This document records the hearing of a Subcommittee of the House on its 3-month investigation of the College Housing Loan Program and the Academic Facilities Loan Program, which are administered by the Department of Education. These programs have awarded about $5 billion in loans to finance the construction of dormitories, dining halls, student unions, and other campus buildings. The loans have been made at an interest rate of around 3 percent spread over 30 to 40 years for each borrower. The majority of the loans—4.5 billion dollars worth—were made for college housing. Attention is directed to ways in which effective and efficient management of programs can be achieved. General Accounting Office audits of the Department of Education's management of the program have found the programs to be mismanaged, and the Department of Education to be lenient to colleges that have defaulted on their loans, which was confirmed by the Subcommittee's investigation. Included in this hearing are the Department of Education's audits of 10 institutions that had loans in default. Problems were found in billing and collection, loan security and controls, program regulations, staff utilization, and audit and inspection fees. Six of these 10 institutions were also in default on academic facilities loans. The hearing also includes letters and statements of Department of Education officials (Edward M. Elmendorf, Ronald Kimberling, and Mitchell L. Laine); as well as a paper entitled "Public Policy Debt Deferral for Higher Education Facilities Loans," written by Joseph P. O'Neill, to attendees of a meeting sponsored by the Conference of Small Colleges, February 22, 1982 (minutes are included). (SW)
HEARING
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES
NINETEEN-EIGHTY EIGHT CONGRESS
SECOND SESSION
MAY 15, 1984

Printed for the use of the Committee on Government Operations
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(III)
DEPARTMENT OF EDUCATION'S COLLEGE CONSTRUCTION LOAN PROGRAMS

TUESDAY, MAY 15, 1984

HOUSE OF REPRESENTATIVES, INTERGOVERNMENTAL RELATIONS AND HUMAN RESOURCES SUBCOMMITTEE OF THE COMMITTEE ON GOVERNMENT OPERATIONS, Washington, DC.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 2154, Rayburn House Office Building, Hon. Ted Weiss (chairman of the subcommittee) presiding.

Present: Representative Ted Weiss and Robert S. Walker. Also present: James R. Gottlieb, staff director; Marc Smolonsky, professional staff member; Pamela H. Welch, clerk; and Martha Morrison, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN WEISS

Mr. WEISS. The subcommittee will come to order. Let the record show that a quorum is present.

Today's hearing is based on a 3-month investigation by the subcommittee of the College Housing Loan Program and the Academic Facilities Loan Program, which are administered by the Department of Education.

The College Housing Loan Program was created in 1950 to alleviate housing shortages on our Nation's campuses caused by booming student enrollments. This program was run by the Department of Housing and Urban Development until 1980 when it was transferred to the Department of Education.

The Academic Facilities Loan Program was authorized in 1965, and was designed to fund the construction of academic facilities. The Academic Facilities Program was also created in response to an upsurge in college student enrollments. Together, these programs have awarded approximately $5 billion in loans to finance the construction of dormitories, dining halls, student unions, and other campus buildings. The loans have been made at an interest rate of around 3 percent spread over 30 to 40 years for each borrower. The majority of the loans—4.5 billion dollars' worth—were made for college housing.

According to the Department of Education's records, nearly $163 million in loans are in default. Although this is a small percentage of the $3 billion in loans still outstanding to more than 1,300 borrowers, the actual amount of delinquent funds is increasing, having
more than doubled since 1977. It is more important than ever to make sure the loans in current status do not go into default.

These loan programs have operated under little scrutiny for three decades. But in the last 2 years, the Education Inspector General and the General Accounting Office have conducted audits of the Department of Education's management of the programs. The audits have found the programs to be woefully mismanaged, and the Department to be extremely lenient to colleges that have defaulted on their loans.

Staff of this subcommittee have conducted an independent investigation and have found similar problems.

Today's hearing is particularly timely because the Department has recently published a regulation that would authorize discounts of as much as 55 percent for colleges that prepay their loans under the College Housing Loan Program only. All schools—those that are current and those that are in default on their loans—will be eligible for this discount. Theoretically, this discount could result in the forgiveness of more than $1.5 billion if all schools take advantage of the pending regulation.

For example, one school that recently received a loan of $4 million would be allowed to pay off its loan for $1.8 million, if it is allowed to take advantage of the discount.

This discount regulation is based on a law passed by Congress in 1983, which gives the Secretary of Education authority to discount these loans. The authority expires on October 1, 1984.

I believe it is critical to review the current status of the program before the discount regulation takes effect. I fear we may have simply created a giveaway for many schools that have refused to pay their obligations to the Federal Government.

The Department of Education seems to be operating under a double standard in its loan programs. On one hand, the Department is cracking down on students, who may owe thousands of dollars each, but, on the other hand, the Department is bending over backward to be lenient to colleges that each owe millions of dollars. The only thing the colleges have in this case that the students do not is political clout, and that, it seems to me, is not a good enough reason for such inequitable treatment.

The subcommittee's investigation has found colleges that lease federally financed buildings to other Federal agencies while remaining delinquent on their Education Department debt; colleges that divert revenues which belong to the Federal Government, and remain delinquent on their debt; and colleges which continue to maintain payments on private loans but remain in default on their obligations to the Federal Government. We intend to find out today why these colleges have been treated with such leniency.

Today, we will hear testimony of witnesses from the Education Inspector General's Office and the Office of Postsecondary Education.

Before we go on to the witnesses, let me ask the distinguished ranking minority member, Mr. Walker, for his opening statement.

Mr. WALKER, Mr. Chairman, I thank you for the opportunity to make an opening statement. Apparently, the Speaker has not extended his gag order to this subcommittee yet, but I appreciate it.
I would also note that we do have a number of people with us this morning. Evidently that is something that the Speaker regards as unique when I appear to speak, so I thank you for that, too.

Seriously, Mr. Chairman, I do appreciate the opportunity to review the administration of the College Housing and Academic Facilities Loan Programs here today. However, I cannot resist the temptation to express a grave concern which initially comes to mind about these construction programs. Annual appropriations of $40 million and yearly off-budget costs of over $210 million incurred to maintain these low-interest loan programs strike me as ludicrous at a time when we face record high budget deficits and compound those expenditures with the decline in college enrollments or projected to decline, anyhow, over the next 10 years, and I must question the continued existence of such programs.

That concern stated, the programs do exist, and we are here today to discuss ways in which effective and efficient management of the programs can be achieved and maintained.

While I hope that our efforts will focus on delinquent institutions, thereby encouraging remedial action in future compliance, I also trust that we will keep our perspective. I believe it is important to recognize that the vast majority of our institutions of higher education have excellent-track records with respect to loan repayments. We have read a great deal about the problem areas associated with the administration of these college construction loan programs.

I look forward now to hearing the thoughts of the Department and to learning about your efforts to improve the management of the programs—efforts which I trust are directed toward protecting the taxpayers' considerable investment.

Thank you, Mr. Chairman.

Mr. WEISS. Thank you very much, Mr. Walker.

Our first witness will be Mitchell Laine, Assistant Inspector General for Audit.

Mr. Laine, if you will approach the witness table. As you may know, it is the practice and tradition of this subcommittee and, in fact, all of the subcommittees of the Government Operations Committee, to swear in all of our witnesses. And, we have done it with people from the Attorney General on down, so, if you would, raise your right hand. Do you swear or affirm that the testimony that you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. Laine. I do.

Mr. WEISS. Thank you.

You may proceed.

STATEMENT OF MITCHELL L. LAINE, ASSISTANT INSPECTOR GENERAL FOR AUDIT, OFFICE OF INSPECTOR GENERAL, DEPARTMENT OF EDUCATION

Mr. Laine. Thank you, Mr. Chairman.

Thank you for the opportunity to testify before your subcommittee on our audit and investigative findings related to the College Housing Loan Program and the Academic Facilities Loan Program.
Since the Department was established in 1980, the time at which the College Housing Loan Program was transferred to the Education Department, the Office of Inspector General has performed several audits related to the two loan programs. We made a review of the management of the programs by the Office of Postsecondary Education [OPE] at the headquarters level.

We also initiated a nationwide effort which included audits of 10 institutions, identified jointly by OPE and OIG [Office of Inspector General], that had loans in default. We have issued reports on each of these reviews. Based on the results of this work, we are developing additional recommendations for the Department, which will improve the management of the programs.

Also, since 1980, we have investigated several instances of suspected or alleged criminal wrongdoing related to the College Housing and Academic Facilities Loan Programs. These instances involved improper use of loan funds, personal use of property purchased with college housing funds, and improper subcontracting procedures.

One allegation is still under investigation, and since none of the other allegations warranted final prosecution, these cases were closed.

I would like to summarize for you some of the findings and recommendations from our completed audits.

We made a survey of the management of the two loan programs to identify potential problem areas and to provide a basis for subsequent detailed audits of institutions. Our survey disclosed problems in: One, billing and collection activities, two, loan security and controls, three, program regulations, four, staff utilization, and five, audit and inspection fees.

We found that the fiscal agent had not always been provided with the necessary documents to initiate the billing and collection of loans. We looked at 111 college housing loan files and found that 21 had original loan documents, totaling $19.6 million, which are required by the Federal Reserve Bank of Richmond to initiate billing, still in the Department’s files. In addition, six original loan documents could not be located.

Eleven of the twenty-one loans should have been in the billing and collection cycle and had payments past due. We could only determine the amount of principal and interest payments past due on 6 of the 11 loans because the files did not have the information on the other 5. These six loans totaled about $10 million with initial principal and interest payments totaling $231,967 past due.

We recommended that the loan documents be forwarded to the Federal Reserve bank and a reconciliation be made of ED’s records with the bank’s records to ensure that all necessary documents are at the bank. ED officials subsequently informed us that action on our recommendations has been completed.

We found that improvements were needed in loan security and controls to protect the Government’s interest in these loans. While we did not review all aspects of loan security and controls, we noted that security for loans at four institutions was questionable. Consequently, in the event of forfeiture, ED may not be able to recover about $10.5 million loaned to these institutions. To improve areas where we found weaknesses, we recommended that OPE:
One, require that inspections and appraisals be performed at the sites by qualified individuals prior to closing on loans, that legal counsel representing ED be present at loan closings to protect ED's interest and, two, assure that ED has a first mortgage position on all loans where the institution constructed facilities on donated property.

In response to our report, officials told us that with one exception our recommended actions were and had always been taken and had always been policy. They disagreed with us on the need for having legal representation for the Department at loan closings because representation by the school's attorney at loan closings was sufficient. We plan to review OPE's position on this finding in the near future.

The College Housing Loan Program is directed toward alleviating severe housing shortages. To be eligible for a loan, an institution must establish that a severe housing shortage exists at the time of the application. However, we found that institutions are not required to establish that a severe housing shortage exists at the time of the execution of a loan agreement.

One institution had received a $4.75 million fund reservation in October 1980, with construction to be started by April 1982. A fund reservation, in effect, indicates money has been set aside for a project. The institution was granted an extension to October 1982. Prior to the final execution of the loan agreement in mid-1982, the availability of housing for the institution's students increased to the point that a severe housing shortage was questionable. We recommended that ED regulations and loan agreements be revised to preclude final approval of the loan agreement when a severe shortage does not exist.

In response to this recommendation, OPE indicated that it would not require institutions to verify that a severe housing shortage exists at the time of final approval. OPE feels that this requirement is not necessary because institutions are required to start construction within 18 months or the loan reservation will be canceled. OPE believes that economic conditions will not change enough in an 18-month period to alleviate a severe housing shortage. We disagree and believe that providing for cancellation of a loan reservation based on changed conditions, up to the time of final loan execution, would be beneficial.

We noted that OPE adopted a collection procedure which resulted in its staff concentrating its efforts on delinquent loans, which account for about 5 percent of all college housing and academic facilities loans. Their emphasis on delinquent loans has precluded efforts by the staff to identify and provide technical assistance to institutions with a high default potential. We recommended that OPE undertake such efforts. OPE officials informed us that they are in the process of implementing our recommendation.

For each executed college housing loan, the U.S. Department of Housing and Urban Development [HUD] withheld funds from the institution for the purpose of paying for audits and inspections during the life of the project. When the Department of Education was formed, the Office of Management and Budget instructed HUD to transfer, the remaining audit and inspection fees to ED. The transfer was never made and, at the time of our review, little had
been done by ED to initiate such a transfer. We estimated that the fees could range from about $1.6 million to $4.9 million. We recommended that ED formally request the fees from HUD.

Since our review, ED has attempted to determine how much money should have been transferred. However, indications are that such a determination is difficult because: One, HUD commingled the audit and inspection fees with other funds since 1971, two, college housing loan records were destroyed and, three, the money was used to pay general administrative expenses, such as salaries. Our review of ED's recent letters to HUD indicates that this issue has not been resolved.

In addition to specific comments on the individual findings of our survey, OPE stressed that management was aware of some of the problems before the audit and had initiated corrective action.

After our survey work at OPE, we initiated an audit of the College Housing and Academic Facilities Loan Programs. We chose for audit 10 institutions that were in default on their college housing loans. Eight of these institutions also had academic facilities loans, and six were in default on these loans. We have provided copies of the reports on these audits to the subcommittee.

Mr. WEISS. Without objection, copies of those audits will be placed in the record at this point.

[The material follows:]
Dear Dr. Olds:

Enclosed for your information and use is a copy of an ED OIG Office of Audit report titled, "AUDIT OF SELECTED ASPECTS OF COLLEGE HOUSING AND ACADEMIC FACILITIES LOAN PROGRAMS, ALASKA PACIFIC UNIVERSITY, ANCHORAGE, ALASKA." Your comments dated June 6, 1983 have been incorporated into the final report and included as an APPENDIX. If you have any additional comments, please submit them within 30 days from the date of this letter. You should provide any comments or additional information that you believe may have a bearing on the settlement of this audit. These comments must be forwarded directly to the following Education Department official responsible for the final determination of corrective actions on deficiencies covered in this report and, where necessary, the determination of amounts that must be refunded to the Federal Government:

Assistant Secretary
Office of Postsecondary Education
Department of Education
Room 4907, ROB-3
Washington, DC 20202

Revised Office of Management and Budget (OMB) 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 principles of the Freedom of Information Act (Public Law 90-23), reports issued to the Department’s grantees and contractors are made 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.

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

Sincerely,

Leland S. Beach
Regional Inspector General for Audit
ED OIG Office of Audit

Enclosure

Direct Reply To:
Assistant Secretary
Office of Postsecondary Education
Department of Education
Room 4507, ROB-3
Washington, DC 20202
Office of Inspector General

Office of Audit

AUDIT OF SELECTED ASPECTS OF COLLEGE HOUSING AND ACADEMIC FACILITIES, LOAN PROGRAMS

ALASKA PACIFIC UNIVERSITY
ANCHORAGE, ALASKA

NOTICE

The designation of financial and/or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the ED OIG Office of Audit. Final determination on these matters will be made by appropriate ED officials.

ED OIG Office of Audit
Region X
Seattle, Washington
Audit Control No. 10-30012
June 10, 1983

U.S. DEPARTMENT OF EDUCATION
Background

Alaska Pacific University (University), formerly Alaska Methodist University, is a private nonprofit institution of higher education founded in 1959 under the laws of the State of Alaska. The University is an ecumenical, nonsectarian institution, offering undergraduate, graduate, and associate degree programs. In June 1976, the Board of Trustees closed the University to study, reorganize, and determine new directions. In September 1977, the institution reopened as Alaska Pacific University.

A College Housing Loan was awarded to the University in 1962 by the U.S. Department of Housing and Urban Development (HUD). The administration of the loan was transferred from HUD to ED in May 1980. The principal amount of the loan was $2,956,000, repayable over 38 years. The University issued first mortgage bonds (Series A for $1,550,000 at 3.375 percent interest and Series B for $1,406,000 at 3.625 percent interest) as security for the loan. The purpose of the loan was to construct (i) a student dormitory for 88 students with one faculty apartment (ii) a student union consisting of dining facilities, snack bar, post office, bookstore, offices, activity rooms, lounges, and storage; (iii) 21 family apartments for students and faculty; and (iv) three faculty duplexes.

The pledged facilities for the College Housing Loan consisted of the project facilities, the existing faculty/staff duplexes, and the existing dormitory and apartment building known as Gould Hall. Pledged revenues for the loan consisted of the net revenues from pledged facilities, $40,000 of student tuition per year, and a student union fee of $30 per semester (including summer session) for each full-time student enrolled at the University.

The University applied for and received approval from ED for alternate use of Gould Hall. Since December 1981, Gould Hall has been leased as office and laboratory space to the U.S. Geological Survey. The lease provided for annual payments of $283,945 for 5 years with an option to renew for an additional 5 years.

The University had obtained annual deferments for debt service payments on the College Housing Loan which were in default. The current deferment, approved by ED, covers the period July 1, 1982 through June 30, 1983. Conditions for the deferment required the University to make monthly payments of $15,000 from July 1, 1982 through June 30, 1983, plus two payments of $50,000 to be made in

AUDIT OF SELECTED ASPECTS OF COLLEGE HOUSING AND ACADEMIC FACILITIES LOAN PROGRAMS

ALASKA PACIFIC UNIVERSITY
ANCHORAGE, ALASKA

INTRODUCTION
October 1982 and April 1983. These payments will be applied to past due interest by ED. The following summarises amounts past due, as of January 31, 1983, for principal and interest payments on original loan amounts of $1,550,000 for Series A Bonds and $1,406,000 for Series B Bonds.

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<th>Interest From 10/1/77</th>
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<tr>
<td></td>
<td>$2,656,000</td>
<td>$575,000</td>
<td>$501,738</td>
<td>$1,076,738</td>
</tr>
</tbody>
</table>

An Academic Facilities Loan was awarded to the University in 1966 by the U.S. Department of Health, Education, and Welfare's Office of Education. The principal amount of the loan was $95,000 repayable over 18 years at 3 percent interest. The administration of the loan was transferred to the U.S. Department of Education (ED) when the Department was established in May 1980. The purpose of the loan was to renovate Grant Hall and construct an addition thereto.

Scope of Audit

The purpose of our audit was to review selected aspects of the College Housing and Academic Facilities Loans at the University. Our specific objectives were to determine whether (i) debt service payments were current for the Academic Facilities Loan, (ii) terms and conditions of the college housing deferment were complied with, (iii) these loans received equal treatment with other long-term obligations, and (iv) pledged revenues had been utilised for other than the college housing loan.

