
- required that lenders and guaranty agencies share more of the risk of defaults in FFELP by reducing the maximum insurance and reimbursement rates on a defaulted loan from 100 to 98 percent;
- authorized the Department to provisionally certify schools to participate in federal student aid programs, allowing the Department to limit the length of time a

school is approved to participate and to more closely monitor and evaluate the school's performance; and

- authorized the establishment and federal funding of state postsecondary review entities (SPRE) responsible for conducting or coordinating reviews of schools licensed in their state that participate or seek to participate in federal student aid programs.

Except for establishing SPRES, for which funding was not maintained, the Department implemented each of the amendments' provisions. In our 1995 high-risk report, we recognized that the Department had begun

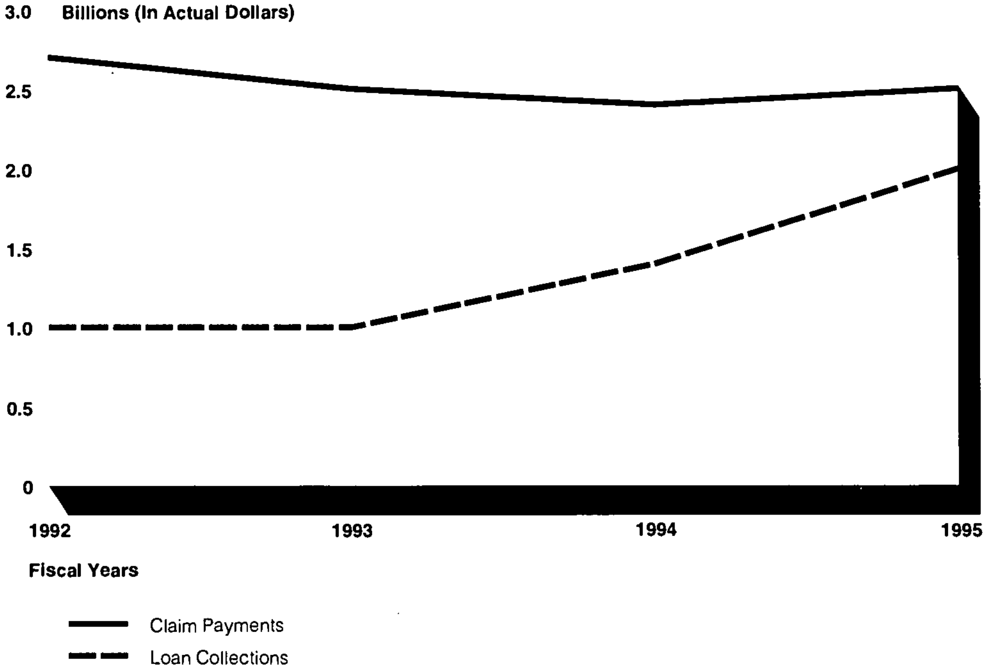
- strengthening gatekeeping[4] by expanding the criteria used to select schools for audit and review and increasing the number of staff conducting reviews,
- improving management practices by reorganizing the Office of Postsecondary Education (OPE) to permit it to better administer and oversee federal student aid programs,
- implementing several new information systems designed to provide more accurate and timely information, and

[4]Gatekeeping generally refers to the Department's procedures for determining which schools may participate—and whether they should continue participating—in federal student aid programs.

- improving financial management by revising the auditing requirements for guaranty agencies and lenders and by developing and maintaining more detailed financial records.

The Department has generally tried to address problems in its student aid programs, and some of these efforts appear to be achieving some results. For example, as shown in figure 1, FFELP default claim payments declined slightly from $2.7 billion in fiscal year 1992 to $2.5 billion in fiscal year 1995. Collections on defaulted loans have increased from $1 billion in fiscal year 1992 to $2 billion in fiscal year 1995.

Figure 1: FFELP Default Claim Payments and Collections, FYs 1992-95



Moreover, in July 1996, the Department had completed actions or had actions in progress or planned to address 186 (91 percent) of 205 recommendations—most made over a 4-year period by the Department's Office of Inspector General (OIG) and us—to improve its management of federal student financial aid.[5] These actions by the Department have the potential to further remedy many of the underlying program problems.

Outlook for the Future

Although the Department has shown a commitment to improving its oversight and management of the student aid programs, the financial risk to U.S. taxpayers remains substantial. The procedural and structural program elements that are the root causes of the problems remain. Some of these problems arose from the statutory design of the programs and will persist unless changed through congressional action. Although the Department can mitigate some of these problems through more effective oversight and management, many of the Department's initiatives, discussed in our 1995 report, have not been fully implemented. Progress toward their full implementation has been mixed.

The student aid programs employ complex and cumbersome processes with many participants. Each major program—FFELP, FDLP, and Pell grants—has its own procedures and set of participants. Overseeing these processes clearly presents a management challenge to the Department.

[5] Department of Education: Status of Actions to Improve the Management of Student Financial Aid (GAO/HEHS-96-143, July 12, 1996).

Moreover, the introduction of FDLP has added a new dimension of complexity. FDLP was originally authorized to account for about 60 percent of student loans after a 5-year phase-in period. (In 1995-96, FDLP accounted for about 33 percent of loans.) Although the administration subsequently planned for FDLP to replace FFELP, the Congress has allowed both programs to operate in competition with each other, pending any restructuring of the programs during the reauthorization of HEA scheduled for the 105th Congress.

