

# Demystifying the Compliance Audit

By Sharon Sweeney

**F**or compliance and financial aid staff, preparing for the annual compliance audit often ends up feeling like tax season for accountants. If the institution has been doing what it needed to do all year, the preparation should not be difficult. But like the many taxpayers who don't keep track of business receipts, deductions, and other critical documents—if the institution has not engaged in ongoing activities throughout the year to ensure the necessary information is ready and available for the compliance audit, then preparation can be a truly overwhelming experience. Senior administrators who understand the basics of a compliance audit can better assist compliance staff in developing operations and procedures that lighten the last minute workload and help ensure a clean audit.

To provide a better sense of the process, we'll take you through an audit of "Quality University." Of course, your experience may differ, but by the end of our story, you should have perspective on the types of information your institution will be required to provide, and perhaps some insight into how you might adjust your processes to achieve clean audits with minimal stress.

## Overview

Federal regulations require institutions that participate in the federal

Title IV programs to submit annual compliance audits along with audited financial statements to the U.S. Department of Education (USED). An independent public accountant, in accordance with the Generally Accepted Accounting Principles, must conduct the audit. The audit must be submitted within six months after the close of the institution's fiscal year.

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Institutions with multiple campuses are required to submit a compliance audit for each Office of Postsecondary Education Identification Number (OPE ID) that exists within the institution. Schools with multiple branches submit a single audit for each OPE ID, which incorporates student information from all the branches, and auditors will likely conduct site visits at the branch campuses at least once every other year.

Institutions that view the compliance audit as an audit of the entire institution, rather than an audit of the financial aid office alone, generally experience

cleaner audits. Information and cooperation from the registrar’s office, student accounts and finance, at a minimum, will be necessary to complete the audit. When all departments work together throughout the year and share critical student information, the audit process is likely to be more tolerable and efficient. The amount of time the auditors spend on site and the overall cost of engaging the auditors will be determined based on how well the institution is prepared.

**Compliance Audit of Quality University**

Quality University (Quality U) has an enrollment of approximately 2500 students. Their fiscal year recently ended, and the CFO has once again engaged Eagle Eyes Auditing & Associates (Eagle Eyes) to conduct the annual compliance audit. Several staff members have been assigned the responsibility of preparing for the auditors’ visit. The new director of financial aid has been on board for three months and has been focused on getting acquainted with her new position. She appreciates the help of her colleagues as she attempts to locate all the required documents that are requested in the engagement letter.

**Sample Size**

A list of financial aid recipients was sent to Eagle Eyes Auditing a few weeks prior. The composition of files to be audited was determined based on the fiscal year’s ratio of withdrawn students to the total federal student aid population at Quality U. The ratio was 28 percent, so the audit sample will consist of 50 students who are enrolled, graduated or are on an approved leave of absence and 25 withdrawn students. If the withdrawal ratio were 33 percent or greater, then the sample size would be reversed for enrolled and withdrawn students. Eagle Eyes’ auditors randomly select the student files they choose to audit, but per the requirements, cannot share this information with Quality U until they arrive on campus.

Quality U has hired some temps to catch up on filing. The stacks of financial aid files have piled up. After all, classes will be starting soon, and Quality U has been working hard to get all the students packaged.

**The Audit Begins**

On the first day of the audit, Eagle Eyes sends one auditor who worked on Quality U’s audit last year and two junior auditors. After the initial greetings and introductions, Eagle Eyes hands the list of selected students to the financial aid director.

**Student File Review (All files)**

The financial aid staff finds almost all of the selected files immediately, but there are two files they cannot seem to locate. They deliver the files they found and keep searching for the missing two files. Eagle Eyes will review the files to determine student eligibility and assess the accuracy of the federal aid the students received. They will review the following specifics in each student’s file:

**Student Eligibility**—In order to receive federal student aid, Eagle Eyes knows students must meet general eligibility requirements. The student must:

- Be a regular student enrolled in an eligible program
- Have a high school diploma or a GED or pass an approved ability to benefit test (depending on the admission criteria of the institution) or have the home-schooling equivalent
- Have a valid social security number



**SHARON SWEENEY** is executive vice president of student finance and leads the financial aid consulting practice at Cardean Learning Group. With twenty-five years of experience in financial aid, Sharon has been responsible for administering billions of dollars in student aid. Sharon and her team streamline financial aid processes while helping institutions effectively administer aid through the use of technology and metrics. As a

result, institutions see improved compliance, increased cash flow and lower student receivables.