We reviewed the University's Loan Management Reports for the Fiscal Years ended June 30, 1981 and 1982, tested selected items of receipts, evaluated allocation bases for claiming maintenance and operation expenses, and analyzed notes payable to the Federal Government. Our audit was conducted in accordance with generally accepted government auditing standards appropriate to the limited scope audit described above. Our audit did not include an evaluation of the reasonableness of expenses claimed for maintenance and operation, nor a review of the efficiency and economy of operation.

Audit field work was performed during the period February 28 through March 4, 1983 at the University in Anchorage, Alaska.
HIGHLIGHTS OF AUDIT RESULTS

The University was current on debt service payments for the Academic Facilities Loan. Although significantly in default on the College Housing Loan, the University had generally complied with the terms and conditions of the current deferment agreement. These loans were the University's only current long-term obligations.

Management attention was needed to enhance the operation of facilities pledged under the College Housing Loan and improvements were needed regarding (i) financial ability, (ii) pledged revenues, (iii) maintenance and operation expenses, and (iv) accounting system. Our findings are summarized in the following paragraphs and presented in detail in the FINDINGS AND RECOMMENDATIONS section of this report.

The University had executed an agreement to sell about 40 acres of land for about $10.9 million. A $1 million option payment is due in the near future. In our opinion, since the College Housing Loan has been delinquent for about 10 years, a priority use of the proceeds from this sale should be to repay the College Housing Loan. We recommend that proceeds from the sale be used to (i) bring the debt service payments current, and (ii) establish a fund to repay the balance of the loan. (Page 5)

Some pledged revenues were used for general operation and one pledged facility was used without reimbursement. As a result, pledged revenues estimated at $136,500 were not available to help meet debt service payments. We recommend that (i) tuition and student union fees be deposited to College Housing revenue accounts, as required, (ii) approval for alternate use of the Student Union be requested from ED and such approval be subject to a use fee, and (iii) an independent audit be performed of bookstore revenues. (Page 7)

Expenses for maintenance and operation were not properly allocated, or should not have been allocated, to the College Housing Project. The project had been allocated or charged about $110,000 more than its equitable share of such expenses. We recommend that expenses be (i) charged directly to each facility, (ii) allocated on an equitable basis and exclude depreciation and general administration, and (iii) reduced by $110,000 for the project. (Page 11)

The accounting system was capable of providing separate accountability for revenues and expenses for pledged facilities, but the University had not elected to fully utilize the system. Information was not readily available to assess rental rates and use charges for pledged facilities. We recommend that systems and procedures be implemented to (i) identify, classify, and aggregate revenues and expenses for each pledged facility, and (ii) revise rental rates and use charges as necessary. (Page 14)

The President of the University advised us in writing June 6, 1983 (See APPENDIX) that the University would not be providing comments to us on the specific findings and recommendations in the audit report. He advised us that the University is in the process of negotiating a new agreement on the College Housing Loans with ED officials. He stated the University would not be in a position to respond point-by-point to the audit until a new agreement is in place.

The issues as presented in this audit report are issues that will need to be considered by ED officials in the negotiation of a new agreement. Therefore, the final audit report is being issued by us based on the University President's decision not to provide comments to us on the audit findings and recommendations.
FINDINGS AND RECOMMENDATIONS

Financial Ability

A pending sale of real property will provide the University about $10 million. The University's College Housing Loan is about $1.1 million in arrears for delinquent principal and interest. A priority use of the proceeds from the sale of real property should be to pay this delinquent principal and interest.

The University's financial statements for the years ending June 30, 1981 and 1982 were audited by an independent public accountant. The statements showed that the University had made an agreement to sell about 40 acres of its land for about $10.9 million. The sales agreement provided for an option period of about two years, July 1, 1982 to July 31, 1984, and payment of $2 million in annual installments to bind the option. The option payments are to be deducted from the purchase price and are nonrefundable if the option is not exercised.

Subsequent to June 30, 1982 the University received the first option payment of $1 million and is to receive the second option payment on July 31, 1983. Indications were that the second option payment would be received. Since the two option payments represent about 20 percent of the agreed sale price and are not refundable, it appears likely that the sale will be consummated.

None of the $1 million from the first payment was used by the University to pay on the delinquent College Housing Loan. We recognized that the University had been in a cash shortage position and had other obligations to pay. Our concern now is that subsequent receipts from the sale of this property may be used for purposes other than repayment of the College Housing Loan.

The audited financial statements showed that the University's assets significantly exceeded the University's liabilities. However, most of the assets were in property and were not previously available for debt payments. The liabilities of $4.6 million included the College Housing Loan of about $2.7 million. If the remaining $2 million is received from the sale of property, conditions will change so that the University should be able to pay debts as they become due.

In our opinion, since the College Housing Loan dates back to 1973 for delinquent principal and to 1977 for delinquent interest, the $1 million to be received in July 1983 should be used to pay the entire balance of delinquent principal and interest. Also, upon receipt of the net proceeds from the sale of this property, a fund should be set up to reserve the funds to pay the outstanding...
balance of the loan (estimated to be about $2.1 million at July 31, 1983). Such a fund would provide the University with the financial ability to make payments on these loans by the dates due.

There are many factors to consider when determining the cost to ED for these loans remaining in arrears. Therefore, it was not possible to determine a precise amount. However, the difference between the interest rate the University pays ED and the interest rate the Federal Government pays to borrow funds has recently been 6 to 10 percent. If a million dollars remained in arrears for 10 years, the cost to the Federal Government would be in excess of $600,000.

Recommendations

We recommend that:

1. The $1 million option payment to be received in July 1983 be used to pay the Department of Education the total delinquent principal and interest due on the College Housing Loan.

2. A fund be established from the proceeds of the sale of real property, when received, to repay the balance of the College Housing Loan.
Pledged Revenues

Pledged revenues of about $136,500 had not been deposited to the College Housing Project's revenue accounts as required by the Trust Indenture. Pledged tuition and fees had been used for general operations. Pledged facilities had been used without reimbursement and some other revenues were understated. These conditions contributed to the net revenues from the operation of the pledged facilities not being sufficient to meet debt service payments.

Background

The Trust Indentures for the College Housing Loan establish the pledged revenues for the loan and prescribe conditions designed to assure the availability of pledged revenues:

Sections 7 and 20 define pledged revenues to be (1) the net revenues from the operation of ownership of the pledged facilities, (2) the income from tuition fees not to exceed $40,000 per year, and (3) a student union fee of not less than $30 per regular semester and $30 per summer session for each full-time student enrolled at the University.

Sections 14 through 18 contain conditions to assure the availability of pledged revenues and are generally referred to as "flow of funds" provisions. These provisions prescribe the establishment of the Revenue Fund Account, Bond and Interest Sinking Fund Account, and Repair and Replacement Reserve Account. These provisions detail the flow of pledged revenues into those accounts and the use of pledged revenues for maintenance and operation expenses, annual debt service, debt service reserve, and the repair and replacement reserve. These provisions also provide for the disposition of any remaining residual revenues.

Tuition and Student Union Fees

During the two years ended June 30, 1982, $80,000 of tuition fees and $56,500 ($16,900 of reported and $39,600 of unreported) student union fees pledged as revenues to the College Housing Loan had been used for general operation of the University. The $39,600 of student union fees was not reported on the Loan Management Reports. Tuition and student union fees had been collected by the University and deposited to its General Fund rather than to specified restricted funds, as required.
The terms of the Trust Indenture required tuition fees to be deposited to the Bond and Interest Sinking Fund and used only for debt service payments. Student union fees were required to be deposited to the Revenue Fund Account to be used, together with other pledged revenues, for the (i) maintenance and operating expenses of the pledged facilities, (ii) debt service on the bonds, and (iii) required reserves.

Student union fees included on the Loan Management Reports for the years ended June 30, 1981 and 1982 may not have accurately reflected the fees collected by the University. The University reported student union fees of $4,500 and $12,400 for 1981 and 1982, respectively. We analyzed student union fees to determine whether amounts reported were reasonable.

We determined the fees that should have been collected by multiplying the number of full-time students reported each semester by the required $30 fee. This review indicated that the University should have collected student union fees of about $22,100 and about $34,400 for 1981 and 1982 respectively. Student union fees not reported were $17,600 ($22,100 less $4,500) and $22,000 ($34,400 less $12,400).

The tuition and student union fees that had not been deposited in the College Housing project's revenue accounts are shown in the following schedule:

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<td>$136,500</td>
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</table>

The University had used space in the Student Center, a pledged facility, for purposes other than those intended when the College Housing Loan was approved. The University had been using space on the first floor of the Student Center building as offices for six faculty and staff members and one room for classroom instruction. The University had neither requested nor received approval from ED for this alternate use of the pledged facility. Also, the University had neither reimbursed the College Housing project for use of the space nor absorbed its fair share of the buildings maintenance and operation expenses. We did not attempt to determine the total square footage of the space involved in this alternate use of the facility. A study should be performed to determine the total space used for University activities in order to compute a reasonable fee for the University's use of this pledged facility. Also, the University should request approval for the alternate use of the facility.
We did note that some space on the first floor of the Student Union building was used for such purposes as offices for the Health Nurse and Student Government. In our opinion, the use of space in a pledged facility for these purposes would be acceptable.

**Bookstore Revenues**

The University's Loan Management Reports indicated that bookstore revenues of $41,830 for 1981 and $63,213 for 1982, as reported to ED, may have been understated. The bookstore was operated within the Student Union building, a pledged facility, and bookstore revenues are, therefore, part of pledged revenues for the College Housing Loan.

A review of maintenance and operation expenses charged to the bookstore indicated that purchases exceeded revenues by about $10,300 and $3,250 for 1981 and 1982, respectively. However, these losses did not appear to be reasonable. Therefore, we evaluated bookstore revenues reported to ED for 1982.

Our evaluation was based on the University's reported enrollment and certain assumptions. Our assumptions were that each student enrolled at the University for a regular semester or summer session would need to purchase at least one textbook and that the average retail price for a textbook would be about $20. We multiplied enrollment reported for Fall 1981, Spring 1982, and Summer 1982 by $20 and arrived at a figure of about $78,000. In our opinion, this would be the minimum revenue expected from textbook sales. For those students who were required to purchase several textbooks (e.g., full-time students), revenues from textbook sales would increase substantially.

We believe that an independent audit should be performed to determine the reasonableness of bookstore revenues.

**Recommendations**

We recommend that:

1. Tuition fees of $88,000 be deposited to the College Housing project's Bond and Interest Sinking Fund account as required by the Trust Indenture.

2. Student union fees be properly accounted for and as much as $56,500 ($22,100 for 1981 and $34,400 for 1982) be deposited in the College Housing project's Revenue Fund account as required in the Trust Indenture.

3. Approval be requested from ED for alternate use of the Student Union building and that such use be subject to a fee based on space used.

4. An independent audit be performed on bookstore revenues to ensure that total revenues are reasonable.
The University had allocated maintenance and operation expenses between College Housing and University facilities. Although some maintenance and operation expenses had been direct costed to the benefiting facility, the majority of these expenses had been allocated on a basis which had not been properly supported and documented. Our review indicated that (i) the allocation basis used was not proper; and (ii) maintenance and operation expenses included some expenses which were not allowable and some which should have been direct costed to the University. During the two years ended June 30, 1982, the College Housing Project had been charged about $110,000 more than its equitable share of maintenance and operation expenses.

### Background

The Trust Indenture established the allowable charges to the College Housing pledged facilities. In Section 15, current expenses of the pledged facilities are defined as all necessary operating expenses, current maintenance charges, expenses of reasonable upkeep and repairs, properly allocated share of charges for insurance, and all other expenses incident to the operation of the pledged facilities, but shall exclude depreciation, all general and administrative expenses of the University, the payment into the Repair and Replacement Reserve Account, and all expenses of existing University facilities incurred prior to the date of the loan.

### Allocation Basis

University officials advised us that large purchases for maintenance and operation had been charged directly to the benefiting facility. However, the University had allocated 75 percent of the remaining maintenance and operation expenses to the College Housing Project and 25 percent to the University. We were advised by University officials that documentation was not available to support that the allocation basis was reasonable and proper.

Maintenance and operation expenses normally include expenses incurred for such items as janitorial and utility services; repairs to buildings, furniture, and equipment; care and maintenance of grounds, buildings, and other plant facilities; and charges representing use allowance and/or depreciation applicable to the buildings and equipment utilized. The expenses included in this category normally are apportioned and allocated to applicable cost objectives based on space utilization.
We performed a study of space utilisation at the University. Our study indicated that the allocation basis used by the University had resulted in the College Housing project being charged maintenance and operation expenses in excess of its equitable share. Our study indicated that University activities had occupied at least 34 percent of total University space while being allocated only 25 percent of maintenance and operation expenses. These expenses should have been allocated on the basis of space utilized.

**Custodian Expenses**

At the time of our review, the campus maintenance staff included 5 custodians and 5 maintenance employees. Custodians, except for the Supervisor, were assigned to a particular facility and should have been direct-costed to that facility. The maintenance employees were not assigned to a particular facility and allocation of expenses for these employees appeared to be proper.

Allocation of the expenses for all 5 custodians would not be proper. However, allocating the supervisor's salary would be reasonable because the supervisor's efforts benefit both the College Housing project and the University. Expenses for the remaining custodial staff should be direct-costed to the facility to which they were assigned rather than being included in expenses to be allocated.

We recomputed custodian expenses for 1982. We direct-costed expenses to assigned activities and allocated supervisory effort based on space utilisation. Our analysis indicated that maintenance and operation expenses for custodians had been overallocated to the College Housing project by about $7,700 for 1982.

**Motor Pool Expenses**

Motor pool expenses had been included in maintenance and operation expenses and allocated at 75 percent to College Housing facilities. At the time of our review, the motor pool consisted of 14 vehicles of which seven were assigned to maintenance employees and seven were assigned to faculty and staff. Inclusion of the expenses for the seven maintenance vehicles in maintenance and operation expenses for allocation between College Housing and University facilities was considered proper.

Inclusion of the expenses for the seven faculty/staff vehicles to be allocated was not proper. Expenses for the operation of faculty/staff vehicles would be general and administrative expenses of the University and would not be allowable under terms of the Trust Indenture.
Assuming that motor pool expenses would be about equally distributed between the vehicles used for maintenance and the vehicles used for general and administration, the University should have eliminated about 50 percent of motor pool expenses from maintenance and operation expenses. Such an adjustment to gas and oil expenses would reduce maintenance and operation expenses by about $6,400 for 1981 and about $3,800 for 1982.

Summary

College Housing's share of maintenance and operation expenses needed to be reduced because (i) the allocation was not based on space utilization and (ii) certain expenses should not have been allocated to the College Housing project.

We noted that maintenance and operation expenses should have been allocated differently for the years ended June 30, 1981 and 1982. Custodial salaries should have been reduced by $7,700 and motor pool expenses by about $10,000. The remaining maintenance and operation expenses should have been allocated based on space utilization of 66 percent for College Housing and 34 percent for University facilities. Our review, using such adjustments and changes, indicated that the College Housing project had been charged about $110,000 ($62,300 for 1981 and $47,500 for 1982) more than its equitable share of maintenance and operation expenses.

Recommendations

We recommend that:

1. Maintenance and operation expenses identifiable to a particular facility be direct costs to that facility.

2. General and administrative expenses be removed from maintenance and operation expenses to be allocated.

3. Allowable maintenance and operation expenses be allocated between College Housing and University facilities on an equitable basis.

4. Maintenance and operation expenses charged to the College Housing facilities be reduced by $62,300 for 1981 and $47,500 for 1982. These funds of about $110,000 should be deposited to the Bond and Interest Sinking Fund Account.
The University's accounting system did not identify, classify, and segregate revenues and maintenance and operation expenses to each of the pledged facilities. The University had an accounting system available which included the necessary account classification codes to separately identify revenues and expenses for each of the pledged facilities. However, as of June 30, 1982, the available account classification codes had not been used. As a result, information was not available to ensure that rental rates and charges for use of each pledged facility were sufficient to meet maintenance and operation expenses and to contribute to debt service payments.

Background

Under Section 20 (b) of the Trust Indenture, the University agreed to establish such parietal rules, rental rates, and charges for the use of the pledged facilities as may be necessary to (i) assure maximum occupancy and use of said facilities, and (ii) provide, together with the other funds herein pledged, (a) the operating and maintenance expenses of said facilities, (b) the debt service on the bonds, (c) the required reserve therefore, and (d) a repair and replacement reserve.

Section 20 (j) requires the University to keep accurate financial records and proper books relating to the operation of the pledged facilities and other pledged revenue sources.

Current Procedures

The University's accounting system did not provide separate accountability for revenues from the operation of the pledged facilities. Instead, revenues generated by the student dormitory, faculty/student apartments, and faculty/staff duplexes were accounted for in one account titled "Dorm and Housing." Without separate revenue accounts, the University could not readily determine how much revenue had been generated from each facility.

Also, maintenance and operation expenses allocated to these pledged facilities had not been specifically identified to the dormitory, apartments, or duplexes. Maintenance and operation expenses for the three facilities were entered in the "Dorm and Housing" expense accounts. Because expenses had not been segregated by facility, the University was precluded from knowing whether the expenses of a given facility were being offset by its revenues.

Systems Capability

The University's accounting system was capable of providing separate accountability for the revenues and expenses associated
with each individual pledged facility. Account classification codes had been established to account for the revenues and expenses of each of the pledged facilities. However, as of June 30, 1982, the University had elected not to utilize the available account codes. University officials advised us that they plan to fully utilize all available account codes when the accounting system is computerized in the near future.

Summary

The accounting system did not contain sufficient information to identify, classify, and segregate revenues and expenses for each of the College Housing pledged facilities. Therefore, the University did not have the necessary information to determine whether the rental fee for a particular pledged facility needed to be adjusted, nor the amount of the adjustment needed, to meet maintenance and operation expenses and to contribute to debt service payments.

Recommendations

We recommend that:

1. Systems and procedures, for financial management of College Housing pledged facilities, be implemented which will effectively and reliably identify, classify, and segregate revenues and expenses to the individual facilities.

2. Information regarding revenues and expenses for each pledged facility be used to review and adjust rental rates. Charges for use of the facility should be adjusted, if necessary, to ensure that revenues are sufficient to meet maintenance and operation expenses and contribute to debt service payments.
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**Total**

| $105,000 | $219,722.17 | $324,722.17 |

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**Total**

| $120,000 | $251,998.25 | $371,998.25 |
June 6, 1983

Leland S. Beach
Regional Inspector General for Audit
ED OIG Office of Audit
U.S. Department of Education
Third & Broad Building M/S 105
2901 Third Avenue
Seattle, Washington 98121

Dear Mr. Beach:

On our Board of Trustee's and legal counsel's review of the audit we have respectfully come to the following conclusion. We have been operating on a negotiated annualized agreement with the Department of Education for the past two years. We have been in full compliance with that agreement, and, therefore, find the audit on the original conditions of the loan at this time an inappropriate assessment of our situation.

