



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

76-016

HUMAN RESOURCES
DIVISION

B-164031(1)

SEPTEMBER 8, 1978

The Honorable
The Secretary of Health, Education,
and Welfare



Dear Mr. Secretary:

The Comptroller General is required by the Higher Education Act of 1965, as amended, to examine annually the financial statements of the Student Loan Insurance Fund. The Fund is used to finance Federal insurance and reinsurance of loans made under the Guaranteed Student Loan program (GSL). Specifically, payments on defaulted loans are made from the Fund while insurance premiums and proceeds from collections on defaulted loans are deposited in it. As of the end of fiscal year 1977, over \$700 million had been paid out of the Fund for defaulted loans since inception of the program.

Since 1968 we have issued seven reports to the Congress on the financial aspects of the Fund, in which we discussed the inability of the Office of Education's (OE) accounting system and computer system to provide accurate information for the Fund's financial statements and operation of the program. The deficiencies noted in our reports for fiscal years 1968 through 1975 were of such severity that we either (1) issued an adverse opinion on the financial statements because they did not fairly present the financial position of the Fund or (2) did not express an opinion on the Fund's financial statements because of inadequate records.

Some of the more significant problems found in our annual audits were that (1) major accounts were unsupported by subsidiary records, (2) the allowance for loss rates for defaulted loans purchased, accrued interest, and claims-in-process was not based on actual program experience, and (3) the automated computer systems needed to provide accurate information for the Fund's financial statements were not functioning properly.

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In the past, corrective action has been promised but many of the problems have persisted from year-to-year. For example, in a May 1975 response to our fiscal year 1974 audit the Department recognized that the automated system was not providing accurate information to prepare the Fund's financial statements. The Department stated that OE was developing new mechanisms for recordkeeping and management information which should help in providing accurate information for the financial statements. The Department added that parameters for a successor system to the then automated system were developed by OE and that the system would be designed and implemented between June 1975 and June 1977. Presently, major objectives of the successor system have not been met. For example, a concept (escrow agent) for disbursing loan proceeds has been dropped and controls for the verification of interest benefits and special allowance payments have not been implemented. Interest benefits are payments made by the Federal Government for interest on loans for qualified student borrowers. Special allowance payments are made to lenders to encourage participation.

Because we have found the condition of the Fund's records to be unsatisfactory in past years, we performed a limited review of the Fund's financial transactions and operations for fiscal years 1976 and 1977 to assess the progress made in correcting noted deficiencies.

In a September 1977 letter to the Acting Associate Commissioner, Office of Guaranteed Student Loans, we pointed out that a report on the fiscal year 1976 and transition quarter financial statements would not be issued until completion of our fiscal year 1977 audit. We concluded that the Fund's automated records did not provide reliable information to administer the program nor necessary detailed accounting records to adequately support the financial statements. We felt that the installation of a new management information system designed to improve program operations must be completed before rendering an opinion.

Our limited work relating to fiscal year 1977 operations disclosed that deficiencies in the accounting system/records and the computer system discussed in our prior reports remain uncorrected. To render an opinion at this time would require additional work by us which would be time-consuming and expensive because of the poor condition of the accounting records and the lack of adequate internal control procedures.

When records and procedures are not properly designed and maintained, the extent of testing and verification work has to be greatly increased to enable us to be in a position

to render an opinion. Furthermore, because the problems remain uncorrected, we anticipate that another adverse opinion would be rendered on the financial statements.

We believe that such an opinion would serve no useful purpose to the Congress or the Department and would only reiterate the financial management weaknesses of the Fund at additional unnecessary cost to the Government and with little lasting curative effect.

We believe that if the Fund is to have a system of financial accountability upon which the Congress and others may rely, a concerted and sustained effort must be made by HEW to correct the accounting and computer system deficiencies.

Improvements are needed before an effective and efficient audit of the Fund's financial situation can be made. It has become more important that financial accountability be developed since additional types of expenditures under the GSL program are being paid from the Fund. Beginning with fiscal year 1978 interest subsidies, special allowances, and death and disability claims are being paid from the Fund. These were previously paid from the higher education appropriation. Interest subsidies alone are estimated at \$247 million for fiscal year 1978.