The programs' structural flaws remain. To maximize access to aid funds, HEA placed nearly all the financial risk of loan defaults on the federal government. Since 1980, as the number of borrowers has increased, so has the number of defaults. In addition, the number of students from lower income families who attend proprietary trade and other nontraditional schools has increased, raising the risk of programwide defaults. How FDLP will affect these problems is unclear: Loan repayment and default histories are just beginning to be developed as the first FDLP borrowers complete their education and begin repaying their loans.

Management shortcomings are a major problem, although in some areas, such as gatekeeping, the Department has improved some of its practices. In others, many past problems remain. For example, Department initiatives to improve information resources management have not fully succeeded in improving data quality and systems integration. This situation also affects the programs' internal controls as follows:

- Poor quality and unreliable FFELP student loan data remain in the Department's systems. As a result, the Department cannot obtain complete, accurate, and reliable FFELP data necessary to report on its financial position.
- Inaccurate loan data are being loaded into the National Student Loan Data System (NSLDS), the Department's principal student aid database intended to help resolve data quality problems.

The Department has begun planning a major re-engineering effort that it expects will resolve these problems in the next several years. This effort, which is known as Easy Access for Students and Institutions, or Project EASI, is envisioned as a student-based, integrated data system through which program management and control functions will be conducted.

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Complicated Processes, Structural Flaws, and Management Shortcomings Cause Student Aid Program Problems

The root causes of FFELP's persistent problems are (1) complicated, cumbersome processes; (2) structural flaws; and (3) Department management shortcomings. In addition, many of FFELP's problems also plague the other major federal student aid programs such as Pell grants.

Complicated, Cumbersome Processes Still Hinder Operation of Federal Student Aid Programs

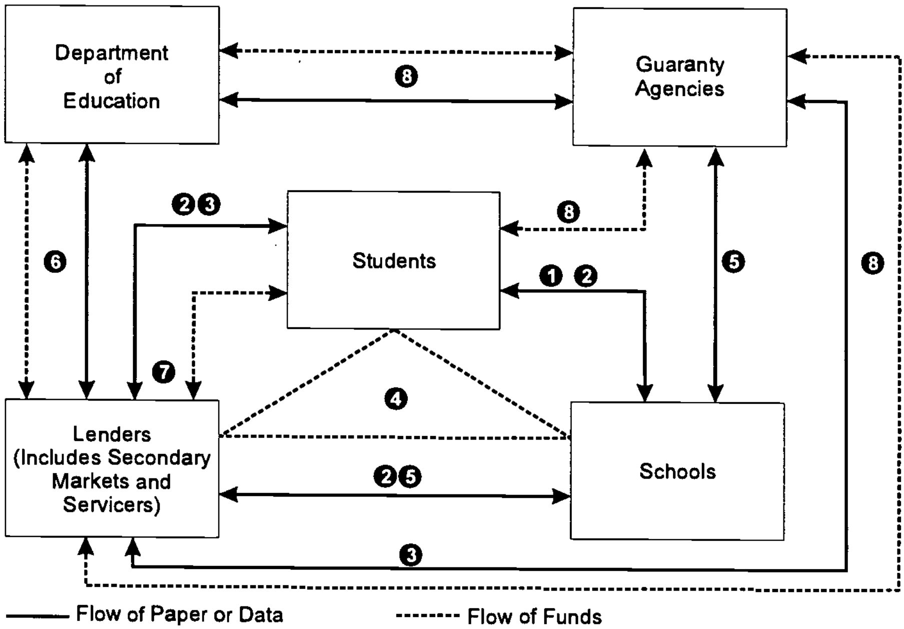
The Department administers and oversees federal student aid programs authorized by HEA and monitors participants' activities. It also determines which schools and lenders can participate and establishes program requirements.

These requirements affect millions of students and thousands of schools, lenders, and other entities. The three principal entities are students, schools, and the Department of Education. Two additional entities—lenders and guaranty agencies—also have roles in FFELP.

Generally, students initiate the student aid process by applying to the Department to determine their eligibility for aid. The Department notifies students of their expected family contribution, which is used, in part, to determine the type and amount of federal aid they can receive. To obtain a Pell grant, students submit this information to their schools, which must ensure that students (1) meet federal eligibility requirements for the grant and, (2) if eligible, are paid the full Pell grant they are eligible to receive.

Figures 2 and 3 show the two different, complicated processes that occur in applying for a loan under FFELP and FDLP.

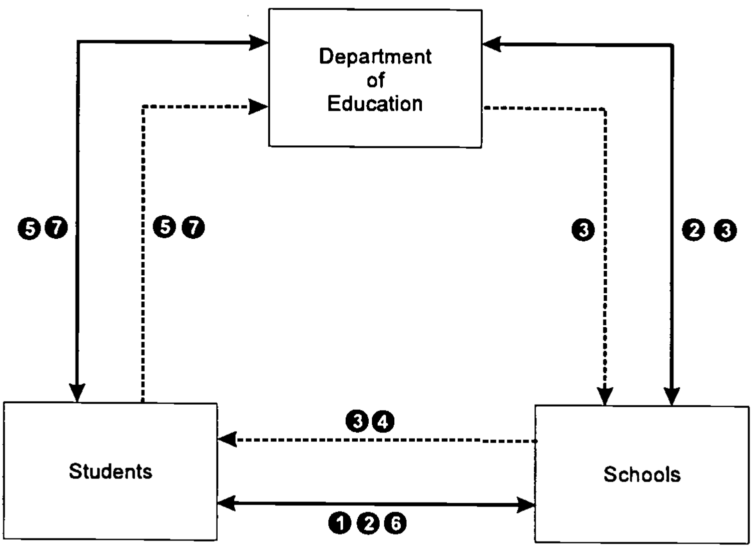
Figure 2: Applying for and Repaying an FFELP Loan



