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Report to the Congress

June 1993

FINANCIAL AUDIT

Federal Family Education Loan Program's Financial Statements for Fiscal Year 1992

149447

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-202873

June 30, 1993

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

This report presents the results of our audit of the Principal Financial Statements of the Department of Education's Federal Family Education Loan Program (FFELP), formerly the Guaranteed Student Loan Program, and its internal controls and compliance with laws and regulations for the fiscal year ended September 30, 1992. In accordance with the Chief Financial Officers Act of 1990, the Department of Education prepared the accompanying Principal Statements for the FFELP. We elected to perform an audit of these statements because of the importance of financial information and internal controls to the successful administration of the largest postsecondary education loan program of the federal government. Additionally, the guaranteed student loan program has been on GAO's list of high-risk programs since GAO began this designation in 1990.

While we were unable to give an opinion on the Principal Statements taken as a whole, we recognize the effort Education put forth to prepare the first comprehensive financial statement for the FFELP. Preparation of the Principal Statements presented a substantial undertaking to Education, made even more difficult because Education's systems were not designed to provide the meaningful and reliable financial management information needed to effectively manage and report on the FFELP's operations. Education fully cooperated with us and has begun significant efforts towards developing such information.

We are sending copies of this report to the Secretary of Education; the Deputy Secretary of Education; the Assistant Secretary for Postsecondary Education; Education's Assistant Secretary for Management and Budget/Chief Financial Officer; Education's Inspector General; the Secretary of the Treasury; the Director, Office of Management and Budget;

the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs and the House Committee on Government Operations; other interested congressional committees; and other interested parties.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Contents

Abbreviations

CFO	Chief Financial Officers Act
FFELP	Federal Family Education Loan Program
FMFIA	Federal Managers' Financial Integrity Act
OMB	Office of Management and Budget

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To the Secretary of the Department of Education

In our audit of the Department of Education's Federal Family Education Loan Program (FFELP) for fiscal year 1992, we found

- the Statement of Cash Flows to be reliable in all material respects; however, because reliable data upon which to base the liabilities for loan guarantees was not available, we could not give an opinion on the Principal Statements taken as a whole;
- internal controls in operation were ineffective in protecting assets and assuring that there were no material misstatements in the Principal Statements; however, they were effective in assuring material compliance with laws related to the use of budget authority and with significant provisions of other laws and regulations; and
- no material noncompliance with laws and regulations we tested.

Each of these conclusions is outlined in more detail below along with significant matters considered in performing our audit. This report also discusses (1) our conclusions on the Overview of the Financial Entity and other supplemental information and (2) the scope of our audit.

As a preface to the following discussions, it is important to understand that Education relies extensively on lenders and guaranty agencies, while it functions primarily as an overseer of these entities and as the ultimate guarantor of the loans. Education reinsures loans made by lenders to eligible students or their parents in an effort to ensure the availability of private capital and thereby increase the educational opportunities of these students. In addition, Education pays an interest subsidy to lenders on certain loans. Guaranty agencies reimburse lenders for loans that default and generally recover all such default payments from Education. During fiscal year 1992, the program guaranteed about $14.7 billion in new loans and paid a total of $5.1 billion for gross interest subsidies, special allowances to lenders, and gross loan defaults to guaranty agencies. The loan default payments were primarily for loans guaranteed in prior years that defaulted in fiscal year 1992.

Significant Matters

Material Weaknesses

Education reported accrued liabilities of $13.7 billion for the estimated costs to be incurred on outstanding guaranteed loans (referred to as liabilities for loan guarantees) as of September 30, 1992. These liabilities are the most significant amounts in the FFELP Principal Statements. Education calculated these liabilities using a model it created based on an analysis of its historical loan data. This data was the only detailed information on student and parent borrowers' loan history readily available to Education. The detailed information comprising this database was maintained and provided to Education by the 46 guaranty agencies and consisted of data on over 22 million student and parent borrowers with outstanding loans made or held by over 8,000 lenders.

Our tests of this detailed data showed that it was unreliable and, therefore, estimates of liabilities for loan guarantees based on such data are unreliable as well. For example, our reviews and several by Education found significant errors in the students' loan status (such as whether the student was still in school, payments were being made, or the loan was in default) and the students' outstanding loan balances when loans were in default. Due to the number of entities involved and the range of errors found, we were not able to practically determine the potential magnitude of such errors and their effect on the FFELP's liabilities for loan guarantees as of September 30, 1992. Education told us that it plans to follow up with the guaranty agencies to ensure that significant errors in the underlying historical loan data are corrected. We do not know when this objective can be achieved given the present program structure and the resources Education has available to manage and oversee this program. Until the data integrity problem is resolved, Education will continue to lack the information it needs to effectively budget for and manage the program.

The above data integrity problem is considered a material weakness in internal controls and it, along with the material internal control weaknesses described below, was discussed in greater detail in our report, Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, March 16, 1993). Education also reported these matters in its fiscal year 1992 Federal Managers' Financial Integrity Act (FMFIA) report.

- Education did not have adequate financial reporting processes and procedures. Its estimated liabilities for loan guarantees were not properly documented or reviewed and its general ledger was neither supported by subsidiary ledgers nor reconciled to other supporting data on a timely basis. These control weaknesses, combined with the questionable assumptions Education used in its model for estimating program costs, further undermined the reliability and accuracy of reported (1) FFELP financial position and results of operations in its Principal Statements and (2) program costs in its budget submission. Over the past year, Education's Office of the Chief Financial Officer and Office of Postsecondary Education have taken significant steps that begin to address these problems.
- Internal controls did not provide reasonable assurance that bills and reports from guaranty agencies and lenders were accurate or that Education received all origination fees owed. Numerous errors and discrepancies in these bills and reports, which Education used to manage the program, have led to program losses and data integrity problems. Education's management has recently begun focusing more attention on the oversight of guaranty agencies and lenders and has initiated various corrective actions.

The deficiencies in internal controls just described could have an adverse impact on any decision by management which is based, in whole or in part, on information that is inaccurate because of the deficiencies. Unaudited financial information reported by Education, including budget information, also may contain misstatements resulting from these deficiencies.

Extraordinary Item

During fiscal year 1992, the FFELP incurred an extraordinary, that is, nonoperational, item associated with legislation, which extended unemployment benefits and enhanced Education's collection authority. This enhanced collection authority was expected to result in increased collections of $2.1 billion, on a net present value basis, over the next 13 years. Notes 5 and 8 to the Principal Statements explain the accounting transactions related to this extraordinary item.

Budget Formulation Concerns

FFELP's estimates of program costs, which are incorporated in Education's annual budget submission, were derived from the same unreliable data as its liabilities for loan guarantees and are affected by the same internal control deficiencies noted with respect to the liabilities. As a result, the accuracy of projected program costs is in question. In addition, Education estimated program costs using some assumptions which were substantially more optimistic than historical data would support. These assumptions were related to the percentage of loans estimated to default in the future (default rate) and the estimated percentage of such defaults that might subsequently be collected (collection rate). Education assumed a lower than historical default rate and a higher than historical collection rate.

Education based these assumed lower default and higher collection rates on several statutes which authorized it to garnish wages of defaulted borrowers, continue collecting on defaulted loans through Internal Revenue Service tax refund offsets, continue collecting on defaulted student loans without regard to any statute of limitations, and discontinue guaranteeing loans to students attending schools with high default rates. Although such legislation should result in lower default rates and higher collection rates, we found no basis to support the level of change (a 35 percent reduction in defaults and a 75 percent improvement in subsequent collections as compared to historical data) that Education had projected.

The use of optimistic assumptions resulting in substantial understatements of budgeted program costs is not a new situation for Education. We reported a similar situation related to Education's Pell grant program in our report, Pell Grants: How the Department of Education Estimates Program Costs (GAO/HRD-90-73BR, February 21, 1990). Education has had annual budget shortfalls in the Pell grant program, primarily due to its optimistic estimates of savings from legislative proposals, since fiscal year 1983, and, most recently, requested a supplemental appropriation to cover a $2 billion shortfall. We believe that the optimistic assumptions being used in estimating program costs for the FFELP could also result in a shortfall that could require substantial use in future years of the permanent indefinite appropriation provided by the Federal Credit Reform Act of 1990.

Recognizing that the underlying data itself is questionable, we recalculated FFELP default and collection rates using what we believe to be more realistic assumptions. Our rates were developed by reviewing the program's historical trends at Education, guaranty agencies, and lenders and making adjustments for anticipated improvements due to the statutes referred to earlier. These adjustments were significantly lower than Education's because the available historical data already reflected the benefits provided by those statutes since the statutes primarily extended the availability of collection tools provided by previous legislation. Additionally, the default reduction tool, eliminating schools with high default rates, has not yet proven to have a significant effect on default rates. Using our recalculated default and collection rates, the cost to taxpayers for loans guaranteed in fiscal year 1992, which includes estimated defaults and interest subsidies, could be as high as $3.9 billion. About $2.6 billion was included in the President's fiscal year 1992 budget.

