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REPORT TO THE CONGRESS

Examination Of Financial Statements Of The Student Loan Insurance Fund, Fiscal Years 1971 And 1972

B-164031(1)

Office of Education

Department of Health, Education, and Welfare

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

JUNE 8,1973

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

This is the report on our examination of financial statements of the Student Loan Insurance Fund, administered by the Office of Education, Department of Health, Education, and Welfare, for fiscal years 1971 and 1972.

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

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

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

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

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

EXAMINATION OF FINANCIAL STATEMENTS OF THE STUDENT LOAN INSURANCE FUND, FISCAL YEARS 1971 AND 1972
Office of Education
Department of Health, Education, and Welfare B-164031(1)

D I G E S T

WHY THE EXAMINATION WAS MADE

The Student Loan Insurance Fund finances Federal insurance of student loans and Federal reinsurance of student loans insured by State or private nonprofit agencies. The fund is administered by the Office of Education (OE), Department of Health, Education, and Welfare (HEW).

The Comptroller General is required by law to audit annually the Student Loan Insurance Fund. Appendix II lists prior reports on the financial statements of the fund and other reports concerning the Guaranteed Student Loan program.

FINDINGS AND CONCLUSIONS

In the opinion of GAO the accompanying financial statements do not present fairly the financial position of the Student Loan Insurance Fund at June 30, 1971, and June 30, 1972, and the results of its operations and the sources and application of its funds for the fiscal years then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General.

The expenses of both the insurance and reinsurance programs were understated significantly for both fiscal years because no liability was established for estimated future losses on insured or reinsured loans. OE estimated that net deferred losses as of June 30, 1972, were $47.6 million for insured loans and $39 million for reinsured loans. (See pp. 13 and 14.)

GAO cannot express an opinion regarding the reasonableness of the amounts shown on the financial statements for:

--Insurance premium income and deferred insurance premium income. These figures were based on amounts billed and accounts receivable which GAO could not verify. (See p. 13.)

--Accounts receivable. OE records were not adequate to permit GAO to confirm yearend balances with lenders or to satisfy itself by other auditing procedures of the validity of the accounts receivable. (See p. 15.)

--Loans receivable. OE records were not adequate to permit GAO to verify amounts owed by individual borrowers on defaulted loans. Also, the loans receivable included amounts owed by borrowers who had been adjudicated bankrupt with no legal obligation to repay their loans and other apparently uncollectible amounts. (See pp. 15 and 16.)

--Interest income and accrued interest receivable. These figures were computed by applying an inappropriate

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interest rate to loans receivable balances, which GAO could not verify. (See p. 16.)

--Allowances for losses on loans receivable and accrued interest receivable. The loss rate used to compute these allowances was not based on experience of the Guaranteed Student Loan program. (See p. 17.)

The insurance premium rate authorized by the statute on loans insured under the Federal insurance program is not sufficient to finance the program. Insurance premiums on loans insured between August 1967 and June 30, 1972, totaled $10.1 million. OE estimates that losses on loans insured during this period will be $69.8 million. Thus, OE records show that the insurance program incurred a net loss of $59.7 million between August 1967 and June 30, 1972. (See p. 9.)

RECOMMENDATIONS OR SUGGESTIONS

The Secretary of HEW should have OE:

--Develop records necessary for both efficient administration of the Guaranteed Student Loan program and preparation of accurate financial statements for the Student Loan Insurance Fund. (See p. 12.)

--Provide the Congress with full information on the future financial requirements of the Guaranteed Student Loan program. (See pp. 10 and 11.)

--Recognize insurance premium income when it is billed and include estimated future losses on both insured and reinsured loans in arriving at net income. (See pp. 13 and 14.)

--Remove uncollectible loans from the loans receivable. (See p. 16.)

--Compute the allowances for losses on the basis of the loss experience of the Guaranteed Student Loan program. (See p. 17.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

HEW said that:

--Measures have been taken to improve the quality of the records.

--Action is being taken to develop an improved forecasting system which will enable HEW to fully inform the Congress of the program's future financial requirements.

--Insurance premium income will be recognized when billed, and estimated losses on loans not yet defaulted will be recognized in preparing fiscal year 1973 financial statements.

--Uncollectible loans will be removed from the loans receivable as soon as they are determined to be uncollectible.

--Actual loss experience of the program will be used in computing allowances for losses.

These actions taken or planned should substantially improve the accounting records and reports. Because many of the problems noted by GAO have existed for several years, GAO believes that the HEW Audit Agency should be involved in resolving these problems. The Agency could (1) advise the Secretary of HEW of the progress being made in accomplishing the above discussed action, (2) assist OE in resolving questions related to the financial operations, and (3) provide the Secretary of HEW with recommendations on additional financial or operational matters which warrant improvements.

MATTERS FOR CONSIDERATION BY THE CONGRESS

In future legislative actions on the Student Loan Insurance program, the Congress may wish to consider the (1) lack of disclosure of the full costs being incurred under the Student Loan Insurance Fund, (2) substantial future funding required to pay future losses, and (3) inadequacy of the insurance premium rate to finance the direct Federal insurance of student loans.

CHAPTER 1

INTRODUCTION

The Office of Education (OE), Department of Health, Education, and Welfare (HEW), administers various support and assistance programs for education. The Guaranteed Student Loan program insures low-interest loans for students in institutions of higher education and vocational schools. This program, established under title IV, part B, of the Higher Education Act of 1965, as amended (20 U.S.C. 1071), comprises two components--a State or private nonprofit agency student loan insurance program and a Federal student loan insurance program.

The Guaranteed Student Loan program:

1. Encourages States and private nonprofit agencies to establish adequate loan insurance programs for students in institutions of higher education and vocational schools.

2. Provides a Federal student loan insurance program for students or lenders who do not have reasonable access to a State or private nonprofit student loan insurance program.

