

February 1996

FINANCIAL AUDIT

Federal Family Education Loan Program's Financial Statements for Fiscal Years 1994 and 1993





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

Comptroller General
of the United States

B-258863

February 26, 1996

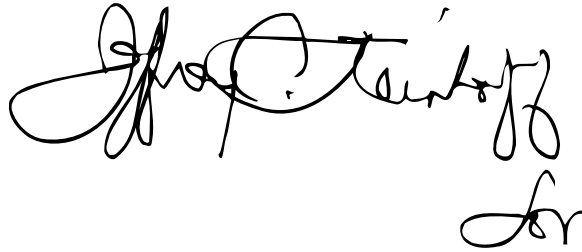
To the President of the Senate and the
Speaker of the House of Representatives

This report presents the result of our review of the Department of Education's Office of Inspector General's (OIG) financial audit of the Federal Family Education Loan Program's (FFELP) Principal Financial Statements and its internal controls and compliance with laws and regulations for the fiscal year ended September 30, 1994. We conducted our review pursuant to section 432(b) of the Higher Education Act of 1965, as amended (20 U.S.C. 1082(b)).

This is the third year the FFELP's Principal Financial Statements were prepared. The OIG was unable to express an opinion on the financial statements taken as a whole because student loan data on which Education based its costs to be incurred on outstanding guaranteed loans (referred to as liabilities for loan guarantees), was not reliable. In addition, the OIG continued to report material weaknesses in internal controls related to determining FFELP's liabilities for loan guarantees and related program costs, effectively monitoring payments to guaranty agencies and lenders, and ensuring accurate financial reporting. Although internal control weaknesses persisted during fiscal year 1994, Education has been working towards correcting these weaknesses. We reviewed the work of the OIG and concur with its reports.

We are sending copies of this report to the Secretary of Education, the Inspector General, and other Department officials. We are also sending copies to the Director of the Office of Management and Budget, the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight, and other interested congressional committees. Copies will be made available to others upon request.

This report was prepared under the direction of Lisa G. Jacobson, Director, Accounting and Information Management Division, who may be reached at (202) 512-9095.

A handwritten signature in black ink, appearing to read "Charles A. Bowsher". The signature is written in a cursive style with a large initial "C" and "A". Below the main signature, there are two smaller, stylized initials, possibly "CB".

Charles A. Bowsher
Comptroller General
of the United States

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Abbreviations

EDCAPS	Education's Central Automated Processing System
FFELP	Federal Family Education Loan Program
NSLDS	National Student Loan Data System
OIG	Office of Inspector General

**Comptroller General
of the United States**

B-258863

To the Secretary of Education

Legislation¹ requires the Department of Education to prepare annual financial statements for the Federal Family Education Loan Program (FFELP) and requires the Comptroller General and Education's Inspector General to audit these statements. Fiscal year 1994 was the third year that FFELP's Principal Financial Statements were prepared, and data reliability problems continued to preclude the auditors from rendering an opinion on three of the four statements. Although internal control weaknesses persisted during fiscal year 1994, Education has been working towards correcting these weaknesses.

Education's Office of Inspector General (OIG) was required to audit the FFELP Principal Financial Statements for the fiscal year ended September 30, 1994, and issued its report dated May 8, 1995.² (See appendix I.) For fiscal year 1993, we worked with the OIG in an effort to audit these statements and jointly issued a report dated May 20, 1994.³ The joint report covering fiscal year 1993 did not include an opinion on the Statement of Financial Position, Statement of Operations and Changes in Net Position, and Statement of Budgetary Resources and Actual Expenses because the student loan data on which Education based its costs to be incurred on outstanding guaranteed loans (referred to as liabilities for loan guarantees) was not reliable. We were able to determine, through detailed audit procedures, that the fiscal year 1993 Statement of Cash Flows presented fairly the cash actually received and disbursed by FFELP. However, because of the material internal control weaknesses identified, we could not determine if the cash Education received or disbursed was all that it should have.

For fiscal year 1994, the OIG was unable to express an opinion on the financial statements taken as a whole because of the previously reported data reliability problems.⁴ We concur with the OIG's disclaimer of opinion. Further, we also concur with the OIG that the fiscal year 1994 Statement of Cash Flows presents fairly, in all material respects, the cash actually

¹Section 3515 and 3521 of title 31, United States Code, and section 432(b) of the Higher Education Act of 1965, as amended (20 U.S.C. 1082(b)).

