118876

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Adverse Opinion On The Financial Statements Of The Student Loan Insurance Fund For The Fiscal Year Ended September 30, 1980

Since the Student Loan Insurance Fund began in 1967, serious accounting and reporting problems have resulted from inadequate internal controls and noncompliance with generally accepted accounting principles. GAO has reported these problems regularly since 1969, but management has done little to correct them. In GAO's opinion, the Fund's financial statements do not fairly present its financial position at September 30, 1980, the results of its operations and the changes in its financial position for fiscal 1980, in conformity with generally accepted accounting principles.

GAO recommends that the Secretary of Education improve internal accounting controls over the Fund, centralize all accounting and financial statement responsibilities, and implement improved computer management practices.

UNITED STATES GENERAL ACCOUNTING OFFICE

118876

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

B-202873

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

The Student Loan Insurance Fund (SLIF) finances the Guaranteed Student Loan Program. This Program was established to (1) encourage States and private nonprofit organizations to establish adequate loan insurance programs for students in eligible institutions, (2) provide Federal loan insurance for students or lenders who do not have reasonable access to State or private nonprofit student loan insurance programs, (3) pay a portion of the interest on loans granted to qualified students, and (4) guarantee a portion of each loan insured under a State or private nonprofit student loan program.

This report transmits to the Congress our opinion on SLIF's financial statements for the fiscal year ended September 30, 1980. Our audit was made in accordance with generally accepted government auditing standards. The Guaranteed Student Loan Program's enabling legislation (20 U.S.C. 1082(b)(2)) requires annual audits of SLIF's financial statements by the U.S. General Accounting Office.

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

Charles A. Bowsher
Comptroller General
of the United States

U.S. GENERAL ACCOUNTING OFFICE
REPORT TO THE CONGRESS

ADVERSE OPINION ON THE FINANCIAL STATEMENTS OF THE STUDENT LOAN INSURANCE FUND FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1980

D I G E S T

The Student Loan Insurance Fund finances the Guaranteed Student Loan Program by reimbursing lenders and State guarantee agencies when students default on their loans. The Fund also pays students' interest until the first loan repayment date plus an interest allowance to lenders. The Department of Education is responsible for managing the Fund, maintaining accounting records, and preparing financial statements.

Since the Fund's inception in 1967, serious accounting and reporting problems have resulted from inadequate internal controls and noncompliance with generally accepted accounting principles. Although GAO has reported the internal control weaknesses, the noncompliance with generally accepted accounting principles, and the resulting accounting problems regularly since 1969, management has done little to correct these problems.

In GAO's opinion, the Fund's financial statements do not fairly present its financial position at September 30, 1980, and the results of its operations and the changes in its financial position for fiscal 1980, in conformity with generally accepted accounting principles.

GAO's adverse opinion was necessary because:

--Control account balances, representing 64 percent of the Fund's assets, could not be reconciled with computerized subsidiary records. (See p. 10.)

--Procedures have not been developed for several accounts, resulting in material misstatements. (See p. 17.)

--Cash transactions were not recorded in the correct fiscal year. (See p. 14.)

--Canceled checks totaling $14 million were added to the fund's cash balance without determining whether they had been recorded when initially issued. (See pp. 15 and 16.)

--Supervisory reviews and other verification procedures were frequently ineffective. (See p. 16.)

--The uncollectible portion of insurance premiums receivable was not recorded. (See p. 16.)

GAO recommends that the Secretary of Education delegate all accounting, recordkeeping, and financial statement preparation responsibilities to the Office of Student Financial Assistance. (See p. 13.) GAO further recommends that the Secretary of Education direct the Office of Student Financial Assistance to

--prepare appropriate written accounting procedures;

--properly train and supervise accounting personnel;

--record all cash transactions promptly;

--analyze the Fund's collection experience and establish allowance for loss rates which are based on this experience;

--consistently verify manual computations when necessary to ensure integrity of files and processing; and

--implement computer system life-cycle management activities, including user needs identification, system design specification, cost justification, acquisition and development planning, and operational evaluation. (See pp. 19 and 20.)

The Department of Education agrees that the delegation of accounting, recordkeeping, and financial statement preparation responsibilities to the Office of Student Financial Assistance has merit. Education has already begun to implement a computer life-cycle management system. It did not comment on the other recommendations.

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CHAPTER 1

INTRODUCTION

The Higher Education Act of 1965 (20 U.S.C. 1071), as amended, established the Guaranteed Student Loan Program to:

--Encourage States and nonprofit private organizations to establish adequate loan insurance programs for students in eligible institutions.

--Provide Federal loan insurance for students or lenders who do not have reasonable access to State or private nonprofit student loan insurance programs.

--Pay a portion of the interest on loans granted to qualified students.

--Guarantee a portion of each loan insured under a State or private nonprofit student loan program.

The Guaranteed Student Loan Program is financed by the Student Loan Insurance Fund. It is divided into two segments:

--Federal Insured Student Loan Program.

--Guarantee Agency Insured Student Loan Program.

STUDENT LOAN INSURANCE FUND

The Student Loan Insurance Fund receives cash from loan principal and interest payments and insurance premiums. These receipts are used to reimburse lenders and guarantee agencies for losses on defaulted loans, and pay interest subsidies and other administrative expenses. Cash receipts and disbursements for fiscal 1980 were reported by fund managers as follows:

	Fiscal 1980 (millions)
Receipts:	
Principal and interest on defaulted loans	$ 64.1
Insurance premiums	2.8
Total Receipts	66.9
Disbursements:	
Interest subsidies	1,223.2
Reimbursements to lenders and guarantee agencies	231.5
Other administrative expenses	6.6
Total Disbursements	1,461.3
Deficiency	($1,394.4)

The deficiency is recovered through appropriations. Each year the Fund receives appropriations to supplement its receipts. From inception through March 31, 1982, the Congress had appropriated $8.2 billion.

The Department of Education's Office of Student Financial Assistance is responsible for managing the Fund and maintaining detailed records. The Department's Office of Financial Management is responsible for maintaining summary financial records and preparing financial statements for the Fund.

FEDERAL INSURED STUDENT LOAN PROGRAM

The Federal Insured Student Loan Program guarantees loans for education beyond the high school level. Such loans are called insured loans. For this guarantee, lenders pay a single amount equivalent to an annual insurance premium of 1/4 of 1 percent of unpaid principal for the period between disbursement and 12 months after the student's graduation date. The program provides an interest subsidy by paying the borrower's interest until the first repayment and by compensating the lender for the difference between the guaranteed interest rate and the market rate. If the borrower defaults, the Federal Government repays the lender, and attempts to collect principal and interest from the borrower. The graph on page 3 shows the growth of the Federal Insured Student Loan Program.

