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REPORT TO THE CONGRESS

Examination Of Financial Statements Of Student Loan Insurance Fund Fiscal Year 1973

B-164031 (1)

Office of Education
Department of Health, Education,
and Welfare

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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SEPT. 17, 1974

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164031(1)

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

We have examined the fiscal year 1973 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.

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.

Elmer B. Staats
Comptroller General
of the United States

Contents

ABBREVIATIONS

GAO	General Accounting Office
GSLS II	Guaranteed Student Loan System
HEW	Department of Health, Education, and Welfare
OE	Office of Education

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

EXAMINATION OF FINANCIAL STATEMENTS OF STUDENT LOAN INSURANCE FUND FISCAL YEAR 1973
Office of Education
Department of Health, Education and Welfare B-164031(1)

D I G E S T

WHY THE REVIEW WAS MADE

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 of student loans and Federal reinsurance of student loans insured by State or private nonprofit agencies.

This program represents a major portion of the Government's efforts to help individuals obtain educations. As of June 30, 1973, the Government was insuring loans amounting to $1.92 billion and reinsuring loans amounting to $2.42 billion.

The Office of Education (OE), Department of Health, Education, and Welfare (HEW), has paid over $780 million in interest on guaranteed student loans, including $236 million during fiscal year 1973.

Financial statements for the Student Loan Insurance Fund show a net loss of $350 million on defaulted loans; however, $302 million of this amount represents estimated losses on loans expected to be defaulted in the future.

OPINION ON FINANCIAL STATEMENTS

The records OE maintained during fiscal year 1973 were not adequate to support the financial statements of the Student Loan Insurance Fund.

Therefore, GAO cannot express an opinion that the financial statements present fairly the fund's financial position at June 30, 1973, the results of its operations, and the changes in financial position for the fiscal year then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General.

GAO was able to satisfy itself that the amounts shown for cash and fund balances, appropriations, claims payable, and amounts due to the Treasury were fairly stated.

FINANCIAL OPERATIONS

Lack of adequate records

The automated Guaranteed Student Loan System which OE uses to maintain detailed accounting records and to provide the information necessary to administer the program, is not working properly. This system contains inaccurate data files and computer programs which do not process the data correctly. (See pp. 12 to 15.)

Substantial increase in reported cost

The fiscal year 1973 financial statements for the fund (see schs. 1

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through 4) are the first statements prepared by OE which include both the current costs of insuring and reinsuring loans and the estimated liability for losses on loans expected to be defaulted.

OE revised the statement format, to include estimated future losses in response to a recommendation by GAO in its report on the financial statements for fiscal years 1971 and 1972. This revision made the financial statements more accurate by showing the costs of insurance when the liability is incurred instead of deferring this disclosure until the money is needed to pay claims.

OE adjusted the June 30, 1972, investment of the U.S. Government to recognize deferred income of $6,630,137 and estimated future losses of $94,247,294. The fiscal year 1973 Statement of Income and Expense (sch. 3) recognized an additional $209,511,000 in estimated future losses.

OE estimates that future losses on loans insured or reinsured as of June 30, 1973, will amount to $302,627,000. Including these losses in the Statement of Financial Condition (sch. 1) resulted in a deficit of $258 million instead of a surplus of approximately $44 million. Any deficit will require appropriations in future years to pay claims for defaulted loans.

Increasing default rate

OE estimated the default rate to be 17.2 percent for loans insured since program inception and 10.1 percent for loans reinsured as of June 30, 1973.

These rates are much higher than the 7.5-percent and 4-percent rates used to estimate defaults on loans insured and reinsured as of June 30, 1972. This increase more than doubled the cost of insuring and reinsuring loans shown on the Statement of Income and Expense. (See pp. 6 to 8.)

Inadequate collection efforts

OE does not have an aggressive program for collecting from defaulted borrowers.

Collection action is not started promptly or pursued adequately to either obtain payments or determine that the loan is uncollectible. Therefore, larger appropriations are needed to provide money to pay claims for defaulted loans.

Also total losses are increased because defaulted loans are harder to collect as time passes. (See pp. 10 and 11.)

Insufficient insurance premium income

OE is authorized to charge an insurance premium rate of one-fourth of 1 percent on loans insured directly by the Government. A comparison of premium income with recognized and anticipated losses indicates that a premium rate of 4 percent would be required to finance the insurance.

OE estimates that losses on loans insured from program inception through June 30, 1973, will exceed income by over $196 million.

OE is not authorized to collect insurance premiums on reinsured loans.

OE's records were not adequate to determine the rate required to finance losses on these loans; however, OE estimates that losses on loans reinsured from the inception of the program through June 30, 1973, will amount to over $153 million. (See p. 8.)

Need to report total program costs

Insurance payments for most defaulted loans are made from the Student Loan Insurance Fund. Payments of interest and special allowances on guaranteed loans and most insurance payments resulting from the death or disability of the borrower are made from higher education appropriations. Salaries and administrative expenses are paid from OE's appropriations for salaries and expenses.

OE does not consolidate information on the total cost of the Guaranteed Student Loan program. However, such information is necessary to enable either the Congress or OE to evaluate the program's effectiveness in relation to its cost. (See pp. 4 to 6.)

