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REPORT TO THE CONGRESS

Examination Of Financial Statements Of The Student Loan Insurance Fund Fiscal Year 1969 B-164031(1)

Office of Education
Department of Health, Education, and Welfare

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

APRIL 12, 1971

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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 the financial statements of the Student Loan Insurance Fund, administered by the Office of Education, Department of Health, Education, and Welfare, for fiscal year 1969 Our examination was made in accordance with section 105 of the Government Corporation Control Act, as required by the Higher Education Act of 1965.

Copies of this report are being sent to the Director, Office of Management and Budget, the Secretary of the Treasury, 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

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

EXAMINATION OF FINANCIAL STATEMENTS OF THE STUDENT LOAN INSURANCE FUND, FISCAL YEAR 1969
Office of Education, Department of Health, Education, and Welfare B-164031(1)

D I G E S T

WHY THE EXAMINATION WAS MADE

The Guaranteed Student Loan program comprises two components, a Federal student loan insurance program and a State or private nonprofit agency student loan insurance program. The Comptroller General is required by the Higher Education Act of 1965 to audit annually, in accordance with the Government Corporation Control Act, the Student Loan Insurance Fund which finances loan insurance activities under the Federal program and Federal reinsurance of loans made under the State program. The fund is administered by the Office of Education, Department of Health, Education, and Welfare (HEW)

FINDINGS AND CONCLUSIONS

In the opinion of the General Accounting Office (GAO), the accompanying financial statements do not present fairly the financial position of the Student Loan Insurance Fund at June 30, 1969, and the results of its operations and the sources and application of its funds for the fiscal year then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States. The financial statements were prepared by HEW, and minor modifications were made by GAO to improve their clarity.

GAO was unable to express an opinion regarding the reasonableness of the amounts shown on the financial statements for·

--Accounts receivable, because it was not practicable for GAO to confirm year-end balances with lenders or to satisfy itself as to the validity of the accounts receivable by other auditing procedures; also, not all the unpaid premiums on loans made during the year had been included in the accounts receivable at the year-end. (See pp. 11 to 13.)

--Income from insurance premiums and insurance premium income deferred, because not all the premiums on loans made during the year had been considered in computing the amounts shown. (See pp 11 and 12)

Tear Sheet

APRIL 12, 1971

--Allowances for losses on loans receivable and accrued interest receivable, because the reasonableness of the data used to compute the loss rate was not readily determinable. (See p. 14.)

Further, the amount for unpaid default claims that were classified as deferred charges was overstated because an allowance for losses was not provided. (See pp. 13 and 14.)

A major change was made in the method of recognizing income from insurance premiums In fiscal year 1968 all insurance premiums applicable to loans insured during the year were treated as income In fiscal year 1969 the method was revised to treat insurance premiums as income over a 5-year period--the estimated average length of time federally insured loans were expected to be outstanding. Although the revised method of recognizing premium income is an acceptable method, GAO believes that such treatment is unnecessary because the premiums are nonrefundable. (See pp 15 and 16.)

GAO also noted that losses due to death or disability of student borrowers that were to be reimbursed from an appropriation, rather than from the fund, were not shown on the financial statements, although the premiums collected on such loans had been deposited as income in the Student Loan Insurance Fund (See pp. 17 and 18.)

RECOMMENDATIONS OR SUGGESTIONS

The following changes are necessary to produce financial statements that will present fairly the financial condition of the fund.

--Lenders' default claims on hand at the year-end, which are submitted to the Office of Education because borrowers failed to repay their loans, should be classified as loans receivable or some similar type of current asset, rather than as deferred charges, and an allowance for losses on these claims should be provided and charged to expense in the year in which the claims are made against the fund. (See p. 13.)

--Accounting procedures need to be strengthened to ensure that the amounts shown on the financial statements for accounts receivable and insurance premium income are derived from reasonable and sound bases. (See p. 12.)

GAO believes also that the Office of Education could provide more informative financial statements by adding a statement showing (1) losses due to death or disability of student borrowers on loans made after December 14, 1968, (2) interest benefits--payment by the Government of a part of the interest on student loans--and (3) administrative expenses. Although such items are paid from appropriations that are not part of the fund, this type of data would disclose the full cost of the Guaranteed Student Loan program to readers of the financial statements. (See pp. 17 and 18.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Assistant Secretary, Comptroller, HEW, advised GAO on October 1, 1970, that he agreed with the findings and views in this report. Appropriate action was taken or planned on most of the matters discussed in this report that affect the financial statements of the Student Loan Insurance Fund. (See pp. 12, 14, and 16 to 18.) The Office of Education, however, is continuing the practice of deferring income from insurance premiums over a period of several years. (See p 16.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

This report is required by law, as previously stated.

Tear Sheet

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ABBREVIATIONS

GAO General Accounting Office

HEW Department of Health, Education, and Welfare

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

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In the opinion of the General Accounting Office (GAO), the accompanying financial statements do not present fairly the financial position of the Student Loan Insurance Fund at June 30, 1969, and the results of its operations and the sources and application of its funds for the fiscal year then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States The financial statements were prepared by HEW, and minor modifications were made by GAO to improve their clarity

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--Income from insurance premiums and insurance premium income deferred, because not all the premiums on loans made during the year had been considered in computing the amounts shown (See pp 11 and 12)

--Allowances for losses on loans receivable and accrued interest receivable, because the reasonableness of the data used to compute the loss rate was not readily determinable (See p 14)

Further, the amount for unpaid default claims that were classified as deferred charges was overstated because an allowance for losses was not provided (See pp 13 and 14)

