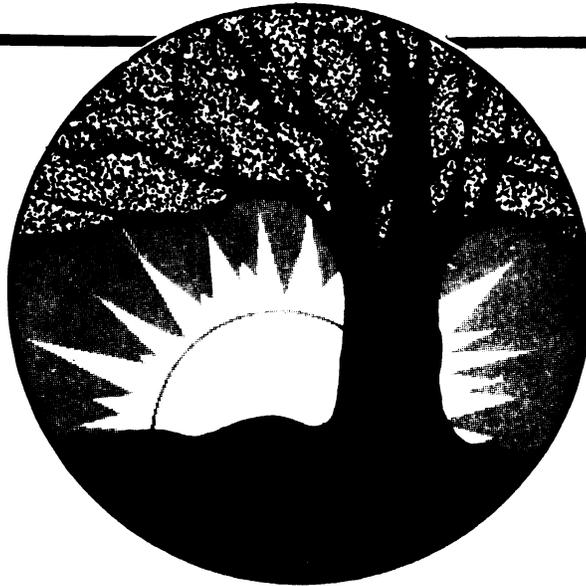


PERFORMANCE AUDIT

Tennessee Student Assistance Corporation
June 2008



John G. Morgan
Comptroller of the Treasury



State of Tennessee
Comptroller of the Treasury
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STATE OF TENNESSEE
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John G. Morgan
Comptroller

June 26, 2008

The Honorable Ron Ramsey
Speaker of the Senate
The Honorable Jimmy Naifeh
Speaker of the House of Representatives
The Honorable Thelma M. Harper, Chair
Senate Committee on Government Operations
The Honorable Mike Kernell, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Tennessee Student Assistance Corporation. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the agency should be continued, restructured, or terminated.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/dww
07-070

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit
Tennessee Student Assistance Corporation
June 2008

AUDIT OBJECTIVES

The objectives of the audit were to determine how the Tennessee Student Assistance Corporation (TSAC) tracks the lender review process and how changes made by the Common Review Initiative affected TSAC's lender review process; to determine what steps have been taken since the December 2002 performance audit to implement a professional license revocation process for defaulted student loans; to review the Graduate Nursing Loan Forgiveness Program to determine how it is being funded and how many participants there have been since the 2002 performance audit; to review TSAC's Request for Proposal process to determine timeliness for issuing RFPs; to review the monitoring of the Nelnet/Guarantec contract and how data reliability is ensured; to review Nelnet's business plan and determine potential conflicts between services provided by Nelnet and TSAC; to determine if staff and board member conflict-of-interest statements are signed annually to review any potential conflicts; to determine how the Communications Services Division is working with the GEAR Up program and what information is being provided to students regarding TSAC services; and to determine TSAC's compliance with Title VI of the Civil Rights Act of 1964 and Title IX of the Education Amendments Act of 1972.

FINDINGS

TSAC Did Not Adequately Monitor Its Contractor, Nelnet Guarantor Solutions (NGS)

Inadequate monitoring resulted in a failure to detect accounting errors and noncompliance with the contract. TSAC did not ensure that the contractor provided an on-line user manual for a computer system, completed data reliability and security

audits, or placed the system source code in an escrow account. Omission of required security audits could result in undetected processing and security problems affecting the accuracy and reliability of the data. Failure of the vendor to place a copy of the source code into an approved escrow account essentially negates TSAC's ownership rights (page 28).

The Nelnet Guarantor Solutions Contract Does Not Adequately Address Liquidated Damages for Failure to Perform All Contractual Obligations

The contract's schedule of liquidated damages does not cover the omissions of required audits or failing to put the source code with an approved escrow company. The schedule does not list any penalties that apply to the grants and scholarship programs or general ledger transactions (page 32).

By Accepting Meals From Nelnet Guarantor Solutions, the Agency's Contractor and a Company That Employs Lobbyists in the State, TSAC Staff May Have Violated Section 3-6-305, Tennessee Code Annotated

State law prohibits executive branch employees (as public officials) from accepting a gift from a lobbyist or the employer of a lobbyist. State employees are responsible for the public trust and should not jeopardize that trust by accepting gifts or favors that could influence future decisions of the agency (page 34).

TSAC Should Improve Information Security Controls Over Its Computer System for Grant and Scholarship Applications

TSAC is responsible for securing student data in its computer system for grant and scholarship applications. We observed

conditions that violated best practices for information security controls (page 34).

TSAC Needs a Policy for Reporting Illegal, Wasteful, or Fraudulent Activity

TSAC does not have a policy for confidential reporting of wasteful and fraudulent activity by employees and other citizens. Without such a policy, employees and others are less likely to report unethical or illegal conduct (page 35).

TSAC Still Lacks Processes for Notifying Licensing Authorities of Defaulted Student Loans That Can Lead to the Suspension, Denial, or Revocation of Any Professional Licenses Held by Those in Default *

Since 1999, state law has required licensing authorities to suspend or revoke the licenses of those who have defaulted on a loan guaranteed by TSAC. TSAC has made little progress in developing a method to inform licensing bodies of those in default. Without a method, individuals who are defaulting on their student loans are allowed to maintain their license without facing the consequences of not repaying their educational loans (page 36).

TSAC Lacks Required and Necessary Documentation for the Agency's Board of Directors

TSAC lacks appropriate documentation for conflict-of-interest forms, written designations for individuals to serve for certain board members, and board member terms and representation (page 38).

*Related issues were also discussed in the 2002 audit of the agency.

OBSERVATIONS AND COMMENTS

The audit also discusses the following issues: TSAC's contract with Nelnet, Inc. allows potential for business conflicts and data misuse; TSAC's market share of guaranteed student loans has decreased since 2002; TSAC should review its policies and procedures for the issuance of Requests for Proposal to ensure fair and open competition to potential bidders; TSAC did not properly compensate a career service employee; the new nursing loan forgiveness program is being implemented; TSAC should improve its process for public notices at board meetings; the Communications Services Division is helping the agency improve its visibility in the Financial Aid Community; and the lender review process has improved (page 13).

Performance Audit

Tennessee Student Assistance Corporation

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Performance Audit Tennessee Student Assistance Corporation

INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Tennessee Student Assistance Corporation (TSAC) was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-229, the Tennessee Student Assistance Corporation is scheduled to terminate June 30, 2008. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the agency and to report to the Joint Government Operations Committee of the General Assembly. The audit is intended to aid the committee in determining whether the Tennessee Student Assistance Corporation should be continued, restructured, or terminated.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to determine how TSAC tracks the lender review process and how changes made by the Common Review Initiative affected TSAC's lender review process;
2. to determine what steps have been taken since the December 2002 performance audit to implement a professional license revocation process for defaulted student loans;
3. to review the current Graduate Nursing Loan Forgiveness Program to determine how it is being funded and how many participants there have been since the December 2002 performance audit;
4. to review TSAC's Request for Proposal (RFP) process to determine any issues with regard to timeliness of issuing RFPs;
5. to review the monitoring of the Nelnet/Guarantec contract and determine how data reliability is ensured;
6. to review Nelnet's business plan and determine potential conflicts between services provided by Nelnet and TSAC;
7. to determine if staff and board member conflict-of-interest statements are signed annually and to review any potential conflicts;
8. to determine how the Communications Section is working with the GEAR Up Program and what information is being provided to students regarding TSAC services; and

9. to determine TSAC's compliance with Title VI of the Civil Rights Act of 1964 and Title IX of the Education Amendments Act of 1972.

SCOPE AND METHODOLOGY OF THE AUDIT

The activities of the Tennessee Student Assistance Corporation were reviewed for the period January 2003 to March 2007. The audit was conducted in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and included

1. review of applicable legislation and policies and procedures;
2. attendance at relevant legislative and corporation meetings;
3. examination of the entity's records, reports, and information summaries and reports from the agency's service company, Nelnet; and
4. interviews with department staff and staff of other state agencies that interact or have the potential to interact with the agency.

The General Assembly has designated the Comptroller of the Treasury both to serve as a board member of the Tennessee Student Assistance Corporation and to audit the agency.

HISTORY AND STATUTORY RESPONSIBILITIES

The Tennessee Student Assistance Corporation (TSAC) was created by the legislature in 1974 by Section 49-4-201, *Tennessee Code Annotated*, as a public nonprofit corporation to administer student assistance programs. The corporation is Tennessee's designated federal guaranty agency responsible for the administration of post-secondary education loan programs authorized by Title IV of the Higher Education Act of 1965 and further authorized by Section 49-4-401, *Tennessee Code Annotated*. TSAC also administers other state and federal student assistance programs as authorized by the General Assembly.

Since the December 2002 performance audit, the TSAC has also been given the responsibility of administering the Tennessee Education Lottery Scholarship Program including specific responsibilities of determining eligibility for students and distributing scholarship funds. TSAC has a lottery scholarship administrator and three staff members that work with the administrator to handle the activities of the program. TSAC has also begun communications and outreach efforts to educate people across the state about the lottery scholarship program and serve as an information resource for parents, students, and schools. Because the lottery scholarship program is still fairly new, there has been much discussion in the General Assembly about what changes may need to be made to the program. TSAC is called upon to participate in discussions with the General Assembly and provide information that will help legislators make decisions regarding the future of the lottery scholarship program. TSAC is also active in helping draft fiscal notes for proposed legislation.

While TSAC is responsible for administering the lottery scholarship program, the responsibility of research and analysis related to the program was given to the Tennessee Higher Education Commission (THEC). THEC is required by statute to evaluate the program and provide a report annually to the General Assembly. The report provides the General Assembly with information pertaining to areas such as student success, scholarship retention, and demographics of scholarship recipients. The most recent report, *Tennessee Education Scholarship Program Annual Report – Outcomes Through Fall 2006* was released January 9, 2007.

Section 49-4-202, *Tennessee Code Annotated*, defines the governing body for TSAC as a 17-member board of directors:

- the Governor,
- the Commissioner of the Department of Education,
- the State Treasurer,
- the Comptroller of the Treasury,
- the Commissioner of the Department of Finance and Administration,
- the Executive Director of the Tennessee Higher Education Commission,
- the President of the Tennessee Proprietary Business School Association,
- the President of the Tennessee Independent Colleges and Universities Association,
- the Chair of the Tennessee Independent Colleges and Universities Association,
- the President of the University of Tennessee,
- the Chancellor of the Tennessee Board of Regents,
- the President of the Tennessee Association of Student Financial Aid Administrators,
- one representative of a commercial lender,
- one student enrolled in an institution of higher education in Tennessee, and
- three private citizens involved in education but not employed by or professionally affiliated with any institution of higher education in the state.

ORGANIZATION

The daily operation of the Tennessee Student Assistance Corporation (TSAC) is managed by an executive director appointed by the board and assisted by 45 administrative staff. In addition, there are two Nelnet (loan servicer) representatives located in the TSAC office. TSAC is divided into five divisions: Loan Administration, Grant and Scholarship Programs, Compliance and Legal Affairs, Business Affairs, and Communication Services. (See the organization chart on the following page.)

Loan Administration

The Loan Administration Division is responsible for oversight of all loans that are part of the Federal Family Education Loan Program (FFELP), authorized in Title IV of the Higher Education Act of 1965. Loans are guaranteed by TSAC with reinsurance provided by the U.S. Department of Education. Per 20 *United States Code*, Section 1078, the Secretary of the Department of Education will reimburse the guarantee agency (TSAC) for losses on student loans resulting from defaulted payments by the student. TSAC uses 64 different lenders, with the top 10 lenders making up 90% of TSAC's loan volume. There are three federally insured student loan programs and one state loan program. Following is a brief description of each program.