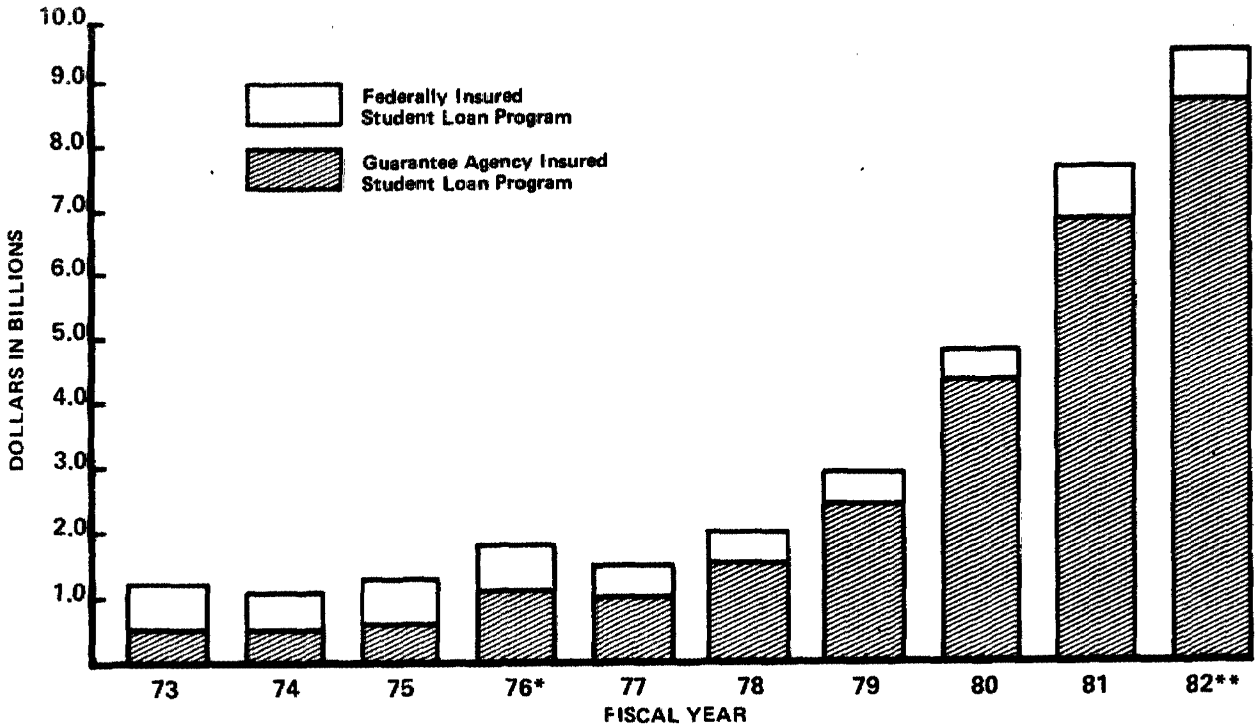
GUARANTEE AGENCY INSURED STUDENT LOAN PROGRAM

The Guarantee Agency Insured Student Loan Program reimburses States and certain private nonprofit organizations (called guarantee agencies) for amounts they paid on behalf of borrowers who defaulted on their guaranteed student loans. These loans are called reinsured loans. Neither lenders nor guarantee agencies pay insurance premiums to the Federal Government. The same interest subsidy is paid to lenders under this program as under the federally insured program. After the program reimburses a guarantee agency, the guarantee agency is responsible for all collection efforts. Seventy percent of any amount the guarantee agency collects is returned to the Guaranteed Student Loan Program. Thirty percent is retained as a collection fee. The graph on page 3 indicates the growth in annual loan volume of the Guarantee Agency Insured Student Loan Program.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Higher Education Act of 1965 requires GAO to audit annually the financial records of the Student Loan Insurance Fund. The objectives of our audit were to express an opinion on the Fund's fiscal 1980 financial statements and provide the Congress with current information on the severity of the Fund's accounting

GROWTH IN LOAN VOLUME
FISCAL 1973 - FISCAL 1982



* 15 month period ending September 30, 1976
** Projected

problems. Our audit was conducted in accordance with generally accepted government auditing standards. Our procedures included:

--Interviewing Department of Education officials and reviewing written procedures as part of our study and evaluation of the Fund's internal accounting and reporting practices.

--Reviewing the Fund's fiscal 1980 financial records.

--Evaluating the Fund's compliance with the laws and regulations that materially affect its financial statements.

--Analyzing data pertaining to the Fund's fiscal 1980 operations.

--Testing selected transactions and account balances.

--Confirming with a sample of lenders and guarantee agencies certain information in the Fund's financial records.

This report contains the conclusions and recommendations resulting from our audit. A summary of problems we reported in past years is in appendix II. Our opinion on the Fund's financial statements is in chapter 2. Chapter 3 contains an analysis of problems we found during this audit and appendix I contains a summary of accounting problems and their effect. The Fund's financial statements and related notes for fiscal 1980 are in appendix III.

CHAPTER 2

AUDIT REPORTS

OPINION ON FINANCIAL STATEMENTS

We have examined the Statement of Financial Position of the Student Loan Insurance Fund at September 30, 1980, and the related Statements of Income and Investment of the U.S. Government and Changes in Financial Position for the year then ended. Our examination was made in accordance with generally accepted government auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary.

As will be discussed in chapter 3, the Student Loan Insurance Fund exhibited several accounting deficiencies, and many of the amounts reported on the financial statements are misstated. These misstatements are the result of numerous departures from sound accounting practices. We were unable to determine the magnitude of the misstatements and their impact on the financial statements taken as a whole. The deficiencies were:

--Due to a lack of cooperation between organizational units, control account balances could not be reconciled with subsidiary records.

--Due to a lack of adequate internal controls and noncompliance with generally accepted accounting principles, account balances were misstated.

- The cash balance did not include all of the Fund's cash, but it erroneously included amounts of uncollectible checks. The cash balance was further distorted because debit memorandums 1/ that had never been added were deducted and canceled checks that had never been deducted were added.
- Insurance premiums receivable was overstated because it included uncollectible amounts.
- Loan principal and interest receivables (and related expenses) were misstated because related cash receipts were recorded incorrectly. The loss rate used to estimate the uncollectible portions of loans receivable, accrued interest receivable, and claims in process was not based on experience. Also, accrued interest receivable (and interest revenue) was estimated based

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1/A debit memorandum is a notice from the Treasury indicating that an account has been reduced.

on an incorrect loans receivable amount and not supported by subsidiary records. Further, although more than $6 million of loans receivable was written off as uncollectible, none of the corresponding accrued interest was written off.

- Insurance premium revenue is misstated because billed premiums are not allocated to appropriate accounting periods.

--Due to procedural and computational errors that resulted from clerical attempts to compensate for the computer system's inability to generate certain information.

For these reasons, in our opinion the accompanying financial statements (appendix III), do not fairly present the financial position of the Student Loan Insurance Fund at September 30, 1980, and the results of its operations and the changes in its financial position for the fiscal year then ended in conformity with generally accepted accounting principles.

The comparative Statement of Financial Position of the Student Loan Insurance Fund at September 30, 1979, and the related Statements of Income and Investment of the U.S. Government and Changes in Financial Position for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

REPORT ON INTERNAL ACCOUNTING CONTROLS

We have examined the financial statements of the Student Loan Insurance Fund for the year ended September 30, 1980. Our opinion on them is on pages 5 and 6. As part of our examination, we made a study and evaluation of the Fund's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Fund's financial statements. Our study and evaluation was more limited than would be necessary to express an an opinion on the system of internal control taken as a whole.

For the purpose of this report, we have classified the significant internal accounting controls in the following cycles.

--Loan buying: the process of acquiring defaulted student loans from lending institutions, excluding cash disbursements (Federally Insured Student Loan Program).

--Insurance selling: the process of determining whether a loan is eligible for insurance and determining the amount of insurance premium required, excluding cash receipts processing.

--Claims and default processing: the process of reimbursing guarantee agencies for amounts they have paid to lenders due to defaulted student loans, excluding cash disbursements (Guarantee Agency Insured Student Loan Program).

--Cash receipts.

--Cash disbursements.

--Loan accountability: the process of controlling receivables and physically safeguarding notes.

--Financial reporting: the process of summarizing transactions into financial statements prepared in accordance with generally accepted accounting principles.

All of the above control cycles were studied and evaluated except the insurance selling and loan accountability cycles. It was more efficient to expand substantive audit tests than to rely on controls in these two cycles.

The management of the Department of Education is responsible for establishing and maintaining a system of internal accounting control. The objectives of a control system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly so that financial statements can be prepared in accordance with generally accepted accounting principles. Because of inherent limitations of any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected.

Our study and evaluation made for the limited purpose described in the first paragraph of this section would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the Student Loan Insurance Fund taken as a whole. However, our study and evaluation disclosed the following conditions that we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the financial statements of the Student Loan Insurance Fund may occur and not be detected within a reasonable period.

--Balances in control accounts could not be reconciled with corresponding amounts in subsidiary records.

--The Fund's management placed too little emphasis on internal accounting controls and financial records and reports.

--Control was inadequate over documents as they flowed between the Office of Student Financial Assistance and the Office of Financial Management, and to and from the Treasury.

--Cash transactions were not recorded promptly.

--Cash records were adjusted for amounts on canceled checks and debit memorandums without determining whether the amounts were originally recorded in the cash records.

--The Fund's accountant was not properly trained or adequately supervised.

--The Fund's accounting procedures were not adequately documented.

We considered these conditions in determining the nature, timing, and extent of the audit tests to be applied in our examination of the fiscal 1980 financial statements.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

We have examined the financial statements of the Student Loan Insurance Fund for the year ended September 30, 1980. Our opinion on them is on pages 5 and 6. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We tested transactions which we felt could have a material affect on the financial statements and found no major departures from applicable laws and regulations that could have materially affected the fund's financial statements. For those transactions not tested, nothing came to our attention in connection with our examination that caused us to believe that the Fund was not in compliance with any of the provisions of applicable agreements, laws, and regulations.

CHAPTER 3

ACCOUNTING AND REPORTING DEFICIENCIES

The Student Loan Insurance Fund has exhibited serious accounting problems since its beginning in 1967. These problems stemmed from management's failure to establish adequate internal controls and to ensure compliance with generally accepted accounting principles. Although GAO reported the Fund's accounting problems almost annually since 1969, the Fund's administrators have done little to correct them. These prior years' accounting problems are discussed in appendix II.

