March 3, 2011

Control Number
ED-OIG/A05K0001

Mr. Richard Boyle
Chief Executive Officer
ECMC Group Inc.
1 Imation Place
Building 2
Oakdale, MN 55128

Dear Mr. Boyle:

This final audit report, titled “Educational Credit Management Corporation’s 2006 Agreement with the United States Department of Education,” presents the results of our audit. The objective of our audit was to determine whether Educational Credit Management Corporation (ECMC) complied with selected terms of a June 29, 2006, agreement, titled “Amended and Restated Agreement Between the United States Department of Education and Educational Credit Management Corporation” (Agreement) (See Attachment 2). The selected terms of the Agreement that we reviewed were (1) Sections 5.b., 12, 13, and 14 (the Federal Services Bureau’s (FSB) revenues and expenses); (2) Section 5.f. (the FSB’s return of funds to the U.S. Department of Education (Department)); and (3) Section 6 (the repurchase interest allocation). Our audit covered the period January 1, 2008, through December 31, 2008 (calendar year 2008).

BACKGROUND

ECMC, headquartered in Oakdale, Minnesota, is a wholly owned subsidiary of Educational Credit Management Corporation Group, Inc. (ECMC Group). ECMC affiliates include other ECMC Group subsidiaries. These entities share services and resources, including strategic oversight and direction. According to ECMC, all ECMC Group entities perform primarily student financial aid related activities or other financial services and are subject to the control of ECMC Group (See Attachment 3).

ECMC is a nonprofit corporation operating as a guaranty agency designated by the Department. As a designated guaranty agency participating in the Federal Family Education Loan Program,
ECMC entered into agreements with the Department. In accordance with those agreements, the Department instructed ECMC to perform various functions.

In accordance with the Higher Education Act of 1965, as amended (HEA),\textsuperscript{1} and the Agreement, ECMC established three funds to segregate its finances. The three funds include the Federal Reserve Fund, maintained by the FSB and property of the Department; the Guarantor Operating Fund, maintained by the Guarantor and property of ECMC; and the Guarantor Federal Fund, maintained by the Guarantor and property of the Department.

ECMC segregated its operations and finances into two separate categories: the Guarantor and the FSB. The Agreement defines the functions of the Guarantor and the FSB. The Guarantor handles all of ECMC’s operations that relate to the performance of the functions commonly performed by agencies or organizations acting as guaranty agencies under the HEA. The FSB handles all functions or assignments carried out by ECMC at the request of the Department. The Department has authorized ECMC to finance these functions and assignments with the FSB Federal Reserve Fund. The Agreement requires ECMC to allocate costs between the Guarantor, the FSB, and any other affiliated entities. The Agreement also requires ECMC to maintain a cost allocation plan (CAP) that has been approved by its independent auditors and the Department.

The FSB’s primary function is to service and monitor bankruptcy cases, currently filed under Chapters 7 and 13 of the Bankruptcy Code, on student loans. The Department and other guaranty agencies transfer bankruptcy loans to ECMC for processing. As of December 31, 2008, the bankruptcy student loan portfolio serviced by the FSB consisted of 172,889 loans with an outstanding balance of $1,453,590,000, including accrued interest and fees. At the request of the Department, the FSB also provides specialty student loan services (such as inactive portfolio maintenance and administrative wage garnishment) for the Department.

All of the FSB’s funds are the property of the Department, and the Agreement requires ECMC to return to the Department 100 percent of the FSB Federal Reserve Fund balance each year. However, the Department, at its sole discretion, may require less than 100 percent transfer of the Federal Reserve Fund balance. The Department did not require ECMC to return any of the $252 million balance that existed in the FSB Federal Reserve Fund as of September 30, 2008. However, in a memorandum to ECMC dated February 5, 2010, the Department required ECMC to return $438 million of the $538 million balance that existed in the FSB Federal Reserve Fund as of September 30, 2009.

**AUDIT RESULTS**

ECMC generally complied with Sections 5.f. (the FSB’s return of funds to the Department) and 6 (the repurchase interest allocation) of the Agreement. However, ECMC did not comply with all of the terms set forth in Sections 5.b., 12, 13, and 14 of the Agreement. We identified two instances of non-compliance related to the FSB’s revenues and expenses. First, ECMC used

\textsuperscript{1} 20 United States Code (U.S.C.) Section 1071, et seq.
FSB revenue to support activities that are not allowed per the Agreement. Second, ECMC’s CAP did not fully explain the allocation of costs, and ECMC did not provide an annual cost allocation report to the Department.

We provided a draft of this report to ECMC for review and comment on October 22, 2010. We received ECMC’s comments on November 4, 2010. ECMC agreed to implement all the recommendations but disagreed with some of the statements made in draft Finding No. 1. Based on ECMC’s comments, we removed from Finding No. 1 our exception regarding the use of the Guarantor Operating Fund as a checking account for all of ECMC’s entities. However, we still take exception to ECMC’s use of the FSB Federal Reserve Fund as a checking account for all of ECMC entities. (ECMC used the FSB Federal Reserve Fund as its checking account until March 2008.) We did not make any other significant revisions to the findings or recommendations.

We summarized ECMC’s comments at the end of each finding. The full text of ECMC’s comments on the draft report is included as Attachment 5.

**FINDING NO. 1 – FSB Supported Activities Not Authorized by the Agreement**

ECMC used the FSB Federal Clearing Account to support activities not authorized by the Agreement. During our review of ECMC’s system of internal control, we learned that the Federal Clearing Account maintained by the FSB paid expenses of ECMC Group, the Guarantor, and other ECMC affiliates. At the end of each month, a net receivable or payable due to the FSB Federal Clearing Account would exist. The receivables and payables usually were settled the following month. However, we identified an affiliate for whom the FSB carried a receivable for nearly 5 years. The receivable balance ranged from $26,000 to $520,000.

In addition, ECMC charged the FSB (1) the full cost ($31,715) for a professional liability insurance policy that included coverage for attorneys who did not work primarily on FSB-related activities and (2) the full cost ($529) of an annual American Bar Association membership for an attorney who did not work primarily on FSB-related activities.²

**FSB Federal Clearing Account Used to Pay the Expenses of Affiliated Entities**

ECMC used the FSB as what the ECMC Group Controller described as a “checking account.” As a checking account, the FSB paid the monthly expenses of ECMC Group and all of its subsidiaries except one (Premiere Credit). The FSB operated as the checking account until March 2008, when ECMC transferred this function to the Guarantor Operating Fund. To operate as a checking account, the FSB maintained a Federal Clearing Account into which deposits were made and from which expenses were paid. The deposits included Guarantor collections on defaulted loans, FSB receipts from bankruptcy trustees, FSB receipts from lenders for repurchases, and Guarantor and FSB payments from the Department. Using the Federal Clearing

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² To determine whether ECMC used FSB funds only for allowable purposes, we judgmentally selected and tested 30 non-personnel expenditures, totaling $1,115,508, from the universe of 4,575 non-personnel expenditures, totaling $9,831,392, charged to the FSB during the period January 1, 2008, through December 31, 2008. Because we used non-statistical sampling procedures, there is no assurance that the judgmental sample was representative of the entire population, and it should not be projected over the unsampled amounts.
Account, the FSB also issued checks to pay the expenses of ECMC Group and all of its subsidiaries (except Premiere Credit). The Guarantor Operating Fund transferred $750,000 each week to the FSB Federal Clearing Account to fund the expenses. At the end of each month, a net receivable or payable due to the FSB Federal Clearing Account from any combination of the FSB Federal Reserve Fund, Guarantor Operating Fund, Guarantor Reserve Fund, or affiliates would exist. These payables and receivables were recorded as FSB payables and receivables because the Federal Clearing Account resided in the FSB. The receivables and payables usually were settled the following month.

According to Section 5.b. of the Agreement,

Unless otherwise provided in this Agreement or otherwise approved by the Department, the following provisions shall apply to all revenues and expenses associated with the other duties performed by ECMC/the Federal Services Bureau under its agreements with the Department: (i) all revenues shall be recorded separately under accounts assigned to ECMC/the Federal Services Bureau; (ii) ECMC agrees that all such revenues are Federal Funds and shall be available to ECMC solely for the purpose of supporting such duties or expenses as may be assigned or approved by the Department including payment of the fees described in Section 9; and (iii) expenditures from such funds shall be subject to all restrictions imposed by the HEA, the Department’s regulations and other directions provided by the Department.

According to Section 12 of the Agreement,

Unless otherwise specified in this Agreement or as approved by the Department, all funds generated by ECMC/the Federal Services Bureau shall be deposited in accounts identified as including Federal Funds and any investment earnings shall be credited to those accounts. All expenses associated with the duties assigned to ECMC/the Federal Services Bureau shall be paid from the accounts described in this paragraph. All expenditures shall comply with the restrictions imposed on the use of Federal Funds by the Department’s regulations and guidance to ECMC.

