

STATE OF LOUISIANA LEGISLATIVE AUDITOR

Office of Student Financial Assistance
State of Louisiana
Baton Rouge, Louisiana

March 29, 2000



Financial and Compliance Audit Division

Daniel G. Kyle, Ph.D., CPA, CFE
Legislative Auditor

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LEGISLATIVE AUDITOR

Daniel G. Kyle, Ph.D., CPA, CFE

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**OFFICE OF STUDENT FINANCIAL ASSISTANCE
STATE OF LOUISIANA
Baton Rouge, Louisiana**

**Financial Related Audit and
Independent Auditor's Report
Dated March 21, 2000**

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge, New Orleans, and Shreveport offices of the Legislative Auditor.

March 29, 2000

OFFICE OF STUDENT FINANCIAL ASSISTANCE
Baton Rouge, Louisiana

Financial Related Audit and
Independent Auditor's Report
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OFFICE OF
LEGISLATIVE AUDITOR
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March 21, 2000

Independent Auditor's Report

LOUISIANA OFFICE OF STUDENT FINANCIAL ASSISTANCE
STATE OF LOUISIANA
Baton Rouge, Louisiana

We have performed a financial related audit of the Louisiana Office of Student Financial Assistance (the agency), based on a request from management of the agency. The purposes of our financial related audit were to review the agency's agreement with the Louisiana Department of Justice (the department) for litigation and collection of delinquent accounts in the Federal Family Education Loan Program (CFDA 84.032 - FFEL), the federal program through which student loans are guaranteed for qualifying college students. Our financial related audit included a review of the agreement to determine (1) the propriety of payments made under the agreement; (2) the adequacy of internal controls at the agency and the department affecting the agreement; and (3) compliance with applicable federal laws and regulations.

Our audit was performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, applicable to a financial related audit. Our limited procedures consisted of (1) examining selected agency and department records for the three year period July 1, 1996, through June 30, 1999; (2) interviewing certain agency and department personnel; (3) reviewing applicable federal laws and regulations; (4) reviewing pertinent agency and department policies, procedures, rules, and regulations; (5) recalculating applicable collection costs for accounts tested; and (6) making inquiries to the extent we considered necessary to achieve our purpose. Our procedures also included an assessment of the likelihood of irregularities and illegal acts, and any such matters that came to our attention are presented in our findings and recommendations.

Based on the application of the procedures referred to previously, the accompanying findings and recommendations represent those conditions that we feel warrant attention by the appropriate parties. Management's responses to the findings and recommendations presented in this report are included in Attachment I.

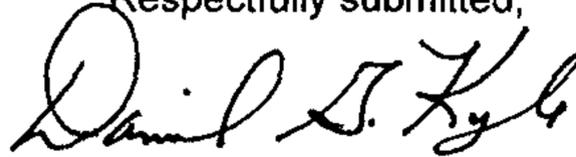
These limited procedures are substantially less in scope than an audit of financial statements in accordance with government auditing standards, the purposes of which are to provide assurances on the entity's presented financial statements, assess the entity's internal control structure, and assess the entity's compliance with laws and regulations that could materially impact its financial statements. Had we performed such an audit, or had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

LEGISLATIVE AUDITOR

LOUISIANA OFFICE OF STUDENT FINANCIAL ASSISTANCE
STATE OF LOUISIANA
Audit Report, June 30, 1999

This report is intended for the use of management of the Louisiana Office of Student Financial Assistance and should only be used by those who fully understand the limited purposes of the procedures performed. By state law, this report is a public document and has been distributed to appropriate public officials as required by Louisiana Revised Statute 24:516.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Daniel G. Kyle". The signature is written in a cursive style with a large initial "D".

Daniel G. Kyle, CPA
Legislative Auditor

CGEW:AJR:dl

[OSFA]



Office of Legislative Auditor

Executive Summary

Financial and Compliance Division Financial Related Audit

Louisiana Office of Student Financial Assistance Federal Family Education Loan Program (CFDA 84.032 - FFEL) Agreement for Litigation and Collection of Delinquent Accounts

The Louisiana Office of Student Financial Assistance (LOSFA or the agency) paid the Louisiana Department of Justice (DOJ or the department) \$1,792,596 for the three year period July 1, 1996, through June 30, 1999. These payments represent DOJ's fees for its collections on defaulted FFEL student loans totaling \$8,369,270. Our financial related audit of the agreement found that:

- LOSFA has overpaid DOJ approximately \$79,000 for DOJ collection activities based on DOJ's billing procedures.
- LOSFA has paid \$227,500 to the U.S. Department of Education (ED) for ED's share of collections on court costs, even though LOSFA never actually received the funds since DOJ pays the court costs directly.
- LOSFA has paid approximately \$52,000 to the ED for ED's share of other fees paid to third parties, even though LOSFA never actually received the funds, which results in a loss to LOSFA of the amount paid.
- LOSFA has failed to establish adequate internal controls to ensure that payments to DOJ are proper and that payment errors are detected in a timely manner. DOJ has failed to submit its billings to LOSFA in accordance with the terms of the contracts.
- LOSFA and DOJ have failed to adequately monitor the contract to ensure adherence to the provisions of the contracts.