²Financial Statement Audit: U.S. Department of Education Federal Family Education Loan Program for the Years Ended September 30, 1994 and 1993 (ACN 17-40302).

³Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Years 1993 and 1992 (GAO/AIMD-94-131, June 30, 1994).

⁴See footnote 3 and Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Year 1992 (GAO/AIMD-93-4, June 30, 1993).

received and disbursed by FFELP. However, because of the material internal control weaknesses identified, the OIG could not determine if the cash Education received or disbursed was all that it should have.

For fiscal year 1994, the OIG reported that material weaknesses in FFELP's internal control structure existed. These material weaknesses, which were previously reported, relate to determining FFELP's liabilities for loan guarantees and related program costs, effectively monitoring payments to guaranty agencies and lenders, and ensuring accurate financial reporting.⁵ We concur with the OIG's findings. As part of a financial audit, the OIG is not required to and therefore did not express an opinion on internal controls. However, the above material weaknesses resulted in ineffective controls over safeguarding assets and assuring that there were no material misstatements in FFELP's Principal Financial Statements.

The OIG also reported that improvements in Education's policies and procedures related to cash reconciliations, loan receivables, and controls over an information subsystem were needed. We agree with the OIG's assessment and related recommendations in these areas.

Further, we concur with the OIG that with respect to the items tested, FFELP complied in all material respects with the provisions of laws and regulations tested. However, since such tests were limited to selected provisions of laws and regulations, this conclusion does not represent an overall opinion on compliance with laws and regulations for fiscal year 1994.

For fiscal year 1994, the OIG also reviewed the financial information in management's Overview of the Reporting Entity and did not report any material inconsistencies with the Principal Financial Statements. However, as noted by the OIG, this information was generally derived from the same sources as the information presented in the Principal Financial Statements. Consequently, we believe that because of ineffective internal controls and unreliable student loan data, the reliability of information presented in the Overview of the Reporting Entity cannot be reasonably determined.

Background

FFELP, established in 1965 and formerly known as the Guaranteed Student Loan Program, is the largest postsecondary education loan program of the federal government. Its primary mission is to increase postsecondary

⁵See footnote 4.

education opportunities for eligible students who otherwise may not be able to further their education. As of September 30, 1994, Education reported an estimated \$77 billion in outstanding loan guarantees, about \$23 billion of which was guaranteed in fiscal year 1994 alone.

Objectives, Scope, and Methodology

To meet our audit responsibility and to avoid duplication and unnecessary expense, we reviewed the OIG's work. To determine the reasonableness of the OIG's work and the extent to which we could rely on it, we

- reviewed the OIG's audit methodology and planning;
- evaluated the qualifications and independence of the OIG's audit staff;
- participated in tests of cash receipts and disbursements;
- reviewed the OIG's working papers to determine compliance with generally accepted government auditing standards and Office of Management and Budget (OMB) Bulletin 93-06 "Audit Requirements for Federal Financial Statements," including assessing the appropriateness of (1) the nature, timing, and extent of substantive tests performed, (2) the evaluation of the entity's internal controls, and (3) the testing of compliance with significant provisions of selected laws and regulations; and
- read the financial statements and the OIG's May 8, 1995, report to evaluate conformity with (1) the other comprehensive basis of accounting stated in note 2 and (2) OMB Bulletin 94-01, "Form and Content of Agency Financial Statements."

Our work was conducted from October 1994 through June 1995 in accordance with generally accepted government auditing standards.

Internal Control Weaknesses Persist but Some Corrective Actions Are in Progress

Consistent with prior GAO and OIG reports, the OIG concluded that

- FFELP's liabilities for loan guarantees and related program costs were primarily calculated using models which continued to be based on student loan data found to be unreliable;
- Education did not have systems or procedures in place during fiscal year 1994 to ensure that individual billing reports submitted by guaranty agencies and lenders were reasonable; and
- the financial reporting process⁶ did not ensure that financial statements and other management reports were reliable.

⁶The financial reporting process includes analyzing, evaluating, summarizing, reconciling, adjusting, and reclassifying information so that it may be reported to management and/or outsiders. Accounting and information systems supporting FFELP are an integral part of this process.