According to Section 13 of the Agreement,

The Department acknowledges that it has been informed that ECMC has reorganized and restructured its corporate structure under a 501(c)(3) tax-exempt holding company, ECMC Group, Inc., and that the new structure includes affiliated for-profit entities, as well as ECMC Foundation, a 501(c)(3) tax exempt foundation. ECMC shall ensure that the reorganization will be consistent with ECMC’s fiduciary obligations to the Department and will ensure that Federal funds are not used to support activities not authorized by the Original Agreements or this Revised Agreement.

Use of FSB Federal Clearing Account to Pay Expenses of Affiliated Entities Exposes the Government to Unnecessary Risk

By covering the expenses of ECMC Group’s other lines of business, the FSB assumed the risk that one or more of the affiliated entities might be incapable of reimbursing the FSB for expenses paid through the FSB Federal Clearing Account. Such risk became reality in the case of Records & Receivable Management Corporation (RRMC), one of ECMC Group’s subsidiaries. The FSB Federal Clearing Account carried a receivable from January 2005 until December 2009 for
RRMC. The amount of the receivable fluctuated during this period, because ECMC used the FSB Federal Clearing Account to pay additional RRMC expenses, and RRMC made payments to the FSB Federal Clearing Account. In July 2007, the receivable reached a high of $520,183. In December 2009, after we identified the receivable and discussed the issue with ECMC officials, ECMC transferred from the Guarantor Operating Fund to the FSB Federal Reserve Fund $139,730, representing the outstanding balance of the receivable, and $72,454 of interest (See Attachment 4).

The ECMC Group Controller stated that the receivable balance occurred because RRMC did not have sufficient funds to reimburse the FSB Federal Clearing Account. The Controller also informed us that, in March 2008 when ECMC transferred the Federal Clearing Account from the FSB Federal Reserve Fund to the Guarantor Operating Fund, ECMC inadvertently neglected to reimburse the outstanding RRMC payable to the FSB Federal Clearing Account.

Professional Liability Insurance Did Not Fully Support the FSB Line of Business

ECMC used the FSB Federal Reserve Fund to pay the full cost of a professional liability insurance policy for its nine attorneys. However, during calendar year 2008, the nine attorneys did not work primarily on FSB-related activities. The cost of the insurance policy for calendar year 2008 was $31,715. Based on ECMC’s analysis of the attorneys’ timesheets, ECMC should have allocated $18,885 to the FSB, $6,411 to the general and administrative indirect cost pool, and the remaining $6,418 to other non-FSB activities.

The ECMC Group Controller stated that ECMC fully allocated the insurance policy cost to the FSB because the costs related to this policy had not been reviewed and modified accordingly. The Controller explained that when ECMC originally purchased the policy, the policy covered only attorneys who worked primarily on FSB-related activities. Therefore, ECMC allocated the full cost to the FSB. However, subsequent annual renewals included coverage for attorneys who did not work primarily on FSB-related activities. ECMC did not revise the allocation as the composition of the covered attorneys changed. In April 2010, after we identified the misallocation and discussed the issue with ECMC officials, ECMC reclassified $12,829 of the $31,714 to reimburse the FSB for the unallowable expenses.

American Bar Association Membership Fee Did Not Support the FSB Line of Business

ECMC used the FSB to pay the full cost of one attorney's annual membership in the American Bar Association. However, the attorney did not work primarily on FSB-related activities. Based on our analysis of the attorney’s timesheets, the attorney charged only 6 of the 1,418 non-leave hours (0.4 percent) to FSB-related activities during calendar year 2008. The attorney charged more than 1,253 hours (88 percent) to general and administrative indirect cost activities. Therefore, the $529 annual membership fee should have been charged to general and administrative indirect cost activities. Section 14 of the Agreement states that “ECMC shall

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3 ECMC prepared the spreadsheet that calculated the interest. We audited the document and did not identify any errors.

4 We audited the analysis and determined it was accurate.

5 ECMC reclassified $6,411 to the general and administrative indirect cost pool and the remaining $6,418 directly to other non-FSB funds.
ensure the allocation of costs between ECMC/the Guarantor, ECMC/the Federal Services Bureau and any other affiliated entities.”

The ECMC Group Controller informed us that ECMC charged the FSB in error. In March 2010, after we identified the misallocation and discussed the issue with ECMC officials, ECMC reclassified the $529 annual membership fee from a direct charge to the FSB to the general and administrative indirect cost pool.

The total amount of unallowable expenses, including interest, was $225,542. As a result of our audit, between December 2009 and April 2010, ECMC reimbursed the FSB Federal Reserve Fund for the full amount.

Our prior audit of ECMC (Control Number ED-OIG/A05C0014, issued on March 18, 2003) disclosed a similar finding. The prior report disclosed that ECMC used the FSB Federal Reserve Fund to subsidize expenses that benefitted other lines of business, such as the Guarantor Operating Fund and ECMC’s affiliates. Based on tests of expenses from selected periods, the prior audit determined that ECMC used $65,832 from the FSB Federal Reserve Fund to pay expenses that benefitted ECMC’s other lines of business.

RECOMMENDATIONS

We recommend that the Chief Operating Officer (COO) for Federal Student Aid (FSA) require ECMC to—

1.1 Use the FSB Federal Clearing Account only for the ECMC lines of businesses (FSB and Guarantor) and only for purposes allowed in the HEA, regulations, and Agreement;

1.2 Develop procedures to ensure that ECMC uses FSB revenue only for allowable FSB-related activities; and

1.3 Review all expenses charged to the FSB since ECMC segregated its operations, make appropriate adjustments if expenditures did not benefit the FSB line of business, and have its independent public accountant attest to the results.

ECMC Comments

ECMC concurred with each of the three recommendations and stated that it already has implemented Recommendation 1.1. In early November 2010, the check clearing function (as it relates to all non-ECMC expenses) was transferred to a bank account maintained by ECMC Group, Inc. To implement Recommendations 1.2 and 1.3, ECMC will retain the services of an independent certified public accounting firm to develop new procedures and to review expenses. ECMC stated that the accounting firm retained will not be the same firm that audits ECMC’s financial statements, and the expense review will be limited to expenses incurred on or after January 1, 2006, because of ECMC’s record retention policies. ECMC will provide to the Department, no later than June 30, 2011, a report of that firm’s findings.

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6 This amount consists of $139,730 + $72,454 + $12,829 + $529.
Although ECMC agreed to implement all of the recommendations, it disagreed with some of the statements that we made in the draft version of Finding No.1. Specifically, ECMC disagreed with our statement that it (1) structured its check clearing account process to gain use of FSB funds for non-FSB expenditures; (2) improperly used FSB funds, resulting in a loss to the FSB Federal Reserve Fund; (3) used the FSB Federal Clearing Account in a manner that exposed the government to unnecessary risk; and (4) used its Guarantor Operating Fund in an inappropriate manner to pay the expenses of for-profit affiliates. ECMC stated that draft Finding No.1 primarily was the result of ECMC’s failure to properly explain to the Office of Inspector General (OIG) how the check clearing account function within the Federal Clearing Account actually operated in practical terms.

Finally, ECMC disagreed that the check clearing account’s operation resulted in an inappropriate use of the Guarantor Operating Fund under 34 Code of Federal Regulations (C.F.R.) Section 682.423(c). First, as mentioned above, ECMC stated that a misunderstanding existed regarding how the check clearing account functioned. Second, ECMC stated that, to the extent the Guarantor Operating Fund might have temporarily financed any portion of expenses owed by an affiliated for-profit business, such financing activity was an “investment” activity permitted under Section 422B of the Higher Education Act of 1965, as amended (20 U.S.C. Section 1072b(b)). All direct or indirect support by ECMC with respect to for-profit affiliated entities, including financings, have been conducted pursuant to “prudent investor standards” as permitted by law.

**OIG Response**

We revised Finding No. 1. After further review, we clarified statements in Finding No. 1 that would indicate that use of the FSB Federal Clearing Account to satisfy the expenses of ECMC affiliates was improper solely because some of the ECMC affiliated entities are for-profit entities. We agree that the Guarantor Operating Fund could be used as a checking account for ECMC affiliates, as long as the affiliates perform activities related to guaranty agency functions or other student financial aid related activities. In modifying the finding on use of the Guarantor Operating Fund, we relied on ECMC’s representations that all of the ECMC entities performed student financial aid activities and, therefore, any expenses paid from the Guarantor Operating Fund were permitted under the HEA. We disagree with ECMC’s assertion that we misunderstood how its check clearing account functioned. The fact that the FSB Federal Clearing Account carried a receivable for RRMC for nearly 5 years supports that the Department was exposed to risk.