The Student Loan Insurance Fund continued to exhibit serious accounting and reporting deficiencies in fiscal 1980. Control accounts could not be reconciled with subsidiary records and most of the accounts were misstated. This chapter explains these problems and recommends actions to correct them.

CONTROL ACCOUNT BALANCES COULD NOT BE RECONCILED WITH SUBSIDIARY RECORDS

Several control accounts maintained by the Office of Financial Mangement--insurance premiums receivable, advances, and net loans receivable--could not be reconciled with subsidiary records maintained by the Office of Student Financial Assistance. One other control account, accrued interest receivable, did not have subsidiary records. These accounts amounted to 64 percent of the Fund's assets.

Control accounts could not be reconciled with subsidiary records partially because of the organizational and physical separation of, and the lack of coordination between, the Office of Financial Management and the Office of Student Financial Assistance. These offices are located in separate buildings, and their only common manager is the Secretary of Education.

The two units reponsible for maintaining the same accounts use different identification numbers

The use of different identification numbers by the two offices resulted in irreconcilable differences between control accounts and subsidiary records. The Office of Student Financial Assistance and the Office of Financial Management record the same transactions at different stages in the processing cycle. The Office of Student Financial Assistance records receipts before they are deposited with the Treasury and disbursements before disbursement documents are sent to the Treasury. In so doing, a schedule number is assigned to each certificate of deposit when its amount is recorded. On the other hand, the Office of Financial Management records receipts after they have been deposited with the Treasury and disbursements after they have been paid by the Treasury. Certificates of deposit are recorded by the preprinted identification numbers on the certificates. The unrelated identification numbers make it very difficult, if not impossible, to locate differences between Office of Student Financial Assistance and Office of Financial Management cash balances. Either each transaction should have only one identification number or, if this is not feasible, different identification numbers should be cross-referenced.

Information in control accounts not obtained from subsidiary records

A second reason why control accounts and subsidiary records cannot be reconciled is because control accounts are posted from sources other than subsidiary records. For example, the Office of Financial Management manually reduces the loans receivable control account based on the amount of deposits credited by the Treasury rather than the amount of loan repayments posted to the Office of Student Financial Assistance's computerized records.

The Office of Financial Management does not use the subsidiary records because it does not believe these records are reliable. The results of our audit support this belief. We asked a sample of 512 lenders and all 50 guarantee agencies to confirm certain information in the Office of Student Financial Assistance's computerized and manual records. Lenders were asked to confirm:

1. Reimbursements received by September 30, 1980, for loan principal defaulted during the fiscal year. (This is a portion of the insured loans receivable account.)

2. Claims in process as of September 30, 1980, for loan principal defaulted during the fiscal year. (This is a portion of the insured claims in process account.)

3. Insurance premiums due as of September 30, 1980. (This is the insurance premiums receivable account.)

Guarantee agencies were asked to confirm:

1. Reimbursements of loan principal received during fiscal 1980. (This is a portion of the reinsured loans receivable account.)

2. Claims in process as of September 30, 1980, for loan principal. (This is a portion of the reinsured claims in process account.)

3. Outstanding advances as of September 30, 1980. (This is the advances account.)

Information pertaining to lenders was taken from the computer system. Information pertaining to the guarantee agencies was taken from manual records because the computer system does not contain information on the Guarantee Agency Insured Student Loan Program.

Four hundred forty-three lenders (87 percent) and 44 guarantee agencies (88 percent) responded to our confirmation requests. Their responses are summarized in the tables below. The item numbers correspond to those just listed.

Lenders' Confirmation Responses

Item	Discrepancies reported (note a) Number	Discrepancies reported (note a) Percentage (note b)	Percentage variance in total dollar value (note c)
1	100	23	(6)
2	61	14	87
3	60	14	(60)

Guarantee Agencies' Confirmation Responses

Item	Discrepancies reported Number	Discrepancies reported Percentage (note d)	Percentage variance in total dollar value (note c)
1	25	57	(5)
2	18	41	82
3	9	20	(7)

a/A difference is reported as a discrepancy only if we could not reconcile a lender's response with the Office of Student Financial Assistance's records.

b/Number of discrepancies divided by 443.

c/Percentage difference between the total amounts in the Office of Student Financial Assistance's records and the total amounts reported by respondents. Negative percentages indicate that the total of reported amounts was less than the total of amounts in the Office of Student Financial Assistance's records.

d/Number of discrepancies divided by 44.

The Office of Student Financial Assistance could not explain the discrepancies in items 1 and 2 reported by lenders because it does not have sufficient resources to extract the required information from its computerized records and reconcile it with the information lenders reported. Regarding discrepancies in item 3, the Office of Student Financial Assistance explained that 14 discrepancies (23 percent) were caused by lender error and 13 (22 percent) were due to Office of Student Financial Assistance error. No satisfactory explanation was provided for the other 33 discrepancies (55 percent).

The Office of Student Financial Assistance did not satisfactorily explain any of the discrepancies reported by guarantee agencies. An October 8, 1981, memo to GAO implied that some of the discrepancies may have been caused by differences in classifying rejected claims and claims paid in early fiscal 1981; however, the Office of Student Financial Assistance did not determine whether classification differences had in fact caused the discrepancies.

Documents not controlled between offices

A third reason why subsidiary records cannot be reconciled with control accounts is because neither the Office of Student Financial Assistance nor the Office of Financial Management has established satisfactory accounting controls over documents flowing between the two offices. When an Office of Student Financial Assistance regional office receives cash, for instance, it prepares a certificate of deposit and forwards it with the cash to a Treasury depository. The Treasury depository stamps the deposit date on the certificate and sends it to the Office of Financial Management, which uses the certificate as the basis for recording the cash receipt. Neither office has procedures to ensure that the Office of Financial Management receives all certificates.

Furthermore, the Office of Financial Management has no means of determining whether it receives all certificates for the deposits made in a particular accounting period. In fact, it did not receive until fiscal 1981, certificates of deposit for approximately $3.7 million deposited during fiscal 1980 and $5.2 million deposited during fiscal 1979. Consequently, these amounts were not reflected in the Fund's cash balance as of September 30, 1980. Documents should have been accounted for from the time they were received or created.

Conclusions and recommendation

Control account balances could not be reconciled with subsidiary records because two separate organizational units responsible for the same accounts did not coordinate their activities. Specifically, (1) the two units used different identification numbers, (2) information in control accounts was not obtained from subsidiary records, and (3) essential accounting documents were not controlled.

To eliminate these problems, we recommend that the Secretary of Education delegate all accounting, recordkeeping, and financial statement preparation responsibilities to the Office of Student Financial Assistance. This will eliminate the need for coordination between the Office of Student Financial Assistance and the Office of Financial Management. Further, the document control problem would be reduced because Treasury would return paid vouchers and certificates of deposit to the same organizational unit that submitted them, thereby leaving the Office of Student Financial Assistance with complete knowledge of and control over the flow of accounting documents.

The consolidation of accounting and reporting responsibility also would have other benefits. Cash receipts could be recorded before funds are deposited, and cash disbursements could be recorded when disbursement vouchers are approved. Also, the management of the program may improve as a result of easier access to more complete information.

AGENCY COMMENTS

The Department of Education stated (app. III) in its response to our draft report that it recognizes there is potential merit to this recommendation and that it will consider the recommendation fully as it establishes a course of action under its management plan.

AMOUNTS ON FINANCIAL STATEMENTS
ARE MISSTATED

Several amounts on the Student Loan Insurance Fund's financial statements were misstated because of management's failure to establish adequate internal accounting controls and adopt generally accepted accounting principles. Cash, insurance premiums receivable, net loans receivable, net accrued interest receivable, insurance premium revenue, interest revenue, and the provisions for losses on defaulted loans and accrued interest were not fairly stated. Because of numerous departures from sound internal control practices and incomplete accounting records, we were unable to determine the extent to which these account balances were misstated.

Cash not recorded when received

Cash receipts are not reported to the Office of Financial Management promptly. As discussed previously, the Office of Financial Management was not notified until fiscal 1981, of approximately $3.7 million deposited during fiscal 1980 and $5.2 million deposited during fiscal 1979. Therefore, the September 30, 1980, cash balance was understated by at least $8.9 million.

Further, although some Office of Student Financial Assistance regional offices had undeposited cash on hand as of September 30, 1980, the Office of Financial Management did not include undeposited cash in its fiscal 1980 financial statements. Incomplete records precluded us from determining the total amount of undeposited cash on hand as of September 30, 1980.

