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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON REGIONAL OFFICE  
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FALLS CHURCH, VIRGINIA 22046

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22 SEP 1977

Ms. Mary Jane Calais  
Acting Associate Commissioner  
Office of Guaranteed Student Loans  
Office of Education  
Department of Health, Education, and Welfare

Dear Ms. Calais:

We have completed our review of the financial statements of the Guaranteed Student Loan Fund (Fund) for the fiscal year ended June 30, 1976, and the transition quarter ended September 30, 1976. A congressional report will not be issued until we complete the fiscal year 1977 audit. That report will present the results of our examinations of the Guaranteed Student Loan Fund financial statements for fiscal years 1976 and 1977.

Enclosure I presents certain matters we have identified in this and prior years, which in our view require management attention. While we recognize that action on some matters must await installation of the new management information system, we urge that action be taken now where possible. As you know, many needed improvements in the Fund's operations are closely associated with the system's implementation.

Considering the results of the audit just completed, we anticipate our opinion on the Fund's fiscal years 1976 and 1977 statements will again be adverse. An overall conclusion based on this and prior years' audit work is that the Fund's automated records do not provide reliable information to administer the program nor necessary, detailed accounting records adequate to support the financial statements.

Our report to the Secretary of Health, Education, and Welfare, 'Collection Efforts, Not Keeping Pace with Growing Number of Defaulted Student Loans,' B-117604 issued August 11, 1977, contains recommendations which are also pertinent to the Guaranteed Student Loan Fund's financial statements. Specifically improved collection procedures to process defaulted student loans to collection, referral for legal action, or

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termination would materially improve the reliability of the defaulted loans receivable and accrued interest receivable accounts by removing known uncollectable amounts from these accounts.

We would appreciate being advised of any actions taken in response to the recommendations presented in the enclosure. We would be happy to meet with you to discuss these matters. We also would like to express our appreciation for the many courtesies extended to the staff during the audit

Sincerely yours,



David P. Sorando  
Regional Manager

Enclosure

NEED TO MAINTAIN SUBSIDIARY RECORDS

Maintaining subsidiary ledgers and balancing the totals of these ledgers to control account balances is essential for good internal control. Recording transactions in such a way that they can be readily traced from the originating documents to summary records and ultimately to the financial reports is necessary for sound financial management.

The Office of Guaranteed Student Loans (OGSL) does not have subsidiary record support for the September 30, 1976, balance in the claims in process, insurance premiums receivable, and accrued interest receivable accounts. OGSL derived the claims-in-process balance by using the following formula: unpaid claims on hand at the beginning of the period plus claims received minus claims paid. The insurance premiums receivable balance was computed from summaries of billings and collections. A listing of individual premiums receivable was not maintained. The accrued interest receivable balance was estimated by applying an interest factor to the average loans receivable balance.

According to OGSL officials, the new management information system should provide the necessary subsidiary records for the insurance premiums receivable account. The system will also compute accrued interest and is expected to provide reliable accrued interest receivable subsidiary records by the end of fiscal year 1977.

Recommendation

We recommend that OGSL develop detailed subsidiary records in support of the claims in process, insurance premiums receivable, and accrued interest receivable account balances.

LOSS RATES SHOULD BE BASED ON  
ACTUAL PROGRAM EXPERIENCE

The allowance for losses should reflect that portion of insured defaulted loans receivable, purchased and accrued interest on insured loans receivable, and claims in process which is estimated to be uncollectable. To most accurately reflect the uncollectable amount, we continue to believe the allowance should be derived from actual collection experience. The allowance should be adjusted annually to reflect most recent collection experience.

In fiscal year 1976, a 55 percent allowance for loss rate was used for defaulted loans. This rate is based on the experience of the Federal Housing Administration's Title I Housing Insurance Fund from July 1934 through June 1967. In our view, the two programs are not sufficiently similar to justify the expectation of identical loss rates. In addition, OGSL has used the same loss rates since 1969 with no annual adjustments for program experience, notwithstanding the enormous program changes that have occurred. As a result, the allowance for losses may not realistically reflect actual program experience.

