



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MAR 30 2001

ED-OIG/A05-A0025

Mr. Greg Woods  
Chief Operating Officer  
Student Financial Assistance  
Regional Office Building, Room 4004  
7<sup>th</sup> and D Streets, SW  
Washington, DC 20202

Ms. Maureen McLaughlin  
Deputy Assistant Secretary for Policy, Planning, and Innovation  
Office of Postsecondary Education  
Room 7115  
1990 K Street, NW  
Washington, DC 20006

Dear Mr. Woods and Ms. McLaughlin:

This ***Final Audit Report*** (Control Number ED-OIG/A05-A0025) presents issues identified during 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. The purpose of our audit was to determine whether Great Lakes Guaranty complied with the Higher Education Act of 1965, as amended (HEA) and regulations governing the establishment and operation of the Federal and Operating Funds during the fiscal year (FY) ending September 30, 1999.

### AUDIT RESULTS

In this report, we identify two issues which warrant your attention because of their potential negative impact on the stability of the FFEL Program Federal Fund at Great Lakes Guaranty and possibly other guaranty agencies. We also discuss a related point in the Other Matters section of the report. U.S. Department of Education (ED) officials informed us that they were aware of the issues and have initiated action to address some of our recommendations. We are separately reporting our findings on Great Lakes Guaranty's compliance with the HEA in administering its Federal and Operating Funds under Control Number ED-OIG/A05-A0002.

We provided ED officials a draft report. Student Financial Assistance (SFA) provided comments and the Office of Postsecondary Education did not respond. SFA generally concurred with two of the three issues in our draft report. We modified the report where appropriate to address their comments. SFA did not agree with the issue regarding assets transferred from the Federal Fund to the Operating Fund. SFA stated that Great Lakes Guaranty's actions pertaining to the transfer were consistent with the intent of the HEA. We deleted the recommendations and moved our

discussion of this point to the Other Matters section of the report. This point is also a factor in the decrease of the Federal Fund in Issue No. 1. We paraphrased SFA's comments after the issues and have included the response in its entirety as an Attachment.

### **Issue No. 1 - Great Lakes Guaranty Federal Fund Balance Decreased by 21 Percent in FY 1999**

During FY 1999, the Federal Fund balance decreased by \$19,194,083 to \$71,863,200, a 21 percent decrease. This was caused by several factors, which, if they continue, could jeopardize the long-term viability of the Federal Fund at Great Lakes Guaranty.

- The Federal Fund lost interest earnings when \$29,406,550 was transferred to establish the Operating Fund. In accordance with the 1998 amendments to the HEA, Great Lakes Guaranty plans to repay the funds over three years and retain interest on the funds transferred.
- Great Lakes Guaranty waived guarantee fees on all loans except for those to for-profit trade and technical school students thereby reducing the guarantee fee revenue to the Federal Fund.
- The current FFEL Program provisions for default claim payment and reinsurance do not make the Federal Fund whole unless the full amount of the claim is recovered during the post-default collection process. This does not occur for every default claim so the effect is a net loss to the Federal Fund.
- Default aversion fees are paid from the Federal Fund and account maintenance fees earned by the guaranty agency are also paid from the Federal Fund if appropriated funds are not sufficient to pay the full amount. For FY 1999 Great Lakes Guaranty transferred default aversion fees totaling \$17,958,204 and account maintenance fees of \$988,734 from the Federal Fund.

If Great Lakes Guaranty's Federal Fund balance continues to decrease at the FY 1999 rate, we estimated that the Federal Fund could be liquidated in five years (end of FY 2003). We asked Great Lakes Higher Education Corporation (Great Lakes) officials to comment on our estimate. They stated that the Federal Fund at Great Lakes Guaranty is not viable as currently structured. They also stated that for competitive reasons the viability of the Federal Fund is dependent on reimplementing the guarantee fee universally for both the FFEL and William D. Ford Federal Direct Loan programs. Great Lakes officials estimated that the decrease in the Federal Fund balance would continue at a lesser rate than for FY 1999 and the Federal Fund would be approximately \$20 million after five years. Their estimate differs from ours but confirms that the Federal Fund will decrease significantly over five years.

We discussed this issue with ED officials during the audit and at the exit conference. They did not identify a contingency plan related to the decreasing Federal Fund at Great Lakes Guaranty.