The same concern can be raised about Education's fiscal year 1993 budget submission. Education expects to guarantee about $18 billion in loans under the FFELP in fiscal year 1993, and the President's budget included an estimated cost of $2.3 billion for loan guarantees. Again, using what we believe to be more realistic assumptions but the same underlying data used by Education, we estimated that the cost to taxpayers for these loans could be as high as $3.8 billion. Therefore, Education's budget may be understated by as much as $1.5 billion. It is very important to note, however, that because budgeted program costs are also affected by the data integrity problem previously mentioned, there is simply no way of knowing at this time the range of error for the potential understatement.

Direct Loan Program

The administration, as part of its overall postsecondary education policy initiatives, has proposed replacing the FFELP with a direct loan program during fiscal year 1997. However, even if this replacement occurs as planned, due to the number of years needed for the phasing out of existing loans, Education could continue to incur costs on guaranteed loans until about fiscal year 2017.

As discussed in our March report, Education has recently made progress in addressing its long-standing controls and systems problems related to the FFELP. The need to fully resolve these problems is critical regardless of whether Education administers the current guaranteed loan program, a direct loan program, or a combination of the two. Adequate resources need to be committed to dealing with existing problems and, if a direct loan program is enacted, to expanding the capacity of Education to effectively manage and oversee the two programs. Unless this is done, the savings anticipated by the administration in the direct loan program may not be fully realized.

CFO Act Implementation

The FFELP is the largest program in the Department of Education subject to audit under the Chief Financial Officers (CFO) Act of 1990. In preparing for the audit of the FFELP's fiscal year 1992 financial statements, Education has taken significant action to meet the objectives of the CFO Act, most notably in accounting and information systems. Additional actions related to the FFELP that would address congressional expectations include consolidating financial management operations, developing reliable cost data and performance measures, and involving Education's CFO in the planning and staffing of all financial management systems. This audit has not addressed these issues in detail.

Opinion on Principal Statements

We determined, through detailed audit procedures, that the Statement of Cash Flows presents fairly the cash flows of the FFELP for the year ended September 30, 1992. However, the Statement of Cash Flows reports only the cash actually received and disbursed by the FFELP. Due to material internal control weaknesses detailed in our March report and summarized in this report, the FFELP may not have received from or disbursed to the lenders and guaranty agencies the amounts that should have been received or disbursed.

Additionally, the inaccuracies in the data provided by the guaranty agencies, as previously discussed, were so pervasive that we could not perform sufficient procedures to conclude whether the FFELP's liabilities for loan guarantees of $13.7 billion were fairly stated as of September 30, 1992. Due to the significance of these liabilities and their impact on related accounts in the Principal Statements, we are unable to give an opinion on the Principal Statements taken as a whole. Thus, the following Principal Statements may be unreliable:

- Statement of Financial Position,
- Statement of Operations before Appropriations,
- Statement of Changes in Net Position, and
- Statement of Budgetary Outlays and Actual Expenses.

Opinion on Internal Controls

The internal controls we evaluated were those designed to

- safeguard assets against loss from unauthorized use or disposition;
- assure the execution of transactions in accordance with laws related to the use of budget authority and with significant provisions of other laws and regulations; and

- properly record, process, and summarize transactions to permit the preparation of financial statements and to maintain the accountability for assets.

Because of the material weaknesses in internal controls described above, internal controls do not provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition or that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and to maintain accountability for assets. However, internal controls do provide reasonable assurance that instances of noncompliance with laws related to the use of budget authority and with other laws and regulations material in relation to the Principal Statements would be prevented or detected.

Our work also identified the need to improve certain general electronic data processing controls over information systems, as described in our March 1993 report. These weaknesses in general controls, although not considered material, represent significant deficiencies in the design or operations of internal controls which could adversely affect the entity's ability to meet the internal control objectives listed above or meet Office of Management and Budget (OMB) criteria for reporting matters under FMFIA.

Compliance With Laws and Regulations

Our tests for compliance with significant provisions of selected laws and regulations disclosed no material instances of noncompliance. Also, nothing came to our attention in the course of our work to indicate that material noncompliance with such provisions occurred. Finally, nothing came to our attention to indicate that Education's report on internal controls prepared under the FMFIA conflicts materially with the results of our evaluation of internal controls.

Consistency of Other Information

The Overview of the Financial Entity and other supplemental information contain a wide range of data, some of which is not directly related to the Principal Statements. We did not subject this information to the level of testing we applied to the Principal Statements and, consequently, we are not expressing an overall opinion on this information. We did, however, compare this information for consistency with the Principal Statements and discussed the methods of measurement and presentation with Education officials. Based on this work, nothing came to our attention that caused us to believe there were any material inconsistencies with the

Principal Statements or nonconformance with OMB guidance. However, some of this data was obtained using the underlying data that we found to be unreliable for purposes of estimating the liabilities for loan guarantees.

Objectives, Scope, and Methodology

Management is responsible for

- preparing the annual financial statements in conformity with applicable accounting principles;
- establishing and maintaining internal controls and systems to provide reasonable assurance that the broad control objectives of FMFIA are met; and
- complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the Principal Statements are reliable (free of material misstatements and presented fairly in accordance with applicable accounting principles), and (2) relevant internal controls are in place and operating effectively. We are also responsible for testing compliance with significant provisions of selected laws and regulations and for performing limited procedures with respect to certain other information appearing in these annual financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the Principal Statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the Principal Statements;
- evaluated and tested relevant internal controls which encompassed financial reporting, cash receipts, cash disbursements, compliance, and budget;
- tested compliance with significant provisions of the following laws and regulations:
  - Part B of Title IV, Higher Education Act of 1965, as amended,
  - Federal Credit Reform Act of 1990 (Public Law 101-508),
  - Chief Financial Officers Act of 1990 (Public Law 101-576),
  - Prompt Payment Act (31 U.S.C. 3901-3907);
- reviewed Education's compliance with OMB Bulletin 93-02, "Form and Content of Agency Financial Statements"; and

- considered compliance with the process required by FMFIA for evaluating and reporting on internal control and accounting systems.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our work to accounting and other controls necessary to achieve the objectives outlined in our opinion on internal controls.

While we examined guaranty agency records in preparation for this report, we did not focus on Education's use of guaranty agency data in calculating school default rates. Hence, this report does not address the Department's procedures for determining school default rates or for considering requests from educational institutions for recalculation of those default rates. We have not examined this process, and therefore express no opinion as to its efficacy.

Except for the limitations on the scope of our work in testing the liabilities for loan guarantees, our work was done in accordance with generally accepted government auditing standards and OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements."

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

May 14, 1993

Financial Statements

Overview of Financial Entity

PROGRAM BACKGROUND

The Federal Family Education Loan (FFEL) Program, formerly called the Guaranteed Student Loan Program (GSLP) is comprised of four components. They are Federal Stafford Loans, Federal Supplemental Loans for Students (SLS), Federal Parent Loans for Undergraduate Students (PLUS) and Federal Consolidated Loans.

The program is operated through state and private non-profit guaranty agencies that guarantee long-term loans to students attending participating postsecondary schools. Most often loans are made by commercial lenders, but some guaranty agencies and schools also participate as lenders in the program. The loans guaranteed by state or private nonprofit guaranty agencies are reinsured by the Federal government.

The FFEL Program has undergone significant changes in the 27 years since its inception in fiscal year 1966. Authorized by Congress in the Higher Education Act of 1965, loans guaranteed indirectly by the Federal government through state and private nonprofit agencies were called Guaranteed Student Loans, while loans guaranteed directly by the Federal government were authorized under the Federal Insured Student Loan Program (FISLP). FISLP accounted for approximately 50 percent of the total dollar amount of new loan guarantees in the mid 1970s, but was gradually phased out with the last direct guarantees being made in July 1984. Over the years, loan volume increased steadily and sometimes quite rapidly due to the rise in loan limits based on the increased costs of a postsecondary education. The Higher Education Act Amendments of 1976 raised the maximum special allowance payment rate to lenders from 3 percent to 5 percent, and provided an in-school subsidy to all students with a family adjusted gross income below $25,000. These changes resulted in a 27 percent increase in loan volume between fiscal years 1977 and 1978. Enactment of the Middle Income Student Assistance Act in 1978 extended the in-school subsidy to all student borrowers regardless of family income. PLUS was created by the Education Amendments of 1980 as a new program of loans to parents of dependent undergraduate students. In 1981, eligibility was expanded to include independent graduate students as well as independent undergraduate students. The Higher Education Amendments of 1986 restricted the PLUS program to parent borrowers of dependent undergraduate and graduate students, but separated the student borrower portion into what is now known as the Federal SLS.

In addition to the changes noted above, the Higher Education Act Amendments of 1986 required all loan applicants to demonstrate a need in order to qualify for a Stafford loan. Additionally, annual and aggregate loan limits were increased for all borrowers and variable interest rates were established for PLUS and SLS loans. Borrowers could refinance their PLUS and SLS loans at a variable rate, and lenders were authorized to make consolidation loans under FISLP, Stafford, Perkins, SLS and Health Professions Student Loan programs. Loans were first consolidated during fiscal year 1987. Consolidated loans are not considered new loans and the volume for this type is small given the relative volume of Stafford, PLUS and SLS loans.

The FFEL Program components - Stafford, PLUS, SLS and Consolidated - are generally considered to be separate program entities because each has its own participants, loan limits and loan volume. In fact, students may participate in more than one program. Approximately 71.3 percent of borrowers took out only Stafford loans in fiscal year 1991; 4.1 percent borrowed under PLUS; 2.8 percent under SLS; 12.8 percent borrowed under both Stafford and SLS, 8.9 percent borrowed as students under Stafford while their parents borrowed on their behalf under PLUS, and .1 percent benefitted from loans under all three components.