1. Student provides school with financial information and school determines loan eligibility and counsels student.
2. Student generally obtains loan application from lender, fills out his or her portion, and forwards it to school; school completes application and forwards it to lender.
3. Lender provides information to guaranty agency; verifies student eligibility and agrees to guarantee loan; lender sends promissory note to student; returns signed note to lender.
4. Lender issues check to be endorsed by both school and student.
5. School periodically confirms borrower's continued student status.
6. Lender bills the Department of Education for interest subsidy, reports loan origination fees collected, and provides summary information on its guaranteed loan portfolio.
7. Lender bills student when repayment starts, collects payments, and conducts statutory loan collection services if borrower becomes delinquent or in default.
8. Guaranty agency reimburses lender for defaulted loans and receives reinsurance and an administrative costs allowance from the Department. The agency also receives an insurance premium from students. The agency pays the Department a loan reinsurance fee, shares collections on defaulted loans, and provides the Department with summary information of loans it guaranteed.

At schools participating in FFELP, students apply to a participating lender for a loan. The school verifies the student's eligibility and determines, on the basis of family income and estimated cost of attendance, the loan amount the student is eligible to receive. The student then receives the loan from the lender. The state-designated guaranty agency guarantees the loan against default. The guaranty agency is the intermediary between the Department and the lender, insuring the loan against default and making certain that the lender and school meet program requirements. For subsidized loans, the Department pays interest due the lender while the student attends school. The student generally begins repaying the loan, including interest and principal, following a 6-month grace period after leaving school and has up to 10 years to repay. The lender is responsible for servicing and collecting it, and, if the student defaults on the loan, the lender files a claim with the guaranty agency for reimbursement of most of its loss. The Department also reimburses guaranty agencies for most of their claims paid to lenders for defaulted loans and for some of their administrative costs.

Figure 3: Applying for and Repaying an FDLP Loan



——— Flow of Paper or Data
-------- Flow of Funds

1. Student generally obtains the loan application, fills out his or her portion and forwards it to school.

2. School determines loan eligibility and amount, counsels student, and forwards the application to the Department's loan origination center (LOC).

3. LOC reviews and accepts or rejects loan origination records, promissory notes, and all other related records; and when it receives and accepts the loan origination record, promissory note and disbursement record, it "books" a borrower's loan, thus making it an official and permanent obligation of the borrower.

4. Student's school account is generally credited by the school.

5. A servicer under contract to the Department services the loan during in-school, grace, and repayment periods and performs and processes deferments, forebearances, and certification; as well as collects the loan.

6. School periodically confirms borrower's continued student status.

7. Servicer notifies student when disbursements are made, contacts borrower to determine choice of repayment options, bills student when repayment starts, and continues to collect on the loan. If a borrower defaults, the servicer forwards the loan to the Department for further collection efforts.

At schools participating in FDLP, students generally apply to the school for a loan because the school operates as the Department's agent in this regard. As it would for FFELP loans, the school verifies the student's eligibility and determines the loan amount. The Department then makes the loan, which the school generally posts to the student's school account. As with FFELP loans, the student generally begins repaying following the 6-month grace period after leaving school. But unlike FFELP loans, the student has from 10 to 30 years to repay under several different repayment options. Under contract to the Department, a third-party entity services loans and collects payments from borrowers. If a borrower defaults, the servicer refers the loan to the Department for collection.

The existence of these two competing loan programs adds another dimension to the already complex delivery of federal student financial aid. Until very recently, both loan programs were administered separately by the Department. In addition, some loan terms, such as repayment periods, differ between the two programs. Also, the role and responsibilities of schools that participate in FDLP are different. This has led to the potential for a fragmented operating environment in which two different groups of students, schools, lenders, Department administrators, and other entities participate in two mostly similar programs.

Programs' Structure Remains Flawed

The structure of the federal student aid programs remains flawed primarily because the (1) federal government continues to bear a major portion of the risk for loan losses and (2) loan programs have shifted away from serving mostly middle-income, traditional 4-year undergraduate school students. The programs now serve more students from low-income families and those attending proprietary schools than the more traditional students the programs were intended to serve. This has contributed to a fundamental tension in both FFELP and FDLP between their primary goal—providing access to postsecondary education—and minimizing costs to the U.S. taxpayer. The programs' current structure makes it difficult for the Department to protect the taxpayers' financial interests. Although a recent legislative change has resulted in some risk sharing by lenders and guaranty agencies for loan defaults, currently, the federal government still assumes nearly all the risk of financial losses from loan defaults. In addition, the number of borrowers from groups at higher risk of defaulting is increasing.

At FFELP's outset, the government expected to share the program's financial risks with state-designated guaranty agencies. When states failed to establish such agencies, the Congress enacted several incentives to increase lender and guaranty agency participation. In doing so, it kept the financial risk almost entirely with the federal government. Recently, the Congress began shifting some risk back to the guaranty agencies, as well as lenders, by reducing the maximum reimbursement and insurance rates on defaulted loans to 98 percent. This was intended, in part, to encourage both lenders and guaranty agencies to work with borrowers to prevent them from defaulting on their loans.

The government generally assumes full risk for defaults under FDLP. HEA and Department regulations allow the use of various legal remedies to collect defaults, such as demanding immediate payment of the full amount due, garnisheeing wages, requesting the Internal Revenue Service to offset federal income tax refunds, and assessing collection fees to recover its costs. Many of these same remedies are used under FFELP.