Daniel G. Kyle, Ph.D., CPA, CFE, Legislative Auditor
Phone No. (225) 339-3800

Introduction

CREATION AND DUTIES

The Louisiana Office of Student Financial Assistance (LOSFA or the agency) was established in accordance with Louisiana Revised Statutes (R.S.) 36:650, as a part of the Louisiana Student Financial Assistance Commission (LSFAC), which is the governing body for LOSFA. LSFAC was established by R.S. 17:3021, et al. The purpose of the commission includes:

- Administration of federal loan and scholarship programs
- Authorizing the commission to operate in other capacities permitted by federal law and regulations and entering into agreements with certain entities
- Providing relative to other powers and duties of the commission
- Providing relative to the amount of student loan guarantees, dissolution of the commission, and acceptance and use of funds by the commission
- Providing for related matters

LOSFA is responsible for administering programs for student financial assistance and certain scholarship programs for higher education. Included in these responsibilities are administration of the guaranty function for the Federal Family Education Loan Program (CFDA 84.032 - FFEL), the federal program providing guaranteed student loans to qualifying individuals attending institutions of higher education. At June 30, 1999, the original principal on the outstanding student loan guarantees in Louisiana totals in excess of \$1.1 billion.

The Code of Federal Regulations, 34 CFR 682.400 to end, establishes the requirements for administration of FFEL, including the activities of guaranty agencies. As a guarantor for student loans, LOSFA is responsible for numerous activities related to those loans. The agency's responsibilities include (but are not limited to) (1) maintaining accurate records for student loans outstanding; (2) acting in a fiduciary capacity with respect to the federal funds it holds on behalf of the U.S. Department of Education (ED); and (3) assisting lenders in preventing defaults on loans that are in repayment status.

Repayment on a student loan generally begins 6 months after a student leaves the educational institution, whether upon graduation or dropping out of school (34 CFR 682.209). There are exceptions to this initial deferment period (i.e., military service, unemployment, educators working in certain schools or school systems, etc.). If a borrower becomes delinquent on a loan that has entered this repayment status, the guaranty agency is required to provide default aversion assistance, which is directed to providing assistance to lenders to return accounts to current status and preventing defaults.

If the guaranty agency and/or the lender are unsuccessful in preventing default on a student loan, the lender may then file a claim with LOSFA for payment of the guaranty. Certain criteria must be satisfied in order for the lender to receive payment on the claim.

Once a claim is paid, the guaranty agency then becomes responsible for collecting the balance of the defaulted student loan. At June 30, 1999, LOSFA's balance of defaulted student loans is \$187,826,725. Collections on defaulted student loans for the state fiscal year ended June 30, 1999, totaled \$14,466,664, of which \$11,384,466 was returned to ED. Guaranty agencies are required to return to ED its equitable share of borrower payments on student loans [34 CFR 682.404(g)]. Currently, LOSFA is allowed to retain 24% of the amounts it collects on defaulted student loans. Before October 1, 1998, the retention percentage was 27%.

34 CFR 682.410 establishes the procedures by which guaranty agencies are to collect balances on outstanding defaulted student loans. LOSFA maintains an in-house collection department, but it also has contracted with private companies for collection of these loans and has also entered into an agreement with the Louisiana Department of Justice (DOJ) for collection of defaulted student loans.

The relationship between LOSFA and DOJ is unique in that DOJ functions as the agency's legal counsel, in accordance with state law, as well as acting in the capacity as a contractor performing activities related to litigation and collection of student loans. As legal counsel for state agencies, DOJ normally represents those agencies in disputes with the parties to a contract.

LOSFA and DOJ entered into their first formal agreement on February 17, 1984 (the 1984 contract), though DOJ assisted LOSFA in collecting on outstanding defaulted student loans before that date. The contract broadly defined DOJ's responsibilities for collecting these balances, and it established a 30% commission rate for DOJ's collections of principal and interest. DOJ's commission was to be withheld by DOJ from funds it collected. The retention rate for guaranty agencies such as LOSFA was 30%, and LOSFA returned 100% of its allowed retention to DOJ.

The 1984 contract was for an initial period of three years, and it was automatically extended for an additional three-year period. It expired February 17, 1990. LOSFA and DOJ operated without a formal agreement until December 22, 1992, when the second agreement (the 1992 contract) became effective. The primary purpose of the agreement was for DOJ to provide litigation and collection services on defaulted student loans on behalf of LOSFA, in accordance with all federal statutes, regulations, and policies, and LOSFA policies and procedures.

Under the 1992 contract, DOJ was required to forward a daily listing of payments to LOSFA. DOJ was also required to invoice LOSFA for its collection fees on a daily basis, and LOSFA would then have five days to approve or deny the invoice. DOJ was required to maintain a computer system with the capability of submitting payment activity electronically.

The 1992 contract established DOJ's reimbursement as follows:

- 20% for first placement accounts
- 21% for second placement accounts
- 22% for accounts in litigation

Introduction

In addition, the contract provided that:

After all amounts due on the account have been paid by the borrower, including court costs, the DOJ invoices LOSFA for a refund of the DOJ's actual court costs and the difference between the litigation rate and the attorney's fees awarded by the court. A copy of the bill from the court, or evidence of such payment, must be attached to the invoice for the refund.