We are in the process of renegotiating the entire matter in the interest of a full and long term agreement, and would not be in a position to respond point by point to the audit until that new agreement is in place.

Our annual agreement carries through June 30, 1983 and we have expected being in full conformity with that policy, the condition would be extended. None the less, it is imperative for the Department of Education and the University to conclude the matter swiftly. We assume that new agreement will supersede all past agreements and become a new basis for audit and recommendations.

Cordially,

Glenn A. Olds
President
GAO/lab
## REPORT DISTRIBUTION

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<thead>
<tr>
<th>Auditee</th>
<th>No. of Copies</th>
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| Dr. Glenn A. Olds  
President  
Alaska Pacific University  
Anchorage, Alaska 99504 | 2 |

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Department of Education  
Room 4907, ROB-3  
Washington, DC 20202 | 2 |

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Office of Student Financial Assistance  
Region X | 1 |
| Secretary's Regional Representative  
Region X | 1 |
Dr. William Odom  
President  
Bethel College  
Cherry Street  
McKenzie, Tennessee  38201

Dear Dr. Odom:

The purpose of this letter is to provide you with the RESULTS OF OUR REVIEW OF THE COLLEGE HOUSING AND ACADEMIC FACILITIES LOAN PROGRAMS AT BETHEL COLLEGE, MCKENZIE, TENNESSEE, FOR THE PERIOD SEPTEMBER 1, 1981, THROUGH JULY 31, 1983.

INTRODUCTION

BACKGROUND

Bethel College is a private, non-profit, 4-year liberal arts college that was established in 1842. The College is supported by the Cumberland Presbyterian Church and is accredited by the Southern Association of Colleges and Schools. Bethel College offers Bachelor of Arts and Bachelor of Science degrees in a wide variety of academic programs. The College is located in McKenzie, Tennessee. Enrollment for the 1982-83 academic year averaged about 450 students each quarter.

Title IV of the Housing Act of 1950, as amended, created the College Housing Loan Program (CHLP) with the objective of assisting educational institutions in providing student and faculty housing and other educational facilities such as student centers, health centers, and dining halls. Assistance is provided through direct loans at 3 percent interest for the construction or purchase of such facilities. The Academic Facilities Loan Program (AFLP) was established under Title VII C of the Higher Education Act of 1965. The program provides long-term financing to institutions for construction of academic facilities such as classrooms and libraries.

The CHLP was managed by the Department of Housing and Urban Development (HUD) until May 1980 when the program was officially transferred to the Department of Education (ED). Under an agreement with ED, HUD continued to administer the program through April 1981. The AFLP was managed by Health, Education, and Welfare's
Office of Education (OE) until May 1980 when the program was transferred to ED. Bethel College received a CILP loan of $319,000 in 1959 for the construction of a dormitory and a dining hall (Project No. TN-40-CH-103A). In 1966, another CHLP loan of $304,000 was granted for the construction of additional dormitories (Project No. TN-40-CH-104). In 1967, the outstanding debt of the 1959 loan was combined with another loan of $515,000 for the construction of a student union building (Project No. TN-40-CH-103B) as an addition to the dining hall. At July 31, 1983, principal and interest in default on the CHLP loans totaled $272,000 and $223,919, respectively.

Bethel College also has two AFLP loans. The College received an AFLP loan of $255,000 in 1965 for the construction of a library (Project No. TN-5-4-345). In 1970, another AFLP loan of $452,000 was granted for the construction of a Fine Arts building and a Physical Education building (Project No. TN-5-4-346). At July 31, 1983, principal and interest in default on the AFLP loans totaled $195,000 and $181,464, respectively.

In 1977, Bethel College entered into workout agreements with OE and HUD providing for a revised schedule of loan payments. The agreements provide for annual payments increasing each year until 1987 when the payments remain constant. ED has accepted the agreements subject to their annual review and evaluation. The College is current in its payments under the workout agreements.

SCOPE OF AUDIT

The purpose of our audit was to review selected aspects of the CHLP and AFLP loans at Bethel College. Specifically, the objectives of the audit were to determine whether:

1. receipts and expenditures for CHLP pledged facilities are being properly determined and reported to ED, and net revenues are properly accounted for and used to make the payments on the loans;

2. the institution complied with the terms and conditions of the workout agreements;

3. Federal loans had received equal treatment with other long term obligations of the institution; and

4. the institution was current in making payments under the workout agreements.

Our audit included a review of the Trust Indentures and workout agreements, a review of the College's accounting system and procedures for allocating revenue and expenditures to the projects, a review of the College's latest audited financial statements, a
review of supporting documentation for selected items of costs charged to the projects, and discussions with College officials. Our audit was conducted in accordance with generally accepted government auditing standards appropriate to the limited scope audit described above. Audit work was conducted at Bethel College and the Nashville OIG audit office August 23, 1983; through November 8, 1983. The audit generally covered loan activities during the period September 1, 1981, through July 31, 1983.

RESULTS OF AUDIT

Bethel College has generally complied with the terms and conditions of the CHLP Trust Indentures and the workout agreements for the CHLP and AFLP loans. The College was current in its payments under the workout agreements. The CHLP and AFLP loans had received equal treatment with other long-term obligations of the College. However, all pledged revenue for one CHLP project was not credited to the project's revenue account.

Except for this matter, which is discussed in detail below, the tested items were, in compliance with applicable laws and regulations. Nothing came to our attention as the result of audit tests that caused us to believe the tested items were not in compliance with applicable laws and regulations.

Pledged Revenue Not Credited to Project

During the period September 1, 1980, through July 31, 1983, pledged revenue of $51,975 was not credited to a CHLP project in accordance with the Trust Indenture. Student union fees and a portion of tuition revenue each year should have been credited to the project revenue account for Project 103 A and B.

The Trust Indenture for CHLP Project 103 A and B states that the project is secured by a first mortgage on the project and a first lien and pledge on project revenue, the first $10,000 of tuition paid by all students attending the College, and the student union fee of $5 per quarter to be paid by all students attending the College.

Our review of records for Project 103 A and B indicated that student union fees and the first $10,000 of tuition revenue was not credited to the project as required. The amounts not credited to the project for FY '81, FY '82, and FY '83 were $16,785, $17,540, and $17,650, respectively. As a result, the Loan Management reports for FY '81 and FY '82 did not report all revenue available to the project.

Since 1977, the College has made the payments required by the workout agreement, even though project revenue was insufficient to pay project expenses and debt service. The College used non-project funds to pay the deficits each year. The application of
the student union fees and the first $10,000 of tuition revenue would have decreased the net deficit but College contributions would have still been necessary to pay project expenses and the payments required under the workout agreement.

College officials agreed that project records should reflect the application of student union fees and the $10,000 of tuition revenue as project revenue.

**Recommendations**

We recommend that the College credit the revenue account for Project 103 A and B for the additional $17,650 of pledged revenue for FY '83. We also recommend that the Loan Management reports for FY '81 and FY '82 be revised and submitted to ED to show the additional revenue. In the future, the project revenue account should be credited with all project revenue including any pledged revenues.

**Auditee's Comments**

The auditee concurred with our finding and recommendations, and indicated that corrective action has been taken.

Your comments to the audit finding are summarized above and included as an attachment to this report. Any additional comments should be forwarded to the following Education Department official responsible for the final determination of corrective actions on deficiencies covered in this report:

Assistant Secretary
Office of Postsecondary Education
Department of Education
Room 4044, ROB-3
400 Maryland Avenue, S.W.
Washington, D.C. 20202

Revised Office of Management and Budget (OMB) 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 principles of the Freedom of Information Act (Public Law 90-23), reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent the information contained therein is not subject to exemptions in the Act.

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

Sincerely,

M. Bruce Nestlehutt
Regional Inspector General for Audit
ED OIG Office of Audit, Region IV

Attachment
January 6, 1984

Mr. M. Bruce Nestlehutt
U. S. Department of Education
Regional Inspector General for Audit Region IV
101 Marietta Tower
P. O. Box 1598
Atlanta, Georgia 30301

Dear Mr. Nestlehutt:

I would like to thank you for sending the draft letter report on the review of the College Housing and Academic Facilities Loan Programs at Bethel College.

We concur with the facts and recommendations that were presented in the draft report.

Our auditors, Rhea & Ivy of Memphis, Tennessee, mailed to you on December 20, 1983, the revised Loan Management Reports that were recommended.

If any additional information is needed, please contact us.

Sincerely,

[Signature]

William L. Odom
President

WLO/ew

AC: Mr. Darrell Smith
Business Manager
DISTRIBUTION SHEET

Auditees

Principal Action Official

Mr. Edward Elmendorf
Assistant Secretary
Office of Postsecondary Education
Department of Education
Room 4044, ROB-3
400 Maryland Avenue, S.W.
Washington, D.C. 20202

Office of Inspector General

Mr. Frank Yanni, Chief
Postsecondary Education Audit Branch, Washington

Mr. Douglas R. Ponci, Chief
Contract Audit Branch
RIGA, Region X (Lead Region)
RIGA, Region IV

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Dear Sirs:

Enclosed is a copy of the Inspector General’s audit report entitled, "Audit of the College Housing and Academic Facilities Loan Programs at Florida Memorial College, Miami, Florida, For the Period July 1, 1982, Through July 31, 1983."

Although your comments to the draft audit findings have been incorporated in this final audit report, please respond within 30 days from the date of this letter to each final finding and recommendation, presenting any comments or additional information that may have a bearing on the settlement of this audit. Your comments should be forwarded directly to the Department of Education official indicated below who is responsible for the final determination of corrective actions on deficiencies covered in this report including, where necessary, the determination of amounts that must be refunded to the Federal Government.

Therefore, receipt of your comments within 30 days would be greatly appreciated.

PLEASE RESPOND DIRECTLY TO Mr. Edward Elmendorf, Assistant Secretary for Postsecondary Education
Department of Education
Mall Stop 3453
400 Maryland Avenue, S.W.
Washington, D.C. 20202

In accordance with the principles of the Freedom of Information Act (Public Law 90-21), reports issued to the Department’s grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to the exemptions in the Act.

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

Sincerely,

M. Bruce Nestlehutt
Regional Inspector General for Audit
ED OIG, Office of Audit, Region IV

Enclosure
AUDIT OF THE
COLLEGE HOUSING AND ACADEMIC FACILITIES LOAN PROGRAMS
AT
FLORIDA MEMORIAL COLLEGE
MIAMI, FLORIDA
FOR THE PERIOD JULY 1, 1982, THROUGH JULY 31, 1983

DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT
REGION IV
Audit Control No. 04-30066
April 1984
INTRODUCTION

BACKGROUND

Florida Memorial College (FMC) is a 4-year, co-educational institution supported by the Baptist Church. FMC offers Bachelor of Arts and Bachelor of Science degrees in a wide variety of academic programs. The College is located in Miami, Florida. Approximately 1,220 students were enrolled in the Spring 1983 semester, a significant increase over previous semesters.

Title IV of the Housing Act of 1950, as amended, created the College Housing Loan Program (CHLP) with the objective of assisting educational institutions in providing student and faculty housing and other educational facilities such as student centers, health centers, and dining halls. Assistance is provided through direct loans at 3 percent interest for the construction or purchase of such facilities. The Academic Facilities Loan Program (AFLP) was established by Congress under Title VII C of the Higher Education Act of 1965. The program provides long-term financing to institutions for construction of academic facilities such as classrooms and libraries.

The CHLP was managed by the Department of Housing and Urban Development (HUD) until May 1980 when the program was officially transferred to the Department of Education (ED). Under an agreement with ED, HUD continued to administer the program through April 1981. The AFLP was managed by the Department of Health, Education, and Welfare's Office of Education until May 1980 when the program was transferred to ED.

FMC received a CHLP of $1,575,000 in 1968 for the construction of two dormitories and a student union building. Revenues from these facilities and a special student union fee were to be used to operate and maintain the facilities and meet debt service requirements. At May 31, 1983, principal and interest in default on the CHLP loan was $200,000 and $190,725, respectively.

The College also received an AFLP loan of $1,536,000 in 1968 for the construction of an academic complex consisting of a new classroom building, library, science building, music building, auditorium, and related service units. At May 31, 1983, principal and interest in default on the AFLP loan was $257,000 and $241,800, respectively.

FMC entered into a workout agreement with HUD in 1980 to pay the delinquent principal and interest on the CHLP loan. A CHLP workout agreement provided for monthly payments of $5,000 and quarterly payments of $11,000 toward repayment of the CHLP loan. An identical agreement was executed with ED for repayment of the AFLP loan. The College has not been current in making the payments required under the workout agreements.
In September 1982, ED Loan Management staff visited the College to finalize another workout agreement for repayment of the defaults on the CHLP and AFLP loans and to inspect the project. As a result of the visit, ED agreed to not exercise any remedies of default pending the College's performance of additional requirements. At the completion of our audit work on November 8, 1983, all requirements had not been met.

**SCOPE OF AUDIT**

The purpose of the audit was to review selected aspects of the CHLP and AFLP loans. Specifically, the objectives of the audit were to determine whether:

1. Receipts and expenditures for CHLP pledged facilities are being properly determined and reported to ED, and net revenues are properly accounted for and used to make payments on the institution's CHLP loans;
2. The institution complied with the terms and conditions of the workout agreements;
3. Federal loans had received equal treatment with other long-term obligations of the institution; and
4. The institution was current in making payments under the workout agreements.

Our audit included a review of the Trust Indentures and workout agreements, a review of the College's accounting system, a review of project financial records, a review of supporting documentation for selected items of costs charged to the projects, and discussions with College officials.

Our audit was conducted in accordance with generally accepted government auditing standards appropriate to the limited scope audit described above. Audit field work was conducted at FMC and the Nashville OIG Audit office during the period August 2, 1983, through November 8, 1983. The audit covered loan activities during the period July 1, 1982, through July 31, 1983.
HIGHLIGHTS OF AUDIT RESULTS

FMC has been delinquent in making the payments required under the CHLP and AFLP workout agreements. At July 31, 1983, the College was delinquent $118,000 in its payments. Subsequent to completion of our on-site field work, FMC brought the payments current.

FMC has not complied with other provisions of the workout agreements. The College has not obtained a Trustee for the CHLP and AFLP loans, made necessary repairs to the project facilities, and submitted Loan Management reports and an analysis of project costs.

FMC also has not complied with several provisions of the Trust Indenture governing the CHLP loan. Adequate accounting and cost allocation procedures have not been established, the required Revenue Fund Account has not been established, all pledged revenue has not been credited to the CHLP project, and the project facilities have not been maintained in good condition, repair, and working order.

The CHLP and AFLP loans have generally received the same treatment as other long-term obligations of the College.

Except for the items highlighted above and the items detailed in the Findings and Recommendations section of this report, the tested items were in compliance with applicable laws and regulations. Nothing came to our attention as the result of audit tests that caused us to believe the untested items were not in compliance with applicable laws and regulations.

FMC generally agreed with our recommendations. Their response to the findings and recommendations is summarized at the end of each finding together with the auditor's comments as appropriate. The complete text of FMC's response is included as an appendix to this report.
FINDINGS AND RECOMMENDATIONS

Finding No. 1 - NON-COMPLIANCE WITH REPAYMENT AND OTHER PROVISIONS OF THE WORKOUT AGREEMENTS

FMC has experienced financial difficulties since 1970 and, as a result, the College defaulted on its CHLP and AFLP loan payments. In March 1980, FMC entered into workout agreements to satisfy the delinquencies. Another workout agreement was executed in September 1982. The College has not fully complied with the provisions of these agreements. At July 31, 1983, the College was delinquent $118,000 in the required payments under the workout agreements on the CHLP and AFLP loans. In addition, the College has not complied with other provisions of the workout agreements which required the College to obtain a Trustee for the CHLP and AFLP loans, to make necessary repairs to the project facilities, to submit Loan Management reports, and to submit an analysis of project costs.

March 1980 Workout Agreement

In March 1980, the College entered into a workout agreement with HUD to satisfy the delinquent CHLP loan. The CHLP workout agreement provided for payments of $5,000 on the 15th of each month for a period of 30 years or until the delinquency was satisfied and $11,000 each quarter until current principal and interest on the debt was repaid. An identical workout agreement was executed with ED for the AFLP loan.

At July 31, 1983, the College was delinquent $118,000 toward the CHLP and AFLP workout agreements as follows:

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<th>Due Date</th>
<th>CHLP</th>
<th>AFLP</th>
<th>Total</th>
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</tr>
<tr>
<td>Jun 15, 1983</td>
<td>5,000</td>
<td>5,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Apr'83 - Jun 83</td>
<td>11,000</td>
<td>11,000</td>
<td>22,000</td>
</tr>
<tr>
<td>Jul 15, 1983</td>
<td>5,000</td>
<td>5,000</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>$59,000</td>
<td>$59,000</td>
<td>$118,000</td>
</tr>
</tbody>
</table>

Our review indicated that the CHLP and AFLP projects are generating sufficient revenues to pay maintenance and operating expenses and meet the payment schedule required under the workout agreements. FMC officials stated the College is still having cash flow problems in that all revenue is not collected at the time the revenue is earned. This causes a lack of cash at the time payments are due. College officials also said that during the past year, the school had three business managers. The lack of continuity in the business office has contributed to the College
being delinquent in its payments. College officials stated that they would be able to bring the repayment schedule current by October 1983.

On September 9, 1983, subsequent to the completion of our on-site work, the College sent ED $160,000 (also includes one quarterly and two monthly payments which came due after July 31, 1983, for each loan) to bring the CHLP and AFLP loans current as of October 1, 1983.

September 1982 Workout Agreement

Because FMC defaulted on the payments required by the March 1980 agreement, ED Loan Management staff visited the College in September 1982 to attempt to resolve the delinquency. As a result of their visit, ED agreed to not exercise any remedies of default provided FMC performed certain actions regarding the administration of the CHLP and AFLP loans. These actions included:

1. obtaining a Trustee for the CHLP and AFLP loans by September 30, 1983,
2. spending $50,000 to bring the project facilities into a proper state of repair by April 30, 1983,
3. submitting Loan Management reports on a semi-annual basis, and
4. providing ED with an analysis of management and operations costs associated with the operation of the project facilities.