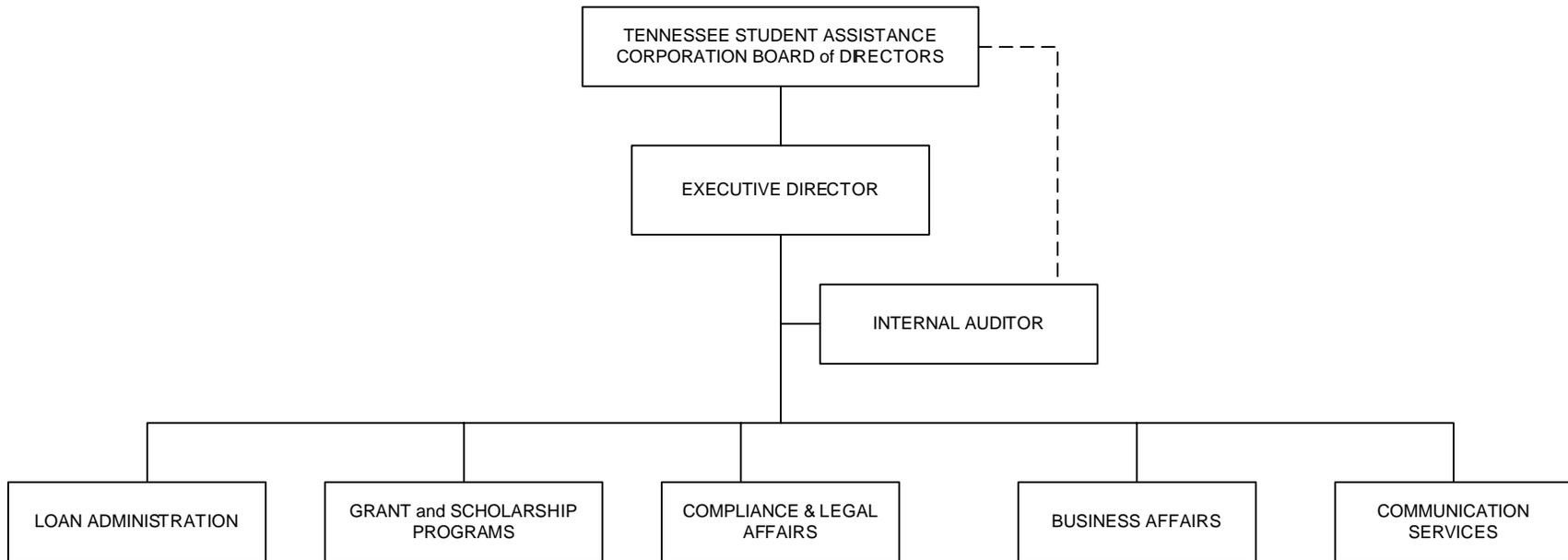
Federally Insured Loans

Stafford Subsidized Loan Program – This program allows undergraduate and graduate students to receive long-term, low-interest educational loans while attending approved educational institutions. To be eligible, a student must be enrolled at least half-time in an approved program and have financial need. Students obtain from private financial institutions loans insured against default by the U.S. Department of Education. Eligible undergraduate students may borrow up to \$2,625 for the first year, \$3,500 for the second year, and \$5,500 for the third year and above. If the student is an independent undergraduate student or a dependent student whose parents are unable to get a PLUS Loan, the student may borrow up to \$6,625 for the first year, \$7,500 for the second year, and \$10,500 for the third year and above. A total of \$23,000 in subsidized loans may be obtained by a dependent undergraduate student, \$46,000 as an independent undergraduate student, and \$138,000 as a graduate or professional student.

Stafford Unsubsidized Loan Program – This program is similar to the Stafford subsidized loan program except that loans are not need-based, and interest accrues while a student is in school and during the grace period.

Parent Loan for Undergraduate Students (PLUS) – The PLUS program is a federally guaranteed loan program providing supplemental funds for academic expenses in addition to the Stafford loans. PLUS loans are made to parents of dependent students for educational expenses of the student without regard to family income. Parents obtain from private financial institutions loans insured against default by the U.S. Department of Education. Parents may borrow up to the cost of attendance minus other financial aid, with no aggregate limit.

**TENNESSEE STUDENT ASSISTANCE CORPORATION
ORGANIZATION CHART
OCTOBER 2007**



State Loan

Tennessee Student Loan Program (TSLP) – According to TSAC staff, this program was created to be a lender of last resort for Tennessee students. Section 49-4-505, *Tennessee Code Annotated*, established the program as a revolving loan fund. No loan has been made through TSLP since 1983, but the money in the fund is used for other purposes as authorized by statute. The balance may be used to cover overexpenditures in the TSAA program and to conduct training, administration, and default management for students, schools, and lenders in the Federal Family Education Loan Program and the Student Loan Program.

Grant and Scholarship Programs

The Grant and Scholarship Programs Division manages the Minority Teaching Fellows Program, the Tennessee Teaching Scholars Program, the Dependent Children Scholarship Program, the Robert C. Byrd Honors Scholarship Program, the Christa McAuliffe Scholarship Program, the Ned McWherter Scholarship Program, the Tennessee Student Assistance Award Program (TSAA), and the Tennessee Education Lottery Scholarship Program. Descriptions of these programs are included below.

Minority Teaching Fellows – This program provides forgivable loans to minority high school graduates who wish to pursue teaching careers. An eligible student must have at least a 2.75 high school GPA and have either scored at least 18 on the ACT (or 850 on the SAT) or have been in the top 25% of their high school class. Recipients may be awarded up to \$5,000 per academic year up to a maximum of \$20,000 over four years. Loans are forgiven at the rate of one year's award for each year of teaching at the K-12 level in a Tennessee public school.

Tennessee Teaching Scholars Program – This program was enacted by the General Assembly in 1995 to replace both the Teacher Loan/Scholarship Program and the Teacher Loan Program for Disadvantaged Areas of Tennessee. The goal of this program is to encourage exemplary students to enter the teaching field. Participation in this forgivable loan program is limited to college juniors, seniors, and post-baccalaureate students formally admitted to a teacher education program in Tennessee. Recipients of the awards incur an obligation to teach one year in a Tennessee public school for each year the award is received.

Dependent Children Scholarship Program – This program provides nonrepayable awards to undergraduate students who are dependent children of a law enforcement officer, a fireman, or an emergency medical service technician who has been killed or totally and permanently disabled while performing duties within the scope of such employment. The amount of the award can cover the costs of up to four academic years of full-time enrollment including tuition, books, supplies, and room and board.

Robert C. Byrd Honors Scholarship Program – This program awards scholarships to entering college freshmen. Eligible students must have achieved at least a 3.5 high school GPA or an average GED score of 570. Alternatively, a student may have a 3.0 high school GPA and

score of 24 on the ACT or SAT equivalent exam. Scholarships may be used to attend any college in the United States and are renewable for a total of four years.

Christa McAuliffe Scholarship Program – This program was created to provide financial assistance to students who aspire to be career teachers. Eligible students must be admitted full-time for the senior year of an approved teacher education program. The program is funded by the annual interest on the principal of contributions made by private citizens when the program was established in 1986. The program awarded the first \$500 scholarship since the 2002-2003 academic year for the 2007-2008 academic year.

Ned McWherter Scholars Program – This program encourages academically superior Tennessee high school graduates to attend college in Tennessee. Eligible students must have a minimum 3.5 high school GPA and a minimum composite score of 29 on the ACT or SAT equivalent. Students must also maintain a 3.2 GPA while in college to remain eligible. Awards are \$3,000 per academic year and must be matched by the college or university.

Tennessee Student Assistance Award – This program makes nonrepayable financial awards to financially needy undergraduate students. For 2005-2006, the maximum award is \$2,322 for eligible Tennessee postsecondary institutions and \$4,644 at eligible Tennessee independent postsecondary institutions. Maximum award amounts are determined by the TSAC Board prior to the beginning of the fall term. Available funding is insufficient to reach all eligible applicants so early filing of the Free Application for Federal Student Aid (FAFSA) is encouraged.

Tennessee Education Lottery Scholarship Program – The Tennessee Education Lottery Scholarship Program began in the fall semester of 2004. The scholarships are available to Tennessee residents who enroll in one of Tennessee's public or private colleges or universities and who meet the academic and/or financial requirements for eligibility. The program includes five different scholarship options for students: the Tennessee HOPE Scholarship, the Aspire Award, the Tennessee HOPE Access Grant, the General Assembly Merit Scholarship, and the Wilder-Naifeh Technical Skills Grant. As of August 2007, maximum award amounts and minimum qualifications for each award are as follows:

HOPE Scholarship

- Maximum award: 4-year institution = \$3,800 per year
2-year institution = \$1,900 per year
- Qualifications: Entering freshmen – 21 ACT (980 SAT) or overall final weighted 3.0 GPA.
Home School Graduates – minimum 21 ACT (980 SAT).
GED Applicants – minimum 525 GED score and 21 ACT (980 SAT).

A student who loses the HOPE Scholarship award may regain it once.

Aspire Award

- Maximum award: \$1,500 supplement to the HOPE Scholarship per year
- Qualifications: Meet HOPE requirements and have parents' or independent students' and spouse's adjusted gross income of \$36,000 or less on IRS Tax form.

HOPE Access Grant

- Maximum award: 4-year institution = \$2,750 per year
2-year institution = \$1,750 per year
- Qualifications: Entering freshmen – Final weighted GPA of at least 2.75 and 18 on ACT (860 SAT) and parents' or independent student's and spouse's adjusted gross income of \$36,000 or less on IRS tax form.

This grant is non-renewable and any individual receiving this grant will be eligible for the Hope Scholarship by meeting the HOPE renewal criteria.

General Assembly Merit Scholarship

- Maximum Award: \$1,000 supplement per year to HOPE
- Qualifications: Entering freshmen – 3.75 final weighted GPA and 29 ACT (1280 SAT).
Home school students – complete 12 college credit hours (at least 4 courses) with a minimum 3.0 GPA at a Tennessee college or university while enrolled in the home school program.

Wilder-Naifeh Technical Skills Grant

- Maximum Award: Up to \$2,000 but no more than cost of attendance
- Qualifications: Cannot be prior recipient of HOPE. Grant is available to all students enrolled at a Tennessee Technology Center who have been a Tennessee resident for one year prior to the term they begin school.

Under some circumstances, Wilder-Naifeh Technical Skills Grant recipients who complete a diploma program may be eligible to receive the HOPE Scholarship by enrolling at an eligible two- or four-year postsecondary institution within three years of completing their diploma program.

The four-fold purpose of the program is

- to provide access for Tennesseans to post-secondary education,
- to improve high school and collegiate academic achievement,
- to keep more of the best and brightest students in Tennessee, and
- to provide social and economic benefits to the State of Tennessee.

The following table details all amounts for loan, grant, and scholarship programs listed above.

Awards By Program

Program	Source	FY 2003-2004		FY 2004-2005		FY 2005-2006	
		Recipients	Amount	Recipients	Amount	Recipients	Amount
<i>Federally Insured Loans</i>							
Stafford Subsidized	Federal/Private	105,119	\$335,890,508	105,352	\$363,770,664	97,538	\$332,397,359
Stafford Unsubsidized	Federal/Private	76,902	\$293,557,186	80,403	\$320,486,299	79,488	\$312,343,803
Parent Loan for Undergraduate Student	Federal/Private	10,644	\$81,694,417	10,984	\$82,904,121	10,545	\$86,977,661
<i>Loan/Scholarship</i>							
Tennessee Teaching Scholars	State	206	\$754,614	218	\$837,000	150	\$599,062
Minority Teaching Fellows	State	116	\$543,998	115	\$521,066	113	\$518,904
<i>Scholarship</i>							
Dependent Children	State	19	\$77,786	20	\$94,885	27	\$133,456
Robert C. Byrd	Federal	548	\$786,479	549	\$781,250	523	\$757,482
Christa McAuliffe	Private	-	-	-	-	-	-
Ned McWherter Scholars	Private/State	172	\$489,000	171	\$488,282	165	\$480,000
<i>Grants</i>							
Tennessee Student Assistance Award	Federal/State	25124	\$41,833,378	23,934	\$42,645,415	19,327	\$38,447,877
<i>Tennessee Education Lottery Scholarships</i>							
HOPE Scholarship (General Assembly Merit Scholarship & Aspire Award)		-	-	31,272	\$86,650,189	40,275	\$126,345,913
HOPE Access		-	-	108	\$152,560	265	\$490,294
Wilder-Naifeh Technical Skills Grant		-	-	8,815	\$6,613,273	10,023	\$7,860,163
Foster Child		-	-	-	-	30	\$88,245
Dual Enrollment		-	-	-	-	5,465	\$2,060,356

Source: Developed from information provided by the Associate Executive Director for Grants and Scholarship Programs and the Student Loan Program Administrator, Tennessee Student Assistance Corporation.

