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ABSTRACT

This report, prepared by the Comptroller General of the U.S., is an examination of the fiscal year 1974 financial statements of the Student Loan Insurance Fund (OE), and discusses many problems regarding the fund. One of the most serious is that the records maintained by the Office of Education are not adequate to support the financial statements. The report also examines the following issues: lack of a time limit within which lenders must file claims for defaulted loans, questionable estimates of losses, the inclusion of many uncollectible loans in the asset accounts, and differences between the official financial statements of the fund and the statements included in the appendix to the Federal budget. The recent establishment of the Student Loan Marketing Association is also discussed. Recommendations addressing these problems are included. (Author)

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REPORT TO THE CONGRESS

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ED109578

Examination Of Financial Statements Of Student Loan Insurance Fund Fiscal Year 1974

Office of Education
Department of Health, Education,
and Welfare

U.S. DEPARTMENT OF HEALTH,
EDUCATION & WELFARE
NATIONAL INSTITUTE OF
EDUCATION

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**BY THE COMPTROLLER GENERAL
OF THE UNITED STATES**

FOD-75-8

FEB. 12, 1975



COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-164031(1)

To the President of the Senate and the
Speaker of the House of Representatives

We are reporting on our examination of the fiscal year 1974 financial statements of the Student Loan Insurance Fund, administered by the Office of Education, Department of Health, Education, and Welfare.

We made our examination in accordance with section 105 of the Government Corporation Control Act, as required by the Higher Education Act of 1965.

The report discusses many problems brought out in prior reports. One of the most serious is that the records maintained by the Office of Education are not adequate to support the financial statements. The Department has started corrective action in these areas but, as of June 30, 1974, had not resolved the problems.

The report also brings out the following additional issues: Lack of a time limit within which lenders must file claims for defaulted loans; questionable estimates of losses; the inclusion of many uncollectible loans in the asset accounts; and differences between the official financial statements of the fund and the statements included in the appendix to the Federal budget. The recent establishment of the Student Loan Marketing Association is also discussed.

The report contains recommendations addressing these problems. HEW agreed with our recommendations and has begun or proposed corrective action to resolve these issues.

As a result of these shortcomings and errors in the financial statements, we are of the opinion that the accompanying financial statements do not fairly present the financial position of the Student Loan Insurance Fund at June 30, 1974, or the results of its operations, or the changes in financial position for the fiscal year then ended.

B-164031(1)

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of Health, Education, and Welfare; and the Commissioner of Education, Department of Health, Education, and Welfare.

Thomas B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

| | |
|-----|--|
| GAO | General Accounting Office |
| HEW | Department of Health, Education, and Welfare |
| OE | Office of Education |

INTRODUCTION

The Comptroller General is required by law to examine annually the financial transactions of the Student Loan Insurance Fund, which is used to finance Federal insurance and reinsurance of loans made under the Guaranteed Student Loan program. This program is administered by the Office of Education (OE), Department of Health, Education, and Welfare (HEW). As of June 30, 1974, the Government was insuring loans amounting to \$2.28 billion, and reinsuring loans amounting to \$2.61 billion. In addition to the insurance and reinsurance expenses paid from the fund, OE has paid over \$1 billion in interest benefits and special allowances on guaranteed student loans, including more than \$300 million paid during fiscal year 1974. These expenses are paid from higher education appropriations rather than from the fund. The program's administrative expenses are paid from higher education appropriations and salaries and expenses appropriations.

RECURRING PROBLEMS

The report on our examination of the fiscal year 1973 financial statements of the Student Loan Insurance Fund was issued on September 17, 1974 ("Examination of Financial Statements of Student Loan Insurance Fund, Fiscal Year 1973," B-164031(1)). That report included a description of the program and an analysis of many problems identified during our review. Because the report was so recently issued, we are not repeating the information contained in it, except to note that the following problems, identified in previous reports, still exist.

- The automated guaranteed student loan system, which OE relies on to maintain detailed records of the program, is not functioning properly. The system cannot provide the information needed to prepare accurate financial statements.
- OE does not have an adequate program for collecting from defaulted borrowers. As a result, OE cannot identify uncollectible loans or establish a reasonable basis for estimating either current or future losses.
- The rate OE uses to calculate losses on defaulted loans does not take into consideration experience of the program.
- OE has not reported consolidated information on the full cost of the Guaranteed Student Loan program to

the Congress. This program is funded from higher education appropriations, salaries and expenses appropriations, and the Student Loan Insurance Fund.

- The accounting system used for the fund has not been submitted to the Comptroller General for approval.