3. Guarantees a part of the loans insured under an eligible loan insurance program established by a State or private nonprofit agency.

4. Pays, on behalf of qualified students, part of the interest charged by lending institutions on loans insured under either the Federal program or an eligible loan insurance program established by a State or private nonprofit agency.

The Guaranteed Student Loan program enables students to borrow funds from participating lending agencies to help pay their educational costs while attending vocational or technical schools or other institutions of higher education. Any student who is a U.S. citizen or national or who is in the United States for other than a temporary purpose and is at least a half-time student at an eligible institution is eligible for loan insurance. Through fiscal year 1972 the maximum loan that could be insured for each academic year was $1,500 and the total amount of loans that could be insured for any one student was $7,500.[1]

The act of 1965 established the Student Loan Insurance Fund to pay defaulted student loans insured by the Government. The act established the fund with appropriations and provided for additional financing with insurance premiums collected from participating lenders and with the proceeds from collecting defaulted loans. OE is authorized to borrow from the U.S. Treasury if additional funds are required. If available funds from sources other than appropriations exceed current operating needs, OE may invest such excess funds in bonds or other obligations guaranteed by the United States.

INSURANCE PROGRAM

During August 1967 OE initiated the Federal Insured Student Loan program because the demand for student loans exceeded the amount of State and/or Federal funds available for insuring loans at the State level. The Federal insurance program is used by students ineligible for State programs, because of their residence or the location of the schools they attend, or by students in States without State programs. As of June 30, 1972, the Federal program was insuring loans in 46 States, the District of Columbia, Puerto Rico, Guam, and American Samoa.

Under the insurance program, loans are insured by the Government. If a student defaults on a loan, the lender is reimbursed for 100 percent of the unpaid principal. If a student dies or becomes totally and permanently disabled, the Government pays 100 percent of the unpaid principal of an insured loan disbursed before December 15, 1968, and pays both principal and interest for a loan disbursed on or after that date. However, death and disability payments for loans disbursed on or after December 15, 1968, are made not from the Student Loan Insurance Fund but from separate appropriations.

Upon payment of a lender's claim for a defaulted loan, the Government acquires title to the borrower's note on which the claim is filed and then attempts to collect the loan. If the borrower dies or becomes totally and permanently disabled, the obligation to make any further payment is canceled.

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[1]Public Law 92-318 raised these limits to $2,500 and $10,000, respectively, effective June 23, 1972. However, the implementation of Public Law 92-318 seriously disrupted the program's operation. To remedy this, Public Law 92-391 suspended the effective date of most of the provisions of Public Law 92-318 until March 1, 1973.

REINSURANCE PROGRAM

Public Law 90-460, approved August 3, 1968, amended the act of 1965 to include Federal reinsurance of student loans guaranteed by State or private agencies. Reinsurance is financed entirely by appropriations. No insurance premiums are collected from the State or private agencies even though some of these agencies collect premiums from the lenders. Reinsurance increases the guaranty capacity of State or private agencies because these agencies will be reimbursed by OE for a large percentage of their losses. As of June 30, 1972, the Federal Government was reinsuring loans in 24 States and the District of Columbia.

Under the reinsurance program, loans are insured by State or private guaranty agencies. If a student defaults on a loan, the Government reimburses the insuring agency for 80 percent of the unpaid principal of the amount insured. If a student dies or becomes totally and permanently disabled, the Government pays 80 percent of the unpaid principal of a reinsured loan disbursed before December 15, 1968, and pays both principal and interest for a loan disbursed on or after that date. However, death and disability payments for loans disbursed on or after December 15, 1968, are made not from the Student Loan Insurance Fund but from separate appropriations.

The Government does not acquire title to the borrower's note on any claim. After a payment has been made to a guaranty agency for a default claim, that agency has full collection responsibility. It is required to return to the Government 80 percent of any amount subsequently recovered. If the borrower dies or becomes totally and permanently disabled, the obligation to make further payment is canceled.

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GAO is required by the Higher Education Act of 1965, as amended, to examine only those transactions affecting the Student Loan Insurance Fund under which Federal insurance and reinsurance activities authorized by the act are financed. This report does not discuss the portions of the Guaranteed Student Loan program which are not financed from the Student Loan Insurance Fund. This report covers the operation of the Student Loan Insurance Fund for the fiscal years ended June 30, 1971, and June 30, 1972.

CHAPTER 2

STUDENT LOAN INSURANCE FUND FINANCING

SOURCES OF FUNDS

The act of 1965, as amended, provides four sources of financing for the Student Loan Insurance Fund: appropriations, insurance premiums, collection of defaulted loans, and interest on investments. Also, OE is authorized to borrow from the U.S. Treasury if additional funds are required. The major sources of financing are discussed below.

Insurance premiums

The act requires OE to charge lenders participating in the insurance program a premium on each insured loan. No insurance premiums are collected under the reinsurance program.

The insurance premium charged under the insurance program is restricted by statute to an amount not to exceed one-fourth of 1 percent a year of the unpaid loan principal. The lenders may pass the charges on to the students borrowing the funds. State or private agencies participating in the reinsurance program are authorized to charge an insurance premium up to one-half of 1 percent a year of the unpaid principal, even though the Federal Government reimburses these agencies for a large percentage of their losses.

During fiscal years 1971 and 1972, the insurance premiums were computed at the rate of one-fourth of 1 percent a year. This rate was applied from the month following the loan to the borrower's anticipated month of graduation plus 12 months. According to an official, OE elected to compute the premium over this period, rather than over the full life of the loan, to avoid added administrative work and cost, both to OE and to the lender. If the full life was used, the premium would have to be recomputed for every unscheduled change in the principal balance during the repayment period or for changes in the student's status, such as leaving school or entering military service.

OE does not refund or adjust a premium as a result of a student's leaving school, repaying the loan prior to the date used in computing the premium, or extending his educational program.