## Recommendations

We recommend that ED:

- 1.1. Continue to monitor the decrease in Great Lakes Guaranty's Federal Fund balance during the next year.
- 1.2. Make contingency plans before the Federal Fund at Great Lakes Guaranty is completely depleted.
- 1.3. Continue to monitor and initiate corrective actions as needed for similar situations at other guaranty agencies.

**SFA Comments** - SFA generally concurred with our recommendations. SFA also commented that the reasons for the decrease in the Federal Fund were related to current provisions of the HEA. SFA stated it would consider whether legislative changes should be suggested to Congress.

**OIG Response** - We made several minor changes to the report to address the SFA comments. We considered it important to identify the reasons for the decrease. SFA will need to take appropriate action if the viability of the Federal Fund is jeopardized. Those actions may include contingency plans and seeking legislative change as deemed necessary by ED.

### **Issue No. 2 - ED Should Clarify the Title to Great Lakes Guaranty's Buildings and Arrange for Their Sale/Lease**

Great Lakes acknowledges that the Federal Government owns the two buildings and a connecting structure that Great Lakes Guaranty and related corporations occupy. The buildings were acquired with FFEL Program reserve funds. The buildings and associated depreciation are recorded in the Federal Fund on Great Lakes Guaranty's 1999 financial statements.

The Federal Government's interest in the buildings is not recorded or reflected on documents relating to building ownership. Great Lakes pays property taxes on the portion of the buildings utilized by its related loan servicing corporations. According to September 1996 agreements, Great Lakes Guaranty also leases the land occupied by the buildings, and charges a usage fee for the portions of the buildings and equipment used by its related corporations.

As of September 30, 1999, the book value of the buildings was \$7,882,770 net of depreciation. According to 1998 property tax bills, the estimated fair market value of the buildings was \$5,725,300. The related corporations paid a usage fee to the Federal Fund for use of the buildings and equipment totaling \$868,156 in FY 1999. Great Lakes Guaranty planned to begin paying a usage fee to the Federal Fund beginning July 1, 2000. Great Lakes Guaranty calculated the building usage fee based on square footage occupied, using market rental rates for comparable office space less budgeted building maintenance costs.

Great Lakes made building improvements totaling \$285,495 during FY 1999 which were recorded as assets in the Operating Fund and depreciated. A Great Lakes Guaranty official informed us that it intends to record building improvements as Federal Fund assets in the future and reduce the usage fee paid to the Federal Fund for improvements funded by the Operating Fund.

The HEA provides that non-liquid assets purchased with Federal reserve funds are the property of the Federal Government. The Federal Fund must receive an amount representing the net fair value of the use of the asset when those assets are used in guaranty or other activities. Neither the HEA nor guidance from ED specifies how that ownership should be evidenced or how the usage fee should be calculated. In the case of Great Lakes Guaranty, the Federal Government's interest in the buildings is not recorded or reflected in property records. Also, Great Lakes Guaranty determined how the usage fee would be calculated without input or oversight from ED.

### **Recommendations**

We recommend that ED:

- 2.1. Require Great Lakes Guaranty to reflect the Federal Government's interest in the buildings Great Lakes occupies.
- 2.2. Determine whether it is in the Federal Government's best interest to sell or lease the buildings and negotiate specific sale/lease agreements.
- 2.3. Develop a uniform method for calculating Federal non-liquid asset usage fees and issue appropriate guidance to guaranty agencies.
- 2.4. Continue to monitor and initiate corrective actions as needed for similar situations at other guaranty agencies.

**SFA Comments** - SFA concurred with the issue and our recommendations.

### **OTHER MATTERS**

During the audit, SFA officials informed us that they were aware of the issues described in this report through technical assistance visits to all guaranty agencies which were completed by the end of June 2000. SFA officials also stated they have initiated action to address some of our recommendations. SFA also plans to complete compliance reviews at selected guaranty agencies.

Great Lakes Guaranty transferred \$29,406,550 from the Federal Fund to establish the Operating Fund and planned to repay the funds over three years. This was the maximum amount the HEA permitted Great Lakes Guaranty to transfer. The HEA also permitted Great Lakes Guaranty to retain interest earned on the funds transferred.