HEW response

In response to these problems, HEW:

- Agreed that program records were not adequate and outlined actions being taken to provide accurate program and financial information.
- Listed various steps being taken to improve its collection program, identify uncollectible loans, and more accurately determine current and future losses.
- Agreed that program experience was not being used to calculate losses on defaulted loans. After implementing its new collection program, HEW plans to obtain reliable information on program experience. This experience will then be used to estimate losses.
- Stated that it would develop procedures to report consolidated information on the full cost of the program as soon as the principles and standards for the Department-wide cost accounting system are established.
- Stated that it was presently working with GAO to develop a new accounting system and was planning to submit the accounting manual to the Comptroller General for approval by June 30, 1975.

Additional actions

During fiscal year 1974 HEW did more to improve the operation of the Guaranteed Student Loan program. OE reorganized the Division of Insured Loans that formerly administered the program into the Office of Guaranteed Student Loans, reporting directly to a Deputy Commissioner of Education. OE used funds authorized by Public Law 93-305 (June 8, 1974) to hire additional data processing managers and analysts and assigned more than 100 new collections personnel to regional offices across the country.

The HEW Audit Agency is focusing its attention on the Guaranteed Student Loan program. It is reviewing OE's loan collection procedures at the headquarters level and at four regional offices. The Agency also has plans for a nationwide

review of the operations of selected proprietary schools participating in the program.

OE has proposed new and revised regulations in an effort to improve the management of the Guaranteed Student Loan program. The proposed regulations spell out new and more stringent criteria for educational institutions' participation in the program. They establish procedures which will enable OE to limit, suspend, or terminate the eligibility of schools participating in the program, as well as the eligibility of lenders participating in the federally insured phase of the program, who do not comply with applicable laws and regulations. The proposed regulations were published in the October 17, 1974, Federal Register, and have been submitted to the Congress as required by Public Law 93-380.

These actions should improve HEW's ability to administer the program and prepare accurate financial statements.

LACK OF TIME LIMIT ON FILING CLAIMS

The existing and proposed regulations for the Guaranteed Student Loan program do not impose a time limit for lenders and guarantee agencies to submit claims to OE after the borrowers default, die, or become disabled. Lenders or guarantee agencies can retain defaulted loans until after the statute of limitations expires and then file claims. This procedure could result in OE's paying claims and having no legal remedies available to obtain collections. Any delay in submitting claims for federally insured loans reduces the collectibility of the defaulted loans and correspondingly increases both the collection effort required and the eventual loss incurred by the Government.

This problem can become more significant under the new regulations proposed by OE. Schools and lenders could, in effect, be encouraged to delay filing claims to avoid detection of a high default rate and a possible limitation, suspension, or termination of their participation in the program.

OE calculates its current and future losses on the basis of claims paid. Because OE does not require prompt filing of claims, OE may not be aware of all loans that have been defaulted. Subsequent claims for loans previously defaulted would mean that both current losses and estimated future losses are understated.

We recognize that revising the program to impose a time limit on submitting claims may create problems, possibly

including substantial payments for claims on loans which have already been defaulted. OE personnel informed us that establishing a time limit on filing claims may greatly increase the costs to the Government by causing lenders to file claims which might otherwise never be filed. In our opinion, a time limit would not have this effect because lenders who do not intend to file claims would not be concerned with this limit. However, setting a time limit would cause claims to be filed more promptly.

The Government cannot reasonably continue to incur an increasing liability for claims on loans which have already been defaulted. Some action must be taken to limit the Government's liability and determine the program's full cost.

Recommendation to the Secretary of HEW

We recommend that the Secretary of HEW have OE:

--Establish the following procedures for all loans which are defaulted in the future.

1. Require lenders to submit claims within a reasonable time, such as 1 year from the date when students default, die, or become disabled, in order to be eligible for payment by the Government.
2. Require guarantee agencies to impose a similar requirement on their lenders.
3. Require guarantee agencies to submit claims to OE within a reasonable time, such as within 1 year of the guarantee agencies' payment of the claim.

--Establish a specific deadline for submitting claims on loans which are in default prior to the implementation of the procedures outlined above.

HEW response

HEW agreed that deadlines should be established for filing claims with OE. HEW stated that it planned to seek a ruling from its Office of General Counsel on how to strengthen present filing provisions for both lenders and guarantee agencies. It agreed to establish a deadline for submission of claims presently outstanding, if its General Counsel determines that such deadlines are feasible.

QUESTIONABLE ESTIMATES OF CURRENT AND FUTURE LOSSES

Most losses under the Guaranteed Student Loan program are a direct result of defaults by student borrowers on either insured or reinsured loans. OE's loan estimation model estimated the 24.3 percent of the loans insured as of June 30, 1974, will eventually be defaulted. This is well above the 17.2 percent estimated as of June 30, 1973. On September 18 and 19, 1974, the Subcommittee on Education, Senate Committee on Labor and Public Welfare, held hearings concerning the Guaranteed Student Loan program. We provided the Subcommittee with details on the 24.3-percent eventual default rate. Due to a lack of data, the loan estimation model could not calculate an estimated eventual default rate for loans reinsured as of June 30, 1974.

