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U.S. Department of Education
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Subcommittee on Government Operations and the
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Chairman Meadows, Chairwoman Foxx, Ranking Member Connolly, Ranking Member Hinojosa, and members of the Subcommittees:

Thank you for inviting me here today to discuss the work of the U.S. Department of Education (Department) Office of Inspector General (OIG) involving the Department's office of Federal Student Aid (FSA). As many of you know, the Federal student aid programs have long been a major focus of the OIG's audit and investigative work, as these programs have been considered the most susceptible to fraud and abuse. The programs are large, complex, and inherently risky due to their design, reliance on numerous entities, and the nature of the student population. In conducting our work, we look to promote efficiency and effectiveness in Federal student aid programs. We also work to protect America's students from harm and help to safeguard the taxpayer's investment in education. My office has produced volumes of significant work involving the Federal student aid programs since our inception 35 years ago, which has led to changes to the Higher Education Act of 1965, as amended (HEA), implementing regulations, and Departmental operations.

FSA as a Performance-Based Organization

Today's hearing focuses on FSA as a Performance-Based Organization (PBO). The 1998 amendments to the HEA mandated that the Department establish a PBO as a discrete unit responsible for managing the operational functions supporting the Federal student aid programs.[1] FSA was designated as the PBO. In 2008, the OIG conducted an audit to determine whether FSA was meeting its responsibilities as a PBO in three key areas: planning and reporting, systems integration, and cost reduction. The audit found that FSA was not completely fulfilling its responsibilities in those areas. First, FSA's planning and reporting processes were not always effective or efficient, as it did not issue its first 5-year performance plan until 2004—6 years after it became a PBO, and none of the strategic objectives included in the plan were measurable or quantifiable. Second, in reviewing FSA's systems integration efforts, our audit revealed that FSA had not made significant progress in completing activities designed to integrate its student financial assistance systems and therefore was unable to realize the expected benefits of systems integration. Third, we found that FSA's progress towards the reduction of program administration costs was uncertain as it had not yet established measurable strategic goals in the area of cost reduction and its anticipated cost savings from three of four major system initiatives it had identified were not expected to be realized until after fiscal year (FY) 2008 and beyond.

Much has changed since our 2008 audit. In 2010, there was a significant shift in FSA's operations with passage of legislation eliminating the origination of new Federal Family Education Loan Program (FFELP) loans and requiring that all new Federal student loans be originated under the William D. Ford Federal Direct Loan (Direct Loan) program. This resulted

[1] The 1998 amendments also authorized the Secretary to assign additional functions to the PBO. In 2008, the Higher Education Opportunity Act amended the responsibilities of the PBO to include oversight responsibility that had previously been assigned to the PBO by the Secretary.

in a significant increase in the work done for FSA by contractors for the Direct Loan program for the originating, disbursement, and servicing of the loans, resulting in the need for additional contractor oversight by FSA. As FSA took on these added responsibilities, it still continued overseeing the guaranty agencies and the thousands of FFELP lenders who continue to service the existing FFELP loans during the wind down of the program. FSA must continue to provide services to students and also ensure school compliance with requirements of Title IV of the HEA. The Federal student aid programs also have grown dramatically: Federal student aid delivered by FSA increased from $82 billion in 2008 to almost $130 billion in 2015; the number of students served has more than doubled, increasing from 6.2 million in 2008 to 13 million in 2015. During the same time period, the portfolio of Federal loans has grown from $359 billion to more than $1.2 trillion, making FSA one of the largest financial institutions in the country. Although we have not conducted an audit of FSA as a PBO since 2008, we have issued more than 80 audit, inspection, and other reports involving Federal student aid programs and operations since that time. This work forms the foundation for my testimony today, where I will focus on our recent work related to FSA's oversight and administrative responsibilities.