We recommend that the Department develop a plan of action that will detail the steps needed to improve (1) the Student Loan Insurance Fund accounting controls and procedures and (2) the computer system that provides data for the Student Loan Insurance Fund and the management of the GSL program. Results expected should be specifically stated and progress periodically measured.

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Enclosure I summarizes some of the more significant problems disclosed as a result of our annual financial audits and current work. Enclosure II is a listing of our previous reports on the GSL program.

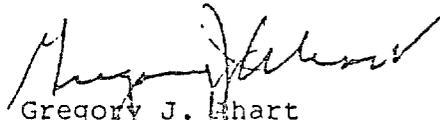
As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

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We are sending copies of this letter to the Senate Committee on Governmental Affairs; the House Committee on Government Operations; the Senate Committee on Human Resources; the House Committee on Education and Labor; the House Committee on Appropriations; and the Subcommittee on Labor and Health, Education, and Welfare, Senate Committee on Appropriations. Copies are being sent to the Director, Office of Management and Budget; the Assistant Secretary for Education; the Assistant Secretary, Management and Budget; and the Commissioner of Education.

We would appreciate being advised of any actions taken in response to our recommendation. We would be happy to meet with you to discuss these matters. We have informally discussed these matters with CE officials and were advised that efforts have been initiated in fiscal year 1978 which should help provide more accurate information for the Fund's financial statements. We also would like to express our appreciation for the courtesies extended to our staff during the audit.

Sincerely yours,



Gregory J. Hart
Director

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INTRODUCTION

The Guaranteed Student Loan (GSL) program was authorized by the Higher Education Act of 1965. Its basic objective is to provide loan guarantees for students beyond the high school level. There are two components--a program of direct federally insured loans and a reinsurance program for eligible State or private nonprofit agency loans. Under both, loans are made by commercial lending institutions, State lending agencies, or schools.

NEED TO MAINTAIN SUBSIDIARY RECORDS

In past reports we noted that certain amounts reported on the Fund's financial statements lacked adequate support while support for other amounts conflicted with the amounts reported. Good accounting requires that subsidiary records be maintained in support of general ledger control accounts and that such records be periodically reconciled with their control accounts. We have made recommendations dealing with these problems since our initial audit for fiscal year 1968.

We reviewed the accounts for accrued interest receivable, insurance premiums receivable, defaulted loans receivable and claims-in-process for fiscal year 1977. We found that the records are not adequate to support the amounts reported for these accounts on the Fund's financial statements as of September 30, 1977.

Accrued interest receivable

As of June 30, 1975, \$30,393,081 was reported on the financial statements as the balance of accrued interest receivable on defaulted loans. We found that the amount of accrued interest as reported was based on estimates and did not coincide with subsidiary records. Subsidiary records showed about \$9.0 million more than the amount reported. Although some of the difference could be accounted for by computational errors, OE used estimated amounts and could not provide supporting documentation.

In response to this problem, HEW officials informed us in April 1977 that a new management system was expected to provide reliable accrued interest receivable subsidiary records by June 30, 1977. An OE official advised us in August 1978 that OE is not accruing interest on all outstanding defaulted loans.

Insurance premiums receivable

We reported that as of June 30, 1975, insurance premiums due from lenders were understated by about \$203,000, or 23 percent. It appeared that one major reason for the difference was that the Bureau of Student Financial Assistance had collected premiums which had not been billed to lenders. These collections reduced the insurance premiums receivable control account balance maintained by the Finance Division. However, the premium amounts due had never been recorded.

In December 1976 OE informed us that a new management system would eliminate the billing problem. Pilot projects were expected to be implemented in February 1977. Our most recent work revealed that the new management system has not corrected this deficiency. An OE official informed us that the present computer system does not contain information on premiums billed before March 1977. As a result, the insurance premiums receivable balance could not be verified as of September 30, 1977.

Defaulted loans receivable

The Fund's financial statements as of June 30, 1975, showed a balance of \$279,762.982 for defaulted loans receivable. Our fiscal year 1975 audit disclosed that the financial statement amount was almost \$400,000 less than the subsidiary records. OE could not explain the difference.

We found that as of September 30, 1977, the situation had worsened dramatically. The Fund's financial statements showed a balance of \$601,025,675 for defaulted loans receivable, whereas an OE official informed us that the subsidiary records show \$673,957,152, or a difference of \$72,931,477.