Sound internal control procedures require that cash be recorded immediately upon receipt rather than after it is transmitted to a depository.

Interest receipts not recorded
in the proper account

All amounts received from students in payment of loan principal or interest are applied to loan principal. Accrued interest receivable is never reduced. Since the Office of Financial Management uses the certificate of deposit as the basis for recording cash receipts and a certificate of deposit does not indicate whether cash should be applied to loan principal or interest, the office simply reduces loan principal. This practice understates loans receivable and overstates accrued interest receivable by an indeterminable amount. Sound accounting practice is to credit payments to accrued interest receivable first and then to principal.

Uncollectible checks and some debit memorandums not recorded correctly

The September 30, 1980, cash balance includes uncollectible checks that had been returned to the Office of Financial Management by Treasury depositories. One hundred ninety-eight uncollectible checks, totaling approximately $21,000, deposited during fiscal 1978, 1979, and 1980 were kept in a safe in the Office of Financial Management until fiscal 1981. It is difficult to determine whether these checks were recorded in the cash receipts journal because cash receipts are recorded under certificate of deposit numbers and these checks do not contain such numbers. In addition, it is impossible to determine by observation whether a particular check was recorded as a cash receipt because several checks are combined to form a certificate of deposit.

Similarly, when the Office of Financial Management receives a notice from the Treasury indicating that a program's cash account has been reduced (debit memorandum), the Office of Financial Management has no means of identifying the original certificate of deposit or the program affected. Therefore, the Office of Financial Management cannot be sure that the amount on the debit memorandum was originally recorded as a cash receipt or to which program the amount pertains. Because most regional office cash receipts are payments on defaulted loans under the Student Loan Insurance Program, the fund's cash account is arbitrarily decreased and loans receivable increased by the amounts of debit memorandums received. This practice probably results in an understatement of cash and overstatement of loans receivable in an indeterminable amount because some debit memorandums may pertain to other programs and the receipt of some amounts may not have been recorded initially.

The Office of Financial Management should reduce the cash balance by the amounts of uncollectible checks immediately upon receiving them from Treasury depositories. A record of the certificate of deposit number for each check should also be maintained so that the Office of Financial Management can easily determine whether an amount has been previously recorded as a cash receipt. In addition, each check should be annotated to indicate the program to which it applies.

Some canceled checks not recorded correctly

Canceled checks could not be matched with corresponding disbursement vouchers. During fiscal 1980, 644 canceled checks totaling $14 million were processed. Only 13 of these checks totaling $1 million were cross-referenced to disbursement vouchers. When a check was canceled, the Office of Financial Management could not determine whether the check had been deducted from the Fund's cash balance because checks are only recorded, by disbursement voucher number, after notification from the Treasury that a check has been issued. It is possible for the Office of Financial Management to receive notification that a check has been canceled before it receives notification that the check was issued. The Office of Financial Management makes the assumption that all canceled checks were previously deducted from the Fund's cash balance and, therefore, adds them back to the cash balance. This could cause further misstatement of the Fund's cash balance because some canceled checks may not have been previously recorded as cash disbursements.

This problem can be avoided by providing the Fund's acountant with the disbursement voucher number for each canceled check and by recording each disbursement when the disbursement voucher is approved instead of waiting until the Treasury makes the disbursement. This will ensure that the canceled checks have been previously deducted from the cash balance.

Insurance premiums receivable misstated

Although 44 percent of insurance premiums receivable were more than a year old and 27 percent were more than 2 years old, the Fund does not have an allowance for losses on insurance premiums. Because insurance premiums are due within 60 days of the billing date and lenders are not billed for past due insurance premiums, premiums that were more than a year old are not likely to be collected. Therefore, insurance premiums receivable is overstated. Generally accepted accounting principles require that regular estimates be made from time to time of the portion of accounts receivable that may not be collectible. Such estimates should be accounted for and disclosed separately in the financial statements. Therefore, the Fund's accountant should establish an allowance for losses on insurance premiums receivable.

Due to clerical error, approximately $20,000 of insurance premium receipts were recorded as collections on defaulted loans. Accordingly, insurance premiums receivable was overstated by $20,000 and net loans receivable was understated by $20,000 as of September 30, 1980. A supervisory review or other verification of entries in the cash receipts journal should have disclosed this error.

Uncollectible accrued interest receivable not written off

Over $6 million of loans receivable was written off during fiscal 1980; however, the corresponding accrued interest receivable was not written off. If the loan principal is determined to be uncollectible, then the interest on that principal should also be uncollectible. Because there were no subsidiary records for accrued interest receivable, we could not determine the amount of interest that had accrued on the specific loans that were written off. Whenever loan principal is written off, the corresponding accrued interest must also be written off.

Unsupportable rates and inconsistent procedures used in computing allowances for losses on uncollectible accounts

Allowances for losses arising from uncollectible loans receivable, accrued interest receivable, and claims in process do not reflect experience. In response to our previous criticism of loss rates, the Office of Student Financial Assistance attempted to develop a loss rate based on experience. When officials realized that a satisfactory loss rate could not be developed before the fiscal 1980 financial statements had to be prepared, the project was dropped. Subsequently, an Office of Student Financial Assistance official developed the 27 percent loss rate used for the fiscal 1980 financial statements. Our analysis of the loss rate computation revealed that the rate was not based on experience, but on judgment. The Fund's managers should develop an allowance for loss rate (or rates, as appropriate) that is based on the Fund's collection experience.

Different methods, with inconsistent results, were used to compute the September 30, 1980, allowance for losses on reinsured loans receivable, accrued interest receivable, and claims in process. In addition to estimated losses from uncollectible receivables, these allowance accounts also include estimated collection expenses. Guarantee agencies retain 30 percent of any amount they collect on defaulted loans. This 30 percent comprises their collection fee and the Fund's estimated collection expense. In fiscal 1980, an Office of Student Financial Assistance official asked the Office of Financial Management to increase the allowance accounts by the estimated collection expense for reinsured loans receivable, accrued interest receivable, and claims in process. While the Office of Financial Management complied with the official's request, three different, incompatible computational procedures were used. The Fund's accountant should select and consistently use the most appropriate method for computing the allowances for loss.

Collection fee never removed from loans receivable

The 30 percent collection fee that guarantee agencies retain is never removed from the loans receivable account. When the Fund reimburses a guarantee agency for a defaulted loan, loans receivable is increased by the total amount of the disbursement. Later, when the guarantee agency collects on the defaulted loan and remits 70 percent to the Fund, loans receivable is reduced by 70 percent. Therefore, in these instances, loans receivable is overstated by 30 percent. The overstatement of loans receivable caused an overstatement of other amounts that were derived from loans receivable, such as accrued interest receivable and the allowances for losses on loans and accrued interest receivable. As a result of amounts remitted to the Fund by guarantee agencies in fiscal 1980, loans receivable as of September 30, 1980, was overstated by $10.5 million and accrued interest receivable was overstated by $0.7 million. In addition, allowance for losses on loans and accrued interest receivable are overstated by $5.1 million and $0.4 million, respectively. When a guarantee agency has collected the entire loan amount and remitted 70 percent of its collections to the Department of Education, the loans receivable account should be reduced by 100 percent of the loan amount.

Insurance premium revenue is improperly recognized

Amounts billed for insurance premiums during fiscal 1980 were included in fiscal 1980 income rather than being allocated among the periods covered. Generally accepted accounting principles require that premiums be recognized as being earned evenly over the term of the insurance contract as the coverage is provided. Therefore, part of the insurance premium revenue recognized in previous years should have been recognized in fiscal 1980, and part of the insurance premium revenue recognized in fiscal 1980 should be recognized in future periods. It was not feasible for us to determine to what extent fiscal 1980 insurance premium income was misstated. In the future, the Fund's accountant should allocate billed insurance premiums evenly to the periods covered.

The Department of Education has taken exception to allocating premium revenues to the periods covered because: (1) they feel immediate recognition of revenue does not materially affect the Statement of Income; and (2) it would not be cost-effective to amortize premiums so that they are matched with expenditures in the proper period. (Premiums totaling $3.8 million represent about 5 percent of the revenues.)

Nevertheless, the Department has stated that correcting and updating their automated systems will solve many of their problems. We believe the corrections could include using the automated system to allocate revenues to proper periods. Once accomplished, we do not believe the cost of properly recognizing income would be excessive.