A major change was made in the method of recognizing income from insurance premiums In fiscal year 1968 all insurance premiums applicable to loans insured during the year were treated as income In fiscal year 1969 the method was revised to treat insurance premiums as income over a 5-year period--the estimated average length of time federally insured loans were expected to be outstanding Although the revised method of recognizing premium income is an acceptable method, GAO believes that such treatment is unnecessary because the premiums are nonrefundable (See pp. 15 and 16)

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--Lenders' default claims on hand at the year-end, which are submitted to the Office of Education because borrowers failed to repay their loans, should be classified as loans receivable or some similar type of current asset, rather than as deferred charges, and an allowance for losses on these claims should be provided and charged to expense in the year in which the claims are made against the fund (See p. 13)

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GAO believes also that the Office of Education could provide more informative financial statements by adding a statement showing (1) losses due to death or disability of student borrowers on loans made after December 14, 1968, (2) interest benefits--payment by the Government of a part of the interest on student loans--and (3) administrative expenses Although such items are paid from appropriations that are not part of the fund, this type of data would disclose the full cost of the Guaranteed Student Loan program to readers of the financial statements. (See pp 17 and 18)

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The Assistant Secretary, Comptroller, HEW, advised GAO on October 1, 1970, that he agreed with the findings and views in this report Appropriate action was taken or planned on most of the matters discussed in this report that affect the financial statements of the Student Loan Insurance Fund (See pp. 12, 14, and 16 to 18.) The Office of Education, however, is continuing the practice of deferring income from insurance premiums over a period of several years. (See p. 16)

MATTERS FOR CONSIDERATION BY THE CONGRESS

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CHAPTER 1

INTRODUCTION

The General Accounting Office has made an examination of the financial statements of the Student Loan Insurance Fund administered by the Office of Education, Department of Health, Education, and Welfare, for the fiscal year ended June 30, 1969.

The Office of Education is responsible for administering various support and assistance programs in the educational field. One such program, commonly known as the Guaranteed Student Loan program, established pursuant to title IV, part B, of the Higher Education Act of 1965, as amended (20 U.S.C. 1071), provides low-interest insured loans for students in institutions of higher education and in vocational schools. This program comprises two components--a State or private nonprofit agency loan insurance program and a Federal loan insurance program.

The basic purposes of the Guaranteed Student Loan program are to (1) encourage States or private nonprofit institutions and organizations to establish adequate loan insurance programs for students in institutions of higher education and in vocational schools, (2) provide a Federal program of student loan insurance for students or lenders who do not have reasonable access to a State or private nonprofit program of student loan insurance, (3) pay, on behalf of qualified students,[1] a part of interest charged by lending institutions on loans which are insured under either the Federal program or an eligible loan insurance program established by State or private nonprofit institutions, and (4) guarantee a part of loans insured under an

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[1]A student qualifies for interest benefits--payment by the Government of a portion of the interest on his loan--if the combined adjusted gross income of the student (and his parents and spouse, if applicable), as reported for Federal tax purposes for the preceding year, less 10 percent and amounts allowable for exemptions, was less than $15,000.

eligible loan insurance program established by a State or private nonprofit institution.

Low-interest insured loans were initially provided to vocational students under a program established pursuant to the National Vocational Student Loan Insurance Act of 1965 (20 U.S.C. 981). Under this act, the Government was also authorized to make interest payments to participating lenders on behalf of qualified students on loans insured at the State or Federal level.

At the time the Higher Education Act and the National Vocational Student Loan Insurance Act were enacted in 1965, 17 States had independent agencies which administered student loan insurance programs at the State level. The Congress intended that the two acts would encourage each State to further develop its student loan insurance program. In its report on the Higher Education Act, the Senate Committee on Labor and Public Welfare stated that the Federal insurance program was a standby program to be used only when the State programs were not adequate to meet the demand for student loans.

To help accomplish the objectives of the two acts, the Congress, through fiscal year 1969, had appropriated $31,875,000 to the Office of Education for making advances to help establish or strengthen the student loan insurance programs operated by States or private nonprofit agencies, hereinafter referred to as the State program. As of June 30, 1969, the Office of Education had advanced $18,620,483 to State and private nonprofit agencies for this purpose. After funds were made available, either the States or the Office of Education initiated action to have a student loan insurance program established at the State level in each of the remaining 33 States.

During August 1967 the Office of Education initiated the Federal Insured Student Loan program, hereinafter referred to as the Federal program, because the demand for student loans exceeded the amount of State and/or Federal funds available for insuring loans at the State level. As of June 30, 1969, 27 States and Puerto Rico were participating in the Federal program under the provisions of the Higher Education Act of 1965, as amended. (See app. I.)

During 1968 legislation was enacted which affected the operation of the Student Loan Insurance Fund beginning in fiscal year 1969. The Higher Education Amendments of 1968 (Pub. L. 90-575, approved October 16, 1968) repealed the National Vocational Student Loan Insurance Act of 1965 and amended title IV, part B, of the Higher Education Act of 1965 to include students in vocational schools covered by the former act.

In addition, Public Law 90-460, approved August 3, 1968, amended section 428 of the Higher Education Act of 1965 (20 U.S C. 1078) to provide for Federal reinsurance of loans guaranteed by State or private guaranty agencies. This was done to promote the continuation of existing State or private guaranty agencies and to encourage the development of adequate State programs where none existed. Reinsurance has the effect of increasing the guaranty capacity of State or private agencies because these agencies will be reimbursed by the Office of Education for a large percentage of their losses. As of June 30, 1969, 16 States and the District of Columbia were participating under the reinsurance provision of the act. (See app. II.)

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 program insurance activities and reinsurance activities authorized by the act are financed.