Trustee for the CHLP and AFLP Loans. The College had not appointed a Trustee at the completion of the audit site work on August 10, 1983. We contacted the College by telephone on November 8, 1983, to determine if a Trustee had been appointed and were told that a Trustee had not been appointed.

Expenditure of $50,000 for Repairs. The College was able to show that approximately $25,000 in material, labor, and other costs had been spent toward making needed repairs. Our inspection of the pledged facilities indicated that repair work was still in progress and additional repairs are needed. (See also Finding No. 2.)

Loan Management Reports and Analysis of Project Operating Costs. The College has not submitted the Loan Management reports or the analysis of project operating costs. The last Loan Management Report submitted to ED was for the period ended December 31, 1981. College officials stated that because of the turnover of Business Managers during the past year the reports were overlooked and not completed. College officials said that the delinquent reports would be submitted as soon as possible and future reports would be submitted on time.
Recommendations

We recommend that FMC:

(1) make all future payments required by the work-out agreement in a timely manner.

(2) make all necessary repairs required to bring the project facilities into good working order and condition.

(3) prepare and submit to ED all delinquent Loan Management reports and submit all future reports in a timely manner, and

(4) prepare and submit to ED an analysis of the project operating costs for the project facilities for the fiscal year ended June 30, 1983.

Auditee's Response (Summary)

College officials agreed with the finding and recommendations, stating that actions have been taken or planned to improve the administration of the projects. The College has been unable to obtain a trustee because of its fiscal problems; however, College officials feel that a trustee will be appointed by September 30, 1984. The following actions have been taken by the College:

1. Loan payments have been brought current, and efforts will be made to make payments as agreed;

2. Necessary repairs are being made to maintain the project facilities in good condition; and

3. Loan Management Reports are being submitted.

Auditor's Comments

In addition to the above, the College should prepare and submit to ED an analysis of the operating costs for the project facilities for the fiscal year ended June 30, 1983.
Finding No. 2 - NON-COMPLIANCE WITH TRUST INDENTURE

FMC was not in compliance with several provisions of the Trust Indenture governing the CHLP loan since 1) adequate accounting and cost allocation procedures were not established, 2) the required Revenue Fund Account was not established and maintained, 3) all pledged revenue was not credited to the CHLP project, and 4) the project facilities have not been maintained in good condition, repair, and working order.

Inadequate Accounting and Cost Allocation Procedures

FMC did not have adequate accounting and cost allocation procedures to assure that all project revenues were credited to the project and only project-related expenditures were charged against project revenue. Section 616 of the Trust Indenture states that proper books of accounts and records will be kept in which full, true, and correct entries will be made of all dealings and transactions relating to the operation of the project, other revenue which is pledged to secure all Bonds, and the operation of the borrower.

FMC did not have adequate accounting and cost allocation procedures to assure that all project revenues were credited to the project and only project-related expenditures were charged against project revenue. Section 616 of the Trust Indenture states that proper books of accounts and records will be kept in which full, true, and correct entries will be made of all dealings and transactions relating to the operation of the project, other revenue which is pledged to secure all Bonds, and the operation of the borrower.

FMC had not established separate revenue and expense accounts to account for CHLP revenue and expenses. FMC used a manual accounting system without any procedures for allocating revenue and expenses between several functions. Only those items which were directly related to a particular facility, based on the knowledge of the Business Office personnel, were charged to that facility. CHLP revenue and expenses were sometimes combined with non-CHLP revenue and expenses. For example, all housing revenue, on-campus and off-campus, was credited to a single housing revenue account; Student Union fees of $101,400 which were pledged to the CHLP project were not credited to the CHLP revenue account; and utilities, waste disposal, and maintenance costs were not allocated to the pledged facilities or other non-CHLP facilities. Because FMC did not maintain complete and accurate accounting records, FMC was unable to ensure that all CHLP revenue was credited to the pledged facilities and that the revenue was used only for the operation and maintenance of the CHLP project or to pay other project-related costs. FMC was also unable to determine whether rental rates and fees were adequate to operate sufficient revenue to pay debt service requirements and all maintenance and operating expenses of the CHLP project.

Our review of CHLP revenue and expenses for Fiscal Year 1982-83 indicates that the pledged revenue and the revenue from the project facilities are sufficient to pay all operating and maintenance expenses and the payments required by the CHLP workout agreement. However, as stated in Finding No. 1, FMC was not timely in making the payments under the workout agreement.

According to College officials, a lack of continuity in the Business Office has affected the College's ability to establish and
maintain adequate accounting and cost allocation procedures. FMC had several different business managers in recent years and three since the beginning of the 1982-83 fiscal year.

**Revenue Fund Account Not Established**

Article V of the Trust Indenture states that all rentals, charges, and revenues arising from the operation of the project, and proceeds of the pledged Student Union fee shall be deposited to the credit of a special fund to be known as the Revenue Fund Account, separate and apart from all other funds. Such Revenue Fund Account shall be maintained, so long as any Bonds are outstanding, in a bank which is a member of the Federal Deposit Insurance Corporation. Section 616.61 of 34 CFR also states that all pledged revenues are required to be deposited into the Revenue Fund Account and may be disbursed only in accordance with the loan requirements.

FMC has not established the Revenue Fund Account for the CHLP project. College officials maintain that a separate fund account would place an additional burden on the College because it would require additional personnel to maintain these accounts. They contend that because all revenue is not received at once, but periodically during the year, there would be difficulty in allocating the funds when they are received to the proper accounts.

The intent of the program is that the pledged facilities be self-sufficient and operated and maintained separately from the general operation of the College. A separate Revenue Fund Account is not only required, but is necessary to assure that project funds are separately identified to operate and maintain the project facilities.

**Pledged Revenues Not Credited to Project**

Pledged revenue of $101,040 had not been credited to the project and made available to pay project operating and maintenance expenses and other project-related costs. Article VI of the Trust Indenture states that the borrower covenants and agrees to establish initially the following rates and/or charges:

**Student Union Fee:**

- Regular: $40.00 per enrolled student  
- Summer: $20.00 per regular student

During Fiscal Year 1982-83, Student Union fees of $101,400 were received by FMC. These fees have not been credited to the CHLP project for use in operating and maintaining the project facilities.
Pledged Facilities Not Adequately Maintained

Section 6.07 of the Trust Indenture states that the College will at all times operate, maintain, preserve, and keep the property in good condition, repair, and working order. During a September 1982 visit to FMC, the ED Loan Management staff noted that maintenance and repair work was needed to the extent that ED required that $50,000 be spent by April 30, 1983, to bring the facilities into a proper state of repair.

Our field work at FMC included a site inspection of the pledged facilities. During our inspection, we noted that some repair and maintenance work had been completed and other work was in process. However, the pledged facilities were still in need of additional repair to return the facilities to good working order and condition. The Men's dormitory was especially in need of additional repairs. We noted that windows were broken, the restrooms needed cleaning, and the doors and walls needed painting. Some of the damages to the Men's dormitory and the other pledged facilities was caused by intentional acts rather than through normal usage. College officials stated there was inadequate supervision in the dormitories because of understaffing. They felt a full-time housing director was needed because the College official in charge of student housing functioned in that capacity only on a part-time basis. College officials also mentioned overcrowding and the lack of recreational facilities, a functional Student Union, and telephones in the dormitory rooms as contributing to the defacement to the pledged facilities.

Recommendations

We recommend that FMC:

(1) develop accounting and cost allocation procedures to properly account for revenues and expenses applicable to project facilities;

(2) establish a Revenue Fund Account at an approved bank and deposit any existing project funds and all future project revenue into the account, including the $101,040 of Student-Union fees; and

(3) perform any additional repairs necessary to return the pledged facilities to good condition, repair, and working order.

Auditee's Response (Summary)

College officials agreed to that portion of the finding and recommendations concerning the accounting and cost allocation procedures, and making necessary repairs to the pledged facilities. The College did not agree to the establishment of a Revenue Fund Account.
FMC has revised its accounting system to properly identify the financial results of each project. In addition, procedures are being implemented to determine the allowability and allocability of costs pertaining to the project. College officials stated they have made it a priority to improve the condition of the project facilities and to maintain the facilities in good condition to improve student life on campus.

The College did not agree to establish and maintain a Revenue Fund Account because it creates a hardship to collect revenues at the time they are earned. They stated it is difficult for the institution to segregate cash payments from students in order to credit a Room and Board account at the time of receipt.

Auditor's Comments

The Trust Indenture and Section 616.61 of 34 CFR require that project income and revenue be deposited into the Revenue Fund Account. The purpose of these requirements is to insure that project funds are separately maintained and available to pay project expenses. When the funds are commingled with other University funds, the possibility exists that project funds could be used for non-project expenses. Separate receipts would not necessarily be needed as long as a single receipt provided for an allocation of the cash or credit between the two CHLP projects and non-CHLP functions. Deposits of CHLP revenue into the Revenue Fund Accounts could be made on reasonable intervals, such as weekly.
Dear Mr. Nestlehutt:

Enclosed is our official institutional response to the draft report of your review of Florida Memorial College's "Housing and Academic Facilities Loan Programs", for the period which ended July 1, 1982 through July 31, 1983.

The college agrees in general with the audit findings that it has not complied with the provisions of the work-out agreement pertaining to the College Housing and Academic Facilities Loan Programs. We do realize that there were problems in complying with the provisions of the work-out agreement, but think it significant to note that the college has already made improvements in the areas during the current year.

We wish to thank you for your precise and detailed audit and the recommendations you have made for the improvement of the project administration.

Sincerely,

V. V. Rao
Business Manager

Mr. M. Bruce Nestlehutt
Regional Inspector General for Audit
Office of Inspector General
U.S. Education Department
101 Marietta Tower
P.O. Box 1598
Atlanta, Georgia 30301

March 30, 1984

Ret: Audit Control Number 04-30066
FLORIDA MEMORIAL COLLEGE

PRELIMINARY RESPONSE TO ED.-OIG
AUDIT: DRAFT OF THE COLLEGE HOUSING,
AND ACADEMIC FACILITIES LOAN PROGRAM

AUDIT PERIOD
JULY 1, 1982 THROUGH JUNE 30, 1983

March 28, 1984
FINDING NO. 1 - NON-COMPLIANCE WITH REPAYMENT AND OTHER PROVISIONS OF THE WORK-OUT AGREEMENTS.

INSTITUTIONAL RESPONSE

Florida Memorial College concurs in general, the findings of the auditor that it was in non-compliance with repayment and other provisions of the work-out agreements with the U.S. Education Department pertaining to the "Audit of the College Housing and Academic Facilities Loan Programs". It further acknowledges, that non-compliance with the repayment agreement and the provisions of the work-out agreement was the result of its fiscal problems as well as turnover of personnel in the Business Office. The college does not acknowledge "the possibility of intent" for non-compliance with the repayment agreement and work-out agreements.

TRUSTEE FOR THE CHLP AND AFLP LOANS

The college acknowledges the fact that it has not appointed a Trustee to administer the CHLP and AFLP Loans as required by the agreements. The college could not obtain a trustee because of its fiscal problems which affected the image of the college. However, the college is rebuilding its credibility in the community through institutional progress. This could be evidenced by its recent successful fund raising campaign for $3.5M, of which it had realized $4.1M from the community. Also, the college is experiencing significant growth in its enrollment for the last three years. Additionally, the college has hired trained and competent staff in the Business Office. As a result of the above factors and its 'turn-around' in its fiscal operation, the administration feels certain that it will be able to appoint a trustee by September 30, 1984.
Florida Memorial College further endorses the audit's recommendations regarding the need for making future loan payments in a timely manner, make all repairs needed to maintain the project facilities in good condition, submission of Loan Management Reports and analysis of the project operating costs for the fiscal year 1983 to the Education Department.

The Administration of the college has made strenuous efforts to improve the administration of the projects to be in compliance with the work-out agreement. The following actions have been taken by the institution:

1. The college has brought the loan payments current, and efforts will be made to make payments as agreed.

2. Necessary repairs are being made to maintain the project facilities in good condition.

3. Loan Management Reports are being submitted (see Exhibit A & B).

1. DEVELOP ACCOUNTING AND COST-ALLOCATION PROCEDURES TO PROPERLY ACCOUNT FOR REVENUES AND EXPENSES APPLICABLE TO PROJECT FACILITIES.

INSTITUTIONAL RESPONSE

In accordance with the Trust Indentures governing loans, the college has revised its accounting system to properly identify the financial results of each project. Also, procedures for determining the allowability and allocability of costs pertaining to the project are being implemented in accordance with the applicable cost principles. With the revised accounting system, the institution can properly identify revenue and expense categories related to the project.
2. ESTABLISH A REVENUE FUND ACCOUNT AT AN APPROVED BANK AND DEPOSIT ANY EXISTING PROJECT FUNDS AND ALL FUTURE PROJECT REVENUE INTO THE ACCOUNT.

INSTITUTIONAL RESPONSE

With regard to the establishment of a Revenue Fund Account at an approved bank for depositing project monies, the college does not agree with the auditor, because it creates a hardship on its part to collect revenues at the time they are earned. The college is currently facing the problem of timing difference in receiving financial aid to pay students' tuition and fees. Also, it is difficult for the institution to segregate a cash payment from the student in order to credit a Room and Board account at the time of the receipt.

As a result of the above problems, the institution can properly identify source and application of funds with proper account classification. As mentioned earlier, the institution can properly account for funds of each project with the new accounting system.

3. PERFORM ANY ADDITIONAL REPAIRS NECESSARY TO RETURN THE PLEDGED FACILITIES TO GOOD CONDITION.

INSTITUTIONAL RESPONSE

The institution has made it a priority to improve the condition of the project facilities. As of February 29, 1984, the college has spent $40,841 in making necessary repairs to the facilities. It is the intent of the administration to maintain the project facilities in good condition not only to comply with the trust indenture, but also to improve student life on campus.
### LOAN MANAGEMENT REPORT

**FLORIDA MEMORIAL COLLEGE**

15800 N.W. 42nd Avenue Miami, Florida 33054

**June 30, 1983**

#### EDGED REVENUES

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**Other Sources**

- **COMMENTS**

#### Results of Current Rent Changes in Project/Resident Per Student

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<th>Week</th>
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<td>1040.00</td>
<td>80 (AY)</td>
<td>20 (Summer)</td>
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**Support Coverage (To Be Completed By HUD)**

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<th>Debt Service Coverage</th>
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<tr>
<td>Total Pledged Revenue</td>
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<tr>
<td>Total Net Revenue</td>
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<th>Total Deposits</th>
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<th>Balance at End of Year</th>
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<td>Repair and Replacement Reserve</td>
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<td>$</td>
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<tr>
<td>Other</td>
<td>$</td>
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<td>$</td>
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<tr>
<td><strong>TOTAL</strong></td>
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#### B. Status of Reserve Accounts

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<td>Repair and Replacement Reserve</td>
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<tr>
<td>Other</td>
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<tr>
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#### Enrollment for Each Term for Past School Year

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<td>Residential</td>
<td>188</td>
<td></td>
</tr>
</tbody>
</table>

**Comments:**

- Yearly Enrollment for Past Three (3) Years as Reported to DEW/DOE

#### C. Sample of Financial Statement (To Be Completed by NYC)

- Fiscal Year Ending
- Total Income
- Total Expenses
- Net Income (Loss)
- G/L Included in Above Income
- Long-Term Debt Ratio
- Operating Ratio

#### Download Information

<table>
<thead>
<tr>
<th>MUSEUM</th>
<th>ADDRESS</th>
<th>REVENUE FUND ACCOUNT</th>
<th>ADDRESS</th>
</tr>
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<tbody>
<tr>
<td></td>
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*For a Form of Receipt of Deposits and Withdrawals in Other Funds*
<table>
<thead>
<tr>
<th>FACILITY LOANS</th>
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<tbody>
<tr>
<td>IDENTIFY</td>
<td></td>
</tr>
<tr>
<td>W 36 2008's</td>
<td></td>
</tr>
<tr>
<td>Academic Building Bonds</td>
<td>$1,526,000</td>
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</tbody>
</table>

Use of the person who prepares the form

Koduru V. Rao
(2/28/84)

Koduru V. Rao, Business Manager
(2/28/84)
<table>
<thead>
<tr>
<th>FLORIDA MEMORIAL COLLEGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>DORMITORY AND STUDENT UNION - CAFETERIA</td>
</tr>
<tr>
<td>REVENUE AND EXPENSES</td>
</tr>
<tr>
<td>JULY 1, 1982 - JUNE 30, 1983</td>
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<table>
<thead>
<tr>
<th>Revenues:</th>
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</thead>
<tbody>
<tr>
<td>Student Union Revenue</td>
<td></td>
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<tr>
<td>(Fall '82 - 921 x $40)</td>
<td>$36,840</td>
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<tr>
<td>(Spring '83 - 1050 x $40)</td>
<td>42,000</td>
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<td>(Summer '83 - 710 x $20)</td>
<td>14,200</td>
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<td>Board Revenue</td>
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<tr>
<td>Room Revenue</td>
<td>367,584</td>
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<td>Total Revenues:</td>
<td>$934,175</td>
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<table>
<thead>
<tr>
<th>Expenses:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personnel:</td>
</tr>
<tr>
<td>Counselors (3)</td>
</tr>
<tr>
<td>Supervision</td>
</tr>
<tr>
<td>Maintenance</td>
</tr>
<tr>
<td>(10 staff 4 wks x 40 hrs to paint repair &amp; refurbish)</td>
</tr>
<tr>
<td>(2 staff continuous maintenance 40%)</td>
</tr>
<tr>
<td>Custodial/Custodial</td>
</tr>
<tr>
<td>(4 persons 12 months)</td>
</tr>
<tr>
<td>Total Personnel</td>
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| Utilities: | |
|-----------|
| FPAL (40% $196,138) | 78,455 |
| BFI Waste (40% $10,300) | 4,120 |
| Total Utilities | |

| Total Expenses: | $140,126 |

<p>| Total Net: | $794,049 |</p>
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
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<tr>
<td>City Gas</td>
<td>5,029</td>
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<tr>
<td>Telephone Service</td>
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<td><strong>Total Utilities</strong></td>
<td><strong>96,922</strong></td>
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<td>Board Expenses</td>
<td>396,765</td>
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<td><strong>Other Expenses</strong></td>
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<tr>
<td>Repair &amp; Refurbishing</td>
<td>5,586</td>
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<td>Maintenance Supplies</td>
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<td>Insurance (25% $40,000)</td>
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<td><strong>Total Other Expenses</strong></td>
<td><strong>40,028</strong></td>
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<td>Debt Services</td>
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<td><strong>Total Expenses</strong></td>
<td><strong>783,916</strong></td>
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<td>Excess Revenue/Expenses</td>
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## FLORIDA MEMORIAL COLLEGE