But for most FDLP loans, the Department has additional flexibility because it can let some defaulters use the income contingent repayment option to determine their monthly loan payments and resume repayment.

In addition, students in groups at higher risk of defaulting—low-income students and students receiving a nontraditional college education—have increasingly received student aid. Loans authorized under title IV were initially targeted to middle-income students, generally a low-risk group, and Pell grants were targeted to students from low-income families. But the loans' client base has shifted more toward low-income students as the cost of education has exceeded the amount of grant funds available. As a result, low-income students have turned to student loans to help finance their postsecondary education. This has placed greater debt burden on low-income students, who often have little or no means to repay. Also, FFELP was originally intended to finance a traditional college education. The expansion of the program to include other education and training schools, such as proprietary (for-profit and trade) schools, has resulted in grants and loans to students to attend schools that did not always provide a high-quality education.

Abusive practices of some proprietary schools, along with plentiful loans, have contributed to loan defaults and program costs. For example, students who attended proprietary schools represented 23 percent of borrowers entering repayment in fiscal year 1993, but they accounted for 47 percent of those who defaulted in fiscal years 1993 and 1994. Some proprietary school operators have enriched themselves at the expense of economically disadvantaged students, while providing little or no education in return. Faced with large debts and no new marketable skills, these students have often defaulted on their loans. Lenders and guaranty agencies who have little financial risk have also contributed to the default problem. Had sufficient risk-sharing arrangements been in place, lenders and guaranty agencies would have had an incentive to monitor the kind of education their borrowers were receiving and their repayment practices. With increased risk to the government from increasing participation in FDLP, attention to educational quality is much more important now and in the future.

Department's Difficulty in Managing Its Programs Persists

Although it has made many improvements in the last several years, the Department still has some problems in managing its student aid programs. These problems have been the subject of congressional hearings and investigations, reports by OIG and us, and other studies and evaluations. These reviews, for example, have shown that the Department (1) did not adequately oversee schools that participate in the programs; (2) relied too heavily on managing each title IV program through separate administrative structures, with poor or little communication among programs; (3) used inadequate management information systems that contained unreliable data; and (4) did not have sufficient and reliable student loan data to determine the liability on outstanding loan guarantees.

Concerns have been raised about the way the Department addresses management problems. For example, OIG observed in June 1996 that the Department takes a piecemeal approach to improving its processes. The Advisory Committee on Student Financial Assistance—established by law to provide advice and counsel to the Congress and the Department on student financial aid matters—believes that problems take longer to fix than they should.

The known inventory of Department management and oversight problems indicates that the potential for fraud, waste, and abuse in the student aid programs remains high. Also, as noted earlier, sound Department management of the programs must be in place to mitigate their procedural and structural weaknesses. Since our 1992 high-risk report, the Department has taken many actions to address program and management problems identified by OIG, other organizations, and us. Many of these efforts show signs of success, and others, if fully implemented, could make further improvements. Actions directed to four areas in particular are critical for minimizing waste, fraud, and abuse and require the Department's continuing attention and improvement: (1) gatekeeping, (2) program administration, (3) information resources management, and (4) financial management.

Gatekeeping Procedures Improving but Significant Weaknesses Remain

In the last several years, the Department has taken the following steps to improve its gatekeeping procedures for determining which schools may participate, and whether they may continue participating, in the federal student aid programs:

- Required all schools to have annual financial and compliance audits.
- Increased the number of program reviews and hired additional staff to conduct reviews. The Department has also outlined in its program review guide specific indicators of potential noncompliance or mismanagement that reviewers should identify. More detailed reviews are called for if these indicators are present.
- Began to implement a new database of schools to help Department staff monitor schools' performance. The database will include financial and past performance data as well as findings from prior reviews and audits and previous program violations.
- Reviewed all federally recognized accrediting agencies to ensure that they meet new standards for recognition by the Department.

Still, the following weaknesses continue to cause concern: lack of funds to put SPREs into operation, problems with the school recertification process, and questions about the implementation of the "85-15" rule (so named because proprietary schools are required to obtain no more than 85 percent of their revenue from federal student aid programs).

SPREs Not Funded

The 1992 amendments authorized the Department to establish SPREs to encourage states to play a more active role in gatekeeping. The role of SPREs, under an agreement with the Department, was meant to include coordinating and conducting reviews of schools licensed in their state. SPREs would have had authority to determine a school's eligibility to participate in the student aid programs. SPREs were to be funded by the federal government, but because funding was not maintained, SPREs never materialized. This effectively blocked the states from playing a more active role in overseeing schools. Moreover, the Department, partly in response to opposition to the SPREs from the higher education community, decided to limit the role of the states to a more traditional one, most notably licensing. The Department also proposed that information provided by schools on their programs and performance be distributed to prospective students through state-supported career centers.

School Recertification Process Has Flaws

Problems with the Department's school recertification process could increase the likelihood that schools not in compliance with school eligibility requirements continue to participate in title IV programs. The Department considers a school's loss of certification a risk factor for federal financial losses. OIG found that the Department was recertifying schools it probably should not have. In a review of a sample of Department recertification actions, 27 percent of schools sampled had violations, such as unpaid liabilities or failing to meet financial responsibility requirements, that could be grounds for noncertification.[6] The Department acknowledged that a few of these recertifications should not have been made but said that most were justified. Department officials also stated they were taking action to ensure that up-to-date financial data on schools would be made available for future recertification reviews. The Department acknowledged to OIG, however, that it would not be able to complete recertification reviews for all participating schools within a deadline mandated by the 1992 amendments and generally agreed with OIG that it should focus on completing reviews for higher risk schools first.