RECOMMENDATION

GAO is not repeating specific recommendations concerning the lack of adequate records or collections on defaulted loans in this report because GAO made recommendations on these areas in prior reports. OE is aware of the problems in these areas and has begun correcting them.

GAO plans to monitor these areas in future audits of the financial statements of the Student Loan Insurance Fund.

OE has not begun to prepare consolidated information on the cost of the Guaranteed Student Loan program; therefore, the Secretary of HEW should have OE provide the Congress with consolidated information on program costs. (See p. 6.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

HEW said that:

--Corrective action was begun in fiscal year 1973 and OE is planning further improvement in the management of the Guaranteed Student Loan program in fiscal years 1974 and 1975; however, not all problems discussed in the report can be addressed during that period.

--It is considering establishing cost accounting concepts and requirements for all agencies. When these concepts and requirements are available, OE will incorporate them into its financial systems and establish reports containing all administrative and program costs.

--A perfected and tested default estimation model will yield more conservative estimates of default rates and future losses.

--The expansion of the collection staff, provided for in the fiscal year 1974 supplemental and fiscal year 1975 regular appropriations requests, should enable OE to improve its collection performance and develop loss rates for loans receivable and accrued interest receivable based on experience.

These actions should substantially improve the accounting records and reports and strengthen OE's overall management of the program. However, as indicated by HEW, several years will be required to resolve all of the problems discussed in this report.

MATTERS FOR CONSIDERATION BY THE CONGRESS

The attention of the Congress is called to (1) the high default rate and resulting increase in costs of the Guaranteed Student Loan Program, (2) the substantial future funding required to pay future losses, and (3) OE's inability to provide accurate information on the program.

CHAPTER 1

INTRODUCTION

The Office of Education (OE), Department of Health, Education, and Welfare (HEW), administers the Guaranteed Student Loan program. This program, established under title IV, part B, of th Higher Education Act of 1965, as amended (20 U.S.C. 1071), provides Federal insurance of student loans and Federal reinsurance of student loans insured by State or private nonprofit agencies. Students attending either institutions of higher education or vocational schools are eligible for low-interest loans under this program. The program pays, for qualified students, part of the interest charged by lending institutions.

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. The Education Amendments of 1972 (Public Law 92-318) raised these limits to $2,500 and $10,000, respectively, effective March 1, 1973.

The Student Loan Insurance Fund is used to finance Federal insurance and reinsurance of loans made under the Guaranteed Student Loan program. This report does not deal with interest subsidies or administrative expenses of the program because these expenses are paid from higher education appropriations and salaries and expenses appropriations.

Administrative expenses are paid from OE's appropriations for salaries and expenses, but the portion applicable to the program was not readily available. The following chart shows expenditures from higher education appropriations.

	Fiscal year 1973	From program inception through June 30, 1973
	(millions)	
Interest on guaranteed loans (including special allowances)	$236.5	$777.9
Losses resulting from the death or disability of the student borrower	2.2	5.0
Total	$238.7	$782.9

FEDERAL REINSURANCE AND INSURANCE

Reinsurance of loans guaranteed by State or private nonprofit agencies increases the guaranty capacity of these agencies because OE reimburses them for a large percentage of their losses. If a student defaults on a loan, the insuring agency retains the borrower's note and is responsible for subsequent collection efforts. As of June 30, 1973, the Government was reinsuring loans in 24 States and the District of Columbia. OE estimated that, as of June 30 1973, the Government was reinsuring loans amounting to $2.42 billion, and the Government's contingent liability for reinsurance was $1.92 billion.

The program provides direct Federal insurance of loans for students who are ineligible for State programs because of their residence or the location of the schools they attend or for students in States without State programs. If a student defaults on a loan, the Government reimburses the lender for the unpaid principal and acquires title to the borrower's note, along with the responsibility for subsequent collection efforts. As of June 30, 1973, the Government was insuring loans in 46 States, the District of Columbia, Puerto Rico, Guam, American Samoa, an the Trust Territory of the Pacific Islands. OE estimated that, as of June 30, 1973, the Government was insuring loans amounting to $1.92 billion.

CHAPTER 2

FUNDING

SOURCE OF FUNDS

The Student Loan Insurance Fund receives money from insurance premiums, collections of principal and interest on defaulted loans, and interest on investments. Appropriations are used to supplement these funds and provide money to make payments in connection with the default of any insured or reinsured loan. OE is also authorized to borrow from the U.S. Treasury if additional funds are required. The following chart shows the amounts that the fund received from each source.

	Fiscal year 1973	From program inception through June 30, 1973
	(millions)	
Insurance premiums	$ 3.5	$ 13.6
Collections	3.9	5.9
Interest on investments	-	0.1
Appropriations	46.6	92.0
Treasury borrowings	15.0	15.0
Total	$69.0	$126.6

Insurance premiums

OE is required to charge lenders an insurance premium not to exceed one-fourth of 1 percent a year on the unpaid principal of loans insured by the Government. Since program inception, OE has charged lenders the maximum rate for the period from disbursement of the loan to the start of repayment. The act does not authorize OE to collect insurance premiums on reinsured loans.

Collection on defaulted loans

All money which OE collects from borrowers who have defaulted on insured loans is deposited in the fund. All money which OE receives from State or private nonprofit agencies as a result of payments from borrowers who defaulted on reinsured loans is also deposited in the fund. Some of the collections reported by OE actually represent tuition refunds from schools instead of payments from defaulted borrowers. These tuition refunds represent one-time collections and do not mean that the defaulted borrowers are either willing or able to repay the loans. OE records were not adequate to determine the amount actually paid by defauted borrowers.