Collections that OE obtains from defaulted borrowers reduce the Government's losses below the amount paid for defaulted loans. OE computed losses on defaulted insured and reinsured loans for fiscal year 1974 by estimating that 45 percent of the money paid for defaulted loans would eventually be collected from the student borrowers. This 45-percent estimate was based on the Federal Housing Administration title I program because OE did not consider its own program experience valid for computing losses. OE has agreed that the title I program is not comparable to the Guaranteed Student Loan program. Since the loss rate used by OE does not take into consideration actual experience of the program, we cannot accept OE's estimates of current losses as computed for the fiscal year 1974 Statement of Income and Expense (sch. 3).

Current losses and estimated future losses should be computed in a manner consistent with each other. The methods OE used to compute these figures were not consistent because OE used program experience in estimating future losses but not in computing current losses. However, we cannot accept the \$74.9 million in estimated future losses shown on the Statement of Income and Expense (sch. 3) because this figure was computed incorrectly. (See p. 9.)

Recommendation to the Secretary of HEW.

We recommend that the Secretary have OE use consistent methods to estimate current and future losses. These estimates should take into consideration experience of the Guaranteed Student Loan program.

HEW response

HEW stated that consistent methods would be used to estimate current and future losses. HEW added that, due to a lack of information, estimates of losses on reinsured loans

are not comparable to estimates on insured loans. However, OE is attempting to develop comparable data for both programs.

UNCOLLECTIBLE LOANS INCLUDED
IN LOANS RECEIVABLE

Almost \$100 million of the \$113 million in assets shown on the June 30, 1974, Statement of Financial Condition (sch. 1) consists of loans receivable, interest accrued on these loans, and claims that will become loans receivable when paid. All of these loans have been defaulted by the student borrower. OE accrues interest on all loans receivable. This accrued interest accounts for approximately 80 percent of the income shown on the Statement of Income and Expense.

When OE pays a claim for a defaulted insured loan, OE obtains title to the note and assumes responsibility for future collections. These loans are subject to Federal laws and regulations. Reinsured loans are subject to differing State laws and regulations. OE does not obtain title to reinsured loans; guarantee agencies are responsible for all collections on these loans. OE has very little ability to influence eventual recoveries on defaulted reinsured loans. These differences between insured and reinsured loans are not recognized in the financial statements.

As of June 30, 1974, uncollectible loans were included in both the insured and reinsured loans. These accounts included loans which were uncollectible because the statute of limitations had expired and loans which were uncollectible because the borrower could not be located. The following chart shows defaulted loan activity from the beginning of the program through June 30, 1974.

| | (millions) |
|--|------------|
| Claims paid (excluding death, disability, and bankruptcy) | \$184.9 |
| Collected from borrowers | 13.1 |
| Written off as uncollectible | .07 |
| Loans receivable, June 30, 1974 | 171.7 |
| Allowance for losses, June 30, 1974 | 94.4 |

OE accrues interest on all loans receivable. Consequently, including uncollectible loans in loans receivable affects both interest income and accrued interest receivable. The following chart shows interest income from the beginning of the program through June 30, 1974.

(millions)

| | |
|--|---------|
| Interest income | \$ 15.0 |
| Collected from borrowers | .06 |
| Written off as uncollectible | .01 |
| Accrued interest receivable, June 30, 1974 | 14.9 |
| Allowance for losses, June 30, 1974 | 8.2 |

The allowances for losses were not based on program experience, and OE records were not adequate to determine if they were reasonable. These allowances should be an estimate of amounts that will become uncollectible in the future. Uncollectible loans should be written off against this allowance as soon as they can be determined to be uncollectible, and interest should be accrued only on loans that have been determined to be collectible.

As of June 30, 1974, OE's collection efforts were not adequate to determine the collectibility of individual loans. However, OE is expanding its efforts in this area. In accordance with our responsibilities under the Federal Claims and Collections Act of 1966, we made a separate review of OE's collection activities on defaulted insured loans and are preparing a separate report on that review. That report will include specific recommendations to improve OE's collection efforts.

Recommendation to the Secretary of HEW

We recommend that the Secretary of HEW have OE:

- Establish procedures to determine the collectibility of each defaulted loan.
- Eliminate uncollectible loans from the accounts and establish an allowance for losses based on the collectibility of the remaining loans.
- Accrue interest only on loans which have been determined to be collectible.
- Change the caption "Loans Receivable" to more descriptive captions which show that these loans have been defaulted. Captions such as "Defaulted Loans Purchased" for insured loans and "Investment in Defaulted Reinsured Loans" for reinsured loans should be considered.

HEW response

HEW:

- Agreed with the first three recommendations, stating that it was establishing procedures to determine the

collectibility of defaulted loans. Those considered to be uncollectible will be transferred to GAO and written off as bad debts. However, due to the many program changes required, HEW does not plan to implement these procedures until fiscal year 1976. Until these procedures are established, HEW plans to consider all loans receivable to be collectible and will continue to accrue interest on all these loans.

