May 15, 2013

FINAL ALERT MEMORANDUM

To: James W. Runcie  
Chief Operating Officer  
Federal Student Aid

From: Patrick J. Howard /s/  
Assistant Inspector General for Audit

Subject: Federal Student Aid Paid Private Collection Agencies Based on Estimates  
Control Number ED-OIG/L02N0002

The purpose of this final alert memorandum is to inform you of our concern that Federal Student Aid (FSA) paid estimated commissions and bonuses to Private Collection Agencies (PCAs) because of system modification delays with the Debt Management and Collection System 2 (DMCS2). FSA was unable to calculate the actual commissions earned by PCAs and the Competitive Performance and Continuous Surveillance (CPCS) scores used to calculate PCA bonuses. As a result, FSA paid an estimated $448 million in commissions, without reviewing supporting documentation, and paid an estimated $8.3 million in bonuses based on a revised methodology. FSA’s revised methods for paying commissions and bonuses may have resulted in overpayments or underpayments to the PCAs.

During fiscal year (FY) 2012, FSA had individual contracts with 23 PCAs to perform collection services on defaulted loans. According to the contracts, PCAs are paid commissions based on successfully collecting on defaulted loans, and a PCA qualifies for bonuses based on its performance relative to other PCAs. Section B.8 of the PCA contracts states that FSA is to prepare and submit invoices and supporting documentation to the PCAs for review in order for FSA to pay the PCAs. Before FSA transitioned to DMCS2 in September 2011, FSA prepared invoices using collection data from the Debt Management and Collection System (DMCS) to calculate commissions for PCAs and used various other DMCS data to calculate CPCS scores to determine bonuses for qualifying PCAs. However, DMCS2 has been unable to produce the data necessary for FSA to calculate PCA commissions based on actual collections data and PCA bonuses based on actual CPCS scores. Therefore, during FY 2012, FSA staff modified the contract to (1) require PCAs to submit to FSA invoices, without supporting documentation, that calculated estimated commissions and (2) pay estimated bonuses based on bonus payments made

1 CPCS scores are calculated based on performance indicators related to the borrower payments received, the number of accounts that were serviced, and the amount of administrative resolutions performed.
for the prior year. As of February 20, 2013, DMCS2 is still unable to provide accurate data to calculate PCA commissions and bonuses based on CPCS scores, and FSA has been unable to provide us with a formal plan containing sufficient details as to how and when it will resolve the DMCS2 data problems.

**FSA Paid Estimated Commissions**

Due to issues with DMCS2, FSA instructed all PCAs to prepare and submit invoices for estimated commissions without providing supporting documentation. FSA has been unable to determine the amount to invoice PCAs for commissions since September 2011. During FY 2012, the director of the Default Division e-mailed the PCAs monthly instructions to create and submit their invoices. In these e-mails, the PCAs were instructed not to submit supporting documentation to FSA but were required to maintain documentation supporting the estimated invoices the PCAs calculated. According to FSA officials, the PCAs were to submit invoices, with estimated commission calculations, based on data the PCAs maintained and incomplete collection data FSA provided. This revised methodology differs from section B.8 of the contracts, which requires FSA to prepare and provide invoices to the PCAs with calculated commissions.

The Department’s Directive on Contract Monitoring,\(^2\) Section VII.O, states that contracting officers approve invoices for payment, usually after an analysis concerning the contents of the invoice and the contractor’s performance relative to what is being billed. Because FSA did not require the PCAs to submit supporting documentation with their invoices, FSA was unable to ensure invoices, totaling $448 million, were acceptable before payment. FSA performed no oversight before paying PCA invoices to determine whether the PCAs had overstated or understated their estimated commissions. Consequently, FSA must address any overpayments or underpayments of invoices for estimated commissions.