Interest revenue computed using improper procedures

Interest was not accrued on each loan. Instead, interest revenue was computed quarterly by multiplying the average loans receivable balance by 1.75 percent (one-fourth of the 7 percent interest rate in effect through September 30, 1980). This computation only provided an estimate of interest revenue. To acurately determine interest revenue, interest must be accrued on each loan. In addition, because loans receivable balances are misstated, under the current procedure, the interest revenue estimate is also misstated. Furthermore, the Office of Financial Management made computational errors which caused additional misstatement of interest revenue and also improperly netted fourth quarter estimated collection expense against interest revenue. It is not feasible for us to determine the amount of the misstatement. In the future, interest should be accrued on each individual loan to increase the accuracy of interest revenue.

Conclusions and recommendations

Nine accounts representing 90 percent of the Fund's assets and 100 percent of its revenue and three other accounts which caused a 10 percent reduction in expenses were misstated because of inadequate internal control procedures and noncompliance with generally accepted accounting principles. The causes of these and four other probable misstatements are summarized in appendix I.

To correct these deficiencies, we recommend that the Secretary of Education direct the Office of Student Financial Assistance to

--prepare appropriate written accounting procedures,

--record all cash transactions promptly,

--analyze the Fund's collection experience and establish allowance for loss rates which are based on this experience,

--properly train and supervise accounting personnel, and

--consistently verify manual computations when necessary to ensure the integrity of files and processing.

AGENCY COMMENTS

The Department of Education did not address these recommendations in its response (app. III) to our draft report.

COMPUTER SYSTEM UNABLE TO PROVIDE CERTAIN REQUIRED INFORMATION

Many of the Student Loan Insurance Fund's accounting and reporting problems were caused by clerical attempts to compensate for the computer system's inability to generate certain information.

In a January 1979 memorandum to the Office of Student Financial Assistance, the Office of Financial Management listed data requirements that had not been satisfied by the Office of Student Financial Assistance. Magnetic tapes containing the following had not been received since the time indicated in parenthesis.

--Accrued interest receivable for the federally insured segment (since the inception of the Guaranteed Student Loan Program in 1965).

--Allowances for losses on loans and interest receivable (since the program's inception in 1965 although required semiannually).

--Writeoffs of loans and interest receivable (since the program's inception in 1965).

--Collections of loans receivable for the federally insured segment (since the end of fiscal 1977).

--Insurance premium collections (since March 1977).

--Insurance premiums receivable (since August 1978).

--Manual payments for the federally insured segment (since the program's inception in 1965).

--Adjustments for uncollectible checks and duplicate payments (since the program's inception in 1965).

In response to the memorandum, the Office of Student Financial Assistance developed two lists of tasks to satisfy the Office of Financial Management's requirements. None of these tasks has been completed.

In September 1981, we issued a report on attempts by the former Department of Health, Education, and Welfare and, more recently, the Department of Education to develop and operate an automated information system for the Guaranteed Student Loan Program. 1/ We concluded then that throughout the program's existence the Government has not developed an automated information system that monitors adherence to program rules and regulations or that properly accounts for the expenditure of program funds. We reported that as of April 1981, computer system deficiencies persisted.

Efforts to correct computer system deficiencies have been unsuccessful principally because of a failure to establish an effective process for computer system life-cycle management. As discussed in our September 1981 report, we again recommend that the

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1/"The Guaranteed Student Loan Information System Needs a Thorough Redesign to Account for the Expenditure of Billions," HRD-81-139, Sept. 24, 1981.)

Secretary of Education direct the Office of Student Financial Assistance to implement life-cycle management activities, which include

--user needs identification,

--system design specification,

--cost justification,

--acquisition and development planning, and

--operational evaluation.

AGENCY COMMENTS

The Department of Education concurred with this recommendation in its response (app. III) to our draft report and stated that it is working to establish life-cycle management activities for all systems within the Department.

SUMMARY OF ACCOUNTING PROBLEMS AND THEIR EFFECT ON THE FISCAL 1980 FINANCIAL STATEMENTS

Problem	Accounts Involved	Effect
Cash not recorded when received	Cash	Understatement
	Loans Receivable	Overstatement
	Allowance for Losses on Loans Receivable	Overstatement
	Insurance Premiums Receivable	Overstatement
	Accrued Interest Receivable	Overstatement
	Allowance for Losses on Accrued Interest Receivable	Overstatement
	Interest Revenue	Overstatement
	Provision for Losses on Defaulted Loans	Overstatement
	Provision for Losses on Accrued Interest	Overstatement
Cash receipts for loan principal and interest applied only to loan principal	Loans Receivable	Understatement
	Accrued Interest Receivable	Overstatement
	Allowance for Losses on Loans Receivable	Understatement
	Allowance for Losses on Accrued Interest Receivable	Overstatement
	Interest Revenue	Understatement
	Provision for Losses on Defaulted Loans	Understatement
	Provision for Losses on Accrued Interest	Overstatement
Uncollectible checks included in cash balance	Cash	Overstatement
	Loans Receivable	Understatement
	Allowance for Losses on Loans Receivable	Understatement
	Accrued Interest Receivable	Understatement
	Allowance for Losses on Accrued Interest Receivable	Understatement
	Interest Revenue	Understatement
	Provision for Losses on Defaulted Loans	Understatement
	Provision for Losses on Accrued Interest	Understatement

Problem	Accounts Involved	Effect
Debit memorandums deducted from cash balance regardless of which program affected or whether the amounts were originally recorded as cash receipts	Cash	Probable Understatement
	Loans Receivable	Probable Overstatement
	Allowance for Losses on Loans Receivable	Probable Overstatement
	Insurance Premiums Receivable	Probable Overstatement
	Accrued Interest Receivable	Probable Overstatement
	Allowance for Losses on Accrued Interest Receivable	Probable Overstatement
	Interest Revenue	Probable Overstatement
	Provision for Losses on Defaulted Loans	Probable Overstatement
	Provision for Losses on Accrued Interest	Probable Overstatement
Canceled checks added to cash balance regardless of whether the amounts were originally recorded as cash disbursements	Cash	Probable Overstatement
	Loans Receivable	Probable Understatement
	Allowance for Losses on Loans Receivable	Probable Understatement
	Accrued Interest Receivable	Probable Understatement
	Allowance for Losses on Accrued Interest Receivable	Probable Understatement
	Claims in Process	Probable Overstatement
	Allowance for Losses on Claims in Process	Probable Overstatement
	Claims and Administrative Expenses Payable	Probable Overstatement
	Interest Payable	Probable Overstatement
	Interest Revenue	Probable Understatement
	Provision for Losses on Defaulted Loans	Probable Understatement
	Provision for Losses on Accrued Interest	Probable Understatement
	Provision for Losses on Claims in Process	Probable Overstatement
No allowance for losses on insurance premiums	Insurance Premiums Receivable	Overstatement

Problem	Accounts Involved	Effect
$20,000 of insurance premium receipts recorded as collections on defaulted loans	Loans Receivable	$20,000 Understatement
	Allowance for Losses on Loans Receivable	$5,400 Understatement
	Insurance Premiums Receivable	$20,000 Overstatement
	Accrued Interest Receivable	$1,400 Understatement
	Allowance for Losses on Accrued Interest Receivable	$378 Understatement
	Interest Revenue	$1,400 Understatement
	Provision for Losses on Defaulted Loans	$5,400 Understatement
	Provision for Losses on Accrued Interest	$378 Understatement
Uncollectible accrued interest receivable not written off	Accrued Interest Receivable	Overstatement
	Allowance for Losses on Accrued Interest Receivable	Overstatement
	Provision for Losses on Accrued Interest	Overstatement
Allowance for loss rate not based on experience	Allowance for Losses on Loans Receivable Allowance for Losses on Accrued Interest Receivable Allowance for Losses on Claims in Process Provision for Losses on Defaulted Loans Provision for Losses on Accrued Interest Provision for Losses on Claims in Process	Overstatement or Understatement (depending on actual loss rate)
Different and incompatible methods used to compute allowances for losses	Allowance for Losses on Loans Receivable Allowance for Losses on Accrued Interest Receivable Allowance for Losses on Claims in Process Provision for Losses on Defaulted Loans Provision for Losses on Accrued Interest Provision for Losses on Claims in Process	Overstatement or Understatement (depending on most appropriate method)

Problem	Accounts Involved	Effect
Collection fee never removed from loans receivable	Loans Receivable	$10.5 million Overstatement
	Accrued Interest Receivable	$0.7 million Overstatement
	Allowance for Losses on Loans Receivable	$5.1 million Overstatement
	Allowance for Losses on Accrued Interest Receivable	$0.4 million Overstatement
	Interest Revenue	$0.7 million Overstatement
	Provision for Losses on Defaulted Loans	$5.1 million Overstatement
	Provision for Losses on Accrued Interest	$0.4 million Overstatement
Insurance premium revenue improperly recognized	Insurance Premium Revenue	Overstatement or Understatement (depending on results of proper allocation)
Interest revenue computed using improper procedures	Interest Revenue Accrued Interest Receivable Allowance for Losses on Accrued Interest Receivable Provision for Losses on Accrued Interest	Overstatement or Understatement (depending on results of using proper procedures)

ACCOUNTING DEFICIENCIES:

HISTORICAL PERSPECTIVE

The Student Loan Insurance Fund has exhibited serious accounting problems since its beginning in 1967. These problems stemmed from management's failure to establish adequate internal controls and to ensure compliance with generally accepted accounting principles. Although GAO reported the Fund's accounting problems almost annually since 1969, the Fund's administrators have not displayed the necessary resolve to correct them.

