



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MAR 3 9 2001

MEMORANDUM

TO: Greg Woods  
Chief Operating Officer  
Student Financial Assistance

FROM: Lorraine Lewis *Lorraine Lewis*

SUBJECT: FINAL AUDIT REPORT  
***Great Lakes Higher Education Corporation's Administration of the Federal Family Education Loan Programs, Madison, Wisconsin***  
Control Number ED-OIG/A05-A0002

Attached is our subject report presenting our findings and recommendations resulting from our audit of the Federal Family Education Loan Programs administered by Great Lakes Higher Education Corporation, Madison, Wisconsin.

In accordance with the Department's Audit Resolution Directive, you have been designated as the action official responsible for the resolution of the findings and recommendations in this report.

If you have any questions or wish to discuss the contents of this report, please contact Richard J. Dowd, Regional Inspector General for Audit, at 312-886-6503.

Please refer to the above audit control number in all correspondence relating to this report.

Attachment



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MAR 30 2001

ED-OIG/A05-A0002

Mr. Richard D. George  
President and Chief Executive Officer  
Great Lakes Higher Education Corporation  
2401 International Lane  
Madison, Wisconsin 53704

Dear Mr. George:

This ***Final Audit Report*** (Control Number ED-OIG/A05-A0002) presents the results of our audit of Great Lakes Higher Education Guaranty Corporation's (Great Lakes Guaranty) administration of the Federal Family Education Loan (FFEL) Program Federal and Operating Funds in accordance with the Higher Education Act of 1965, as amended (HEA) and regulations during the fiscal year (FY) ending September 30, 1999. The purpose of our audit was to determine whether Great Lakes Guaranty complied with the HEA and regulations governing the establishment and operation of the Federal and Operating Funds during the fiscal year ending September 30, 1999. Specifically, we evaluated the initial establishment and continued maintenance of the two funds, compliance with conflict of interest regulations, and ownership of nonliquid assets and usage fees paid.

### AUDIT RESULTS

During the fiscal year ending September 30, 1999, Great Lakes Guaranty, except as discussed below, complied with the HEA regarding the establishment and operation of its Federal and Operating Funds. We identified two findings involving Great Lakes Guaranty's treatment of the administrative cost allowance (ACA) and interest on assets transferred from the Federal Fund. Great Lakes Guaranty transferred \$499,480 from the Federal Fund to the Operating Fund for an estimated liability related to the return of ACA for canceled loans and also transferred \$261,255 for retroactive interest on cash and investments from the Federal Fund to the Operating Fund. These transfers were not authorized by the HEA. We are recommending that the Chief Operating Officer (COO) for Student Financial Assistance (SFA) require Great Lakes Guaranty to return \$840,169 (\$499,480 + \$261,255 + imputed interest of \$79,434) to the Federal Fund related to these transfers. We also identified issues regarding the adequacy of oversight by the U.S. Department of Education (ED). These issues are reported separately under Control Number ED-OIG/A05-A0025.

Great Lakes Guaranty disagreed with the findings. We considered the comments but did not change our position. We paraphrased Great Lakes Guaranty's comments after each finding and have included the response in its entirety as an Attachment to this report.

**Finding No. 1 - Great Lakes Guaranty Transferred Federal Funds to the Operating Fund for the Estimated ACA Liability**

In addition to transferring 30 percent (\$2,102,563) of the ACA received on or after October 1, 1998, for loans insured before that date as required by Section 422B of the HEA, Great Lakes Guaranty transferred \$1,078,644 from the Federal Fund to the Operating Fund on December 1, 1998. This cash was transferred to fund the entire balance of the ACA liability account which was also transferred to the Operating Fund as part of the establishment of that fund. The ACA liability is an estimate of the ACA fees that Great Lakes Guaranty would have to refund to ED for canceled loans. Nothing in the 1998 amendments to the HEA authorized Great Lakes Guaranty to use the Federal Fund to transfer cash to the Operating Fund for ACA refunded to ED for loans that are canceled.