--Agreed that the investment in defaulted reinsured loans should not be classified as loans receivable but disagreed with our suggested title for defaulted insured loans. OE considers the account properly titled and plans to take no action. We believe the account should be retitled and plan to discuss it further with OE officials.

FEDERAL BUDGET

The appendix to the 1975 Federal budget contains fiscal year 1973 financial statements of the Student Loan Insurance Fund which are not the official financial statements submitted to the Treasury by OE and audited by GAO. The Federal budget is prepared on a funded basis. As a result, the financial statements shown in the budget appendix do not include unfunded estimated future losses. Omitting the estimated future losses from the fiscal year 1973 financial statements in the Federal budget appendix resulted in the budget statement showing a net loss of \$24 million during fiscal year 1973, instead of the \$239 million loss shown on the official financial statements. The budget appendix shows that, as of June 30, 1973, the Government's equity in the fund was \$44 million. The official financial statements, which include estimated future losses, show that the Government equity as of June 30, 1973, was a negative \$258 million.

GAO plans to work with the Office of Management and Budget, the Congressional Budget Office, and the appropriate congressional committees to improve reporting of unfunded losses and liabilities. (See app. III.)

STUDENT LOAN MARKETING ASSOCIATION

In 1972 the Congress established the Student Loan Marketing Association (Sallie Mae) to provide liquidity to lenders in the Guaranteed Student Loan program and to expand funds available for student loans. Sallie Mae is a Government-sponsored private corporation which serves as a secondary market (purchases student loans from lenders) and warehousing facility (accepts student loans as collateral for loans to lenders) for guaranteed student loans.

The Secretary of HEW is authorized by law to guarantee payment of debt obligations incurred by Sallie Mae prior to July 1, 1982. As of June 30, 1974, the Secretary was guaranteeing \$250 million of Sallie Mae's outstanding obligations, borrowed from the Federal Financing Bank. Public Law 92-318, which formally established Sallie Mae, requires annual independent audits but did not give GAO audit authority over Sallie Mae.

SCOPE OF REVIEW

Our examination of the financial statements of the Student Loan Insurance Fund for the fiscal year ended June 30, 1974, was made in accordance with generally accepted auditing standards and included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Our examination included a review of the laws authorizing the Student Loan Insurance Fund and a review of OE's policies and procedures for implementing the legislation.

OPINION ON FINANCIAL STATEMENTS

HEW prepared schedules 1 and 3 of the financial statements accompanying this report. We modified the schedules to improve their clarity and prepared schedules 2 and 4 from OE's financial statements and records.

In our opinion, the records kept by OE during fiscal year 1974 were not adequate to support the financial statements. OE did not maintain accurate records showing balances due from individual debtors for accounts receivable, loans receivable, and accrued interest receivable. Therefore, we were not able to satisfy ourselves as to the accuracy of the yearend balances through direct confirmation or other means. Because of the lack of adequate records, the only amounts that were, in our opinion, fairly stated were cash and fund balances, and appropriations.

We found that the figures shown for estimated future losses on the Statement of Income and Expense (sch. 3) were computed incorrectly. Amounts that should have been applied as adjustments to the prior year's Statement of Financial Condition were included in this year's Statement of Income and Expense. These errors caused the fiscal year 1974 expenses on insured loans to be overstated by about \$27.1 million and the expenses on reinsured loans to be understated by about \$46 million. Total expenses were thus understated by nearly \$19 million. As a result, the Statement of Income and Expense does not reflect the results of operations for fiscal year 1974.

We cannot accept loans receivable and accrued interest receivable as shown on the Statement of Financial Condition because (1) the financial statements do not show that all of these loans have been defaulted, (2) the amounts include investments in defaulted reinsured loans held by State guarantee agencies and these investments cannot properly be classified as loans receivable, and (3) the amounts include loans which are uncollectible.

The lack of an effective collection program, as indicated earlier, has prevented us from evaluating the reasonableness of the rate used by OE to compute losses on defaulted loans and accrued interest receivable.

Because OE does not require prompt filing of claims, OE may not be aware of all loans that have been defaulted. Subsequent claims for loans previously defaulted would mean that both current losses and estimated future losses are understated.

For the reasons set forth in the preceding paragraphs, we are of the opinion that the accompanying financial statements do not fairly present the financial position of the Student Loan Insurance Fund at June 30, 1974, or the results of its operations, or the changes in financial position for the fiscal year then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States.