FINANCIAL OPERATIONS AND PROGRAM STRUCTURE

An important element of the FFEL Program is the commercial lender. The program uses private loan capital supplied by commercial lenders; the lenders in turn receive interest subsidies and special allowance payments, when applicable, on eligible Stafford loans to supplement the interest rate they charge for a Stafford loan. Lenders do not receive interest benefit payments for SLS and PLUS loans, but may receive special allowance payments if the variable interest rate exceeds 12 percent. Borrowers generally have a maximum of 10 years to repay FFEL Program loans. As of September 30, 1992, there were approximately 8,000 lenders participating in the program, collectively holding an estimated outstanding balance of about $63 billion in loans. At the disposal of lenders are numerous secondary market institutions. These institutions purchase loans from the original lender, thereby restoring the lender's liquidity, thus making it easier for lenders to continue making loans. The largest of these secondary markets is the Student Loan Marketing Association (Sallie Mae), a federally chartered stockholder-owned corporation, established by Congress in 1972 to provide a national secondary market for FFEL Program loans. At the end of fiscal year 1991, Sallie Mae had outstanding loan purchases of $18.7 billion, which constituted about one-third of the guaranteed student loan program dollars.

Another important element of the FFEL Program is the guaranty agency. These agencies are individual state or private, nonprofit organizations that guarantee loans that are, in turn, reinsured by the Federal government. Guaranty agencies existed prior to the enactment of the Higher Education Act of 1965. At that time, guaranty agencies existed in only 17 states. Legislation provided funding in the form of advances to existing guaranty agencies, but by the summer of 1967 these agencies had exhausted their guarantee capacity because the "seed money" from advances had been depleted. FISLP, which could only be implemented when a guaranty agency did not serve all eligible schools, students, or lenders, was then initiated in August 1967. North Dakota became the first state to request guarantees under FISLP with about half of the remaining states requesting it by the end of 1968. Congress reaffirmed its position that guaranty agencies were needed in all states, and the 1976 Amendments to the Higher Education Act provided incentives and inducements for establishing them where needed. Currently one or more guaranty agencies operate in each of the 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, and the Pacific Islands.

The original FFEL Program legislation encouraged the formation of additional agency programs, continued use of the existing ones, and provided support for establishing private, nonprofit agencies where none existed. The purpose of guaranty agencies is to insure lenders against losses due to borrower defaults and to ensure loan access for eligible students. Guaranty agencies receive financial assistance from the Federal government in the form of reinsurance payments, a 30 percent retention of collections on defaulted loans, administrative cost allowances and Federal advances. Reserve funds held by the guaranty agencies are restricted to purposes outlined in Education regulations.

OUTPUT OF THE FEDERAL FAMILY EDUCATION LOAN PROGRAM

Designed to increase postsecondary education opportunities for eligible students, the FFEL Program has helped provide access to numerous students who otherwise may not have been able to further their education. Since the program's inception in fiscal year 1966, the number of loans made annually has increased from about 89,000 to over 5 million in fiscal year 1992; the cumulative loan volume increased from about $73 million to over $142 billion during this period. Participation rates for the program provide insight into its effect. Statistical data for the 1989-90 academic year (see tables below), the latest year for which such data are available, show that approximately 16.1 percent of all undergraduate students in public 4-year institutions, 27.6 percent of all undergraduate students in private 4-year institutions and 61.7 percent of all proprietary school students received a Stafford loan. Below are some additional utilization rates. It is also notable that 80.5 percent of the proprietary school students received some form of student aid.

Institution Type	Undergraduate Students	Any Aid[1]	Stafford
Public 4-Year	5,260,502	43.0%	16.1%
Private 4-Year	2,297,503	63.4%	27.6%
Public 2-Year	7,051,968	27.9%	4.0%
Private 2-Year	268,476	58.0%	19.0%
Proprietary	1,391,194	80.5%	61.7%
TOTAL	16,269,643	Avg 42.8%	Avg 16.4%

Statistical data for all postgraduates shows that 56.6 percent of persons seeking to enter professional fields received Stafford

[1] "Any Aid" includes grants, loans, and work-study that originates with the Federal Government, the states, postsecondary institutions, and private institutions or a combination of these sources.

loans. Following are some additional utilization rates for the 1989-90 academic year:

Program	Postgraduate Students	Any Aid[2]	Stafford
Masters	1,346,080	39.8%	11.6%
Doctoral	254,580	59.9%	8.8%
Professional	302,790	64.4%	56.6%
Other	414,450	34.5%	7.0%
TOTAL	2,317,900	Avg 45.1%	Avg 16.3%

These data provide only a partial look at the levels of participation because they exclude PLUS, SLS and Consolidated loans.

PROGRAM PERFORMANCE AND RISKS

While the FFEL Program has expanded access to postsecondary education for millions of students, its costs and risks have also increased. Loan defaults are a factor which greatly affects the operation of the program. From 1981 to 1991, default claims paid increased from $257 million to $3.2 billion, then declined to $2.9 billion in 1992. Under the program, after a loan has been delinquent for at least 180 days, a guaranty agency makes payment to a lender on a default claim. The guaranty agency may file a reinsurance claim with the Department of Education after it has paid the lender. Under the HEA Amendments of 1992, this claim must be

[2] Ibid note 1.

filed within 45 days after paying the lender. Most guaranty agencies are reimbursed 100 percent for their default payments to lenders.

The factors responsible for the increase in defaulted loans are 1) the increase in the FFEL Program loan volume and 2) the changing characteristics of the program population, especially the increase in loans to proprietary school students. Annual loan commitments increased from $6.2 billion to $14.7 billion during the 10 years from 1982 to 1992. The number of borrowers attending proprietary schools also climbed during the 1980's. Borrowers attending proprietary schools have a higher default rate than those attending other types of postsecondary institutions. Higher default rates are also associated with students who withdraw rather than graduate, have low adjusted gross incomes, and are financially independent, rather than dependent on their parents.

The collection of defaulted loans is a significant and costly activity. In fiscal year 1992, Education collected $1.12 billion of defaulted student loans through direct payments to Education, Internal Revenue Service offsets (tax refunds), and guaranty agencies' efforts. In fiscal year 1992, the average cost of a dollar collected was $0.19; in other words, of every dollar collected, the Federal government netted approximately $0.81. However, some collections, cost more. For example, Education pays guaranty agencies 30 percent of the amount of defaulted loans they collect.

Education is currently working to determine what should be done to reduce administrative and default costs, increase the cost-effectiveness of the program, and replace the FFEL Program with a less costly student aid program. Other measures are being taken within Education to reduce costs. There are major new activities under way toward implementing the HEA Amendments of 1992 and an Office of Postsecondary Education reorganization.

EXTRAORDINARY ITEM

During fiscal year 1992, Congress provided Education with enhanced collection authority that, on a net present value basis, is expected to result in increased collections of $2.1 billion. These expected collections were sufficient to offset the cost of benefits provided under the Emergency Unemployment Compensation Act of 1991, consistent with the pay-as-you-go provisions of the Budget Enforcement Act of 1990. In accordance with Office of Management and Budget directions on implementing the Federal Credit Reform Act requirements, Education will repay its borrowing from the U.S. Treasury with the increase in collections of defaulted student loans expected from legislated changes in the program. These changes include the authorization of wage garnishment, extending IRS offsets and elimination of the statute of limitations on these loans. Relevant legislation and Education's related accounting treatment are discussed in the notes to the principal financial statements (see note 8).

ADDITIONAL INFORMATION

Education's Office of Postsecondary Education, prepares the Guaranteed Student Loan Programs Data Book annually. This publication, most recently published for fiscal year 1991, is a compilation of statistical data, tables and charts for all components of the FFEL Program since its inception in 1966. It is forwarded to Congress, the guaranty agencies, and other interested parties upon request.

Education has a major initiative underway to develop meaningful performance measures for all programs. The effort is spearheaded by the Monitoring and Performance Measures Team (MPMT), established by the Deputy Secretary. This team consists of executives and managers appointed by appropriate senior officers. The MPMT has initiated a pilot effort with the National Academy of Public Administration (NAPA) in which performance measures are being developed for five specific programs. These will include measures of inputs, outputs, efficiency, effectiveness, and outcomes. NAPA will also produce a handbook to guide performance indicator development for other Education programs.

This effort, which has been designed to produce measures that will have relevance and be useful for planning, managing and controlling departmental programs, will require several years to complete. In the meantime, the performance indicators presented in this report were derived from existing information, primarily the data book previously discussed, and the September 30, 1992, guaranty agency quarterly reports (Education Form 1130), to provide a preliminary view of the FFEL Program's performance.

Fiscal year 1992 was the first year that the FFEL Program financial statement was issued and audited in accordance with the Chief Financial Officers Act of 1990 and related Office of Management and Budget guidance. Financial data for periods prior to fiscal year 1992 and all statistical data included in this financial entity overview is unaudited and based solely on the books and records of the Department of Education.