**Contact Information:**

Sharon Sweeney  
Executive VP/Student Finance  
Cardean Learning Group  
111 N. Canal St., Suite 455  
Chicago, IL 60606-7204  
Phone: 312-669-5199  
E-mail: [ssweeney@cardean.com](mailto:ssweeney@cardean.com)  
Web site: [www.cardean.com](http://www.cardean.com)

- Be a U.S. citizen or permanent resident
- Not be in default on a federal loan or owe an overpayment on a federal grant
- Be registered with selective service (if male between the ages of 18–25)
- Be making satisfactory academic progress

All of the files contain a printed copy of the Institutional Student Information Report (ISIR), which is the electronic document the school receives when a student lists Quality U's school code on his or her Federal Application for Student Aid (FAFSA). Eagle Eyes closely reviews the printed comments on each ISIR. All ISIRs are subject to federal data matches; that is, the information the student submitted on his or her FAFSA is compared with information from the Social Security Administration, Selective Service, the Department of Veteran's Affairs, the Department of Homeland Security and the National Student Loan Data System. If there is a problem with the data match, a "C Code" is generated on the ISIR.

**Attendance**—Although it sounds basic, a student must have actually been in attendance in order to receive federal student aid. Quality U has the option to disburse federal student aid 10 days prior to the start of the term, but they decided not to do so. While this might have been beneficial for Quality U from a cash flow perspective, doing so requires increased administrative oversight to ensure the student actually attended classes. federal Pell Grant disbursements may need to be revised depending on the actual enrollment status of the student. For example, if the student was scheduled to attend full-time but only attended half of the courses, the federal Pell Grant would need to be reduced accordingly. Quality U therefore made the decision to disburse aid beginning with the second week of the term after the add/drop period ends and the students' enrollment has settled.

**Verification**—Approximately 30 percent of all student ISIRs are selected for verification by the USED. Eagle Eyes closely reviews the ISIRs to

determine whether the students were selected for verification as noted with an asterisk on the ISIRs. Verification requires Quality U to obtain a verification worksheet and a copy of the student's (and parents', if applicable) federal tax return. Quality U must match the information on the ISIR with the information supplied on the other required documents. If changes are required, the ISIR must be resubmitted to correct or update the information. Eagle Eyes determines if verification was accurately completed for those students selected in the sample.

**Financial Aid Funds**—Eagle Eyes reviews the cost of attendance budgets assigned to students and makes a determination as to whether the student was packaged appropriately. Total aid in the package cannot exceed the cost of attendance. Need-based aid cannot exceed a student's calculated need, and the federal Pell Grant award must be accurate based on the Expected Family Contribution (EFC) as well as the student's enrollment status. The EFC is calculated by the USED based on the information supplied on a student's FAFSA.

**Entrance Counseling**—Quality U must conduct entrance counseling that explains the rights and responsibilities of borrowing to first-time student loan borrowers before a first disbursement can be made. There must be documentation that the student completed entrance counseling.

**30-Day Disbursement Delay**—If the undergraduate is a first-time, first year student loan borrower, Quality U cannot schedule the first installment of the loan to disburse until the student has been enrolled for 30 days. (There are exceptions for institutions with low default rates.)

**Three-Day Disbursement Rule**—Quality U is required to disburse federal student aid as soon as possible, but no later than three business days after the federal funds are received. The student's ledger will be examined to determine if the disbursement of federal funds occurred within the three-day time period.

**Satisfactory Academic Progress**—Quality U is required to have a satisfactory academic progress (SAP) policy that meets the federal minimum standards. Eagle Eyes will determine if the institution ensured the student was meeting the qualitative (grade point average) and quantitative (progression toward completion) SAP standards. In addition, Quality U must establish the maximum timeframe in which a student is expected to finish their program. Typically, this timeframe cannot exceed 150 percent of the length of the program.

**Credit Balances**—Eagle Eyes will review student ledgers to ensure that any credit balance resulting from federal aid was paid to the student (or parent, if the credit was due to a PLUS loan) within 14 days. Quality U may hold the credit balance provided the student has an authorization on file.

#### **Student File Review (Withdrawn students)**

Eagle Eyes reviews the files of withdrawn students for the same information as that for enrolled students; however, their review of withdrawn student files will also include the following:

**Exit Counseling**—Students who are graduating or no longer enrolled at least half time must receive exit counseling before the end of their program or within 30 days from the time Quality U determines the student is no longer enrolled. Exit counseling reinforces the rights and responsibilities of borrowing and gives students guidance on expected monthly payments. Quality U is required to document that exit counseling took place or that exit counseling information was mailed to the student.

**Return of Title IV Funds**—A student who received federal student aid but did not complete the payment period, or period of enrollment, is required to have a Return of Title IV Funds Calculation performed to determine how much federal aid the student earned. The timeframe for completing the Return Calculation depends on whether an outside entity requires the institution to take attendance and whether the student officially or unofficially withdrew.

The institution has 30 days from the date it determines the student withdrew to perform the Return Calculation and 45 days from the date of determination of the withdrawal to return the unearned federal funds. Eagle Eyes will determine whether the Return Calculations and return of funds were completed within the required timeframes.