FSA Oversight

Title I, Part D of the HEA lays out seven purposes of FSA as a PBO that include improving services to students, increasing accountability, implementing open and common systems for delivery of funds, and developing systems to provide accurate data to ensure program integrity. To achieve its mission as a PBO, FSA has established five strategic goals, two of which are that (1) it will work to ensure that all participants in the system of postsecondary funding serve the interests of students, and (2) it will ensure program integrity and safeguard taxpayers' interests. Further, Congress has stressed the importance of ensuring that the interests of students are

served. In 2008, the U.S. House of Representatives Committee on Education and Labor report for the Higher Education Opportunity Act stated, "[t]he nation's financial aid system exists for a single purpose: to serve students and their families." Additionally, the U.S. Senate Committee on Health, Education, Labor, and Pensions stated in a 2007 report on proposed amendments to the HEA that "[t]he committee believes strongly that lenders, guaranty agencies and institutions of higher education must act with honesty and integrity at all times to ensure that the financial aid programs under title IV serve the best interests of students." Our work over the last three years has shown that FSA needs to improve its oversight so as to ensure that all participants in the Title IV programs are serving the interests of students. When FSA does not ensure that the interests of students are being served, it is also not ensuring the integrity of the Federal student aid programs or that the taxpayers' interests in postsecondary education are protected.

Audit Resolution

One of the means of discouraging abuses by participants in the postsecondary education funding process is having a robust process for ensuring audit recommendations to external entities are timely and effectively resolved and corrective actions are taken. In 2013, I testified before the House Oversight and Government Reform Committee on the issue of audit resolution and recommendations made in OIG reports that the Department had not yet implemented. I testified that although the Department had made progress in resolving internal audits,[2] improvements were needed in its processes to resolve external audits.[3] External OIG audit reports generally include recommendations for Department management to require the external entity to take corrective action. These recommendations may be for the entity to return funds to the Department or for the entity to

[2] *Internal audits* identify deficiencies and recommend improvements in Department operations and programs to ensure that the Department is using Federal education funds effectively and efficiently and accomplishing program goals.

[3] *External audits* are of external entities that receive funding from the Department, such as institutions of higher education (schools).

improve operations or internal controls. At present, and we report in our most recent Semiannual Report to Congress, the Department has not yet resolved 7 external audits that include 84 recommendations for corrective actions and monetary recommendations totaling more than $47.3 million.

In 2015, we issued an audit report on FSA's audit follow-up processes for recommendations made in OIG external audits. We found that FSA did not close[4] audits timely and did not adequately maintain documentation of audit follow-up activities. Between October 1, 2008, and September 30, 2013, FSA had resolved[5] a total of 36 external OIG audit reports, but only 1 audit had been closed. The total of the monetary recommendations associated with the 36 resolved audits was more than $1.3 billion. We also found that FSA did not adequately maintain documentation that showed requested corrective actions were completed or were being monitored for completion. Not requiring external entities to take timely corrective action diminishes the deterrent value of OIG audits and their impact on ensuring student and taxpayer interests are protected. By not obtaining or maintaining appropriate documentation, FSA did not have assurance that identified deficiencies had actually been corrected. As such, the risk remains that related programs are not effectively managed and taxpayer funds are not being used as intended.

Program Reviews

In addition to our own audits of external entities, FSA performs program reviews of schools to ensure that student and taxpayer interests are protected. Our 2015 audit of FSA's school program review function showed significant weaknesses in FSA's oversight of schools participating in the

[4] An audit is *closed* when the Department determines that the agreed-upon actions have been completed.
[5] An audit is *resolved* when the Department and OIG agree on the corrective action to be taken to address our findings and recommendations.

Title IV programs. We found that FSA's program review specialists did not always conduct program reviews in accordance with FSA's program review procedures. Specifically, required forms and documents were missing from the program review files, and staff did not always complete forms, adequately document fiscal testing for timely disbursement of funds, determine whether schools had implemented Direct Loan quality assurance systems, and conduct distance education program reviews; there was also a lack of supervisory review. In addition, we found that FSA managers did not consider high annual dropout rates for prioritizing program reviews as required by the HEA. In 2014, FSA updated its program review quality control process such that staff should identify deficiencies such as the lack of documentation and supervisory review. However, there was no requirement that corrective action be taken on any recommendations.