Education has made some progress in addressing these issues. It has begun implementing the National Student Loan Data System (NSLDS)—the first national database of loan-level data. According to the OIG, although NSLDS was not designed as a financial system, it could provide valuable information on characteristics of Education’s loan portfolio that would be useful in estimating program costs. However, as noted by the OIG, the usefulness of this data depends on its accuracy and validity. As a result, we agree with the OIG’s recommendation that Education needs to test the accuracy and validity of the loan data in NSLDS. Education is currently working with a contractor to identify and verify critical data items in NSLDS.

In March 1995, the OIG issued an audit guide requiring all lenders participating in FFELP to have an annual compliance audit by a nonfederal auditor. The purpose of these audits is to obtain auditor attestations regarding lenders’ assertions that their respective requests for payment of interest and special allowances are accurate, complete, properly classified and computed, and supported by adequate loan documents. Education will need to monitor implementation of the audit guide requirements to ensure that it receives those assurances regarding the accuracy of lenders’ billings.

Education is redesigning its current financial management systems into a newly integrated core financial system called Education’s Central Automated Processing System (EDCAPS). The Financial Management Systems Software module within EDCAPS will replace the current antiquated and inefficient general ledger system and is expected to directly produce the FFELP financial statements. This module is expected to be implemented in fiscal year 1997.

In addition, Education has initiated a task order with the FFELP information system contractor to develop permanent subsidiary ledgers supporting general ledger balances and to improve the interface between the FFELP subsidiary systems and the general ledger system. As reported by the OIG, one of the primary purposes of these improvements is to provide a detailed audit trail for all transactions posted from the subsidiary systems to the general ledger system. If successful, these initiatives should assist Education in addressing identified financial reporting problems.

We have separately reported on Education’s computer general controls over FFELP’s information system. We continued to find weaknesses in that

system's ability to adequately protect sensitive data files, applications programs, and systems software from unauthorized use.⁷ Effective computer general controls over FFELP's information system are critical to safeguarding assets, maintaining sensitive student loan data, and ensuring the reliability of financial management information. Education reported that it has acted to correct the weaknesses identified, such as implementing new security oversight procedures and working with the information system contractor to remedy access and software control problems. Future audits should determine the effectiveness of these and other corrective actions.

Status of Previous Recommendations

Education has made some progress in addressing prior years' recommendations. Of the 21 recommendations made during the past 2 years, 8 have been closed and action was in progress or planned for 11. Of the remaining 2, one requires congressional action and no specific action was planned for the other.⁸ Until corrective action is completed on all prior year recommendations, we continue to reaffirm open recommendations included in the OIG's report on FFELP's Principal Financial Statements for fiscal years 1994 and 1993. (These prior years' recommendations are reprinted on pp. 65 and 66 of this report.)

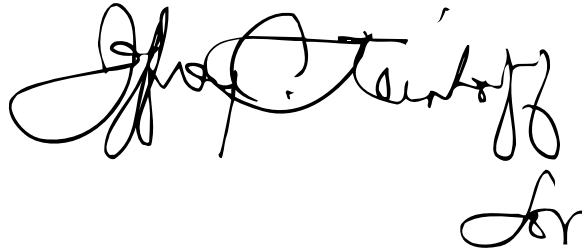
Agency Comments

Officials in Education's Office of the Chief Financial Officer and Office of Postsecondary Education reviewed a draft of this report and generally concurred with the conclusions. Their comments have been incorporated where appropriate. Consistent with their comment on the OIG's report, Education officials disagreed with the conclusion that unreliable loan data prevents them from reasonably estimating FFELP liability costs. They believe that the estimates of liabilities for loan guarantees and subsidy expenses are reasonable because prior years' estimates were consistent with actual cash flows. However, we agree with the OIG that there was insufficient reliable audit evidence to support management's estimate.

⁷Federal Family Education Loan Information System: Weak Computer Controls Increase Risk of Unauthorized Access to Sensitive Data (GAO/AIMD-95-117, June 12, 1995).

⁸No action was planned for the study of the feasibility of requiring guaranty agencies to standardize their FFELP loan accounting systems because Education believes that the role of the guaranty agencies is expected to be significantly phased down as a result of the Federal Direct Student Loan Program.

Education officials advised us that they are developing a methodology they believe will produce auditable and verifiable estimates of liabilities for loan guarantees and subsidy expenses.

A handwritten signature in black ink, appearing to read "Charles A. Bowsher". The signature is written in a cursive style with large, sweeping loops. Below the main signature, there are two smaller, separate cursive marks that look like "for".