In response to our report, HEW's Assistant Secretary, Comptroller, said that HEW would reclassify collections of tuition refunds as overpayments for fiscal year 1975.

Interest on investments

OE is authorized to invest money not needed for current operations in bonds or other obligations guaranteed by the United States. No money has been available for investment since fiscal year 1971.

Appropriations

The cost of reinsuring loans insured by State or private nonprofit agencies is financed from appropriations. Due to the lack of adequate income from other sources, appropriations are also used to finance most of the cost of direct Government insurance of student loans.

Loans from the Treasury

OE is authorized to borrow from the Treasury when moneys in the fund are insufficient to make payments in connection with the default of any insured or reinsured loan. During fiscal year 1973, OE used its borrowing authority for the first time to obtain a $15 million loan from the Treasury. OE used appropriated funds to repay this loan early in fiscal year 1974.

REPORTING PROGRAM COSTS

The fiscal year 1973 financial statements for the fund (see schs. 1 through 4) are the first statements prepared by OE which include the current costs of insuring and reinsuring loans and the estimated liability for losses on loans expected to be defaulted in the future. OE revised the statement format to include estimated future losses in response to a recommendation in our report on the financial statements for fiscal years 1971 and 1972 (B-164031(1), June 8, 1973).

The following table shows the net deficit reported on the fund's Statement of Income and Expense.

Fiscal year	Net deficit: Insured loans	Net deficit: Reinsured loans	Total
1968 through 1971	$ 3,645,852	$ 6,129,305	$ 9,775,157
1972	7,819,729	5,988,793	13,808,522
Adjustment to 1972	48,309,605	39,307,552	87,617,157
1973	136,634,767	102,419,647	239,054,414
Cumulative total	$196,409,953	$153,845,297	$350,255,250

The deficit figures represent estimates of amounts which must be funded from future appropriations. The large deficits shown for fiscal years 1972 and 1973 are due primarily to including estimated future losses. The June 30, 1973, Statement of Financial Condition (sch. 1), shows that, as of that date, estimated future losses of $302.6 million were responsible for a deficit of $258.3 million. Appropriated funds will be needed to pay claims when loans default in future years.

In our opinion, including estimated future losses greatly increases the accuracy of the financial statements by showing the costs of insurance when the liability is incurred, instead of deferring this disclosure until the money is needed to pay claims for defaulted loans.

Besides the liability to pay insurance claims for defaulted loans, the Government also has a liability to pay interest on most loans made under the program. Interest costs are not included in the fund's financial statements because these costs are paid from higher education appropriations.

In our opinion, both OF management and the Congress should be able to evaluate the program's effectiveness in relation to its cost. An evaluation of this type cannot be made until consolidated information is available on full program costs, regardless of the source of the funding. Therefore, besides preparing the fund's financial statements, OE should prepare a separate statement showing all program expenses which are not paid from the fund. This statement would include interest and special allowances on guaranteed loans, salary and administrative costs, and insurance payments resulting from the death or disability of a borrower who obtained a loan on or after December 15, 1968. This statement should also include an estimate of the Government's liability for future payments of interest benefits on loans insured or reinsured as of the statement date.

Recommendation to the Secretary of HEW

The Secretary of HEW should have OE provide the Congress with consolidated information on the costs of the Guaranteed Student Loan program.

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HEW's Assistant Secretary, Comptroller, agreed that consolidated cost information is necessary. In addition, he said that HEW was considering establishing cost accounting concepts and requirements. When these concepts and requirements are available, OE will include them in its financial system and establish reports providing consolidated cost information.

INCREASING DEFAULT RATE

The following chart shows the rates which OE used to estimate defaults in preparing financial statements for the fund.

Fiscal year	Insured loans	Reinsured loans
	(percent)	
From inception through 1971	1.2	1.2
1972	7.5	4.0
1973	17.2	10.1

The 1.2-percent rate initially used was not based on fund experience. The revised rates established for fiscal year 1972 were based on fund experience, but OE's statistics were not adequate for us to determine the reliability of the rates.

The 17-percent default rate for insured loans which OE used in preparing the June 30, 1973, financial statements is actually a composite of numerous default rates. OE used an automated default estimation model to compute default rates for various categories of loans. This model represents a significant improvement in OE's attempt to estimate future defaults. However, we cannot establish the reliability of the composite rate or the individual estimates it was derived from, because these estimates were the preliminary output from an incomplete model and the model depended on information in the automated Guaranteed Student Loan system (GSLS II). (See pp. 12 to 15.)

In response to this report, HEW's Assistant Secretary, Comptroller, stressed the continuing development of the default estimation model. He said that OE believes a perfected and tested model will give more conservative estimates for fiscal year 1974.

The default estimation model could not estimate defaults on reinsured loans because of incomplete information in the automated GSLS II system. OE computed the 10-percent rate manually; however, OE's statistics were not adequate for us to establish the reliability of this rate.