At fiscal year-end, Great Lakes Guaranty determined that it over-estimated the ACA liability because the actual ACA refunded during FY 1999 only totaled \$399,480, not \$1,078,644. Great Lakes Guaranty reduced the ACA liability by \$399,480 and recognized that amount as revenue to the Operating Fund. Great Lakes Guaranty then estimated that the ACA liability for FY 2000 would be \$100,000 and adjusted the ending ACA liability balance at September 30, 1999. Great Lakes Guaranty returned \$579,164 to the Federal Fund and also transferred an additional \$20,705 to the Federal Fund representing estimated interest the Operating Fund earned on the \$579,164 (based on a 3.3 percent interest rate). Therefore, \$499,480 (\$1,078,644 - \$579,164) of the original \$1,078,644 in cash transferred from the Federal Fund remained in the Operating Fund.

We calculated imputed interest of \$56,452 relating to the transfer to the Operating Fund. This amount consists of \$45,786 in interest on the \$499,480 from December 1, 1998 to September 30, 2000, at the 5 percent U.S. Treasury Current Value of Funds Rate (CVFR). The remaining \$10,666 is the difference between the estimated interest of \$20,705 Great Lakes Guaranty returned to the Federal Fund (based on a 3.3 percent interest rate) and \$31,371 at the 5 percent CVFR.

Great Lakes Guaranty treated the return of ACA received for FY 1998 loans that were later canceled as an expense of the Federal Fund. Its rationale was that prior to the 1998 amendments to the HEA, ACA was deposited into the Federal Reserve Fund (September 30, 1998, ending balance transferred to the Federal Fund) and ACA returned for canceled loans was deducted from this fund. Great Lakes Guaranty transferred cash from the Federal Fund, so the estimated ACA liability for canceled loans would be reflected in the Federal Fund and not the Operating Fund. It believed this was consistent with the treatment of ACA liability prior to the 1998 amendments to the HEA.

Great Lakes Guaranty's rationale is based on the HEA provisions in effect prior to the 1998 amendments. The 1998 amendments established the Federal Fund and specified its allowable uses. Payment of refunded ACA is not a permissible use of Federal Fund assets according to Section 422A of the HEA, or the implementing regulation, 34 CFR §682.419 (c). The \$499,480

that remains in the Operating Fund would also be considered the property of the guaranty agency, not the Federal Government.

### **Recommendations**

We recommend that the COO for SFA require Great Lakes Guaranty to return:

- 1.1. \$555,932 to the Federal Fund. This amount includes the remaining \$499,480 transferred from the Federal Fund to the Operating Fund and imputed interest of \$56,452.
- 1.2. Imputed interest to the Federal Fund that accrues after September 30, 2000, on the \$499,480. This interest should be calculated using the CVFR through the date this finding is resolved.

**Great Lakes Guaranty Comments** - Great Lakes Guaranty generally agreed with our description of the transactions relating to the ACA liability but disagreed with our conclusion and recommendations. Great Lakes Guaranty stated the transactions were necessary to conform to Generally Accepted Accounting Principles (GAAP). The 3.3 percent repurchase agreement rate used to calculate the \$20,705 transferred to the Federal Fund represented the actual interest earnings rate on the \$579,164 returned to the Federal Fund. It also informed us that the estimated ACA liability of \$100,000 for FY 2000 was returned to the Federal Fund at the end of FY 2000. Great Lakes Guaranty stated that its treatment of the ACA liability was correct in the absence of specific statutory language and was consistent with discussions with SFA personnel.

**OIG Response** - Great Lakes Guaranty's comments did not convince us to alter our conclusion that its treatment of the ACA liability as an expense of the Federal Fund was not authorized by the 1998 amendments to the HEA. Although Great Lakes Guaranty states that its treatment was consistent with discussions with SFA, it did not provide further support for this statement.