Claims-in-process

In our letter report to OE dated September 22, 1977, we reported that claims-in-process (about \$35 million) as of September 30, 1976, were not supported by subsidiary records. We recommended that detailed records be developed. However, our most recent work disclosed that as of September 30, 1977, subsidiary records for claims-in-process had not yet been developed.

LOSS RATE SHOULD BE BASED ON
ACTUAL PROGRAM EXPERIENCE

Beginning with our audit of the fiscal year 1971 and 1972 financial statements, we have recommended that the allowance for loss rate for defaulted loans receivable, accrued interest on insured loans receivable, and claims-in-process be based on actual program experience. An allowance for loss rate of 55 percent has been used since 1969 with no annual adjustments to reflect program experience. The rate used is based on the experience of the Federal Housing Administration's title I Housing Insurance Fund from July 1934 through June 1967. OE officials told us that this rate was used because of similar factors involved in the operations of the two funds and because of the lack of experience under the Student Loan Insurance Fund. However, we believe that ample experience now exists.

In our opinion, these two programs are not sufficiently similar to justify the expectation of identical loss rates. Although both programs deal primarily with unsecured personal loans, title I loans are made only to homeowners with established credit while student loans are made to youths most of whom have no established credit. Also, lenders are responsible for credit approval of loan applicants under title I and no credit approval is required for insured student loans.

In response to our recommendations to base the allowance for loss rate on guaranteed student loan collection experience, OE has told us that changes in the rate would be made. In response to our fiscal year 1973 audit, we were informed that the change would be made by fiscal year 1974 or fiscal year 1975. In response to our fiscal year 1975 audit, when the changes had not been made, we were told that the changes might be accomplished by fiscal year 1978 because OE planned to develop a loss estimation model. Although development of a model was started in August 1977 the work was subsequently halted because OE officials felt the model was too costly. Furthermore, we were informed by OE officials that there are currently no plans to develop an allowance for loss rate based on actual collection experience as promised.

SPLIT RESPONSIBILITY FOR
ACCOUNTING DATA

In our report on the financial operations of the Fund for fiscal year 1975, we described a situation which we believe contributes significantly to the financial data problems noted above. Specifically, we reported that the responsibility for

the accounting data of the Fund is held by two OF divisions without appropriate controls between the two groups to assure the accuracy of the data for which each is responsible.

The OE Finance Division maintains, in summary form, control accounts which constitute the official accounting records from which the annual financial statements are prepared. Much of the detailed information needed to support these control accounts and the Fund's financial statements comes from subsidiary records which are independently maintained by OE's Bureau of Student Financial Assistance and are not periodically reconciled to the control accounts maintained by OE's Finance Division.

Since the records are maintained separately, it is essential that appropriate controls exist between the two groups to assure that both the subsidiary records and control accounts accurately support the balances shown in the financial statements of the Fund. Accordingly, in our fiscal year 1975 report we recommended that the Secretary of HEW require OE to establish the necessary controls between the two organizations. Although HEW's response to our recommendation was positive, our recent work revealed that although OE is looking into the situation it still has not been corrected.

PROBLEMS WITH THE
AUTOMATED COMPUTER SYSTEM

Effective administration of the GSL program is dependent, in part, upon adequate computer support because of the large volume of data that must be processed. An estimated 11 million loans have been either insured by the Federal Government or guaranteed by State or private nonprofit agencies since the program began. In prior reports and testimony, we have discussed a number of problems involving the computer systems, which we believe have severely impacted on OE's ability to provide the data integrity necessary for financial reporting and to protect the Government's interests.

The amounts obligated or expected to be obligated for computer-related contracts for the GSL systems are shown below. These amounts do not include salaries and related expenses for the program personnel involved in the development and maintenance of the computer systems.

Obligations for GSL Computer Support Contracts

<u>Fiscal year</u>	<u>Obligations</u>
	(000 omitted)
1967	\$ 139
1968	470
1969	1,099
1970	1,414
1971	2,037
1972	2,951
1973	2,793
1974	3,848
1975	5,774
1976	6,227
Transition quarter	1,511
1977	9,354
1978	a/ <u>10,500</u>
Total	\$48,117 =====

a/Fiscal year 1978 budget estimate

Computer support

Since the program began, three computer systems have been used. The first computer system, GSLS I, was implemented in June 1968. However, GSLS I was quickly outmoded because OE did not envision the rapid growth of the Federal program and GSLS I was unable to handle the large volume of loans. GSLS I was particularly weak in the claims and collections aspects because OE expected that more States than did would create guarantee agencies which, in case of student defaults, would be responsible for collections.