Although we cannot determine the reliability of the estimated default rates used to prepare the fiscal year 1973 financial statements, they are based on more complete information than was available in prior years and have been computed in a manner which should produce more accurate results. OE's current efforts to expand its collection efforts, improve the automated GSLS II system, and refine the default estimation model should increase OE's ability to accurately estimate future defaults. The use of higher estimated default rates in preparing fiscal year 1973 financial statements greatly increased the program's reported cost.

INADEQUATE INCOME FROM INSURANCE PREMIUMS

We have noted in several of our reports on the fund's financial statements that the authorized insurance premium rate (one-fourth of 1 percent of the unpaid principal balance) does not produce enough income to finance losses on loans insured by the Government. The following chart compares the cumulative reported income and expenses of the fund from its inception through June 30, 1973.

	Insured loans	Reinsured loans	Total
Income:			
Insurance premium	$ 13,648,088	-	$ 13,648,088
Interest on loans receivable	3,326,821	$ 3,011,571	6,338,392
Interest on investments	86,723	-	86,723
Total	17,061,632	3,011,571	20,073,203
Expenses:			
Losses on defaulted loans	39,134,758	25,014,100	64,148,858
Estimated future losses on loans	172,477,000	130,150,000	302,627,000
Losses on interest	1,820,761	1,656,489	3,477,250
Interest on Treasury borrowing	39,066	36,279	75,345
Total	213,471,585	156,856,868	370,328,453
Net loss	$196,409,953	$153,845,297	$350,255,250

These figures show that OE anticipates almost $16 in losses for every $1 of insurance premiums. If these estimates are accurate, a premium rate of approximately 4 percent would be required to finance losses on the direct Government insurance of student loans. OE has recommended that the Secretary of HEW propose a legislative change to increase the premium rate to 1 percent to increase the portion of default costs met from premium income.

OE is not authorized to collect insurance premiums on reinsured loans. OE authorizes State and private nonprofit agencies to collect a premium rate of up to one-half of 1 percent of the unpaid principal balance, even though OE reimburses these agencies for 80 percent of their losses. OE records were not adequate to determine the rate that would be necessary to finance the Government's losses on reinsured loans. The legislative change which OE has recommended that the Secretary of HEW propose includes a provision for a premium to be charged to State agencies for Federal reinsurance.

CHAPTER 3

NEED FOR MORE AGGRESSIVE COLLECTION ACTION

The Federal Claims Collection Act of 1966 and the Joint Standards prescribed under that act by the Attorney General and the Comptroller General require Government agencies to take aggressive action to recover debts resulting from their activities. During fiscal year 1973 OE's collection effort for defaulted Government-insured loans did not meet this requirement.

The Comptroller General addressed OE's inadequate collection efforts in a letter to the Secretary of HEW on January 5, 1971; in a special report to the Congress ("Office of Education Should Improve Procedures to Recover Defaulted Loans Under the Guaranteed Student Loan Program") on December 30, 1971; and in a letter to the Secretary of HEW on November 30, 1973.

In our report on the financial statements for fiscal years 1971-72, we noted that OE was beginning collection efforts as soon as it paid a claim. During fiscal year 1973, OE abandoned this practice because it did not have adequate resources to process the responses from defaulted borrowers.

In addition, OE has not developed procedures to insure that State agencies establish effective programs to collect from borrowers who have defaulted on reinsured loans. State agencies retain title to reinsured loans after payment of default claims and are responsible for subsequent collection. However, OE regulations require that these agencies remit 80 percent of their collections to OE to compensate for OE's 80-percent payment. This arrangement appears equitable; however, it provides little incentive for the agencies to develop aggressive collection programs. Permitting these agencies to retain a reasonable loan collection expense in addition to their equity could substantially improve their collection programs. We addressed problems in the State agencies' collection efforts in a report to the Secretary of HEW entitled "Improvement Needed in Administration of the Guaranteed Student Loan Program (B-164031(1), Mar. 30, 1973).

The lack of aggressive collection effort is resulting in the need for larger appropriations from the Congress to provide the funds necessary to pay claims. In addition, these loans are harder to collect as time passes, and money which could be collected with prompt action may not be collectible at a later date.

Since the loss on uncollectible loans represents virtually all the expenses of the Student Loan Insurance Fund, OE will not be able to prepare accurate financial statements for the fund until it has a collection program which will identify uncollectible loans and provide a record of actual loss experience for use in estimating future losses.

On January 23, 1974, the Secretary of HEW replied to our letter of November 30, 1973, and advised the Comptroller General of action being taken to improve OE's collection efforts and strengthen the management of the Guaranteed Student Loan program. (See app. II.) These actions included increasing the staff, changing regulations, developing legislative proposals aimed at improving collection, reducing defaults, and generally tightening program administration.

We plan to follow up on OE's progress in improving its collection efforts in our future examinations of the fund's financial statements.

CHAPTER 4

NEED TO IMPROVE

FINANCIAL RECORDS AND PROCEDURES

LACK OF ADEQUATE ACCOUNTING SYSTEM

During fiscal year 1973 OE continued to use a manual accounting system for the Student Loan Insurance Fund. In our report on the financial statements for fiscal years 1971 and 1972, we concluded that the accounting records for the fund were not adequate to support the financial statements. We recommended that OE develop the records necessary to prepare accurate financial statements.

HEW agreed that better records were needed and identified specific actions being taken to improve them. In addition, OE is developing a new accounting system which will be used for the fund, and OE plans to informally submit the accounting manual for the new system to the Comptroller General for review during fiscal year 1975.