CHAPTER 2

OPERATION AND FINANCING

OPERATION

The Guaranteed Student Loan program enables students to borrow funds from participating lending institutions to help pay for their educational costs while attending vocational, technical, or degree-granting institutions. Under the Federal program, these loans are insured by the Government, and, in the event of a student's death, total and permanent disability, or failure to pay, the lender is reimbursed for 100 percent of the unpaid principal balance of the loan.

Under Federal reinsurance of loans made under the State program, the Office of Education is authorized to enter into agreements with State or private guaranty agencies whereby such an agency will be reimbursed for 80 percent of its loss resulting from a student's default of a loan or from the nonpayment of a loan made prior to December 15, 1968, due to death or disability of a student borrower.

The loss resulting from the death or disability of a student borrower on a loan made on or after December 15, 1968, is not covered by reinsurance. For such a loan, the legislation provides that the Office of Education pay the entire amount owed on a loan by a student borrower who dies or is totally and permanently disabled, regardless of the source of guaranty (State or private) and regardless of whether the guaranty agency has signed a reinsurance agreement. (See pp. 17 and 18 for further discussion regarding payment of these claims.)

Upon payment of a lender's claim under the Federal program, the Government acquires title to the borrower's note on which the claim is filed. The Government then attempts to collect the loan, except on a claim resulting from the death or disability of a student borrower. In the event the borrower dies or becomes totally and permanently disabled, the obligation to make any further payment of principal and interest is canceled.

Under Federal reinsurance of a loan made under the State program, however, the Office of Education does not acquire title to the borrower's note on any claim that is paid. After a payment has been made by the Office of Education to a guaranty agency for a default claim, that agency has full collection responsibility and is required to return to the Office of Education 80 percent of any amount it subsequently recovers from a borrower. As under the Federal program, in the event the borrower dies or becomes totally and permanently disabled, the obligation to make further payment is canceled.

Any student, regardless of residence or family income, who is a citizen or national of the United States or who is in the United States for other than a temporary purpose and who is enrolled as at least a half-time student at an eligible institution can apply for a loan. Prior to December 15, 1968, the maximum loan that could be insured each academic year was $1,000 for a vocational or undergraduate student and $1,500 for a graduate student. The total amount of loans to any one student that could be insured was $5,000 for an undergraduate; $2,000 for a vocational student; and $7,500 for a graduate student, including loans for undergraduate and graduate years. Since that date, the maximum loan that can be insured for each academic year is $1,500 and the total amount of loans to any one student that can be insured is $7,500, regardless of the type of student.

FINANCING

The Higher Education Act of 1965 established the Student Loan Insurance Fund. Prior to December 15, 1968, all moneys in this fund were to be used for making payments in connection with losses incurred under the Federal program. Effective December 15, 1968, the fund was to be used also for making payments in connection with losses on defaulted loans covered under the reinsurance provision of the act.

The Student Loan Insurance Fund is a revolving fund which is financed by direct appropriations from the Congress, insurance premiums collected from participating lenders on loans made under the Federal program, and proceeds from the collection of defaulted loans. Also the Office of

Education is authorized to issue notes or other obligations to the Secretary of the Treasury if additional funds are required. If available funds exceed current operating needs, such excess funds may be invested by the Office of Education in bonds or other obligations guaranteed by the United States.

The Higher Education Act of 1965 requires the Office of Education to charge lenders participating in the Federal program a premium on each insured loan in an amount not to exceed one fourth of 1 percent a year of the unpaid principal amount of such loan, payable in advance, at such times and in such manner as may be prescribed by the Commissioner of Education. The lenders may pass the charges on to the students borrowing the funds. The Office of Education has the option of either collecting the premiums or offsetting them against amounts payable to the lenders for interest on student loans. During fiscal year 1969 the Office of Education billed participating lenders for the premiums due.

During fiscal year 1969 insurance premiums charged to a lender were computed from the date of disbursement of the loan to the student borrower to the anticipated date of his graduation plus 12 months. An Office of Education official informed us that the Office of Education had elected to compute the premium over this period, rather than over the full life of the loan, to avoid the administrative work and cost (both to the Office of Education and to the lender) that would be involved in recomputing the premium each time the principal balance changed during the repayment period or for every change in the student's status (such as leaving school or entering military service). The Office of Education also does not refund or adjust a premium as a result of (1) a student's leaving school or repaying his loan prior to the date used in computing the premium or (2) the extension of a student's educational program.

In July 1969 we were informed by the Assistant Secretary, Comptroller, HEW, that the policy of not collecting premiums during the loan repayment period would remain in effect, subject to periodic reevaluation.

Precise estimates were not readily available to show the period in which students would actually repay their loans. Usually, the amount of premiums charged would be greater, however, if the premiums were computed over the full life of the loan rather than over the shorter period used under the present method. The maximum repayment period for an insured loan is generally 10 years, beginning 9 to 12 months after the student graduates or ceases to carry an acceptable academic work load. The repayment period is extended for service in the armed services, Peace Corps, or Volunteers In Service To America.

Because the Federal program has been in operation for only a short period, sufficient experience on loan defaults does not exist to permit any determination as to whether the present method of collecting premiums will provide sufficient revenue to cover such defaults. We plan to examine more fully into this matter after the Federal program has been operating for a sufficient period to allow for an appraisal of the premium collection policy.

Under Federal reinsurance of loans made under the State program, no insurance premiums are charged the State or private agencies even though some of these agencies collect premiums from the lenders. The conference report on the Higher Education Amendments of 1968 (H. Rept 1919, dated Sept. 25, 1968) stated that it was the intention of the Congress that payments under the reinsurance provision with respect to default claims be made from appropriated funds and that collections on all defaulted loans and premium income under the Federal program be used only for making payments under that program.