Compliance and Legal Affairs

The Compliance and Legal Affairs Division has responsibilities for preparing and reviewing legislation, contracts, and rules. The Associate Executive Director of Compliance and Legal Affairs serves as a liaison with the legislature, to work with newly introduced legislation that would change the lottery scholarship or other grants and scholarships that TSAC is responsible for. The Compliance and Legal Affairs Division is also responsible for preparing, reviewing, and maintaining the 20-30 active contracts the agency has. This division is also responsible for drafting new rules and making changes to existing rules based on legislative changes.

Business Affairs

The Business Affairs Division maintains the accounting for the state and federal financial aid programs and is responsible for reporting to both state and federal officials. For fiscal year 2006, the corporation had administrative expenditures of \$16,733,600. The Business Affairs Division oversees all fiscal and budget activities, maintains the agency's property inventory and general ledger postings, and approves all Tennessee Online Purchasing System (TOPS) transactions and purchases. The Business Affairs Division includes personnel and data processing staff.

Communication Services

The Communication Services Division is responsible for the dissemination of information pertaining to financial aid to parents, students, colleges, and high schools. This division is responsible for all outreach functions such as agency publications and presentations, including the monthly newsletter published on TSAC's website. The Communication Services Division is also responsible for the call center which is available to parents, students, colleges, and high school teachers and counselors who have questions about loans or scholarships.

REVENUES AND EXPENDITURES

Statement of Revenues and Expenses Revenues by Source For the Fiscal Year Ending June 30, 2006

<i>Source</i>	<i>Amount</i>	<i>% of Total</i>
State	\$984,800	5.9%
Federal	\$6,636,200	39.7%
Other	\$9,112,600	54.4%
Total Revenue	\$16,733,600	100%*

Source: *The Budget 2007-2008*. TSAC's "Other" revenue comes from the collection of loan and interest payments.

Statement of Revenues and Expenses Expenditures by Account For the Fiscal Year Ending June 30, 2006

<i>Account</i>	<i>Amount</i>	<i>% of Total</i>
Payroll	\$2,126,200	12.7%
Operational	\$14,607,400	87.3%
Total Expenses	\$16,733,600	100%

Source: *The Budget 2007-2008*.

Budget and Anticipated Revenues For the Fiscal Year Ending June 30, 2007

<i>Source</i>	<i>Amount</i>	<i>% of Total</i>
State	\$1,454,100	6.8%
Federal	\$5,246,100	24.6%
Other	\$14,593,500	68.6%
Total Revenue	\$21,293,700	100%

Source: *Budget 2007-2008*. TSAC's "Other" revenue comes from the collection of loan and interest payments.

OBSERVATIONS AND COMMENTS

The topics discussed below did not warrant a finding but are included in this report because of their potential effect on the operations of Tennessee Student Assistance Corporation (TSAC) and on the citizens of Tennessee.

CONTRACT WITH NELNET GUARANTOR SOLUTIONS (NGS), INC., ALLOWS POTENTIAL FOR BUSINESS CONFLICTS AND DATA MISUSE

We examined the most recent Securities and Exchange Commission filings for Nelnet, Inc., NGS' (Nelnet Guarantor Solutions, Inc.) parent company, to determine whether the parent company or any related subsidiary offered similar services to those offered by TSAC that could be considered a conflict of interest regarding the potential misuse of data for marketing purposes by NelNet. TSAC contracts with NGS to provide computer processing services used for guaranteeing student loans and administering student assistance programs to maintain and support the general ledger system. The contract term is from January 1, 2006 to December 31, 2010. We reviewed the various business units described on the Nelnet website and the services offered there. We then compared those to the services TSAC offers to determine whether similarities in services exist. Although the parent company has numerous subsidiaries, none appear to be in direct conflict with TSAC services providing grants and scholarships or guarantying student loans.

We found that Nelnet's list of subsidiaries includes a business unit called "Enrollment Services and List Management Services," whose purpose is direct marketing and the generation of leads for marketing. At least three subsidiary companies under this business unit generate lists of students' names, addresses, and other personal information for resale. These subsidiaries are Student Marketing Group, CUnet, and National Honor Roll Publications. In 2003, before the company was acquired by Nelnet, Student Marketing Group was fined \$75,000 by the Attorney General of the State of New York for its method of acquiring students' personal data for the purposes of resale.

Recently the Department of Education temporarily removed all lender and guarantor companies' access to the National Student Loan Data System (NSLDS) because some lenders were using borrower information for marketing purposes. New privacy legislation and federal restrictions on lenders' access to the NSLDS could impair Nelnet's lead generation, direct marketing, and list-selling activities. As the student information from NSLDS and other sources becomes increasingly restricted, the information from the TSAC databases becomes an increasingly valuable resource to Nelnet's direct marketing, lead generation, and list-selling business units.

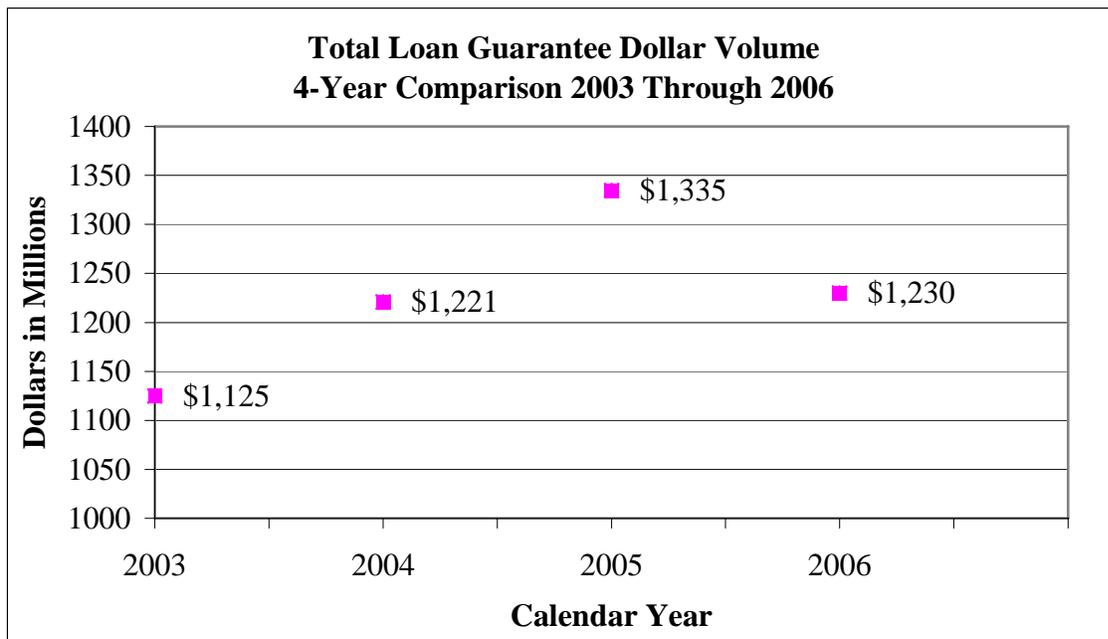
Currently, the personal and financial data on students, student borrowers, grant and scholarship recipients, and even students' parents is stored in NGS' databases for TSAC in

Jacksonville, Florida. There are almost 200 NGS employees who already have access to this data. TSAC does not know the extent of security measures to prevent unauthorized use of this data because NGS has not performed data security audits. (See Finding 1.) TSAC should ensure the audits are completed and review the results to determine if there are adequate measures in place to prevent unauthorized use of student data by the parent company and its subsidiaries.

TSAC’S MARKET SHARE OF GUARANTEED LOANS IN TENNESSEE HAS DECREASED SINCE 2002

We reviewed reports provided by TSAC’s Compliance and Legal Affairs Division that names lenders, their rankings, and the total dollar value of loans for 2003 through 2006. When total volume for each calendar year is charted in Table 1, it appears that the dollar volume of loans guaranteed by TSAC dropped from 2005 to 2006, but total volume has actually increased over the past five years from almost \$846 million to \$1.2 billion. The loan volume for Nelnet and subsidiaries shown in Table 2 for which TSAC is the guarantor spiked in 2003 at over \$9 million but has dropped since 2003 to about \$147,000. At the September 28, 2006, board meeting, the Associate Executive Director for Loan Administration reported there were 39 guarantor companies operating in Tennessee during fiscal years 2004 and 2005; however, TSAC still holds the overwhelming majority of loan guaranty volume with 171,969 loans at over \$685 million versus 36,125 loans at \$168.5 million for its closest competitor, USA Funds.

**Table 1
Tennessee Student Assistance Corporation**



Source: Schedule of Loans Guaranteed provided by the Director for Student Loans Administration.

Table 2
Tennessee Student Assistance Corporation

Schedule of NelNet, Inc., and its Combined Subsidiaries' Loans Guaranteed by TSAC
For 2002 Through 2005

Name	CY2002 Dollar Volume	FY2003 Dollar Volume	CY2004 Dollar Volume	CY2005 Dollar Volume
NelNet Academic Loan	\$ -	\$ 881	\$ -	\$ 84,229
EFS Finance Co	-	29,380	10,310	30,425
NelNet Education Loan Funding	-	-	-	21,267
NelNet /Key Bank	8,479	19,000	10,000	11,375
NHELP III	-	95,665	-	-
NelNet Student Loan Trust	-	-	3,063	-
NelNet	-	9,550,922	-	-
Combined Total of NelNet Subsidiaries	8,479	\$ 9,695,848	\$ 23,373	\$ 147,296

Source: Market Share Report prepared by the Associate Executive Director for Loan Administration.

Table 3
Tennessee Student Assistance Corporation

Comparison Schedule of Loan Volume and Amount of Loan Balances for Top Ten Guarantors in Tennessee
For the Years Ended December 31, 2005, and 2004

Guarantor Name	Fiscal Year 2005				Fiscal Year 2004				Variance			
	Number of Loans	Market Share by Loans	Amount of Balance	Market Share by Amount of Balance	Number of Loans	Market Share by Loans	Amount of Balance	Market Share by Amount of Balance	Variance in Number of Loans	Percent Change in Number of Loans	Difference in \$ Balance	Percent Change in Balance
1 TSAC	171,969	63.1%	\$ 685,237,155	60.8%	169,938	64.7%	\$ 653,957,604	62.4%	2,031	1.2%	\$ 31,279,551	4.8%
2 USA Funds	36,125	13%	168,521,122	15.0%	26,823	10.2%	119,380,348	11.4%	9,302	34.7%	49,140,774	41.2%
3 Direct Loans	38,126	14.0%	140,641,378	12.5%	45,778	17.4%	177,345,663	16.9%	(7,652)	-16.7%	(36,704,285)	-20.7%
4 California Student Aid Commission	13,565	5.0%	47,041,787	4.2%	10,541	4.0%	33,928,256	3.2%	3,024	28.7%	13,113,531	38.7%
5 American Student Assistance (ASA)	3,018	1.1%	30,621,791	2.7%	2,825	1.1%	27,538,039	2.6%	193	6.8%	3,083,752	11.2%
6 National Student Loan Program (NSLP)	2,827	1.0%	25,691,295	2.3%	1,179	0.4%	9,828,373	90.0%	1,648	139.8%	15,862,922	161.4%
7 Great Lakes Higher Education Corp.	1,767	0.6%	11,865,545	1.1%	2,050	0.8%	12,810,226	1.2%	(283)	-13.8%	(944,681)	-7.4%
8 Texas Guaranteed Student Loan Corp.	2,976	1.1%	8,222,695	0.7%	1,420	0.5%	4,184,537	0.4%	1,556	109.6%	4,038,158	96.5%
9 Colorado Student Loan Corp.	1,063	0.4%	3,559,074	0.3%	764	0.3%	2,501,854	0.2%	299	39.1%	1,057,220	42.3%
10 Pennsylvania Higher Education Assistance Agency	202	0.1%	1,381,307	0.1%	233	0.1%	1,469,221	0.1%	(31)	-13.3%	(87,914)	-6.0%
	<u>271,638</u>		<u>\$ 1,122,783,149</u>		<u>261,551</u>		<u>\$ 1,042,944,121</u>		<u>10,087</u>	<u>3.9%</u>	<u>\$ 79,839,028</u>	<u>7.7%</u>

Source: FFELP Reports provided by the Director of Compliance.