Table 1

Table 1

Federal Family Education Loan Program

TOTAL LOANS COMMITTED AND AVERAGE LOAN SIZE

Fiscal Year	Annual Loans Committed (thousands)	Annual Loan Volume (millions)	Average Loan Size
1987	3,876	$ 9,736	$2,512
1988	4,513	$11,816	$2,618
1989	4,713	$12,465	$2,645
1990	4,497	$12,291	$2,734
1991	4,817	$13,499	$2,804
1992	5,130	$14,749	$2,875

Table 2

Table 2

Federal Family Education Loan Program

DEFAULT CLAIMS PAID TO LENDERS BY GUARANTY AGENCIES

Fiscal Year	Number Of Loans Defaulted (thousands)	Total Defaults Paid To Lenders (millions)	Total Loan Dollars Outstanding (millions)
1987	461	$1,318	$38,550
1988	504	$1,434	$43,109
1989	708	$2,018	$46,889
1990	953	$2,663	$54,126
1991	1,064	$3,205	$57,497
1992	831	$2,757	$62,778

Table 3 Table 3

Federal Family Education Loan Program

LOAN VOLUME (COMMITMENTS) BY TYPE OF INSTITUTION

Number of Loans In Thousands

Fiscal Year	Public 4-Year	Private 4-Year	Public 2-Year	Private 2-Year	Proprietary	Total
1987	1,084	917	355	111	1,409	3,876
1988	1,259	1,080	327	84	1,763	4,513
1989	1,369	1,143	329	89	1,783	4,713
1990	1,503	1,238	339	91	1,326	4,497
1991	1,771	1,421	396	99	1,130	4,817

Dollars In Millions

Fiscal Year	Public 4-Year	Private 4-Year	Public 2-Year	Private 2-Year	Proprietary	Total
1987	$2,559	$2,684	$723	$267	$3,503	$ 9,736
1988	$3,276	$3,546	$636	$205	$4,153	$11,816
1989	$3,747	$3,806	$642	$210	$4,060	$12,465
1990	$4,232	$4,206	$658	$218	$2,977	$12,291
1991	$5,094	$4,865	$788	$233	$2,519	$13,499

Table 4 | Table 4

Federal Family Education Loan Program

LOAN COMMITMENTS BY GUARANTY AGENCY MADE DURING FY 1992

Guaranty Agency	Number Of Loans	Loan Volume	Average Dollars Per Loan
Alabama	30,554	$83,561,874	$2,735
Arkansas	31,624	$80,137,900	$2,534
California	380,735	$1,209,486,636	$3,177
Colorado	94,940	$271,663,178	$2,861
Connecticut	35,117	$110,054,689	$3,134
Delaware	5,822	$18,168,019	$3,121
Florida	118,632	$313,691,080	$2,644
Georgia	68,338	$181,551,944	$2,657
Idaho	15,811	$41,988,546	$2,656
Illinois	177,845	$504,479,339	$2,837
Indiana	87,435	$232,323,074	$2,657
Iowa	96,086	$256,996,664	$2,675
Kentucky	51,121	$125,453,392	$2,454
Louisiana	42,872	$113,007,203	$2,636
Maine	24,217	$65,983,242	$2,725
Maryland	52,954	$159,152,159	$3,005
Massachusetts (1)	188,133	$647,002,621	$3,439
Michigan	130,349	$333,866,058	$2,561
Minnesota (2)	139,637	$518,348,460	$3,712
Mississippi	42,089	$111,035,705	$2,638
Missouri	73,872	$200,623,651	$2,716
Montana	25,583	$66,506,939	$2,600
Nebraska	73,298	$221,526,878	$3,022
New Hampshire	21,552	$60,417,250	$2,803
New Jersey	84,876	$251,197,635	$2,960
New Mexico	24,367	$58,003,809	$2,380
New York	377,379	$1,109,076,428	$2,939
North Carolina	48,012	$123,950,477	$2,582

Table 4 Table 4

Federal Family Education Loan Program

LOAN COMMITMENTS BY GUARANTY AGENCY MADE DURING FY 1992
(Continued)

Guaranty Agency	Number Of Loans	Loan Volume	Average Dollars Per Loan
North Dakota	24,731	$53,088,777	$2,147
Ohio	123,475	$338,810,005	$2,744
Oklahoma	66,128	$163,392,191	$2,471
Oregon	47,720	$131,557,696	$2,757
Pennsylvania (3)	456,271	$1,295,464,703	$2,839
Puerto Rico	8,922	$25,764,270	$2,888
Rhode Island	22,873	$66,429,424	$2,904
South Carolina	36,742	$106,648,642	$2,903
South Dakota	27,938	$66,648,678	$2,386
Tennessee	67,198	$178,066,733	$2,650
Texas	253,434	$699,709,223	$2,761
USAF (4)	980,799	$2,864,322,503	$2,920
Utah	39,992	$118,535,493	$2,964
Vermont	22,053	$59,244,380	$2,686
Virgin Islands	403	$1,132,545	$2,810
Virginia	92,003	$263,233,576	$2,861
Washington	69,039	$202,396,680	$2,932
Wisconsin	246,844	$645,403,337	$2,615
Total	5,129,815	$14,749,103,706	Avg $2,875

NOTES:

(1) Massachusetts became the designated guarantor for the District of Columbia after January 16, 1991.
(2) Northstar Guarantee, Inc., became the designated guarantor for Minnesota on May 1, 1991.
(3) Pennsylvania became the designated guarantor for West Virginia after January 16, 1991.
(4) United Student Aid Funds (USAF) became the designated guarantor for Alaska, Hawaii, Kansas, Nevada, the Pacific Islands, and Wyoming after January 1, 1991.