Because GSLS I proved inadequate, another computer system, GSLS II, was installed in 1972. GSLS II 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 although it produced the records used by OE to prepare the financial statements. In our fiscal year 1973 report on the Fund, we noted that GSLS II was unable to provide the information needed to prepare accurate financial statements, in part, because of OE's

failure to adequately consider accounting requirements in the design and implementation of GSLS II.

Development of the successor system

Rather than correct GSLS II deficiencies, a completely new computer system was developed. This system was based upon the use of an escrow agent which would enable OE to have better control over loan disbursements, thus minimizing losses. Under the concept, OE would require lenders to send the entire proceeds of federally insured loans to an escrow agent. The agent, in turn, would disburse the money to the school and borrower in appropriate installments. If the borrower did not attend or withdrew from school, the unused loan funds would be returned to the lender and applied to the borrower's debt. The escrow agent concept, however, was dropped in June 1977.

In addition to the use of the escrow agent concept, OE intended that the current successor system would resolve the data problems encountered with GSLS II and enable OE to

- track the status of loans at frequent intervals over their entire life;
- compute interest and special allowance payments independently of lenders;
- reduce the loss rate; and
- ensure certification of the financial statements by us.

Our most recent review has disclosed that the successor system, as currently designed and operating, is unlikely to achieve the improvements as originally envisioned. Some development deficiencies include

- developing the new system without analyzing other alternatives to correct the problems with GSLS II;
- developing the new system without conducting a study to identify user requirements; and
- developing the new system without preparing a cost/benefit analysis.

Problems with the successor system

Although the current successor system was justified on the basis that it would resolve the problems encountered with GSLS II, our review disclosed that many of the deficiencies in the prior system have been perpetuated under the current system and major objectives or milestones set forth for this system have not been met. Some examples of these computer system problems are described below.

Interest benefits and special allowances

OE pays (1) interest on loans (interest benefits) for qualified student borrowers and (2) special allowance subsidies to lenders over the life of all loans to encourage lender participation. These payments, previously made from the higher education appropriation, are the largest costs of the program and amounted to over \$340 million during fiscal year 1977.

In past years, we as well as the Congress and the HEW Audit Agency, have expressed concern about OE's lack of control over interest benefits and special allowance payments. OE had no mechanism to verify the accuracy of the billings submitted by the various lending institutions and relied heavily on the lenders to identify overpayments and on examinations of lenders made by HEW regional offices.

One of the major objectives of the successor system was to enable OE to verify the accuracy of interest benefits and special allowance payments. Our work disclosed that OE still does not have this capability. Such a capability is needed because currently payments are made based on unverified lender reports of loan balances.

Although limited checks on the accuracy of the loan balances were made through HEW regional office examinations of lenders, these examinations were suspended in March 1978 because OE was primarily concerned with processing and collecting defaulted loans. This action is contrary to assurances that OE has given to us, the Congress, and the HEW Audit Agency that interest benefit and special allowance billing errors will be discovered and adjusted as a result of field examinations of the lenders. OE, in responding to questions raised by the Chairman, Intergovernmental Relations and Human Resources Subcommittee, House Committee on Government Operations, stated that by September 30, 1978, new criteria for these examinations will be developed.

Loan control master file

In prior reports and testimony, we noted deficiencies in the data integrity of the computerized loan control master file. The loan control master file is OE's most complete record of loan commitments, disbursements, and student data. It is used in screening loan applications, recording and updating information on insured loans and student status (inschool, repayment, completed repayment, default, etc.). During our 1975 testimony on the GSL program before the Permanent Subcommittee on Investigations, Senate Committee on Government Operations, we pointed out that in a contractor evaluation of the file, a sample of 50,000 records contained 205,000 errors.

The accuracy of the loan control master file is important so that loans which exceed the statutory limitation for a student borrower are not insured. We found that the loan control master file is not complete and does not contain about 250,000 loan records held in an inactive file. While this is a small fraction of the total number of records, these records need to be included in the loan control master file so that OE does not insure loans which exceed established limits.