Note: Market Share calculations include all guarantors in Tennessee.

Analysis of the data provided in the schedule of Loans Guaranteed by TSAC shows that while TSAC had a modest 4.8% volume increase between 2004 and 2005, six of the top ten guarantors experienced greater volume growth percentages. The September 2006 report to the TSAC board of directors on market share notes that TSAC's loss of market share seems to be increasing competition from for-profit guarantor companies expanding into the Tennessee market. The competition and resulting loss of market share results in lower earnings in TSAC's Operating Funds and the Federal Reserve Fund. TSAC uses the earnings from guaranteeing student loans for student and school outreach programs and the administration offices of TSAC.

TSAC's market share of loan guarantee volume might also have been impacted by the increased amount of scholarship funds available to Tennessee's student population through the Tennessee Education Lottery Scholarships (TELS) and others. Students who receive scholarships should have less need to borrow or may borrow less to fund their college educations. Lower student loan debt after graduation could also positively impact students' abilities to repay as well as the loan default aversion programs. While graduating students could derive economic benefits from lower student loan debt and putting more disposable income into the economy, the impact for TSAC could result in lower student loan volume and a lower total amount of loan guarantor volume to be shared among the competing guarantors.

The Tennessee Student Assistance Corporation (TSAC) was created by the legislature in 1974 by Section 49-4-201, *Tennessee Code Annotated*, as a public nonprofit corporation to administer student assistance programs. Because TSAC is a not-for-profit entity, its management may wish to focus on the quality of financial support services offered to the students and schools residing in Tennessee rather than the quantity of student loans guaranteed by TSAC. As long as the earnings from guaranteeing student loans allow TSAC to be self-supporting without taxpayer funding, efforts and expense to increase market share may not be needed.

THE TENNESSEE STUDENT ASSISTANCE CORPORATION SHOULD REVIEW ITS POLICIES AND PROCEDURES REGARDING THE ISSUANCE OF REQUESTS FOR PROPOSALS TO ENSURE FAIR AND OPEN COMPETITION TO POTENTIAL BIDDERS

The Tennessee Student Assistance Corporation (TSAC) is required to follow the Department of Finance and Administration's policies regarding the procurement of services through a competitive bidding process. The policy requires that "service providers shall be given a reasonable time, as determined by the state, to consider the required scope of services and the proposal evaluation factors before proposals must be submitted." The department's policy does not specify a time frame for how long a request for proposal (RFP) must stay open in order to allow participation by potential bidders, but the policy does state that an RFP will be approved by the department based upon certain criteria, including the adequacy of the RFP's assurance of:

- fairness to potential service providers,
- clear and open competition,
- achievement of procurement objectives, and

- protection of the state’s interests.

The agency has issued one RFP since July 1, 2004. The RFP was issued in July 2005 for a full-service contract for the period January 1, 2006, to December 31, 2010. The following describes desired services:

The State intends to secure a contract for the full servicing of TSAC’s Federal Family Education Loan Program and loan portfolio, servicing of TSAC’s grants, scholarships, loan forgiveness programs, and the TSAC General Ledger System.

At the time of the RFP, TSAC had a service agreement with Nelnet, formerly known as Guarantec. TSAC has had an ongoing contractual relationship with Nelnet as its service provider since 1986. The agency created a list of 14 potential bidders; however, there was no documentation to show that 3 of the bidders were mailed a package. There was also a package refused and returned from another one of the potential bidders. One of the potential bidders was the state’s Office for Information Resources (OIR). According to the Chief Information Officer for OIR, it is not OIR’s policy to participate in competitive bidding for services with another state agency, but it would have been able to provide some of the services listed in the RFP if a service agreement had been reached in accordance with policy and procedure.

The following outlines the timeline for the RFP:

Event	Time	Date
State Issues RFP		July 1, 2005
Disability Accommodation Request Deadline		July 11, 2005
Pre-Proposal Conference	2:00PM	July 13, 2005
Notice of Intent to Propose Deadline		July 15, 2005
Written Comments Deadline		July 20, 2005
State Responds to Written Comments		July 29, 2005
Proposal Deadline	2:00PM	August 5, 2005
State Completes Technical Proposal Evaluations		August 12, 2005
State Opens Costs Proposals and Calculates Scores	9:00AM	August 15, 2005
State Presents Recommendation to TSAC’s Board of Directors		August 16, 2005
State Issues Evaluation Notice and Opens RFP Files for Public Inspection	9:00AM	August 16, 2005
Contract Signing		August 26, 2005
Contract Signature Deadline		September 2, 2005
Performance Bond Deadline		August 31, 2005
Contract Start Date		January 1, 2006

The agency received a total of 69 questions related to the RFP and released an amendment that addressed all of the questions in a single document. (The amendment was not approved by the Department of Finance and Administration as required by state rules.) The

agency received one complete proposal, from the current service provider Nelnet, as well as one incomplete proposal from Sallie Mae. In Sallie Mae's submission of its proposal, there were concerns regarding the timeline of the RFP and how the agency was "seeking an extremely aggressive implementation schedule for completion of the scope of services and required objectives."

Sallie Mae's proposal stated,

No competing contractor can successfully accomplish data mapping and system conversion efforts to a new platform and be operationally capable of serving TSAC's Federal Family Education Loan (FFEL) program between the time of selection and contract start date (essentially four months).

TSAC has stated there is no flexibility in the schedule of events. Consequently, there can be no consideration given to a potential new servicer, therefore assuring TSAC will retain its current servicing relationship. More critical, however, the lack of schedule flexibility reduces the number of potential competitive bids, and, therefore, TSAC cannot be assured of getting the best services at the most competitive price.

The RFP required a potential bidder to develop and fully implement an entire comprehensive system in approximately four months. Even though Sallie Mae chose not to formally protest the RFP, based on the comments made in its proposal and the fact that TSAC only received one complete proposal from the current contractor, it appears that TSAC did not allow for fairness to potential bidders as well as clear and open competition. It also appears that it would have been nearly impossible for anyone other than the current service provider to be awarded this contract. TSAC management were not willing to negotiate the scope of the services to accommodate more potential bidders nor were they willing to add flexibility to the RFP's schedule in order to allow more potential bidders an opportunity to submit a comprehensive proposal that could feasibly be implemented.

The agency's current Executive Director, appointed in August 2005 after the RFP release, has stated that in hindsight, the timeline was probably too rushed and that it left many of the bidders unable to compete because they could not meet the contract deadlines. The executive director also stated that the agency is beginning now to work with vendors so that when the current contract expires, more bidders will have an opportunity to participate. The agency is considering splitting the single contract into multiple contracts; this is because there are vendors who can perform some of the services but may not be able to perform all of the services in a single contract. The agency feels this will also increase the amount of competitive bids received.

The Tennessee Student Assistance Corporation should review its procedures concerning the issuing of requests for proposals (RFP). The agency should ensure that an RFP fosters clear communication with all potential bidders as well as fair and equal competition. The agency should consider the scope of services when developing the timeline for any RFP issued and should ensure that a timeline is appropriate for the scope of services in that it gives potential

bidders adequate opportunity not only to submit a proposal but also to have the contract services operational by the deadline. Also, TSAC should ensure that amendments to RFPs are submitted to the Department of Finance and Administration.

TSAC Comment: This review has been conducted and the agency is already planning a more open RFP for the next contract, intended to increase the number of potential bidders. The Office of Contract Review in the Department of Finance and Administration has been consulted.

TSAC DID NOT PROPERLY COMPENSATE A CAREER SERVICE EMPLOYEE

In October 2005, the Executive Director reorganized TSAC's administration and created five separate Associate Executive Director positions. In creating the Associate Executive Director positions, positions within the agency had to be converted from civil service to executive service.

In October 2005, the agency's Fiscal Director was offered the title of Associate Executive Director of Business Affairs. This change would require converting from an appointed civil service position to an at-will executive service position. A civil service position has a set process for complaints of disciplinary action or dismissal whereas an individual in an executive service position serves at the will of the agency and the employee would have no formal recourse if dismissed or disciplined. When the Fiscal Director refused to accept the change in his position to an executive service position, the Executive Director felt he was justified in keeping this person's pay the same as that of a Fiscal Director while requiring him to take on the increased duties of the Associate Executive Director position. The creation of the Associate Executive Director of Business Affairs position allowed several administrative areas to be combined into one and added additional responsibilities to the Fiscal Director which included supervising more personnel, adding human relations functions to his responsibilities, and overseeing data processing.

A January 2007 e-mail from the Department of Personnel to TSAC states that if a civil service employee is not willing to voluntarily change his or her position to executive service, the employee has the right to remain in his or her current position. This e-mail also stated that this employee would be able to make the case that he or she is performing duties of a higher level class and should be compensated even if the position is never reclassified to the higher level.

The Associate Executive Director of Business Affairs retired in May 2007. With his retirement imminent, the agency began the process of converting his position to Executive Service. In doing so, the new Associate Executive Director of Legal and Regulatory Affairs determined that the Executive Director's failure to compensate the Associate Executive Director of Business Affairs at the higher level classification did not comply with Section 8-30-224, *Tennessee Code Annotated*. The agency worked with the Departments of Personnel and Finance and Administration to ensure the Associate Executive Director of Business Affairs was compensated the more than \$19,000 he was owed for the additional responsibilities he was required to take on for the 18 months prior to his retirement.

TSAC Comment: The observation is correct. TSAC identified the error and corrected it independent of and apart from the auditor's direct knowledge.

IMPLEMENTATION OF NEW NURSING LOAN FORGIVENESS PROGRAM

The December 2002 performance audit recommended that the legislature repeal statutes related to four TSAC-administered programs that were inactive but still authorized in statute. Three of those four programs have been repealed; however, the General Assembly amended Section 49-4-702, *Tennessee Code Annotated*, for the Loan-Scholarship Program for Graduate Nursing Students in May 2006 to reflect a new nursing loan forgiveness program.

The new nursing loan forgiveness program was the result of goals set forth in the Nursing Education Master Plan Project developed by a steering committee convened by the Tennessee Center for Nursing. The Nursing Education Master Plan discusses problems the nursing profession faces regarding faculty to teach incoming classes of nurses. One of the recommendations of the Nursing Education Master Plan was to obtain state funding and implement a Nursing Loan Forgiveness Program for students applying for and receiving a Master's Degree or Ph.D. to teach in the nursing field.

Current statute states that "any resident of Tennessee who becomes a candidate for a master's degree in nursing, or any resident with a master's degree in nursing who becomes a candidate for a doctoral degree program in nursing or a related field that would qualify the person to become a teacher, administrator or supervisor in nursing" is eligible to apply to TSAC for a loan-scholarship. The annual loan-scholarship funding cannot exceed the cost of attending an approved graduate school of nursing or doctoral program in a nursing related field for one academic year. The student may receive the loan-scholarship for up to a maximum of four years. When the student graduates and becomes a full-time teacher in a nursing school in Tennessee approved by the state board of nursing, the student will receive a credit of 25% of the amount borrowed plus interest at the end of each year. All loan-scholarship recipients in this program will have notes payable to TSAC for each year the loan-scholarship is awarded.