At the inception of the 1992 contract, guaranty agencies were allowed to keep 100% of the attorney fees awarded by the courts. However, these regulations changed, and guaranty agencies are required to return ED's equitable share of attorney's fees [34 CFR 682.404(g)]. Before October 1, 1998, ED's equitable share was 73% of borrower payments. This rate changed to 76% beginning on October 1, 1998.

On May 28, 1996, LOSFA and DOJ entered into a new agreement for the litigation and collection of defaulted FFEL loans (the 1996 contract). The agreement became effective upon the date of the first new placement of a defaulted loan. LOSFA and DOJ records indicate that the first placement occurred on July 1, 1996. The agreement applied to all accounts placed with DOJ on or after December 22, 1992. It did not consider any accounts held by DOJ placed before the effective date of the 1992 contract.

The 1996 contract established DOJ's reimbursement as follows:

- 18% for first placement accounts
- 19% for second placement accounts
- 20% for accounts in litigation

The 1996 contract changed the amount of attorney's fees to which DOJ was entitled and limited DOJ's reimbursement to:

... the portion of attorney's fees OSFA does not have to remit to the Department of Education as prescribed by legislative, regulatory or administrative guidance, as payments are received on the Attorney's Fees and Court Costs.

As with the 1992 contract, DOJ was required to maintain a computer system with the capability of submitting payment activity electronically. DOJ was required to forward a daily listing of payments to LOSFA via facsimile transmission. Within four working days of receiving a payment, DOJ was required to classify the daily listing of payments. DOJ was required to invoice LOSFA for its collection fees on a daily basis. LOSFA then had five days from the date of the receipt within which to approve or deny the invoice.

EXAMINATION OBJECTIVES

The objectives of our financial related audit were to review LOSFA's agreement for litigation and collection of delinquent accounts with DOJ in order to determine:

- The propriety of payments made under the agreement
- The adequacy of the internal controls affecting the agreement
- Compliance with applicable federal laws and regulations

Findings and Recommendations

In conducting the procedures previously described, our financial related audit resulted in the following findings and observations. Our procedures did not disclose any instances in which individual borrower accounts relative to defaulted student loans required adjustment.

CONTRACT OVERPAYMENTS

LOSFA has overpaid DOJ approximately \$79,000 for DOJ's collections on defaulted FFEL student loans for the three-year period ended June 30, 1999. The fees to be paid to DOJ were established in the contracts between the two agencies.

All payment transactions for the three-year period ended June 30, 1999, were obtained from DOJ, and the amounts due to DOJ were recalculated to determine if payments were made in accordance with contract provisions. We provided LOSFA and DOJ with a schedule supporting the overpayment resulting from our recalculation.

The \$79,000 overpayment resulted from errors in the rates applied for DOJ's share of attorney's fees awarded by the courts. Neither LOSFA nor DOJ adequately monitored the contracts and invoices submitted by DOJ to LOSFA to ensure that the fees billed were prepared in accordance with the contracts.

LOSFA and DOJ should review the payment data submitted for the three-year period ended June 30, 1999, and DOJ should refund the net overpayment amount to LOSFA. LOSFA and DOJ should establish an adequate payment submission and approval process to ensure that all payments are made in accordance with the contracts and applicable federal regulations. LOSFA and DOJ should establish a review process by which changes in federal regulations that impact any future contract(s) are incorporated into those agreements.

COURT COSTS

LOSFA has paid approximately \$227,500 to the U.S. Department of Education (ED) for ED's share of DOJ's collections on court costs from borrower payments on defaulted FFEL loans, even though LOSFA never actually received a share of these borrower payments. DOJ received payments from borrowers that included court costs and remitted 100% of these payments to the district courts that assessed these costs on borrowers. DOJ reported the borrower payments allocable to court costs to LOSFA, and LOSFA remitted ED's equitable share of those payments to ED.

When a court issues a judgment in favor of DOJ on behalf of LOSFA, the award generally includes principal, interest, attorney's fees, and court costs. Court costs due are established by the district courts in which the lawsuits against the borrowers are filed and settled. Court costs become the legal obligation of the borrower when a judgment is executed. ED has determined that it is entitled to a share of court costs paid by borrowers to guaranty agencies.

All borrower payments for the three-year period ended June 30, 1999, from which either all or a portion of the payments included court costs were examined. Total borrower payments for court costs were approximately \$307,000, and the estimated payment to ED for its share of these payments is \$227,500.

LOSFA failed to monitor DOJ's collection activities to ensure that DOJ collects only those amounts that LOSFA is legally obligated to collect. As a result, LOSFA expended \$227,500 more than it received from DOJ for ED's share of borrower payments. The agency and the state have lost funds that might otherwise have been used for FFEL related activities or other student financial assistance related activities.

Because LOSFA has no legal obligation for the payment of court costs to the district courts, DOJ should not collect these costs from the borrowers nor remit them to the district courts on the borrowers' behalf.