Chart 1

Chart 1

Federal Family Education Loan Program

TOTAL LOANS COMMITTED AND AVERAGE LOAN SIZE

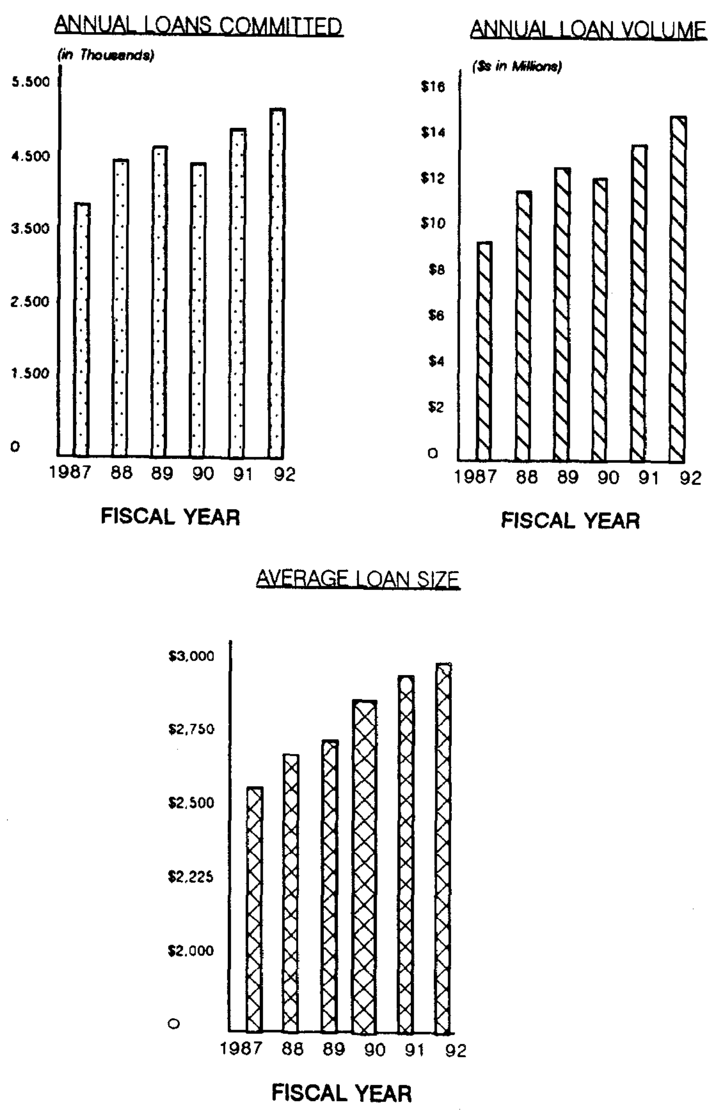


Chart 2 Chart 2

Federal Family Education Loan Program

DEFAULT CLAIMS PAID TO LENDERS BY GUARANTY AGENCIES

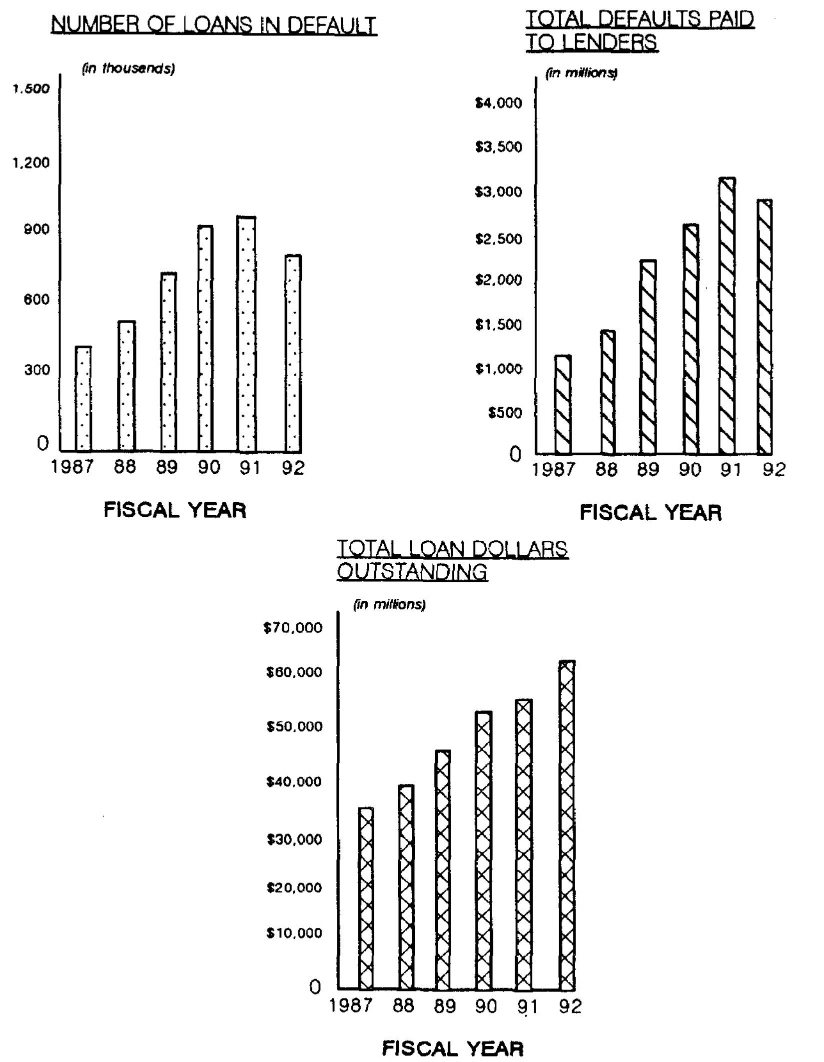


Chart 3 Chart 3

Federal Family Education Loan Program

LOAN VOLUME (COMMITMENTS) BY TYPE OF INSTITUTION

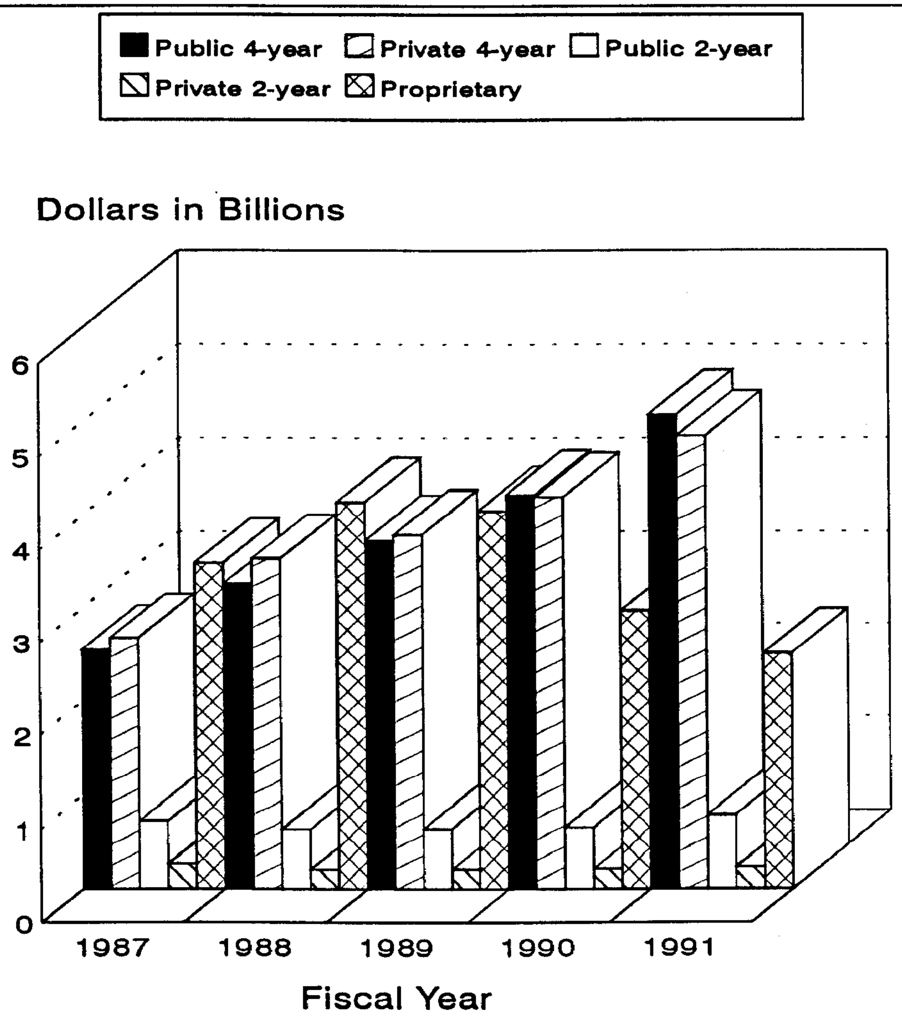
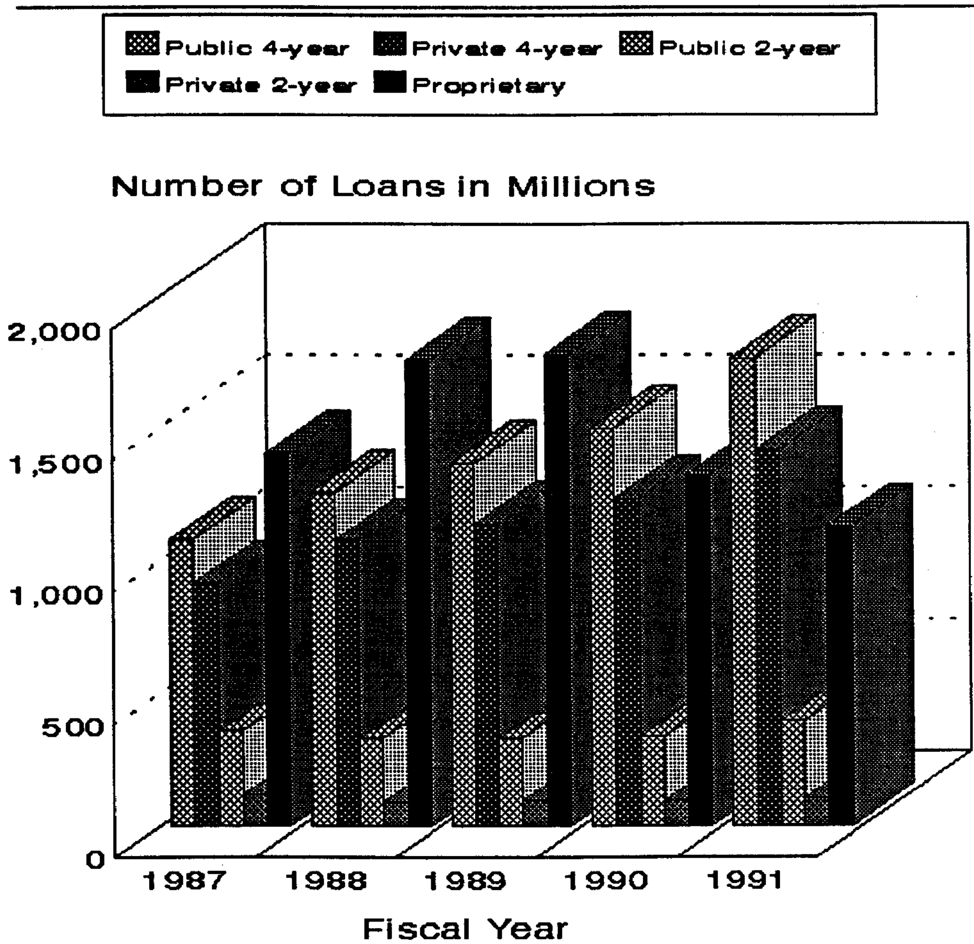


Chart 4

Chart 4

Federal Family Education Loan Program

LOAN VOLUME (COMMITMENTS) BY TYPE OF INSTITUTION



Statement of Financial Position

As of September 30, 1992
(Dollars in Thousands)

ASSETS	
Financial Resources:	
Fund Balances with U.S. Treasury	$ 4,023,651
Advances to Guaranty Agencies, Net	40,803
Accounts Receivable, Net	15,541
Total Assets	$ 4,079,995
LIABILITIES	
Funded Liabilities:	
Liabilities for Loan Guarantees, Short-Term	$ 1,430,743
Liabilities for Loan Guarantees, Long-Term	1,549,846
Due to U.S. Treasury	1,057,960
Accrued Salaries	643
Total Funded Liabilities	4,039,192
Unfunded Liabilities:	
Liabilities for Loan Guarantees, Short-Term	2,996,631
Liabilities for Loan Guarantees, Long-Term	7,737,388
Borrowing from U.S. Treasury	2,090,103
Accrued Compensated Leave	1,819
Total Unfunded Liabilities	12,825,941
Total Liabilities	16,865,133
NET POSITION	
Invested Capital	40,803
Future Funding Requirements	(12,825,941)
Total Net Position	(12,785,138)
Total Liabilities and Net Position	$ 4,079,995

The accompanying notes are an integral part of these financial statements.