In our draft report we stated that the amount transferred was excessive because it exceeded the amount needed to keep the Operating Fund solvent. The funds transferred included U.S. Treasury Notes with a total par value of \$17,000,000. Most of those investments were not liquidated during FY 1999 indicating that cash was not needed to pay operating expenses. The average month end balance for total cash and investments in the Operating Fund during FY 1999 was \$34,744,977 which greatly exceeded the average expenditures each month of \$4,979,806. We recommended that ED require Great Lakes Guaranty to accelerate repayment of funds transferred plus interest on funds transferred in excess of need. We also recommended that ED address any similar situations at other guaranty agencies. SFA responded that ED does not have the legal authority to implement our recommendations. Based on SFA's response, we dropped the recommendations. We are reporting this matter because at Great Lakes Guaranty (see Issue No. 1), the loss of interest earnings on the funds transferred contributed to the decrease in the Federal Fund.

### **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 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 non-stock, non-profit 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 established both the Federal and Operating Funds on December 1, 1998, but accounted for the transactions retroactively to October 1, 1998. Great Lakes 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 FY 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 non-liquid 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. This report discusses the results of our work related to the last objective. The results of our work related to the first four objectives will be reported separately under Control Number ED-OIG/A05-A0002.

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 default aversion fees. 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 discussed the results of the audit with ED program officials during an exit conference on August 29, 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 ED's management control structure, policies, procedures, and practices applicable to its oversight of the guaranty agencies whose Operating Funds contain funds transferred from the Federal Fund. We did not test these controls because they were not significant to our audit objectives. Our assessment was performed to determine the level of risk exposure (that is, the likelihood that significant noncompliance with the law and regulations occurred), and to determine the extent of testing needed to accomplish the audit objectives.

### ADMINISTRATIVE MATTERS

Please provide the Supervisor, Post Audit Group, Office of the Chief Financial Officer and the Office of Inspector General, with quarterly status reports on promised corrective actions until all such actions have been completed or continued follow-up is unnecessary.

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 the exemptions of the Act. Copies of this audit report have been provided to the offices shown on the distribution list enclosed in the report.

We appreciate the cooperation given us in this review. If you have any questions concerning this report, please contact Mr. Richard Dowd, Regional Inspector General for Audit, at 312-886-6503. Please refer to the control number in all correspondence related to the report.

Sincerely,

A handwritten signature in cursive script that reads "Lorraine Lewis".

Lorraine Lewis

Attachment



## UNITED STATES DEPARTMENT OF EDUCATION

*Student Financial Assistance  
Chief Operating Officer*

FEB 22 2001

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

Dear Mr. Dowd:

Thank you for the opportunity to review and comment on the draft audit report presenting the results of your audit of Great Lakes Higher Education Guaranty Corporation's administration of the Federal Family Education Loan (FFEL) program Federal and Operating Funds, Control Number ED-OIG/A05-A0025, issued January 19, 2001.

We agree with two of the three issues identified in the report (Issues 1 and 3), but believe more information needs to be provided to place Issue 1 in the proper context. While it is true that the Great Lakes Guaranty Federal Fund Balance decreased in FY 1999, and you identified key factors that caused the decline, there is no mention that the factors cited are a direct result of statutory language and provisions. Without this crucial information, the implication is that the Department should be able to take some action to stem the decrease when, in fact, the circumstances are beyond our control.

We do not agree at all with Issue 2, which concerns the appropriateness of the transfer of funds from the Federal Fund to the Operating Fund. You stated in the report that you consider the amount of funds transferred to be excessive. However, based on the information you provided, and our knowledge of what Great Lakes Guaranty has done, it appears that the transfers made were in accordance with the intent and provisions of Higher Education Act, as amended (HEA). Hence, there is no action required on our part. For more information concerning this and the other issues, please see the enclosure, which provides specific responses to each issue and recommendation.

Again, we appreciate the opportunity to review and comment on the draft report.