OFFICE OF EDUCATION
STUDENT LOAN INSURANCE FUND
STATEMENT OF FINANCIAL CONDITION
AS OF JUNE 30, 1974

| ASSETS | June 30, 1974 | | |
|--|---------------------|--------------------|----------------------|
| CASH AND FUND BALANCE: | | | |
| Cash on hand and in transit | | \$ 99,235 | |
| Fund balance with U.S. Treasury | | 14,257,561 | |
| Total cash and fund balance | | | \$ 14,356,796 |
| ACCOUNTS RECEIVABLE | | | |
| | | <u>Insured</u> | <u>Reinsured</u> |
| LOANS RECEIVABLE (note 1) | \$ 99,175,047 | | \$72,478,464 |
| Less allowance for losses | <u>54,546,276</u> | | <u>39,863,155</u> |
| Net loans receivable | <u>44,628,771</u> | <u>32,615,309</u> | 77,244,080 |
| ACCRUED INTEREST ON LOANS RECEIVABLE | 9,013,150 | | 5,931,088 |
| Less allowance for losses | <u>4,957,231</u> | | <u>3,262,099</u> |
| Net accrued interest receivable | <u>4,055,919</u> | <u>2,668,989</u> | 6,724,908 |
| OTHER ASSETS: | | | |
| Claims in process (note 2) | 31,251,954 | | 976,933 |
| Less allowance for losses (note 2) | <u>17,188,575</u> | | <u>482,313</u> |
| Net other assets | <u>14,063,379</u> | <u>394,620</u> | 14,457,999 |
| Total assets | | | <u>\$113,488,488</u> |
| LIABILITIES | | | |
| | | <u>Insured</u> | <u>Reinsured</u> |
| CLAIMS PAYABLE (note 2) | \$ 32,485,984 | | \$ 901,617 |
| ESTIMATED FUTURE LOSSES | <u>273,049,200</u> | <u>104,436,150</u> | <u>377,485,350</u> |
| Total liabilities | | | 410,872,951 |
| INVESTMENT OF THE U.S. GOVERNMENT | | | |
| CAPITAL APPROPRIATED | \$180,649,000 | | |
| Deficit accumulated since inception of program | <u>-478,033,463</u> | | |
| Balance | | | <u>-297,384,463</u> |
| Total liabilities and investment | | | <u>\$113,488,488</u> |

GAO's opinion on these financial statements is on pages 9 and 10.

GAO's notes on page 15 should be considered when reading the Statement of Financial Condition.

OFFICE OF EDUCATION
STUDENT LOAN INSURANCE FUND
STATEMENT OF CHANGES IN INVESTMENT
OF THE U.S. GOVERNMENT
FOR THE FISCAL YEAR ENDED
JUNE 30, 1974

| | |
|---|-----------------------|
| BALANCE AT BEGINNING OF PERIOD | \$-258,274,249 |
| FUNDS APPROPRIATED | 88,668,000 |
| NET INCOME OR DEFICIT (-) FOR YEAR ENDED June 30, 1974 (see sch. 3) | <u>-127,778,214</u> |
| Balance at the end of period (note 3) (see sch. 1) | <u>\$-297,384,463</u> |

GAO's opinion on these financial statements is on pages 9 and 10.

GAO's notes on page 15 should be considered when reading the Statement of Changes in Investment of the U.S. Government.

OFFICE OF EDUCATION
STUDENT LOAN INSURANCE FUND
STATEMENT OF INCOME AND EXPENSE
FOR THE FISCAL YEAR ENDED JUNE 30, 1974

| | June 30, 1974 | | |
|----------------------------------|-----------------------|---------------------|-----------------------|
| | <u>Insured</u> | <u>Reinsured</u> | <u>Total</u> |
| INCOME: | | | |
| Insurance premiums | \$ 2,709,807 | \$ -0- | \$ 2,709,807 |
| Interest on loans receivable | <u>5,755,341</u> | <u>2,919,291</u> | <u>8,674,632</u> |
| Total | <u>8,465,148</u> | <u>2,919,291</u> | <u>11,384,439</u> |
| EXPENSE: | | | |
| Interest on Treasury loan | \$ 167,503 | \$ 92,272 | \$ 259,775 |
| Losses: | | | |
| Death and disability | 130,842 | 267,770 | 398,612 |
| Accrued interest receivable | 3,147,267 | 1,605,610 | 4,752,877 |
| Loans receivable | 20,471,134 | 17,769,838 | 38,240,972 |
| Unpaid loans receivable (note 2) | 17,188,575 | 482,313 | 17,670,888 |
| Bankruptcy | 2,068,487 | 912,692 | 2,981,179 |
| Estimated future losses (note 4) | <u>100,572,200</u> | <u>-25,713,850</u> | <u>74,858,350</u> |
| Total expenses | <u>143,746,008</u> | <u>- 4,583,355</u> | <u>139,162,653</u> |
| Total income or deficit (-) | <u>\$-135,280,860</u> | <u>\$ 7,502,646</u> | <u>\$-127,778,214</u> |

GAO's opinion on these financial statements is on pages 9 and 10.

GAO notes on page 15 should be considered when reading the Statement of Income and Expense.