Statement of Operations Before Appropriations

For the Fiscal Year Ended September 30, 1992
(Dollars in Thousands)

PROGRAM REVENUES AND EXPENSES			
Program Revenues			
Estimated Collections from Special Legislation	$2,120,639		
Interest Earned on Funds Deposited with U.S. Treasury	30,536		
Total Program Revenues			$2,151,175
Funded Program Expenses			
Provision for Defaults (Net of Collections and Reinsurance Fees)	1,267,727		
Provision for Interest Rate Subsidies (Net of Loan Origination Fees)	1,079,910		
Mandatory Administrative Expenses	150,949		
Interest Expense	30,536		
Other Expenses, Net	42,278		
Total Funded Program Expenses		$2,571,400	
Funded Salaries and Administrative Expenses			
Salaries and Benefits	21,601		
Contractual Services	15,732		
Administrative Services	1,356		
Rent, Communications, and Utilities	3,761		
Equipment, Materials, and Supplies	776		
Interagency Agreements	644		
Total Funded Salaries and Administrative Expenses		43,870	
Total Funded Expenses		2,615,270	
Unfunded Program Expenses			
Provision for Defaults (Net of Collections and Reinsurance Fees)	780,508		
Provision for Interest Rate Subsidies (Net of Loan Origination Fees)	508,272		
Mandatory Administrative Expenses	$ 39,828		
Total Unfunded Program Expenses		1,328,608	
Unfunded Salaries and Administrative Expenses			
Compensated Leave Expense		55	
Total Unfunded Expenses		$1,328,663	
Total Expenses			3,943,933
Net Operating Activity Before Extraordinary Item and Appropriations			(1,792,758)
Extraordinary Item			
Transfer to Treasury			(2,120,639)
Net Operating Activity Before Appropriations			($3,913,397)

The accompanying notes are an integral part of these financial statements.

Statement of Changes in Net Position

For the Fiscal Year Ended September 30, 1992
(Dollars in Thousands)

	Invested Capital	Future Funding Requirements	Total
Net Position, Beginning of Year	$41,671	($16,251,457)	($16,209,786)
Decrease in Advances to Guaranty Agencies	(868)	868	0
Appropriations Received		7,936,353	7,936,353
Appropriations Returned		(598,308)	(598,308)
Net Operating Activity		(3,913,397)	(3,913,397)
Net Position, End of Year	$40,803	($12,825,941)	($12,785,138)

The accompanying notes are an integral part of these financial statements.

Statement of Cash Flows

For the Fiscal Year Ended September 30, 1992
(Dollars in Thousands)

CASH PROVIDED (USED) BY OPERATING ACTIVITIES:	
Cash Provided	
Default Claim Principal and Interest Collected	$1,124,860
Default and Bankruptcy Overpayments Refunded	269,709
Interest Benefit Overpayments Refunded	15,109
Special Allowance Overpayments Refunded	1,888
Administrative Cost Allowances Refunded	4,884
Administrative Charges	2,603
Origination Fees	422,362
Reinsurance Fees	49,330
Penalty Fees	43
Collections on Advances to Guaranty Agencies	1,745
Interest Income	30,536
Other Operating Cash Provided	15,848
Total Operating Cash Provided	1,938,917
Cash Used	
Default Claim Payments (Principally to Guaranty Agencies)	(2,948,916)
Death, Disability, and Bankruptcy Payments (Principally to Guaranty Agencies)	(176,536)
Interest Subsidy Payments	(1,763,962)
Special Allowance Payments	(225,481)
Guaranty Agency Collection Fees	(147,007)
Mandatory Administrative Expenses	(162,985)
Salaries and Administrative Expenses	(43,953)
Other Operating Cash Used	(37,166)
Total Operating Cash Used	(5,506,006)
Net Cash Provided (Used) By Operating Activities	(3,567,089)
CASH PROVIDED (USED) BY FINANCING ACTIVITIES:	
Appropriations Received	7,936,353
Appropriations Returned	(598,308)
Borrowing from U.S. Treasury	2,090,103
Funds Transferred to Treasury	(2,120,639)
Net Cash Provided (Used) By Financing Activities	7,307,509
Net Increase (Decrease) in Cash	3,740,420
Fund Balances with U.S. Treasury, Beginning of Year	283,231
Fund Balances with U.S. Treasury, End of Year	$4,023,651

The accompanying notes are an integral part of these financial statements.

RECONCILIATION OF NET OPERATING ACTIVITY BEFORE APPROPRIATIONS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITITES

Net Operating Activity		($3,913,397)
Adjustments to Reconcile Net Operating Activity to Net Cash Provided (Used) By Operating Activities		
Decrease in Advances to Guaranty Agencies, Net	$ 868	
Increase in Accounts Receivable, Net	(14,013)	
Decrease in Liabilities for Loan Guarantees	(2,789,308)	
Increase in Due to U.S. Treasury	1,057,960	
Increase in Accrued Salaries	643	
Increase in Borrowing from U.S. Treasury	2,090,103	
Increase in Accrued Compensated Leave	$ 55	
Net Adjustments		346,308
Net Cash Provided (Used) By Operating Activities		($3,567,089)

The accompanying notes are an integral part of these financial statements.

Statement of Budgetary Outlays and Actual Expenses

For the Fiscal Year Ended September 30, 1992
(Dollars in Thousands)

RELATION OF EXPENSES TO OUTLAYS		
Ordinary Expenses	$3,943,933	
Extraordinary Item	2,120,639	
Total Expenses and Extraordinary Item		$6,064,572
Adjustments to Reconcile Total Expenses and Extraordinary Item to Budgetary Outlays, Net		
Budgetary Outlays Previously Expensed (Principally Default Claims and Interest Subsidy Payments)		4,963,855
Expenses Not Outlayed		
Extraordinary Item	(2,120,639)	
Transfers Due to HEA Amendments of 1992	(57,149)	
Unfunded Liabilities (Principally Default Claims and Interest Subsidy Payments)	(1,328,663)	
Obligated Balance Not Transferred to the Financing Account by Fiscal Year-end	(915,351)	
Other Expenses Not Outlayed	$ (13,111)	
Total Expenses Not Outlayed		(4,434,913)
Budgetary Outlays, Gross		6,593,514
Less: Reimbursements		(3,339,866)
Budgetary Outlays, Net		$3,253,648
RELATION OF OBLIGATIONS TO OUTLAYS		
Obligations Incurred, Current Year		$7,566,516
Recoveries of Prior Year Obligations		(102,098)
Change in Unpaid Obligations		(870,904)
Budgetary Outlays, Gross		6,593,514
Less: Reimbursements		(3,339,866)
Budgetary Outlays, Net		$3,253,648

The accompanying notes are an integral part of these financial statements.

Notes to the Principal Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These financial statements have been prepared to report the financial position, results of operations, changes in net position, cash flows, and budgetary outlays and actual expenses of the Department of Education's (Education) Federal Family Education Loan (FFEL) Program, as required by the Chief Financial Officers Act of 1990 (Public Law 101-576). They have been prepared by Education from the books and records of the FFEL Program in accordance with Office of Management and Budget (OMB) Bulletin 93-02, Form and Content of Agency Financial Statements and FFEL Program's accounting policies, which are summarized in this note. These statements are therefore different from the financial reports, also prepared by Education for the FFEL Program pursuant to OMB directives, that are used to monitor and control the FFEL Program's use of budgetary resources.

OMB approved the following deviations from OMB Bulletin 93-02 in the FFEL Program's Principal Statements:

(1) The Statement of Operations Before Appropriations uses the format suggested in the Governmental Accounting Standards Board's Codification of Governmental Accounting and Financial Reporting Standards, which identifies a separate disclosure for the total effects of operations, exclusive of appropriations or intra-governmental funding sources.

(2) The Statements of Operations Before Appropriations and Changes in Net Position are presented as separate statements in accordance with the theory and logic of the Accounting Principles Board in its Statement #9, Reporting the Results of Operations.

(3) The Statement of Budgetary Outlays and Actual Expenses is in a format that Education has found more useful than what is presented in Bulletin 93-02.

Reporting Entity

The FFEL Program, formerly known as the Guaranteed Student Loan Program, is a program of the United States Department of Education (appropriation symbols 91X0230 and 91X0231). The FFEL Program was authorized by the Higher Education Act of 1965, as amended (HEA). As currently authorized, the program operates through state and private nonprofit guaranty agencies to provide insurance and interest supplements on loans to eligible students attending participating postsecondary schools. The program uses private loan capital, supplied almost exclusively by commercial lenders, but in some instances by state agencies and schools. Loans disbursed under the program are guaranteed by guaranty agencies and reinsured by the Federal government.

There are four FFEL Program components:

(1) Federal Stafford Loans - under this component loans are made to undergraduate and graduate students. The Federal government pays the loan interest while the student is in school and during certain grace and deferment periods;

(2) Federal Supplemental Loans to Students (SLS) - under this component loans are made to independent undergraduate and graduate students. These loans do not have interest subsidies for borrowers;

(3) Federal Parent Loans for Undergraduate Students (PLUS) - under this component loans are made to parents of dependent students. These loans also do not have interest subsidies for borrowers; and

(4) Federal Consolidated Loans - under this component borrowers may have their FFEL Program obligations consolidated and their repayment schedules extended. Loans made under the Perkins and Health Professions Student Loan programs may also be consolidated under this component.