We also analyzed the program review process as part of our 2014 audit of FSA's oversight of schools' compliance with the incentive compensation ban (which prohibits schools participating in the Federal student aid programs from providing any bonus or incentive payment to any person or entity for their success in securing school enrollments or awarding of Federal student aid). We found that FSA's program review policies and guidance were insufficient and not always followed; we also found that FSA did not properly resolve incentive compensation ban findings and singularly relied on imposing fines on schools found to have violated the incentive compensation ban. My office has a long history of identifying harm to students as a result of incentive compensation practices by schools. When the Department issued the incentive compensation safe harbors in 2002, we non-concurred with the final regulations. When the Department eliminated the safe harbors in 2010, we anticipated that the Department and FSA would revise their enforcement policies to provide instructions to employees on appropriate

sanctions to enforce the ban, including severe administrative actions for egregious behavior. Unfortunately, we found in our review that this was not the case. Our work through the years has shown that incentive compensation has led to aggressive recruiting practices by unscrupulous school owners that prey on vulnerable students, harming both students and taxpayers.

School Third Party Servicers

Our 2014 review of schools' use of third party servicers—such as banks or other financial services companies—providing debit cards to deliver Federal student aid to students determined that FSA should take action to better ensure that student interest are served. When schools use servicers to deliver credit balances, FSA and schools need to do a better job at monitoring debit card servicers to protect student interests, such as ensuring that they do not charge fees for delivery of Title IV funds, and that they protect students' personally identifiable information. Although the Department did develop regulations concerning the use of debit cards and third party servicers for the disbursement of Federal student aid, it was not until the issue was identified outside of the Department and we had initiated this audit that the Department moved towards a regulatory framework to address the identified issues.

School Closures

Prior to the collapse of Corinthian Colleges, my office was concerned about FSA's oversight of schools that might close precipitously. Because of this concern, we performed an inspection to determine whether FSA was monitoring schools to be prepared for a sudden closure. Our 2014 inspection found although FSA had created a Publicly Traded and Large School Workgroup, the workgroup had not met regularly since its inception, nearly three years before our inspection, and that the financial analysts had not regularly or systematically used data from outside of FSA to assist in monitoring schools or in selecting program reviews. We also found that information for

students in the event of a school closure was located in various places on FSA's Web site, making relevant information more difficult for students to find. In addition, FSA's procedures did not provide clear guidance on how analysts should perform outreach to students affected by a school closure and did not provide for a process that analysts should follow in the event of a sudden closure. The collapse of a large school can harm both students who may be unable to complete their education and taxpayers for the cost of any loans that are discharged as a result of the closure.

Distance Education

The unique characteristics and growth of distance education pose another significant challenge to the Department. Through our audit and investigative work, we have noted an increasing risk of people attempting to fraudulently obtain Federal student aid from distance education programs. The OIG issued an investigative program advisory report in 2011 alerting FSA to significant fraud vulnerability in distance education programs: distance education "fraud rings." Fraud rings are large, loosely affiliated groups of criminals who seek to exploit distance education programs in order to fraudulently obtain Federal student aid. In 2005, the OIG had opened 16 distance education fraud ring investigations; as of July 28, 2015, the OIG had opened 146. All aspects of distance education—admission, student financial aid, and course instruction—may take place through the Internet, so students may not be required to present themselves in person at any point. Because institutions offering distance education are not required to verify all prospective and enrolled students' identities, fraud ringleaders use the identities of others (with or without their consent) to target distance education programs. These fraud rings mainly target lower cost institutions because the Federal student aid awards are sufficient to satisfy institutional charges

and result in disbursement of the balance of an award to the student for other educational expenses.

Since our 2011 report and other work we have completed on distance education, FSA has implemented several controls, including expanded data analysis capabilities to detect patterns and predict potential fraud, in addition to enhanced verification requirements. For example, it is now incumbent on schools to verify certain data elements, such as student identity and completion of secondary school or its equivalent. FSA has also expanded the program review procedures to strengthen oversight of distance education programs. Although FSA has implemented some controls, fraud rings continue to be a significant area of concern.