Effective February 1, 2013, FSA issued a formal contract modification to section B.8, stating that the PCAs are to prepare and submit invoices, with supporting documentation, to FSA in order to be paid their commissions. However, as of February 20, 2013, PCAs were still submitting estimated commissions without supporting documentation, and FSA had not finalized a process to reconcile prior estimated commission amounts paid with actual collection data from DMCS2.

**FSA Paid Estimated Bonuses**

Due to data issues with DMCS2, FSA was unable to calculate actual CPCS scores to determine which PCAs earned bonuses during FY 2012. FSA then modified 12 of 23 PCA contracts to pay bonuses based on prior quarters’ bonus payments instead of the quarters’ actual CPCS scores. The remaining 11 PCAs did not receive a notification of the revised process because they did not receive a bonus in these prior quarters. This revised process modified section H.6 of the contracts, which stated that bonuses would be paid based on a PCA’s CPCS scores during the current quarter. FSA and the 12 PCAs agreed to the revised process of awarding bonuses with a provision that any bonus overpayments would have to be returned. For quarters 8, 9, and 10 of the contract, FSA awarded the same bonus amounts to the same PCAs as in quarters 5, 6, and 7, respectively, despite not knowing how their performance compared with the other PCAs in

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quarters 8, 9, and 10. See Table 1 for total amount of bonuses paid to the PCAs by quarter. Bonuses for quarters 8, 9, and 10 were paid in September 2012 and October 2012 invoices.

<table>
<thead>
<tr>
<th>FY 2011 Quarters</th>
<th>For Quarter Ending</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>March 31, 2011</td>
<td>$2,450,461.47</td>
</tr>
<tr>
<td>6</td>
<td>June 30, 2011</td>
<td>$2,531,797.68</td>
</tr>
<tr>
<td>7</td>
<td>September 30, 2011</td>
<td>$3,313,947.89</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$8,296,207.04</td>
</tr>
</tbody>
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</tr>
</tbody>
</table>

The process FSA used to pay estimated bonuses may have resulted in (1) overpayments or underpayments to PCAs that received an estimated bonus, (2) some PCAs that earned a bonus but not awarded an estimated bonus payment, and (3) some PCAs that received the estimated bonus payments may not have been entitled to the bonus payment. Therefore, FSA will have to resolve any overpayments or underpayments of bonuses.

Effective December 31, 2012, FSA issued a formal contract modification to revise its methodology of calculating CPCS scores to determine the final FY 2012 PCA bonuses. FSA calculated CPCS scores using its revised methodology but has not finalized PCA bonus payments for FY 2012 because of data issues with DMCS2. FSA plans to revert to the contracts’ original methodology for calculating CPCS scores and bonuses for FY 2013. However, FSA has not calculated CPCS scores or awarded bonuses for FY 2013 due to continued data issues with DMCS2.

Because FSA paid $448 million in PCA estimated commissions without supporting documentation and $8.3 million in estimated bonuses without knowing actual quarterly CPCS scores, FSA may have created liabilities due to or from the Department after final commissions and bonuses are determined. Therefore, FSA will have to resolve any overpayments or underpayments of estimated commissions and bonuses.

**Recommendations**

We recommend that the Chief Operating Officer for FSA:

1.1 Require FSA to calculate any overpayments or underpayments of PCA commissions and bonuses based on actual collections data and CPCS scores and require PCAs to return any overpayments, with applicable interest, to the Department. Likewise, FSA should address any underpayments made to the PCAs.
1.2 Require PCAs to submit supporting documentation for all commissions invoiced since October 2011.

**FSA Response**

We provided a draft of this alert memorandum to FSA for comment. In its response, dated April 10, 2013, FSA stated that it shares our concerns and is committed to resolving the problems with the DMCS2 invoice process. FSA stated it is in the process of addressing each recommendation. However, FSA believes that the alternative invoice process in place since DMCS2 was implemented has reduced the risk of significant underpayments and overpayments and will ensure that all payments to PCAs are ultimately reconciled and adjusted as needed. In addition, FSA stated that commission payments were based on actual collection data from the Department of Treasury. The collection data was posted to the borrower’s account in DMCS2. DMCS2 generates a daily file, which is provided to the PCAs, containing the collection payments allocated to collection costs, interest, and principal.