85-15 Rule Not Properly Implemented

OIG is concerned that the Department is not implementing the 85-15 rule in a timely fashion. The 1992 amendments require that participating proprietary schools receive no

[6] Subsequent Review to Follow-Up Review on Selected Gatekeeping Operations, U.S. Department of Education, OIG, ACN: 11-60004 (June 7, 1996).

more than 85 percent of their revenues from the student aid programs. This rule was enacted to help ensure that schools did not rely entirely on federal student aid for their operations. The basis for this is that if schools are required to raise some of their revenue privately, they will be more likely to provide students a good education and less likely to close. OIG told us that Department guidance on implementing the rule allowed schools to demonstrate compliance using accounting methods that were not consistent with sound financial standards. Although the Department guidance has been revised, OIG remains concerned that the guidance is not being properly implemented.

The Department is also in different stages of implementing two gatekeeping initiatives designed to focus resources and attention on higher risk schools. The first initiative—experimental sites—was called into question as a result of congressional oversight activities and is not being expanded. The second initiative involves re-engineering the school review process used by the Department's Institutional Participation and Oversight Service (IPOS) and is known as the IPOS Challenge.

Experimental Sites Initiative

A provision in the 1992 amendments authorized the Department to grant schools relief from certain regulatory requirements, or some flexibility in implementing them, as part of an effort to experiment with alternative ways to verify student financial aid data. The experiments approved by the Department also cover loan entrance and exit counseling and the 30-day waiting period for disbursing loans to new borrowers. Currently, 135 schools are participating in the experimental sites initiative, and they are required to periodically report to the Department on the experiments' outcomes and effects. The Department also proposed, under the experimental sites authority, to broadly relax regulation and reviews of schools that have historically had strong compliance records, while maintaining more traditional oversight of and requirements for, and increasing reviews of, schools that have had past compliance problems.

The Congress, however, raised questions about whether both this proposal and the approval granted at some of the experimental sites may have exceeded the authority provided in the 1992 provision. As a result, the proposal has not been implemented. Subsequently, congressional conferees considering a 1997 appropriations bill did not object to continuing experiments already approved but directed the Department to notify the appropriate congressional committees before approving new ones.[7]

IPOS Challenge

Under the IPOS Challenge, the Department will identify schools for review on the basis of their risk for noncompliance. It will calculate risk using a computer model that analyzes schools' past performance and Department compliance data. Department officials believe this approach will allow review staff to identify risk on the basis of objective analysis and compare schools on the basis of similar factors rather than on individual reviewers' judgments as is the current practice. They expect that it will take a couple of years to complete and test the computer model and fully implement the process. Also, as part of this initiative, review teams will decide on the basis of a school's overall compliance record how to structure school reviews and which compliance and penalty actions to recommend for violations. Because the IPOS Challenge is in the initial phase of implementation, it is too soon to assess its effectiveness.

[7]H.R. 104-863, p. 1061.

Program Administration Improvements Continue as New Concerns Must Be Addressed

The Department has improved program administration in response to a 1991 joint study by the Office of Management and Budget and the Department.[8] Although the Department has addressed many of the problems the study identified, further action is needed. For example, the Department has administered FDLP and FFELP separately, and at times it was unclear whether these two programs' offices were communicating with each other. This has contributed to a fragmented operating environment that has complicated the student aid programs and caused other management and coordination problems.

The Advisory Committee on Student Financial Assistance reported in 1995 that the Department was giving low priority to reforming FFELP oversight, largely in anticipation of full transition to FDLP in the coming years.[9] In June 1996, OIG reported no signs that FFELP reform was receiving low priority. OIG also found, however, that the Department's formation of a separate

[8] Improving Guaranteed Student Loan Management: A Blueprint for Action, Department of Education and the Office of Management and Budget (Washington, D.C.: Apr. 1991).

[9] Integrity and Accountability: Recommendations for Improving the Management, Delivery, and Operations of the Federal Student Loan Programs, Advisory Committee on Student Financial Assistance (Washington, D.C.: Aug. 1995).

organization to implement FDLP reporting directly to the Secretary—the Direct Loan Task Force—created the perception that Department management viewed FFELP as less important than FDLP. Regardless of whether this perception was valid, OIG believed it somehow affected the Department's management of the two programs. But the Department's recent reintegration of the task force with other OPE units and the Congress' decision in 1996 to allow both programs to continue to exist appear to have produced an environment in which both programs get equal attention.

In addition to the appearance of competition between FFELP and FDLP management, other program administration issues remain. These include the use of guaranty agency reserves; review of third-party servicers; lender, servicer, and guaranty agency waivers; and management of FDLP.

Use of Guaranty Agency Reserves

We have expressed concern that, under certain circumstances, guaranty agencies might be inclined to spend portions of their reserve funds on unnecessary expenditures for additional staff; the purchase of facilities, furniture, computers, and the like; or for higher salaries.[10] This money, which the

[10] Guaranty Agency Finances (GAO/HEHS-96-81R, Mar. 11, 1996).

federal government has a right to recover, would then not be available to the federal government or for covering losses on defaulted loans that cannot be collected. In November 1996, the Department issued regulations restricting the types of expenditures guaranty agencies may make with their reserve funds. For example, the reserves cannot be used for entertainment, lobbying, promoting the image of the guaranty agency, or paying legal fees arising from violations of the law. This rule should prevent some abuses.