CHAPTER 3

COMMENTS ON FINANCIAL STATEMENTS

ACCOUNTS RECEIVABLE

Generally accepted accounting principles and techniques require that all transactions affecting accounts receivable and income be properly recorded during the accounting period. We found that the amount of $485,807 included in the Student Loan Insurance Fund statement of financial condition at June 30, 1969 (sch. 1), as accounts receivable did not include all unpaid insurance premiums applicable to loans made by lenders during the fiscal year.

Under the Office of Education's billing practices, lenders were billed for insurance premiums on the basis of loan transaction statements which showed amounts of the insured loans as reported by the lenders and the premiums applicable to the loans. Under the Office of Education's operating procedures, lenders were required to report loans no later than 31 days after the date of the loan disbursement.

Our review showed that the amount of the accounts receivable at June 30, 1969, comprised (1) the unpaid balance of premiums billed to lenders through August 11, 1969, on insured loans made during the year and (2) estimated premiums on loans made during the year that had not been billed to lenders due to a need for clarification of the data they had submitted to the Office of Education. The amount, however, did not include an estimate for premiums billed in September and October 1969 on loans made during fiscal year 1969. The September billing of $62,286 comprised primarily premiums on loans made during the year, and the October billing included some premiums on loans made during the year.

An Office of Education official informed us that the loan disbursement data forming the basis for the premiums included in these two billings was not available at the time the year-end amount of the accounts receivable was computed because of computer-processing problems and not because lenders had failed to report loan disbursements timely

Since the Office of Education did not have data available showing the actual year-end accounts receivable, it was not feasible for us to follow the normal auditing procedure of confirming accounts receivable with lenders or to satisfy ourselves as to the validity of the accounts receivable by other auditing procedures. We are therefore unable to express an opinion regarding the amount of the accounts receivable as shown on the financial statements. Because the premium billings also affected income, we cannot express an opinion regarding the amounts shown on the financial statements for insurance premium income earned during the year and for insurance premium income deferred. (See pp. 15 and 16 for a discussion of deferring this income.)

We suggested that accounting procedures be strengthened to ensure that the amount shown for accounts receivable on the statement of financial condition and the amount shown for insurance premium income earned on the statement of income and expense are derived from reasonable and sound bases.

In his letter to us dated October 1, 1970, the Assistant Secretary, Comptroller, HEW, agreed that such accounting procedures needed to be strengthened. He stated that lending institutions would be requested to report loan transactions more accurately and that attempts would be made to improve procedures for estimating year-end accounts receivable and insurance premium income earned.

HEW informed us that Office of Education records showed that an upward adjustment of $54,738 had been made to the amount of the accounts receivable for premiums on loans disbursed in fiscal year 1969 for which lenders were billed in fiscal year 1970. Our analysis of this adjustment showed, however, that it was for estimated premiums on loans that the computer would not record because of a need for clarification of the data submitted by lenders, rather than for premiums on loans disbursed in fiscal year 1969 but not included in the financial statements because of the processing time lag.

HEW suggested that GAO attempt to confirm accounts receivable on a scientific-sampling basis, in order to reach a conclusion as to their validity We believe that requesting certain lenders to furnish us with information regarding insurance premiums due the Office of Education would not be useful in reaching a conclusion as to the validity of the amount of the accounts receivable shown on the financial statements, because, as previously stated, the Office of Education did not have data available showing the actual year-end accounts receivable.

LOANS RECEIVABLE, DEFERRED CHARGES AND ALLOWANCE FOR LOSSES

The Office of Education 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 charged to loans receivable and further attempts are made to collect the amount from the borrower.

At the request of the Treasury Department, loan default claims on hand but not paid at June 30, 1969, in the amounts of $9,595 under the Federal insured loan program and $157,384 under Federal reinsurance were classified as deferred charges instead of loans receivable on the statement of financial condition. (See sch. 1.) An Office of Education official informed us that these claims, totaling $166,979, were classified as deferred charges and were not included in the amount of loans receivable in order for that amount to be in agreement with the year-end reports which are submitted to the Treasury Department on a cash basis.

Because "deferred charges" is a classification which usually denotes expenditures which are allocable to the income of a number of years, we believe that the unpaid default claims should have been classified as loans receivable, or some similar type of current asset, and that an allowance for losses should have been provided to reduce them to their estimated realizable value. The amount of the total assets on the statement of financial condition would have been reduced correspondingly. This treatment would have been consistent with that accorded to loan default claims paid and charged to loans receivable during the fiscal year. The effect of such treatment would have been consistent also with the Office of Education's practice of charging unpaid death and disability claims at the end of the fiscal year as expense in the fiscal year.

The Office of Education used a rate of 55 percent to compute the allowances for losses on accrued interest receivable and on default claims paid and charged to loans receivable during fiscal year 1969. This rate was based on the experience of the Federal Housing Administration's Title I Insurance Fund for the period July 1934 through June 1967. An Office of Education official informed us that this rate had been used because of similar factors involved in the operations of the two funds and because of the lack of experience to date under the Student Loan Insurance Fund. We are unable to readily determine the propriety of this loss rate with respect to the Federal program or the Federal reinsurance of loans under the State program and therefore cannot express an opinion on the reasonableness of the allowances for losses on loans receivable and on accrued interest receivable.

If an allowance for losses on the loan default claims that were classified as deferred charges had been provided on the basis of the rate of 55 percent used to establish an allowance for losses on the loans receivable, the total assets, as shown on the statement of financial condition at June 30, 1969, would have been decreased by $91,838, and the expenses, as shown on the statement of income and expense for the fiscal year, would have been increased by $91,838.