Precise estimates were not readily available to show the period in which students would actually repay their loans.

Usually the premiums charged would be greater if computed over the full life of the loans rather than over the shorter period used under the present method. The maximum repayment period for an insured loan generally is 10 years, beginning 9 to 12 months after the student graduates or ceases to carry an acceptable academic workload. The repayment period is extended for service in the armed services, Peace Corps, or Volunteers In Service to America.

OE estimates show that recorded losses and estimated future losses on insured loans exceeded premiums earned by $59.7 million as of June 30, 1972, as shown below.

	Amount (millions)
Defaults less anticipated collections	$15.6
Estimated future defaults less anticipated collections	54.2
Total losses anticipated	69.8
Insurance premium earned	10.1
Estimated net loss	$59.7

Appropriations

Through fiscal year 1970 appropriated funds totaling $14,576,000 were provided to the Student Loan Insurance Fund to support operations under the insurance program. The appropriations for fiscal years 1971 and 1972 were $18,000,000 and $12,765,000, respectively.

OE budget estimates indicate that the Student Loan Insurance Fund will continue to require substantial annual appropriations.

Collection of defaulted loans

OE estimates that 45 percent of the money paid for defaulted loans (excluding defaults due to death or disability) will eventually be recovered from the student borrower. Collections on defaulted loans during fiscal year 1972 amounted to $1.4 million.

We reviewed OE's collection efforts on loans receivable during fiscal year 1971 and reported to the

Congress[1] on the inadequacy of OE's collection efforts. For example, in January 1971 collection action had not been initiated on 59 percent of the loans receivable. In addition, form letters used for collection purposes were not sufficiently forceful to impress the debtor with his legal obligation.

Our report contained several recommendations for improving collection procedures. HEW concurred in our recommendations and provided more personnel to administer claims and collections activities during the latter part of fiscal year 1972. We were not able to assess the full effect of this action during our audit; however, collection action is now started concurrently with the payment of claims.

NEED FOR SUBSTANTIAL FUTURE FUNDING

The act of 1965, as amended, does not require OE to obtain funding for anticipated losses before incurring liabilities for student loan insurance. Consequently, the appropriations requested by OE are sufficient to meet only the short-term cash requirements of the Student Loan Insurance Fund. Furthermore, the requests do not provide estimates of the total amount needed to finance future losses.

The cost of the Guaranteed Student Loan program has been much greater than initially anticipated because both loan volume and defaults have significantly exceeded original estimates. A rapid increase in the default of both insured and reinsured student loans significantly increased the expenditure from the Student Loan Insurance Fund during fiscal years 1971 and 1972. The following chart shows payments from the fund for defaulted loans since the program's establishment.

Fiscal year	Payments (note a)	Cumulative total
	(000 omitted)	
1968	$ 13	$ 13
1969	271	284
1970	4,731	5,015
1971	15,958	20,973
1972	30,707	51,680

[a]Includes claims payable at June 30 of each year. At June 30, 1972, claims payable amounted to $2,008,585.

[1]"Office of Education Should Improve Procedures to Recover Defaulted Loans Under the Guaranteed Student Loan Program" (B-117604(7), Dec. 30, 1971).

During fiscal year 1971 OE continued to compute estimated defaults using the rate of 1.2 percent established in 1969. After our audit of the 1971 financial statements, we informed OE that the rate did not appear to be adequate. OE revised this rate during fiscal year 1972 to those shown in the table below. Program statistics are not adequate for us to determine the reliability of the new default rates; however, they appear to be more realistic than the 1.2-percent rate.

	Loans outstanding June 30, 1972	Default rate	Estimated defaults
	(millions)		(millions)
Insurance program	$1,362	7.5 percent	$102
Reinsurance program	1,861	4.0 percent	74
Total	$3,223		$176

Our August 2, 1972, report to the Congress[1] stated that student enrollment and tuition costs had increased significantly in recent years and had added to the demand for financial assistance and to the Government's potential liability for defaulted loans. According to OE 1970 projections, the number of students seeking postsecondary education was expected to increase over the next few years by more than 20 percent and tuition and other educational expenses were expected to increase significantly. Under Public Law 92-318 the maximum loan for each academic year was raised and the maximum total loan was increased, as discussed on page 6. Under these circumstances, students can incur large financial liabilities which are difficult to repay and which can add to the existing nationwide problem of defaulted student loans.

We believe the problem of collecting student loans will become more serious as the number of guaranteed loans increases and as students become responsible for repaying such loans.

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[1]"Need For Improved Coordination of Federally Assisted Student Aid Programs in Institutions of Higher Education" (B-164031(1)).

CHAPTER 3

COMMENTS ON FINANCIAL STATEMENTS

ACCOUNTING SYSTEM

During fiscal years 1971 and 1972, OE continued to use an interim manual accounting system designed for temporary use in fiscal year 1968 when the Student Loan Insurance Fund was first used. This accounting system does not include subsidiary records showing the amounts due from individual lenders and students. The validity of the accounts receivable and loans receivable balances cannot be determined without verifying the amounts due from individual lenders and students. Therefore, we do not consider the accounting records adequate to support the financial statements for the fund.

During 1967 OE began developing computerized records to facilitate the operation of the Guaranteed Student Loan program. OE recognized the inadequacy of these computerized records and in October 1969 began developing an expanded computerized accounting system. The initial computerized records were used during fiscal years 1971 and 1972; however, they did not provide adequate information to operate the program efficiently and they provided very little accounting information.

Officials have stated that accurate financial statements with adequate supporting records will not be available until they can be based on data from the expanded computerized accounting system. The expanded system is designed to provide detailed records for both accounts receivable and loans receivable and is scheduled to become fully operational by the end of fiscal year 1973.

OE initially planned to use the computerized system to support the financial statements for fiscal year 1971. However, problems in developing the system made it incapable of supporting the financial statements for fiscal years 1971 or 1972. We briefly reviewed the development of the system and noted that progress was being made. OE told us that the system should be capable of supporting a large portion of the fiscal year 1973 financial statements.