We also disagree with ECMC that the use of the Guarantor Operating Fund from March 2008 through November 2010 to finance ECMC affiliated entities is an investment activity allowed under Section 422B(b) of the HEA. We do not consider financing the affiliated entities to be in accordance with prudent investor standards, unless ECMC can show that a prudent investor would loan money to another entity to meet its cash flow needs, without security or a defined repayment schedule, at the interest rate ECMC paid the Guarantor Operating Fund for use of the funds.
FINDING NO. 2 – Cost Allocation Terms of the Agreement Not Always Followed

ECMC did not fully comply with the cost allocation terms set forth in Section 14 of the Agreement. ECMC did not clearly describe the full cost allocation process in the CAP and did not maintain documentation to support all of its cost allocations. In addition, ECMC did not submit a material 2007 CAP modification to the Department for approval. Finally, ECMC did not provide annual cost allocation reports to the Department.

Cost Allocations Are Not Clearly Described in the CAP and Are Not Fully Documented

According to Section 14 of the Agreement—

ECMC shall maintain a cost allocation plan . . . . The cost allocation plan shall be reasonable, defensible, consistent in its application, determined in accordance with generally accepted accounting principles, and be adequately documented. The cost allocation plan shall allow for the application of direct costs and indirect costs.

ECMC maintains a CAP that explains the application of most of its direct and indirect costs. The CAP adequately explains the application of direct costs to a single project and indirect costs for fringe benefits, facilities, and general and administrative expenses. However, the CAP does not adequately explain the allocation of direct costs to multiple projects.

ECMC allocates a direct cost to multiple projects by one of two methods.

- **Multi organization project (MOP) code method.** Using the MOP method, ECMC identifies an activity that affects multiple projects and establishes a predetermined cost allocation percentage for each project affected. Then, when costs are charged to a MOP code, the costs are allocated to the projects according to the predetermined cost allocation percentages. For example, the Board of Directors MOP code has predetermined cost allocation percentages of 15 percent to the FSB, 75 percent to the Guarantor, and 10 percent to ECMC Group. If ECMC treated the Board of Directors’ costs as general and administrative indirect costs, the costs would be allocated to all of ECMC’s subsidiaries. Instead, the MOP code limits the allocation of the Board of Directors’ costs to the Guarantor, the FSB, and ECMC Group. During calendar year 2008, ECMC allocated $256,212 in costs to the FSB through 17 MOP codes.

- **Case-by-case method.** Using the case-by-case method, if a particular cost applies to multiple projects but ECMC has not established a MOP code, an individual determines the cost allocation. For example, a business unit hires a vendor to print and mail annual privacy letters. Some of the letters are for FSB purposes; others are for Guarantor purposes. Upon receiving the invoice, the manager of the business unit determines the cost allocation percentages for the FSB and the Guarantor. The manager writes the cost allocation percentages on the invoice.

Although the CAP briefly identifies the use of the MOP code method, it does not provide a detailed explanation of allocating costs by this method. ECMC maintains a list of MOP codes and the corresponding cost allocation percentages. However, the CAP does not include this information. The CAP does not address the use of the case-by-case method. Without detailed
explanations, the Department cannot evaluate whether allocating costs by either method is reasonable and defensible.

In addition, ECMC did not retain supporting documentation for the cost allocation percentages used for the MOP code and case-by-case methods. When we requested the supporting documentation for the cost allocation percentages, ECMC recreated the documentation. We reviewed three MOP codes, and none of the allocation percentages matched precisely the percentages shown on the recreated documentation. For example, the recreated documentation provided for the Board of Directors MOP codes indicated that the allocation was based on the ratio of hours charged for the period January 1, 2007, through December 31, 2007 (calendar year 2007). The hours included ECMC Group plus all of its subsidiaries. According to the recreated documentation that ECMC provided to us, the allocation percentages should have been 22 percent to the FSB, 71 percent to the Guarantor, and 7 percent to ECMC Group and all the remaining subsidiaries. However, the percentages that ECMC used for the Board of Directors MOP code were 15 percent to the FSB, 75 percent to the Guarantor, and 10 percent to ECMC Group.

Material Modification to the CAP Not Provided to the Department for Approval

According to Section 14 of the Agreement, ECMC shall maintain a cost allocation plan which has been approved by its independent auditors and the Department . . . . Indirect costs such as fringe benefits and facilities . . . shall be allocated to all projects based on total salaries. Administrative costs . . . shall be allocated to all projects based on the total cost of the projects. ECMC shall review the cost allocation plan annually and modify the plan as necessary, provided that any material modifications shall be approved by its independent auditors and the Department.

In calendar year 2007, ECMC made a material modification to the CAP by changing the allocation basis for administrative costs. The modification allocated administrative costs to all projects based on total salaries instead of the total cost of the projects (as required by the Agreement). This change in allocation resulted in a reduction of the amount of administrative costs allocated to the FSB by more than $123,000 for calendar year 2008.

The ECMC Group Controller stated that the modification occurred so that ECMC would more conservatively allocate administrative costs to the Federal Reserve Fund. However, there is no evidence that the Department or the independent auditors approved this modification to the CAP as required by the Agreement. There also is no evidence that ECMC informed the Department about the modification. According to the ECMC Group Controller, the independent auditors cannot approve the CAP, as required by the Agreement, because the auditors must be independent of management. We concur with the ECMC Group Controller’s statement that the independent auditors cannot approve the CAP.

Annual Cost Allocation Reports Not Provided to the Department

According to Section 14 of the Agreement, “On an annual basis, ECMC shall provide the Department with a cost allocation report from ECMC's independent auditors.”
As part of the financial statement audit, the independent auditors review the CAP for reasonableness and to give assurance that the plan is implemented correctly. The independent auditors also provide a presentation on the results of their cost allocation review to the Board of Directors’ audit committee. This presentation does not specifically state the auditor’s formal opinion on the reasonableness of the CAP.

ECMC contends that this presentation is the “cost allocation report” required by the Agreement. However, ECMC does not provide the annual presentation to the Department. Furthermore, it is unclear whether these presentations meet the intent of the requirement in the Agreement. Although the Agreement does not explicitly define what constitutes a “cost allocation report,” Section 14 states,

ECMC shall ensure the allocation of costs between ECMC/the Guarantor, ECMC/the Federal Services Bureau and any other affiliated entities. ECMC shall maintain a cost allocation plan which has been approved by its independent auditors and the Department. The cost allocation plan shall be reasonable, defensible, consistent in its application, determined in accordance with generally accepted accounting principles, and be adequately documented. . . . ECMC shall review the cost allocation plan annually and modify the plan as necessary, provided that any material modifications shall be approved by its independent auditors and the Department. **On an annual basis, ECMC shall provide the Department with a cost allocation report from ECMC’s independent auditors** [emphasis added]. ECMC shall maintain appropriate records reflecting the basis for the cost allocation plan and shall provide such records to the Department at its request.

Because the CAP does not fully explain the allocation of costs, and ECMC does not provide an annual cost allocation report to the Department, the Department is not fully aware of the cost allocation process or material modifications made to the CAP. In addition, the Department does not have assurances that the CAP is reasonable, defensible, and consistent in its application. Finally, without adequate documentation to support the cost allocations under the MOP code or case-by-case methods, it is difficult to determine whether the cost allocations are reasonable, defensible, and have been calculated correctly.

**RECOMMENDATIONS**

We recommend that the COO for FSA require ECMC to—

2.1 Include in the CAP a detailed explanation of the basis for its cost allocations under the MOP code and case-by-case methods;

2.2 Retain supporting documentation of the cost allocation percentages established for the MOP code and case-by-case methods;

2.3 Submit all material modifications of the CAP to the Department for approval;

2.4 Submit the annual cost allocation report to the Department; and

2.5 Return funds to the FSB Federal Reserve Fund if unallowable costs or overcharges are identified based on implementation of recommendations 2.1 through 2.4.
We also recommend that the COO for FSA—

2.6 Revise the Agreement, removing the requirement that an independent auditor approve the CAP (only FSA has the authority to approve ECMC management’s CAP); and

2.7 Revise the Agreement to explicitly define what constitutes a “cost allocation report.”

ECMC Comments

ECMC concurred with the first five recommendations that require action on its part. ECMC stated that these five recommendations would be implemented by June 30, 2011. ECMC stated that it will retain the services of an independent certified public accounting firm to assist ECMC in fully implementing the recommendations. ECMC also stated that it will submit to the Department the proposed modifications to the cost allocation plan for suggestions prior to implementation.

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**OBJECTIVE, SCOPE, AND METHODOLOGY**

The objective of our audit was to determine whether ECMC complied with selected terms of a June 29, 2006, agreement, titled “Amended and Restated Agreement Between the United States Department of Education and Educational Credit Management Corporation.” The selected terms of the Agreement that we reviewed were (1) Sections 5.b., 12, 13, and 14 (the FSB’s revenues and expenses); (2) Section 5.f. (the FSB’s return of funds to the Department); and (3) Section 6 (the repurchase interest allocation). Our audit covered calendar year 2008.

To achieve our objective, we performed the following procedures:

1. Reviewed the HEA, regulations, Office of Management and Budget Circular A-122 (revised May 10, 2004), the Agreement dated June 29, 2006, and ECMC Group’s 2008 CAP to identify the criteria relevant to our audit objective.