In response to Recommendation 1.1, FSA stated that CPCS scores for FY 2012 have been calculated and validated, and the bonus payment calculation for FY 2012 is in process. In addition, appropriate adjustments will be calculated in April 2013 and PCAs will reimburse the Department, with interest, for any overpayments.

In response to Recommendation 1.2, FSA stated that PCAs were required to keep all supporting documentation for invoices the PCAs created. When the DMCS2 invoice reporting is functional for the periods of October 2011 through March 2013, DMCS2 will provide invoice reports to the PCAs that will allow the PCAs to ensure each invoice matches the data within DMCS2. FSA will maintain documentation on the results of the reconciliations.

We included FSA’s response in its entirety as an attachment to this memorandum.

**OIG Comments**

In response to our finding that commission payments were based on estimates, FSA stated that commission payments were based on actual collection data from the Department of Treasury. However, the Department of Treasury data has to be loaded into DMCS2 in order to allocate collection detail that PCAs can use to develop invoices. The resulting daily file from DMCS2 was incomplete because some collections were not being accepted by DMCS2. FSA has noted that the PCA invoice reporting function was one of the non-functioning areas of DMCS2. Since complete collection data was not available and because DMCS2’s invoice reporting function was not working, FSA has instructed PCAs to estimate their commissions earned for the period October 2011 through March 2013 using the detailed collection data on their system.

We considered FSA’s comments to be responsive to our recommendations. However, FSA described many of its corrective actions as in progress or subject to future completion. FSA stated that bonus payments and appropriate adjustments would be calculated in April 2013. However, as of April 30, 2013, FSA has not calculated the final FY 2012 bonus payments and adjustments. In addition, FSA expects that the reconciliation process will be performed by the
PCAs, however FSA did not provide a date regarding when the reconciliation process will be completed. When DMCS2’s invoice reporting is functional, FSA stated that the invoice report will allow them to ensure each invoice matches DMCS2 data. However, FSA had not established a date when DMCS2’s invoice reporting will be functional. While the invoice reporting process is not functional, the PCAs will have to continue submitting estimated invoices. Therefore, FSA should require PCAs to submit supporting documentation and FSA should review such documentation before paying monthly invoices.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department’s Audit Accountability and Resolution Tracking System.

This alert memorandum issued by the Office of Inspector General will be made available to members of the press and the general public to the extent information contained in the memorandum is not subject to exemptions in the Freedom of Information Act (5 U.S.C. § 552) or protection under the Privacy Act (5 U.S.C. § 552a).

We conducted our work in accordance with the Office of Inspector General quality standards for alert memorandums.

For further information, please contact Daniel P. Schultz, Regional Inspector General for Audit at (646) 428-3888.

cc: Philip H. Rosenfelt, Acting General Counsel, Office of the General Counsel
    Dawn Dawson, Audit Liaison Officer, Federal Student Aid
    W. Christian Vierling, Director, Student Financial Assistance Advisory & Assistance Team, Office of Inspector General
    Patrick Bradfield, Director, Federal Student Aid Acquisitions Group
    Dwight Vigna, Director, Federal Student Aid, Default Division
TO: Daniel P. Schultz  
Regional Inspector General for Audit  
Office of Inspector General  

FROM: James W. Runcie  
Chief Operating Officer  

SUBJECT: Draft Alert Memorandum—“Federal Student Aid Paid Private Collection Agencies Based on Estimates,” Control Number ED-OIG/L02-N0002.

Thank you for providing Federal Student Aid with an opportunity to respond to the Office of Inspector General’s (OIG) concerns expressed in the draft alert memorandum regarding the Private Collection Agency (PCA) invoice process. FSA’s management shares these concerns and is committed to resolving the problems with the new Debt Management and Collection System (DMCS) invoice process as quickly as possible.