SCHEDULE 4

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE FISCAL YEAR ENDED JUNE 30, 1974

FUNDS PROVIDED:

| | |
|--|-------------------|
| Appropriations | \$88,668,000 |
| Loan repayments received | 7,193,289 |
| Interest earned on loans receivable | 8,674,632 |
| Insurance premiums earned | 2,709,807 |
| Decrease in cash balance | 10,155,320 |
| Decrease in accounts re- ceivable | 467,134 |
| Increase in default claims payable (note 5) | <u>18,270,489</u> |

Total funds provided

\$136,143,671

FUNDS APPLIED:

| | |
|--|-------------------|
| Death and disability claims paid | \$ 398,611 |
| Bankruptcy claims paid | 2,981,179 |
| Repayment of loan from Treasury | 15,000,000 |
| Interest paid on Treasury loan | 335,120 |
| Increase in loans receiv- able | 91,079,235 |
| Increase in accrued in- terest on loans re- ceivable | 8,632,762 |
| Increase in unpaid loans receivable (note 5) | <u>17,716,764</u> |

Total funds applied

\$136,143,671

GAO's opinion on these financial statements is on pages 9 and 10.

GAO notes on page 15 should be considered when reading the State-
ment of Changes in Financial Position.

GAO NOTES TO FINANCIAL STATEMENTS

1. Loans receivable represents the principal balance outstanding on (1) federally insured defaulted loans (the notes are assigned to OE) and (2) reinsured defaulted loans (the notes are retained by the State and private guaranty agencies). OE is specifically prohibited by statute from any collection action on reinsured loans.
2. The liability, claims payable, represents the unpaid claims for defaulted loans on hand as of June 30, 1974. The asset, claims in process, represents the portion of claims payable that will become loans receivable when paid, excluding claims payable because of death, disability or bankruptcy. Losses on unpaid loans receivable represent the amount expensed to the allowance for losses on claims payable.
3. The financial statements as of June 30, 1974, which OE submitted to the Treasury, included a schedule showing the fund's estimated net contingent liability of \$2.28 billion for federally insured loans and \$2.09 billion for reinsured loans. OE computed these amounts by deducting claims paid and an estimated amount for repayments made by student borrowers from the total amount of loans insured or reinsured. An additional \$431 million for federally insured loans and \$74 million for reinsured loans was shown on the schedule as the potential contingent liability for loans that had been approved but not disbursed as of June 30, 1974.
4. OE included as expenses amounts that should have been applied as adjustments to prior years' Statements of Income and Expense. This resulted in the Statements of Income and Expense showing an overstatement of approximately \$27 million in the estimated future losses on insured loans and an understatement of approximately \$46 million in the estimated future losses on reinsured loans. This error did not affect the Statement of Financial Condition.
5. The difference between the increase in default claims payable under funds provided on the Statement of Changes in Financial Position, and the increase in unpaid loans receivable under funds applied is attributed to the increase in unpaid death and disability claims and bankruptcy claims. With those exceptions, all claims payable will result in loans receivable.



DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20201

JAN 20 1975

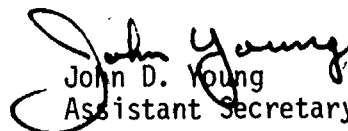
Mr. Gregory J. Ahart
Director, Manpower and
Welfare Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

The Secretary has asked that I reply to your letter dated December 2, 1974, pertaining to the General Accounting Office draft report to the Congress entitled, "Examination of Financial Statements of Student Loan Insurance Fund, Fiscal Year 1974".

The attached statement sets forth our comments on the matters discussed in the report. We appreciate the opportunity to comment on this draft report before its publication.

Sincerely yours,


John D. Young
Assistant Secretary, Comptroller

Enclosure

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
COMMENTS ON A GAO DRAFT REPORT "EXAMINATION
OF FINANCIAL STATEMENTS OF STUDENT LOAN
INSURANCE FUND FISCAL YEAR 1974"

OVERVIEW

We recognize that the Automated Guaranteed Student Loan System (AGSLS) has not functioned properly in that it has not provided accurate information for preparing the Fund's financial statements. However, the Office of Education (OE) is developing new mechanisms for record-keeping and management information which should provide accurate information to be used in preparing the financial statements:

. . . a consulting study covering general management review and reporting is currently being reviewed, and implementation of its recommendation should begin during the fourth quarter of FY 75, and

. . . parameters for a successor system to the AGSLS have been developed by OE. They are procuring the necessary detailed design and operations support for this new system. GAO staff have been briefed on its design.

As a result of these ongoing efforts, we believe OE should have a system that will enable them to manage more effectively and to reflect the fund's financial conditions fairly.

GAO RECOMMENDATION

That OE:

-- Establish the following procedures for all loans which are defaulted in the future:

(1) Require lenders to submit claims within a reasonable time, such as one year from the date of students' default, death, or disability, in order to be eligible for payment by the Government;

(2) Require guarantee agencies to impose a similar requirement on their lenders;

(3) Require guarantee agencies to submit claims to OE within a reasonable time, such as within one year of the guarantee agencies' payment of the claim.