PROBLEMS WITH THE AUTOMATED SYSTEM

Both the accounting system used for the fund during fiscal year 1973 and the system currently being developed depend on GSLS II for detailed supporting records. GSLS II, which a contractor developed for OE, was designed to maintain detailed program records and provide information needed by management to administer the program. GSLS II was not developed as an accounting system; however, it maintains the detailed records used by OE to prepare financial statements.

In our report on the financial statements of the Student Loan Insurance Fund for fiscal years 1971 and 1972, we noted that OE was not able to obtain accurate accounting information from GSLS II. The principles and standards of accounting prescribed by the Comptroller General require agencies to maintain a suitable system of financial and related records so that information needed on resources, liabilities and obligations, expenditures, revenues, and costs can be reported to internal management, to other agencies and authorities having control responsibilities, to the Congress, and, ultimately, to the public.

GSLS II cannot provide the information needed to prepare accurate financial statements. In our opinion, that is due, in part, to OE's failure to adequately consider accounting requirements in the design and implementation of GSLS II. GSLS II's inability to provide accurate accounting information also resulted from numerous other problems in the design and implementation of the system.

In response to recommendations in our report on the financial statements for fiscal years 1971 and 1972, HEW identified numerous changes to the automated system designed to improve the quality of the records. In addition, HEW requested that GAO work with HEW personnel before they prepared the fiscal year 1973 financial statements to identify any problems which could affect GAO's opinion on the statements. This joint effort resulted in a thorough analysis of GSLS II.

We have not included a detailed explanation of each of the problems in the design and implementation of GSLS II in this report because OE's task force, which we worked with, submitted a detailed report on the system to OE management. The following examples from the task force report show the system's status and some of the reasons for the problems.

Current status:

--The system data files contain erroneous information.

--The system programs are poorly designed and coded and do not process data properly.

--The system does not contain adequate controls to insure the integrity of the data bases.

Reasons for these problems:

--Excessive changes to the system indicate that OE did not understand the scope of the development effort.

--Inadequate standards, guidelines, and procedures were used to manage the contract and control the system's development and maintenance.

--The system was installed prematurely without thorough and complete acceptance tests.

--Each computer program within the system has been undergoing constant modification since its development.

--System documentation is inadequate and has not been properly maintained.

--OE's Division of Insured Loans does not have an adequate staff to manage the program.

--Modifications needed due to legislative changes have not been made.

--Data errors are being caused by program errors, system design deficiencies, operating errors, and incorrect entry of data by users.

OE's task force recommended many improvements to make GSLS II more accurate, including rewriting several computer programs and adding more controls. The report suggested that many of the needed improvements would require expanding GSLS II and that this expansion and other improvements should be provided for by designing a new system. Because the design and implementation of a new system will require several years, the task force concluded that GSLS II must be modified to provide usable information during this period and prevent similar problems in the new system.

We are not repeating recommendations for improving the accounting system or GSLS II because we made recommendations on this matter in prior reports. OE is aware of the problems and has begun correcting them. The improvements which OE initiated in response to the recommendation in our report on the financial statements for fiscal years 1971 and 1972 were not completed in time to improve the quality of the records for fiscal year 1973. However, these changes should improve the quality of records available for future years. In addition, OE has already started correcting many of the problems identified in the task force report. We will monitor OE's progress in improving this system through future audits of the fund's financial statements.

Because the automated system does not provide accurate information, we could not establish the reasonableness of amounts shown on the financial statements which were based on information obtained from the system. We could satisfy ourselves as to the reasonableness of amounts for only cash and fund balances, appropriations, claims payable, and amounts due the Treasury. These were not obtained from GSLS II.

IMPROVEMENTS NEEDED IN ESTIMATING LOSSES

During fiscal year 1973, OE used a 55-percent rate to compute allowances for losses on loans receivable and accrued interest receivable. In response to our report on the financial statements for fiscal years 1971 and 1972, HEW acknowledged that this rate is not based on program experience and agreed to develop a more accurate method of estimating losses.

OE did not have a valid basis for computing losses for the fund during fiscal year 1973 because losses can be computed only by determining that specific loans are uncollectible. OE personnel informed us that they were not willing to write off any loans as uncollectible because their collection effort was not yet adequate to determine the collectibility of the loans. (See ch. 3.) Through June 30, 1973, the only defaulted loans which OE had classified as uncollectible were $5.4 million in loans defaulted by borrowers who were bankrupt.

The lack of effective collection action during fiscal year 1973 prevented us from evaluating the reasonableness of this loss rate. Therefore, we cannot express an opinion on the reasonableness of the allowances for losses on loans receivable and on accrued interest receivable. We are not repeating recommendations on these areas because we made recommendations in prior reports and because HEW is trying to improve its collection efforts and develop a more accurate method of estimating losses.

In response to this report, HEW's Assistant Secretary, Comptroller, stated that expanding the collection staff, as provided for in the fiscal year 1974 supplemental and fiscal year 1975 regular appropriation requests, should make it possible to develop a loss rate based on program experience.

PROBLEMS IN ESTIMATING FUTURE LOSSES

Prior to fiscal year 1973 OE deferred a portion of insurance premium income to cover future losses on loans which had not yet been defaulted.