2. Reviewed ECMC’s organization charts, Web site, 2006 through 2008 annual financial statement audit reports and the accompanying schedules of expenditures of Federal awards, 2008 Guaranty Agency Financial Report (ED Form 2000), and various internal and external audit reports relevant to our audit period to gain an understanding of ECMC’s structure, financial position, and prior audit findings relevant to our audit objective.

3. Interviewed ECMC Group and ECMC officials, including ECMC Group’s Controller and ECMC’s Director of Finance, and reviewed written policies and procedures to obtain an understanding and assess the adequacy of ECMC’s policies and procedures for recording and allocating revenues and expenses.
4. Judgmentally selected 13 revenue transactions totaling $27,922,268 from the universe of 1,507 revenue transactions totaling $116,796,348 to determine whether the revenue belonged to the FSB. We used judgmental sampling to select transactions that we considered potentially out of the ordinary and transactions that would provide us with a cross-section of the transaction types. We considered the dollar amount, account category, transaction description, transaction date, and whether the transaction was estimated or actual.

5. Judgmentally selected 30 non-personnel expenditure transactions totaling $1,115,508 from the universe of 4,575 non-personnel expenditure transactions totaling $9,831,392 to determine whether the expenditures benefitted the FSB. We selected transactions that we considered potentially out of the ordinary and transactions that would provide us with a cross-section of the transaction types. We considered the transaction description, dollar amount, and whether the expenditure was recurring or a one-time expenditure.

6. Reviewed timesheets, interviewed employees, and judgmentally selected 10 individuals with personnel costs totaling $188,890 from the universe of 174 individuals and 1 temporary agency (which charged time to FSB-related activities in calendar year 2008) with personnel costs totaling $2,364,651 to determine whether the costs benefitted the FSB and to verify that the work performed was related to the FSB line of business. We selected transactions that we considered potentially out of the ordinary and transactions that would provide us with a cross-section of the transaction types. We considered the dollar amount of personnel costs, number of hours, allocation of hours, and type of employee.

7. Calculated the indirect costs per the cost allocation plan and compared those costs to the actual indirect cost charges to verify ECMC charged the FSB Federal Reserve Fund the correct amount of indirect costs. As part of the review of indirect costs, we gained an understanding of the use of MOP codes. The understanding included the amount of funds allocated through MOP codes and the procedures for requesting, approving, processing, and documenting MOP codes. In addition, we compared the recreated supporting documentation to the allocation percentages used for three MOP codes.

8. Reviewed FSA’s memorandum that cited the amount to be returned (the balance reported on ED Form 2000 as of September 30, 2008) and ECMC’s financial records to verify that ECMC returned the correct amount of funds from the FSB Federal Reserve Fund to the Department in accordance with Section 5.f. of the Agreement.

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7 Employee bonuses and incentives are included in the non-personnel universe.
8 Of the 10 individuals selected, 6 were ECMC employees, and 4 were contractors or temporary employees. We interviewed 4 of the 6 to verify that the work performed benefitted the FSB line of business.
9 For items 4, 5, and 6, because we used non-statistical sampling procedures, there is no assurance that the judgmental samples were representative of the universes described, and they should not be projected over the unsampled amounts.
9. Recalculated the amount of repurchase interest to be deposited in the Guarantor Federal Fund and compared our calculation to the amount of repurchase interest reported on ECMC’s financial documents to verify that ECMC deposited at least 60 percent of the repurchase interest into the Guarantor Federal Fund in calendar year 2008 (repurchase interest is interest accrued on accounts repurchased by lenders).

We relied, in part, on computer-processed financial data from ECMC’s financial system. The computer-processed financial data on which we relied included the full general ledger detail for the FSB and the indirect cost pools and revenue general ledger for the Guarantor Operating Fund. To determine reliability, we applied logic tests to the general ledger detail. In addition, we verified the general ledger detail agreed to the trial balance (that is, balance sheet and income statement). Further, we verified that the trial balance agreed to the annual audit report. We concluded that the computer-processed data were sufficiently reliable for the purposes of our audit.

We conducted our audit from December 2009 through August 2010 at ECMC’s headquarters in Oakdale, Minnesota, and at our offices. We discussed the results of our audit with ECMC officials on April 22 and August 27, 2010.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

**ADMINISTRATIVE MATTERS**

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the OIG. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Department of Education official, who will consider them before taking final Departmental action on this audit:

William J. Taggart  
Chief Operating Officer  
Federal Student Aid  
U.S. Department of Education  
Union Center Plaza, Room 112G1  
830 First Street, N.E.  
Washington, DC 20202
It is the policy of the U. S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be appreciated.

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

Sincerely,

/s/

Gary D. Whitman
Regional Inspector General for Audit

Attachments
### Abbreviations, Acronyms, and Short Forms Used in this Report

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agreement</td>
<td>“Amended and Restated Agreement Between the United States Department of Education and Educational Credit Management Corporation,” dated June 29, 2006</td>
</tr>
<tr>
<td>Calendar year 2007</td>
<td>January 1, 2007, through December 31, 2007</td>
</tr>
<tr>
<td>Calendar year 2008</td>
<td>January 1, 2008, through December 31, 2008</td>
</tr>
<tr>
<td>CAP</td>
<td>Cost allocation plan</td>
</tr>
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<td>C.F.R.</td>
<td>Code of Federal Regulations</td>
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<tr>
<td>COO</td>
<td>Chief Operating Officer</td>
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<tr>
<td>Department</td>
<td>U.S. Department of Education</td>
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<tr>
<td>ECMC</td>
<td>Educational Credit Management Corporation</td>
</tr>
<tr>
<td>ECMC Group</td>
<td>Educational Credit Management Corporation Group, Inc.</td>
</tr>
<tr>
<td>FSA</td>
<td>Federal Student Aid</td>
</tr>
<tr>
<td>FSB</td>
<td>Federal Services Bureau</td>
</tr>
<tr>
<td>HEA</td>
<td>Higher Education Act of 1965, as amended</td>
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<tr>
<td>MOP</td>
<td>Multi organization project</td>
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<td>OIG</td>
<td>Office of Inspector General</td>
</tr>
<tr>
<td>RRMC</td>
<td>Records &amp; Receivable Management Corporation</td>
</tr>
</tbody>
</table>
ATTACHMENT 2

AMENDED AND RESTATED AGREEMENT
BETWEEN
THE UNITED STATES DEPARTMENT OF EDUCATION
AND
EDUCATIONAL CREDIT MANAGEMENT CORPORATION

This Agreement, effective as of the latest date of the signatures below, is between the United States Department of Education (Department) and the Educational Credit Management Corporation (ECMC).

WHEREAS, ECMC is a guaranty agency participating in the Federal Family Education Loan (FFEL or FFELP) Program administered and regulated by the Department under Title IV, Part B of the Higher Education Act of 1965, as amended (HEA), 20 U.S.C. [United States Code] §1071, et seq.; and

WHEREAS, ECMC and the Department are parties to the following agreements: the Agreement for Federal Reinsurance of Loans (dated March 17, 1994); the Agreement Pursuant to Section 428(b) of the Higher Education Act of 1965 as amended, with a State or Private Non-Profit Institution or Organization for Coverage of its Student Loan Insurance Program under the Interest Benefits Provision of Section 428(a) of the Act, dated March 17, 1994; and a Designation Agreement and Amendment to Agreement for Federal Reinsurance of Loans dated June 19, 1996 (collectively called “Original Agreements”); the Agreement (dated January 3, 2001) dealing with additional roles undertaken by ECMC at the request of the Department, as well as changes to ECMC’s financial operations resulting from those additional roles and statutory changes since the Original Agreements (“2001 Agreement”); and a Letter Agreement (dated January 27, 2005) from the Department to ECMC designating ECMC as the Oregon guaranty agency and dealing with related issues (all of the foregoing agreements collectively called the “Prior Agreements”); and

WHEREAS, the Department and ECMC desire to (i) restructure and reaffirm ECMC’s role and responsibilities to “maintain standby capacity” for the Department under the FFEL Program; and (ii) clarify, amend and reconfirm other terms and provisions set forth in the 2001 Agreement; and

WHEREAS, the Department and ECMC desire to restate the amended and revised 2001 Agreement in its entirety as set forth in this Agreement.

NOW THEREFORE, the parties agree as follows:

1. Interpretation. This Agreement shall be construed in the light of, and all terms used herein shall have the same meaning as in the HEA and the regulations promulgated by the Department. ECMC agrees to be bound by and comply with all changes in the HEA or the regulations in accordance with their effective dates.
2. **Other Agreements.** The terms of the Prior Agreements remain in full force and effect unless specified otherwise by this Agreement. The 2001 Agreement is hereby amended and restated in its entirety by this Agreement.

3. **Designated Guaranty Agency.** In accordance with the Prior Agreements, ECMC shall continue as the designated guaranty agency for the states of Virginia and Oregon, unless such designations are terminated by the Department.