Review of Third-Party Servicers

OIG has reported that the Department needs to improve monitoring of FFELP third-party servicers—organizations that schools, lenders, and guaranty agencies contract with to originate, service, guarantee, or collect student loans.[11] OIG was concerned that 20 percent of the servicers it reviewed may be unable to fully meet their financial responsibilities. If servicers went out of business, the financial viability of FFELP could be jeopardized because some functions, such as posting of borrower payments and other transactions, may be delayed. This would disrupt service to borrowers and possibly lead some

[11] ED Needs to Consider Implementing Changes for Monitoring Lenders and Servicers, Department of Education, OIG, ACN: 05-40005 (Feb. 15, 1996).

borrowers to stop making their scheduled repayments. The Department concurred with OIG's recommendations to improve its servicer database and establish a process to identify servicers that show marginal financial responsibility.

Lender, Servicer, and Guaranty Agency Waivers

OIG has also found that the Department lacks a formal or consistent process for granting lenders and guaranty agencies waivers of its right to collect loan refunds, penalties, and other fees or costs owed by them.[12] For example, the Department may assess penalties when lenders, their servicers, or guaranty agencies fail to follow Department requirements for making, servicing, and collecting loans. The Department can also refuse to make future payments or it can recover payments already made to lenders and agencies for such things as interest subsidies and insurance claims. The law allows the Department to waive its right to collect these funds at its discretion. In an OIG review of a list of such waivers totaling $120 million, neither a definition of nor criteria for granting waivers was found, nor was sufficient documentation to support waivers that were granted. In addition, OPE had not clearly delegated authority to grant

[12] OPE Waivers: The Department Should Establish and Follow a Process, Department of Education, OIG, ACN: 07-58051 (Feb. 13, 1996).

such waivers—OIG considered this a control failure. Before the Department relinquishes its right to collect these kinds of liabilities, OIG believes it needs to be sure that the reasons for granting waivers are sound and serve a government or public interest. The Department has proposed corrective actions to address OIG's concerns.

Management of FDLP

In 1995, we reported that the Department allowed schools with FFELP default rates above those authorized by statutory eligibility standards to participate in FDLP.[13] At the time, 10 of these schools were subject to losing eligibility for all student aid programs, and another 3 schools faced losing eligibility for FFELP. When the schools were selected, one of the Department's criterion for participating in FDLP was that schools must not be prohibited from participating in FFELP because their default rates exceeded the statutory limit. An analysis by the Advisory Committee also found many schools with high default rates. A Department official advised us that, under current requirements, if a school is eligible to participate in any student aid program authorized by title IV, it is eligible to participate in FDLP. In accordance with

[13]Direct Student Loans: Selected Characteristics of Participating Schools (GAO/T-HEHS-95-123, Mar. 30, 1995).

regulations issued in December 1995, however, the Department can place schools into one of several participation classifications to limit the types of fund transactions they are allowed to carry out.

In addition, FDLP schools may be able to hide high default rates by persuading students to repay through the income contingent repayment option. Under this option, the student's payment is based on his or her income. This is intended to help former students have manageable loan repayments and, therefore, reduce the chance for default. Schools with poor-quality programs—schools that typically have a high default rate—may possibly do this to lower their default rate. This would limit the rate's usefulness to the Department as an indicator of low quality. Under FFELP, borrowers do not have access to the income contingent repayment option, and borrowers who default in their loan repayment would be counted in calculating their school's default rate. Regulations issued in December 1995 require that borrowers in the income contingent repayment option who attend proprietary, nondegree-granting schools be counted in the calculation of such schools' default rate if they are paying less than $15 a month and these payments are insufficient to cover accrued interest.

Project EASI Initiative

During the past year, the Department has been developing a major re-engineering project, Project EASI, to redesign the entire title IV student aid program delivery system. Under Project EASI, the Department plans to redesign over several years its current management and control systems around a student-based integrated data system. The Department envisions that management and control functions, including accounting, auditing and program reviews, and quality control procedures, such as computer edit checks and applicant data matches, will be conducted through this new system. Department officials said that Project EASI, although loosely defined at present, is the Department's major effort to more fully integrate title IV programs both internally and externally and will address many student aid delivery problems. Members of the higher education community are participating with Department staff in this effort.

Project EASI has had a tentative start. The Department did not commit many full-time staff to it, and top management's commitment to it has been uncertain. The project's first steering committee chairman (a university financial aid administrator) resigned, and most of the teams established to work on specific projects stopped meeting regularly. Department officials acknowledged that activity had waned in recent months.

New cochairs for the steering committee were recently appointed, and we were told that participants are meeting to rededicate themselves to moving forward. The project staff anticipates spending the next 9 to 12 months developing plans for the project and more detailed requirement statements. The Department has not determined how long it will be before Project EASI is fully implemented, but it is expected to be a long-term undertaking.

Integration of NSLDS With Other Recipient Databases

Department information systems and data are currently used to support a variety of student aid program and financial operations, such as ensuring that student aid recipients are complying with federal requirements and monitoring the status of the programs. Under HEA, the Department is authorized to establish an NSLDS. The HEA Amendments of 1986 authorized the Secretary of Education to implement NSLDS to ensure (1) accurate information on student loan indebtedness and institutional lending practices and (2) improved compliance with the repayment and loan limitation provisions. The Omnibus Budget Reconciliation Act of 1989 amended the HEA to allow the Department to require guaranty agencies to use NSLDS before approving new loans. The 1992 HEA amendments required the Department to integrate NSLDS with Pell grant applicant and recipient databases as of January 1, 1994, and with any other of its databases relating to student aid program participation.