OTHER FEES

LOSFA may have paid as much as \$52,000 to ED for ED's share of DOJ's collections on other fees from borrower payments on defaulted FFEL loans even though LOSFA never received a share of these borrower payments.

To assist with collecting payments from borrowers on defaulted FFEL loans, DOJ may employ the services of local sheriffs who collect directly from borrowers. Also, the Louisiana Department of Revenue may withhold borrower state income tax refunds in certain instances. These entities charge a commission or fee for collecting payments on behalf of DOJ and withhold their commissions before submitting the borrower payments to DOJ.

DOJ reported borrower payments to LOSFA at their gross amounts (including the commissions paid), even though payments were received by DOJ net of commissions. Commissions paid by borrowers are allocated to a specific category in DOJ's payment tracking system. We attempted to identify all borrower payments that included these commissions for the three-year period ended June 30, 1999, and determined that they totaled approximately \$70,000. Of this amount, it was estimated that LOSFA paid approximately \$52,000 to ED for its share of the borrower payments, even though LOSFA did not receive any portion of the \$70,000.

Upon further review, DOJ explained that the \$70,000 includes other transactions that do not represent commissions. For example, certain borrower refunds were included in the same category as the commissions and should be removed from the total. However, these other transactions are not clearly identifiable in DOJ's payment tracking system. The only way to determine if a transaction should not be included in the calculation is by manual review.

LOSFA failed to monitor borrower payments to DOJ to ensure that only actual amounts received by DOJ are reported as payments and to ensure that all collections are accurately reported. DOJ failed to report actual collections to LOSFA, and DOJ failed to adequately identify transactions indicating their nature and disposition, which results in a potential loss to the state of as much as \$52,000. LOSFA expended funds that might otherwise have been used for FFEL related activities or other student financial assistance related activities.

Findings and Recommendations

LOSFA should determine what portion of the \$70,000 represents commissions and should determine whether an adjustment to recover amounts paid to ED as a share of commissions is appropriate. DOJ should identify in its payment tracking system those transactions that include commissions.

LOSFA should establish adequate internal controls and a payment review and approval process to ensure that it reports collections accurately and in accordance with federal regulations, and LOSFA should determine if reporting borrower payments to ED at their actual (or net) amounts complies with federal regulations. LOSFA and DOJ should review all amounts classified as commissions for the three-year period ended June 30, 1999, to determine if DOJ has recouped any of these commissions. If so, then DOJ should refund these recoupements to LOSFA at rates in accordance with the terms of the contract.

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Matters for Additional Consideration

During our financial related audit, we noted several areas that may require additional consideration of management. These areas were not within the scope of our financial related audit, and no additional work was conducted. However, LOSFA and DOJ should review these issues and should seek to resolve or arbitrate each matter.

- DOJ billed numerous payments to LOSFA at a rate of 30%, which was the effective rate for the 1984 contract. The 1992 contract was silent relative to the prior placements and to the commission rate to be paid to DOJ on those accounts. The 1996 contract was effective for accounts placed on or after December 22, 1992. LOSFA believes the 1992 contract includes the older accounts, and the rates established in the 1992 and 1996 contracts should have been applied to payments on these accounts. DOJ stated that the contracts do not include the older accounts, and no overpayment has occurred. We estimated that DOJ was paid at least \$16,000 more than contractually required if these accounts had been calculated using the 1992 and 1996 contracts rates. LOSFA has continued to pay DOJ's commissions on these accounts at the 30% rate.
- The U. S. Internal Revenue Service (IRS) seizes certain borrowers' federal income tax refunds to offset the refunds against their defaulted FFEL loans. The IRS sends the amount seized to the ED. ED keeps 100% of the amount seized, reporting the seizure to LOSFA so that its accounts may be adjusted to reflect their proper balances. DOJ stated that when a seizure included an amount allocable to attorney's fees that it lost the ability to collect on those fees. DOJ stated that LOSFA has since explained that these amounts are collectible directly from the borrower--the tax seizure does not forgive the borrower's obligation to pay the attorney's fees to DOJ. However, DOJ believes that it has lost between \$20,000 and \$22,600 in revenues for past collections in which the borrowers have been released from the judgments and in which no attorney's fees were collected by DOJ.
- Attorney's fees are awarded and included in judgments entered against borrowers who have defaulted on their FFEL loans when DOJ is successful in litigating against a borrower. In some instances, DOJ is not successful in collecting from these borrowers, and LOSFA requests that DOJ cancel the account in accordance with the terms of the contract. In these instances, LOSFA removes any attorney's fees awarded as a part of the judgment and assesses a separate collection charge as prescribed in the Code of Federal Regulations, 34 CFR 682.410(b)(2). DOJ believes that LOSFA does not have a legal basis for "forgiving" attorney's fees awarded as a part of the judgment and that it [DOJ] has a right to those funds. LOSFA believes that in accordance with the terms of the contract that DOJ has no right to any fees for collections made subsequent to the recall of the accounts from DOJ. Attorney's fees awarded on accounts that have been recalled by LOSFA total approximately \$3,900,000, according to DOJ.