The Budget and Accounting Procedures Act of 1950 requires HEW to establish accounting systems which conform to the principles, standards, and related requirements prescribed by the Comptroller General. HEW has not requested the Comptroller General's approval of an accounting system for OE. Therefore the accounting system for the fund, which is administered by OE, has not been approved by the Comptroller General. GAO is working with OE on the development of an acceptable accounting system.

INSURANCE PREMIUM INCOME AND ESTIMATED FUTURE LOSSES

Insurance premiums for loans insured during fiscal years 1971 and 1972 amounted to $2,571,872 and $4,020,913, respectively. OE deferred this income over a 5-year period--the estimated average length of time insured loans were expected to be outstanding. Because the insurance premium income is based, in part, on amounts billed and accounts receivable which we could not verify (see p. 15), we cannot express an opinion regarding the amounts shown on the financial statements for either insurance premium income earned or deferred.

In its fiscal year 1969 financial statements, OE began deferring insurance premium income to cover future losses. OE began this deferral because we objected to the fiscal year 1968 financial statements' recognizing the total premium income but not providing for future losses which should be matched against the income.

In a letter of October 1, 1970, the Assistant Secretary, Comptroller, HEW, stated that the decision to prorate insurance premiums over a period of years was based upon generally accepted accounting principles requiring assignment of revenues and expenses to the periods affected.

Our report on the fiscal year 1969 financial statements stated that the practice of deferring premium income was unnecessary because OE does not refund or adjust premiums for any reasons. However, in fiscal years 1969 and 1970 OE estimated that future losses and the deferred income would be almost equal. Therefore, the practice of deferring both income and expenses did not, in our opinion, seriously affect the financial statements for fiscal years 1969 and 1970.

For fiscal years 1971 and 1972, the insurance premium income OE deferred was not adequate to cover expected future losses, as shown below.

	June 30, 1971	June 30, 1972
	(millions)	
Deferred income	$4.3	$ 6.6
Anticipated future losses	5.5	54.2
Deferred loss	$1.2	$47.6

Most of the increase in anticipated future losses as of June 30, 1972, was due to an increase in the estimated default rate from 1.2 to 7.5 percent, as previously discussed on page 11.

The financial statements also do not include future losses on the reinsurance program which are estimated at $39 million. Because this program is financed entirely with appropriations, there is no income to defer. Therefore, the June 30, 1972, net loss of the reinsurance program is understated by the entire $39 million.

The principles and standards of accounting prescribed by the Comptroller General of the United States for Federal agencies (2 GAO 13.4) provide that:

> "The accounts and financial reports on Federal insurance, pension, and similar programs, involving the incurrence of liabilities which require measurement on an actuarial basis, shall clearly disclose the full current costs of these programs as they accrue and the estimated liability at any given time to make future payments, regardless of the degree to which funds have been appropriated or otherwise obtained to make such payments."

Therefore, to properly show the results of operation, OE should recognize insurance premium income when it is billed and include estimated future losses on both insured and reinsured loans which have not yet been defaulted. This should be done in arriving at the net income from operations on the statement of income and expense.

Including these deferred losses would have the following effect on the June 30, 1972, net worth of the fund.

	Amount (millions)
Net worth (see sch. 1)	$21.8
Less:	
Deferred loss--insurance program	47.6
Deferred loss--reinsurance program	39.0
Net worth	-$64.8

ACCOUNTS RECEIVABLE

OE estimated accounts receivable by subtracting the premiums collected from the total premiums billed and adding an estimate for unbilled premiums due. Records were not maintained showing the amounts billed to and received from individual lenders. Also, OE records were not adequate to enable us to determine the reliability of the estimate of unbilled premiums.

Consequently, we could not follow the normal auditing procedure of confirming accounts receivable with lenders or satisfy ourselves as to the validity of the accounts receivable by other auditing procedures. We are therefore unable to express an opinion regarding the reasonableness of the amount of accounts receivable as shown on the financial statements.

LOANS RECEIVABLE

OE pays lenders and State or private guaranty agencies for claims made for defaulted loans. If a loan is in default due to the death or disability of the borrower, the amount of the unpaid loan is charged to an expense account; otherwise, it is recorded as a loan receivable, and, except in instances of certain bankruptcies, further attempts are made to collect the amount from the borrower. OE plans to write off bankruptcies in the same manner used for defaults due to death or disability.

The loan receivable amounts on the statement of financial condition at June 30, 1971, and June 30, 1972, were computed without subsidiary records showing the amounts owed by individual debtors. The loans receivable consist of (1) all claims paid since inception of the programs, less claims resulting from death or disability and less collection on defaulted loans, and (2) unpaid claims on hand as of June 30, except for claims resulting from death or disability.

The loans receivable figures may be significantly overstated because OE has not written off any bad debts as uncollectible. For example, OE reports show that approximately $2.5 million in loans receivable at June 30, 1972, resulted from the borrowers' being adjudicated bankrupt. Most of these involved ordinary bankruptcies which relieve the borrowers from the legal obligation to repay their debts. Accordingly, there is little likelihood that OE will recover any significant amount on these loans. Only 18 bankruptcies, totaling $25,084, have been removed from the loans receivable since inception of the program.

Also, numerous loans are included as loans receivable even though OE has been unable to locate the defaulted borrowers for several years. Although OE maintains a sizable allowance for losses on loans receivable, this allowance should be an estimate of receivables which may become uncollectible. Loans determined to be uncollectible should be written off against this account.

OE did not have data available showing the amounts owed by individual borrowers. Therefore we could not follow the normal auditing procedure of confirming individual loans receivable with borrowers or satisfy ourselves as to the validity of the individual loans receivable by other auditing procedures. Further, because OE did not write off uncollectible loans as bad debts, we were not able to satisfy ourselves as to the validity of the total loans receivable figures. We are therefore unable to express an opinion regarding the reasonableness of the amount of loans receivable as shown on the financial statements.