During fiscal year 1973 OE eliminated deferring this income and recognized estimated future losses to comply with recommendations made in GAO's report on the financial statements for fiscal years 1971 and 1972. OE also adjusted the net worth of the fund for income and expenses which should have been charged during prior years. The effects of this change in accounting procedures on the net income for fiscal year 1972 are shown on the chart on page 5. The effects on the Government's investment in the fund are shown in schedule 2.

The adjustment of prior years' expenses was understated by approximately $140 million and expenses for fiscal year 1973 were overstated by the same amount due to the use of the estimated default rates computed for the June 30, 1972, financial statements instead of the more current estimates computed for the June 30, 1973, financial statements. This error did not affect the June 30, 1973, Statement of Financial Condition (sch. 1).

As of June 30, 1973, the Government's investment in the fund was reduced to a deficit of $258.3 million. The negative investment represents OE's estimate of the Government's liability to provide future appropriations to cover losses resulting from defaults on loans insured or reinsured as of June 30, 1973.

The only records available for computing estimated future losses were maintained in GLSL II. Consequently, the problems with this system (see pp. 12 to 17) affected OE's ability to compute accurate estimates. In addition, the automated default estimation model provided only preliminary estimates of future defaults on insured loans and it could not provide a usable estimate of future defaults on reinsured loans due to incomplete data in GSLS II. OE used manual techniques to estimate future defaults on reinsured loans on the basis of incomplete information.

OE estimated that 55 percent of the future defaults would represent actual losses. This 55-percent loss rate is the same rate which OE used to compute allowances for losses on loans receivable and accrued interest receivable. As noted previously, OE has acknowledged that this rate is not based on program experience and has agreed to develop a more accurate method of estimating losses. OE's current expansion of its collection efforts should provide a more accurate basis for estimating future losses.

CHAPTER 5

SCOPE OF REVIEW

We examined the financial statements of the Student Loan Insurance Fund administered by OE, HEW, for the fiscal year ended June 30, 1973. 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.

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.

CHAPTER 6

OPINION ON FINANCIAL STATEMENTS

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 records OE maintained during fiscal year 1973 were not, in our opinion, adequate to support the financial statements. OE did not maintain accurate records showing the amount due from individual debtors for accounts receivable, loans receivable, or accrued interest receivable. Therefore, we could not follow the normal auditing procedure of confirming yearend balances due from debtors or satisfy ourselves as to the reasonableness of the amount of the yearend balances through other means. Because of the lack of adequate records (see ch. 4), the only amounts shown on the financial statements which in our opinion were fairly stated at June 30, 1973, were: cash and fund balances, appropriations, claims payable, and amounts due the Treasury.

In addition, the lack of effective collection action, as discussed in chapter 3, prevented us from evaluating the reasonableness of the rate used to compute allowances for losses on loans receivable and accrued interest receivable and to estimate future losses. These estimated losses represent all but $700,000 of the $247 million of the fund's expenses.

OE's adjustment for prior years' expenses (see sch. 2) was understated due to the use of an inappropriate estimated default rate. The use of the default rates computed for the fiscal year 1973 financial statements would have increased prior years' expenses by approximately $140 million and would have reduced losses for fiscal year 1973 by the same amount. (See sch. 3.) This error did not affect the Statement of Financial Condition. (See sch. 1.)

For the reasons set forth in the preceding paragraphs, we cannot express an opinion that the accompanying financial statements present fairly the financial position of the Student Loan Insurance Fund at June 30, 1973, and the results of its operations and 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.

SCHEDULE 1

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF FINANCIAL CONDITION

AS OF JUNE 30, 1973

ASSETS	June 30, 1973		
CASH AND FUND BALANCE:			
Cash on hand and in transit	$ 333,345		
Fund balance with U.S. Treasury	24,178,771		
Total cash and fund balance			$ 24,512,116
ACCOUNTS RECEIVABLE			1,171,840
	Insured	Reinsured	
LOANS RECEIVABLE (note 1)	$ 62,088,800	$ 40,169,486	
Less allowance for losses	34,148,840	22,093,217	
Net loans receivable	27,939,960	18,076,269	46,016,229
ACCRUED INTEREST RECEIVABLE:			
Accrued interest on loans receivable	3,310,476	3,011,797	
Less allowance for losses	1,820,762	1,656,488	
	1,489,714	1,355,309	2,845,023
Total assets			$ 74,545,208
LIABILITIES			
DUE THE U.S. TREASURY			
Borrowing			$ 15,000,000
Interest			75,345
	Insured	Reinsured	
CLAIMS PAYABLE	$ 10,731,758	$ 4,385,354	$ 15,117,112
ESTIMATED FUTURE LOSSES (note a)	172,477,000	130,150,000	302,627,000
Total liabilities			$332,819,457
INVESTMENT OF U.S. GOVERNMENT			
CAPITAL APPROPRIATED	$ 91,981,000		
Less deficit accumulated since inception of program	-350,255,249		
Balance (note 2)			-258,274,249
Total liabilities and investment			$ 74,545,208

a/This figure equals the estimated claim payments on all loans insured through June 30, 1973, minus all claims paid through June 30, 1973, minus estimated future collections.

GAO's opinion on these financial statements is on pp. 19 and 20.

GAO notes on p. 25 should be considered when reading the Statement of Financial Condition.