We should note, however, that we believe the alternative invoice process FSA has had in place since DMCS was implemented in October 2011 has reduced the risk of significant under- and overpayments and will ensure that all payments to PCAs are ultimately reconciled and adjusted as needed. As discussed in more detail below, all commission payments to PCAs have been based on actual collection data from the Department of the Treasury. All invoices have been reviewed prior to payment, compared with historical invoice data for reasonability, and reviewed with PCAs as needed to resolve questions. Estimated bonus payments were made with the explicit understanding that any overpayments would be repaid to the Department with interest. More broadly, in an effort to provide further interim validation, in FY 2012 FSA asked the Defense Contract Audit Agency (DCAA) to inspect PCA invoices and supporting documentation and match it against the Treasury lockbox files and DMCS. DCAA advised us that they believed it would be wasteful for them to provide these services since under FSA’s plan all payments would ultimately be validated through DMCS. In summary, we do not believe this issue has put significant taxpayer funding at risk.

More specifically, the draft alert memorandum notes that FSA is required to pay commissions and bonuses based on actual collections data and Competitive Performance and Continuous Surveillance (CPCS) scores. For commission payments, PCAs have been creating monthly invoices from actual collection data. All borrower payments come through the Treasury Lockbox contractor, Bank of America, and are posted to the borrower’s account in DMCS. PCAs receive a daily file with payment amounts and allocations across each debt; this file details amounts applied to collection costs, interest and principal. PCAs apply this data to the borrower accounts in their systems to match the DMCS data.
For each month since the new DMCS was implemented, FSA has instructed PCAs to create their invoices using the detailed collection data on their system rather than the DMCS invoice report.

It has always been FSA's intention to perform a consolidated reconciliation for all invoices once the necessary reporting was available in DMCS and then make adjustments as necessary for overpayments and underpayments. This process was completed last month and will be used to reconcile invoices for the months of October 2011 through March 2013. When the DMCS invoice reporting is functional for the periods of October 2011 through March 2013, DMCS will provide invoice reports to the PCAs that will allow them to ensure each invoice matches the data within DMCS.

CPCS scores for fiscal year 2012 have been calculated and validated by FSA and were sent to the PCAs on April 5, 2013. The terms for the alternative CPCS methodology, which were used to calculate the CPCS scores for fiscal year 2012, were agreed to by all 22 PCAs via bilateral modifications. The scores will be used to calculate bonus values as well as Long Term Bonus winners and values. Once the bonus amounts for fiscal year 2012 are calculated, the estimated bonuses that were provided for fiscal year 2012 will be adjusted accordingly and the PCAs will reimburse the Department with interest for any overpayments. This was a condition they agreed to in order to receive the estimated bonuses.

FSA is still validating new reports developed to move forward with the CPCS scores for fiscal year 2013. FSA expects these reports to be validated by the end of May 2013.

Our response to each of the recommendations follows:

**Recommendation 1.1:** Require FSA to calculate any overpayments or underpayments of PCA commissions and bonuses based on actual collections data and CPCS scores and require the PCAs to return any overpayments with applicable interest to the Department. Likewise, FSA should address any underpayments made to the PCAs.

**Response to Recommendation 1.1:** This process is already in place and is set to begin in April 2013. The bonus calculation process for fiscal year 2012 is also in process and appropriate adjustments will be calculated in April 2013.

**Recommendation 1.2:** Require PCAs to submit supporting documentation for all commissions invoiced since October 2011.

**Response to Recommendation 1.2:** PCAs were required to keep all supporting documentation for invoices they created. As part of the invoice reconciliation process, this information along with DMCS data will be used to ensure all invoices from October 2011 through March 2013 are reconciled. FSA will maintain documentation of the results of the reconciliations.

Thank you again for the opportunity to comment on your draft alert memorandum.

**cc:** W. Christian Vierling, Director, Student Financial Assistance Advisory Team

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