FSA Management of Administrative Functions

The HEA provides that FSA as a PBO has responsibility for managing the administrative functions of the Title IV programs. Recent OIG work has identified weaknesses in this area, specifically: (1) FSA's improper payment estimates for the Pell Grant and Direct Loan programs and (2) FSA's management of contractors, including its actions addressing functional deficiencies with the Debt Management and Collection System 2 (DMCS2). Weaknesses in this area undermine FSA's strategic objectives to ensure that all participants in the system of postsecondary funding serve the interests of students, ensure program integrity, and safeguard taxpayers' interests.

Improper Payments

As you know, under the Improper Payments Elimination and Recovery Act (IPERA), Federal agencies are required to periodically review all programs and activities that the agency administers and identify all programs and activities that may be susceptible to significant

improper payments. The Department identified the Pell Grant and Direct Loan programs as susceptible to significant improper payments. IPERA also requires each agency's Inspector General to determine the agency's compliance with the statute for each fiscal year. As reported in each of our IPERA reviews, FSA has not taken full advantage of IPERA to improve its operations and identify and reduce improper payments in the Pell Grant and Direct Loan programs. For FY 2012 and 2013, we reported that the Department complied with IPERA, but we identified weaknesses in the methodology used to calculate improper payments in both years.

For FY 2014, we reported that the Department did not comply with IPERA because it did not meet the annual reduction target for the Direct Loan program. In addition, we found that the improper payment estimates and estimation methodologies for both the Pell Grant and Direct Loan programs were inaccurate, incomplete, and unreliable such that we could not conclude that the Department actually met its reduction target for the Pell Grant program. We also found that the estimates deviated from the OMB-approved methodologies that were in effect at the time. When we informed FSA that it had deviated from the approved OMB methodology, it requested and received retroactive approval from OMB to use an alternative methodology, although we continue to have concerns about the methodology approved. As we noted in previous IPERA reviews, when the Department initially proposed relying on program reviews for its estimation methodologies, we determined that reliance was flawed because it excluded other sources of improper payments, such as the inaccurate self-reporting of income on the FAFSA, which FSA had identified as a root cause of Pell Grant improper payments in previous years. In addition to the inherent weaknesses involved with using program reviews to estimate improper payments noted in our IPERA audits, our review of FSA's program review function

noted above concluded that because the results of program reviews are used in the calculation of the Department's annual estimates of improper payments for the Pell and the Direct Loan Programs, under IPERA, the estimates may not be valid due to the significant weaknesses in the program review function we identified. Yet despite these inherent weaknesses, the Department continues to use program reviews as the sole source of information to estimate improper payments for the Pell Grant program and OMB continues to approve that methodology.

Contractor Management

FSA relies heavily on contactor support to accomplish the purposes of the PBO, particularly as it relates to managing the administrative functions of the Title IV programs. Our work has identified numerous deficiencies in contract monitoring. For example, our 2013 audit of FSA's oversight of the Title IV Additional Servicers (TIVAS) contracts, we found that although FSA had negotiated cost effective rates, it did not properly validate invoices, resulting in our conclusion that there was a heightened risk that invoices from and payments to the TIVAS totaling over $330 million were inaccurate. In addition, we could not determine whether FSA selected the most efficient and cost-effective prices for 18 of the 21 changes it made to the TIVAS contracts. In addition, because FSA did not confirm the timeliness and adequacy of deliverables, it could not ensure that the TIVAS complied with the contract terms. Our 2014 audit that reviewed student loan debt and repayment activities found that FSA did not explicitly establish minimum default prevention activities in its 2009 contract with the TIVAS, although FSA did incorporate these requirements in the 2013 contracts. We also found that FSA did not adequately monitor calls to delinquent borrowers.

In our 2014 audit of FSA's handling of complaints against Private Collection Agencies (PCAs) by borrowers, we found that FSA did not effectively monitor borrower complaints against PCAs and ensure that corrective actions were taken. This resulted in FSA not knowing the magnitude of the problems that borrowers were encountering and FSA not holding PCAs accountable. In addition, FSA did not ensure that corrective actions were taken by PCAs for valid borrower complaints against them to ensure that similar harm to borrowers would not occur in the future.