Statute also allows TSAC to receive funding for this program from outside sources with the understanding that the funds will be used solely for awards in this program and unused funds will not revert to the general fund but be carried forward for future student awards. According to the TSAC Grant Administrator, the program has received 107 applications, but awards will not begin until the 2007-2008 academic year. So far the state has not funded this program, so all funding for the awards to be made in 2007-2008 has come from private contributions. TSAC expects state funding for the program beginning in 2008-2009.

THE TENNESSEE STUDENT ASSISTANCE CORPORATION SHOULD IMPROVE ITS PROCESS REGARDING PUBLIC NOTICES FOR BOARD MEETINGS

Tennessee's Open Meetings Act requires that any "governmental body which holds a meeting previously scheduled by statute, ordinance or resolution shall give adequate public notice of such meeting." The same requirement also applies to special meetings.

The board of directors for the Tennessee Student Assistance Corporation (TSAC) meets at various times throughout the year. According to TSAC staff, a public notice is posted in the state's Legislative Plaza office building ten days prior to each meeting. The agenda for each meeting and the minutes for prior meetings are posted on the agency's website.

Since the public notices are only posted at Legislative Plaza, the number of people from the public who would see the notices would be limited to those who visit the building. The board does not meet during a designated day and/or month of the year so members of the general public do not know when a meeting is going to be held unless they happen to see a public notice. While the agency's current methods may fall within the statute's requirement of "adequate notice," there are other avenues available to the agency that could easily offer information to a broader range of the population.

The agency's website could be used to post this type of information since it is more readily accessible at all times. The agency could also use an e-mail distribution system that would send out an e-mail to various people involved with higher education across the state and alert them of upcoming board meetings. The agency should also consider adding a feature on its website that would allow people to sign up to receive notices from the agency regarding upcoming meetings.

TSAC Comment: While improvement is always possible, TSAC believes that it has done a very good job of notifying the public about board meetings. Meeting announcements are posted on bulletin boards in Legislative Plaza. Meetings are announced in the agency's monthly newsletter, often with a special invitation from the Executive Director to attend. The agency's web site announces meetings and provides a complete agenda for all meetings. Meetings have been standardized (third Thursday of March and September) so that all potential meeting attendees can "save the date" long in advance of the meetings.

THE COMMUNICATIONS SERVICES DIVISION IS HELPING THE AGENCY IMPROVE ITS VISIBILITY IN THE FINANCIAL AID COMMUNITY

The Tennessee Student Assistance Corporation (TSAC) has recently developed a Communications Services Division to improve its visibility with the financial aid community. The division was created in 2005, and an Associate Executive Director of Communications and Outreach was hired in October of the same year.

The Communications and Outreach Division developed a strategic plan in September 2006 based on the following goals:

1. Increase the total number of high school graduates from Tennessee public high schools who enroll in college.
2. Increase the total number of non-traditional students participating in higher education.
3. Increase the number of minority and low-income students qualifying for, applying for, and receiving financial aid for college in Tennessee.
4. Increase the retention rate of the TELS award at the 24-hour credit checkpoint. (At the end of the semester in which a student has attempted a total of 24 semester hours the student must have a cumulative grade point average of at least 2.75 to continue to receive the scholarship.)

As part of the communications and outreach plan, TSAC has developed regional offices at locations across the state and is in the process of adding new sites for regional offices. Offices have been established at East Tennessee State University and at the University of Memphis. TSAC has recently received approval to establish a regional office at Bethel College in McKenzie, and it is in communication with Tennessee Technological University in Cookeville to explore the possibility of having a regional office at that school. TSAC staff who work at the regional offices also live in the nearby communities, and TSAC felt this would help in establishing a more recognizable presence in those areas as well as enable the staff to spend their time more efficiently by being located in their assigned area and not having to spend as much time traveling back and forth from TSAC's main office in Nashville.

TSAC publishes a monthly newsletter that is distributed to lenders, individuals involved in financial aid, and the agency's board of directors. The newsletter contains information such as legislative updates, agency staff changes, system upgrades, and upcoming events. The newsletter is also posted on the agency's website.

To determine the impact of TSAC's focused effort and communication and outreach, we interviewed 32 people from the education community including staff from colleges and universities, lenders, and the state Department of Education. Overall, the response regarding TSAC's communication and outreach efforts was very positive, and the majority of those interviewed stated that they had not had any customer service issues with TSAC or any problems with getting information in a timely manner. The following is a summary of the questions asked as well as the responses received:

What changes have you seen over the last few years in TSAC’s communication/outreach efforts?

Response	# of Responses	% of Total Responses
Improved efforts, more efforts	17	53.1%
Decreased efforts	1	3.1%
No change	14	43.8%
Total	32	100.0%

Do you have any problems getting information from TSAC in a timely manner?

Response	# of Responses	% of Total Responses
Yes	4	12.5%
No	27	84.4%
Has not contacted TSAC	1	3.1%
Total	32	100.0%

Do you have any customer service issues with TSAC?

Response	# of Responses	% of Total Responses
Yes	4	12.5%
No	27	84.4%
Has not contacted TSAC	1	3.1%
Total	32	100.0%

How are TSAC’s printed materials? Are they informative, helpful?

Response	# of Responses	% of Total Responses
Printed materials are informative, helpful	22	68.8%
Has not seen recent publications	6	18.8%
Concerned about timeliness of brochures	1	3.1%
N/A	3	9.4%
Total	32	100.0%

How could TSAC improve its communication/outreach efforts?

Response	# of Responses	% of Total Responses
No suggestions for improvement	23	72.0%
More visible representation	1	3.1%
Improve service from counselors	2	6.3%
Promote TSAC programs as much as possible	1	3.1%
Promote loan guarantor data applications	1	3.1%
Continue to keep website current	1	3.1%
Increase visibility in Mississippi	1	3.1%
Did not answer	1	3.1%
More outreach efforts w/ lenders	1	3.1%
Total	32	100.0%

TSAC should continue its focus on improving communications as well as developing relationships with the education community. Financing higher education in Tennessee has changed tremendously with the introduction of the lottery scholarship program. It is important that TSAC continue to educate people not only about the lottery scholarship program but about all of the financial aid opportunities available to students.

LENDER REVIEW PROCESS IMPROVED

The Tennessee Student Assistance Corporation (TSAC) serves as the state’s student loan guaranty agency and is required to conduct biennial on-site reviews of each participating lender whose dollar volume of Federal Family Education Loans made or held by the lender and guaranteed by the agency

1. equaled or exceeded 2% of the total of all loans guaranteed in that year by the agency,
2. caused the lender to be one of the ten largest lenders whose loans were guaranteed in that year by the agency, or
3. equaled or exceeded \$10 million in the most recent fiscal year.

The 2002 performance audit found that the lender reviews by TSAC were similar to reviews by the U.S. Department of Education, thus creating a duplication of effort. The audit noted that according to the U.S. Department of Education, “it is expected that the guaranty agency review would be comparable to the reviews done by the Department of Education” since both groups are basing their reviews on the same criteria and using the same data. The U.S. Department of Education also noted that “to provide more consistency in the review process by both the guaranty agencies and the department, we are close to completing a review guide that will be used by both entities.”

In January 2004, the U.S. Department of Education began a pilot program that was developed to streamline the lender review process and eliminate duplications in the review of lenders. The program, known as the Common Review Initiative (CRI), has participating state guaranty agencies across the United States. The program uses the same previously stated lender review requirements; the only difference is that the reviews are now streamlined through the CRI rather than each guarantor conducting its own review. At the end of the year, each guarantor is responsible for sending lender information to a CRI Review Committee. This lender information includes the guarantors’ top 10 lenders for that period and the volume for each. The CRI Review Committee will determine which lenders are required to be reviewed during a specific year and asks each guarantor who deals with that lender to submit information to the committee regarding loan volume so that the committee can pull a sample of data for each guarantor involved with that lender. The CRI assigns a review team to conduct the review, and the results of the review are available to everyone with access to the CRI database. TSAC staff stated that while this may still be a pilot program, they feel the program has been very positive in achieving its goals and they feel confident that the program will be continued. TSAC has recently trained one lead lender reviewer who will participate in 6-7 CRI review teams per year.

The 2002 performance audit also noted that TSAC had no formal system for tracking institution or lender reviews. In response to the audit, TSAC developed a spreadsheet that is used to track school reviews and also tracks correspondence dates related to the reviews. TSAC also uses the U.S. Department of Education’s Postsecondary Education Participants System (PEPS) as part of tracking school reviews. PEPS is a database that guarantors use to report information about lender and school reviews to the U.S. Department of Education. This database allows the agency to see if another agency has conducted a review of a school and what the findings of that review were. This database also allows TSAC to schedule reviews more effectively and makes the results of other reviews readily available.

FINANCIAL AND COMPLIANCE AUDIT REPORT

The financial and compliance audit of TSAC for the year ended June 30, 2007, addressed the following areas:

- TSAC management and the audit committee have failed to carry out their respective responsibilities regarding adequate controls and oversight of entries to its accounting records and performance of documented risk assessment activities, increasing the risks of errors in financial statements and the possibility that fraud, waste, and abuse could occur and not be detected timely.
- Management submitted the annual financial report for the Federal Family Education Loans Program late and with significant errors.

FINDINGS AND RECOMMENDATIONS

1. TSAC did not adequately monitor its contractor, Nelnet Guarantor Solutions (NGS)

Finding

The Tennessee Student Assistance Corporation (TSAC) contracts with Nelnet Guarantor Solutions, Inc., (NGS) to provide computer processing services used for guaranteeing student loans and administering various student assistance programs which include grants, scholarships, and tuition loan forgiveness programs. The \$48 million contract also requires NGS to maintain and support the general ledger system. The contract began on January 1, 2006, and will end on December 31, 2010. TSAC does not adequately monitor the contract with NGS, resulting in failure to detect accounting errors and lack of compliance with the contract. (See finding 2 regarding lack of penalties.)

The August 11, 2006, U.S. Department of Education Forms 2000 Review Report found two errors in NGS' calculations. The review focused on TSAC data reported to the US Department of Education (ED) and data from which the agency financial statements are produced, National Student Loan Data System (NSLDS) reasonability reports, and an analysis of the Guaranty Agency Scorecard. The period of the review was 10/1/03 through 9/30/05. NGS miscalculated an amount in a monthly spreadsheet of collections retention reported to TSAC in August of 2005. This \$24,240.06 error caused TSAC to deposit too much into the Federal Fund. Another error of \$9,373.40 was found in the calculation of the reinsurance rate reported. TSAC reported \$472,281.57 as its reinsurance amount but should have reported \$462,908.17.

TSAC's lack of centralized monitoring of the contract has led to the agency's failure to prevent or detect errors and will inhibit detecting these types of errors in the future. Additionally, NGS did not fulfill the following terms and provisions of the contract:

- Providing an online user manual for the newly implemented GuaranteePro system within 90 days of the contract start date;
- Completing quarterly SAS 70 or SysTrust data reliability and security audits; and
- Placing the system source code in an escrow account with a TSAC-approved escrow company.

Online User Manual

The contract requires NGS to provide a comprehensive user guide online in an electronic format within 90 days. Since the Guarantee Pro System was implemented in January 2007, the online guide should have been available by the end of March 2007. As of June 2007, the Associate Executive Director for Loan Administration at TSAC stated that all of the user guides, with the exception of GuaranteePro, were online and could be accessed by users once they had

logged into the program. NGS had not completed the online version of the GuaranteePro user guide but had provided the agency with a hard copy “Training Guide.”

TSAC management was aware this manual was not complete or provided electronically six months after implementation, yet TSAC took no action to ensure NGS’ compliance with the contract. Lack of such a manual available to all users could cause users to make unnecessary errors because they did not adequately understand system functions.