- DOJ withholds its fees before remitting borrower payments to LOSFA. DOJ receives borrower payments and classifies them in the Integrated Statewide Information System (ISIS), the state's accounting system. The contract requires that DOJ invoice LOSFA for its collection fees on a daily basis. LOSFA has stated that the current method in which DOJ withholds its fees does not comply with the contract's terms and reduces LOSFA's ability to correct any billing errors that may occur.
- LOSFA maintains that DOJ has not returned recalled accounts to LOSFA within the timeframes as prescribed in the contract. The contract defines those circumstances in which LOSFA may request the cancellation and return or recall of an account from DOJ. DOJ then has a maximum 30-day period in which it must return the accounts. LOSFA has maintained that DOJ has not complied with the request to return these accounts within the time period specified in the contract.
- LOSFA has stated that DOJ has not developed the computer capabilities as required in the contract, which would eliminate the manual labor required to re-enter borrower payments in LOSFA's computer system. Currently, DOJ submits borrower payment information manually, and LOSFA has to re-enter this information in its computer system, effectively doubling the manual data entry required to record the transactions. LOSFA has included provisions in the contract that require that DOJ's system be compatible with LOSFA's system so that data may be transmitted electronically, eliminating the need for LOSFA to enter the information manually. The contract is not specific relative to these requirements.
- The contract requires that DOJ immediately suspend collection efforts on a defaulted FFEL loan in which the borrower has declared bankruptcy and return the account to LOSFA. LOSFA has identified a defaulted FFEL loan in which the borrower has declared bankruptcy, but DOJ continued to collect payments from the borrower and retained a collection fee. ED's share of payments received from borrowers who have declared bankruptcy is 100%--all payments received on bankrupt loans must be returned to ED. LOSFA is concerned that there may be other instances in which DOJ has continued to collect payments from borrowers who have declared bankruptcy and in which DOJ has retained a collection fee, resulting in a loss to the state.
- DOJ provides litigation and collection services to colleges and universities for borrowers who defaulted on their Carl Perkins Loan Program loans, some of whom also defaulted on their FFEL loans and for which DOJ provides litigation and collection services to LOSFA. Payments made by students on their loans are allocated to the FFEL and Perkins programs, either based on instructions from the borrower or on an allocation method established by DOJ. However, DOJ has no written policy on how payments are to be allocated between the two programs in those instances in which the borrowers have not provided specific instructions on how the payments are to be applied. Without a formalized policy, the allocation of borrower payments between the two programs could appear arbitrary. DOJ receives a higher collection rate on Carl Perkins Loan Program collections.

Matters for Additional Consideration

- DOJ plays a unique role in its relationship with LOSFA. DOJ normally represents state agencies in contract disputes, but in this instance, DOJ is also a contracting party. LOSFA believes that its ability to resolve contract disputes between the two agencies is limited because LOSFA has little or no recourse to settle any disagreements. The agency to which LOSFA would normally turn is a party to the contract in which the disputes have arisen.

LOSFA and DOJ should agree to a formalized dispute resolution process to provide both with the ability to have their differences objectively heard when disagreements arise relative to the contracts' terms. This dispute resolution process should be documented in any future contracts.

LOSFA and DOJ should resolve any differences relative to these and other matters and incorporate any necessary changes and additional provisions in future contracts, and they should review federal regulations that are applicable to the agreement to ensure future contracts are consistent with federal regulations. The agencies should meet at least annually to determine the impact, if any, of changes in federal regulations on their contractual relationship, and LOSFA should communicate any changes in federal regulations as they become aware of those changes.

LOSFA and DOJ should maintain documentation of any disagreements and of any meetings held between the two agencies to support their positions on any disagreements, to document any understandings reached, and to document the intention of the parties related to any amendments or modifications for any future contracts. This documentation should also be used to support the communication of any changes in federal regulations and the agencies' consideration of the impact of changes on the contracts.

LOSFA should audit DOJ's contract performance on a regular basis to ensure that DOJ has complied with the terms of the contracts.

LOSFA should monitor billings more closely to ensure that DOJ has billed correctly for its fees for collecting payments from borrowers. LOSFA should determine if any errors have occurred, correct those errors, and either require that DOJ return any overpayments or refund any underpayments to DOJ timely. The billing method employed should provide LOSFA with the ability to identify payment errors before actual payment to DOJ.

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Attachment I

Management's Responses



M.J. "MIKE" FOSTER, JR.
GOVERNOR

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March 20, 2000
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Dr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
1600 North Third Street
Baton Rouge, LA 70804

Re: Auditor's Report on the Contract Between the Louisiana Office of Student Financial Assistance (LOSFA) and the Department of Justice (DOJ)

Dear Dr. Kyle:

We have reviewed the report of the subject audit and concur with the Findings and Recommendations contained in the report, with the notable exception of that relating to our failure to ensure that DOJ collected only those amounts that LOSFA is legally obligated to collect. We also concur that the "Matters for Additional Consideration" should be resolved before resuming a contractual relationship with DOJ.