In his letter to us of October 1, 1970, the Assistant Secretary, Comptroller, HEW, agreed that the preferred accounting and reporting treatment would require an adjustment of the loans receivable for the items classified as deferred charges and of the allowance for losses to show the realizable value of the assets. He stated, however, that HEW's accounting and reporting treatment was governed by instructions of the Office of Management and Budget and the Treasury Department which require that the amount of the loans receivable include only those defaulted loans for which lending institutions have been reimbursed. He advised us that our suggested accounting and reporting treatment would be discussed with the Office of Management and Budget and the Treasury Department.

We were subsequently informed that the Office of Education, in preparing its fiscal year 1970 financial statements on the Student Loan Insurance Fund, had provided an allowance for losses on unpaid default claims on hand at year-end.

DEFERRED CREDITS--INSURANCE PREMIUM INCOME

For fiscal year 1968, the first year of operation of the Student Loan Insurance Fund, the Office of Education followed the policy of treating premiums on loans insured during the fiscal year as income in that year. In fiscal year 1969 the Office of Education adopted the policy of including premiums on loans insured during the fiscal year as income over a 5-year period--the estimated average length of time federally insured loans were expected to be outstanding.

This change in accounting policy resulted in the inclusion in:

--The statement of financial condition at June 30, 1969, of a deferred credit of $1,188,219, representing insurance premium income of $322,921 and $865,298 on loans insured in fiscal years 1968 and 1969, respectively.

--The statement of changes in accumulated net income for fiscal year 1969 of an adjustment of $415,184, representing the deferral to later years of premiums on loans insured in fiscal year 1968.

--The statement of income and expense for fiscal year 1969 of premium income of $210,077, representing premiums of $92,263 on loans insured in fiscal year 1968 and premiums of $117,814 on loans insured in fiscal year 1969.

In his letter to us of October 1, 1970, the Assistant Secretary, Comptroller, HEW, stated that the decision to prorate insurance premiums over a period of years, beginning with the fiscal year 1969 financial statements, was based upon generally accepted accounting principles which require assignment of revenues and expenses to the periods affected.

This method of recognizing premium income, which is an acceptable practice, would be necessary if, under certain circumstances, the Office of Education was obligated to refund parts of the premiums collected. Since there are no refunds or adjustments of premiums, regardless of when students repay loans, we believe that deferring premium income is unnecessary. We noted that the Office of Education, in preparing its fiscal year 1970 financial statements on the Student Loan Insurance Fund, continued the practice of deferring income from insurance premiums over a period of several years.

CAPITAL APPROPRIATED

Through fiscal year 1969 Federal funds totaling $3,750,000 were provided as capital for the Student Loan Insurance Fund, to support operations under the Federal program. Of this amount, $50,000 was appropriated in fiscal year 1966 and $3,200,000 was appropriated in fiscal year 1967. In fiscal year 1967 $500,000 additional was transferred to the fund from the higher education insured loans appropriation. No appropriations were made to the fund during fiscal years 1968 and 1969.

The statement of financial condition of the Student Loan Insurance Fund at June 30, 1969, shows that the appropriated capital of the fund was reduced by $262,325, representing the payment of claims of losses under the Federal reinsurance of loans made under the State program. Because the Congress provided that claims for such losses be paid from appropriated funds (see p. 10), we believe that the losses of $262,325 should not have been charged to the capital of the fund but should have been shown as a receivable due from appropriations for losses under the Federal reinsurance of loans made under the State program.

In his letter to us of October 1, 1970, the Assistant Secretary, Comptroller, HEW, agreed with our view that such losses should not have been charged to the capital of the fund and stated that additional funds for making such payments had been requested and had been made available through appropriations by the Congress. We noted that the Office of Education had provided full disclosure on this matter in the fiscal year 1970 financial statements.

CONTINGENT LIABILITIES

The Office of Education notes to the statement of financial condition (sch. 1) showed contingent liabilities of $205,256,220 for loans insured under the Federal program and of $496,115,602 for reinsured loans made under the State program. These amounts were not reduced, however, by repayments made by student borrowers.

We noted that in fiscal year 1970 the Office of Education began requiring State or private guaranty agencies participating under the Federal reinsurance provision of the Higher Education Act of 1965 to report data on repayments by borrowers. In our opinion, it would also be desirable for the Office of Education to know, at the end of the fiscal year, the correct contingent liability under the Federal program. Therefore we suggested to the Office of Education that it consider the feasibility of obtaining such information from lenders participating in the Federal program, since current procedures do not provide for lenders to report the unpaid balance of loans.

In his letter to us of October 1, 1970, the Assistant Secretary, Comptroller, HEW, agreed with our suggestion and stated that all participating lenders had been requested to provide this and other related data to the Office of Education.

GENERAL COMMENTS

The Higher Education Amendments of 1968 provided for the payment of claims for loans made on or after December 15, 1968, that were unpaid because of the deaths or disabilities of the borrowers, to be charged to the higher education activities appropriation rather than to the Student Loan Insurance Fund. Consequently premiums on all loans under the Federal program are shown as income on the income and expense statement but only losses resulting from defaults (not because of the deaths or disabilities of the borrowers) of loans made on or after December 15, 1968, are shown as expenses on the statement.

We believe that all losses on loans insured under the Federal program and on reinsured loans made under the State program should be shown in a footnote to the statement of income and expense. We believe also that the Office of Education should consider including with the financial statements a statement showing the interest benefits (see p. 4), administrative expenses, and losses on insured loans made after December 14, 1968, that are paid from the higher education activities appropriation, so that the full cost of the Guaranteed Student Loan program will be apparent to readers of the financial statements.