In response to this legislative mandate, in January 1993 the Department awarded a 5-year contract to develop and maintain the NSLDS database to replace a system in which guaranty agencies would submit data tapes of their FFELP loan portfolios to the Department. NSLDS became partially operational in November 1994 and was expanded to include FDLP and Pell grant data. Loan status information for both FDLP and FFELP is now transmitted to NSLDS by schools, lenders, guaranty agencies, and the FDLP servicer. The guaranty agencies update FFELP data monthly.

As a result of the NSLDS implementation, in July 1996, the Deputy Secretary of Education reported that prescreening data matches identified approximately 125,000 loan applicants who had previously defaulted among students applying for financial aid. This prevented as much as $310 million in future defaults and enabled the Department to deny about $75 million in Pell grants to ineligible students.

Use of Many Data Systems Complicates Administration of Student Aid Programs

The Department does not yet have an efficient, integrated, nationwide student loan data system. During the past 30 years, in addition to NSLDS, separate data systems—including the FFELP System for the guaranteed loan programs, Pell Grant Recipient and Financial Management System, and Direct Loan Origination System—have been developed to support student aid programs as they were established. The Department developed these systems, but many have incompatible data in nonstandard formats. This has contributed to problems with data integrity, system efficiency, and cost. According to the Assistant Secretary for Postsecondary Education, the Department will spend approximately $325 million in fiscal year 1997 to operate these "stovepipe" systems.

Data integrity and integration problems also remain. In 1995, we reported that the Department's use of available student aid data was generally ineffective for monitoring and enforcing compliance with requirements.[14] The lack of a fully functional and integrated title IV-wide recipient database hinders program monitoring and data quality assurance. For example, the current system cannot always identify where a student is enrolled, even after an award is made and thousands of dollars in student aid disbursed. As a result, program managers often lack the accurate, complete, and timely data required to effectively manage and oversee the student aid programs. OIG found, in a sample of 1,072 loans in repayment status in the NSLDS database, that 93 loans, or about 9 percent, were misclassified.[15] In response to these findings, the Department stated that data quality was being improved as data were loaded into NSLDS. It also stated that about half of these loans have been corrected in NSLDS. However, it also recognized that poor-quality data would

[14] Student Financial Aid: Data Not Fully Utilized to Identify Inappropriately Awarded Loans and Grants (GAO/HEHS-95-89, July 11, 1995).

[15] The Department Should Continue Its Efforts to Improve the Accuracy of Its Student Loan Database, Department of Education, OIG, ACN: A09-38058 (June 14, 1996).

remain an issue as long as the Department continued to rely on guaranty agency databases, some of which were known to have inaccuracies.

The Department also seems to lack a sound, integrated information technology architecture or strategy to manage its portfolio of information systems supporting student financial aid program outlays—estimated to be $41 billion for fiscal year 1997. The lack of such an architecture may have contributed in part to the nonstandard development of many systems, contractors, and user support organizations Departmentwide. This, in turn, has led to data interface or exchange problems, confusion, and delays in service. For example, a Department consultant showed that a simple address change for a college financial aid administrator would require a minimum of 19 manual and automated steps performed by a series of contractors who would have to enter the change in their respective systems from printed reports generated by another system.[16] In addition, redundant data are being submitted by schools, lenders, and guaranty agencies and stored in many

[16] Future Title IV Delivery System—Draft Systems Architecture and Plan of Action, presented to the Advisory Committee on Student Financial Assistance, Gunnison Consulting Group, Inc. (Washington, D.C.: Mar. 21, 1996).

databases. These procedures and practices increase the inefficiency of and the overall cost for the information systems as well as the chance of data errors occurring.

Another problem with this multiple-system environment is a lack of common identifiers for schools. Without these, tracking students and institutions across systems is difficult. The 1992 amendments required the Department to establish, no later than July 1, 1993, common identifiers for students and schools. The Department's current plans, however, do not call for developing and implementing common identifiers for schools until academic year 1999-2000.

Information Systems Improvement Initiatives

Although the Department has improved data systems somewhat, major improvements are still needed. For example, NSLDS, which is used to check student loan and grant eligibility, is now partially operational. Nonetheless, Department staff and we recognize that NSLDS can be useful only if the data captured are reliable. As reported in 1996, OIG and we believe that the Department has not adequately tested the accuracy and validity of loan data in NSLDS.[17]

[17]GAO/HEHS-96-143, July 12, 1996.

Several major initiatives are now under way to improve the Department's student financial aid delivery systems. Project EASI is a long-term reengineering effort being considered by the Department, that, as envisioned, will improve the current student financial aid delivery system. In addition, the following are two other Department initiatives.

- Integrated Student Aid Management System: This system is designed primarily to help small to medium-sized schools manage all student aid data from initial application to reconciliation using personal computer-based software. The overall goal is to develop software that will allow schools to organize their data by student rather than by program.
- Just-in-Time Cash Management: This is designed to streamline the payment process to schools for Pell grants and FDLP loans.

In addition to these initiatives, the Department has recently appointed an Acting Chief Information Officer. We find these and other initiatives encouraging, although it is too soon to evaluate the effectiveness of any of them because they have not been fully implemented.

Improvements Through the Clinger-Cohen Act

The Clinger-Cohen Act of 1996 (part of which was formerly known as the Information Technology Management Reform Act of 1996) requires, among other things, that federal agencies improve the efficiency and effectiveness of operations through the use of information technology by

- establishing goals to improve the efficiency and effectiveness of agency operations, and, as appropriate, the delivery of services to the public through the effective use of information technology;
- preparing an annual report as part of an agency's budget submission to the Congress on the progress in achieving agency goals; and
- ensuring that performance measurements are prescribed for information technology used or acquired by an agency and that they measure how well the information technology supports agency programs.