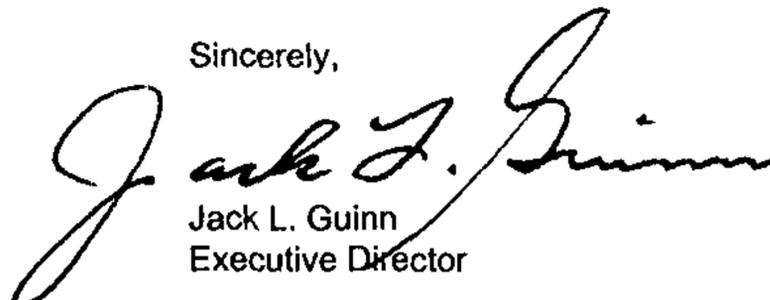
DOJ's contractual relationship with this office is anomalous and we have been unsuccessful in enforcing compliance with the provisions of our contract with that agency or, in the absence of compliance, to terminate the contract. As pointed out in your report, this agency has become frustrated over the years by its attempts to enforce the terms of its contract with DOJ. Our demands for compliance with the reporting and billing provisions of the contract and our attempts to terminate the contract have been ignored over time to the point of our acquiescence. DOJ is, by law, our "attorney," that party which is expected to protect our interests by enforcing the terms of contracts executed by this office.

However, over the course of the last twelve months, DOJ and LOSFA have attempted to resolve existing contractual issues and to improve our working relationship. We shall incorporate the additional controls recommended by the report into any future contract with DOJ. Critical to LOSFA's ability to administer a future contract will be the implementation of your recommendation for a formalized procedure for the resolution of disputes. Any future contract with DOJ proposed by this office will call for binding arbitration by an independent third party to resolve disputes which relate to compliance with the terms of such contract.

We do not concur with your finding relating to "Court Costs" that LOSFA failed to monitor DOJ's collection activities to ensure that DOJ collected only those amounts which LOSFA was legally obligated to collect. Prior to entering into the 1996 contract with DOJ and based upon specific discussions with DOJ about the propriety of including attorney's fees and court costs in the calculation of the U.S. Department of Education's (USDE) "fair share", LOSFA and DOJ corresponded with USDE seeking guidance on recovery of these costs. In responses dated November 3, 1994, and December 6, 1995, USDE specifically stated that attorney's fees and court costs collected from the debtor were to be included in the calculation of USDE's "fair share". DOJ was aware of USDE's guidance and continued to collect and report court costs, which obligated LOSFA to remit the Secretary's "fair share." In effect, LOSFA was relying upon the advice of its legal counsel, DOJ, in collecting court costs.

We appreciate the efforts of the Legislative Auditor in responding to our request for assistance. Our Corrective Action Plan is enclosed.

Sincerely,



Jack L. Guinn
Executive Director

JLG/MR/csm
Enclosure

AUDITOR'S REPORT ON THE CONTRACT BETWEEN
LOUISIANA OFFICE OF STUDENT FINANCIAL ASSISTANCE
AND THE DEPARTMENT OF JUSTICE
DATED MARCH 10, 2000

CORRECTIVE ACTION PLAN

The subject audit made three separate findings and recommendations, entitled as follows:

- 1) Contract Overpayments
- 2) Court Costs
- 3) Other Fees

In each case, the findings were as a result of the inability of the Louisiana Office of Student Financial Assistance (LOSFA) to enforce the terms of the contract or the lack of proper contract management by LOSFA and the lack of understanding of the collection accounting systems utilized by the Department of Justice (DOJ). In each case, these issues are being specifically addressed in the proposed contract which is currently being negotiated between LOSFA and DOJ as a replacement to the contract which expired on July 1, 1999, and was the subject of this audit. To ensure that LOSFA has the ability to enforce terms of the contract, the new contract will call for binding arbitration of disputes by an independent third party. To ensure proper contract management by LOSFA, the contract will be managed by a contract management team consisting of representatives of LOSFA's legal and collections departments. Further, LOSFA will utilize its internal audit staff to periodically audit the performance of the DOJ under the contract. Many of the areas of controversy under the expired contract were the result of the unique collection accounting and reporting system utilized by DOJ. At any given time, LOSFA has a minimum of three collection contracts with external vendors (to include DOJ) and, in each case, those vendors are required to provide software which is compatible with the Collection Interface Software which is a component of the system utilized by LOSFA. Under the terms of the expired contract, DOJ was required to provide compatibility with this software and failed to do so. The result was LOSFA's inability to properly monitor the collection and reporting activities of DOJ. DOJ has agreed to provide the appropriate software interface as a prerequisite to any new contract.

The point of contact for this corrective action plan is Mark S. Riley, Assistant Executive Director, at (225) 922-1019. It is anticipated that all corrective action with respect to proper contractual controls will be in place at the signing of the new contract. Recoupment of amounts owed will be dependent upon the terms of any agreement which may be entered into with DOJ and/or the U.S. Department of Education.

Specifically, as to each of the findings, the following action is proposed:

CONTRACT OVERPAYMENTS

LOSFA will negotiate with DOJ for the return of \$79,000 in overpaid fees. The proposal will be to amortize the payment over an agreed period of time and to offset payments against invoices submitted under the new contract, until full restitution is made.