INTEREST INCOME AND ACCRUED INTEREST RECEIVABLE

OE did not attempt to accrue interest income on individual loans receivable. The interest income shown on the June 30, 1971, and June 30, 1972, financial statements was estimated on the basis of 6 percent a year of the average loans receivable during each quarter of the fiscal year. This method of computation might provide a reasonable estimate of interest if the loans receivable figures were reliable and the 6-percent interest rate was appropriate for all loans receivable. However, the actual interest rate on the loans varies from 6 to 7 percent, with most loans disbursed since August 1968 bearing 7-percent interest. Also, interest was accrued on all loans receivable, including those which should have been written off as bad debts.

OE did not have data available showing either the actual amount of loans receivable at yearend or the amounts owed by individual borrowers, so we could not satisfy ourselves as to the validity of the interest income as shown on the financial statements.

Because the interest computations form the basis for accrued interest receivable, we cannot express an opinion of the amounts shown in the financial statements for accrued interest receivable.

ALLOWANCES FOR LOSSES ON LOANS RECEIVABLE AND ON ACCRUED INTEREST RECEIVABLE

During fiscal years 1971 and 1972, OE used a 55-percent rate to compute allowances for losses on loans receivable and accrued interest receivable. This rate was used in prior years and was based on the experience of the Federal Housing Administration's title I Housing Insurance Fund from July 1934 through June 1967. Officials said this rate was used because of similar factors involved in the operations of the two funds and because of the lack of experience under the Student Loan Insurance Fund.

In our opinion, these two programs are not sufficiently similar to justify the expectation of identical loss rates. Although both programs deal primarily with unsecured personal loans, title I loans are made only to homeowners with established credit while student loans are made to youths without established credit. Also, lenders are responsible for credit approval of loan applicants under title I and no credit approval is required for insured student loans.

The lack of effective collection action during fiscal years 1971 and 1972, as discussed on page 9, prevented us from evaluating the reasonableness of this loss rate for the insurance program or the reinsurance program. Therefore, we cannot express an opinion on the reasonableness of the allowances for losses on loans receivable and on accrued interest receivable.

CONTINGENT LIABILITIES

The financial statements submitted by OE to the Treasury included schedules showing the fund's estimated net contingent liability, as follows.

	June 30, 1971	June 30, 1972
	(millions)	
Disbursed loans:		
Insured	$ 809	$1,362
Reinsured	1,367	1,861
Commitments:		
Insured loans	313	216
Reinsured loans	325	-
Total	$2,814	$3,439

OE calculated the contingent liabilities on disbursed loans by subtracting the amount of claims paid and an estimated amount for repayments made by student borrowers from the total amount of all insured and reinsured loans. It had to estimate the amount of repayments by student borrowers because many lenders did not furnish such data in time for OE to use in preparing the fund's financial statements.

As previously noted, we believe that estimated future losses should be shown in the financial statements as liabilities. The contingent liability should be reduced by these estimated losses and by estimated death and disability payments which will not be made from the fund.

In addition to the contingent liability discussed above, OE acknowledged an additional "contingent" liability of $5.3 million in a footnote to its Statement of Financial Condition for June 30, 1972. This liability is for default claims received between May 15 and June 30, 1972. The footnote explains that this liability will be recorded when funds are appropriated.

OE should have recognized this $5.3 million liability as claims payable as of June 30, 1972. This would have increased the net loss for fiscal year 1972 and reduced the net worth of the fund as of June 30, 1972.

CHAPTER 4

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

In our opinion, OE has not devoted sufficient attention to developing the records necessary for efficient administration of the Student Loan Insurance Fund. We have audited every set of annual financial statements prepared for the fund since the initial fiscal year 1968 statements. We have not been able to state that the financial statements for any year present fairly the financial position of the Student Loan Insurance Fund and the results of its operations and the sources and application of its funds in conformity with the principles and standards of accounting prescribed by the Comptroller General of the United States.

The computerized system OE is currently developing should eventually provide the records needed to administer the program and prepare accurate financial statements. However, many of the problems which existed with the financial statements for fiscal year 1968 and the ensuing years continued to exist on the financial statements for fiscal years 1971 and 1972.

The financial statements should provide full information on the total financial requirements of both the insurance and reinsurance programs, including estimated future losses. Such reporting would show both the inadequacy of the present insurance premium rate to finance the insurance program and the future funding needs of the program. This would enable the Congress to evaluate the cost of the program when considering appropriation requests and decide whether to subsidize the program with appropriations or to raise the insurance premium rate to a level which would finance the program.

RECOMMENDATIONS

We recommend that the Secretary of HEW have OE:

--Develop the records necessary for both the efficient administration of the Guaranteed Student Loan program and the preparation of accurate financial statements for the Student Loan Insurance Fund.

--Provide the Congress with full information on the future financial requirements of the Guaranteed Student Loan program.

--Recognize insurance premium income when it is billed and include estimated future losses on both insured and reinsured loans which have not yet been defaulted.

This should be done in arriving at the net income from operations on the statement of income and expense.

--Remove uncollectible loans from the loans receivable.

--Compute the allowances for losses on the basis of the loss experience of the Guaranteed Student Loan program.

AGENCY ACTIONS

HEW, in a letter dated March 26, 1973 (see app. I), concurred in our recommendations and advised us of actions being taken or planned which should substantially improve the accounting records and reports. HEW stated that the difficulties in preparing and supporting financial statements were caused, in part, by the unique and significant growth of the program in recent years.

HEW:

--Acknowledged the need to develop better records to efficiently administer the program and prepare accurate financial statements for the fund. Actions being taken to improve the records include contracting with a firm of management analysts, implementing the revised automated data processing system, and developing a number of new administrative and financial reports.