### AUXILIARY ENTERPRISE ACCOUNTS

#### INCOME AND EXPENSE ACCOUNTS

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<thead>
<tr>
<th>Account</th>
<th>Description</th>
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<tr>
<td>1800-400</td>
<td>Auxiliary Enterprises - Control</td>
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<tr>
<td>1801-400</td>
<td>Student Union Fees</td>
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<td>1801-501</td>
<td>Full Time Staff</td>
</tr>
<tr>
<td>1801-508</td>
<td>Employee Benefits</td>
</tr>
<tr>
<td>1801-509</td>
<td>College Work-Study Matching Expense</td>
</tr>
<tr>
<td>1801-516</td>
<td>Supplies</td>
</tr>
<tr>
<td>1801-542</td>
<td>Utilities</td>
</tr>
<tr>
<td>1801-532</td>
<td>Communications - Telephone &amp; Telegraph</td>
</tr>
<tr>
<td>1801-549</td>
<td>Equipment</td>
</tr>
<tr>
<td>1801-552</td>
<td>Insurance</td>
</tr>
<tr>
<td>1801-558</td>
<td>Repairs &amp; Refurbishing</td>
</tr>
<tr>
<td>1801-598</td>
<td>Miscellaneous</td>
</tr>
<tr>
<td>1805-400</td>
<td>Food Service Fees</td>
</tr>
<tr>
<td>1805-503</td>
<td>Full Time Staff</td>
</tr>
<tr>
<td>1805-508</td>
<td>College Work-Study - Matching Expense</td>
</tr>
<tr>
<td>1805-509</td>
<td>Employee Benefits</td>
</tr>
<tr>
<td>1805-516</td>
<td>Supplies</td>
</tr>
<tr>
<td>1805-532</td>
<td>Communications - Telephone</td>
</tr>
<tr>
<td>1805-542</td>
<td>Utilities</td>
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<td>1805-549</td>
<td>Equipment</td>
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<tr>
<td>1805-552</td>
<td>Insurance</td>
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<tr>
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<td>Repairs &amp; Refurbishing</td>
</tr>
<tr>
<td>1805-598</td>
<td>Miscellaneous</td>
</tr>
<tr>
<td>1825-400</td>
<td>Duo Dormitory - Room Charges</td>
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<tr>
<td>1825-503</td>
<td>Full Time Staff</td>
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<tr>
<td>1825-508</td>
<td>College Work-Study</td>
</tr>
<tr>
<td>1825-509</td>
<td>Employee Benefits</td>
</tr>
<tr>
<td>Code</td>
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<tr>
<td>1825-516</td>
<td>Supplies</td>
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<td>1825-532</td>
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<td>Repairs &amp; Refurbishing</td>
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<td>1830-400</td>
<td>Prime Dormitory - Room Charges</td>
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<td>College Work-Study</td>
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<td>Employee Benefits</td>
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<td>Insurance</td>
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<td>Repairs &amp; Refurbishing</td>
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<tr>
<td><strong>Principal Action Official</strong></td>
<td></td>
</tr>
<tr>
<td>Mr. Edward Eliendorf</td>
<td>1</td>
</tr>
<tr>
<td>Assistant Secretary</td>
<td></td>
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<tr>
<td>Office of Postsecondary Education</td>
<td></td>
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<tr>
<td>Department of Education</td>
<td></td>
</tr>
<tr>
<td>Room 4044, ROB-3</td>
<td></td>
</tr>
<tr>
<td>400 Maryland Avenue, S.W.</td>
<td></td>
</tr>
<tr>
<td>Washington, D.C. 20202</td>
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<tr>
<td><strong>Office of Inspector General</strong></td>
<td></td>
</tr>
<tr>
<td>Mr. Frank Yanni, Chief</td>
<td>1</td>
</tr>
<tr>
<td>Postsecondary Education Audit Branch,</td>
<td></td>
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<tr>
<td>Washington</td>
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<tr>
<td>Chief, Contract Audit Branch, Washington</td>
<td>3</td>
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<tr>
<td>RIGA, Region X (Lead Region)</td>
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<tr>
<td>RIGA, Region IV</td>
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</tbody>
</table>

**TOTAL**                                      | 10           |
Board of Trustees
Hawaii Loa College
45-045 Kamehameha Highway
Kaneohe, Hawaii 96744

Dear Board Members:

Enclosed is a copy of the Department of Education (ED) Inspector General’s report, "Hawaii Loa College - Review of the College Housing Program and Academic Facilities Loan Program for the two year period July 1, 1980 to June 30, 1982."

Your attention is directed to the contents of this report. Please respond to each finding and recommendation within 30 days from the date of this letter, presenting any comments or additional information that you believe may have a bearing on the settlement of this audit. These comments must be forwarded directly to the following Education Department official responsible for the final determination of corrective actions on deficiencies covered in this report and, where necessary, the determination of amounts that must be refunded to the Federal Government:

Mr. Edward M. Elmendorf
Assistant Secretary for Postsecondary Education
U.S. Department of Education
P. O. Box 23458
L’Enfant Plaza Station, SW
Washington, D.C. 20024

Revised OMB Circular A-73 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 principles of the Freedom of Information Act (Public Law 90-23), ED Office of Audit reports issued to the Department’s grantees and contractors are made 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.

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

Yours truly,

SEFTON BOYARS
Regional Inspector General for Audit

Enclosure
Hawaii Loa College (BLC), a Hawaii corporation, is a private nonprofit four-year liberal arts college located on approximately 136 acres near Kaneohe on the island of Oahu, Hawaii. The land was donated to BLC in 1966 by the Harold K.L. Castle Foundation, subject to the conditions that it be used for educational purposes only and that if used for other purposes, abandoned or not used, it will revert to the Foundation. Prior to receiving loan assistance from the Federal government to construct permanent facilities, BLC was located in temporary quarters. In 1967, BLC was awarded a loan under Title III of the Higher Education Facilities Act of 1963 (HEFA) by the U.S. Department of Health, Education, and Welfare's Office of Education. In 1972, the HEFA was merged with the Academic Facilities Loan Program (AFLP), which is currently in effect. The administration of the loan was transferred to the U.S. Department of Education (ED) when the Department was established in May 1980. The award (Project No. 5-9-0027-0) provided a low-interest loan to construct a new library/classroom building. The principal amount of the loan was $2,190,000, the proceeds from the Library and Classroom Building Bonds of 1970 (Bond) issued by BLC. The terms of the award provided for repayment of the debt over a period of 10 years at 3 percent interest. The Bond is secured by the library/classroom building and a portion of the BLC land. The Bond was originally scheduled to be repaid in annual installments of $65,700. In addition, a Debt Service Reserve Account of $123,000 was to have been established. Principal reductions were scheduled to begin in November of 1975. However, due to BLC's poor financial condition, it has been unable to make any payments towards the retirement of the Bond principal. Interest payments on the Bond have been made sporadically. In 1980, ED rescheduled the Bond repayment because of BLC's inability to pay. In 1982, BLC defaulted on this revised payment schedule. As of June 30, 1982, BLC owed ED delinquent principal and interest of $470,000 and $296,400 respectively, including payments due in May 1982. In addition, BLC has not established the required Debt Service Reserve Account of $123,000. In 1972, another loan (Loan No. CH-Hawaii-10(D)) was made to BLC under the College Housing Program (CHP) by the U.S. Department of Housing and Urban Development (HUD). The administration of the loan was transferred from HUD to ED subsequent to May 1980. The principal amount of the loan was $2,000,000 repayable over 50 years at 3 percent interest. The purpose of the CHP loan was to construct six dormitories, with accommodations for 180 single students, a dining and kitchen facility, and student common areas. The loan (Mortgage) is secured by the facilities and a portion of
the BLC land. In addition, BLC pledged the net revenues of operating the facilities to make its mortgage payments.

The Mortgage was originally scheduled to be repaid in annual amounts of approximately $77,000, with principal reductions scheduled to commence in 1975. BLC has not made any of the required principal payments on the Mortgage. Interest payments on the Mortgage have been made at irregular intervals. In 1980, BLC executed a workout agreement with ED for revised payments on the Mortgage, but defaulted it in 1982. BLC has not established the required Note Sinking Fund Account of $77,400, nor has BLC contributed any funds toward the required Repair and Replacement Reserve Account of $195,000. In addition, as of June 30, 1982, BLC owed ED delinquent principal and interest of $157,590 and $197,564, respectively.

In November of 1982, BLC received approval to remain temporarily in arrears on all principal and interest payments for both the Bond and Mortgage until April 30, 1983. The current deferments on both the Bond and Mortgage, approved by ED, expired April 30, 1983. BLC has not made any debt service payments since the expiration of the deferment agreements.

The pledged facilities mentioned above are the only structural improvements on the BLC campus, and a majority of the 136 acre site is unimproved. The entire physical installation and most of the 24 acres of improved land is pledged as security for debts to the U.S. Department of Education incurred to construct the college.

Scope of Audit

The purpose of our audit was to review selected aspects of the CEP and APLP loans to BLC. Our audit was performed in accordance with generally accepted governmental auditing standards, except that it was limited to determining (1) the current status of debt service payments, (2) BLC's compliance with the terms and conditions of its debt deferment and workout agreements, (3) whether Federal and non-Federal loans received equitable debt service treatment (4) whether pledged operating revenues were properly accounted for by BLC, and (5) whether or not the financial condition of the College indicated a potential to bring the Bond and Mortgage into current payment status.

Audit field work was performed during July 1983 at BLC in Kaneohe, Hawaii.
BLC is substantially in arrears on both its CFIP and AFLP loan payments to ED. Furthermore, BLC's weak financial condition will probably preclude it from bringing its debt service payments into current status in the foreseeable future unless it can significantly reduce its operating costs or increase its revenues. In addition, BLC had not been consistent or equitable in its repayment of debt to the Federal government. BLC made its debt service payments (both principal and interest) to private lenders while in arrears on both its CFIP and AFLP loans.

BLC should immediately review its revenues and expenses and consider changes to its rate structure, develop other sources of income, devise techniques to reduce its expenses, or some combination thereof, in order to generate sufficient revenue to cover its expenses, including debt repayments to ED. Further, BLC should make its payments to both its Federal and non-Federal creditors in a consistent and equitable manner.

BLC also allocated certain costs to the Revenue Fund without adequate support, thereby overstating the reported expenses and operating losses. Because of the poor overall financial condition of BLC, a recommended financial adjustment to the Revenue Fund, would have no effect on servicing BLC's debt to ED for its CFIP loan. Accordingly, we have restricted our recommendations to future changes in the allocation of indirect costs to the Revenue Fund.

BLC generally agreed with the majority of findings and recommendations contained in the report. BLC stated that in most circumstances, it was already in compliance or actively seeking to be in compliance with the report's recommendations.
FINDINGS AND RECOMMENDATIONS

Low Probability of Repayment

BLC is substantially in arrears on both its CHP and AFLP loan payments to ED. This occurred because revenues, derived primarily from fees charged to students (room, board, and tuition) have been significantly less than operating expenses on a continuous basis. BLC's financial position has been so precarious that its independent CPAs have issued qualified opinions on its financial statements for each of the past five years because of concerns about BLC's ability to remain in existence. As a result of its ongoing financial problems, BLC has sought and received modifications to its debt servicing agreements, either by rescheduling or deferring the payments, for both its CHP and AFLP loans. We recommend that BLC immediately review its revenues and expenses and consider changes to its rate structure, develop other sources of income, devise techniques to reduce its expenses, or some combination thereof, in order to generate sufficient revenues to cover its expenses, including debt repayments to ED.

Background

Under the terms of its loan agreement, BLC was required to separately account for the revenues and expenditures of operating the dormitories and dining facilities in the "Hawaii Loa College Revenue Fund Account" (Revenue Fund). The use of a Revenue Fund was necessary because BLC had pledged the net operating revenues derived from the dormitory/cafeteria facilities for debt service payments on BLC's CHP mortgage. Specific revenues were not pledged to make payments on the BLC Library and Classroom Building Bonds of 1970. Rather, payments were to be made from other college revenues.

Poor Financial Condition

The BLC Unrestricted Current Fund has had annual operating deficits in four of the last five years for which audited financial statements have been issued. As of June 30, 1982, the cumulative Unrestricted Current Fund deficit was $930,657, including the cumulative Revenue Fund deficit of $789,062. Moreover, BLC staff indicated the Unrestricted Current Fund deficit will increase as a result of fiscal year 1983 losses.

Because of BLC's significant current fund deficits and debt obligations, the opinions rendered by BLC's independent CPAs on its audited financial statements have been qualified based on the "going concern" concept.

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The opinion expressed for the fiscal year ending June 30, 1982, stated in part:

As reflected in the financial statements, the College has accumulated a significant deficit in its unrestricted current fund and has substantial debt obligations in its current and plant funds. These factors, among others, as discussed in note 2 to financial statements, indicate that the College may be unable to continue in existence. The financial statements do not include any adjustments relating to the recoverability of recorded asset amounts or the amounts of liabilities that might be necessary should the College be unable to continue in existence.

Note 2 to the audited financial statements, entitled Financial Condition, stated:

The College had an Unrestricted Current Funds deficit of $930,657 as of June 30, 1982, an increase of $376,729 during the year. The College was also unable to make all required payments on its housing and academic facility debt to the United States Department of Education and the Department of Housing and Urban Development in a timely manner, as discussed in note 4. In order to meet certain current operating obligations, the Unrestricted Current Fund borrowed $100,000 from the Endowment Funds during the year.

The ability of the College to meet its current and long-term obligations is dependent upon several factors. Among these factors are the need for increased enrollment, additional gifts and other sources of revenues, and a level of expenditures which does not exceed available revenues. The College continues its efforts to improve its financial position, but the results of these efforts cannot be predicted at this time.

In light of the increasingly large losses suffered by ELC and its significant debt obligations, we also conclude there is a high degree of uncertainty concerning ELC's ability to continue to exist. More specifically, however, we believe there is little probability that ELC will be able to make payments on the Bond or Mortgage owed to Ed at any time in the future unless ELC can significantly reduce its operating costs or increase its revenues.
Rate Structure

The acute Revenue Fund deficits, the result of continuing operating losses, occurred because rates charged to students for room and board were too low to offset expenses even before consideration of debt service. The dormitories have experienced an average vacancy rate of about 25 percent. However, while a contributing factor, the vacancy rate did not appear to be the primary cause of the Revenue Fund operating losses. Even if the dormitories were filled to capacity, the revenues derived from user fees would not be sufficient to offset operating costs. As a result the Revenue Fund has suffered losses of $39,834, $191,419 and $211,973 for the three fiscal years 1980, 1981 and 1982. Therefore, we believe BLC should immediately consider adjusting its rates for room and board, and review expenditures for areas of potential cost reduction in order to ensure revenues at least cover current operating costs, including debt service on BLC's obligations to ED.

Recommendation

BLC should immediately consider any necessary adjustments to its rate structure for tuition and fees, and should develop other sources of income in order to generate sufficient revenue to cover its expenses, including debt repayments to ED.

BLC Response

BLC generally agreed with the findings and recommendations included in this section of the report. The response stated that BLC's financial condition is precarious but steps taken by its management "to correct past deficiencies, stay afloat in the present and build a basis for a stronger future both academically and financially" may be working. BLC discussed the effect on occupancy levels of changes in the dormitory rate structure in the past. The response indicated BLC's belief that annual adjustments made to its dormitory fees, increased occupancy, and other external factors would enable the dormitories to break even or show a surplus in the current or future years.

Auditor's Comments

BLC's response primarily related to current and prospective conditions that are outside the scope of our audit period. We have not reviewed the support for BLC's assertions and, accordingly, are unable to express an opinion on the probability of BLC's success or failure in achieving its goals as delineated in the response.
Inconsistent Treatment of Debt Repayment

Our review disclosed that HLC has not been consistent or equitable in its repayment of debt to the Federal government. HLC made debt service payments (both principal and interest) to private lenders while in arrears on both its CHF and AFBP loans. Although no specific evidence was available to determine the cause for HLC's inequitable treatment of Federal debt service payments, we believe HLC pursued this policy because of ED's lenient loan policies, including ED's willingness to grant annual debt deferments and the fact that ED's loans were made at a 3 percent interest rate, substantially below interest rates on its other debt. As a result, HLC has remained continuously in arrears on its Federal debt to the detriment of the Federal government. We recommend that HLC make its payments to both its Federal and non-Federal creditors in a consistent and equitable manner.

Background

As discussed in the Introduction section to this report, HLC borrowed $2,190,000 from ED to construct the library/classroom complex, a three-story facility. Due to a lack of funds, the interior of the third floor remained uncompleted. In order to complete the interior of the third floor, HLC borrowed $425,000 in additional funds from a local bank to finance the construction. In addition, HLC has also borrowed and refinanced debt with non-Federal lenders to provide funds for its current operations.

Inequitable Debt Treatment

During the two-year period covered by our audit, HLC failed to make its required debt payments under the Mortgage workout and Bond rescheduling agreements negotiated with ED. These agreements provided for reduced payments toward the interest payable to ED. Since January of 1982, HLC has not made any payments to the Federal government. However, during the same period, HLC has made substantial principal and interest payments to its private creditors. For the two years ending June 30, 1982, HLC repaid in excess of $169,000 and $94,000 in principal and interest respectively on debt to private lending institutions.

HLC officials stated that certain repayments were made from funds specifically pledged by private foundations for construction of the third floor facilities. However, it appears inequitable to the Federal government for HLC to seek loans and pledges for additional construction while in arrears on its loans outstanding to ED for the existing structures.
Furthermore, HLC has made payments for both principal and interest on other non-Federal debt while in arrears on its Federal loans. For example, in July of 1982, a private bank loaned HLC $180,000 for 24 months at an interest rate equal to the prime rate plus 1 3/4 percent. HLC has made the required monthly interest payments on this loan. In addition, HLC staff informed us that the first principal payment of $40,000, due July 1, 1983, had been made.

While we can understand and appreciate the financial benefit that HLC receives by repaying high interest loans to private institutions as soon as possible while delaying as long as possible repayment of 3 percent interest loans to the Federal government, we do not consider such inconsistent treatment equitable. In our opinion, the leniency ED has shown HLC in the past through debt rescheduling, deferrals, and modifications has been abused.