4. **ECMC Reorganization to Comply with the 1998 Amendments to HEA.** The Department acknowledges that ECMC reorganized its financial structure to meet the requirements of §§422A and 422B of the HEA as added by the Higher Education Amendments of 1998. In accordance with those requirements, ECMC segregated its operations and financial data into two separate categories: ECMC/the Guarantor and ECMC/the Federal Services Bureau. ECMC/the Guarantor includes all of ECMC’s operations that relate to the performance of functions commonly performed by agencies or organizations acting as guaranty agencies under the HEA. ECMC/the Federal Services Bureau includes all functions or assignments carried out by ECMC at the request of the Department and which the Department has authorized ECMC to finance with ECMC/the Federal Services Bureau Federal Reserve Fund funds. ECMC performs all functions included in both categories, unless expressly noted to the contrary in this Agreement, as a guaranty agency and a fiduciary for the Department and by virtue of its authority as a guaranty agency under the HEA.

5. **Accounts and Funds.** As a result of the restructuring described in Paragraph 4, ECMC agrees to continue to comply with the following requirements:

   a. All revenues and expenses associated with ECMC’s activities as the “designated” guaranty agency for Virginia, Oregon, and any other states for which it is named as the designated guaranty agency in the future by the Department, shall be recorded separately under accounts assigned to ECMC/the Guarantor. The receipt and use of such revenues and the payment of expenses shall be subject to all of the provisions of the HEA and the Department’s regulations governing the funds maintained by guaranty agencies.

   b. Unless otherwise provided in this Agreement or otherwise approved by the Department, the following provisions shall apply to all revenues and expenses associated with the other duties performed by ECMC/the Federal Services Bureau under its agreements with the Department: (i) all revenues shall be recorded separately under accounts assigned to ECMC/the Federal Services Bureau; (ii) ECMC agrees that all such revenues are Federal Funds and shall be available to ECMC solely for the purpose of supporting such duties or expenses as may be assigned or approved by the Department including payment of the fees described in Section 9; and (iii) expenditures from such funds shall be subject to all restrictions imposed by the HEA, the Department’s regulations and other directions provided by the Department.

   c. ECMC/the Guarantor and ECMC/the Federal Services Bureau may jointly use assets or services purchased by either entity provided appropriate, fully documented charges are paid by the using party for such use in accordance with
asset/expense allocation policies and procedures (i) approved and monitored by ECMC’s independent auditors and (ii) approved by the Department. In no case shall the paying party pay more than the actual cost of the asset or service. ECMC has informed the Department that effective January 1, 2006 ECMC purchased from the Federal Reserve Fund, at book value with funds from its Operating Fund, all “shared assets” originally purchased with funds from the Federal Reserve Fund of ECMC/the Federal Services Bureau. ECMC agrees that all future purchases or leases of assets or services which are intended for joint use by ECMC/the Guarantor and ECMC/the Federal Services Bureau will be paid by the Operating Fund, and an appropriate allocation to ECMC/the Federal Services Bureau will be made for the use of such assets or services in accordance with the above-referenced asset/expense allocation policies and procedures.

d. Upon the effective date of this Agreement, (i) the cost of maintaining the facilities for standby capacity for guarantor services shall no longer be assigned to ECMC/the Federal Services Bureau (other than the cost of the guarantor system which shall be governed by the provisions of Paragraph 9.c.(ii)); (ii) the financial concept of “infrastructure costs” previously used by ECMC in accordance with the Prior Agreements to report and allocate such costs shall be discontinued; and (iii) ECMC shall thereafter be entitled to receive the fees referenced in Paragraph 9.

e. ECMC/the Federal Services Bureau shall deposit all gross revenues derived from the processing of borrower payments received while the loan is held by ECMC/the Federal Services Bureau into the Federal Reserve Fund.

f. No later than December 31 of each year, ECMC/the Federal Services Bureau shall return to the Department 100% of the Federal Reserve Fund balance (calculated on an accrual basis as reported on the Department’s Form 2000 as of September 30th of such year). The Department, in its sole discretion and upon notice to ECMC prior to December 31 of each year, may determine that ECMC should transfer less than 100% of the Federal Reserve Fund balance and may designate any remaining amounts as reserve for specific projects to be authorized by the Department during the current or future fiscal years.

6. Administration of Bankruptcy Loan Portfolio; Repurchase Interest. ECMC shall remain responsible for collecting and administering loans on which the borrower has filed a petition for relief under the U.S. Bankruptcy Code. ECMC/the Federal Services Bureau shall be responsible for all aspects of servicing these loans. This responsibility includes, but is not limited to, arranging for a lender to repurchase a loan on which the borrower’s bankruptcy case has concluded and the loan is subject to repurchase. In this situation, ECMC/the Federal Services Bureau shall retain the amount that would otherwise be due to the Department under the Department’s regulations. A new guarantee shall be issued by ECMC/the Guarantor. Upon the effective date of this Agreement, ECMC will thereafter, on an annual phased-in basis, begin treating interest accrued on accounts repurchased by lenders (“Repurchase Interest”) as a Federal asset which shall be deposited into ECMC/the Guarantor’s Federal Fund in 20% increments per year beginning with calendar year 2006, with 20% increases each year thereafter, so that by
calendar year 2010, and for all periods thereafter, 100% of Repurchase Interest will be deposited into ECMC/the Guarantor’s Federal Fund. Correspondingly, beginning with calendar year 2006, Repurchase Interest deposited into ECMC/the Guarantor’s Operating Fund, which is currently 100%, will be reduced 20% per year, so that 80% will be deposited in calendar year 2006 and by 2010, and for all periods thereafter, no Repurchase Interest will be deposited into ECMC/the Guarantor’s Operating Fund. Deposits shall be made in accordance with the following schedule:

<table>
<thead>
<tr>
<th>Effective Date of this Agreement to</th>
<th>% Deposited to ECMC/Guarantor Federal Fund</th>
<th>% Deposited to ECMC/Guarantor Operating Fund</th>
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</thead>
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<tr>
<td>12/31/2006</td>
<td>20%</td>
<td>80%</td>
</tr>
<tr>
<td>1/1/2007 - 12/31/2007</td>
<td>40%</td>
<td>60%</td>
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<td>1/1/2008 – 12/31/2008</td>
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<td>40%</td>
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<td>1/1/2009 – 12/31/2009</td>
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<td>20%</td>
</tr>
<tr>
<td>1/1/2010 and Thereafter</td>
<td>100%</td>
<td>0%</td>
</tr>
</tbody>
</table>

7. Post-Bankruptcy Collections. When administering loans on which a borrower has filed a petition for relief under the U.S. Bankruptcy Code, in instances where the bankruptcy case concluded and the loans were in default at the time the borrower filed bankruptcy, the loans shall be assigned by ECMC/the Federal Services Bureau to ECMC/the Guarantor for post-default collections. After such transfer, ECMC/the Guarantor shall remit to the Department an amount equal to the Secretary’s equitable share of the post-bankruptcy collections as determined in accordance with the Department’s regulations.

8. Existing Assignments to ECMC/the Federal Services Bureau. As of the date of this Agreement, the Department has requested that ECMC/the Federal Services Bureau perform the following roles:

a. Bankruptcy Processing – ECMC is authorized to accept assignment of all FFELP loans on which the borrower has filed a petition for relief under the U.S. Bankruptcy Code. ECMC may accept assignment of a loan in any stage of the bankruptcy process and from any guaranty agency or the Department. ECMC shall fulfill all remaining guaranty agency responsibilities on any loan in this category. ECMC shall deposit any and all payments it receives on such loans while the loans are held by ECMC/the Federal Services Bureau into its Federal Reserve Fund. ECMC is currently developing a new bankruptcy servicing system, which will be paid for and owned by ECMC/the Guarantor’s Operating Fund, and ECMC anticipates the new bankruptcy servicing system will be made available in 2009 to ECMC/the Federal Services Bureau for bankruptcy processing services for a monthly usage fee to be jointly determined by the Department and ECMC prior to October 2008. In addition to the foregoing, the Department has also authorized ECMC to perform certain DSLP bankruptcy servicing.
b. Bankruptcy Litigation – The Department acknowledges that, over the past 10 years in performing its bankruptcy servicing role referenced in subparagraph 8.a, ECMC has developed unique legal expertise and capabilities in defending and promoting the interests of the FFEL Program on a national basis. Subject to applicable law and regulations, ECMC is authorized to continue to take all appropriate action to defend and promote the interests of the FFEL Program on a national basis, including without limitation helping develop a more uniform interpretation and enforcement of the student loan provisions within the U.S. Bankruptcy Code and other applicable laws throughout all jurisdictions in the United States.

c. Maintenance of Standby Capacity – ECMC is directed to maintain standby capacity sufficient to ensure that it can assume responsibility for maintaining access to FFEL Program loans in any state where the current guarantor ceases to provide such access. The financial and other terms regarding ECMC’s performance of this role are set forth in Paragraph 9.