--Concurred in our recommendation to fully inform the Congress of the future financial requirements of the Guaranteed Student Loan program. To do this, HEW contracted with a management firm to develop an estimation model for the program. Estimates of future financial requirements based on this model are expected to be available by September 15, 1973.

--Agreed to recognize insurance premium income when billed and to include estimated future losses on both insured and reinsured loans which have not yet been defaulted in preparing the fiscal year 1973 financial statements.

--Started action to remove uncollectible loans from the loans receivable by recently expanding its efforts to collect defaulted loans. On the basis of efforts, loans will be written off after determining that they are uncollectible and the necessary documentation is in order. In addition, HEW plans to write off most claims resulting from bankruptcies at the time the claims are paid, thereby eliminating these uncollectible loans from the loans receivable.

--Stated that the actual loss experience of the Guaranteed Student Loan program would be one of the factors used in establishing allowances for losses. HEW plans to use the previously discussed estimation model in establishing the allowances.

CHAPTER 5

OPINION ON FINANCIAL STATEMENTS

We have examined the financial statements of the Student Loan Insurance Fund, administered by OE, HEW, for the fiscal years ended June 30, 1971, and June 30, 1972. Our examination 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, except as stated in the following paragraph.

OE did not maintain records showing the amount due from individual debtors for accounts receivable, loans receivable, or accrued interest receivable. Therefore, it was not feasible for us to follow the normal auditing procedure of confirming yearend balances due from debtors or to satisfy ourselves as to the reasonableness of the amount of the yearend balances through other means. Because the yearend balances affected income, we were unable to satisfy ourselves as to the reasonableness of the reported income.

Our examination included a review of the laws authorizing the Student Loan Insurance Fund and of OE's policies and procedures for implementing the legislation. In making our examination, we could not use the work of the HEW Audit Agency. The Agency has reviewed certain aspects of the Guaranteed Student Loan program. This work, however, has not been directed at the management or financial aspects of the fund.

The financial statements accompanying this report (see schs. 1 through 4) were prepared by HEW, and modifications were made by GAO to improve their clarity.

The expenses of both the insurance and reinsurance programs were significantly understated because no liability was established for estimated future losses on loans which were insured or reinsured as of June 30, 1971, and June 30, 1972. As of June 30, 1972, net losses deferred to future years were estimated by OE to be $47.6 million for insured loans and $39 million for reinsured loans.

In addition, the records maintained by OE during fiscal years 1971 and 1972 were not, in our opinion, adequate to support the financial statements. We cannot express an opinion regarding the reasonableness of the amounts shown on the financial statements for:

--Insurance premium income and deferred insurance premium income. These figures were based on amounts billed and accounts receivable which we could not verify.

--Accounts receivable. OE records were not adequate to permit us to confirm yearend balances with lenders or to satisfy ourselves by other auditing procedures of the validity of the accounts receivable.

--Loans receivable. OE records were not adequate to permit us to verify the amounts owed by individual borrowers on defaulted loans; also, the loans receivable included amounts owed by borrowers who had been adjudicated bankrupt with no legal obligation to repay their loans and other apparently uncollectible amounts.

--Interest income and accrued interest receivable. These figures were computed by applying an interest rate not appropriate to loans receivable balances which we could not verify.

--Allowances for losses on loans receivable and accrued interest receivable. The loss rate used to compute these allowances was not based on experience of the Guaranteed Student Loan program and the rate was applied to loans receivable and accrued interest receivable balances which we were unable to verify.

For the reasons set forth in the preceding paragraphs, we are of the opinion that the accompanying financial statements do not present fairly the financial position of the Student Loan Insurance Fund at June 30, 1971, and June 30, 1972, and the results of its operations and the sources and application of its funds for the fiscal years then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States.

O F F I C E   O F   E D U C A T I O N

STUDENT LOAN INSURANCE FUND

STATEMENT OF FINANCIAL CONDITION

AS OF JUNE 30, 1971, AND JUNE 30, 1972

ASSETS	June 30, 1971			June 30, 1972		
CASH AND FUND BALANCE:						
Cash on hand and in transit	$ 69,257			$ 44,257		
Fund balance with U.S. Treasury	19,906,032			6,107,222		
Total cash and fund balance			$19,975,289			$ 6,151,479
ACCOUNTS RECEIVABLE			930,062			1,583,409
	Insured	Reinsured		Insured	Reinsured	
LOANS RECEIVABLE (note 1)	$9,414,821	$9,748,429		$27,221,785	$20,775,093	
Less allowance for losses	5,178,152	5,361,636		14,971,981	11,426,301	
Net loans receivable	4,236,669	4,386,793	8,623,462	12,249,804	9,348,792	21,598,596
ACCRUED INTEREST RECEIVABLE:						
Accrued interest on loans receivable	268,597	329,669		1,208,596	1,152,652	
Less allowance for losses	147,728	181,318		664,728	633,959	
	120,869	148,351	269,220	543,868	518,693	1,062,561
Total assets			$29,798,033			$30,396,045
LIABILITIES						
CLAIMS PAYABLE			$ 2,678,630			[a]$ 2,008,585
DEFERRED CREDITS:						
Insurance premium income			4,318,559			6,630,138
Total liabilities			6,997,189			8,638,723
INVESTMENT OF U.S. GOVERNMENT						
CAPITAL APPROPRIATED	$32,576,000			$45,341,000		
Less deficit accumulated since inception of program	-9,775,156			-23,583,678		
Balance (notes 2 and 3)			22,800,844			21,757,322
Total liabilities and investment			$29,798,033			$30,396,045

[a]The claims payable reported do not reflect contingent liabilities of approximately $5.3 million. The liabilities will be formally established when supplemental appropriated funds are made available.

GAO's opinion on these financial statements is on pp. 22 and 23.