Recommendation

We recommend that HLC repay its Federal debt in a manner consistent with its non-Federal debt.

BLC Response

BLC concurred with the facts as presented in the report, and provided additional facts which it believed would influence the interpretation of this section. BLC stated that structural improvements were needed to improve the physical and psychological constraints existing at the college, modernize the facilities, and increase enrollment. To accomplish this, BLC obtained pledges and borrowed funds to improve portions of the school with the approval of ED officials. BLC concurred that it had repaid high interest private sector debt while not repaying Federal debt, but that anticipated revenue increases, other revenue options, and alternate lines of credit will allow HLC to treat Federal debt consistently with non-Federal debt in the future.
Improperly Allocated Costs

BLC inappropriately charged certain of its allocated costs to the Revenue Fund. This occurred because the basis for allocation was not adequately supported or the allocation bases used did not appear reasonable considering the services provided. As a result, Revenue Fund expenses and the operating losses were overstated. During the two-year period ended June 30, 1982, about $27,000 was charged to the Revenue Fund for general expenses which did not appear allowable under the terms of the CBP Loan Agreement. In addition, a significant amount was charged to the Fund using allocation bases for which documentation was not available to support that the allocation bases were reasonable and proper for the costs being allocated. Because of the poor overall financial condition of BLC, a recommended financial adjustment to the Revenue Fund would have no effect on servicing BLC’s debt to ED for its CBP loan. Accordingly, we have recommended future changes in the allocation of indirect costs to the Revenue Fund.

Background

Under the terms of its loan agreement, BLC was required to separately account for the revenues and expenditures of operating the dormitories and dining facilities in the Revenue Fund. The use of a Revenue Fund was necessary because BLC had pledged the net operating revenues derived from the dormitory/dining facilities for debt service payments on BLC’s CBP loan.

Exhibit “B”, paragraph (6) to the Loan Agreement provided that:

Current Expenses of the Project shall be payable as a first charge from the Revenue Fund as the same become due and payable. Current Expenses shall include all necessary operating expenses, current maintenance charges, expenses of reasonable upkeep and repairs, properly allocated share of charges for insurance and all other expenses incident to the operation of the Project, but shall exclude depreciation, all general administrative expenses of the Borrower and the-payment into the "Repair and Replacement Reserve" hereinafter provided for.

The expenses of the Revenue Fund have exceeded revenues in increasingly larger amounts over the last three years. The cumulative fund deficit was $789,062 at June 30, 1982.
Utilities Costs

For fiscal years 1981 and 1982, HLC allocated a total of $183,604 in utility costs between the dormitory/dining facility and the classroom/library building based on estimated hours of usage. This basis allocated approximately 66 percent of the utility costs for the 1981 and 1982 fiscal years to the dormitory/dining facility Revenue Fund, and the remaining 34 percent of the costs to the classroom/library building. While estimated hours of usage may be a reasonable allocation basis for similar use buildings, it does not appear reasonable for buildings of dissimilar use. For example, dormitories may use less electricity than administrative offices, while kitchen facilities may use more.

We were unable to determine whether the basis for allocation provided a reasonable distribution of costs to either facility. However, since the dormitory/dining facility is a separate facility, we believe a separate utility meter would adequately measure utilities usage. HLC officials indicated the cost of installation of a separate meter would be minimal compared with total utilities costs. Therefore, we recommend HLC install a separate utility meter to accurately measure the costs of utilities to the Revenue Fund.

Grounds and Maintenance

Grounds and maintenance costs of $62,099 were equally distributed between the dormitory/dining and classroom/library facilities using square footage as an allocation basis. However, since these activities are performed outside of the buildings, the functions appear to be primarily related to the buildings' exteriors, improved land and roads. We believe a more equitable allocation basis would be based on total improved acreage. Because most of the improved property is contained in the areas surrounding the two facilities on campus, about 24 acres, we recommend an allocation basis of 38% to the dormitory/dining facility (9 acres) and 62% to the classroom/library facility (14 acres). During the period of our audit this would have resulted in a reduction of grounds and maintenance costs of about $14,900.

Custodial Costs

For the two fiscal years 1981 and 1982, custodial costs of $85,157 were equally distributed to the two facilities using square footage as an allocation basis. However, since dormitory rooms are cleaned by the resident students and the dining facility is cleaned and maintained by the food service staff, these areas probably require less custodial staff time than the administrative, classroom, and library areas. However, we could not determine how much effort would be required for each of the
facilities. We recommend that BLC maintain records showing the number of hours worked at each facility location by its custodial staff. Custodial costs could then be charged to each facility in proportion to actual time and effort expended.

General Costs

During 1981, BLC charged about $23,258 of general college costs to the Revenue Fund. These costs included the Campus Ministry, President's Office, Public Relations and Development costs. Because these costs were general in nature and thus excluded by the CHF loan agreement, they were not allowable charges to the Revenue Fund. In 1982, BLC charged a portion of the Athletic Director's costs ($4,012) to the Revenue Fund. We recommend that BLC not charge general college expenditures to the Revenue Fund in the future.

Recommendations

We recommend that BLC:

1. Adopt allocation bases that distribute allowable indirect costs to the Revenue Fund in proportion to the benefits received by the dormitory/dining facilities.

2. Discontinue charging the Revenue Fund for costs which are general and administrative in nature.

BLC Response

Although BLC indicated some minor disagreement with factual data as presented in the report, the response indicated agreement with the finding and recommendations to adopt allocation bases that distribute allowable indirect costs to the Revenue Fund in proportion to the benefits received, and to discontinue charging the Revenue Fund for costs which are general and administrative in nature.
Dear Mr. Boyars:

My staff and I have gone over the draft audit report for Hawaii Loa College (Audit Control No. 09-30044) very carefully and, using the format suggested in your letter of November 30, offer the following responses:

ED-OIG NOTE: HLC comments have been deleted as they pertain to issues no longer contained in the report.

2. Findings & Recommendations: Low Probability of Repayment - We are in substantial agreement with this section of the audit. The College's financial condition is precarious and has been for almost the entire 18 years of its operations. The present administration of the College took over in 1978 what was essentially a bankrupt institution and has been working to correct past deficiencies, stay afloat in the present and build the basis for a stronger future both academically and financially. It has not been a short-term effort and has required considerable deficit financing, resulting in repeated "going concern" qualifications on the College's audits. Increasing enrollments, higher dormitory occupancies, and increased levels of gifts and grants to
the College in the last several years offer at least some indication that this longer-term strategy may be working.

With specific reference to the "Rate Structure" paragraph on page 6, we have several observations. The College sets its residence halls rates according to a specific "break-even" analysis using the assumptions that an 85% occupancy during the fall and spring semesters and a 60% occupancy during the winter and summer sessions will result in a break-even operation of the dorms (debt service included). The analysis for the setting of the 1984/85 rates is attached for your review. The losses of recent years were due to low occupancies which were the result of several factors, including hurricane damage which put some of the rooms out of service, several years of rapid turnover in management of the dorms, and a depressed local housing market which led to unusually inexpensive off-campus rentals. All of these factors have been corrected or changed in the interim and the current year's occupancy has been in excess of break-even thus far.

I would also like to note that during the negotiations concerning the restructuring of the HUD loan with the local (Hawaii) office of HUD, which has since been closed, the College was advised to lower its dorm rates to make them more attractive to students. Although we did not lower the rates, we did hold them constant for a year to see if that had any effect upon the occupancy. It did not appear to have any effect and so the normal procedure for setting the rates (mentioned above) was once again adopted.

With respect to the "Recommendations" section of the report on page 6, we believe that we have made annual adjustments to the dorm fees to bring them into line with costs and that the dorms will break-even or show some surplus in the current year and future years. The College's enrollment continues to increase and the percentage of mainland U.S. and foreign students has remained relatively constant. Since it is primarily these students who seek on-campus housing, the College is presently developing plans to accommodate a housing shortage for the 84/85 year. The College has also been working since 1978 to develop the "conference use" of its dorms during summer and winter session months in order to increase income from the housing units. The College has developed an increasingly successful summer language institute program which all but fills the dorms during late July and August. The College has also been responsible for pioneering the "Elderhostel Program" in Hawaii which adds considerably to dorm occupancy during the months of January and June. A special "outside groups" coordinator in the Community Service Office works on a year-round basis to develop educational conferences on campus which will use the dormitories for the conferences. Finally, beginning in 1982, the College began offering "residential incentive grants" to financial aid students (i.e., special grants to students who choose to live in the dorms) to encourage on-campus living. These grants are funded by the operating fund and benefit the revenue fund.

In summary, we concur with the recommendations of this section and believe that we are already in compliance.
3. Findings & Recommendations: Inconsistent Treatment of Debt Repayment

While there are no factual errors in this section, there are additional facts, which influence the interpretation one brings to this section. The incomplete academic center — the third floor was just an empty shell — posed both physical and psychological constraints on the College community. Physically, many of the labs and library functions of the College were occupying classrooms on the second floor which prevented additional growth of the student body as well as preventing effective use of the College's learning resources by the faculty and students. Psychologically, the incompleteness of the building lent an unfinished sense to the College as an institution as well. The new administration sought and received a pledge from the Atherton Family Foundation for $500,000 (paid over four years) to complete the construction of the third floor of the academic center as a modern learning resources center. The addition of this 18,000 sq. ft. of instructional resource space (library, A/V, computer, art, theater, music) not only provided attractive and effective academic support services to faculty and students (increasing the attractiveness of the College to current and potential students), it also effectively doubled the amount of available classroom space and allowed for expansion of the undergraduate student body from 300 FTE to a potential 600 FTE (current enrollment is 400) in the day program as well as the continued development of evening continuing and community education programs (enrollment growth from 1980 to 1983 has been from 450 to over 1,200 students in these programs). It also gave a feeling of completion to the building.

It was only after this pledge of financial support for the project had been obtained that the College sought bank financing for the project using the pledge as the repayment source. This strategy was discussed in advance with the HEW officials and it was generally agreed that this approach both increased the value of the academic center (the mortgaged property) as well as increased the potential for income generation (from additional student fees) which would make repayment of the federal loans more likely. Both of these assumptions have proven correct; both applications and retention have increased since the completion of this facility in 1982 and the additional students in both the undergraduate programs and the continuing education programs will result in additional revenues during the coming years which will make repayment of the federal loans more likely.

It is true that the College has sought to repay the high interest private sector loans first and has let its federal debt service slide. It is also true that the College has been forced to borrow additional funds for operating during the past several years. Insofar as the student body continues to grow and the occupancy of the dorms is increasing, we think this is a sound investment in the future of the College. The College has also been working on several fronts — sale/leaseback, lease of land, fundraising, etc. — to develop other revenue sources which can be used to reduce the overall federal and private indebtedness of the College. In time, we believe that several of these options will come through and the combined incomes of the increased student body and the alternative activities for using the College's property will make the College a going concern able to maintain its debt service.
The College is currently working on a long-term line of credit which would allow for bringing the federal rescheduled debt service current as well as consolidate the private debt of the Institution.

4. Findings & Recommendations: Improperly Allocated Costs

There have been problems in this area and the College has made some mistakes, most of which have been corrected. In part, the problem was due to the lack of information on how cost allocations should be made in some cases. NACUBO has recently published a book on cost accounting for colleges and universities and the College has adopted these principles as its primary guide in this area for the future. Our response in this section will be to the specific cost areas outlined in the reports.

a. Utilities Costs - The College has struggled with this area of allocation more than any other and various auditors have suggested various approaches to the problem. We are in agreement that installing water and electrical meters is the best approach and action will be taken to implement this recommendation.

b. Grounds and Maintenance - The report is somewhat in error in this section and the next with respect to what is contained under these department headings. The "Roads and Grounds" department handles only the maintenance of the roads and grounds of the campus and does not include building maintenance. The decision to split the expenses of this department 50%/50% rather than simply on the basis of improved acreage (i.e., 38%/62%) was based upon:

1) the fact that the operation of the sewage treatment plant falls in this department and is relevant as an expense only to the dorms (the academic center is on a septic tank system) and this operation requires considerable time and effort of one person, and

2) although there is less land involved in the dormitory parcel financed through HUD note (9 acres as opposed to 14 for the HEW parcel) there is more work involved in the maintenance of the dormitory landscape than in the maintenance of the academic center grounds (i.e., there are seven buildings and many more walks and roads in the dorm area, while there is only one building and mostly open lawn areas on the HEW "side" of the campus). The College will begin keeping time and effort sheets relative to specific tasks in this department in the future as a basis for allocating costs.

c. Custodial Costs - During 1981 and 1982, this department included both the custodial (cleaning) and maintenance costs (repair) for the HUD and HEW facilities. The custodial costs are somewhat higher in the academic center which needs more cleaning, but the maintenance costs are higher in the dorm areas which take more wear and tear from student living. The students are responsible for cleaning only their own rooms; the common areas of all dorms and the dining commons are cleaned by the staff. In line with the recommendations of the NACUBO cost accounting guidelines, the College has split out its physical plant costs into two funds (the operating fund, relative to the academic center [HEW note], and the revenue fund, relative to the dorms [HUD note]) and eight separate
departments (physical plant administration, roads & grounds, maintenance, custodial, utilities, campus security, transportation, and capital improvements). The allocation of specific costs to specific areas will be clearer under this structure.

d. General Costs - The allocation of general administrative costs to the revenue fund during 1981 and 1982 was an error of interpretation on the College's part and was corrected immediately after the error was pointed out to us by an ED official. The 1983/84 budget does not allocate any of the costs mentioned in the report to the revenue fund.

5. Summary - The College is, thus, in agreement with the majority of the findings and recommendations of the report with the exception of those items specifically noted. In most cases, the College is already in compliance with the recommendations or seeking actively at this time to come into compliance with them. The College has maintained the facilities well, including recent repainting (interior and exterior) and reroofing of all facilities, replacement of air conditioning and installation of energy saving (and hence costs saving) heat exchangers in both areas, and a variety of other actions which have both maintained and improved the value and attractiveness of the facilities. It is the College's opinion that actions taken in the past five years will result in the continued growth and development of the College as a going concern and that this will enable the institution to repay all of its debt in the coming years.

Sincerely,

[Signature]

Philip J. Bossert, Ph.D.
President

Enclosure
ROOM & BOARD RATE CALCULATIONS

Assumptions:
1. Estimated 1984/85 Budget (E-Fund) = $760,000
2. Estimated 1984/85 Occupancy - Summer months @ 60% - Fall & Spring months @ 85%
3. All 180 beds available for assignment

Calculations:
1. Summer = 122 days @ 60% = 122 days x 180 beds = 21,360 beds/days
2. Fall & Spring = 243 days @ 85% = 243 days x 153 beds = 37,179 beds/days
3. Total bed/days = 55,539
4. Cost/bed day = $760,000/55,539 = $13.70/bed/day for Room & Board
5. Fall & Spring Allocations:
   2/3 of expenses and 37,179 bed/days = $509,400/37,179 = $13.70/day
6. Summer Allocations:
   1/3 of expenses and 13,176 bed/days = $258,400/13,176 = $19.61/bed/day

Recommendations:
1. To attract more full-time students to live in dorms, charge slightly less than daily expense allocation of $13.70/day/bed; Recommend $12.70/bed/day or $3,500/semester (116 days).
2. To pick up difference in expense, charge higher rates for shorter term occupancies of summer months for students and outside group use of dorms; recommend double occupancy rates off

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<th>Monthly</th>
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<td>$ 115</td>
<td>$ 460</td>
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<tr>
<td>Outside Groups</td>
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<td>178</td>
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3. To minimize expenses to A-Fund departments, charge actual cost of bed/day operations, i.e., $15/bed/day, for interdepartmental charges in dorm use.
## DISTRIBUTION SCHEDULE

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<th>Auditee</th>
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<tr>
<td>40-045 Kamehameha Highway</td>
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<tr>
<td>Kaneohe, Hawaii 96744</td>
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**Primary Action Official**

- Assistant Secretary, Office of Postsecondary Education: 4

**Other**

- Secretary's Regional Representative: 2

**Office of Inspector General**

- Postsecondary Audits Branch: 1
- Contracts Audit Branch: 3
- Region X, Regional Office of Audit: 1
- Region IX, Regional Office of Audit: 3
- **Total**: 16
Dr. Ted DeVries, President
Huron College
Huron, South Dakota 57350

Dear Dr. DeVries:

The purpose of this letter is to inform you of the results of our audit of the College Housing Loan Program at Huron College.

Please respond to each finding and recommendation within 30 days from the date of this letter, presenting any comments or additional information that you believe may have a bearing on the settlement of this audit. These comments should be forwarded directly to the following Education Department official responsible for the final determination of corrective actions on deficiencies covered in this report and, where necessary, the determination of amounts that must be refunded to the Federal Government:

Assistant Secretary, Office of Postsecondary Education
Department of Education
Room 4044, ROB-3
400 Maryland Avenue, SW
Washington, DC 20202

Revised Office of Management and Budget (OMB) Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Accordingly, comments received beyond the 30-day time frame established will not be considered during the resolution phase, unless an extension has been granted beforehand by the appropriate operating official, indicated above.

INTRODUCTION

BACKGROUND

The College Housing Loan Program (CHLP) was established by Title IV of the Housing Act of 1950. The Program originally provided long-term loans to educational institutions for student and faculty housing. The Program was later broadened to include financing of other facilities such as student centers, health centers, and dining halls. About $4.5 billion has been loaned over the life of the program, and about $2.9 billion is
outstanding to about 1,250 borrowers. The loans are normally secured by a first mortgage on the facilities and the site, a specific pledge of revenues and a general obligation of the State or public body.

The CHIP was managed by the Department of Housing and Urban Development (HUD) until May 1980 when the Program was officially transferred to the Department of Education (ED). Under an agreement with ED, HUD continued to administer the Program through April 14, 1981. HUD awarded Huron College, a private nonprofit institution of higher education located in Huron, South Dakota, three College Housing Loans (CHLs) totalling $1,604,000.

The first loan for $504,000, project ISD-39-CH-0044, was awarded in 1964 to finance the construction of a 72 bed addition to Churchill Hall and to retire the Government bonds used for the initial construction of the 100 bed dormitory. Three series of bonds were issued as follows:

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<th>Series</th>
<th>Amount</th>
<th>Interest Rate</th>
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The second loan, project ISD-39-CH-0065, was awarded in 1967 for the construction of a 144 bed dormitory, Kerr Hall. The loan for $554,000 was in the form of bonds bearing interest at 3 percent per annum, maturing on October 1, 2007 and payable in installments from October 1, 1967 to October 1, 2007.