-- Establish a specific deadline for submission of claims on loans which were defaulted prior to the implementation of the procedures outlined above.

DEPARTMENT COMMENT

We concur with the desirability of establishing deadlines for filing claims. We are actively pursuing with the Office of General Counsel (OGC) the development of a regulation to specifically define reasonable time schedules on prompt filing of claims by lenders and State guarantee agencies.

With respect to the last part of the recommendation, Counsel is reviewing the legal ramifications and on the basis of this review and other policy considerations, we will move to establish a specific deadline for filing the backlog of claims held at that time by lenders.

GAO RECOMMENDATION

That OE use consistent methods to estimate current and future losses. These estimates should take into consideration experience of the Guaranteed Student Loan Program.

DEPARTMENT COMMENT

We concur. OE is taking the necessary steps to ensure consistency in future estimates. With regard to data on reinsurance for guarantee agencies, the five percent figure used in the financial statement is based on the best data the agencies could supply.

Data is not available from the guarantee agencies to compute a default rate in a comparable manner to the rate computed for the FISL program. However, OE is moving toward data comparability for both programs in developing AGSLs.

GAO RECOMMENDATION

That OE establish procedures to determine the collectibility of each defaulted loan.

APPENDIX I

DEPARTMENT COMMENT

We concur. OE is currently implementing an improved collections program which will identify collectible accounts and provide experience necessary to project current and future losses. Of the 200 additional staff authorized, 109 collectors and 44 clerical support positions were allocated to the collection program in the regional offices. A comprehensive training program has been developed and will be implemented in the third quarter of FY 75. OE plans soon to introduce a reporting system that focuses on collector performance. Finally, collection procedures will be reviewed in each regional office.

GAO RECOMMENDATION

That OE eliminate uncollectible loans from the accounts and establish an allowance for losses based on the collectibility of the remaining loans; accrue interest only on the loans which have been determined to be collectible.

DEPARTMENT COMMENT

We concur. OE is currently developing procedures for the write-off of bad debts. Specific time frames for declaring a debt uncollectible will be developed and a routine for transferring such cases to the GAO will be established. At that time the receivables, both principal and interest will be removed from the records as an adjustment to Allowance for Loss.

An aging schedule for all loans receivable under the Insured Loan Program will be developed and distributed to the collection points for review and comment. Until these procedures are established, all receivables will be considered collectible. Interest will accrue, consistent with the rates established in the subrogated note. We anticipate that these procedures will be available by June 30, 1975, but implementation will not occur until sometime in FY 76 due to the programming changes needed to our automated systems.

GAO RECOMMENDATION

That OE change the caption "Loans Receivable" to more descriptive captions which show that these loans have been defaulted. Captions such as "Defaulted Loans Purchased" for insured loans and "Investment in Defaulted Reinsured Loans" for reinsured loans should be considered.

DEPARTMENT COMMENT

We agree that receivables under the reinsured portion of the program should be retitled. These are not loans receivable, but investments in loans receivable of another organization. OE will take the necessary action to accomplish this.

With regard to retitling loans receivable under the insured portion of the program, we do not concur. The Federal Insured Loan Program is accounted for under a revolving fund that is specifically limited to this program. The only type of loan receivable that can be accounted for are those purchased from lending institutions on default of the debtor. Once OE has been subrogated to all rights of the note, the transaction then becomes a binding indebtedness, i.e., loan receivable, between the U.S. Government/OE and the debtor. Thus, we feel the account is appropriately titled.

STATUS OF CORRECTIVE ACTION ON PRIOR FINDINGSGAO FINDING

The rate used by OE to calculate losses on defaulted loans does not take into consideration experience of the program.

DEPARTMENT COMMENT

We concur. However, as our new collections program is implemented, we will gain reliable experience which will then be used exclusively when calculating anticipated loss rates.

GAO FINDING

OE has not reported consolidated information on the full cost of the Guaranteed Student Loan Program to the Congress. This program is funded from the following appropriations: Higher Education appropriations, Salaries and Expenses appropriations, and the Student Loan Insurance Fund.

DEPARTMENT COMMENT

We concur. Departmental cost accounting principals and standards are being developed. Upon receipt of the documented specifications, OE will develop and implement the detailed cost accounting and reporting system, which will include the recommended cost reports.

APPENDIX I

GAO FINDING

The accounting system used for the Student Loan Insurance Fund has not been submitted to the Comptroller General for approval.

DEPARTMENT COMMENT

We concur. OE is working with GAO to develop a new accounting system which will be used for the Fund. OE plans to submit the accounting manual for the new system to the Comptroller General for review by June 30, 1975.

GAO NOTES TO FINANCIAL STATEMENTS

OE included as expenses, amounts that should have been applied as an adjustment to prior years' Statements of Income and Expense.