The Department could benefit greatly by fully implementing this law. Full implementation of the Clinger-Cohen Act would provide another opportunity to correct many of the Department's student financial aid system weaknesses. Because the act is in the early stages of implementation, however, it is too soon to predict how well the Department will incorporate the law's provisions into its overall information technology strategy.

Financial Management Problems Continue

Many FFELP financial management problems previously reported by OIG and us remain. Fiscal year 1995 was the first year the Department prepared—and had audited—agencywide financial statements. However, the auditor could not determine whether the financial statements were fairly presented because of the insufficient and unreliable FFELP student loan data underlying the Department's $13 billion in loan guarantee liabilities. Furthermore, because guaranty agencies and lenders have a crucial role in the implementation and ultimate cost of FFELP, the auditors stressed that the Department complete steps under way for improving oversight of guaranty agencies and lenders. Until such problems are fully resolved, the Department will continue to lack the financial information necessary to effectively budget for and manage the program or to accurately estimate the government's liabilities.

As a result of this audit as well as financial audits of FFELP conducted by OIG and us, the Department is taking the following actions:

- It has initiated efforts to develop and implement a comprehensive project plan to address NSLDS data integrity issues. These efforts include participation by the guaranty agency community and other data providers and users. Once this task is completed, the Department expects NSLDS to provide the Department and guaranty agencies with more detailed current and useful information to help ensure that more timely and accurate information is available on students' loan status and level of indebtedness.
- It is developing guidance to be used by external auditors that requires specific audit procedures such as testing guaranty agencies' billings for default payments.
- It is implementing a process to reconcile the loans receivable balances reported by guaranty agencies with such amounts reported in the Department's accounting records.
- It is continuing to develop Education's Central Automated Processing System (EDCAPS) to provide more accurate financial and program management data. EDCAPS will also upgrade the Department's financial management systems; facilitate accounting

procedures, such as cash reconciliations; and automate manual procedures.

Because the Department has begun corrective actions and has demonstrated a commitment to resolving financial management problems, we believe the Department is making progress. A sustained effort will be critical, however, to the Department's having sound financial management and reliable financial information.

Further Action Needed

Federal student financial aid programs remain a high-risk area and require continued attention. The root causes we identified—complicated, cumbersome processes; structural flaws; and management shortcomings—continue to exist, and the financial interests of the U.S. taxpayers are not well served. Although further congressional action can change these circumstances, continued strengthening of Department management and program oversight is critical. The need to address problems in the student financial aid programs becomes more critical as (1) the concurrent operations of FDLP and FFELP further complicate program processes and structure, (2) the volume of student loans continues to increase, and (3) the Department plans to increase the percentage of loans made directly to students under FDLP.

Building on congressional and Department actions in response to recommendations OIG, others, and we have made, the Department must continue to improve its program management and act promptly to address problems that could lead to the programs' misuse. These actions include

- continuing its ongoing efforts to improve gatekeeping—including the IPOS Challenge—and act to address the problems we identified with school recertification and the 85-15 rule;
- ensuring that both FFELP and FDLP are managed at the level needed to minimize program abuse and that regulatory and other corrective actions are implemented to address the specific program administration problems we identified;
- integrating its information systems and ensuring the accuracy and validity of NSLDS data and data in other systems for it to better identify possible program misuse by students, schools, and other participants; and
- continuing its efforts to improve financial management, including improving the accuracy, quality, and reliability of the Department's student loan data to ensure that reliable financial information is available to agency managers, the Congress, and others.

Because one of Project EASI's goals is to implement a fully integrated data system that the Department can use to perform its responsibilities in each of the four management areas we discussed, we find the project encouraging. Project EASI is a major undertaking, but it has had a checkered past. Its ability to solve the problems of student aid programs depends on the commitment of the Department's top management as well as the continued active participation of those in the education community.

Related GAO Products

Department of Education: Status of Actions to Improve the Management of Student Financial Aid (GAO/HEHS-96-143, July 12, 1996).

Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Years 1994 and 1993 (GAO/AIMD-96-22, Feb. 26, 1996).

Student Financial Aid: Data Not Fully Utilized to Identify Inappropriately Awarded Loans and Grants (GAO/T-HEHS-95-199, July 12, 1995).

Student Financial Aid: Data Not Fully Utilized to Identify Inappropriately Awarded Loans and Grants (GAO/HEHS-95-89, July 11, 1995).

Federal Family Education Loan Information System: Weak Computer Controls Increase Risk of Unauthorized Access to Sensitive Data (GAO/AIMD-95-117, June 12, 1995).

High-Risk Series: Student Financial Aid Programs (GAO/HR-95-10, Feb. 1995).

Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Years 1993 and 1992 (GAO/AIMD-94-131, June 30, 1994).

Direct Student Loans: The Department of Education's Implementation of Direct Lending (GAO/HRD-93-26, June 10, 1994).

Student Loans: Millions Loaned Inappropriately to U.S. Nationals at Foreign Medical Schools (GAO/HEHS-94-28, Jan. 21, 1994).

Financial Management: Education's Student Loan Program Controls Over Lenders Need Improvement (GAO/AIMD-93-33, Sept. 9, 1993).

Department of Education: Long-Standing Management Problems Hamper Reforms (GAO/HRD-93-47, May 28, 1993).

Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, Mar. 16, 1993).

Department of Education: Management Commitment Needed to Improve Information Resources Management (GAO/IMTEC-92-17, Apr. 20, 1992).

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