SCHEDULE 2

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF CHANGES IN INVESTMENT

OF THE U.S. GOVERNMENT

FOR THE FISCAL YEAR ENDED

JUNE 30, 1973

BALANCE AT BEGINNING OF PERIOD	$21,757,322	
ADJUSTMENT TO PRIOR YEARS (note 3):		
Recognition of deferred income	6,630,137	
Recognition of deferred loss	-94,247,294	
ADJUSTED BALANCE AT BEGINNING OF PERIOD		$-65,859,835
FUNDS APPROPRIATED		46,640,000
NET INCOME OR DEFICIT (-) FOR YEAR ENDED June 30, 1973 (see sch. 3)		-239,054,414
Balance at end of period (notes 2 and 3) (see sch. 1)		-$258,274,249

GAO's opinion on these financial statements is on pp. 19 and 20.

GAO notes on p. 25 should be considered when reading the Statement of Changes in Investment of the U.S. Government.

SCHEDULE 3

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF INCOME AND EXPENSE

FOR THE FISCAL YEAR ENDED JUNE 30, 1973

	June 30, 1973		
	Insured	Reinsured	Total
INCOME:			
Insurance premiums	$ 3,515,832	$ -	$ 3,515,832
Interest on loans receivable	2,114,195	1,859,145	3,973,340
Total	5,630,027	1,859,145	7,489,172
EXPENSE:			
Interest expense	39,066	36,279	75,345
Losses:			
Death and disability	336,976	281,039	618,015
Accrued interest receivable	1,156,034	1,022,530	2,178,564
Loans receivable	16,875,656	9,358,338	26,233,994
Unpaid loans receivable	5,546,062	2,380,606	7,926,668
Estimated future losses	118,311,000	91,200,000	209,511,000
Total expenses	142,264,794	104,278,792	246,543,586
Total income or deficit (-)	-$136,634,767	-$102,419,647	-$239,054,414

GAO's opinion on these financial statements is on pp. 19 and 20.

GAO notes on p. 25 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, 1973

FUNDS PROVIDED:		
Appropriations	$46,640,000	
Treasury borrowing	15,000,000	
Loan repayments	3,855,186	
Interest on loans receivable	3,973,340	
Insurance premium	3,515,832	
Decrease in accounts receivable	411,569	
Increase in claims payable	13,108,526	
Increase in accrued interest payable	75,345	
Total funds provided		$86,579,798
FUNDS APPLIED:		
Increase in loans receivable	$58,116,595	
Death and disability claims paid	618,015	
Bankruptcy claims (note 4)	5,448,180	
Increase in cash balance	18,360,637	
Increase in accrued interest receivable	3,961,026	
Interest on loans payable	75,345	
Total funds applied		$86,579,798

GAO's opinion on these financial statements is on pp. 19 and 20.

GAO notes on p. 25 should be considered when reading the Statement of Changes in Financial Position.

GAO NOTES TO FINANCIAL STATEMENTS

1. Loans receivable represented 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). Loans receivable also included amounts for loan default claims on hand but not paid as of June 30, 1973.

2. The financial statements as of June 30, 1973, which OE submitted to the Treasury, included a schedule showing the fund's estimated net contingent liability of $1.92 billion for federally insured loans and $1.92 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 $296 million was shown on the schedule as the potential contingent liability for federally insured loans that had been approved but not disbursed as of June 30, 1973.

3. The adjustment to prior years' income and expense on schedule 2 was made in response to recommendations in our report on the financial statements for fiscal years 1971 and 1972. The adjustment for prior years' expenses was understated because it was based on default rates computed by OE for the June 30, 1972, financial statements. Using the more current default rates computed by OE for the June 30, 1973, financial statements would have increased prior years' losses by almost $140 million and would have reduced losses for fiscal year 1973 by the same amount.

4. The funds applied to bankruptcy claims include the total amount of all bankruptcy claims written off during fiscal year 1973. A large portion of these claims was paid in prior years and carried as loans receivable prior to June 30, 1973. This procedure resulted in overstating the funds applied to bankruptcy claims. The overstatement of bankruptcy claims is offset by a corresponding understatement of funds applied to the increase in loans receivable.

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

JUN 24 1974

Mr. Gregory J. Ahart
Director
Manpower and Welfare Division
U.S. General Accounting Office
Washington, D.C. 20001

Dear Mr. Ahart:

We have reviewed the GAO Draft Report, "Examination of the Financial Statements of Student Loan Insurance Fund, Fiscal Year 1973, B164031(1)". As outlined in the draft report, corrective action was begun in Fiscal Year 1973. In Fiscal Years 1974 and 1975, the Office of Education (OE) is planning further improvement in management of the Insured Student Loan Program; however, not all problems discussed in the report can be addressed during that period.

[6]

We believe the establishment of a cost system, as discussed on page 17, that fully discloses the administrative as well as the program costs, is not only necessary for the Guaranteed Student Loan Program, but for all programs managed by the agency. In this connection, we are considering the establishment of cost accounting concepts and requirements for all the agencies. However, the actual specifications and documentation for this has not been developed and established at this time. When these concepts and requirements are made available, OE will take the necessary action to incorporate them into its [6] financial systems, and establish reports as described on page 17, as a standard requirement for all programs.