DEPARTMENT COMMENT

The transaction in question was a one-time adjustment to the Estimated Future Losses on receivables under the Reinsured portion of the program. OE concurs that the transaction should have been handled as a direct entry to retained earnings vice an operating expense. We will take action to insure appropriate recordation of like or similar transactions in the future.



THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D C 20201

NOV 25 1974

Honorable Elmer B. Staats
Comptroller General of the
United States
General Accounting Office
Washington, D.C.

Dear Mr. Staats:

We are pleased to furnish you our statement of the Department's views on your report entitled, "Examination of Financial Statements of Student Loan Insurance Fund, Fiscal Year 1973," B-164031(1), dated September 17, 1974.

Under the newly organized Office of Guaranteed Student Loans, a separate and distinct Division of Program Systems was established to address those problems related to the accuracy of the accounting records. We acknowledge that the automated Guaranteed Student Loan System has failed to provide accurate and timely information. Every available resource will be used to correct this situation.

Late in fiscal year 1974, the Congress authorized hiring 200 additional people to assist in the effort to gain positive control of the program. Of these 200 authorized positions, 109 were allocated to the collection program operated from our 10 Regional Offices. Most of these recently authorized positions are already filled, and we are vigorously recruiting to fill the remainder as soon as possible.

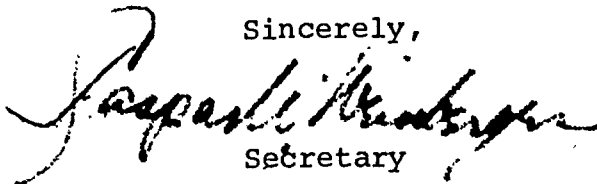
With respect to the GAO recommendation that consolidated information on program cost be provided to the Congress, we concur in the need for such information. As mentioned in our response to a draft of this report, we are considering establishing cost accounting requirements and concepts that would enable the Office of Education to prepare consolidated cost reports for all programs. When the actual specifications and documentation for this are developed, OE will take the necessary action to incorporate them into their financial system and establish the recommended reports.

APPENDIX II

Page 2 - Honorable Elmer B. Staats

These actions taken or planned should substantially improve the overall management of the Guaranteed Student Loan Program and related accounting records and reports.

Sincerely,


Secretary



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

DEC 27 1974

Mr. Victor Lowe
Director, General Government
Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Lowe:

We have been invited to comment on GAO Draft Report No. B-164031(1), entitled "Examination of Financial Statements of the Student Loan Insurance Fund, Fiscal Year 1974." Our comments pertain to the section on page 10 that discusses information contained in the Federal Budget. That section highlights the differences in information contained in the Student Loan Insurance Fund business-type statements as shown in the Budget and information contained in the statements submitted by the Office of Education to the Treasury Department.

Business-type budget statements generally relate to financial statements submitted to the Treasury Department. However, as the report points out, budget presentations, for the most part, are prepared on a funded basis and for the current year and ensuing year (i.e., the budget year), as well as for the most recent completed year. The statements submitted by the Office of Education to the Treasury Department cover only the most recent completed year. Treatment in the budget is designed to reflect the President's determination on the most effective allocation of resources in the period under review, i.e., the budget year. Consistent with this objective, the Budget includes information on estimated unfunded liabilities in text tables appearing in the narrative and in footnotes to the financial statements, rather than in the statements proper.

We recognize that continued improvement is desirable in the presentation of information in the Budget. This improvement can be accomplished in the narrative discussion and in footnotes to the financial statements, as well as in the statements proper. Accordingly, we agree that it is appropriate for members of our respective staffs to discuss further the areas for potential improvement in the presentation of business-type budget information.

Sincerely,

Dale R. McOmber
Assistant Director
for Budget Review

APPENDIX IV

PRINCIPAL OFFICIALS OF THE
DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
RESPONSIBLE FOR THE ACTIVITIES -
DISCUSSED IN THIS REPORT

| | Tenure of office | |
|---|------------------|-----------|
| | <u>From</u> | <u>To</u> |
| SECRETARY OF HEALTH, EDUCATION, AND WELFARE: | | |
| Caspar W. Weinberger | Feb. 1973 | Present |
| Frank C. Carlucci (acting) | Jan. 1973 | Feb. 1973 |
| Elliot L. Richardson | June 1970 | Jan. 1973 |
| ASSISTANT SECRETARY FOR EDUCATION: | | |
| Virginia Y. Trotter | June 1974 | Present |
| Charles B. Saunders, Jr. (acting) | Nov. 1973 | June 1974 |
| Sidney P. Marland, Jr. | Nov. 1972 | Oct. 1973 |
| COMMISSIONER OF EDUCATION: | | |
| Terrel H. Bell | June 1974 | Present |
| John R. Ottina | Aug. 1973 | June 1974 |
| John R. Ottina (acting) | Nov. 1972 | Aug. 1973 |

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