Each component has its own eligibility requirements and loan limits. A fifth component, Unsubsidized Federal Stafford Loans, was authorized by the HEA Amendments of 1992 (Public Law 102-325). The FFEL Program did not guarantee any Unsubsidized Federal Stafford Loans in fiscal year 1992. The majority of loans guaranteed in fiscal year 1992 were Federal Stafford Loans (approximately 76 percent). The accompanying Principal Statements of the FFEL Program include the accounts of all components of the program. The Principal Statements do not include the effects of centrally administered assets and liabilities related to the Federal government as a whole, such as borrowings by the U.S. Treasury which may, in part, be attributable to the FFEL Program.

Basis of Accounting

Transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and control over the use of Federal funds. The differences between the accrual basis recognition of expenses and the budgetary basis recognition of outlays are presented in the Statement of Budgetary Outlays and Actual Expenses. For the purposes of this statement, Obligations Incurred represents liabilities for loan guarantees that will require payments from previous, current, or future period appropriations. Reimbursements include sums received for origination fees, reinsurance fees, collections on defaulted loans, and certain transfers from the Financing Account. Additionally, in accordance with the Federal Credit Reform Act of 1990 (Public Law 101-508), the estimated subsidy costs of loans guaranteed and disbursed in the fiscal year is included in budgetary outlays.

Budgets and Budgetary Accounting

The FFEL Program is an entitlement program. Budget authority (i.e. the ability to incur obligations) for the program is derived from the HEA. The Federal administrative costs to operate the FFEL Program are discretionary and the budget authority for these costs is derived from the appropriations acts. There are two budget accounts for the FFEL Program corresponding to the requirements of the Federal Credit Reform Act of 1990: (1) a Liquidating Account to account for all cash flows, including appropriations, to and from the program resulting from loan guarantee commitments made prior to fiscal year 1992 (pre-1992 loans); and (2) a Program Account to account for budgetary commitments made in fiscal year 1992 and thereafter (post-1991 loans). The Program Account also includes administrative expenses consisting of Federal administrative costs (i.e. salaries and overhead expenses) and mandatory administrative costs (i.e. contract collection costs, supplemental preclaims assistance, and administrative cost allowances). The Program Account will receive an appropriation equal to the estimated net present value of all subsidy costs (primarily interest subsidies and loan defaults) for loans guaranteed in each fiscal year beginning in fiscal year 1992. The FFEL Program will earn interest on the uninvested balance of these funds to make future subsidy payments on the related guarantees. In addition to the budgetary accounts, the FFEL Program has a non-budgetary account called the Financing Account, which holds cash balances, receives the subsidy payments from the Program Account, and includes other cash flows to and from the FFEL Program. Interest on uninvested funds is recorded in the Financing Account. Disbursements from the Financing Account are not reflected in the budgetary accounts displayed on the Statement of Budgetary Outlays and Actual Expenses.

Financing Sources and Program Revenues

The FFEL Program receives the majority of the funding needed to support the program through appropriations. The FFEL Program is funded primarily by two appropriations: (1) an appropriation for its Liquidating Account (appropriation symbol 91X0230), and (2) an appropriation for its Program Account (appropriation symbol 91X0231).

The FFEL Program recognized program revenues during fiscal year 1992 for estimated future collections on defaulted loans resulting from enacted legislation. This legislation, the Emergency Unemployment Compensation Act of 1991 (Public Law 102-164) and the Higher Education Amendments of 1992, authorized collections on defaulted loans through offsets to borrowers' IRS tax refunds and wage garnishments and eliminated previously imposed time limitations on the collection period. In addition, under the Federal Credit Reform Act, the FFEL Program receives interest income on uninvested funds in the Financing Account.

Fund Balances With U.S.Treasury

The FFEL Program does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. The Fund Balances with U.S. Treasury are primarily appropriated funds that are available to pay current liabilities and finance subsidy expenses for post-1991 loans.

Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by the FFEL Program as the result of a transaction or event that has already occurred. However, no liability can be paid by the FFEL Program absent an appropriation. Liabilities for which an appropriation has not been enacted are therefore classified as unfunded liabilities. Funding for these liabilities will be provided by future collections and the use of a permanent indefinite appropriation provided by the Federal Credit Reform Act. Unfunded liabilities are principally the estimated future costs of loans guaranteed prior to fiscal year 1992. Under the Federal Credit Reform Act estimated subsidy costs for post-1991 loans will be funded in the year the loans are guaranteed. If these estimates are later adjusted, any additional liability will be funded through future collections and the use of a permanent indefinite appropriation. The majority of the FFEL Program's liabilities are considered entitlements and therefore the program is required to pay these liabilities if all eligibility requirements are met. Any non-entitlement liabilities of the FFEL Program, such as Federal administrative costs, not arising from contracts, and entitlements not yet vested, can be abrogated by the government acting in its sovereign capacity.

Under the FFEL Program's accounting policies, liabilities for loan guarantees include provisions for payment of loan defaults, interest and special allowance benefits, mandatory administrative expenses (administrative cost allowances, supplemental preclaims assistance, and contract collection costs) and interest expense. The liabilities are offset by estimated future collections on loans that default and loan origination and reinsurance fees paid by lenders and guaranty agencies.

In addition, a distinction is made between short-term and long-term liabilities. A short-term liability is anticipated to be paid within one year, whereas a long-term liability is anticipated to be paid beyond one year of the balance sheet date.

Annual, Sick, and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of nonvested leave are expensed as taken.

Retirement Plan

FFEL Program employees participate in one of two retirement plans. The first plan is the Civil Service Retirement System (CSRS), to which the FFEL Program makes matching contributions equal to seven percent of pay. The second plan, the Federal Employees Retirement System (FERS), became effective on January 1, 1987, pursuant to Public Law 99-335. Employees hired prior to January 1, 1984, can elect to join either FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to FFEL Program employees, which automatically contributes one percent of pay and matches any employee contribution up to an additional four percent of pay. In addition, for employees covered under FERS, the FFEL Program also contributes the employer's matching share for Social Security. The FFEL Program does not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management.

Comparative Data

Comparative data for the prior year have not been presented because this is the first year for which financial statements are issued for FFEL Program activities. In future years, comparative data will be presented in order to provide an understanding of changes in the financial position and operations of the FFEL Program.

NOTE 2 - ADVANCES TO GUARANTY AGENCIES, NET

Advances to guaranty agencies represent amounts advanced to guaranty agencies under sections 422(a) and 422(c) of the HEA for commencement of agency operations and making loan default payments to lenders. The balance as of September 30, 1992, was (in thousands):

Advances to Guaranty Agencies	$41,215
Allowance for Doubtful Accounts	(412)
Advances to Guaranty Agencies, Net	$40,803

NOTE 3 - LIABILITIES FOR LOAN GUARANTEES

The estimated costs of pre-1992 loans are reported primarily as unfunded liabilities for loan guarantees. Post-1991 loans are governed by the Federal Credit Reform Act. That Act provides that the net present value of the subsidy costs (i.e. interest rate differentials, interest subsidies, defaults, fee offsets, and other cash flows) associated with loan guarantees be recognized as a cost in the year the loan guarantee is made for both accounting and budgetary purposes.

Liabilities for loan guarantees at September 30, 1992, were (in thousands):

SHORT-TERM LIABILITY	Pre-1992 Loans	Post-1991 Loans	Total Liability
Loan Defaults Payable	$2,961,089	$ 259,324	$ 3,220,413
Interest & Special Allowance Benefits Payable	1,263,000	781,758	2,044,758
Mandatory Administrative Costs Payable	45,522	3,266	48,788
Interest Payable	- 0 -	30,536	30,536
Collections on Defaulted Loans Receivable	(736,970)	(3,085)	(740,055)
Fees Receivable	- 0 -	(177,066)	(177,066)
Subtotal, Short-Term	$3,532,641	$ 894,733	$ 4,427,374
LONG-TERM LIABILITY			
Loan Defaults Payable	$4,888,062	$2,478,530	$ 7,366,592
Interest & Special Allowance Benefits Payable	2,373,410	1,044,307	3,417,717
Mandatory Administrative Costs Payable	292,387	41,081	333,468
Collections on Defaulted Loans Receivable	(1,189,927)	(640,616)	(1,830,543)
Subtotal, Long-Term	$6,363,932	$2,923,302	$ 9,287,234
TOTAL LIABILITY	$9,896,573	$3,818,035	$13,714,608

A distinction is made in the FFEL Program's Principal Statements between funded and unfunded liabilities. The total liability for loan guarantees at September 30, 1992, was (in thousands):

	Short-Term	Long-Term	Total Liability
Funded Liabilities	$1,430,743	$1,549,846	$ 2,980,589
Unfunded Liabilities	2,996,631	7,737,388	10,734,019
Total Liability	$4,427,374	$9,287,234	$13,714,608

Education estimates that the outstanding balance of guaranteed loans was $63 billion at September 30, 1992. Additionally, the outstanding balance of defaulted loans at September 30, 1992, was about $12 billion.