The third loan, project ISD-39-CH-0074, provided $560,000 in 1969 for construction of a student union building, the Campus Center. Those bonds bear interest at 3 percent per annum, mature on December 1, 2009, and are payable in installments from December 1, 1972 to December 1, 2009.

Pledged facilities for the CHLs consisted of a first mortgage on the project facilities and the site thereof, and any other property assigned by the College or by anyone on its behalf or with its written consent. Pledged revenues for the loans consisted of net revenues from the pledged facilities including, for the Campus Center, a $75 annual fee per student. A summary of the loans and amounts past due are attached as a Schedule to this report. The College had no other long-term debt.

SCOPE OF AUDIT

The purpose of our audit was to review selected aspects of the CHIP at Huron College. Our specific objectives were to determine whether the College had the ability to make payments on the loans, the terms of the CHIP had been complied with, pledged
revenues had been properly reported and paid, and CHLB had received equal treatment with other long term obligations.

We reviewed the College's Loan Management Reports for the fiscal years 1981 and 1982, tested selected receipts, evaluated allocation bases for claimed maintenance and operation expenses, analyzed notes payable to the Federal Government, and reviewed the College's audited financial statements. Our audit was conducted in accordance with generally accepted government auditing standards appropriate to the limited scope audit described above.

Audit field work was performed in July 1983, at the College in Huron, South Dakota.

RESULTS OF AUDIT

FINANCIAL CONDITION

Huron College had not made the annual installment payments on any of its loans since October 1, 1973 nor had it negotiated a workout agreement with ED. We believe there is little probability that the College will be able to make payments on the bonds held by ED at any time in the future unless the College can significantly reduce its operating costs or increase its revenue. At June 30, 1983, the delinquent interest payments totaled $461,554 while the delinquent principal payments were $318,000. The College needs to examine its options for settling the loan obligations and work with ED to reach an acceptable settlement.

Our audit disclosed that the College did not have sufficient funds or the likelihood of obtaining such funds, to meet its obligations under its loans. The certified public accountants (CPAs) audit report contained a disclaimer of opinion on the fiscal year 1981 financial statements because the ability of the College to realize certain of its recorded assets was questionable. The College had substantial operating losses that resulted in selling restricted endowment assets and plant assets, and utilizing building renovation funds for current operating expenditures. The fiscal year 1982 audit report contained a qualified opinion on the fairness of the financial statement presentation subject to the ability of the College to recover the major portion of its recorded assets which in turn was dependent upon the College's continued operations, meeting financial requirements, and maintaining financing. As endowment assets were sold, current revenues were further depleted by the income those assets would have generated. College officials need to raise an additional $250,000 by September 1, 1983 to meet operating obligations.
Because College officials did not anticipate being able to meet their present loan obligations, they planned to offer $600,000 to the Government, to be paid over a 24 month period, as complete settlement of the three loans. The funds would be provided by a $1 million fund raising drive. The remaining $400,000 would be used to replace the depleted endowment funds in order to continue operations. The officials understood that legislative relief would be required to provide authority for ED to accept such an offer.

College officials expressed the opinion that there was a chance for continued operations if the College could obtain program and legislative support for the settlement. They also believed that failure to reach a settlement would probably cause the College to be placed on probation by its accrediting organization and could eventually cause the College to lose its accreditation. According to College officials, loss of accreditation would put the College out of business. College officials believed $600,000 was the largest settlement the College could make and that that was more than the Government would realize if the College ceased to operate.

We recommend that Huron College examine all its options, including negotiating a workout agreement with ED, for settling its loan obligations and actively pursue those options with ED in order to reach a satisfactory settlement.

College Response

College officials responded that they were actively pursuing different options to reach a satisfactory settlement with ED.

**ALTERNATE USE OF FACILITIES**

During fiscal year 1983, the College used space in the Campus Center and Kerr Hall for other than approved purposes. Because of disrepair, the College had closed its main classroom and administrative building and relocated whose facilities in Kerr Hall and the Campus Center. One-half of Kerr Hall, a 144 bed dormitory, was converted to faculty and administrative offices. The student recreation areas and the dining area in the Campus Center became the President's office and reception area. College officials said that the moves were necessary to keep the College functioning but neither notified ED of those changes nor requested approval for them.

Federal regulation 34 CFR 614.61(a)(2) requires ED-assisted facilities to be used for the purposes for which the loan was made. Any alternate use must be approved by ED.
At the time of our audit the 1983 Loan Management Report had not been completed, therefore we could not determine whether the College had credited the Kerr Hall and the Campus Center accounts for any lost revenue resulting from conversion of dormitory and dining rooms to offices, or if the costs associated with the alternate use were properly allocated.

We recommend the College request permission for the alternate use of facilities and properly report the actual cost of operating the facilities.

College Response

College officials responded that they would notify ED of the alternate uses of facilities.

ACCOUNTING SYSTEM

The College's accounting system did not identify, classify and segregate revenues and maintenance and operation expenditures by pledged facility as required by the Trust Indentures. Therefore, the costs allocations for fiscal year 1982 could not be supported and some revenues were not properly reported. The College should develop procedures so that expenditures and revenues could be identified with the appropriate pledged facility.

The Trust Indentures required the College to establish a Revenue Fund Account, an Interest Sinking Fund Account and a Repair and Replacement Reserve Account for each pledged facility. The College had not established those fund accounts. Instead, revenues and expenditures were recorded in the general fund and allocated to the pledged facilities. We were able to verify the accuracy of the cost allocations for fiscal year 1981 but determined that revenues from the three facilities were understated by $3,685. Had the income been correctly recorded, the College still would have reported an operating loss. Fiscal year 1982 revenues were understated by $9,324. We were unable to verify the allocation of costs for fiscal year 1982 because there was no explanation in support of the allocations. We did note that the reported operating loss was significantly understated if 1982 costs were allocated in the same manner as the 1981 costs.

The College initiated a new accounting system on July 1, 1983. However, the new system still did not include the required accounts. College officials stated a system which accurately segregated accounts would not be administratively feasible for them.

We recommend that Huron College establish the required accounts to properly record and report revenues and costs associated with pledged CHL facilities.
Officials responded that every effort would be made to segregate the accounts in the coming fiscal year.

Except for the items reported above, tested items were in compliance with applicable laws and regulations. Nothing came to our attention as the result of audit tests that caused us to believe the untested items were not in compliance with applicable laws and regulations.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), reports issued to the Department's grantees and contractors are made 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.

Please refer to audit control number 08-10024 in all correspondence relating to this report.

Sincerely,

[Signature]

Janice LeRoy
Regional Inspector General for Audit

Attachments
### Schedule of Loans and Delinquent Amounts

As of June 30, 1983

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<td><strong>Total</strong></td>
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<td><strong>816,000</strong></td>
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<td><strong>105,000</strong></td>
<td><strong>173,250</strong></td>
<td><strong>278,250</strong></td>
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<td><strong>$1,604,000</strong></td>
<td><strong>$1,486,000</strong></td>
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<td><strong>$318,000</strong></td>
<td><strong>$461,554</strong></td>
<td><strong>$779,554</strong></td>
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Interest on the CHL was accumulating at a rate of $46,093 per year.
December 30, 1983

Ms. Janice LeRoy
Regional Inspector General for Audit
4185 Federal Office Building
Denver, Colorado 80224

Dear Ms. LeRoy:

In reference to your audit report concerning the College Housing Loan Program (CHLP) at Huron College. Although the report summarizes the status of our loan and the College appropriately, I would like to offer the following comments in relation to your findings and recommendations.

1. Financial Condition

The financial status of the College is correctly described. I may add here that the operating cash deficit is now larger than we projected earlier (deficit of $750,000 - $1,000,000 is being projected now). This resulted from a significant campus deterioration due to deferred maintenance and decreasing enrollment. However, the college is actively pursuing different options in order to reach a satisfactory settlement with ED.

2. Alternate Use of Facilities

Due to the temporary nature of relocating the administrative offices (not faculty as reported), the previous administration did not seek an approval from ED. If the relocation did not occur, the cost of maintenance, repair and utilities to the building would be considerably higher (because of the very low occupancy rate of Kerr Hall, the remaining half is approximately half occupied). Therefore, the move is definitely cost efficient. The College will notify the ED of the changes.

3. Accounting System

As the report indicates, an entire segregated account for the building would not be administratively feasible. Due to the high cost and low revenue associated with the building, some expenses and revenue are grouped together. However, we will make every possible effort to segregate the accounts in our coming fiscal year.

I hope the above comments assist you to complete your report. Please do not hesitate to contact me if you have any questions.

Sincerely,

Ted D. DeVries
President
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Office of Inspector General
Office of Audit
REGION II

REPORT ON AUDIT OF SELECTED ASPECTS OF COLLEGE HOUSING AND ACADEMIC FACILITIES LOAN PROGRAMS

KEUKA COLLEGE
KEUKA PARK, NEW YORK

NOTICE

The designation of financial and/or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the ED, OIG Office of Audit. Final determinations on these matters will be made by appropriate ED program agency officials.

Audit Control No. 02-30039
March 9, 1984

U.S. DEPARTMENT OF EDUCATION
March 9, 1984
Audit Control No. 02-30039

Dr. Arthur F. Kirk
President
Keuka College
Keuka Park, New York 14478

Dear Dr. Kirk:

Enclosed is a copy of the Office of Inspector General’s report titled: "Audit of Selected Aspects of College Housing and Academic Facilities Loan Programs, Keuka College, Keuka Park, New York".

Your attention is directed to the contents of this report. You have previously provided comments. If you have any additional comments or information that you believe may have a bearing on the settlement of this audit, please respond within 35 days from the date of this letter. These comments should be forwarded directly to the following Department of Education official who is responsible for the final determination of corrective actions on deficiencies covered in this report and, where necessary, the determination of amounts that must be refunded to the Federal Government:

Assistant Secretary
Office of Postsecondary Education
Department of Education
400 Maryland Avenue, S.W.
Room 4044, ROB - J
Washington, D. C. 20202

Revised Office of Management and Budget (OMB) 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 35 days would be greatly appreciated.

In accordance with the principles of the Freedom of Information Act (Public Law 94-75-2), reports issued to the Department’s grantees and contractors are made 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.

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

Sincerely,

Peter L. Amaya
Regional Inspector General for Audit

Enclosure
HIGHLIGHTS OF AUDIT RESULTS

Keuka College did not comply with certain provisions of the College Housing Loan (CHL) and Academic Facilities Loan (AFL) programs. Our determinations are summarized below and are presented in more detail in the "Findings and Recommendations" section of this report.

---

Maintenance and operation expenses, allocated to CHL program pledged facilities for the fiscal years 1981 and 1982, included unsupported and unallowable cost allocations. As a result, maintenance and operation expenses, allocated to pledged facilities for fiscal years 1981 and 1982, were overstated by $82,823 and $17,836, respectively, or a total of $100,659. In addition, certain other allocations were predicated on budgeted, rather than actual, expenses. Information made available to us did not permit a determination of the impact of this condition on CHL program cost allocations. Besides, recommending cost disallowances of $82,823 and $17,836 for the fiscal years 1981 and 1982, respectively, we are recommending that all budgeted maintenance and operation expenses be adjusted to actual, and that other procedural improvements be made to ensure the propriety and accuracy of the expenses allocated to CHL program pledged facilities. The College did not fully concur, mainly contending that some of the cost items at issue were properly charged to the program or were immaterial. (Page 5.)

---

Keuka College is providing rent-free office space at the Student Center for other than eligible activities, without the required ED approval. We are recommending that the College promptly request ED approval and, in accordance with the Federal Regulations, pay a rental fee therefor. The College did not concur, essentially contending that the activities at issue were within the range of activities permissible under the Federal criteria. (Page 9.)

---

Contrary to the Federal Regulations, Keuka College did not inform ED of unusual circumstances necessitating a change to the AFL program financing plan. Without ED's approval, the College extended the loan term beyond the permissible 30-year period. This type of situation could possibly lead to a forfeiture of interest grant subsidy payments. In August of 1983, we notified ED officials of this situation, and, on October 17, 1983, they approved the extension of the loan term. We are recommending that the College promptly advise ED program officials of any future changes in the terms and conditions of the AFL program financing plan. The College did not address our recommendation. (Page 11.)

Except for the items highlighted above, and discussed in more detail in the "Findings and Recommendations" section of this report, the tested items were in compliance with applicable laws and regulations. Nothing came to our attention, as the result of audit tests, that caused us to believe that the untested items were not in compliance with applicable laws and regulations.
INTRODUCTION

Background

Keuka College, Keuka Park, New York, a private nonprofit institution of higher education, offers undergraduate degree programs. The College was founded in 1890 under the laws of the State of New York, and, at present, has a student body of approximately 500 female students.

Five College Housing Loan (CHL) program loans were awarded to the College in 1972 by the U. S. Department of Housing and Urban Development (HUD). Administration of the loans was transferred from HUD to ED in May of 1980. The five loans, totaling $3,443,000, had terms from 25 to 45 years. And the College issued the following first mortgage bonds as security for the loans:

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<th>Principal Amount</th>
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<tr>
<td>Series A</td>
<td>2.750%</td>
<td>25</td>
<td>$199,000</td>
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<td>Series B</td>
<td>3.254%</td>
<td>29</td>
<td>605,000</td>
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<tr>
<td>Series C</td>
<td>3.375%</td>
<td>31</td>
<td>888,000</td>
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<tr>
<td>Series D</td>
<td>3.000%</td>
<td>45</td>
<td>920,000</td>
</tr>
<tr>
<td>Series E</td>
<td>3.000%</td>
<td>40</td>
<td>831,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$3,443,000</td>
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</table>

The purpose of these loans was: (i) to construct a dining hall addition and a student activities complex; and (ii) to refund the Keuka College Dormitory bonds of 1956, 1960, and 1966 and the Keuka College Dormitory and Dining Hall bonds of 1962.

The pledged facilities for the CHL program loans consisted of structures known as Blyley Hall, Space Hall, Saunders Hall, Davis Hall, Dahlstrom Student Center, and the dining hall addition. Pledged revenues for these loans consisted of the net revenues from the pledged facilities and an annual student "building fee" of $50 to be collected from each full-time student as long as any of the loans remained outstanding.

The College has obtained annual deferments for CHL program principal and debt service payments which were in default. A "workout" agreement was reached with ED in December of 1982 to repay, over a five-year period ending August 31, 1987, defaulted interest for the period April 1, 1979, to April 1, 1982, totaling $297,169. This agreement also allowed the College to defer current, CHL program principal and interest payments, subject to an annual assessment by ED of the College's financial condition. As of June 30, 1983, past due principal and interest payments amounted to $531,000 and $400,989, respectively.
In 1971, the College obtained a bank loan to construct the Weed Physical Arts Building and the Lightner Library. The principal amount of the loan was $1.5 million, repayable over 30 years at 8 1/4 percent interest in semiannual installments of $67,878. Under the Academic Facilities Loan (AFL) program, the then-Office of Education of the U.S. Department of Health, Education, and Welfare awarded the College an annual interest grant subsidy of $54,567, thereby reducing the effective interest rate of the loan to 3 percent. Administration of the AFL program was transferred to ED in May of 1980.

Scope of Audit

The purpose of our audit was to review selected aspects of the College Housing and Academic Facilities Loan programs at Keuka College. Our specific objectives were to determine whether:

a. Receipts and expenditures for pledged facilities were properly determined and reported to ED, and net revenues were properly accounted for and used to make payments on the AFL program loans by the College.

b. The College complied with the terms and conditions of the AFL "workout" agreement that deferred loan payments.

c. Federal loans had received equal treatment with other long-term obligations of the College.

d. Debt service payments were current for the College's Academic Facilities Loan.

We tested selected pledged revenues; we evaluated the bases used for allocating maintenance and operation expenses; and we analyzed notes payable to the Federal Government. Our audit was conducted in accordance with generally accepted governmental auditing standards appropriate to the limited scope audit described above. Our audit did not include a detailed analysis of maintenance and operation expenses, nor a review of the efficiency and economy of operations.

The audit field work was performed during August of 1983 at the College in Keuka Park, New York.
FINDINGS AND RECOMMENDATIONS

Finding No. 1 - Ineligible College Housing Loan Program Maintenance and Operation Expenses

Maintenance and operation expenses, allocated to CHL program pledged facilities for the fiscal years 1981 and 1982, included unsupported and unallowable cost allocations. As a result, maintenance and operation expenses allocated to pledged facilities for the fiscal years 1981 and 1982 were overstated by $82,823 and $17,836, respectively, or a total of $100,659. In addition, certain other allocations were predicated on budgeted, rather than actual, expenses. Information made available to us did not permit a determination of the impact of this condition on CHL program cost allocations.

In the special conditions section of the CHL program loan agreement, current expenses for the maintenance and operation of pledged facilities are defined as all necessary operating expenses, current maintenance charges, properly allocated share of insurance costs, and all other expenses incident to the operation of the pledged facilities, excluding depreciation and all general and administrative expenses of the university.

Our review of the annual Loan Management Reports (HUD 4370) for the fiscal years 1981 and 1982 disclosed several conditions that affected the allocation and accuracy of the maintenance and operation expenses charged to CHL program pledged facilities. These conditions and the recommended cost disallowances are discussed below (details were previously furnished the College).

Unsupported Allocation of Maintenance and Operation Expenses ($15,865)

The cost allocation ratios used by Keuka College to allocate a share of the maintenance and operation expenses to CHL program pledged facilities were unsupported. College officials advised us that these ratios were not current and that all related documentation had been discarded. In addition, they advised us that the individual responsible for the development of these ratios was no longer employed by the College. Accordingly, we developed current allocation ratios for 11 cost categories and we determined that the CHL program had been overcharged $6,835 and $9,030 for the fiscal years 1981 and 1982, respectively.

Unallowable Charges ($84,794)

College Work-Study Program ($51,159)

Keuka College employs students, under the College Work-Study (CwSP) program, to perform various tasks for the food service center, the bookstore, and the grounds activity, as well as other...
services allocable to CHL program pledged facilities. For the fiscal year 1981, the College improperly allocated the Federal share of CWS program salaries to CHL program pledged facilities. This resulted in a $51,159 overstatement of maintenance and operation expenses for fiscal year 1981.