The notes on p. 29, prepared by GAO, 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 YEARS ENDED JUNE 30, 1971, AND JUNE 30, 1972

	June 30, 1971	June 30, 1972
BALANCE AT BEGINNING OF PERIOD	$12,326,174	$22,800,844
FUNDS APPROPRIATED	18,000,000	12,765,000
NET INCOME OR DEFICIT (-) FOR YEARS ENDED JUNE 30, 1971, AND JUNE 30, 1972 (see sch. 3)	-7,525,330	-13,808,522
Balance at end of period (notes 2 and 3) (see sch. 1)	$22,800,844	$21,757,322

GAO's opinion on these financial statements is on pp. 22 and 23.

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF INCOME AND EXPENSE

FOR THE FISCAL YEARS ENDED JUNE 30, 1971, AND JUNE 30, 1972

	June 30, 1971			June 30, 1972		
	Insured	Reinsured	Total	Insured	Reinsured	Total
INCOME:						
Insurance premiums	$ 983,454	$ -	$ 983,454	$ 1,709,335	$ -	$ 1,709,335
Interest on public debt securities	33,764	-	33,764	-	-	-
Interest on loans receivable	241,025	281,985	523,010	943,274	822,757	1,766,031
Total income	1,258,243	281,985	1,540,228	2,652,609	822,757	3,475,366
EXPENSE (note a):						
Loss on loans--deaths and disabilities	187,083	434,325	621,408	131,641	294,244	425,885
Estimated losses on accrued interest receivable	132,166	155,092	287,258	516,999	452,641	969,640
Estimated losses on loans receivable	4,207,543	3,949,349	8,156,892	9,823,088	6,064,665	15,887,753
Loan collection expense	-	-	-	610	-	610
Total expenses	4,526,792	4,538,766	9,065,558	10,472,338	6,811,550	17,283,888
Total income or deficit (-)	-$3,268,549	-$4,256,781	-$7,525,330	$-7,819,729	-$5,988,793	-$13,808,522

[a]Under section 437 of the act, losses by death or disability on loans made after Dec. 15, 1968, are paid from the higher education activity appropriation (75X0293) and therefore excluded from these statements.

GAO's opinion on these financial statements is on pp. 22 and 23.

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF SOURCES AND APPLICATION OF FUNDS

FOR THE FISCAL YEARS ENDED JUNE 30, 1971, AND JUNE 30, 1972

	June 30, 1971	June 30, 1972
FUNDS PROVIDED BY:		
Appropriations	$18,000,000	$12,765,000
Sale of investment--public debt securities	900,000	-
Loan repayments	505,842	1,418,229
Interest on loans receivable	523,010	1,766,031
Insurance premiums	983,454	1,709,335
Interest on public debt securities	33,764	-
Decrease in working capital (see subschedule below)	-	13,049,015
Total funds provided	$20,946,070	$30,707,610
FUNDS APPLIED TO:		
Increase in loans receivable	$15,336,555	$30,281,114
Death and disability claims paid	621,408	425,886
Loan collection expense	-	610
Increase in working capital (see subschedule below)	4,988,107	-
Total funds applied	$20,946,070	$30,707,610

SUBSCHEDULE

CHANGE IN WORKING CAPITAL

	June 30, 1971		June 30, 1972	
INCREASES IN WORKING CAPITAL:				
Cash on hand and in transit	$ 37,240		$ -	
Operating fund balance with U.S. Treasury	7,828,496		-	
Accrued interest receivable	505,256		1,762,982	
Decrease in discount on investment	4,526		-	
Accounts receivable	-		653,347	
Claims payable	-	$ 8,375,518	670,045	$ 3,086,374
DECREASE IN WORKING CAPITAL:				
Accounts receivable	269,193		-	
Claims payable	1,527,319		-	
Deferred insurance premiums	1,588,418		2,311,579	
Decrease in premium on investment	2,481		-	
Cash on hand and in transit	-		25,000	
Operating fund balance with U.S. Treasury	-	3,387,411	13,798,810	16,135,389
Change in working capital		$ 4,988,107		-$13,049,015

GAO's opinion on these financial statements is on pp. 22 and 23.

GENERAL ACCOUNTING OFFICE

NOTES TO FINANCIAL STATEMENTS

1. Loans receivable represented the (1) amounts paid to lenders for federally insured defaulted loans (the notes are assigned to OE) and (2) amounts paid to State and private guaranty agencies for federally reinsured defaulted loans (the notes are retained by those agencies). Loans receivable also included amounts for loan default claims on hand but not paid as of June 30.

2. The financial statements as of June 30, 1971, which OE submitted to the Treasury, included a schedule showing the fund's estimated net contingent liability of $809 million for federally insured loans and $1.37 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. Additional amounts of $313 million for federally insured loans and $325 million for reinsured loans were shown on the schedule as the potential contingent liabilities for loans that had been approved but not disbursed as of June 30, 1971.

3. The financial statements as of June 30, 1972, which OE submitted to the Treasury, included a schedule showing the fund's estimated net contingent liability of $1.36 billion for federally insured loans and $1.86 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 $216 million was shown on the schedule as the potential contingent liabilities for federally insured loans that had been approved but not disbursed as of June 30, 1972.

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

MAR 26 1973

Mr. H.L. Krieger
Regional Manager
U.S. General Accounting Office
803 West Broad Street
Falls Church, Virginia 22046

Dear Mr. Krieger:

The Secretary has asked that I respond to your request for our comments on the General Accounting Office draft report to the Congress entitled, "Examination of Financial Statements of the Student Loan Insurance Fund, Fiscal Years 1971 and 1972." The enclosed comments set forth the actions taken and planned on the matters discussed in the report.