d. Inactive Portfolio Maintenance – ECMC shall maintain and provide access to, in accordance with the HEA and applicable regulations, the student loan records of the former Higher Education Assistance Foundation (HEAF), the former Virginia Guarantor (SEAA), the former Oregon Guarantor (OSAC) and any other guarantors for which ECMC assumes responsibility in the future. ECMC shall ensure that the records are maintained on a system that allows rapid retrieval of individual files. ECMC agrees to respond to requests for information from borrowers of loans previously guaranteed by inactive guarantors, lenders and other parties authorized to access borrower records.

e. Bankruptcy Processing for Non-Assigned Loans – The Department and ECMC have agreed that ECMC should have responsibility for processing documents on the Department’s system which support bankruptcy-related transactions of the Department for FFELP and other loans held by the Department as provided in Appendix A to this Agreement. The Department agrees that ECMC shall have access to all data maintained by the Department relating to these loans for use in processing these transactions.

f. Interim Guarantee Processing Assignments – The Department and ECMC agree that ECMC will provide interim guarantee processing support to the Department, at the Department’s request, in any instance where the Department requires short-term assistance delivered on an accelerated basis.

g. Special Guarantor Assignments – ECMC agrees to provide the Department such assistance as the Department may request from time-to-time in analyzing processing or reporting issues which arise at other guaranty agencies or program participants.

h. Administrative Wage Garnishment – ECMC agrees to provide administrative hearing services to guaranty agencies, collection agencies and other entities and shall establish an appropriate fee structure for such services.
The parties agree that ECMC may pay the costs of conducting the tasks listed in this Paragraph from the ECMC/the Federal Service Bureau’s Federal Reserve Fund, other than the role of maintaining standby capacity which shall be governed by the provisions of Paragraph 9. ECMC shall maintain accounting records of sufficient detail to allow periodic review of the costs associated with each task by the Department, the Department’s Office of Inspector General or any other authorized entity.


a. The Department may ask ECMC to assist or assume the responsibilities for an insolvent or otherwise failing guarantor. ECMC agrees that it will agree to the Department’s request unless such action would significantly interfere with the performance of its other responsibilities under this Agreement or have a significant negative effect on ECMC’s financial stability. The Department directs ECMC that, in performing its role under this provision, ECMC shall have three primary objectives:

(i) Ensuring the continuing availability of all FFELP services to the students, schools, and lenders in the guarantor’s service area;

(ii) As directed by the Department, protecting the Federal fiscal interest by securing the guarantor’s assets to ensure their proper use and ultimate disposition per a plan approved by the Department; and

(iii) Ensuring maintenance of program integrity and continued compliance with applicable provisions of the HEA and applicable regulations.

ECMC acknowledges that its efforts towards realizing the above objectives must be as sensitive to the concerns of the guarantor’s various stakeholders as circumstances permit.

b. A listing of specific issues and actions which ECMC may need to address in any engagement under Paragraph 9 follows. The listed actions are intended to promote one or more of the objectives referenced in subparagraph 9.a. The parties agree that this list is not exhaustive and that ECMC will take any and all actions necessary to achieve the Department’s objectives identified in subparagraph 9.a. and in accordance with the Department’s directions.

(i) Ensuring continuing availability of guarantor services to borrowers, schools, and lenders via temporary maintenance of the guarantor’s existing guarantee system pending conversion to ECMC’s system;

(ii) Ensuring continuing provision of default aversion services to lenders;

(iii) Ensuring continuing proper review and timely payment of lender claims;

(iv) Timely conversion of the guarantor’s database to ECMC’s systems to support on-going provision of the above and other guarantor services;
(v) Full review of the guarantor’s financial records and current financial position, followed by development of a transition plan for Department review and approval;

(vi) Ensuring continuing post-default collections efforts pending integration of the guarantor’s portfolio into ECMC’s collections program;

(vii) Full review of the guarantor’s contractual obligations, followed by timely modification or termination of all contracts where appropriate;

(viii) Rapid development of a plan for on-going operations after the transition period so that such plan can be communicated to all of the guarantor’s stakeholders as soon as possible;

(ix) Implementation of a communications program designed to provide all stakeholders as much information as rapidly as possible as to what is being done and why; and

(x) Review of all Federal reporting requirements to ensure that such reporting is maintained as accurate and timely as Department and ECMC standards require.

c. In consideration for ECMC’s performance of its duties and responsibilities under this Paragraph 9, ECMC shall receive the following fees:

(i) an annual fee for the 12-month period October 1 to September 30, payable in advance on October 1 of each year, equal to $1,305,500 (“Standby Capacity Fee”) to compensate ECMC for (1) all personnel costs, (2) “know-how” and capacity developed and maintained by ECMC and (3) all ordinary and necessary expenses incurred by ECMC to perform its duties and responsibilities under this Paragraph 9. For the current period, the Standby Capacity Fee will be prorated from the effective date of this Agreement to September 30, 2006, and shall be payable in advance on the effective day of the Agreement; and

(ii) a guarantor systems fee (“Guarantor Systems Fee”), payable monthly determined as follows:

(1) Until ECMC has successfully implemented a new guarantor system (EPIC I) currently under development, which is expected to be completed by January 31, 2008, the Guarantor Systems Fee shall equal the actual costs of maintaining and operating the current GSII system in accordance with the existing cost methodologies and procedures used under the Prior Agreements and the Operating Fund shall continue reimbursing the Federal Reserve Fund a monthly fee of $35,000; and

(2) Upon the successful implementation of EPIC I, the Guarantor Systems Fee shall be an amount equal to $81,000 per month.

All such fees shall be payable by transfers from ECMC/the Federal Services Bureau’s Federal Reserve Fund to ECMC/the Guarantor’s Operating Fund.
d. All ordinary and necessary expenses incurred by ECMC in connection with the performance of its duties and responsibilities under this Paragraph 9, shall be paid for by ECMC out of its Operating Fund. The Department and ECMC agree that the following expenses arising out of or related to the performance of its duties and responsibilities under this Paragraph 9 shall not be considered “ordinary and necessary” expenses under this Paragraph 9 and shall not be required to be paid for by ECMC without its express written agreement: (1) litigation expenses of any type; (2) employment expenses, liabilities or claims owing by the subject guaranty agency; (3) expenses, obligations or liabilities of the subject guaranty agency owed to third parties (including the Department and any governmental entity); (4) contingent liabilities; and (5) other extraordinary expenses as may be identified in the transition.

10. Assignment of Additional Duties to ECMC/the Federal Services Bureau. In addition to the tasks listed in Paragraph 8, the Department may request that ECMC assume additional tasks.

a. Without limitation on the Department’s authority to request ECMC to take on additional tasks under this Agreement, the Department and ECMC acknowledge that the following are potential topics for additional assignments:

   (i) ECMC may be authorized to provide certain processing services to the Direct Student Loan Program provided such services justify ECMC receiving fee revenues from DSLP funds sufficient to provide for the full cost of such services. ECMC may be authorized to utilize FFELP resources to finance the initial costs of providing such services but must repay such initial start-up costs from fee revenues within a reasonable period of time.

   (ii) ECMC may be called upon to provide guarantor specific technical services to the Department, including use or access to ECMC’s Financial Analysis & Planning (FAPS) tools.

   (iii) ECMC may be called upon to provide interim guarantor services in a state during an interval of time while the Department crafts a permanent solution to whatever circumstances must be addressed in that state.

   (iv) ECMC may be called upon to assume custody of an existing guarantee portfolio in a state where provisions of new, future guarantees have been assigned to one or more other guarantors.

   (v) ECMC may be authorized to provide certain processing services to other guarantors and/or the Department in such instances as where the Secretary determines that assigning such services to ECMC shall result in an effective and efficient process.

   (vi) ECMC may be called upon to take on specific, limited scope, limited timeframe projects on behalf of the Department such as review of a FFELP participant’s computer systems or procedures.
(vii) ECMC may be called upon to assist the Department in other projects within
the FFEL Program as determined from time to time by the Department.

11. ECMC Proposals. ECMC may propose additional work assignments based on its analysis of
the benefits that may be provided to the FFELP. However, ECMC shall not initiate or
implement any new projects for ECMC/the Federal Services Bureau without the written approval
of the Department.

12. Revenues and Expenses for ECMC/the Federal Services Bureau. Unless otherwise specified
in this Agreement or as approved by the Department, all funds generated by ECMC/the Federal
Services Bureau shall be deposited in accounts identified as including Federal Funds and any
investment earnings shall be credited to those accounts. All expenses associated with the duties
assigned to ECMC/the Federal Services Bureau shall be paid from the accounts described in this
paragraph. All expenditures shall comply with the restrictions imposed on the use of Federal
Funds by the Department’s regulations and guidance to ECMC.