Quarterly Data Reliability and Security Audits

The contract requires that NGS provide data reliability and security audits equivalent to an SAS 70 or SysTrust audit on a quarterly basis. A SAS 70 audit (*Statement on Auditing Standards no. 70: Audits of Service Organizations*) allows service organizations such as NGS to disclose their control activities and processes to their customers and their customers’ auditors in a uniform format. A SysTrust report evaluates a system’s reliability in terms of availability, integrity, and security. (SysTrust is an assurance service developed by the American Institute of Certified Public Accountants and the Canadian Institute of Chartered Accountants.) The annual compliance attestation reports prepared by the NGS independent auditor, KPMG, have been limited in scope for the last four years and only cover NGS’ loan servicing operations. The Associate Executive Director for Loan Administration stated that the agency did not feel a need for SAS 70 or SysTrust audits because they would have been conducted on an old system that the agency and NGS were working toward upgrading to the new Guarantee Pro system and transferring this data into the new system. Omission of these required audits could result in undetected processing and security problems impacting the accuracy and reliability of the student data.

Source Code Not in an Escrow Account

TSAC has purchased the software and all rights to it, and the contract requires NGS to place a hard copy of the system source code with an escrow company that TSAC has approved. Access to the source code enables TSAC or a vendor of its choosing to reproduce or enhance the processes provided by NGS, should the contract with NGS end. The Associate Executive Director for Loan Administration stated that NGS has not complied with this requirement. Failure of the vendor to place a copy of the source code into an approved escrow account essentially negates TSAC’s ownership rights. In addition, the failure deprives the state of a purchased asset and potentially creates the need to start anew in future development or enhancements, thereby duplicating at least part of the expenditure.

According to the Associate Executive Director for Compliance and Legal Affairs, program divisions monitor NGS performance as it relates to their program function. However, the various examples of noncompliance with this contract’s terms and provisions appear to be the result of inadequate centralized monitoring. For example, the contract does not tie the provisions for the source code and the service provider audits to a specific program activity because those provisions apply to all programs. Because there are no centralized monitoring procedures, TSAC

management does not have adequate oversight controls in place to ensure that NGS is fulfilling all of the contractual requirements.

Recommendation

The Tennessee Student Assistance Corporation should review the contract with Nelnet Guarantor Solutions, a subsidiary of Nelnet, Inc., and institute a comprehensive contract oversight procedure to ensure that the vendor has met all of the terms and provisions of the contract. TSAC should consider focusing the overarching responsibility for the contract to a central authority capable of monitoring the vendor's compliance with all contract provisions.

To reduce the potential for unbalanced bidding, TSAC should review the contract and determine if all services which NGS failed to provide are actually necessary. For example, if NGS knows that certain tasks required by the contract are not required or reviewed regularly, they can bid lower than other vendors that do not have the same inside knowledge. Also, some vendors may not even bid because they know they cannot meet the specifications of the contract at a cost competitive to that of NelNet. If TSAC finds that certain contractual obligations are not necessary, they should be omitted from future RFPs and the costs to the state should be reduced accordingly.

Because NGS failed to perform in accordance with various terms or provisions of the contract, TSAC should consider NGS in breach of the contract and pursue all legal remedies for contract breach or consider terminating or amending the contract. (See finding 2.)

Management's Comment

We concur in part, as follows.

Failure to prevent or detect accounting and Form 2000 errors.

We concur. As addressed in our response to the financial and compliance audit for FYE 6/30/07, management is in the process of developing accounting policies and procedures to strengthen internal controls to prevent such accounting and reporting errors. These policies and procedures will include guidelines for all accounting processes. They will include reviewing and approving general ledger balances, adjusting journal entries, reconciliations, NGS billings, etc. Cut-off procedures will be established to appropriately record transactions in the correct fiscal year for preparation of financial statements. Also outside training is being sought to properly prepare the Form 2000 report. Written policies and procedures for the preparation of the GAFR Form 2000 report will also be developed.

Online User Manual.

We do not concur. While we agree that an online manual was not provided for the GuaranteePro product, we do not believe that this is an issue. The GuaranteePro product is used by TSAC staff in the Nashville office, and printed training manuals were provided to the appropriate TSAC staff. GuaranteePro is not used by financial aid officers or lenders across the state so there is no reason to publish an online training manual for their use. However, in order to respond positively to this audit finding, a user manual will be placed online by April 1, 2008 for the use of TSAC staff in the Nashville office.

Quarterly Data Reliability and Security Audits.

We concur. Because NGS was in the process of developing a new loan system at the beginning of the current contract, TSAC delayed the requirement that a Type II SAS70 audit be conducted until after the new loan system was in place and stable. TSAC found no value in requiring an audit of a legacy system with a short remaining life span. In the third quarter of calendar year 2007, NGS engaged KPMG to perform a readiness report as a precursor to a full Type II SAS70 audit. Once the readiness report has been received and reviewed, KPMG will be instructed to proceed with the Type II SAS 70 audit. NGS has advised TSAC that they will notify TSAC of the results of the audit and remedy any deficiencies found as stated in our contract. The readiness report has been prepared and TSAC received a copy on March 7. After reviewing the readiness report, by April 1, 2008, TSAC will instruct NGS to move forward with the next phase of the audit.

Source Code not in an Escrow Account.

We concur. In September 2007, NGS notified TSAC of its proposed escrow company, and TSAC approved the named company. To date, NGS has not confirmed to TSAC that the source code has been placed with the escrow company. TSAC will seek confirmation by April 1, 2008. The auditors' specific recommendations (paraphrased) and TSAC's responses follow:

- o TSAC should institute a comprehensive contract oversight procedure

Given the dual nature of the current contract (loans and grants), comprehensive contract oversight is especially cumbersome. Rather, TSAC's approach has been for the chief loan officer to oversee the loan portion of the contract and the chief grant officer to oversee the grant portion of the contract. Comprehensive oversight will not be an issue with future contracts, as TSAC expects to issue separate contracts for grant services and for loan services, rather than issuing a single contract for all services (as is the case currently).

- o TSAC should determine if all services which NGS failed to provide are actually necessary

This recommendation is underway as part of the process by which TSAC is writing an RFP and preparing for the next contract.

- TSAC should consider NGS in breach of the contract and pursue all legal remedies

TSAC will seek advice from the Tennessee Attorney General.

2. The Nelnet Guarantor Solutions contract does not adequately address liquidated damages for failure to perform all contractual obligations

Finding

TSAC has a \$48 million contract with Nelnet Guarantor Solutions (NGS) for computer processing services for student assistance programs and for maintaining the general ledger system for the term January 1, 2006, through December 31, 2010. The Schedule of Liquidated Damages provides for financial penalties to NGS for not completing various day-to-day student loan responsibilities such as timely processing of:

- loans;
- notices and letters;
- forms;
- deposits of payments on defaulted loans, guarantee fees, and adjustments;
- unresolved disputes;
- help line calls;
- reinsurance payment data; and
- changes to systems or other documents NGS prepares for TSAC.

The contract's schedule of liquidated damages does not cover the omissions of required audits or of failing to put the source code into an approved escrow company. (See Finding 1.) It does not list any penalties in the liquidated damages schedule that apply to the Tennessee Student Assistance Award, the Tennessee Education Lottery Scholarship, or General Ledger transactions processed by Nelnet.

Recommendation

Future contracts should cover non-performance of contract requirements in the schedule of liquidated damages.

Management's Comment

We do not concur. The contract does include liquidated damages provisions for certain violations of the contract by the contractor in which the measure of damages was determinable and determined in advance. We do not consider it reasonable to expect that the schedule of liquidated damages will address every conceivable violation. The Office of Contract Review (OCR) reviewed the schedule of liquidated damages and raised no objection. Nevertheless, in future contracts, TSAC will consider expanding the schedule of liquidated damages.

3. By accepting meals from Nelnet Guarantor Solutions (NGS), the agency's contractor and a company who employs lobbyists in the state, TSAC staff may have violated Section 3-6-305, Tennessee Code Annotated

Finding

Section 3-6-305(a)(2), *Tennessee Code Annotated*, prohibits executive branch employees (as public officials) from accepting a gift from a lobbyist or the employer of a lobbyist. TSAC contracts with Nelnet Guarantor Solutions, Inc., (NGS) to provide computer processing services used for guaranteeing student loans and administering student assistance programs which include grants, scholarships, and tuition loan forgiveness programs and to maintain TSAC's general ledger. Nelnet, Inc., NGS' parent company, is listed on the Tennessee Ethics Commission's website as employing lobbyists. The Associate Executive Director for Loan Administration told the auditors that a representative from NGS had taken two of TSAC's staff members to lunch in August 2007 while in Nashville and has done so in the past.

The Tennessee Ethics Commission's *Guiding Principles of Ethical Conduct for Public Officials* states, "A public official should not solicit, receive, or accept a gift, favor, or service from any entity or individual which has a matter before the public official or the public official's direct authority, under circumstances where it could reasonably be inferred that such gift would influence the official in the discharge of his or her duties." This publication further states, "Public officials should be independent and impartial, and should avoid conflicts of interest and the appearance of conflicts of interest when performing their duties."

As representatives of TSAC, employees should not accept meals and/or other gifts offered by lobbyists or employers of lobbyists. In addition, Governor Bredesen's Executive Order No. 3 prohibits state employees from accepting gifts from any person or entity that has is or is seeking to obtain contractual or financial relations with the state department or agency in which the individual is employed. State employees are responsible for the public trust and should not jeopardize that trust by accepting gifts or favors that could influence future decisions of the agency. The appearance of such improprieties to potential vendors may affect whether other qualified vendors choose to bid on RFPs for TSAC in the future.

Recommendation

TSAC employees and officials should carefully review Section 3-6-305, *Tennessee Code Annotated*, regarding accepting gifts from lobbyists and employers of lobbyists to ensure TSAC staff remain independent and impartial while performing their duties for the state. They should request a formal advisory opinion from the Tennessee Ethics Commission to help them to ensure that staff are complying with all applicable laws.

The Executive Director and the Audit Committee should determine if there have been any other gifts/trips related to NGS or any other vendors, including periods before TSAC entered the contract with NGS.

Management's Comment

We do not concur. TSAC has received an "informal staff opinion" from the Tennessee Ethics Commission General Counsel indicating that TSAC is not an executive branch agency and its employees are not subject to the prohibited gifts provision of Section 3-6-305, *Tennessee Code Annotated*. Nevertheless, TSAC acknowledges that accepting gifts could create an appearance of impropriety and might be considered inconsistent with the Tennessee Ethics Commission's *Guiding Principles of Ethical Conduct for Public Officials* or Governor Bredesen's *Executive Order No. 3*. Thus, TSAC will develop an agency policy which will prohibit any TSAC employees from soliciting, receiving or accepting a gift, favor or service from an entity or individual where to do so might create the appearance of a conflict of interest in performing such employee's duties except under clearly defined circumstances. This policy will be developed by June 30, 2008.

4. TSAC should improve information security controls over the computer system for grant and scholarship applications

Finding

Several hundred employees of postsecondary schools have access to TSAC's computer system for grant and scholarship applications (eGRandS). The eGRandS system, operated and maintained by Nelnet Guarantor Solutions, contains personal financial information about students and their parents. TSAC is responsible for securing that data from unauthorized access. The auditors observed conditions that violated best practices for information security controls during the audit.

The wording of this finding does not identify specific vulnerabilities that could allow someone to exploit TSAC's computer system. Disclosing these vulnerabilities could present a potential security risk by providing readers with information that might be confidential pursuant

to Section 10-7-504(i), *Tennessee Code Annotated*. We provided TSAC with detailed information regarding specific vulnerabilities as well as our recommendations for improvement.

Recommendation

TSAC management should ensure that these conditions are remedied by the prompt development and implementation of effective controls. Management should ensure that risks associated with this finding are adequately identified and assessed in TSAC's risk assessment. Management should implement effective controls to ensure compliance with applicable requirements, assign staff to be responsible for ongoing monitoring of the risks and mitigating controls, and take action if deficiencies occur.