PRIOR YEARS' ACCOUNTING PROBLEMS

On December 10, 1969, GAO reported that the fiscal 1968 financial statements did not present fairly the Fund's financial position, the results of its operations, or changes in its financial position. For each year since fiscal 1968, GAO has either issued an adverse opinion or has been unable to express an opinion on the Fund's financial statements because the accounting records were inadequate. The following is a summary of accounting problems that GAO encountered during its reviews of the Fund's financial statements for the previous 5 fiscal years.

Fiscal 1975

On February 10, 1977, GAO issued an adverse opinion on the Fund's fiscal 1975 financial statements. The Fund's problems included the following:

--Controls over payments were inadequate.

--Records did not adequately identify outstanding balances for advances to guarantee agencies.

--Cash transactions were not always recorded promptly.

--Control accounts were not reconciled with subsidiary records.

--Allowance for loss rates were not based on program experience.

--Liabilities and expenses were overstated by $128 million because of a failure to verify computations.

The Department of Health, Education, and Welfare, which was responsible for maintaining the Fund before the Department of Education was established (May 1980), agreed to the following improvements to resolve these problems:

--Better controls over canceled checks and duplicate payments would be implemented.

--Procedures would be developed to reconcile the advance funds records of the Office of Student Financial Assistance with those of the Office of Financial Management.

--Cash transactions would be recorded in the year in which they occur.

--Reports which would satisfy the Office of Financial Management's data requirements would be developed and, at that time, general ledger control accounts would be periodically reconciled with subsidiary records.

--The Office of Education (then part of Health, Education, and Welfare) would develop a meaningful loss estimation model to generate allowance for loss rates based on program experience.

--Computations used to develop financial statement amounts would be verified and properly supported.

These improvements were never implemented, and accounting and reporting problems continued to plague the Fund.

<u>Fiscal 1976 and 1977</u>

Between the issuance of the fiscal 1975 report and the current examination of the fiscal 1980 financial statements, GAO did not attempt a comprehensive audit of the Fund's financial statements because needed improvements had not been made. We conducted a limited review of the fiscal 1976 transactions and reported that the Fund's records did not adequately support the financial statements and that an audit would be fruitless. We conducted another limited review of fiscal 1977 transactions and, once again, reported that the deficiencies in the Fund's accounting records had not been corrected.

<u>Fiscal 1978</u>

In a September 1978 letter to the Secretary of Health, Education, and Welfare, we summarized the continuing accounting deficiencies that we had presented in our audit reports since inception of the program. They included the following:

--Subsidiary records were not adequate to support balances in the accrued interest receivable, insurance premiums receivable, defaulted loans receivable, and claims in process accounts.

--The allowance for loss rate for defaulted loans receivable, accrued interest receivable, and claims in process was not based on actual program experience.

--Responsibility for accounting data was held by two organizational units without appropriate controls between the two groups to ensure the accuracy of the data for which each was responsible.

--The Office of Education lacked control over interest payments.

--Lenders were not billed for past due insurance premiums.

--The Office of Education did not have

- a complete and accurate list of all federally insured loans,
- a complete and accurate list of amounts 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 with overdue payments.

Once again, our recommendations were largely ignored.

Fiscal 1979

On October 25, 1979, we reported that the then Deputy Commissioner of the Office of Student Financial Assistance and the Director of the Office of Financial Management had advised us that an audit of the Student Loan Insurance Fund would disclose that previously reported deficiencies remained uncorrected. Therefore, we decided not to audit the fiscal 1979 financial statements. Had we conducted an audit, it was apparent that we would have rendered another adverse opinion.

Fiscal 1980

As we began our examination of the fiscal 1980 financial statements we were again warned by Department of Education officials that the Fund's internal controls had not improved since our last report. We again found this to be true.

UNITED STATES DEPARTMENT OF EDUCATION
Student Loan Insurance Fund
Comparative Statement of Financial Position
As of September 30, 1980 and 1979

	1980		1979 (UNAUDITED)	
ASSETS				
Cash		$ 466,194,366.72		$ 264,827,145.10
Insurance Premiums Receivable		2,348,918.85		1,368,457.17
Advances		63,408,660.72		56,204,693.78
Loans Receivable				
Insured	$ 568,361,620.33		$ 526,620,684.83	
Reinsured	533,959,816.37		414,742,444.14	
	$1,102,321,436.70		$ 941,363,128.97	
Less Allowance for Losses on Loans Receivable	(411,528,000.00)	690,793,436.70	(517,749,720.94)	423,613,408.03
Claims in Process				
Insured	$ 43,959,611.00		$ 23,157,619.00	
Reinsured	31,650,042.00		25,519,313.00	
Claims in Process Purchased Interest	802,452.00		547,720.00	
	$ 76,412,105.00		$ 49,224,652.00	
Less Allowance for Losses on Claims in Process	(18,145,000.00)	58,267,105.00	(27,073,558.60)	22,151,093.40
Accrued Interest Receivable				
Insured	$ 179,845,735.71		$ 137,588,400.80	
Reinsured	115,828,905.14		83,207,972.77	
	$ 295,674,640.85		$ 220,796,373.57	
Less Allowance for Losses on Accrued Interest Receivable	(105,207,000.00)	190,467,640.85	(121,412,757.60)	99,383,615.97
Accounts Receivable		1,773,109.95		
Total Assets		$ 1,473,253,238.79		$ 867,548,413.45
LIABILITIES				
Claims and Administrative Expenses Payable				
Insured	$ 62,262,063.00		$ 25,306,147.00	
Reinsured	31,650,042.00	$ 93,912,105.00	25,519,313.00	$ 50,825,460.00
Interest Payable		246,988,466.00		167,124,800.00
Total Liabilities		$ 340,900,571.00		$ 217,950,260.00
INVESTMENT OF THE U.S. GOVERNMENT				
Cumulative Appropriations Net of Cumulative Deficit		$ 1,132,352,667.79		$ 649,598,153.45
Total Liabilities and Investment of the U.S. Government		$ 1,473,253,238.79		867,548,413.45

NOTE: This statement excludes unfunded liabilities in the amount of $538,000,000.00 which are the estimated future losses on guaranteed loans that will default and not be collected by the Department of Education.

NOTE: This statement excludes unfunded liabilities of $155,000,000.00 which are the estimated future losses on guaranteed loans that will default and not be collected

APPENDIX III

APPENDIX III

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE DEPUTY UNDER SECRETARY FOR MANAGEMENT

STUDENT LOAN INSURANCE FUND
COMPARATIVE STATEMENT OF INCOME & INVESTMENT OF THE U.S. GOVERNMENT
FOR FISCAL YEARS ENDED SEPTEMBER 30, 1980 and 1979

	1980	1979(UNAUDITED)
INCOME:		
Insurance Premiums	$ 3,823,839.58	$ 2,549,300.96
Interest on Defaulted Loans	67,419,286.89	60,587,664.48
TOTAL INCOME	$ 71,243,126.47	$ 63,136,965.44
EXPENSES:		
Interest	$1,302,889,684.64	$729,112,185.04
Provision for Losses:		
Defaulted Loans	(93,219,570.31)	87,286,737.76
Claims in Process	(15,505,176.23)	3,483,434.90
Accrued Interest	(18,980,757.60)	35,767,786.37
Salaries	16,000,000.00	10,000,000.00
Death and Disability Claims	4,794,548.42	143,578.97
Bankruptcy Claims	17,654.95	-0-
Computer Services	1,305,011.28	1,230,204.90
Collection Commissions	791,486.77	63,523.71
Fraud and Abuse	(260,269.79)	-0-
TOTAL EXPENSES	$1,197,832,612.13	$ 867,087,451.65
NET INCOME (LOSS)	(1,126,589,485.66)	(803,950,486.21)
INVESTMENT OF THE U.S. GOVERNMENT, BEGINNING OF YEAR	649,598,153.58	496,045,639.79
	$ (476,991,332.08)	$(307,904,846.42)
APPROPRIATIONS	1,609,344,000.00	957,503,000.00
INVESTMENT OF THE U.S. GOVERNMENT, END OF YEAR	$1,132,352,667.92	$ 649,598,153.58