We used the 5 percent CVFR to compute interest Great Lakes Guaranty should have returned to the Federal Fund because it represents the estimated interest cost to the Federal Government. The rates of return on Operating Fund investments ranged between 3.3 and 8.875 percent during FY 1999.

We did not confirm that Great Lakes Guaranty returned \$100,000 to the Federal Fund. SFA should confirm whether the \$100,000 was returned and adjust the calculation of imputed interest related to this finding accordingly.

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### **Finding No. 2 - Great Lakes Guaranty Recognized Retroactive Interest Revenue on Cash and Investments Transferred from the Federal Fund to the Operating Fund**

The 1998 amendments to the HEA enacted on October 7, 1998, required guaranty agencies to establish a Federal Fund and an Operating Fund by December 6, 1998. Great Lakes Guaranty

established its two funds in December 1998, but accounted for the transactions retroactively to October 1, 1998.

Section 422A of the HEA, states that in order to establish the Operating Fund, guaranty agencies may transfer up to 180 days of normal operating expenses from the Federal Fund and may do so within the first 3 years following the establishment of the Operating Fund. Section 422A of the HEA, further states that each guaranty agency shall begin repayment of sums transferred no later than the start of the fourth year after the establishment of the Operating Fund, and shall not be required to repay any interest on the funds transferred and subsequently repaid.

Great Lakes Guaranty transferred the maximum allowable amount of \$29,406,550 from the Federal Fund to establish the Operating Fund, and notified ED of the transfer along with a repayment schedule. The transfer included \$19,178,206 in investments (Treasury Notes, U.S. Government Agency obligations, and repurchase agreements) and \$10,228,344 in cash. Great Lakes Guaranty transferred the investments to the Operating Fund on November 30, 1998, and transferred the cash on December 1, 1998. Great Lakes Guaranty recorded these transactions retroactively as of October 1, 1998.

Great Lakes Guaranty decided that because the \$29,406,550 transfer was recorded retroactively as of October 1, 1998, any earnings that those funds would have earned in October and November 1998 if they had actually been transferred on October 1, 1998, should also be transferred to the Operating Fund. Accordingly, Great Lakes Guaranty transferred \$203,245 to the Operating Fund, representing the estimated interest earned on the transferred investments during October and November 1998. Great Lakes Guaranty also transferred \$58,010 to the Operating Fund representing the estimated interest earned on the transferred cash during those two months.

Great Lakes Guaranty's letter notifying SFA of the \$29,406,550 transfer did not disclose the transfer was retroactive to October 1, 1998, or that interest revenue totaling \$261,255 (\$203,245 + \$58,010) applicable to the transferred funds was also transferred to the Operating Fund. Great Lakes Guaranty did not include the interest revenue transferred to the Operating Fund in its repayment schedule.

Great Lakes Guaranty appropriately established the Operating Fund in December 1998, however, accounted for the transaction retroactively to October 1, 1998. The \$29,406,550 transfer from the Federal Fund was a separate transaction and should have been recorded on the date of the transfer. Section 422A of the HEA does not provide for retroactive transfers but permits transfers from the Federal Fund during the first three years following the establishment of the Operating Fund. The transfer of interest revenue earned on the \$29,406,550 from October 1, 1998 to the dates of the transfers was an unauthorized use of Federal funds.

We calculated imputed interest of \$22,982 relating to the \$261,255 in interest revenue transferred to the Operating Fund. The \$22,982 consists of \$18,631 in imputed interest on the \$203,245 from November 30, 1998 to September 30, 2000, at the 5 percent CVFR. The remaining \$4,351

represents imputed interest on the \$58,010 from March 31, 1999 to September 30, 2000, at the 5 percent CVFR.