Management's Comment

We concur. TSAC is taking specific steps, beginning in April 2008, to improve information security controls.

5. TSAC needs a policy for reporting illegal, wasteful, or fraudulent activity

Finding

Section 4-35-107, *Tennessee Code Annotated*, requires audit committees created under the "State of Tennessee Audit Committee Act of 2005" to establish a process for confidential reporting of illegal, improper, wasteful, or fraudulent activity by employees and other citizens. This statute also prohibits retaliatory actions against those who report or cooperate with the audit committee or other auditors. The statute further states that anyone who knowingly or willingly retaliates or takes adverse action of any kind against any person for reporting alleged wrongdoing under this section commits a Class A misdemeanor.

The TSAC audit committee charter describes one of the audit committee's duties to "ensure that TSAC develops procedures for the receipt, retention, and treatment of complaints about accounting, internal controls, or auditing matters." When asked about this policy, the internal auditor stated that there is no policy; TSAC follows the charter. There is nothing in the charter that would ensure employees know where to report or that the reports would be confidential and the employee would be safe from retaliation. Without these mechanisms in place, employees are less likely to report unethical conduct or violations because they are unsure whom to contact, there is no confidentiality of reporting, and/or they fear retaliation by their superiors or co-workers. The Audit Committee Chair stated that the committee began working on a policy for anonymous reporting of suspected fraud, waste, and abuse on September 12; however, as of November 27, 2007 the policy was not complete.

Recommendation

The audit committee should establish clear policies and procedures for the confidential reporting of instances of fraud, waste, or abuse. The policy regarding fraud, waste, and abuse should be clearly communicated to employees to ensure that they understand there will be no retaliation by superiors or coworkers for filing reports. TSAC may wish to review the Tennessee Higher Education Commission's brochure titled, "Reporting and Preventing Fraud, Waste, or Abuse."

Management's Comment

We concur that this statement was correct at the time of the audit, but note that the issue has been resolved.

On September 12, 2007, the Audit Committee discussed TCA 4-35-107, *Establishment of confidential reporting of illegal, improper, wasteful or fraudulent activity*. As a result of the September 12 Audit Committee Meeting, TSAC management has developed a Fraudulent and Dishonest Conduct Policy encouraging employees to report fraudulent and unethical conduct. All employees have signed an acknowledgment of Fraudulent and Dishonest Conduct Policy, and are required to do so annually.

A link labeled "Fraud, Waste, and Abuse Hotline," has been added to TSAC's webpage at http://www.state.tn.us/tsac/about_us.htm. The link encourages individuals to report illegal, wasteful, or fraudulent activity by directing individuals to the Comptroller's hotline. The following statement is on the web page: "The Tennessee Student Assistance Corporation is a recipient of taxpayer funding. If you observe an agency director or employee engaging in any activity which you consider to be illegal, improper, or wasteful, please call the **State Comptroller's toll free hotline: 1-800-232-5454**." This statement is also posted in public and employee break areas throughout the TSAC office.

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- 6. The Tennessee Student Assistance Corporation still lacks processes for notifying licensing authorities of defaulted student loans that can lead to the suspension, denial, or revocation of any professional licenses held by those in default**

Finding

In 1999, the Tennessee General Assembly passed legislation requiring that licensing authorities (i.e., boards, commissions, committees, etc.) attached to the Department of Commerce and Insurance's Division of Regulatory Boards or the Department of Health's Division of Health Related Boards "suspend, deny or revoke the license of, or take other such appropriate disciplinary action against, any person who has defaulted on a repayment or service obligation" related to a financial assistance program administered by TSAC or another guaranty agency.

Legislation also encouraged the Supreme Court “to establish guidelines to suspend, deny or revoke the license of an attorney who is delinquent or in default on a repayment or service obligation” related to a program administered by TSAC or another guaranty agency.

The December 2002 performance audit reported that the administrator of TSAC’s loan program was working on methods to compare TSAC’s loan recipients who were in default to the Department of Health’s database of licensed health professions.

Since 2002, TSAC has made little progress in developing a method to inform licensing bodies of those in default. According to the Associate Executive Director for Loan Administration, a staff position for implementing the license revocation and administrative wage garnishment processes was created in January 2007; however, as of April 30, 2007, this position had not been filled. The Associate Executive Director for Loan Administration also stated that he did not want to pursue these processes further until this position is filled. He drafted a letter to the Assistant Commissioner of the Division of Regulatory Boards at the Department of Commerce and Insurance requesting a meeting to discuss how the two agencies might coordinate efforts in complying with the statute but has not sent it. The Associate Executive Director for Loan Administration also stated that he would first like to work toward a voluntary payment plan and wants revocation of someone’s license to be a last resort.

Section 56-1-312, *Tennessee Code Annotated*, gives TSAC statutory authority to request disciplinary action by regulatory boards. Such disciplinary action would include revoking professional licenses of individuals who default on their student loans. 20 U.S.C.A. 1095a gives TSAC, as a guaranty agency, the ability to garnish the pay of individuals who are not making required payments under a repayment agreement. Without implementing these processes, individuals who are defaulting on their student loans are allowed to continue practicing or maintain their licensing without facing the consequences of not repaying their educational loans. According to TSAC, the total number of loans in default for fiscal year 2006-2007 was 26,960 loans for \$94.4 million.

Recommendation

TSAC should immediately contact the Division of Regulatory Boards at the Department of Commerce and Insurance and the Division of Health Related Boards at the Department of Health to develop an efficient method to identify default loan recipients who hold professional licenses so that these regulatory agencies can take disciplinary action.

The Associate Executive Director of Loan Administration should ensure this process is implemented so as to ensure that those students needing financial assistance are not denied due to others’ non-repayment of loans.

Management's Comment

We concur. Although preliminary steps have begun, more detailed operational aspects such as file structures, database field definition and tracking processes are not yet complete. By July 1, 2008, TSAC expects to have worked with at least one licensing authority on a pilot project.

7. The Tennessee Student Assistance Corporation lacks required and necessary documentation for the agency's board of directors

Finding

The Tennessee Student Assistance Corporation (TSAC) has a board of directors that consists of the following 17 members:

- the Governor,
- the Commissioner of the Department of Education,
- the State Treasurer,
- the Comptroller of the Treasury,
- the Commissioner of the Department of Finance and Administration,
- the Director of the Higher Education Commission,
- the President of the Tennessee Independent Colleges and Universities Association,
- the President of the Tennessee Proprietary Business School Association,
- the Chair of the Tennessee Independent Colleges and Universities Association,
- the President of the University of Tennessee,
- the Chancellor of the Tennessee Board of Regents,
- the President of the Tennessee Association of Student Financial Aid Administrators,
- a representative of a commercial lender,
- a student enrolled in an institution of higher education in Tennessee,
- three private citizens involved in the field of education but not employed by or professionally affiliated with any institution of higher education in the state,

The private and citizen members are appointed to a three-year term on the board. The student members are appointed to a one-year term, and the student appointments alternate between public and private institutions. The board elects its own chair and appoints an executive director for the agency.

We reviewed conflict-of-interest forms for TSAC employees and board members, information regarding board member designees, and board member appointment data. TSAC lacks appropriate documentation pertaining to the board in all of these areas.

Conflict-of-Interest Forms

TSAC’s policy requires board members to sign conflict-of-interest forms annually. For the purpose of this audit, we reviewed the conflict-of-interest forms filed for the time period July 1, 2002, through June 30, 2007. The board consists of 17 members, and the following table breaks down the missing forms by board position for each fiscal year. (Note: Since the agency did not maintain detailed information regarding board member terms, it was not possible to determine how many people were serving on the board during each fiscal year or even if the board membership was complete. This table does not include forms that may have been missing for designees since the agency does not keep documentation on file for individuals serving as designees.)

Board Members Missing Conflict-of-Interest Forms

	FY2002-2003	FY2003-2004	FY2004-2005	FY2005-2006	FY2006-2007
# Missing Form	6	5	1	6	4

The forms provide a place for an individual’s signature; however, there is no place on the form for an individual to print his or her name. During the review, there were five conflict-of-interest forms that had illegible signatures. The agency should consider adding typed names and positions to each form so that the person signing the form can be clearly identified.

Written Statements for Designees

Section 49-4-202, *Tennessee Code Annotated*, allows TSAC board members (with the exception of the commercial lender representative, student representative, and the private citizens) to designate an individual to serve in their place on the board. The designee has the same voting and participating privileges as the appointed member. The member must submit the designation in writing to the chairman of the board and file a copy with TSAC’s executive director as well as the Secretary of State’s Office.

The agency was unable to provide these written designations for individuals who have a designee serving in their place on the board. In addition, officials with the Secretary of State’s Office stated that they did not have any documentation related to designees serving on the TSAC board. The following members have designees: the Governor, State Treasurer, Commissioner of the Department of Finance and Administration, the Director of the Tennessee Higher Education

Commission, the President of the University of Tennessee, the chancellor of the Board of Regents, and the Comptroller of the Treasury.

Since a designee has the same voting and participation privileges as an appointed member, it is important that the agency maintain documentation concerning who is authorized to serve in another individual's place. It is also important that the designees complete a conflict-of-interest form for each term that they serve and disclose any relationships or interests that could conflict with the business of the agency.

Member Appointment Data

TSAC does not maintain adequate information on board members such as appointment date, term expiration date, and agency/position represented. Because the agency was unable to provide this information, it was not possible to determine the terms of the individuals who served on the board for the scope of the audit. It was also not possible to determine if any of the individuals who were missing conflict-of-interest forms had signed forms for each year in the period of their term on the board since the information regarding term appointment dates and term expiration dates was incomplete. As previously mentioned, the agency does not maintain documentation on individuals who have a designee serving in their place on the board. The agency not only lacks information on the board member making the designation but also lacks information on the person serving as the designee.

Recommendation

The Tennessee Student Assistance Corporation should obtain conflict-of-interest forms from all board members and board member designees on an annual basis. The conflict-of-interest forms should include a space for members to print their name as well as a place for their signature.

The agency should also maintain documentation that details each board member's position/agency represented, term appointment date, and term expiration date.

With regard to designees, if an individual wishes to designate someone to serve in his or her place on the board, the agency should have this information documented in writing and collect conflict-of-interest forms from those individuals designated to serve in another's place. The documentation authorizing the designees should also be on file with the Secretary of State's Office.

Management's Comment

We concur that this statement was correct at the time of the audit, but note that the issue has been resolved. For the 2007-2008 year, signed conflict-of-interest forms are on file for all board members and alternates, all alternates are documented, and member appointment details are complete.

RECOMMENDATIONS

ADMINISTRATIVE

The Tennessee Student Assistance Corporation should address the following areas to improve the efficiency and effectiveness of its operations.

1. The Tennessee Student Assistance Corporation (TSAC) should review the contract with Nelnet Guarantor Solutions (NGS), a subsidiary of Nelnet, Inc., and institute a comprehensive contract oversight procedure to ensure that the vendor has met all of the terms and provisions of the contract. TSAC should consider focusing the overarching responsibility for the contract on a central authority capable of monitoring the vendor's compliance with all contract provisions.

To reduce the potential for unbalanced bidding, TSAC should review the contract and determine if all services which NGS failed to provide are actually necessary. For example, if NGS knows that certain tasks required by the contract are not required or reviewed regularly, it can bid lower than other vendors that do not have the same inside knowledge. Also, some vendors may not even bid because they know they cannot meet the specifications of the contract at a cost competitive to that of Nelnet. If TSAC finds that certain contractual obligations are not necessary, they should be omitted from future RFPs, and the costs to the state should be reduced accordingly.

Because NGS failed to perform in accordance with various terms or provisions of the contract, TSAC should consider NGS in breach of the contract and pursue all legal remedies for contract breach or consider terminating or amending the contract.

2. Future contracts should cover non-performance of contract requirements in the schedule of liquidated damages.
3. TSAC employees and officials should carefully review Section 3-6-305, *Tennessee Code Annotated*, regarding accepting gifts from lobbyists and employers of lobbyists to ensure TSAC staff remain independent and impartial while performing their duties for the state. They should request a formal advisory opinion from the Tennessee Ethics Commission to help them to ensure that staff are complying with all applicable laws.