Under the terms of the expired contract, DOJ was required to submit all sums collected to LOSFA and to submit an invoice for fees due. Through LOSFA's acquiescence, DOJ retained its fees and only submitted the net amount to OSFA. The terms of the new contract will include the same provisions and those terms will be enforced. LOSFA will audit each invoice submitted to ensure amounts paid are, in fact, owed.

COURT COSTS

This finding stated that LOSFA had overpaid the U.S. Department of Education (the "Secretary") approximately \$227,500 as a result of court costs which were collected by DOJ. The Legislative Auditor determined that court costs in a law suit filed by DOJ on behalf of LOSFA were not costs incurred by LOSFA and, therefore, did not have to be included in the return of the Secretary's "fair share". Previously, in conjunction with DOJ, LOSFA requested a ruling from the Secretary on this issue. By letter dated November 3, 1994, the Secretary issued a ruling which is not consistent with the findings of the Legislative Auditor. DOJ was aware of this ruling and LOSFA's position that any court costs which were collected must be included in the Secretary's "fair share".

LOSFA will ask the Secretary to resolve this conflict of interpretations and proceed accordingly. Pending the Secretary's response, LOSFA will seek recoupment of these court costs if permitted by the Secretary. DOJ has agreed to follow LOSFA's procedures concerning the collection of court costs.

OTHER FEES

Through the implementation by DOJ of the Collection Interface Software, all amounts collected by DOJ will be properly classified and reported and LOSFA will receive from DOJ the appropriate amount for submission to the Secretary. LOSFA will review the disputed amounts with DOJ and agree as to the amount owed. LOSFA will utilize the procedure discussed under "Contract Overpayments" to recover any amounts owed.



State of Louisiana

Department of Justice
Collections Section

Baton Rouge

70821-3478

P. O. Box 3478
TEL: (225) 342-7892
FAX: (225) 342-1571

March 16, 2000

Daniel G. Kyle, PhD, CPA, CFE
Legislative Auditor
State of Louisiana
Baton Rouge, Louisiana

RE: Financial Related Audit, conducted by the Financial and Compliance Division, of the Louisiana Office of Student Financial Assistance Federal Family Education Loan Program Agreement for Litigation and Collection of Delinquent Accounts

Dear Dr. Kyle:

Attached please find the responses to the above referenced audit findings and recommendations. If there is any other information this office can provide for you please feel free to contact me at 342-7880. As this was my first in depth involvement with your office, I must say it has been an interesting and enlightening eight (8) months. While we do have serious differences and disputes regarding your findings, I thank you and your office for the time and energy expended throughout this endeavor.

Respectfully submitted,

A large, stylized handwritten signature in black ink, reading "K. Renee Fontenot".

K. Renee Fontenot
Assistant Attorney General
Collections Section Chief

Attachments



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“CONTRACT OVERPAYMENTS”

In May 1999, the Attorney General’s office discovered that its Automated Collections System (AGACS) was incorrectly calculating the Department of Justice’s (DOJ) attorney fees on Louisiana Office of Student Financial Assistance (OSFA) accounts. The Attorney General’s office notified OSFA of the problem. DOJ and OSFA Collection personnel met at DOJ for an in-depth review of the proposed changes to AGACS in order to accurately correct this miscalculation. After the parties mutually agreed to the changes, all system adjustments were successfully implemented and in effect on July 1, 1999. To date, everything is being calculated accurately.

“COURT COSTS”

Pursuant to Louisiana Revised Statute Title 13 Section 4521, the DOJ is exempted from paying courts costs, but is obligated to make an effort to collect court costs on behalf of the courts from the debtor. Specifically, R.S. 13:4521 B provides:

“It shall be the duty of the exempted entities set forth above to assist in the collection of court costs due by requesting the court in question to tax costs in accordance with the provisions of Article 1920 of the Code of Civil Procedure.”

DOJ, in the past, has sought the assessment of court costs against the debtors in the judgments DOJ obtained, and sought to collect such costs on behalf of the courts from the debtors.

100% of the collected court costs were forwarded to the Clerks of Court and Sheriff’s Offices. These costs are the sole property of the courts, not DOJ’s, or OSFA’s, or the U.S. Department of Education’s (ED). ED contends that they are entitled to 76% of these court costs even though they have no interest whatsoever in the funds and the costs are not being collected for them. ED contends that the federal regulations governing the FFEL program are written to assure that every guarantee agency will “lose money” on some of the loans that they guarantee.

Since OSFA has been paying 76% of every dollar reported to ED, DOJ has changed procedures to assist in reducing unnecessary expenditures to ED. Effective July 1, 1999, DOJ discontinued collecting court costs on OSFA accounts. On OSFA cases, the debtor is responsible for the payment of their court costs directly to the courts. To insure that DOJ does not cost OSFA any money with regard to court costs, the AGACS database has been reprogrammed (effective 7/1/99) to prohibit the posting of any payment towards court costs on OSFA accounts.