### **Recommendations**

We recommend that the COO for SFA require Great Lakes Guaranty to return:

- 2.1. \$284,237 to the Federal Fund. This amount includes interest revenue of \$261,255 (\$203,245 + \$58,010) and additional imputed interest of \$22,982 (\$18,631 + \$4,351) that the Federal Fund could have earned on the \$261,255 transferred from the Federal Fund on or before September 30, 2000.
- 2.2. Imputed interest to the Federal Fund on the \$261,255 that accrues after September 30, 2000. This interest should be computed using the CVFR applied to the remaining amount transferred through the date this finding is resolved.

**Great Lakes Guaranty Comments** - Great Lakes Guaranty did not agree with our finding and recommendations. Great Lakes Guaranty stated that it established the Federal Fund and Operating Fund retroactively to October 1, 1998 in accordance with GAAP. This was done to be consistent with the implementation of other ED guidance such as default aversion fees (DAF) and Great Lakes Guaranty's Voluntary Flexible Agreement which were implemented retroactively. Following GAAP benefits the Federal Fund and ED when compared to using the cash basis of accounting.

**OIG Response** - The issue in this finding is which fund should have the benefit of interest earned on the \$29,406,550 before it was transferred to the Operating Fund. Section 422A of the HEA permits transfers during the first three years following the establishment of the Operating Fund. Because the transfer could occur any time during this period, there is no basis for recognizing it retroactively. While it was reasonable and consistent with SFA's guidance, for Great Lakes Guaranty to recognize the establishment of the Federal and Operating Funds as of October 1, 1998, the transfer was a separate transaction and should be recognized when it occurred. The Federal Fund should retain the benefit of interest it earned prior to the transfer.

### **BACKGROUND**

The 1998 amendments to the HEA, enacted October 7, 1998, required each guaranty agency to establish a Federal Fund and an Operating Fund within 60 days. The final date for establishing these funds was December 6, 1998. Unless otherwise specified, the 1998 amendments were effective October 1, 1998. ED issued guidance, including January and November 1999 Dear Guaranty Agency letters, and published regulations relating to the Federal and Operating Funds on October 29, 1999.

All funds, securities, and other liquid assets of the guaranty agency's FFEL Program reserve fund were to be transferred to the Federal Fund, which is the property of the Federal Government. The HEA required a guaranty agency to deposit revenue from specified sources into the Federal

Fund and also specified the uses of Federal Fund assets. The HEA also specified deposits into the Operating Fund and the general uses of Operating Fund assets. Except for funds transferred from the Federal Fund, the Operating Fund is the property of the guaranty agency. If the Operating Fund contains funds transferred from the Federal Fund, the Operating Fund may be used only as permitted by the regulations which prohibit certain uses of reserve funds.

Great Lakes Higher Education Corporation (Great Lakes) is a non-profit Madison, Wisconsin corporation established in 1967 for the purpose of guaranteeing student loans for Wisconsin residents. Since then, Great Lakes has administered the Guaranteed Student Loan (now known as FFEL) Program in accordance with several agreements with ED. In addition to being a guaranty agency, Great Lakes has serviced student loans for lenders since 1977.

Effective September 30, 1996, Great Lakes created two new Wisconsin nonstock, nonprofit corporations - Great Lakes Guaranty and Great Lakes Higher Education Servicing Corporation (GLHESC). Great Lakes Guaranty guarantees student loans under the FFEL Program and is the designated guarantor for Minnesota, Ohio, Wisconsin, Puerto Rico, and the U.S. Virgin Islands. GLHESC services FFEL Program loans guaranteed by Great Lakes Guaranty and held by lenders. GLHESC also operates a wholly owned, for-profit subsidiary, Great Lakes Education Loan Services, Inc. (GLELSI), which is responsible for servicing student loans not guaranteed by Great Lakes Guaranty.

Great Lakes retains certain controls over Great Lakes Guaranty and GLHESC through its rights as the sole corporate member of each corporation. It also provides certain support functions for Great Lakes Guaranty and GLHESC such as information systems, financial and administrative/facilities management services.