In 2012, we alerted FSA that DMCS2, FSA's system for managing defaulted student loans, operated by a contractor, was unable to accept the transfer of certain defaulted student loans from FSA's Title IV servicers**.** At the time of our audit, the entities that service Federal student loans had accumulated more than $1.1 billion in defaulted loans that should have been transferred to the Department for management and collection. This hampered FSA's ability to pursue collection remedies and perhaps more importantly, left borrowers unable to take steps to remove their loans from default status. As a result of the issues with DMCS2, both the Department's Agency Financial Report and FSA's Annual Report for fiscal year (FY) 2012 noted a material weakness resulting from deficiencies with DMCS2 and the ACS, Inc., Educational Servicing systems—the legacy Direct Loan servicing system. The audits found repeat deficiencies in financial reporting processes, and other controls surrounding information systems. The FY 2013 financial statement audit noted that although issues with DMCS2 no longer rose to the level of material weakness, they still represented a significant deficiency. By FY 2014, DMSC2 issues did not materially impact the financial statement.

On November 6, 2015, we issued a report on FSA's determinations that aspects of DMCS2 were functional. In that audit, we found that FSA did not always accurately assess the operational status of various aspects of DMCS2 as of March 2013. This assessment formed the basis for the operational status of DMCS2 that guided the transition to a new contractor, Maximus. Earlier, in August 2015, we issued an audit of FSA's plan to correct significant DMCS2 deficiencies and found that FSA could not ensure that the original contractor delivered a fully functional system because it did not develop an adequate plan, did not ensure milestones were met, did not hold the contractor accountable for missing milestones, and did not use appropriate systems development tools.

FSA responded to the deficiencies identified during the course of our audit by incorporating elements of lifecycle management methodology (LMM) and penalties for missed milestones into its new contract with Maximus; FSA also awarded a separate independent validation and verification contract. Our August report found that FSA's contract with Maximus and its other corrective actions provide a methodology that, if properly implemented, increases the likelihood that Maximus will identify and timely correct DMCS2 system deficiencies. However, we found that FSA did not update its presolicitation baseline plan of expectations for correcting the DMCS2 deficiencies until December 23, 2014, more than 9 months after Maximus began working on DMCS2. As such, we are concerned that FSA's delay in updating the tailoring plan may be an indication that FSA is not fully implementing its LMM. We identified additional opportunities for FSA to improve its oversight of the Maximus contract.

During the course of our FY 2015 Federal Information Security Management Act audit, Total Systems Servicers, Inc. (TSYS), a subcontractor that operates the FSA's Common Origination

and Disbursement (COD) system in Georgia, refused to provide the OIG with documentation reflecting a complete listing of all userids with privileges to the TSYS mainframe on which COD rests. COD is a critical business system because FSA relies on it to deliver Pell Grants and Direct Loans and it contains PII for financial aid recipients. Despite having signed an agreement that allowed us to acquire all needed information, TSYS restricted the OIG testing team's access to certain information. After repeated requests, TSYS provided a copy of Education userids with privileges, but redacted all other userids with privileges in the mainframe environment. Without this data, the OIG was unable to complete a comprehensive vulnerability assessment of the environment and determine whether other customers on the mainframe could improperly access Department data. When we brought this access issue to FSA's attention, FSA was unable to achieve the needed access and was not able to obtain a copy of the contract between the prime contractor and TSYS.

Conclusion

The work we have performed since our 2008 PBO audit has focused in significant part on areas within FSA's oversight and administrative responsibilities. Our work continues to identify problems in FSA's oversight of participants in the Federal student aid programs, its efforts to identify and reduce improper payments, and its contract management to ensure program integrity and better safeguard taxpayers' interests. For the next reauthorization of the HEA, Congress may want to consider adding specific requirements for oversight and contract management to the purposes and functions of the PBO and require the PBO performance plan to establish measurable goals and objectives in these areas. The PBO annual report should also contain an evaluation of those goals and objectives. My office is committed to ensuring integrity and efficiency in the Federal student aid programs and working with FSA, the Department, and

Congress to address areas of risk within these programs to reduce fraud and abuse. I am happy to answer any of your questions.