13. Acknowledgment of Reorganization. The Department acknowledges that it has been
informed that ECMC has reorganized and restructured its corporate structure under a
501(c)(3) tax-exempt holding company, ECMC Group, Inc., and that the new structure
includes affiliated for-profit entities, as well as ECMC Foundation, a 501(c)(3) tax
exempt foundation. ECMC shall ensure that the reorganization will be consistent with
ECMC’s fiduciary obligations to the Department and will ensure that Federal funds are
not used to support activities not authorized by the Original Agreements or this Revised
Agreement.

14. Cost Allocations. ECMC shall ensure the allocation of costs between ECMC/the Guarantor,
ECMC/the Federal Services Bureau and any other affiliated entities. ECMC shall maintain a
cost allocation plan which has been approved by its independent auditors and the Department.
The cost allocation plan shall be reasonable, defensible, consistent in its application, determined
in accordance with generally accepted accounting principles, and be adequately documented.
The cost allocation plan shall allow for the application of direct costs and indirect costs. Direct
costs include but are not limited to salaries, postage, printing, and travel, and shall be charged
directly to benefiting projects. Indirect costs such as fringe benefits and facilities, including but
not limited to general supplies, depreciation and rent, shall be allocated to all projects based on
total salaries. Administrative costs, including but not limited to human resources, accounting,
internal audit, corporate legal, and information technology support, shall be allocated to all
projects based on the total cost of the projects. ECMC shall review the cost allocation plan
annually and modify the plan as necessary, provided that any material modifications shall be
approved by its independent auditors and the Department. On an annual basis, ECMC shall
provide the Department with a cost allocation report from ECMC’s independent auditors.
ECMC shall maintain appropriate records reflecting the basis for the cost allocation plan and
shall provide such records to the Department at its request.

15. Access to Records. ECMC shall provide the Department or its representatives with
full and complete access to all records relating to ECMC’s performance of its obligations
under the Original Agreements or this Agreement or its receipt or use of Federal Funds.
IN WITNESS WHEREOF, this Agreement has been executed by the duly authorized official of ECMC and, on behalf of the Department, by the duly authorized official.

Educational Credit Management Corporation

By: _____ Richard Boyle /s/ __________
Title: __President/CEO___________
Date: ____June 29, 2006___________

United States Department of Education

By: ______ Matteo Fontana /s/ ________
Title: ___General Manager__________
Date: ____June 29, 2006___________
ECMC Group Corporate Structure

ECMC Group

501(c)(3)
Each member of the Board of Directors is a member of the corporation

Business Line
Parent company
Eligible Lenders Trust

ECMC Foundation

501(c)(3)
Sole member is ECMC Group, Inc.

Business Line
Charitable services

ECMC

501(c)(3)
No members

Business Line
Guarantor
Federal Services Bureau

ECSC

For-profit
100% owned by ECMC Holdings Corporation

Business Line
Non-operating holder of private student loan portfolio

RRMC

For-profit
100% owned by ECMC Holdings Corporation

Business Line
Document management services

PREMIERE CREDIT

For-profit
100% owned by ECMC Holdings Corporation

Business Line
Collection agency
### Table 1: RRMC Receivable Due to the FSB Federal Reserve Fund

*Note: Prepared by ECMC and audited by OIG*

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<th>Month</th>
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<th>Interest Due**</th>
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Table 1: RRMC Receivable Due to the FSB Federal Reserve Fund  
Note: Prepared by ECMC and audited by OIG*

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<th>Month</th>
<th>Ending Balance of Receivable</th>
<th>Interest Due**</th>
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<td>October-2008</td>
<td>270,543.76</td>
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<td>214,168.01</td>
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<td>December-2009</td>
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<td><strong>Total</strong></td>
<td><strong>$72,454.24</strong></td>
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</table>

* The full spreadsheet is not included; we deleted some columns.  
**ECMC calculated the interest by multiplying the five-year constant maturity treasury rate plus 1 percent by the average monthly balance of the receivable.
November 4, 2010

Mr. Gary D. Whitman  
Regional Inspector General for Audit  
U.S. Department of Education  
Office of Inspector General  
500 West Madison Street, Suite 1414  
Chicago, IL 60661

Re: Draft Audit Report: Educational Credit Management Corporation’s Compliance with Its 2006 Agreement with the United States Department of Education, Control No. ED-OIG/A05K0001

Dear Mr. Whitman:

Thank you for providing Educational Credit Management Corporation (“ECMC”) the opportunity to respond to the findings and recommendations of the referenced draft audit report. ECMC values its reputation for conducting all of its activities in a manner that fully complies with the provisions of law, regulations and guidance from the U.S. Department of Education (Department). We also recognize the importance of ECMC’s complete and full compliance with all of the provisions of our 2006 Agreement with the Department.

The draft audit report includes findings concerning two issues: ECMC’s use of a “Federal Clearing Account” and ECMC’s cost allocation process. The report outlines eight recommendations for measures ECMC should adopt to correct the problems discussed by the two findings.

ECMC’s response to the draft audit report can be summarized as follows.

1. ECMC will implement all eight of the recommendations of the draft audit report in the manner and within the timeframe discussed below.
2. ECMC has already addressed the “Federal Clearing Account” issue in a decisive manner which will prevent any future instances of inadvertent, temporary use of federal funds to fund non-federal activities.
3. ECMC will substantially exceed the scope of the recommendations related to ECMC’s cost allocation procedures by developing and implementing a new, enhanced cost allocation process, including new internal controls, documentation and related policies and procedures.
4. While ECMC will proceed as outlined above to definitively resolve all issues raised by the draft audit report to the satisfaction of the Department, we feel compelled to take this opportunity to respectfully but firmly disagree with certain assertions in Finding #1.
A more detailed discussion of each of the above four areas follows:

**Implementation of the Eight Recommendations**

ECMC will proceed promptly to fully implement all eight of the draft audit report’s recommendations within the time frames and in the manner indicated below. All actions taken to implement each of the eight recommendations will be reported to the Department in a timely manner.

- **Recommendation 1.1—Use the Federal Clearing Account only for the ECMC lines of businesses (FSB and Guarantor) and only for purposes allowed in the HEA and regulations.**

  ECMC has already implemented this recommendation. In March 2008 ECMC transferred the “check clearing account” function out of the Federal Clearing Account and into the Guarantor Operating Fund. As a result of this transfer, since March 2008 the Federal Clearing Account (1) has only served as an account to clear “revenue receipts” for ECMC and to transfer the receipts to the appropriate fund or account and (2) has not had any responsibility for the payment of any expenses. In early November 2010 the check clearing account function (as it relates to all non-ECMC expenses) was transferred to a bank account maintained by ECMC Group, Inc.

- **Recommendation 1.2—Develop procedures to ensure that ECMC used FSB revenues only for allowable FSB-related activities; and**

- **Recommendation 1.3—Review all expenses charged to the FSB since ECMC segregated its operations, make appropriate adjustments if expenditures did not benefit the FSB line of business, and have its independent public accounts attest to the results.**

  ECMC will retain the services of an independent certified public accounting firm (that does not audit ECMC’s financial statements) to assist ECMC in implementing a comprehensive response to fully comply with each of these recommendations. That firm will have extensive experience in cost accounting and cost allocation methodologies and will conduct the above-mentioned development of new procedures (Recommendation 1.2) and the expense review (Recommendation 1.3). The firm will also assist us with recommended enhancements to our cost allocation plan and processes, including process improvement, internal controls, documentation, and related policies and procedures. A report of that firm’s findings, proposed enhancements, adjustments and recommendations, as well as any recommended corrective account, will be provided to the Department no later than June 30, 2011.

  We should note that we have been informed that under applicable professional accounting standards an independent accounting firm cannot “attest” to the results of their review. We trust that our proposed alternative approach (i.e., providing a copy of the report to the Department for review and comment before any changes are made) will provide appropriate assurances of the comprehensiveness and completeness of this independent review.
We should also note that the expense review will be implemented to the extent that detailed source documents (invoices, general ledger entries, etc.) are available. ECMC’s records retention policies, which have been previously furnished to the Department, will limit the period for this review to dates beginning on or after January 1, 2006.

- Recommendation 2.1—Include in the CAP a detailed explanation of the basis for its cost allocations under the MOP code and case-by-case methods;
- Recommendation 2.2—Retain supporting documentation of the cost allocation percentages established for the MOP code and case-by-case methods;
- Recommendation 2.3—Submit all modifications of the CAP to the Department for approval;
- Recommendation 2.4—Submit the annual cost allocation report to the Department; and
- Recommendation 2.5—Return funds to the FSB Federal Reserve Fund if unallowable costs or overcharges are indentified based on implementation of recommendations 2.1 through 2.4.

All five of the recommendations resulting from Finding #2 will also be implemented by June 30, 2011. This time frame is necessary because ECMC intends to retain the services of the above-referenced independent certified public accounting firm to assist ECMC in developing appropriate modifications to our cost allocation plan, including documentation, process modifications and strategies to fully implement all of the recommendations of Finding #2. Once developed, the proposed modifications to our cost allocation plan, and any required remedial actions, will be submitted to the Department for any suggested enhancements before the modified plan is implemented.