Great Lakes Guaranty established both the Federal and Operating Funds on December 1, 1998, but accounted for the transactions retroactively to October 1, 1998. Great Lakes Guaranty established the Federal Fund when it transferred all accounts listed on Great Lakes Guaranty's September 30, 1998, balance sheet to the Federal Fund. The Operating Fund started with a zero balance until Great Lakes Guaranty transferred 30 percent of its ACA receivable as of September 30, 1998, as authorized under the 1998 amendments to the HEA.

### **AUDIT OBJECTIVE, SCOPE AND METHODOLOGY**

The purpose of our audit was to determine whether Great Lakes Guaranty complied with the HEA and regulations governing the establishment and operation of the Federal and Operating Funds during the fiscal year ending September 30, 1999. Specifically, we evaluated the areas of (1) initial establishment of the two funds, (2) continued maintenance of the two funds, (3) the Operating Fund's compliance with conflict of interest regulations, (4) ownership of nonliquid assets and usage fees paid, and (5) the adequacy of ED's oversight of the guaranty agencies whose Operating Funds contain funds transferred from the Federal Fund. The results of our work related to the last objective are reported separately under Control Number ED-OIG/A05-A0025.

To accomplish our objectives, we reviewed: Great Lakes' accounting records relevant to the establishment of the Federal and Operating Funds; accounting records on the transfer of funds from the Federal Fund to the Operating Fund, legal documents on the title of the buildings, Great Lake's calculation of the building and equipment usage fees, Great Lakes' cost allocation process, and distribution of default loan collections, account maintenance fees, and DAF. We reviewed the Great Lakes Single Audit reports for the years ended September 30, 1998 and 1999 to determine whether there were significant findings relevant to our audit. We reviewed the working papers of the Independent Public Accountant that performed the Single Audits as part of our data reliability testing. We also interviewed various Great Lakes personnel and ED officials.

We conducted our field work at Great Lakes' corporate office in Madison, Wisconsin from November 29, 1999, through March 17, 2000. We later updated the results of our field work through September 30, 2000. We performed our audit in accordance with government auditing standards appropriate to the scope of review described above.

### **STATEMENT ON MANAGEMENT CONTROLS**

As part of our audit, we made an assessment of Great Lakes Guaranty's management control structure, policies, procedures, and practices applicable to the administration of the FFEL Program. Great Lakes maintains these management controls as they relate to its guaranty agency activity so we consider the controls to be those of Great Lakes Guaranty. The purpose of our assessment was to assess the level of control risk, that is, the risk that material errors, irregularities, or illegal acts may occur. We performed the control risk assessment to assist us in determining the nature, extent, and timing of our substantive tests needed to accomplish our audit objective.

To make our assessment, we identified significant controls and classified them into the following categories:

- Establishment of the Federal and Operating Funds
- Maintenance of the Federal and Operating Funds
- Ownership of fixed assets used to administer the FFEL Program
- Transfers of assets from the Federal Fund to the Operating Fund
- Transactions involving the Federal Reserve Fund prior to the establishment of the Federal and Operating Funds which significantly impacted the opening balances of those funds

Due to inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the control structure. However, we identified weaknesses in Great Lakes Guaranty's controls over transfers of assets from the Federal Fund to the Operating Fund. These weaknesses are discussed in Findings Nos. 1 and 2 which relate to controls over the establishment of the Federal and Operating Funds. We are not recommending corrective action regarding these control weaknesses because Great Lakes Guaranty will not establish the Federal and Operating Funds again.



## ADMINISTRATIVE MATTERS

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Department of Education official, who will consider them before taking final Departmental action on the audit:

Greg Woods, Chief Operating Officer  
Student Financial Assistance  
ROB-3, Room 4004  
7<sup>th</sup> and D Streets, S.W.  
Washington, DC 20202-5132

Office of Management and Budget Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be greatly appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. §552), 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 to us during this review. Should you have any questions concerning this report, please call Richard Dowd, Regional Inspector General for Audit, at (312) 886-6503. Please refer to the control number in all correspondence relating to this report.