Another problem is that the loan control master file records are not updated for claims paid to lenders by OE on defaulted student loans. While OE plans to correct this deficiency in the future, records associated with many claims already paid cannot be located. OE could be insuring loans of student borrowers who had previously defaulted and had their loans paid by OE.

Insurance premiums receivable file

Inaccuracies in the computer records for insurance premiums receivable continue in the successor system. Prior to this system, a computer file containing the entire history of insurance payments for about 1,200 lenders was destroyed. While hard copy records of this file have been available for over 5 years, the records have not been reentered into the computer.

In addition to missing data, duplicate entries have been made to lenders' accounts which must be corrected before the outstanding balance of each lender's account is known. OE has decided that until these errors are corrected, lenders will be billed only for insurance premiums due for new loans

and not for past due insurance premiums. As a result, lenders who fail to make insurance premium payments when billed are never notified of past due amounts. OE officials, however, were unable to provide listings showing the amount of insurance premiums that are past due.

Other data base problems

In addition to the above problems, significant problems exist in the GSL data base. In May 1978, an OE official provided informal responses to a number of questions on the GSL program raised by the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs. These responses showed that although efforts were being made to improve the GSL financial data base, OE did not have

- a complete and accurate list of all federally insured loans;
- a complete and accurate list of the amount of money disbursed for each approved loan;
- a listing at regular intervals of the loans which are in up-to-date payment status showing the amount paid and the balance due; and
- a regular listing showing loans where the payments are overdue.

The OE official added that (1) the lack of records affects the control and management of the program, (2) the large bulk of this data was available either in source documents or in the computer data base, and (3) every effort was being made to purify the GSL data base which is timeconsuming and costly.

Potential computer problems

On July 3, 1978, OE issued a Request for Proposal (RFP) to solicit bids for the operation and maintenance of the successor system. The contract for operation of this system expired June 30, 1978. However, the current contractor has agreed to operate the system until a new contract is awarded. The RFP consolidates the successor system contract for computer processing with four active contracts for computer-related services. It permits responsive proposers to either assume the operation and maintenance of the successor system or propose the development of a new or modified system.

If a contractor, other than the current one, is selected, additional time and funds will be required for a new contractor to assume operations and/or develop a new system. We believe the conversion costs in this case may be substantial because of possible hardware differences between the successful contractor's equipment and the sophisticated data base management system used by the current contractor. For example, programming for the successor system is built around the current contractor's data base system. OE's contract with the current contractor did not provide for the continued use of this essential data base system after the contract expired. As a result, OE may have to purchase the data system if the successor system is used by the new contractor. Until the new contract is awarded the extent of future conversion, modification and development costs will be unknown. It is expected the conversion will take about 12 to 15 months, if conversion is necessary.

GAO REPORTS RELATING TO GUARANTEEDSTUDENT LOAN PROGRAM

<u>Title</u>	<u>Reference</u>	<u>Date</u>
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
Improvements Needed in Administration of the Guaranteed Student Loan Program	B-164031(1)	Mar. 30, 1973
Examination of Financial Statements of the Student Loan Insurance Fund, Fiscal Years 1971 and 1972	B-164031(1)	June 8, 1973

ENCLOSURE II

ENCLOSURE II

<u>Title</u>	<u>Reference</u>	<u>Date</u>
Administration of the Office of Education's Student Financial Aid Program	B-164031(1)	Apr. 4, 1974
Examination of Financial Statements of Student Loan Insurance Fund, Fiscal Year 1973	B-164031(1)	Sept. 17, 1974
Examination of Financial Statements of Student Loan Insurance Fund, Fiscal Year 1974	B-164031(1)	Feb. 12, 1975
Examination of Financial Operations for Fiscal Year 1975 Shows Need for Improvements in the Guaranteed Student Loan Program	B-164031(1)	Feb. 10, 1977
Study of Bankruptcy Involving the Guaranteed Student Loan Program	B-164031(1)	Apr. 15, 1977
Collection Efforts Not Keeping Pace With Growing Number of Defaulted Student Loans	B-117604	Aug. 11, 1977
Letter to the Office of Education Concerning Fiscal Year 1976 Examination of Financial Statements of Student Loan Insurance Fund	B-164031(1)	Sept. 22, 1977