The subsidy expense for loans guaranteed in fiscal year 1992 was (in thousands):

	Funded	Unfunded	Total Expense
Provision for Defaults			
Loan Defaults	$1,957,572	$ 780,508	$2,738,080
Collections	(643,701)	- 0 -	(643,701)
Reinsurance Fees	(46,144)	- 0 -	(46,144)
Subtotal, Provision for Defaults	1,267,727	780,508	2,048,235
Provision for Interest Rate Subsidies			
Interest & Special Allowance Benefits	1,544,373	508,272	2,052,645
Origination Fees	(464,463)	- 0 -	(464,463)
Subtotal, Provision for Interest Rate Subsidies	1,079,910	508,272	1,588,182
Mandatory Administrative Expenses	150,949	39,828	190,777
Interest Expense	30,536	- 0 -	30,536
Total Subsidy Expense	$2,529,122	$1,328,608	$3,857,730

NOTE 4 - DUE TO U.S. TREASURY

During its fiscal year 1992 mid-session review of the FFEL Program's subsidy costs, Education concluded that $1.058 billion of funds drawn from the appropriation for the Program Account would not be needed. Accordingly, these amounts are included in the Principal Statements as Due to U.S. Treasury.

NOTE 5 - BORROWING FROM U.S. TREASURY

On September 30, 1992, the FFEL Program borrowed $2.09 billion from the U.S. Treasury in accordance with OMB instructions under the Federal Credit Reform Act on accounting for noncontractual modifications made to its loan guarantees. The FFEL Program will repay the borrowing with collections on defaulted loans resulting from the noncontractual modifications. These collections are expected to occur over the next 13 years. The aggregate maturities of this debt, based on estimated collections on defaulted loans, for each of the five years subsequent to September 30, 1992 and thereafter, are as follows (in thousands): 1993 - $83,006; 1994 - $489,647; 1995 - $444,819; 1996 - $378,097; 1997 - $246,852; and 1998 to 2005 - $447,852. Interest on the borrowing is paid annually at 7.37 percent. (Also see Note 8, Extraordinary Item.)

NOTE 6 - NET POSITION

The FFEL Program's Net Position, at September 30, 1992, included:

Invested Capital - which are amounts advanced to guaranty agencies under sections 422(a) and 422(c) of the HEA for commencement of agency operations and making loan default payments to lenders.

Future Funding Requirements - which is the net amount of financial resources that will be required in the future to liquidate unfunded liabilities. This amount is reported in the Statement of Financial Position as an offset to net position.

NOTE 7 - APPROPRIATIONS RECEIVED

In fiscal year 1992 the FFEL Program received appropriations of $4.226 billion for the Liquidating Account to pay the costs of pre-1992 loans. It also received appropriations of $3.71 billion for the Program Account to pay the costs of post-1991 loans.

NOTE 8 - EXTRAORDINARY ITEM

In fiscal year 1992, the FFEL Program incurred an extraordinary item associated with legislation, which extended unemployment benefits and enhanced Education's collection authority. The Emergency Unemployment Compensation Act of 1991 and the Higher Education Amendments of 1992, contained noncontractual modifications to the program's guarantees. A noncontractual modification is legislation that changes costs to loan programs without changing the terms of contracts under those programs. The modifications referred to above were as follows:

- The Emergency Unemployment Compensation Act of 1991 - authorized Education to continue collecting on defaulted loans through the Internal Revenue Service (offsetting income tax refunds). Authority to collect on defaulted loans by offsetting tax refunds was due to expire in fiscal year 1994. The act also authorized the use of wage garnishment as a collection tool for defaulted student loans.

- The Higher Education Amendments of 1992 - eliminated statute of limitations previously applicable to certain student loans.

The net present value of funds Education expects to collect on defaulted loans because of these modifications is $2.121 billion. This amount was used for purposes of the Budget Enforcement Act of 1990 (P.L. 101-508) to offset the cost of extending unemployment benefits. However, no monies available for the FFEL Program were actually used to pay unemployment compensation.

Consistent with the Federal Credit Reform Act and OMB's implementing instructions, Education executed a series of transactions to account for the expected future savings from the noncontractual modifications. The FFEL Program Financing Account borrowed $2.09 billion from the U.S. Treasury (also see Note 5, Borrowing from U.S. Treasury). These borrowed funds and $31 million in interest earnings (on funds appropriated to pay subsidy costs associated with fiscal year 1992 loan guarantees) were then transferred to the FFEL Program Liquidating Account and subsequently to Treasury for a total transfer of $2.121 billion. These funds were recognized in the fiscal year 1992 Statement of Operations Before Appropriations as a program revenue and an Extraordinary Item, and in the Statement of Financial Position as of September 30, 1992, as a reduction to liabilities for loan guarantees and as a borrowing from U.S. Treasury.

NOTE 9 - HEA CREATED COSTS

The Higher Education Amendments of 1992 resulted in additional costs for current loans. These costs included guaranty agency cash reserve repayments ($8 million) and increased costs for bankruptcy claims for pre-1992 loans ($49 million). These costs are included as a component of Other Expenses, Net, in the Statement of Operations Before Appropriations.

NOTE 10 - COMMITMENTS AND CONTINGENCIES

Guaranty Agency Reserve Funds

Education was committed to guaranteeing approximately $63 billion of loans outstanding at September 30, 1992. These loans are held by about 8,000 lenders who have been guaranteed reimbursement of defaults by the guaranty agencies participating in the program. In turn, guaranty agencies usually receive 100 percent reimbursement from Education on their default claims paid to lenders. Revenues received and reserve funds held by these guaranty agencies related to their FFEL Program activities are considered Federal in nature and can only be used for expenses related to the FFEL Program. Reserve funds held by guaranty agencies at September 30, 1992 were about $1.3 billion. These reserve funds have not been included in the Principal Statements of the FFEL Program.

Financial Difficulties of Guaranty Agencies

On October 31, 1990, Education entered into agreements with the Student Loan Marketing Association (SLMA, also known as Sallie Mae) to wind down the operations of the Higher Education Assistance Foundation (HEAF), the largest guaranty agency participating in the FFEL Program at that time. HEAF was essentially financially insolvent and was unable to pay default claims owed by lenders. Under the agreements, SLMA agreed to manage HEAF's wind down over a three year period ending on December 31, 1993. SLMA is responsible for disbanding HEAF and distributing its outstanding guarantees to other guaranty agencies. Education allowed HEAF to retain the full amount of collections on defaulted loans during the three year period and agreed to pay HEAF 100 percent reinsurance without regard to default rate. At December 31, 1993, the majority of HEAF's net cash assets (minus a small reserve fund to pay contingent liabilities) will be returned to Education. Education estimates that $200 million will be returned at that time. Loan guarantees not distributed to other guaranty agencies by December 31, 1993, will be managed by SLMA. SLMA will be responsible for all costs associated with managing this portfolio except for default claims. Education will continue to pay the applicable reinsurance for default claims on these guarantees. These defaults will immediately be assigned to Education for collection. The net cost of loan defaults guaranteed by HEAF are included in the FFEL Program's liabilities for loan guarantees.

In addition, Education assisted guaranty agencies experiencing financial difficulties through advancement of funds and other means. No provision has been made in the Principal Statements for potential liabilities related to financial difficulties of guaranty agencies, because the likelihood of these liabilities occurring is uncertain and cannot be estimated with sufficient reliability.

SLMA Debt Obligations

The Higher Education Act of 1965, as amended, authorized Education to guarantee payment of principal and interest on certain SLMA debt obligations issued by the U.S. Treasury prior to October 1, 1984. It also provides Education with borrowing authority and further authorizes appropriations, as necessary, for repayment of funds borrowed in discharging the guarantee obligation. SLMA is a shareholder-owned corporation chartered by Congress in the Education Amendments of 1972 (Public Law 92-318) to expand funds available for student loans by purchasing student loans and thus providing liquidity to lenders originating such loans. SLMA's outstanding loans were consolidated into one loan of $5 billion in 1982. Loan principal payments of $30 million are made on an annual basis with a $4.3 billion balloon payment due in 1996 and a final $400 million payment in 1997. The floating rate notes bear interest at 0.125 percentage points above the average rate of the weekly 91-day Treasury bill auctions. The outstanding principal balance of SLMA's debt obligation at September 30, 1992, is $4.8 billion. It is not anticipated that any loss will result to the FFEL Program from the guarantee of this debt.

Borrower Class Actions

Education is involved in pending litigation challenging the enforceability of FFEL Program loans made to students who attended various trade schools that have closed. In most instances, a large percentage of the loans in question are in default and have been acquired by guaranty agencies and reimbursed by Education. Thus, Education has already incurred losses from payment of defaults. No provision has been made in the Principal Statements for any potential reductions in estimated future collections related to the outcome of these suits, since Education's potential loss exposure is uncertain and cannot be estimated with sufficient reliability.

Federal Direct Student Loan Program

The Administration, as part of its overall postsecondary education policy initiatives, has proposed replacing this program with a Federal Direct Student Loan Program beginning in fiscal year 1994. The proposed legislation ensures adequate financing for the current guaranty agencies during the transition and provides for alternative mechanisms to assure loan guarantees in the event that any of the guaranty agencies do not continue to operate. Since such legislation has not been enacted, no provision has been included in the accompanying Principal Statements for Education's cost of transitioning loans outstanding at September 30, 1992.

Other Matters

Education is involved in various other claims and legal actions related to the FFEL Program arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Principal Statements of the FFEL Program.

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