Sincerely,

Greg Woods

Enclosure

cc: Pat Howard  
John Reeves  
Jim Lynch  
Ann Clough



Response to OIG Draft Audit Report, Audit of Great Lakes Higher Education Guaranty Corporation's administration of the FFEL program Federal and Operating Funds, Control Number ED-OIG/A05-A0025

**ISSUE No. 1:**

**Great Lakes Guaranty Federal Fund Balance Decreased by 21 Percent in FY 1999**

Response: The statements made are accurate, but they need to be placed in context. There is no recognition of the fact that the Department does not have the legal authority to solve the problems identified. We have concerns with each of the facts identified:

- *The Federal Fund lost earnings when funds were transferred to the Operating Fund.*
- Comment: Please see our response to Issue 2.
- *Great Lakes Guaranty waived insurance premiums on all loans except for those to for-profit trade and technical school students thereby reducing the guarantee fee revenue to the Federal Fund.*

Comment: We agree that this occurred. It is unclear whether the Secretary has the authority to require guaranty agencies to charge guarantee fees in order to replenish the Federal Fund. The HEA provides that guaranty agencies may charge a fee. Whether the necessity of guaranty agencies meeting their fiduciary duties would lead to our requiring them to charge a fee in order to replenish the Federal Fund is an open legal question.

- *The current FFEL program provisions for default claim payment and reinsurance do not make the Federal Fund whole unless the full amount of the claim is recovered during the post-default collection process. This does not occur for every default claim so the effect is a net loss to the Federal Fund.*

Comment: The HEA sets forth the structure of the Federal Fund. The fact that the Federal Fund may eventually be depleted is a function of the statutory provisions, not lack of oversight on the part of the Department.

- *Default aversion fees are paid from the Federal Fund and account maintenance fees earned by the guaranty agency are also paid from the Federal Fund if appropriated fees are not sufficient to pay the full amount.*

Comment: The statement is accurate. It is also a situation over which the Department has no control. It is an appropriations issue: to the extent that Congress does not appropriate sufficient funds, guaranty agencies may and will use Federal Fund monies.

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Recommendation 1.1: *Monitor the decrease in Great Lakes Guaranty's Federal Fund balance during the next year.*

Response: We concur. We are currently monitoring Great Lakes Guaranty's Federal Fund balance

Recommendation 1.2: *Make contingency plans before the Federal Fund at Great Lakes Guaranty is completely depleted.*

Response: We concur. We will ask Great Lakes Guaranty to prepare contingency plans.

Recommendation 1.3: *Continue to monitor and initiate corrective actions as needed for similar situations at other guaranty agencies.*

Response: We concur in part. We can monitor Federal Funds at other guaranty agencies, but we do not have the legal authority to require corrective actions. However, through our monitoring efforts, we will determine whether legislative changes to Congress should be suggested.

## **ISSUE No. 2:**

### **Great Lakes Guaranty Transferred More Assets from the Federal Fund than Needed to Keep the Operating Fund Solvent**

Response: We do not agree that there is a problem with what Great Lakes Guaranty did. The concerns reflected in the draft report are the result of provisions in the HEA: the purpose of a transfer from the Federal Fund is to give the guaranty agency a "working capital reserve" rather than to use the money for operating expenses. Great Lakes Guaranty's actions were consistent with the HEA.

Recommendation 2.1: *Require Great Lakes Guaranty to accelerate repayment of the funds transferred.*

Recommendation 2.2: *Recover the interest Great Lakes Guaranty earned on the funds transferred in excess of need.*

Recommendation 2.3: *Continue to monitor and initiate corrective actions as needed for similar situations at other guaranty agencies.*

Response to Recommendations 2.1, 2.2, and 2.3: We do not concur with the recommendations. The Department does not have the legal authority to take the steps specified in these recommendations.

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**ISSUE No. 3:**

**ED Should Clarify the Title to Great Lakes Guaranty's Buildings and Arrange for Their Sale/Lease**

Response: We agree with the issue as stated.

Recommendation 3.1: *Require Great Lakes Guaranty to reflect the Federal Government's interest in the buildings Great Lakes occupies.*

Response: We concur. We will take the appropriate action.

Recommendation 3.2: *Determine whether it is in the Federal Government's best interest to sell or lease the buildings and negotiate specific sale/lease agreements.*

Response: We concur. We will obtain information and make a determination.

Recommendation 3.3: *Develop a uniform method for calculating Federal non-liquid asset usage fees and issue appropriate guidance to guaranty agencies.*

Response: We concur. We will take appropriate action and issue guidance.

Recommendation 3.4: *Continue to monitor and initiate corrective actions as needed for similar situations at other guaranty agencies.*

Response: We concur. We will take appropriate action.

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