The Assistant Secretary, Comptroller, HEW, in his letter to us of October 1, 1970, agreed with our views regarding full disclosure of losses and informed us that the fiscal year 1970 financial statements would be developed accordingly. We noted that appropriate footnotes had been added to the fiscal year 1970 financial statements, to provide full disclosure of losses on insured loans under the Federal program and on reinsured loans under the State program.

CHAPTER 4

SCOPE OF EXAMINATION

We have examined the financial statements of the Student Loan Insurance Fund administered by the Office of Education, HEW, for the fiscal year ended June 30, 1969, included herein. 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.

Our examination showed that the amount of the year-end accounts receivable did not include all the unpaid insurance premiums that had been billed to lenders with respect to loans made in fiscal year 1969. Moreover the amount included estimated premiums that had not been billed to lenders for insured loans made during fiscal year 1969. Therefore it was not feasible for us to follow the normal auditing procedure of confirming year-end balances of insurance premiums due from lenders or to satisfy ourselves as to the amount of the year-end accounts receivable through other means.

Our examination included a review of the laws authorizing the Student Loan Insurance Fund and of the Office of Education's policies and procedures for implementing the legislation. We also corresponded directly with students on a test basis to confirm the amount of loans obtained by them.

CHAPTER 5

OPINION OF FINANCIAL STATEMENTS

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

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

--Accounts receivable, because it was not practicable for us to confirm year-end balances with lenders or to satisfy ourselves as to the validity of the accounts receivable by other auditing procedures; also, not all the unpaid premiums on loans made during the year had been included in the accounts receivable at the year-end. (See pp. 11 to 13.)

--Income from insurance premiums and insurance premium income deferred, because not all the premiums on loans made during the year had been considered in computing the amounts shown. (See pp. 11 and 12.)

--Allowances for losses on loans receivable and accrued interest receivable, because the reasonableness of the data used to compute the loss rate was not readily determinable. (See p. 14.)

Further, the amount for unpaid default claims that were classified as deferred charges was overstated because an allowance for losses was not provided. (See pp. 13 and 14.)

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, 1969, and the results of its operations and the sources and application of its funds for the fiscal year then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States.

FINANCIAL STATEMENTS

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF FINANCIAL CONDITION

AS OF JUNE 30 1969

	Insured	Reinsured		
ASSETS				
CASH AND FUND BALANCE				
Cash on hand and in transit			$ 6 877	
Fund balance with U S Treasury			4,095,540	
Total cash and fund balance				$4,102 417
INVESTMENTS--PUBLIC DEBT SECURITIES (par value) (note 1)				412 000
ACCOUNTS RECEIVABLE				485 807
ACCRUED INTEREST RECEIVABLE	$ 1 051	$ 214		
Less allowance for losses	578	118		
Net accrued interest receivable	473	96		569
LOANS RECEIVABLE (note 2)	66 055	21 096		
Less allowance for losses	36,330	11,603		
Net loans receivable	29,725	9,493		39,218
DEFERRED CHARGES (note a)	$ 9,595	$157,384		166,979
Total assets				$5,206,990
LIABILITIES				
ACCRUED LIABILITIES (note 3)				$ 242 844
DEFERRED CREDITS				
Discount on investment--public debt securities			$ 8,036	
Insurance premium income (note b)			1,188,219	
Total deferred credits				1,196,255
Total liabilities				1,439,099
NET INVESTMENT				
CAPITAL APPROPRIATED (note c) (note 4)			$3,487,675	
INVESTMENT IN REINSURED LOANS (schedule 2)			166,974	
ACCUMULATED NET INCOME--INSURED (schedule 2)			113,242	
Total investment				3,767 891
Total liabilities and investment				$5,206 990

[a] Unpaid defaulted loans guaranteed by the U S Government

[b] A major change in our method of statement presentation involves the deferring of insurance premium income over the average length of loans Our best estimate of expected losses for the $205 256 220 of Insured Loans is $1 325 000 As further experience is gained in this program alternate methods of statement presentation will be considered

[c] Reduced by Reinsured Claims processed

Contingent liability for loans underwritten
Insured Loans $205 256 220
Reinsured Loans 496 115 602

Notes
The opinion of the General Accounting Office on these financial statements appears on page 20 of this report

The notes on page 27 which were prepared by the General Accounting Office should be considered when reading the statement of financial condition

SCHEDULE 2

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF CHANGES IN ACCUMULATED NET INCOME

FOR THE FISCAL YEAR ENDED JUNE 30, 1969

	Insured	Reinsured	Total
Balance at beginning of period	$450,491	-	$450,491
Less adjustment to defer income of prior year	415,184	-	415,184
Adjusted balance at beginning of period	35,307	-	35,307
Add net income or deficit (-) for current period (Schedule 3)	77,935	$-95,351	-17,416
Total	113,242	-95,351	17,891
Add costs funded by appropriations	-	262,325	262,325
Balance at end of period	$113,242	$166,974	$280,216

The opinion of the General Accounting Office on these financial statements appears on page 20 of this report.

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF INCOME AND EXPENSE

FOR THE FISCAL YEAR ENDED JUNE 30, 1969

	Insured	Reinsured	Total
INCOME:			
Insurance premiums	$210,077	-	$210,077
Amortization of discount on investment--public debt securities	4,765	-	4,765
Interest on loans receivable	1,036	214	1,250
Total income	215,878	214	216,092
EXPENSE:			
Loss on loans	101,035	83,844	184,879
Allowance for losses on loans receivable	36,330	11,603	47,933
Allowance for losses on accrued interest receivable	578	118	696
Total expense	137,943	95,565	233,508
Net income or deficit(-)	$ 77,935	$-95,351	$-17,416

The opinion of the General Accounting Office on these financial statements appears on page 20 of this report.