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE DEPUTY UNDER SECRETARY FOR MANAGEMENT

STUDENT LOAN INSURANCE FUND
STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR FISCAL YEAR ENDED SEPTEMBER 30, 1980

		1980
FUNDS PROVIDED:		
Appropriations		$1,609,344,000.00
Loan Principal Payments Received		64,115,110.69
Increase in Claims Payable for Reasons Other Than Bankruptcy, Death or Disability of the Borrower		27,187,453.00
TOTAL FUNDS PROVIDED		$1,700,646,563.69
FUNDS APPLIED:		
Operations		
Net Loss from Operations		$1,126.589,485.66
Add (Deduct) Items Not Affecting Cash		
Increase in Accrued Earned Interest Receivable	$67,419,286.94	
Increase in Insurance Premiums Receivable	980,461.68	
Increase in Accrued Liabilities for Bankruptcy, Death & Disability Claims & Administrative Expenses Other Than Interest	(15,899,192.00)	
Provision for Losses		
Defaulted loans	93,219,570.31	
Accrued Interest	18,980,757.55	
Claims in Process	15,505,176.23	
Increase in Interest Payable	(79,863,666.00)	100,342,394.71
Reimbursements to Lenders & Guarantee Agencies for Defaulted Loans		231,498,951.42
Increase in Claims in Process		27,187,453.00
Increase in Advances		7,203,966.94
Increase in Accrued Purchased Interest Receivable		4,683,980.39
Increase in Accounts Receivable		1,773,109.95
TOTAL FUNDS APPLIED		$1,499,279,342.07
Increase (Decrease) in Cash		$ 201,367,221.62
Change in Cash Balances:		
Cash, Beginning of Year		$ 264,827,145.10
Cash, End of Year		466,194,366.72
Increase (Decrease) in Cash		$ 201,367,221.62

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE DEPUTY UNDER SECRETARY FOR MANAGEMENT

STUDENT LOAN INSURANCE FUND
STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR FISCAL YEAR ENDED SEPTEMBER 30, 1979

		1979 (UNAUDITED)
FUNDS PROVIDED:		
Appropriations		$ 957,503,000.00
Loan Principal Payments Received		57,379,039.14
Increase in Claims Payable for Reasons Other Than Bankruptcy, Death or Disability of the Borrower		5,952,289.00
TOTAL FUNDS PROVIDED		$1,020,834,328.14
FUNDS APPLIED:		
Operations		
Net Loss from Operations		$ 803,950,486.21
Add (Deduct) Items Not Affecting Cash		
Increase in Accrued Earned Interest Receivable	$60,587,664.48	
Increase in Insurance Premiums Receivable	150,919.15	
Increase in Accrued Liabilities for Bankruptcy, Death & Disability Claims & Administrative Expenses Other Than Interest	(769,943.00)	
Provision for Losses		
Defaulted loans	(87,286,737.76)	
Accrued Interest	(35,767,786.37)	
Claims in Process	(3,483,434.90)	
Increase in Interest Payable	(35,212,867.00)	(101,782,185.40)
Reimbursements to Lenders & Guarantee Agencies for Defaulted Loans		216,082,198.70
Increase in Claims in Process		6,333,518.00
Increase in Advances		32,363,428.31
Increase in Accrued Purchased Interest Receivable		4,327,668.85
TOTAL FUNDS APPLIED		$ 961,275,114.67
Increase (Decrease) in Cash		$ 59,559,213.47
Change in Cash Balances:		
Cash, Beginning of Year		$ 205,267,931.63
Cash, End of Year		264,827,145.10
Increase (Decrease) in Cash		$ 59,559,213.47

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE DEPUTY UNDER SECRETARY FOR MANAGEMENT

NOTES TO FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

   (a) INTEREST INCOME IS ESTIMATED AND ACCRUED QUARTERLY ON DEFAULTED LOANS PURCHASED.

   (b) INSURANCE PREMIUM INCOME IS RECOGNIZED WHEN BILLED.

2. RECORDING OF CASH RECEIPTS AND DISBURSEMENTS

   THE RECORDING OF CASH RECEIPTS AND DISBURSEMENTS IS DEFERRED UNTIL CONFIRMATION IS TRANSMITTED BY TREASURY TO THE DEPARTMENT OF EDUCATION.

3. LOANS RECEIVABLE

   LOANS RECEIVABLE REPRESENT THE PRINCIPAL BALANCE OUTSTANDING ON (a) FEDERALLY INSURED DEFAULTED LOANS (THE PROMISSORY NOTES ARE ASSIGNED TO ED) AND (b) REINSURED DEFAULTED LOANS (THE PROMISSORY NOTES ARE RETAINED BY THE STATE AND PRIVATE GUARANTEE AGENCIES). ED IS SPECIFICALLY PROHIBITED BY STATUTE FROM ANY COLLECTION ACTION ON REINSURED LOANS.

4. CLAIMS

   THE LIABILITY "CLAIMS PAYABLE," REPRESENTS THE UNPAID CLAIMS FOR DEFAULTED LOANS ON HAND AS OF SEPTEMBER 30, 1980, AND THOSE ON HAND AS OF SEPTEMBER 30, 1979, BUT NOT YET PAID.

5. ADVANCES TO STATES RESERVE FUNDS

   THE ASSET, ADVANCES TO STATES' RESERVE FUND, REPRESENTS FUNDS PROVIDED TO STATES FOR PURPOSES OF ASSISTING IN THE ESTABLISHMENT OR STRENGTHENING OF A LOAN FUND. ADVANCES PURSUANT TO THE 1968 AUTHORIZATION ARE REPAYABLE WITHIN SUCH PERIODS AS THE SECRETARY MAY DEEM TO BE APPROPRIATE IN ACCORDANCE WITH THE ACT. ADVANCE PURSUANT TO THE 1976 AUTHORIZATION ARE REPAYABLE AT THE TIME ADVANCES EXCEEDS 20 PERCENT OF THE STATE'S OUTSTANDING INSURANCE OBLIGATION.

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APPENDIX III

NOTES TO FINANCIAL STATEMENTS CON'T.

6. ALLOWANCE FOR LOSSES

ALLOWANCE FOR LOSS RATE OF 27 PERCENT WAS ESTIMATED AND TRANSMITTED BY THE GSL PROGRAM OFFICE. THIS RATE WAS APPLIED TO FEDERAL AND STATE AGENCY LOANS AND INTEREST RECEIVABLE OUTSTANDING BALANCES AND CLAIMS IN PROCESS. IN ADDITION, AN ESTIMATED COLLECTION EXPENSE RATE OF 30 PERCENT WAS APPLIED TO STATES' LOANS AND INTEREST RECEIVABLE AND CLAIMS IN PROCESS.

7. CONTINGENT LIABILITY

THE RATES USED IN FISCAL YEAR 1980 TO COMPUTE THE ESTIMATED FUTURE LOSSES FOR THE GUARANTEED REINSURED AND FEDERAL INSURED WAS 9.8 AND 15.1 PERCENT, RESPECTIVELY. THESE RATES WERE APPLIED AGAINST AN ESTIMATED OUTSTANDING AMOUNT OF LOANS DISBURSED BUT NOT YET DEFAULTED (REINSURED $4,275,510,204.00 AND FEDERAL $788,079,470.00). THE ESTIMATED FUTURE LOSSES ON LOANS RECEIVABLE NOT YET DEFAULTED ARE AS FOLLOWS FOR 1980 AS COMPARED WITH THAT OF 1979:

ESTIMATED CONTINGENT LIABILITY FOR OUTSTANDING LOANS:	1980 (IN MILLIONS)	1979
REINSURED	$ 419	$91
FEDERALLY INSURED	119	64

UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202

APR 14 1982

Mr. W. D. Campbell
Acting Director
Accounting & Financial Management Division
U.S. General Accounting Office
Washington, D.C. 20548

Re: Draft Report "Examination of Financial Statements of the Student Loan Insurance Fund for the Fiscal Year ended September 30, 1980" (code 920840)

Dear Mr. Campbell:

Attached is our detailed response to the referenced report as requested by your letter of March 15, 1982.