Sincerely yours,

James B. Cardwell
Assistant Secretary, Comptroller

Enclosure

Department of Health, Education, and Welfare Comments Pertinent to the Draft Report to the Congress of the United States by the Comptroller General of the United States Entitled "Examination of Financial Statements of the Student Loan Insurance Fund, Fiscal Years 1971 and 1972"

GAO RECOMMENDATION

That the Secretary develop the records necessary for both the efficient administration of the Guaranteed Student Loan Program and the preparation of accurate financial statements for the Student Loan Insurance Fund.

DEPARTMENT COMMENT

We agree that better records are needed for this rapidly growing program. As the GAO report indicates, the Office of Education (OE) has taken a number of measures to improve the quality of the records for the Student Loan Insurance Fund (Fund). In addition OE has an ongoing contract with a firm of management analysts to further help improve those records. As mentioned by GAO, the revised ADP system for the fund is functioning. As a result, a number of new administrative and financial reports are now being produced which should enable GAO to confirm our accounts, loans, and accrued interest receivable. The following are a few examples of our improved accounting for the Fund:

..more control was imposed on the documents being sent out for processing.

..the posting of receipts and disbursements were automated and deposits are being made timely.

..reports showing the number and dollar amount of loans and number of students are now generated each time the loan control master file is updated.

..lenders are furnished monthly reports of transactions and student status information which enables them to reconcile their records with OE's and report differences.

GAO RECOMMENDATION

That the Secretary provide the Congress with full information on the future financial requirements of the Guaranteed Student Loan Program.

DEPARTMENT COMMENT

We concur. Accurate forecasting of the financial requirements of the Program has been most difficult because of (1) its uniqueness and the dramatic growth over the past three years, and (2) the experience factor of defaults has been limited due to the relatively few loans that had

Page 2

matured prior to fiscal year 1972. Because of these factors, the Office of Planning, Budgeting, and Evaluation has entered into a contract with Systems Group, Inc. of Washington, D.C. for development of a default estimation model for the program. Systems Group, Inc. expects to complete preliminary work on the model by June 30. Program and national enrollment data will then be fitted to the model and initial estimates of interest billings and default claims will be made by September 15. The Model is to be constructed to produce the basis for predicting future financial requirements of the Guaranteed Student Loan Program.

GAO RECOMMENDATION

That the Secretary recognize insurance premium income when it is billed and include provision for estimated future losses on both insured and reinsured loans which have not yet defaulted. These procedures should be followed in arriving at the net income from operations on the statement of income and expense.

DEPARTMENT COMMENT

We concur in the recommendation and will observe these principles and procedures in FY 1973 annual statements of Financial Condition and Income and Retained Earnings. Information will also be provided on adjustments of prior year balances necessary to present cumulative information on a consistent basis.

GAO RECOMMENDATION

That the Secretary have the Office of Education remove uncollectible loans from the loans receivable.

DEPARTMENT COMMENT

The Department has been engaged in a major effort to collect on delinquent loans for only a brief period. This has not been an adequate span of time to accurately determine the overall collectibility of such loans. Since we cannot find other funding instruments which are comparable with regards to collectibility, we feel experience is necessary in order to justify write-off procedures. Submissions for write-offs will take place as soon as determinations are made by those persons responsible for the collection of defaulted student loans, that such accounts are truly uncollectible and all documentation required by GAO is in order. We have been working closely with the Procedures Branch of the Transportation and Claims Division of GAO on the design and format part of the documentation. Requests for write-offs of loans on which the borrower has been discharged in bankruptcy have been submitted. We are seeking to amend our program to write-off bankruptcies (except Chapter XIII) more promptly by effecting the write-off at the time the insurance claims are paid.

Page 3

GAO RECOMMENDATION

That the Secretary have the Office of Education use actual loss experience of the Guaranteed Student Loan Program in determining the rate for computing allowance for losses.

DEPARTMENT COMMENT

We concur in this recommendation to the extent that the actual loss experience of the Guaranteed Student Loan Program will be one of the factors used in computing the allowance for losses. Actual losses have not yet stabilized to a point where they along are predictive of future losses. Several data elements will be utilized in the Guaranteed Student Loan Estimation Model. A contract has been let for this model with an outside firm (see our response to the second recommendation above).

GENERAL ACCOUNTING OFFICE

REPORTS RELATING TO

STUDENT LOAN INSURANCE FUND

AND

GUARANTEED STUDENT LOAN PROGRAM

Title	Reference	Date
Examination of Financial Statements of the Student Loan Insurance Fund Fiscal Year 1968	B-164031(1)	Dec. 10, 1969
Opportunity to Reduce Federal Interest Costs By Changing Loan Disbursement Procedures Under the Guaranteed Student Loan Program	B-164031(1)	Apr. 20, 1970
Examination of Financial Statements of the Student Loan Insurance Fund Fiscal Year 1969	B-164031(1)	Apr. 12, 1971
Office of Education Should Improve Procedures to Recover Defaulted Loans Under the Guaranteed Student Loan Program	B-117604(7)	Dec. 30, 1971
Examination of Financial Statements of the Student Loan Insurance Fund Fiscal Year 1970	B-164031(1)	Jan. 12, 1972
Need for Improved Coordination of Federally Assisted Student Aid Programs in Institutions of Higher Education	B-164031(1)	Aug. 2, 1972

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

	Tenure of office	
	From	To
SECRETARY OF HEALTH, EDUCATION, AND WELFARE:		
Caspar W. Weinberger	Feb. 1973	Present
Elliot L. Richardson	June 1970	Jan. 1973
Robert H. Finch	Jan. 1969	June 1970
ASSISTANT SECRETARY FOR EDUCATION:		
Sidney P. Marland, Jr.	Oct. 1972	Present
COMMISSIONER OF EDUCATION:		
John R. Ottina (acting)	Oct. 1972	Present
Sidney P. Marland, Jr.	Dec. 1970	Oct. 1972
Terrel H. Bell (acting)	June 1970	Dec. 1970
James E. Allen, Jr.	May 1969	June 1970

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