OFFICE OF EDUCATION

STUDENT LOAN INSURANCE FUND

STATEMENT OF SOURCES AND APPLICATION OF FUNDS

FOR THE FISCAL YEAR ENDED JUNE 30, 1969

Funds applied to	
Purchase of investment--public debt securities (par value)	$412,000
Increase in operating fund balance with U.S Treasury	302,078
Insurance claims paid, no asset received	184,879
Loans receivable in payment of claims	85,996
Total funds applied	$984,903
Funds provided by	
Insurance premiums	$210,077
Amortization of discount on investment--public debt securities	4,765
Interest on loans receivable	1,250
Repayments received on loans receivable	645
Decrease in working capital (note 5) (see subschedule below)	768,166
Total funds provided	$984,903

SUBSCHEDULE

DECREASE IN WORKING CAPITAL (note 5)

Decreases in working capital:		
Accrued liabilities	$242,844	
Deferred insurance premium income	773,035	
Deferred discount on investment--public debt securities	8,036	$1,023,915
Increases in working capital		
Cash on hand and in transit	6,877	
Accounts receivable	80,643	
Accrued interest receivable	1,250	
Deferred charges	166,979	255,749
Decrease in working capital (note 5)		$ 768,166

The opinion of the General Accounting Office on these financial statements appears on page 20 of this report

Note 5 on page 28, which was prepared by the General Accounting Office, should be considered when reading this schedule

GENERAL ACCOUNTING OFFICE

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1969

1. Moneys in the Student Loan Insurance Fund not needed for current operations may be invested in bonds or other obligations guaranteed as to principal and interest by the U.S. Government. The moneys available for investment must be from sources other than appropriations and must not jeopardize any appropriations in the fund. The investments at June 30, 1969, consisted of U.S. Treasury bills, maturity date October 23, 1969, having a par value of $412,000 and a market value of $403,379.

2. Loans receivable represented the amounts paid to lenders for federally insured defaulted loans--the notes are assigned to the Office of Education--and the amounts paid to State and private guaranty agencies for federally reinsured defaulted loans--the notes are retained by those agencies.

3. Accrued liabilities represented claims payable to lenders and State or private guaranty agencies and consisted of.

Insured loan claims due lenders	$ 14,135
Reinsured loan claims due State and private guaranty agencies	228,709
Total	$242,844

4. Capital appropriated consisted of:

Balance July 1, 1968	$3,750,000
Less costs for reinsurance claims funded by appropriations	262,325
Balance June 30, 1969	$3,487,675

5. Decrease in working capital does not include consideration of the increase in the cash balance on deposit with the Treasury. As adjusted, the decrease would be as follows.

Decrease in working capital as shown above	$768,166
Less increase in cash on deposit with the Treasury	302,028
	$466,138

APPENDIXES

STUDENT LOAN INSURANCE FUND

VOLUME OF COMMITMENTS FOR FEDERALLY INSURED LOANS

FROM INCEPTION THROUGH JUNE 30, 1969

Location	Date implemented Federal program	Commitments Number	Commitments Amount (note a)
Alabama	5-68	10,763	$ 8,598,820
Arizona	12-67	11,145	8,054,157
California	12-67	94,273	83,265,805
Colorado	8-67	18,922	17,806,311
Florida	2-68	16,551	15,428,464
Hawaii	8-67	3,221	3,124,589
Idaho	2-68	3,785	3,152,696
Indiana	9-67	18,657	16,469,005
Iowa	1-69	4,607	4,177,332
Kansas	9-67	10,358	8,412,959
Kentucky	12-68	4,654	3,932,135
Minnesota	9-67	34,797	29,310,763
Mississippi	12-68	4,631	3,302,073
Montana	10-67	7,787	6,329,615
Nebraska	11-67	7,397	6,399,126
New Jersey	10-67	11,895	11,096,395
New Mexico	8-68	2,222	1,493,091
North Dakota	8-67	16,330	13,337,479
South Dakota	3-68	6,248	5,041,077
Tennessee	10-68	166	155,120
Texas	12-68	6,242	5,491,010
Utah	9-67	9,743	8,305,947
Vermont	9-67	2,842	2,539,680
Virginia	9-68	1,353	1,307,613
Washington	11-67	10,056	7,614,567
West Virginia	10-67	6,380	5,431,911
Wyoming	11-67	1,144	991,236
Puerto Rico	8-68	4,131	2,931,763
Total		330,300	$283,500,739

[a] Amount the Office of Education agreed to insure, not the actual amount of loans disbursed.

STUDENT LOAN INSURANCE FUND

OUTSTANDING PRINCIPAL BALANCES

SUBJECT TO REINSURANCE PROVISION

AS OF JUNE 30, 1969

Location	Effective date of reinsurance agreement	Balance (note a)
Arkansas	9-68	$ 3,639,331
Connecticut	12-68	52,411,383
District of Columbia	9-68	1,518,510
Georgia	12-68	17,854,000
Massachusetts	9-68	30,115,647
Michigan	2-69	20,836,452
New Hampshire	9-68	3,592,386
New Jersey	12-68	53,875,050
New York	9-68	282,500,000
Ohio	6-69	22,528,216
Oklahoma	9-68	6,615,458
Oregon	9-68	8,571,574
Pennsylvania	9-68	88,618,904
Rhode Island	2-69	7,056,517
Tennessee	9-68	10,434,290
Vermont	5-69	2,153,397
Wisconsin	9-68	7,823,386
Total		$620,144,501

[a]Balances were estimated by the Office of Education.