Sincerely,



Lorraine Lewis

Attachment



GREAT LAKES HIGHER EDUCATION GUARANTY CORPORATION  
2401 INTERNATIONAL LANE, MADISON, WISCONSIN 53704-3192, (608) 246-1800

March 9, 2001

Richard J. Dowd  
Regional Inspector General for Audit – Region V  
U.S. Department of Education  
Office of Inspector General  
111 N. Canal Street, Suite 940  
Chicago, IL 60606

Mr. Dowd:

With reference to your *Draft Audit Report* (Control Number ED-OIG/A05-A0002) dated February 9, 2001 and received in our offices on February 14, 2001, we are including the attached responses to the two audit findings identified relating to the estimated ACA liability and interest revenue recognition. In addition, we have also commented on the Statement on Management Controls section of the report.

If you have any questions on this information or need further clarification, please contact Amy Kerwin, our Director of Internal Audit (608-246-1785), or me (608-246-1410).

Sincerely,

Nancy Seifert  
Vice President/Chief Financial Officer

Enclosures

Cc: Patrick Howard, Director, Student Financial Advisory  
and Assistance, Office of Inspector General  
John Reeves, Executive Officer, Student Financial Assistance  
Richard George  
Paul Thornburgh  
Amy Kerwin

Finding No. 1 – Great Lakes Guaranty Transferred Federal Funds to the Operating Fund for the Estimated ACA Liability

The Higher Education Amendments of 1998 (the 1998 Amendments) require that each guaranty agency create and maintain a Federal Student Loan Reserve Fund (Federal Fund) and an Agency Operating Fund (Operating Fund). As part of the establishment of these funds, Great Lakes Higher Education Guaranty Corporation (Great Lakes) recorded a liability associated with prior ACA receipts. All ACA receipts belonged to the guaranty reserve fund through September 30, 1998. To conform to accrual accounting and Generally Accepted Accounting Principals (GAAP), it was both appropriate and necessary that Great Lakes establish a liability in the Operating Fund for future refunds and cancellations related to ACA receipts generated through September 30, 1998. Based on historical experience with regard to the incidence of refunds and cancellations, Great Lakes established the liability at \$1,078,644. At the end of fiscal year 1999 (September 30, 1999), Great Lakes calculated that the applicable amount of refunds and cancellations relating to ACA receipts through September 30, 1998 amounted to \$399,480 and had been deducted from Loan Processing and Issuance Fee payments to Great Lakes after September 30, 1998. In November 1999, Great Lakes transferred \$579,164 plus interest in the amount of \$20,705 to the Federal Fund based on its re-estimate of the amount of refunds and cancellations related to ACA received prior to September 30, 1998. Interest was calculated at a rate of 3.3% which was the repurchase agreement rate effective at that time and represents the actual interest earnings rate (the 5% Treasury Bill interest rate is an arbitrary and, in this case, an inaccurate interest rate benchmark). The remaining \$100,000 was maintained as a liability in fiscal year 2000, evaluated at fiscal year end and transferred to the Federal Fund. This closed the liability account and correctly accounted for the ACA liability.

With the implementation of the 1998 Amendments, the former guaranty reserve fund's accounts as of September 30, 1998 were reallocated to either the Federal Fund or to the Operating Fund based on specific statutory language. In the absence of statutory specificity and consistent with discussions with Student Financial Assistance personnel, GAAP conventions were followed since implementing regulations could not have been adopted prior to July 1, 2000.