Resolving Federal Clearing Account Issues

As indicated in the discussion of Recommendation 1.1 above we believe that the underlying issues associated with a “clearing account” have been resolved in a definitive manner. All that remains to be done is to thoroughly review past transactions and implement any corrective adjustments required.

Implementing Enhanced Cost Allocation Procedures

As indicated in the discussion of Recommendations 2.1 to 2.5 above ECMC intends to invest the time and resources necessary to ensure ECMC has a best-in-class cost allocation process which fully meets with the approval of the Department. Moreover, ECMC will insure that any future modifications to that process are implemented only after appropriate review and approved by the Department.

ECMC’s Disagreement with Certain Assertions in Finding #1

While ECMC is committed to taking all of the corrective actions recommended with regard to Finding #1, we must respectfully disagree with certain key elements of Finding #1—that “FSB Supported Activities Not Authorized by the Agreement.” Specifically, Finding #1 asserts or suggests that ECMC: (i) structured its check clearing account process to gain use of FSB funds for non-FSB expenditures; (ii) improperly used FSB funds, resulting in a loss to the FSB Federal
Reserve Account; (iii) used the Federal Clearing Account in a manner which exposed the government to unnecessary risk; and (iv) used its Operating Fund in an inappropriate manner to pay for expenses of for-profit affiliates.

We strongly disagree with each of these assertions and suggestions. We believe the draft Finding #1 is primarily the result of our failure to properly explain to the OIG how the “check clearing account” function within the Federal Clearing Account actually operated in practical terms during the period that the draft audit report covered. The following discussion provides a more accurate portrayal of these matters.

Prior to March 2008, the Federal Clearing Account, which was an account within the FSB, performed two distinct “clearing” functions: [1] a revenue receipts clearing function (i.e. sorting out checks and wire transfers received by ECMC and transferring the revenues to the appropriate ECMC fund or account) and [2] a check clearing function (described below). In March 2008 the checking clearing function was transferred to ECMC’s Operating Fund and the Federal Clearing Account thereafter ceased to perform any check clearing, check writing or expense payment function. The check clearing account—both while it resided within the Federal Clearing Account (i.e. prior to March 2008) and after the account was transferred to the Operating Fund—has never operated as a normal “checking account” funded by FSB resources—as the OIG suggests. ECMC did not intentionally use the check clearing account to fund non-FSB business lines with FSB funds. Rather, the check clearing account was funded via transfers from a variety of sources and business units, which were responsible for some share of specific expenses. That there were instances where the required transfers were not made in a timely manner, or where an erroneous allocation was made, was not reflective of any attempt to utilize FSB resources improperly. [Please see attached Addendum for a more detailed explanation of how the check clearing account has operated during several time periods.]

The two expense transactions cited in Finding #1 (ABA fees and professional liability insurance premiums) represent an immaterial percentage of the thousands of transactions processed by ECMC each year. These cited expense transactions, which resulted in the misallocation of relatively immaterial amounts, were clearly due to human error. The other expense transaction cited (RRMC payable) was the result of an inadvertent oversight by management to pay an amount owing to the FSB from an affiliated for-profit entity. This non-payment was not due to an intentional decision to have the FSB finance the payable. In our view, these three expense transactions cited by Finding #1 do not undermine the integrity or effectiveness of our cost allocation plan. In any event, we are confident that the results of the FSB expense review contemplated by Recommendation 1.3, which ECMC has agreed to have performed by an independent certified public accounting firm, will fully address any concerns about potential misallocations of expenses to the FSB.

Finally, ECMC disagrees with the conclusion in Finding #1 that the check clearing account’s operation has resulted in an inappropriate use of the Guarantor Operating Fund under 34 C.F.R. § 682.423(c), because ECMC allegedly used the Operating Fund as a “checking account” for certain for-profit affiliated lines of business. First, as discussed above, this allegation is based on a misunderstanding of how the check clearing account functioned. The check clearing account was not used as a “checking account” to pay expenses for for-profit affiliated businesses out of FSB funds. Rather, all for-profit affiliated businesses are responsible for their respective share of expenses and pay their share out of their own resources. Second, to the extent the Operating
Fund may have temporarily financed any portion of expenses owing by an affiliated for-profit business, we believe such financing activity was an “investment” activity—permitted under § 422B of the Higher Education Act of 1965, as amended (20 U.S.C.A. §1072b(b). All direct or indirect support by ECMC with respect to for-profit affiliated entities, including financings, has been conducted pursuant to “prudent investor standards” as permitted by law. Nonetheless, in order to avoid any continuing concern, ECMC has recently restructured the check clearing account function (as it relates to the payment of expenses for for-profit affiliated entities) by moving this function out of the Operating Fund and to a bank account maintained by an affiliated corporate entity.

We welcome the opportunity to meet with you in person concerning our response to the draft audit report and answer any questions you might have concerning how the check clear account has functioned during the audited period, how our cost allocation plan has been designed and implemented and what corrective action and improvements ECMC is undertaking in response to the OIG recommendations.

If you have any questions, please contact me at 651-325-3353 or Steven A. Wellvang, our General Counsel, at 651-325-3050.

Sincerely,

/s/

Richard J. Boyle
President & CEO
ECMC Group, Inc.
APPENDIX
ECMC Group’s Clearing Process

A. Overview

ECMC Group is organized to maximize the efficiencies from the sharing of various routine specific services and overhead costs. As a general rule all expenses that can be clearly attributed to a single ECMC Group company are paid directly by that company from its own checking account.

For expenses split between two or more ECMC Group companies that can be immediately allocated (per an established allocation formula), each impacted company is required to transfer funds to a clearing account on the same day a check is issued to a vendor or supplier.

Some expenses are, however, allocated to the Group’s companies at the end of each month. This approach is used to allocate expenses when the allocation is based on variables that change from month-to-month. Such expenses are paid from the clearing account and then charged back to the individual companies.

B. Expense Payment and Check Clearing Process Prior to March 2008

Prior to March 2008, ECMC Group managed the payment of its expenses in the following manner.

Direct Expenses

- All expenses that could be clearly identified as belonging entirely to a specific company (other than ECMC/GA or ECMC/FSB) were paid directly from that company’s checking account.
- ECMC itself, however, had a single checking account—the Federal Clearing Account—that was used to pay both ECMC/GA and ECMC/FSB expenses. That account was classified as a “federal” account because a portion of the funds that flowed through the account were federal funds.
- On the same day the Federal Clearing Account (described above) issued a check on behalf of direct expenses attributable to ECMC/GA or ECMC/FSB it was immediately reimbursed (via bank transfer) from either ECMC’s Guaranty Agency Operating Fund or ECMC/FSB’s Federal Reserve Fund investment account.

Shared Expenses

- Shared services expenses include two categories of expenses:
o Expenses whose composition can be clearly identified (and immediately allocated among) two or more companies but the expenses were billed on a single invoice by the supplier or vendor.

o Expenses of a general nature (e.g. facilities services) that need to be allocated among the various companies on a monthly basis per various formulae designed to utilize changing variables such as payroll costs.

- Invoices received for the first category were paid from the Federal Clearing Account if one of the entities identified in the allocation were ECMC/GA or ECMC/FSB. If the entities identified were neither ECMC/GA or ECMC/FSB, the expenses were paid from one of the respective entity's checking account.

- Invoices received by ECMC for the second category of shared services expenses were paid from the Federal Clearing Account.

- The Federal Clearing Account was funded in the following manner.
  - For invoices where a clear, constant cost allocation could be applied ECMC/GA and/or ECMC/FSB made their pro-rata deposits to the clearing account on the same day a check was issued by the account to pay an invoice.
  - To provide funding for those expenses including those ultimately attributable to ECMC's affiliated companies for which the clearing account would not receive reimbursement until the month end allocation process ECMC/GA’s Operating Fund advanced the Clearing Account $750,000 per week.

C. What Changed After March 2008

On March 1, 2008, ECMC transferred the “check clearing” function from the Federal Clearing Account and to the Guaranty Agency Operating Fund. After that date, ECMC began using its Guaranty Agency Operating Fund checking account to issue payments on behalf of ECMC/GA’s Operating Fund. Multi-entity shared service expenses are paid from this checking account in ECMC’s Guaranty Agency Operating Fund. Direct costs continue to be paid directly by the individual companies. The Federal Clearing Account remains within the FSB/Federal Reserve but now only clears deposits and no longer issues checks.

The above change ensures that if there is any float required or if one of the affiliated companies does not pay its share of allocated shared services expenses in a timely manner, the consequences of such an occurrence fall entirely to ECMC/GA’s Operating Fund, not to ECMC/FSB’s Federal Fund.

D. Future Actions

ECMC is prepared to further adjust/revise the expense allocation and payment process to fully address any additional concerns the OIG or FSA may have.