Charles A. Bowsher
Comptroller General
of the United States

June 30, 1995

Education's OIG Report on FFELP Financial Statements for Fiscal Year 1994



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

May 31, 1995

Honorable Richard W. Riley
Secretary of Education
Washington, D.C. 20202

Dear Mr. Secretary:


This report presents the results of our audit of the Department of Education's Federal Family Education Loan Program (FFELP) principal financial statements for the fiscal years ended September 30, 1994 and 1993. This audit was required under the Chief Financial Officers Act of 1990.

The results of the audit were discussed with members of your staff throughout the audit. The Offices of the Chief Financial Officer and Postsecondary Education responded to the findings and recommendations presented in the draft audit report. Based on the response, management is in general agreement with the recommendations in the report. Management disagrees with our conclusion that unreliable loan data prevents the Department from reasonably estimating liability costs. The complete text of the combined response and our comments to it are included in Appendix II.

During the course of our audit, we identified other matters which are not reportable but nevertheless warrant management's attention. These are being communicated in a separate letter for management's consideration.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

We appreciate the cooperation given us in the audit.


Steven A. McNamara
Assistant Inspector General
for Audit

Enclosure

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.

**Appendix I
Education's OIG Report on FFELP Financial
Statements for Fiscal Year 1994**

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HIGHLIGHTS OF RESULTS

Requirement	<p>In accordance with the Chief Financial Officers Act of 1990, we were required to audit the accompanying principal financial statements of the United States Department of Education's Federal Family Education Loan Program (FFELP) for the fiscal years ended September 30, 1994 and 1993. Last year, the General Accounting Office and the Office of Inspector General jointly performed the audit of the fiscal year 1993 financial statements.</p>
Inspector General's Report on Financial Statements	<p>The FFELP's liabilities for loan guarantees as of September 30, 1994 and 1993 were primarily calculated using models which were based upon unreliable student loan data. Because we were unable to perform procedures to satisfy ourselves as to the valuation of these liabilities and the related subsidy costs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the principal financial statements taken as a whole.</p> <p>We determined, through detailed procedures, that the statements of cash flows for the fiscal years ending September 30, 1994 and 1993, state fairly the cash actually received and disbursed by FFELP, in conformity with the basis of accounting described in Note 2. Because of material internal control weaknesses, however, we were unable to determine if the Department received or disbursed the proper amounts.</p>
Inspector General's Report on Internal Controls	<p>In planning and performing the audit of the principal financial statements of FFELP for the fiscal year ended September 30, 1994, we considered its internal control structure in order to determine the auditing procedures for the purpose of expressing an opinion on the principal financial statements and not to provide assurance on the internal control structure.</p> <p>The report on internal control structure disclosed conditions existing during fiscal year 1994 which we considered to be material weaknesses. These are the same material weaknesses reported as part of the 1993 and 1992 financial audits. Corrective actions completed and outstanding from previous financial audits are indicated in Appendix I.</p>

Appendix I
Education's OIG Report on FFELP Financial
Statements for Fiscal Year 1994

<i>Unreliable Loan Data</i>	FFELP's estimated liabilities for loan guarantees and related program costs continue to be based on unreliable historical loan data.
<i>Verification of Billings</i>	Improvements are necessary to ensure billings from lenders and guaranty agencies are reasonable. Lender and guaranty agency billings have not been adequately verified for accuracy and completeness.
<i>Financial Reporting Process Capability</i>	<p>Improvements are necessary to enhance the Department's financial management process to ensure that the financial statements and other management reports are reliable. Previously reported problems still exist with the Department's general ledger, FFELP's subsidiary ledgers and in FFELP's operation of the general controls over the information and accounting systems. We also noted two additional areas, cash reconciliations and loans receivable, where the Department could make improvements to financial management policies and procedures.</p> <p>Our recommendations to address these weaknesses are provided on page 14. The Department has already put forth substantial efforts and made progress in correcting these problem areas and we encourage their continued efforts until the recommendations are fully implemented.</p>
Inspector General's Report on Compliance with Laws and Regulations	FFELP complied, in all material respects, with provisions of laws and regulations which we tested. With respect to items not tested, nothing came to our attention that caused us to believe that FFELP had not complied, in all material respects, with those provisions.
Department's Comments and OIG Response	Management is in general agreement with the recommendations in the report. Management disagrees with our conclusion that unreliable loan data prevents the Department from estimating liability costs. The complete text of the Department's comments and our response is included in Appendix II.