“OTHER FEES”

DOJ has reviewed every account listed in the report produced by the auditor. The auditor’s figure is taken from the fees “assessed” in debtor’s accounts, not the actual monies collected and applied to that field. DOJ’s review of the accounts listed in the auditor’s support for the \$52,000.00 revealed that of the alleged \$52,000.00, there were few instances where the DOJ in fact collected any of the “Other Fees” that were required to be tracked by OSFA. In fact, DOJ collected less than \$500.00 that OSFA legitimately should have forwarded to ED.

The inability of OSFA to independently track anything besides principal, interest, and other fees, has created much misunderstanding between the agencies. Therefore, in an attempt to resolve some of these, DOJ changed (effective 7/1/99) in AGACS, the practice of individually itemizing anything except principal, interest and other fees. Of course, when other fees are added to the system, comments distinguish what these costs are. Further (effective 7/1/99), DOJ only posts the net amount of any payment, contrary to previous requirements by OSFA. Refunds to debtors are now only reported in the “excess” field in AGACS, clearly indicating that these funds represent an overpayment by the debtor and must be refunded to the debtor. The other fees field in AGACS is coded to only retain 24% of the funds applied. The remaining 76% is forwarded to OSFA. In the event that the retention rate for OSFA is altered by federal regulation, AGACS can and will be altered accordingly.

Retention of all funds by DOJ are reviewed daily by OSFA. Within five working days, OSFA notifies DOJ of any fee that they dispute. DOJ reviews these notices upon receipt and makes corrections accordingly.

“MATTERS FOR ADDITIONAL CONSIDERATION”

* The accounts placed with DOJ under the 1992 contract and the 1996 contract did not address the accounts placed under the 1984 contract. During negotiations, OSFA never mentioned changing the rates for all accounts held by DOJ. It was neither agencies’ intention to include those accounts placed under the 1984 contract.

* The matter of IRS seizures being applied to fees other than principal and interest by OSFA requires no response by DOJ.

* OSFA may have “forgiven” as much as \$3,900,000.00 in attorney fees awarded by Louisiana courts to DOJ. By collecting principal, interest, and assessing OSFA’s own collection costs in lieu of DOJ attorney fees, OSFA has forgiven money owed to the state. OSFA has provided debtors with releases indicating that the debt has been satisfied once principal, interest, and OSFA’s collection costs are paid. Article VII Section 14 of the Louisiana Constitution entitled “Donation, Loan, or Pledge of Public Credit.” provides in part:

(A) Prohibited Uses. Except as otherwise provided by this constitution, the funds, credit, property, or things of value of the state or of any political subdivision shall not be loaned, pledged, or donated to any person..."

OSFA's forgiveness of any dollar of DOJ's attorney fees is constitutionally prohibited. DOJ suggests that an audit be performed to verify that these fees have been forgiven. DOJ has repeatedly suggested that this be done in the course of this audit. To date, none has been done. Furthermore, it should be determined what, if any of this \$3.9 million is still collectable. After all, if these fees are collectable, it would cost OSFA nothing since they will simply forward 76% to ED.

* DOJ withholds its fees pursuant to OSFA's approval. DOJ deposits the funds received on a daily basis into the state treasury. Payments are posted to the AGACS database. Each deposit is classified into the ISIS system and OSFA is provided with a breakdown of how each payment is posted and how much was retained by DOJ. All this is done within 5 working days of receipt of funds. With appropriate monitoring by OSFA, OSFA reviews the data provided, and notifies DOJ of any fee denial. OSFA's ability to correct billing errors is unaffected by the procedure presently in place. This system is the most expedient, not to mention the most accurate evidenced by the fact that OSFA routinely requests copies of DOJ payment histories in order to post payments correctly on their computer system.

* Due to inconsistencies between the agencies' databases, information extracted from either would in the past, produce different results. Therefore, creating the impression that accounts should have been returned and had not. Through intensive efforts on the part of both agencies, this is no longer the situation. Monthly DOJ produces a list of accounts that merit return to OSFA under the 1996 contract. These accounts are then returned by month's end to OSFA.

* DOJ has electronically transmitted a quarterly inventory to OSFA since the beginning of the 1996 contract. Since February 1, 2000, DOJ sends daily payments to OSFA electronically. DOJ has the capability and has included in other electronic transmissions, the amount of fees withheld on each payment. However, OSFA still manually calculates DOJ fees.

* DOJ can only suspend collection efforts on accounts when notified that the borrower has declared bankruptcy. DOJ suggests that the agencies work together to insure prompt notification of bankruptcy filings.

* There has always existed a policy with regard to the posting of payments to multiple loans. However, it has never been reduced to writing until now. The debtor can direct how he or she desires for a payment to be posted when there are multiple loans, unless the account is in a garnishment or seizure situation. Otherwise, the computer is hard coded to automatically distribute payments pro-rata amongst the various loans.

* Pursuant to La. R.S. 17:3025 and 42:261, the Attorney General shall represent OSFA. It is not unique for a client to disagree with its counsel. This situation is one in which the question is to what state agency is the money to be attributed to? What is unique is the money has always been accounted for and if not used within a fiscal year by DOJ, then has been sent to the general fund. Regardless of which agency the funds were classified to, the state has ultimately benefited.