DEPARTMENT OF HEALTH, EDUCATION AND WELFARE
WASHINGTON, D C 20201

OFFICE OF THE SECRETARY

OCT 1 1970

Mr. Philip Charam
Associate Director
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Charam:

The Secretary has asked that I reply to your letter of July 13, 1970, requesting comments on your draft report on the Fiscal Year 1969 financial statements for the Student Loan Insurance Fund. We have reviewed the report and offer the following information for your consideration:

GENERAL

As previously indicated the Insured Student Loan Program is only a few years old and has unique and complex characteristics. In developing the financial statements for FY 1969, we had several discussions with operating personnel and the DHEW accounting system staff regarding the treatment of certain transactions and accounts and the presentation of information in the formal reports. We plan to continue this process in order to provide the most meaningful and appropriate reports possible. In this regard it should be recognized that until sufficient experience is gained and improvements are made we will, of necessity, have to provide certain estimates in the reports.

ACCOUNTS RECEIVABLE AND INSURANCE PREMIUM INCOME

We recognize the need to further strenghten our accounting procedures and will soon request lending institutions to cooperate with us by reporting loan transactions more promptly and accurately. Also, we will try to develop an improved procedure for estimating outstanding transactions so that our financial statements will be presented on a realistic basis. In this regard the report noted the omission of certain FY 1969 transactions from our statements, however, our records show that we included an estimate of $54,738 in our report for transactions subsequently billed to the lenders.

Page 2 - Mr. Phillip Charam

The report states that GAO did not follow the normal procedure of confirming account balances and that the auditors could not satisfy themselves as to the validity of the accounts receivable balance by other auditing procedures. We are presently obtaining data from participating lending institutions classifying outstanding loan balances. This information should be helpful for both OE planning purposes and for audit reviews. However, until this is compiled we feel that confirmation of transactions could be attempted on a scientific sampling basis in order to reach a conclusion as to the validity of the accounts receivable we report. We will be happy to cooperate in this effort in any way possible.

LOANS RECEIVABLE, DEFERRED CHARGES AND ALLOWANCE FOR LOSSES

This finding concerns our classification of unpaid, defaulted loans as a deferred charge in the statements rather than describing them as loans receivable, and the effect of this treatment upon the loan receivable account and its related allowance for losses on loans. In this instance our accounting and reporting treatment was governed by Bureau of the Budget and Treasury Department instructions which require that we show as loans receivable only those defaulted loans for which we had actually reimbursed the lending institutions. Consequently we recorded the unpaid loans for which we were responsible as a deferred charge and did not make any adjustment to the allowance for note losses.

We agree with GAO that preferred accounting and reporting treatment would require adjustment of the notes receivable and loss accounts for the realizable value of the assets. However, until the conflict between the above mentioned regulations and accounting theory is resolved we will follow the regulations. We will review this matter with the Bureau of the Budget and the Treasury Department, and will invite GAO to participate in or observe the sessions.

DEFERRED CREDITS - INSURANCE PREMIUM INCOME

As noted our policy was changed last year to report as income only that portion of collections which were applicable to FY 1969 and to defer the balance to other periods. As these periods occur the accounts and reports will be adjusted appropriately. This was done based upon our interpretation of generally accepted accounting principles which require assignment of revenues and expenses to the periods affected. Also, it would appear desirable to do this in accord with current emphasis and instructions to achieve the accrual basis of accounting which provides for such an allocation of costs and revenues.

Page 3 - Mr. Phillip Charam

[See GAO note.]

CAPITAL APPROPRIATED

Reference is made to the reinsurance activity of the fund which involves the Government underwriting State insured loan programs. The consequent losses are absorbed by the fund capital which was previously appropriated for other purposes. It is indicated in the report that we should request an additional appropriation for this new activity. We agree; and during FY 1969 we requested and were given additional funds by the Congress.

CONTINGENT LIABILITIES

It is suggested that OE obtain information from lending and guaranteeing agencies participating in the program regarding the outstanding principal balances of loans for which the Government has a contingent liability. We agree, and during June 1970, we requested all participating lenders to provide this and other related data.

GENERAL COMMENTS

Reference is made to a change in legislative requirements and the resulting change in our reports showing part of the loan losses under the Higher Education Activities Appropriation and part under the fund.

GAO note: The deleted material related to matters that were included in the draft report but omitted from the final report.

Page 4 - Mr. Philip Charam

It is suggested that we make full disclosure of all losses in the financial statements of the fund by means of a footnote or other suitable method. We agree, and will develop the FY 1970 fund financial statements accordingly.

Thank you for the opportunity to review and comment on your proposed report.

Sincerely yours,

James B. Cardwell
Assistant Secretary, Comptroller

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

	Tenure of office			
	From		To	
SECRETARY OF HEALTH, EDUCATION, AND WELFARE:				
Elliot L. Richardson	June	1970	Present	
Robert H. Finch	Jan.	1969	June	1970
Wilbur J. Cohen	Mar.	1968	Jan.	1969
ASSISTANT SECRETARY FOR EDUCATION:				
Vacant	June	1970	Present	
James E. Allen, Jr.	May	1969	June	1970
Peter P. Muirhead (acting)	Jan.	1969	May	1969
Lynn M. Bartlett	July	1968	Jan.	1969
COMMISSIONER OF EDUCATION:				
Sidney P. Marland, Jr.	Dec.	1970	Present	
Terrel H. Bell (acting)	June	1970	Dec.	1970
James E. Allen, Jr.	May	1969	June	1970
Peter P. Muirhead (acting)	Jan.	1969	May	1969
Harold Howe, II	Jan.	1966	Dec.	1968

U S GAO Wash , D C