Finding No. 2 - Great Lakes Guaranty Recognized Retroactive Interest Revenue on Cash and Investments Transferred from the Federal Fund to the Operating Fund

The Higher Education Amendments of 1998 (the 1998 Amendments) were enacted on October 7, 1998. For administrative purposes, Great Lakes implemented the Act effective October 1, 1998. Great Lakes operates on the accrual basis of accounting and accordingly established both the Federal Fund and the Operating Fund from an accounting standpoint effective as of October 1, 1998. This was accomplished both to implement the intent of the law as well as to maintain consistency of accounting treatment with similar implementation strategies employed with the Department of Education (the Department).

Namely, on November 15, 1999, the Department issued a Dear Guarantor letter which discussed the implementation of default aversion fees under the HEA. Specifically, it stated the following:

*"The specific rules are contained in the October 29 final regulations. Guaranty agencies may implement this amended guidance retroactively to October 7, 1998."*

Great Lakes has consistently followed the implementation guidelines provided by the Department. Another point that proves this consistency of accounting treatment relates to the implementation of the Voluntary Flexible Agreement (VFA) which was approved on November 27, 2000 but was retroactive to October 1, 2000. Accordingly, after receiving Secretary Riley's memorandum, Great Lakes retroactively implemented the VFA effective as of October 1, 2000. Utilizing accrual accounting, Great Lakes adjusted the recognition of the VFA fees in lieu of the statutory fees. In addition, the VFA also provided for the repayment of the working capital advance. Accordingly, Great Lakes transferred the working capital advance balance of \$25,406,550 including earned interest retroactively to October 1, 2000. This situation is precisely the mirror image accounting treatment which occurred effective October 1, 1998 with the implementation of the 1998 Amendments. In this case, interest earnings in addition to the advance balance were transferred to the Federal Fund with an effective date of October 1, 2000.

Similarly, prior to the implementation of the 1998 Amendments, Great Lakes operated under a pilot program for default aversion activities which extended through December 31, 1998. Due to the implementation of the 1998 Amendments, the pilot program was not renewed but was to be subsequently replaced by the VFA process. Accordingly, the Department informed Great Lakes in March 1999 that Great Lakes needed to terminate the pilot either effective September 30 or December 31, 1998. Great Lakes terminated the pilot effective September 30, 1998 and made the appropriate accounting entries to reflect the change from the pilot to the statutory default aversion requirements.

As the Department has implemented program changes, Great Lakes has consistently applied GAAP in its implementation processes. Great Lakes believes that consistent application of accrual accounting, which the Department has recognized and is now implementing internally within the Department, proves to accurately reflect the intent of the Higher Education Act, is straightforward, is easily understood by all involved parties, provides ease in the monitoring of activities, and most importantly, appropriately reflects the intent of the Act.

In acting consistently in every case in accordance with GAAP, the ultimate impact is that the interests of the Federal Fund and the Department of Education have been significantly benefited from what would have occurred if Great Lakes had used the cash basis as asserted in the report. In this case, as in all other instances, Great Lakes believes that it has acted prudently and has fully complied with the intent of the 1998 Amendments.

Statement on Management Controls

On page 6, the following statement was made:

“Due to inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the control structure. However, we identified weaknesses in Great Lakes Guaranty’s controls over transfers of assets from the Federal Fund to the Operating Fund. These weaknesses are discussed in Findings Nos. 1 and 2 which relate to controls over the establishment of the Federal and Operating Funds. We are not recommending corrective action regarding these control weaknesses because Great Lakes Guaranty will not establish the Federal and Operating Funds again.”

Great Lakes does not agree with this statement. Great Lakes’ external auditors, Ernst & Young, perform an annual OMB Circular A-133 compliance audit and provided the following statements in their audit report relating to fiscal year 2000:

“In our opinion, the Corporation complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2000 (emphasis added).

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses (emphasis added).”

The OIG’s interpretation of the 1998 Amendments and the issues noted in Findings No. 1 and 2 do not constitute internal control weaknesses and to report otherwise is both inaccurate and misleading. Great Lakes must therefore insist that this statement be omitted from the final report.

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