#### **Administrative Responsibilities**

In addition to the student file reviews, Eagle Eyes will need to test Quality U's administrative responsibilities:

**Reporting to the National Student Loan Data System (NSLDS)**—Quality U is required to report changes in enrollment to the NSLDS within 30 days for students who graduated, withdrew or were enrolled less than half time. The timeframe is extended to 60 days depending on the school's reporting cycle.

**Excess Cash**—The USED maintains a Web-based system called G5 that is used by institutions to receive federal funds. As noted above, any federal funds received by Quality U must be disbursed to students within three business days. Federal funds that are not disbursed by the third business day may be considered "excess cash." Eagle Eyes will monitor the date federal funds were received along with the timing of the disbursements to students to determine if Quality U held any excess cash.

**Reconciliation**—Federal Pell Grant origination and disbursement information is reported through the USED's Common Origination and Disbursement site (COD). Eagle Eyes will want to determine that Quality U reported and actually received federal Pell Grant funds from USED for all students who received a Pell Grant disbursement. Reconciling federal loan funds varies depending on whether the institution participates in the Federal Family Education Loan Program (FFEL) or the Direct Loan Program (DL). Bank statements are examined to determine if the receipt of FFEL funds matches the

disbursement and/or return of funds. Reports from COD are reviewed to ensure Direct Loan funds are reconciled at least monthly.

### Consumer Information

In addition to reviewing specific student files, Eagle Eyes is required to verify that Quality U distributed Student Right to Know information. Such information consists of campus security, equity in athletics (if applicable), drug and alcohol abuse prevention, *Family Educational Rights Privacy Act (FERPA)*, completion and graduation rates, the institutional refund policy and other general information about the school. An office other than financial aid may administer the dissemination of this information.

### Exit Interview with the Auditors

Eagle Eyes has been on site at Quality U for a week and has spent most of their time reviewing student files. During the exit interview with Quality U's executive team, Eagle Eyes reports on their initial findings:

- 1) The file review is not quite complete since the two missing files were never located. Quality U is certain these students had files that may have been misfiled by the temps. If the files cannot be located, Quality U will need to return the federal aid received by these students, and Eagle Eyes would note the missing files in the audit report.

*The degree to which the institution's records are organized will directly impact the success of the audit. Extensive searches for missing files or documents while the auditors wait obviously does not reflect well on the institution. Missing files become a financial liability to the institution.*

- 2) Eagle Eyes identified an ISIR in a student's file with a "C Code" relating to the student's social security.

*Eagle Eyes overlooked the copy of the marriage certificate in the student's file noting her name had been changed. The*

*student should be encouraged to contact the Social Security Administration to officially change her name.*

- 3) Eagle Eyes noted one verification error where the federal taxes paid did not match the 1040 tax return.

*Quality U acknowledges that this should have been identified during their verification process. The student reported tax information withheld from the W-2 as opposed to taxes paid from the federal 1040.*

- 4) A Return of Title IV Funds Calculation had been completed on the eleventh day after the student officially withdrew; however, Quality U forgot to return the unearned funds to the lender within the 45 days.

*Quality U acknowledges the error and will immediately return the unearned funds. Unfortunately, this is a repeat finding from the prior year that will be noted in the audit.*

- 5) Eagle Eyes has identified problems with the NSLDS reporting. A couple of students from the withdrawn sample have not yet been reported to the NSLDS as withdrawn even though they left Quality U three months ago.

*The new director of financial aid was under the assumption that the registrar was reporting enrollment changes. The registrar was under the assumption the new director of financial aid would assume this responsibility. Quality U acknowledges the error and will need to review its population to ensure the NSLDS reporting is up to date.*

### Conclusion

Considering all of the information that is reviewed as part of the compliance audit and the number of potential files a school touches in a year, it is not unusual for occasional findings to surface. If the finding is an isolated incident, the institution will need to determine how the finding can be prevented in the future. Repeat

findings, such as that of Quality U in forgetting to return Title IV funds, obviously indicate the need for process improvement. Another indicator is the percentage of errors for a given finding. For example, if 15 percent of the withdrawn students in Quality U's sample had not been reported to the NSLDS, that is a serious issue, which must be addressed by auditing an expanded sample.

Institutions are required to submit to the USED a corrective action plan for the findings identified. One of the most effective measures to avoid findings and eliminate the need for a corrective action plan is to implement an internal quality assurance process. Throughout the year, Quality U can perform file reviews on

the same information the auditors will review. By developing a checklist as a standardized approach to reviewing files, Quality U can resolve issues quickly and internally. This proactive approach results in cleaner audits, is more cost efficient, and is certainly a better reflection on the institution than being regularly required to implement corrective action plans.

If this discussion of the audit process has left you with some more general questions about financial aid, check out the appendix to this article—Ten Things You Need to Know About Financial Aid: *An FA Survival Checklist for College Presidents*.