[3]

The report notes (page 13) there are tuition refunds being received by OE and improperly recorded as collections. We concur and OE plans to reclassify collections of such refunds as overpayments. Currently the GSLS II system is not capable of recording refunds; therefore, additional programming would be required. However, due to the lateness in FY 1974, this action will have to be scheduled for accomplishment in FY 75.

[ii, 6, 7, 15, 16, 17]

The draft report discusses at several points (p.p. 5, 18, 19, 32, 33 and 35) two rates which OE used in estimating future losses. These are the default rate on an entire bloc of loans so insured, and the loss rate on loans receivable and accrued interest receivable. Early application of the default estimation model produced a default rate of 17.2 percent on the bloc of loans made prior to June 30, 1973, on which Federal insurance commitments had been issued. At that stage of development, the model was based on a static maturation concept which assumed constant replication of borrower behavior over the period

Page 2 - Gregory J. Ahart

1973-1985. The Office of Education believes that a perfected and tested model will yield differing and more conservative estimates on this same loan bloc next year.

The 55 percent loss rate on loans receivable and accrued interest receivable was secured from the FHA experience, with Title I Home Improvement Loans during the period 1934-1969, as the best related experience available at the time. With the expansion of the collection staff, as provided for in the FY 1974 supplemental and FY 1975 regular appropriations requests, it should be possible to develop an experience based rate for future application.

As time passes, and the experience base broadens, we believe highly credible rates may be established.

Sincerely yours,

John D. Young
Assistant Secretary, Comptroller

GAO note: Numbers in brackets refer to pages in the final report.

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

JAN 23 1974

Honorable Elmer B. Staats
Comptroller General of the United States
General Accounting Office
Washington, D.C. 20548

Dear Mr. Staats:

Thank you for your letter of November 30 concerning HEW's responsibilities for establishing effective collection operations under the Guaranteed Student Loan Program.

We have delayed our response to your letter pending the outcome of negotiations with the Office of Management and Budget regarding staffing increases for the Guaranteed Student Loan Program in fiscal years 1974 and 1975. I am pleased to report that we have reached agreement on significant increases for staff for this program beginning with a fiscal year 1974 supplemental appropriation request. The request, and additional positions for 1975, we believe, will make a substantial contribution to improving our collection performance and strengthening the overall management of the Guaranteed Student Loan Program. Details of these requests will be made public with the transmission to the Congress of the President's 1975 budget.

In addition to the request for increased personnel, we are preparing a number of changes in the GSLP regulations and developing legislative proposals aimed at improving collections, reducing defaults, and generally tightening up administration of the program. We expect these proposed changes to be announced early this year.

I am also personally tracking Office of Education performance on collections as part of our Department-wide Operational Planning System. The Office of Education's goal this year is to collect $5.2 million on defaulted loans, an increase of $3.1 million over fiscal year 1973. Pending approval of the additional positions we will be requesting from the Congress for 1974, the Office of Education has allocated an additional 44 temporary positions to the collection effort. In total, there are now 70 positions assigned to the collection activity, an increase of 44 positions over fiscal year 1973. Of this number, 51 are filled, and vigorous efforts are underway to recruit persons for the remaining vacancies.

Page 2 - Honorable Elmer B. Staats

As part of our plan to strengthen the management of the Guaranteed Student Loan Program, we expect to make a number of management changes. These are detailed in a memorandum which I am sending the Commissioner of Education. A copy of this memorandum is enclosed.

We hope that these measures will remedy the deficiencies you have identified. We appreciate your constructive criticisms and we will be pleased to work with you and your staff to improve the management of the Guaranteed Student Loan Program.

Sincerely,

Secretary

Enclosure

MEMORANDUM

OFFICE OF THE SECRETARY

TO : Dr. John R. Ottina
Commissioner of Education

DATE: January 23, 1974

FROM : The Secretary Caspar W. Weinberger

SUBJECT: Management of the Guaranteed Student Loan Program

As you know, your recent request for additional personnel to manage the Guaranteed Student Loan Program has been approved.

Resources for this purpose will be incorporated into a fiscal year 1974 supplemental budget request as well as the regular 1975 budget estimates. Both of these requests are scheduled to be transmitted to the Congress on January 28.

This approval, however, is conditioned upon the Office of Education taking the following management actions:

-- Pulling together, under a single project manager, all related GSLP functions.

-- Recruiting a top-level administrator to act as project manager, preferably at the GS-16 or 17 level.

-- Having the project manager report directly to you or the Deputy for Management.

-- Recruiting other qualified personnel with appropriate business and administrative backgrounds to all GSLP vacancies.

-- Reviewing operational procedures to determine whether they can be further rationalized and clarified.

-- Developing a detailed work plan for the effective utilization and management of all GSLP resources.

I am asking the Assistant Secretary, Comptroller, and the Assistant Secretary for Administration to provide you with appropriate assistance in carrying out these tasks.

cc: A

APPENDIX III

GAO REPORTS RELATING TO

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
Examination of Financial Statements of the Student Loan Insurance Fund, Fiscal Years 1971 and 1972	B-164031(1)	June 8, 1973
Administration of the Office of Education's Student Financial Aid Program	B-164031(1)	Apr. 4, 1974

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
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. Sanders, 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
Sidney P. Marland, Jr.	Dec. 1970	Oct. 1972

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