The Executive Director and the Audit Committee should determine if there have been any other gifts/trips related to NGS or any other vendors, including periods before TSAC entered the contract with NGS.

4. TSAC management should ensure that these conditions are remedied by the prompt development and implementation of effective controls. Management should ensure

that risks associated with this finding are adequately identified and assessed in TSAC's risk assessment. Management should implement effective controls to ensure compliance with applicable requirements, assign staff to be responsible for ongoing monitoring of the risks and mitigating controls, and take action if deficiencies occur.

5. The audit committee should establish clear policies and procedures for the confidential reporting of instances of fraud, waste, or abuse. The policy regarding fraud, waste, and abuse should be clearly communicated to employees to ensure that they understand there will be no retaliation by superiors or coworkers for filing reports. TSAC may wish to review the Tennessee Higher Education Commission's brochure titled, "Reporting and Preventing Fraud, Waste, or Abuse."
6. TSAC should immediately contact the Division of Regulatory Boards at the Department of Commerce and Insurance and the Division of Health Related Boards at the Department of Health to develop an efficient method to identify default loan recipients who hold professional licenses so that these regulatory agencies can take disciplinary action.

The Associate Executive Director of Loan Administration should ensure this process is implemented so as to ensure that those students needing financial assistance are not denied due to others' non-repayment of loans.

7. The Tennessee Student Assistance Corporation should obtain conflict-of-interest forms from all board members and board member designees on an annual basis. The conflict-of-interest forms should include a space for members to print their name as well as a place for their signature.

The agency should also maintain documentation that details each board member's position/agency represented, term appointment date, and term expiration date.

With regard to designees, if an individual wishes to designate someone to serve in his or her place on the board, the agency should have this information documented in writing and collect conflict-of-interest forms from those individuals designated to serve in another's place. The documentation authorizing the designees should also be on file with the Secretary of State's Office.

APPENDIX A TITLE VI INFORMATION

All programs or activities receiving federal financial assistance are prohibited by Title VI of the Civil Rights Act of 1964 from discriminating against participants or clients on the basis of race, color, or national origin. In response to a request from members of the Government Operations Committee, we compiled information concerning federal financial assistance received by the Tennessee Student Assistance Corporation (TSAC), and the corporation's efforts to comply with Title VI requirements. The results of the information gathered are summarized below.

TSAC received \$107,863,630 in federal revenue for fiscal year 2006, of which \$99,932,622 was for the Federal Family Education Loan Program, \$6,636,154 was for TSAC administration, and \$1,294,854 was for TSAC awards. The federal government, through the U.S. Department of Education, issues rules and regulations that govern student financial assistance.

We obtained and reviewed the "FY 2007 (2006-2007) Title VI Implementation Plan," which was filed with the Division of State Audit as required. According to the Title VI Plan, TSAC's Compliance Administrator also serves as the Title VI coordinator (with assistance from TSAC's Personnel Officer). The Title VI coordinators' duties include preparing the annual Title VI Implementation Plan, ensuring that TSAC staff have received training and information relating to the Title VI program, and ensuring that Title VI information is appropriately displayed in TSAC's office and on relevant TSAC documents. The Personnel Officer monitors regional demographics of program applicants and obtains surveys from contractors, subcontractors, and special programs participants. Although Title VI compliance falls under the purview of the U.S. Department of Education, TSAC sent surveys to 122 Tennessee Student Assistance Award eligible educational institutions. TSAC obtained responses from 107, or 88%, of the schools surveyed. The responses are filed in the FY2007 Title VI Implementation Plan. TSAC received no Title VI complaints in the last year.

TSAC includes a non-discrimination clause in its contracts that in essence requires the contractor to comply with Title VI and Title IX. In signing the contract, every contracting agency, as well as every subrecipient, agrees to the non-discrimination clause. TSAC staff also monitor Title VI complaints received by contractors. According to the Title VI Plan, one contractor had three complaints during fiscal year 2006 which have been resolved, and the three subcontractors did not have any complaints to report. TSAC's Personnel Officer surveyed 107 schools, colleges, and universities regarding their fiscal year 2006 Title VI complaints. The survey indicated that 98 had received no complaints, 4 had received complaints that were resolved during the fiscal year, and 5 still had complaints pending.

Below are tables detailing TSAC's staff, board members, and program participants by gender and ethnicity, as well as a list of companies and institutions that contract with TSAC. Following those tables is a table of the delegated authority contracts listed by program.

**Staff of the Tennessee Student Assistance Corporation by Title, Gender, and Ethnicity
April 2007**

<i>Title</i>	<i>GENDER</i>		<i>ETHNICITY</i>			
	<i>Male</i>	<i>Female</i>	<i>White</i>	<i>Black</i>	<i>Asian</i>	<i>Other</i>
Account Clerk	0	2	2	0	0	0
Accountant	0	1	1	0	0	0
Accounting Technician	3	2	4	0	1	0
Administrative Assistant	1	1	2	0	0	0
Administrative Secretary	0	4	3	1	0	0
Administrative Services Assistant	0	1	1	0	0	0
Associate Executive Director	3	1	4	0	0	0
Clerk	1	2	1	2	0	0
Collections Manager	1	0	1	0	0	0
Compliance Administrator	0	1	0	1	0	0
Compliance Coordinator	1	0	1	0	0	0
Director	1	1	2	0	0	0
Executive Director	1	0	1	0	0	0
Financial Aid Program Specialist	2	5	7	0	0	0
Financial Analyst	1	0	1	0	0	0
Fiscal Director	1	0	1	0	0	0
Human Resources Analyst	0	1	1	0	0	0
Internal Auditor	1	1	1	1	0	0
Legal Assistant	0	1	1	0	0	0
Outreach Specialist	0	3	2	1	0	0
Program Administrator	1	1	1	1	0	0
Telephone Operations Supervisor	0	1	0	1	0	0
Totals	18	28	38	7	1	0

Source: Tennessee Student Assistance Corporation's staff listing.

**Board Members of the Tennessee Student Assistance Corporation
by Gender and Ethnicity
June 2006**

	<i>Gender</i>		<i>Ethnicity</i>	
	<i>Male</i>	<i>Female</i>	<i>White</i>	<i>Black</i>
Board members	11	6	16	1

Source: Tennessee Student Assistance Corporation staff.

**Breakdown of Program Participants by Gender
Fiscal Year 2005-2006**

<i>Program</i>	<i>Male</i>	<i>Female</i>	<i>No Response</i>
Tennessee Student Assistance Award	5,264	13,544	88
Dependent Children Scholarship Program	22	5	0
Tennessee Teaching Scholars Program	25	126	0
Ned McWherter Scholars Program	87	78	0
Minority Teaching Fellows Program	30	83	0
Robert C. Byrd Honors Scholarship	184	339	0
Christa McAuliffe Scholarship Program	0	0	0
Tennessee Hope (only) Scholarship	11,458	16,153	139
General Assembly Merit Scholarship	2,272	2,805	18
Aspire Award	4,294	7,408	86
Tennessee HOPE Access Grant	102	189	7
Wilder-Naifeh Technical Skills Grant	6,094	7,497	126

Source: *Tennessee Student Assistance Corporation FY2007 Title VI Implementation Plan, Appendix A.*

**Breakdown of Program Participants by Ethnicity
Fiscal Year 2005-2006**

<i>Program</i>	Black	White	Hispanic	Native American Indian	Asian	Other	No Response
Tennessee Student Assistance Award	6,766	10,797	166	28	147	132	861
Dependent Children Scholarship Program	6	20	0	0	0	0	1
Tennessee Teaching Scholars Program	3	147	1	0	1	2	0
Ned McWherter Scholars Program	1	145	3	0	12	1	3
Minority Teaching Fellows Program	101	0	5	1	6	0	0
Robert C. Byrd Honors Scholarship	43	448	3		7	3	19
Christa McAuliffe Scholarship Program	0	0	0	0	0	0	0
Tennessee HOPE (only) Scholarship	1,822	24,501	144	12	342	142	787
General Assembly Merit Scholarship	251	4,587	28	2	99	28	103
Aspire Award	1,849	9,021	90	10	267	93	458
Tennessee HOPE Access Grant	102	189	6		2	2	26
Wilder-Naifeh Technical Skills Grant	2,341	8,617	61	21	36	34	2,591

Source: *Tennessee Student Assistance Corporation FY2007 Title VI Implementation Plan, Appendix A.*

**Active TSAC Contracts With Companies and Institutions
Fiscal Year 2006**

Company Name	Services Provided	Amount
Nelnet Guarantor Solutions, Inc. (formerly GuaranTec, LLP)	Loan servicer/General Ledger	\$48,000,000
National Student Loan Clearinghouse	Loan clearing house	<u>430,000</u>
Total to Companies		<u><u>\$48,430,000</u></u>

Institution Name	Services Provided	Amount
Austin Peay State University	High School Guidance Counselor Program	\$3,200
Bryan College	High School Guidance Counselor Program	3,200
Christian Brothers University	High School Guidance Counselor Program	3,200
East Tennessee State University	High School Guidance Counselor Program	3,200
Johnson Bible College	High School Guidance Counselor Program	3,200
King College	High School Guidance Counselor Program	3,200
Lee University	High School Guidance Counselor Program	3,200
Northeast State Technical Community College	High School Guidance Counselor Program	3,200
Southwest Tennessee Community College	High School Guidance Counselor Program	12,800
Tennessee Technology Center At Nashville	High School Guidance Counselor Program	3,200
Tusculum College	High School Guidance Counselor Program	3,200
University of Tennessee - Chattanooga	High School Guidance Counselor Program	27,900
University of Tennessee - Knoxville	High School Guidance Counselor Program	<u>6,400</u>
Total to Education Institutions		<u><u>\$79,100</u></u>

Source: Tennessee Student Assistance Corporation staff.

**Active TSAC Delegated Authority Contracts for Financial Assistance Programs
Fiscal Year 2006**

Program Name	Services Provided	Amount
Robert C. Byrd Scholarship Program	Scholarships	\$813,500
Dependent Children Scholarship Program	Scholarships	250,000
Federal Family Education Loan Program (FFELP)	Bank Claims	125,000,000
Minority Teaching Fellowship Program (MTFP)	Scholarships	580,000
Ned McWherter Scholarships	Scholarships	555,000
Tennessee Student Assistance Award Program	Scholarships	44,365,362
Tennessee Teaching Scholars program (TTSP)	Scholarships	740,000
TN Education Lottery Scholarship Program	Scholarships	206,000,000
Total for Delegated Authorities		\$378,303,862

Source: Tennessee Student Assistance Corporation staff.

APPENDIX B TITLE IX INFORMATION

All programs or activities receiving federal financial funding are prohibited by Title IX of the *Education Amendments Act of 1972*, from discriminating against participants or clients on the basis of gender. The Tennessee Student Assistance Corporation received \$107,863,630 in federal revenue for fiscal year 2006, of which \$99,932,622 was for the Federal Family Education Loan Program, \$6,636,154 was for TSAC administration, and \$1,294,854 was for TSAC awards.

We obtained and reviewed the “FY 2007 (2006-2007) Title IX Implementation Plan,” which was filed with the Division of State Audit as required. TSAC’s Compliance Administrator also acts as the Title VI and Title IX coordinator. Her duties (with assistance from TSAC’s Personnel Officer) include preparing the annual Title IX Implementation Plan, ensuring that TSAC staff have received training and information relating to the Title IX program, and ensuring that Title IX information is appropriately displayed in TSAC’s office and on relevant TSAC documents. TSAC received no Title IX complaints in the last year.

It appears that the agency has substantially complied with its responsibilities for the notification of the public, employee training and awareness, contractor compliance, complaint handling, and data collecting and analysis requirements under Title IX, *Education Amendments Act of 1972*.