A joint effort by the staffs of Student Financial Aid (SFA) and Financial Management Service (FMS) has been underway since 1979 to identify specific problems of the Student Loan Insurance Fund (SLIF), the best approach to solving them, and specific tasks for correcting and updating the automated systems. Some of the tasks are designed to update the Department of Education Financial Management Information System (EDFMIS) from the SLIF history files and maintain the accounting system in a current status. You will see from our response that many of the deficiencies noted by your staff will be addressed by those tasks. Other tasks are in process or will be developed, as necessary.

We are unable to accept GAO's adverse opinion on the financial statements of the Student Loan Insurance Fund. If the auditor has determined that specific amounts are not fairly presented in the statements, we should be informed what the auditor believes those amounts should be and then be given an opportunity to correct the statements. If the audit work was not sufficient to determine the amounts to be included in the statements, the auditor's report should be revised accordingly. (See GAO note, p. 36.)

To improve accountability for SLIF, we propose to give higher priority to completion of tasks underway and development of those remaining to update the Departmental accounting system and maintain it in a current status. We are presently examining the extent to which staff and other resources will need to be realigned or new resources assigned in order to implement improvements. Within 90 days we will complete a management plan prioritizing resolution of the problems with which we concur. A major step already taken to assure consistency within the record systems is the establishment of a Loans/Bonds Receivable Section in FMS with a specific mission of improving the interface between the general ledgers of FMS and the subsidiary receivable records maintained by SFA.

Sincerely,

Ralph J. Olmo
Comptroller

cc: J. Thomas, IG
J. Melady, ASPE

GAO NOTE: The responsibility for preparation of financial statements rests with management. Often, auditors will recommend adjustments as a result of their audit work in order to improve financial disclosure or accounting treatment so that the statements present more fairly the entity's financial position and results of operations. Auditors are not responsible, however, for creating financial statements where none exist; nor are they responsible for reprocessing transactions to arrive at accurate account balances.

Generally accepted government auditing standards require that when an auditor expresses an adverse opinion, he/she should "disclose in a separate paragraph(s) of his report (a) all the substantive reasons for his adverse opinion and (b) the principal effects of the subject matter of the adverse opinion on financial position, results of operations and changes in financial position, if reasonably determinable" (emphasis added). Because of the difficulties we encountered in substantiating account balances, it was not reasonable for us to determine the correct account balances. The magnitude and pervasiveness of the Student Loan Insurance Fund's problems were so great that, in our opinion, the financial statements taken as a whole could not be fairly presented.

Further, it would have been inappropriate for us to disclaim an opinion on the statements because we had performed an examination of sufficient scope to form an opinion. To do so, would have not only violated our professional standards, but would have ignored our responsibility to the Congress and the public.

ATTACHMENT
Response to GAO 920840

A. Following are our comments on the auditor's recommendations:

1. GAO Recommendation: "That the Secretary of Education delegate all accounting, recordkeeping, and financial statement preparation responsibilities to the Office of Student Financial Assistance."

   ED's Response : We recognize there is potential merit in this recommendation; we will consider it fully as we establish our course of action under our management plan.

2. GAO Recommendation: "That the Secretary of Education implement life-cycle management activities, which include

   : user needs identification,

   : system design specification,

   : cost justification,

   : acquisition and development planning, and

   : operational evaluation."

   ED's Response : We concur.

   The Information Resource Management Service area, Office of the Comptroller, is working towards establishment of life-cycle management for all systems of the Department. The loan programs of SFA are being reviewed for this type activity as part of a Department-wide review of Credit Management under the debt collection initiatives mandated by OMB.

B. The following responses to the auditor's conclusions of deficiencies indicate whether task orders exist in the SLIF Financial Upgrade Completion Plan (Plan) which will correct those deficiencies and if not what alternative steps we are taking.

1. GAO's Conclusion: "The two units responsible for maintaining the same accounts use different identification numbers."

   ED's Comments : We concur. No tasks currently exist to satisfy this deficiency. However, a task will be developed and included in the Plan.

2. GAO's Conclusion: "Information in control accounts not obtained from subsidiary records."

   ED's Comment : We concur. A task has been developed to extract data from SFA records at a summary level for inclusion in EDFMIS that will satisfy this deficiency. This task encompassed the development of a design document outlining the appropriate reporting of Federal Collections transactions, e.g., principal, interest, write-offs, etc., within both the OSFA and EDFMIS systems. This design will accommodate summary-level reporting to EDFMIS. The design document was completed as planned. A task order for implementation is being considered by ED and a completion date will be included in the plan to be developed within 90 days.

3. GAO's Conclusion: "Essential accounting documents were not controlled between offices."

   ED's Comment : We concur. Internal Accounting and Control Procedures are being developed. Completion date is May 30, 1982.

4. GAO's Conclusion: "Cash not recorded when received."

   ED's Comment : We concur. The task for summary level EDFMIS reporting (See B2 above) will satisfy this deficiency.

5. GAO's Conclusion: "Interest receipts not recorded in the proper account."

   ED's Comment : We concur. The task for summary level EDFMIS reporting (See B2 above) will satisfy this deficiency.

6. GAO's Conclusion: "Uncollectible checks and some debit memorandums not recorded correctly."

   ED's Comment : We concur. The task for summary level reporting (See B2 above) will satisfy this deficiency.

7. GAO's Conclusion: "Some cancelled checks not recorded correctly."

   ED's Comment : We concur. The task for summary level reporting (See B2 above) in conjunction with the task for Federal claims obligations reporting will satisfy this deficiency.

8. GAO's Conclusion: "Insurance premiums receivable misstated."

   ED's Comment : We concur. The task for insurance premium enhancements, which includes the following, will satisfy this deficiency.

   a) Development of a payment balancing process similar to that of Federal collections;

   b) Development of a reconciliation process for regular and suspense payments;

   c) Development of the same type of transaction accounting for the Insurance Premium Subsystem as that designed for State and Federal Collection;

   d) Development of collection processing to generate accounts receivable reports and delinquency notices to lenders;

   e) Development of system control software to ensure that loans disbursed result in billings to lenders. A task order for implementation will be included in the Plan.

9\. GAO's Conclusion: "Uncollectible accrued interest receivable not written off."

ED's Comment : We concur. Based on write-off procedures for GSLP established by Financial Management Service, we are currently in the process of determining whether it is cost-effective to automate these procedures through the development of computer software. If it is not cost-effective and practical, then we will inform the regional offices that they are required to initiate appropriate write-offs.

10\. GAO's Conclusion: "Unsupportable rates and inconsistent procedures used in computing allowances for losses on uncollectible accounts."

ED's Comment : We concur. The task for Receivable/Loss rate will satisfy this deficiency. This task encompassed the development of a design document defining specifications for automation of the estimation of the percentage of defaulted accounts that will become uncollectible. This estimation has historically been prepared from manual statistical reports. The design document was completed as planned. A task order for implementation is currently being considered by ED.

11\. GAO's Conclusion: "Collection fee never removed from loans receivable."

ED's Comment : We concur. This will require a task for development of a State Agency System and we will be addressing this in the Plan.

12\. GAO's Conclusion: "Insurance premium revenue is improperly recognized."

ED's Comment : We disagree. Federally insured loans constitute only 5% of total GSL loans made, the balance being guarantee agency loans which do not produce insurance premium revenue to the Government. Total premiums reported for FY 1980 would offset less than 1/2 of 1% of operating costs. Accordingly, we believe that immediate recognition of this revenue when billed does not materially affect the Statement of Income. On the contrary, it would not be meaningful nor cost-effective to amortize the premiums merely to attempt a matching of expenditures in the proper period.

13. GAO's Conclusion: "Interest revenue computed using improper procedures."

ED's Comment : We concur. The task for summary level EDFMIS reporting (See B2 above) will satisfy this deficiency.

SUMMARY

The tasks developed for summary level interfacing between the subsidiary records maintained by SFA and EDFMIS will correct many of the reported deficiencies. Other tasks are in process or are being developed to correct the remaining deficiencies with which we concur. These will be further addressed in the plan which will be developed within 90 days. In the meantime, interim measures have been instituted as follows to bring the control accounts and the subsidiary accounts into agreement for fiscal year 1982.

1) Accounts have been established in FMS based on the FY 81 closing balances for SLIF. As necessary, an unreconciled difference account has been established for the difference between the two records and will be cleared as summary transactions for FY 81 and prior years are generated to update EDFMIS.

2) The GSL system is currently producing data in hard copy for FY 82 transactions from which we are extracting summary-level data pending implementation of electronic summary-level interfacing. FMS, in conjunction with SFA, is inputting this summary data into EDFMIS manually.

3) By the end of June 1982, we will have reconciled EDFMIS records with GSLP for FY 82 transactions only, and will then proceed to reconcile EDFMIS with Treasury.

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