Each year since fiscal year 1973, we have recommended that OGSL develop an allowance for loss rate based on actual program experience. Each year OGSL has stated that these changes would be made. In fiscal year 1973, OGSL stated that the change would be made by fiscal year 1974 or fiscal year 1975. In fiscal year 1975, when the changes still had not been made, OGSL stated the change may be accomplished by fiscal year 1978. OGSL is now developing a loss estimation model that is expected to use historical program data and projected collection data to estimate the unrecoverable portion of default claims and the related accrued interest. According to OGSL officials, the model may be ready for use by fiscal year 1978.

#### Recommendation

We recommend that OGSL develop an allowance for loss rate based on actual program experience without further delay, so that the allowances may be more realistically stated.

#### IMPROVEMENTS NEEDED IN ESTIMATING FUTURE LOSSES

The loss rates used in computing the estimated future loss liability on nondefaulted insured loans should be based on actual program experience and adjusted annually to account for the most recent experience. In addition, the method used to compute the liability should be consistent from year to year to allow for meaningful comparison of historical data and highlight any unusual variation in the account balance.

OGSL does not have support for the rates used in computing the estimated future loss liability on the fiscal year

1976 financial statements. These rates have been carried forward since 1974 with no adjustment for the 1975 or 1976 activity. Also, OGSL's method of determining the estimated future loss liability has varied each year since fiscal year 1973 when estimated future losses were first reported on the financial statements. As a result, we were unable to determine whether the account balance was fairly stated at September 30, 1976.

#### Recommendation

We recommend that OGSL base the estimated future loss rates on actual program experience and update the rates each year to reflect the most recent program experience. The method of computing the rates and calculating the estimated liability for future losses should be consistent from year to year.

#### IMPROPER RECORDING OF UNIDENTIFIED COLLECTIONS

Prior to March 1976, all unidentified collections and suspense items of the Fund were recorded in the Office of Education's (OE) suspense account. Amounts in this account are not reflected in the Fund's accounts or financial statements. In our fiscal year 1975 report to Congress we noted that the Fund's cash account is understated by the amount in the OE suspense account. We suggested that unidentified OGSL collections be recorded in the accounts of the Fund.

Beginning in the third quarter of fiscal year 1976, OGSL began applying all unidentified collections to the Fund appropriation. While this action constitutes a needed improvement, over \$977,000 of OGSL collections still remained in the OE suspense account at September 30, 1976, and thus not included in the financial statements.

A large portion of OGSL collections remaining in the OE suspense account, almost \$800,000, consists of a refund from a bank received by OGSL in trust for students of a proprietary school. We understand OGSL is currently considering methods to distribute the refund to the students.

The remainder in OE's suspense account--over \$184,000--consists of collections that did not contain enough information to determine which defaulted loan accounts should be credited. Approximately, \$11,000 of this amount was placed

in the account in fiscal year 1974, while approximately \$150,000 of fiscal year 1975 collections still remain in this account. Over \$23,000 was placed in the suspense account during fiscal year 1976.

Since last year's audit, few OGSL items have been removed from OE's suspense account. As of September 30, 1976, only \$1,195 of the Fund's items in the suspense account as of January 1976 had been removed. In addition, a review of OGSL's records for the first 7 months of fiscal year 1977 showed that no items had been removed.

#### Recommendation

We recommend that the refund due the students and various unidentified collections be removed from the OE suspense account and recorded in proper Fund accounts.

#### NEED FOR FOLLOWUP COLLECTION ACTION ON OVERDUE INSURANCE PREMIUMS RECEIVABLE

OGSL bills a lender for insurance premiums due and does not attempt further collection if payment isn't received. Previously, a contractor created a delinquent insurance premiums receivable report and followup billing letters for delinquent accounts. However, these two services were discontinued when a new contractor was selected in September 1975. Consequently, no followup collection action has been taken since these services were stopped. Good business practice would require that delinquent accounts be subject to vigorous collection attempts.

We estimate over \$250,000 of insurance premiums billed during or before September 1976 remained uncollected as of April 8, 1977. With an effective system to identify and collect these overdue receivables, many should have been collected or for the older items written off as uncollectable before now. An OGSL official told us a system to report delinquent insurance premiums is under development.

#### Recommendation

We recommend that the report of overdue insurance premiums receivable be developed promptly and used in systematic attempts to collect overdue accounts.