General and Administrative Expenses ($33,635)

General and administrative expenses involving: Food Service Billing and Collection Services ($13,113 for fiscal year 1981); Bookkeeping Services ($7,296 for fiscal year 1981); Auditor’s Fees ($4,400 and $4,975 for fiscal years 1981 and 1982, respectively); and Trustee’s Service Fees ($3,831 for fiscal year 1982) were improperly allocated to CHL program pledged facilities. The allocation of such charges, aggregating $24,829 and $8,806 for the fiscal years 1981 and 1982, respectively, to the CHL program is not permitted by the aforementioned loan agreement. The College allocated these charges to CHL program pledged facilities because it apparently considered them to be maintenance and operation expenses. We, however, feel that these charges relate to administrative functions and are not directly related to the maintenance and operation of the pledged facilities.

Budgeted Expenses

Certain charges allocated to CHL program pledged facilities for the fiscal years 1981 and 1982 represented budgeted, rather than actual, expenses. The charges in question included: director of halls and dormitory supervision salaries, custodial salaries, and upkeep of grounds, physical plant, telephone, and conference expenses. College officials advised us that year-end entries to adjust budgeted expenses to actual expenses were inadvertently not made for these cost categories. Inasmuch as actual expenses for these cost categories were not readily identifiable, we were unable to determine the impact of this condition on CHL program cost allocations.

Recommendations

We recommend that Keuka College:

1. Reduce maintenance and operation expenses charged to CHL program pledged facilities to reflect the recommended cost disallowances of $82,823 and $17,836 for the fiscal years 1981 and 1982, respectively. Additional adjustments of certain expenses charged to CHL program pledged facilities may be necessary after the College updates its records to reflect actual, rather than budgeted, expenses.

2. Determine whether a net income was derived from the operations of CHL program pledged facilities for the fiscal years 1981 and 1982. If so, the net income should be deposited in the CHL program Bond and Interest Sinking Fund Account.
3. Allocate maintenance and operation expenses to CHL program pledged facilities using current allocation data. Also, measures should be taken to ensure that: (a) all expenses are adjusted from budgeted to actual; and (b) unallowable items are removed from the expense pool.


Summary of the College’s Written Comments

The College did not fully concur in our finding and recommendations. It basically contended that: (1) the unsupported allocation of maintenance and operation expenses for fiscal years 1981 and 1982 was the result of misinformation and lack of guidance on the part of Federal officials; (2) the Auditor’s Fees and Trustee’s Service Fees for 1981 and 1982 were necessary expenses and covered only the special audit required under the CHL program; and (3) “supplementary information” relative to budgeted expenses for 1981 and 1982, furnished to us on October 10, 1983, indicated that the differences between actual costs and budgeted allocations were immaterial. But the College acknowledged that the Federal share of College Work-Study program salaries was improperly allocated to CHL program pledged facilities in 1981. (Apparently, this condition has not yet been remedied.) The College, however, did not address the matter of the recommended disallowances for 1981 Food Service Billing and Collection Services and Bookkeeping Services expenses. And it did not comment on our recommendation that revised Loan Management Reports be submitted for 1981 and 1982.

Our Response

We believe that the College’s comments on this finding are without basis and do not address the issues correctly. Firstly, the College’s comments on the unsupported allocation of maintenance and operation expenses for 1981 and 1982 are not relevant. This aspect of the finding deals with lack of current, supported allocation ratios; it does not deal with program cost guidelines. In this respect, the College’s comments miss the point.

Regarding the College’s contention that the Auditor’s Fees and Trustee’s Service Fees for 1981 and 1982 were necessary expenses, we cite the CHL program loan agreement (Special Condition (c)) that explicitly excludes all general administrative expenses from the allocation of expenditures to pledged facilities. Auditor’s Fees and Trustee’s Service Fees are general administrative expenses and, as such, are not allowable.

Lastly, as to the “supplementary information” on 1981 and 1982 budgeted expenses, such was not sent to us on October 10, 1983, as the College stated. Actually, we received it on February 13, 1984, after making a second request, immediately upon receipt of the College’s comments of February 6, 1984. Moreover, the “supplementary information” shows that, for 1981, actual costs were lower than the budgeted expenses by $7,847; while, for 1982, the actual costs were higher than the budgeted expenses by $7,837. These fiscal year differences are relatively material; thus, the College should not offset or ignore them.

Refer to the Appendix for the full text of the College’s written comments.
Finding No. 2 - Unauthorized Alternative Use of College Housing Loan Program Pledged Facilities

Keuka College is providing rent-free office space at the Student Center for other than eligible activities, without the required ED approval.

The Federal Regulations, 34 CFR 614.65 (a), dated June, 1981, stipulate that: "Any use of a ED-assisted facility for other than an eligible use under the College Housing Program requires ED approval." Furthermore, such alternative use should normally be of a temporary nature (34 CFR 614.65 (a)) and should generate sufficient pledged revenues for the requirements of the CHL program (34 CFR 614.65(b)(1)).

We found, however, that Keuka College has been providing, since at least 1980, rent-free office space at the Dahlstrom Student Center to the Assistant Dean of Students and the Chaplain. College officials stated that the use of the Student Center for these activities constituted cost and energy saving measures.

In our opinion, Keuka College should have complied with the Federal regulations by obtaining ED's approval. Additionally, the College should have paid a rental fee for this office space, thereby generating additional pledged revenues, as prescribed by the aforementioned Federal Regulations.

Recommendations

We recommend that Keuka College promptly request ED approval for the alternative use of the Dahlstrom Student Center, and that the College pay a rental fee therefor.

Summary of the College's Written Comments

The College did not concur in our finding and recommendations, contending that: (1) the housing of the Office of the Assistant Dean of Students in Dahlstrom Student Center was part of the original design of the building; and (2) the Chaplain occupies an office in the Dahlstrom Student Center on a temporary basis, and in a non-denominational role, to counsel students.

OIG's Response

It is still our opinion that rent-free office space was provided at the Dahlstrom Student Center, a pledged facility, for other than eligible activities. We note that there is nothing in the loan agreement and other pertinent documents (e.g., correspondence between the College and ED), indicating that the housing of the Office of the Assistant Dean of Students and the Chaplain in the Dahlstrom Student Center was contemplated in the original design of said building. In addition, we found no evidence to suggest that the College, at any point in time, requested and received Federal approval for housing, rent free, the Office of the Assistant Dean of Students, as well as the Chaplain, in the Dahlstrom Student Center.

Refer to the Appendix for the full text of the College's written comments.
Finding No. 5 - Unauthorized Change to the Academic Facilities Loan Program Financing Plan

Contrary to the Federal Regulations, Keuka College did not inform ED of unusual circumstances necessitating a change to the AFL program financing plan. Without ED's approval, the College extended the loan term beyond the permissible 30-year period. This type of situation could possibly lead to a forfeiture of interest grant subsidy payments.

After demonstrating a temporary inability to make semiannual loan payments in 1981, Keuka College was given a one-year moratorium by the lender, thus extending the term of the loan to 31 years. In exchange for additional mortgage collateral, the lender allowed the College to make the payments for 1983, including the accrued interest, 6 and 12 months after the last scheduled payment due in the year 2002, i.e., in the year 2003, or last year of the loan.

Federal Regulations, 34 CFR 617.76 (June, 1981), state that the term of the loan for which the applicant requests an annual interest grant subsidy cannot exceed 30 years. Said regulations, however, provide that, if unusual circumstances warrant an exception, ED program officials may accept a loan term longer than 30 years. But Keuka College did not notify ED of this change. Without such notification and ED acceptance of the change, Keuka College was technically in violation of the ED approved financing plan. This type of situation could possibly lead to a forfeiture of interest grant subsidy payments.

In August of 1983, we notified ED program officials of this situation. Recognizing that Keuka College's unusual circumstances warranted an exception, the ED program officials, on October 17, 1983, approved the extension of the loan term.

Recommendation

We recommend that Keuka College promptly advise ED program officials of any future changes in the terms and conditions of the AFL program financing plan.

Summary of the College's Written Comments

The College basically recounted the actions taken to obtain ED retroactive approval of the extension of the loan term. However, the College did not address our recommendation.

OIG's Response

The College's comments are not entirely accurate in that they do not mention the fact that the College took corrective action only after we brought this regulatory violation to its attention. Further, we would like to stress the importance of our recommendation, which the College does not address in its comments. Had we not informed the College about this condition, and had ED not approved the extension of the loan term, the College would have continued to be in violation of 34 CFR 617.76, and it could have forfeited interest grant subsidy payments.

Refer to the Appendix for the full text of the College's written comments.
January 31, 1983

Mr. Peter L. Amaya
Regional Inspector General
United States Department of Education
Region I1
26 Federal Plaza
New York, New York 10278

Dear Mr. Amaya:

This letter is in reply to your letter of December 16, 1982, which was addressed to Dr. Elizabeth Woods Shat. Dr. Shat's retirement from the presidency of the College became effective December 11, 1981, and I assumed the position of President on January 1, 1982. I wrote to respond to several of the findings of the draft of your audit report.

Finding No. 1, beginning on page 4, deals with maintenance and operations expenses. Keuka College has never received any written guidelines from either DOE or the Department of Education on what constitutes allowable maintenance and operational expenses. Indeed, verbal guidelines received from the Department of Education conflicted with your audit report. We were verbally told by the Department of Education in April 1983 that such items as books and goods purchased for resale by the bookstore located in a pledged facility were not allowable, but income from bookstore sales was to be included. They also stated dormitory supervision and security were not allowable. These positions were clearly untenable, and accordingly, we proceeded without benefit of meaningful guidelines. In the absence of guidelines and with misinformation being supplied by the Department of Education officials, the amounts of $6,835 for 1981 and $9,010 for 1982 represent differences between accountant and bookkeeper's audit in these areas, and are not material in an audit of this size.

Student employees employed by the College Work Study Program were improperly allocated in 1981. During 1982, we learned that this allocation was improper, and this was remedied in the 1982 report.

We strongly believe that both the auditor's fees and the Trustee's service fees are legitimate and necessary expenses incurred by the pledged facilities. The pledged facilities were built with the assumption that revenue generated would pay operating and debt service expenses, and neither the Trustee's fee nor the auditor's fee expense would have been incurred had these buildings not been financed under the College Housing Program. The audit expense covers only the special audit required for the pledge facilities; the College's general audit includes all income and expenses, and no part of its general audit is charged to the pledged facilities.
Supplementary information relative to Budgeted Expenditures was furnished to your auditor, Mr. Allan Bliss, in Ronald D. Erickson’s letter of October 10, 1983. Information was submitted which indicated that the difference between actual cost and budgeted allocations for the two years combined was $9,740.

Finding No. 2 alleges that housing the Office of the Assistant Dean of Students is an ineligible use of Dahlstrom Student Center. The office in question was part of the original design of the building, and was specifically designed for the Assistant Dean of Students. The Assistant Dean’s primary responsibilities are: (1) Administer the Dahlstrom Center; (2) Advise student organizations, whose offices are located in the Dahlstrom Student Center. The offices for student organizations were also part of the original design of the facility. Clearly, housing the Office of the Assistant Dean was part of the original plan which FEDC approved.

Finding No. 2 also alleges that the Chaplain’s office was an ineligible use of the building. The Chaplain occupies an office in the Dahlstrom Student Center on a temporary basis to counsel students; neither religious services, nor activities are conducted in the building. The Chaplain’s role is now non-denominational.

Finding No. 3 concerns changes in the Academic Facilities Loan Program Financing Plan. On September 4, 1983, Lincoln First Bank sent the College a letter outlining conditions which were acceptable to the bank for changes in the financing plan. The bank notified the Department of Education by letter on September 29, 1983, of the proposed changes. Also, on September 29, 1983, Keuka College submitted a letter to the Department of Education, asking for approval of the proposed changes. The Department of Education approved the changes on October 12, 1983. The College’s Board of Trustees authorized execution of documents to effect the proposed changes on October 15, 1983. The documents were executed on January 4, 1984. Formal action on the changes, therefore, was taken after the necessary approval had been obtained.

We recognize that Keuka’s delinquency on meeting loan payments is of serious concern to you. We shall remedy that problem over the next several years. However, your audit did not contribute to that, and in any significant way. Indeed, we have been distracted from the restructuring of the College to defend actions taken commonly on college campuses on the advice of auditors and federal agencies. In sum, other than the work study problem which was corrected prior to the audit, the amounts involved are not material.

We appreciate your responsibility and look forward to your constructive support in helping us meet our obligations to amortize the debts audited.

Sincerely,

Dr. Arthur F. Kiley
President

AFK: JKW
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REPORT ON LIMITED
SCOPE AUDIT OF THE COLLEGE HOUSING
AND ACADEMIC FACILITIES LOAN PROGRAMS
FOR FISCAL YEARS 1981 AND 1982

MONMOUTH COLLEGE
MONMOUTH, ILLINOIS

NOTICE

The designation of financial and/or managerial deficiencies or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions, observations and recommendations in this report, represent the opinion of the E0 OIG Office of Audit. Final determination on these matters will be made by appropriate ED operating or program officials.

Audit Control No. 05-30059

U.S. DEPARTMENT OF EDUCATION
Dear Dr. Haywood,

Enclosed is a copy of our audit report entitled "Report on Limited Scope Audit of the College Housing and Academic Facilities Loan Programs for Fiscal Years 1981 and 1982." Your comments have been incorporated into the final report. If you have any additional comments, please submit them within 30 days from the date of this letter to the following Education Department officials:

Assistant Secretary
Office of Postsecondary Education
Department of Education
Room 4907, ROB-3
Washington, D.C. 20202

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

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), reports issued to the Department's grantees and contractors are made 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.

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

Sincerely,

Robert G. Brooks
Regional Inspector General for Audit - Region V
INTRODUCTION

Monmouth College is a small coeducational institution founded in 1853 by Scottish Presbyterians and committed to the value of ecumenical perspective of the Christian faith. It is accredited as a four year liberal arts institution by the North Central Association of Colleges and Secondary Schools. The College currently serves about 615 undergraduate students.

A $3,067,000 College Housing Loan was awarded to Monmouth College in 1968 by the U.S. Department of Housing and Urban Development (HUD). The administration of the loan was transferred from HUD to the Department of Education in May 1980. The purpose of the loan was to finance the construction of two building projects in addition to exchanging bonds previously issued for two prior construction projects. The four projects were comprised of:

(1) a student center
(2) Fulton and Graham student dormitories
(3) Cleland Hall and a fraternity complex,
(4) Liedman student dormitory.

As security for the loan, the College issued first mortgage bonds for each of the projects (Series A for $442,000 at 3 1/2 percent interest repayable over 23 years, Series B for $335,000 at 2 3/4 percent interest repayable over 30 years, Series C for $1,295,000 at 3 3/4 percent interest repayable over 37 years and Series D for $995,000 at 3 percent interest repayable over 50 years).

The pledged revenues for the College Housing Loan consisted of the net operating income from the facilities constructed with CHLP funds in addition to three existing dormitories known as Winbigler, McMichael and Grier Halls. Due to a rapid decline in student enrollment, the College was unable to achieve full occupancy of the pledged facilities. In 1973-74, permission was obtained from HUD to close two of the pledged facilities (Fulton and Grier Halls), and to lease a third dormitory (Graham Hall) to Warren Achievement Industries as a sheltered care facility. During this time, four rooms of Fulton Hall were also authorized for alternative use as a College Health Center. As compensation for the four rooms, HUD required the College to annually deposit $4,200 to the Bond and Interest Fund, starting June 15, 1975.

In 1975, permission was also received from HUD to use funds from
the Repair and Replacement Reserve and the Bond and Interest Sinking Fund for interest and principal payments.

Because of continued financial difficulties, HUD annually granted the College permission to defer principal payments for fiscal years 1977 through 1980. Requests for deferrals submitted to ED after the transfer of program from HUD and a proposed revised payment schedule were not granted. No workout agreement or authorized deferment has been in effect since June 30, 1980. The College, nevertheless, adhered to the proposed, but unaccepted, repayment schedules for each of the fiscal years, 1981, 1982 and 1983. The following schedule summarizes the principal amounts in default for the College Housing Loan as of June 30, 1983.

<table>
<thead>
<tr>
<th>Series</th>
<th>Balance Outstanding From 11/1/77</th>
<th>Principal Amount Past Due</th>
</tr>
</thead>
<tbody>
<tr>
<td>Series A Bonds</td>
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<td>$118,500</td>
</tr>
<tr>
<td>Series B Bonds</td>
<td>-258,500</td>
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</tr>
<tr>
<td>Series C Bonds</td>
<td>1,099,000</td>
<td>134,000</td>
</tr>
<tr>
<td>Series D Bonds</td>
<td>878,500</td>
<td>63,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,550,500</strong></td>
<td><strong>$378,500</strong></td>
</tr>
</tbody>
</table>

A $1,000,000 Academic Facilities loan was awarded to the College in 1969 by the U. S. Department of Health, Education and Welfare (HEW), payable over 30-years at 3 percent interest. The purpose of the loan was to construct a library and a Science Center (Classroom & Laboratories). The administration of the loan was transferred to ED when the Department was established in May 1980. HEW authorized the College to use its debt service reserve fund to make the 1966 interest payment, and granted a moratorium on replenishment of the reserve account. HEW authorized deferment of the 1977 and 1979 principal payments. In 1979, Monmouth College requested further financial assistance, submitting a revised repayment schedule that proposed payment of interest and delinquent interest only through 1985 with principal contributions thereafter. HEW approved the repayment schedule, but stipulated that the College return to a current loan obligation status at the earliest possible date. The College had met the terms of the revised payment schedule through June 30, 1983, at which time, defaulted principal and interest payments were $211,000 and $38,870, respectively.

SCOPE OF AUDIT

The purpose of our audit was to review selected aspects of the College Housing and Academic Facilities loans at the College.
Our specific objectives were to determine whether (1) pledged revenues were properly recorded, reported and applied to debt service payments of the college housing loan, (2) a workout agreement for deferred loan payments was executed and whether the college complied with the terms and conditions of the agreement, (3) the Federal loans received equal treatment with other long-term obligations of the college, and (4) debt service payments were current for the Academic Facilities loan.

We reviewed the College's Loan Management Reports for the Fiscal Years ended June 30, 1981 and 1982, tested selected items of receipts, evaluated allocation basis for claiming maintenance and operation expenses and analyzed notes payable to the Federal Government. Our audit was conducted in accordance with generally accepted government auditing standards appropriate to the limited scope audit described above. Our audit did not include an evaluation of the reasonableness of expenses claimed for maintenance and operation, or a review of the efficiency and economy of operation.

Audit fieldwork was performed during the period June 9 through June 22, 1983, at the Monmouth College, Monmouth, Illinois.
HIGHLIGHTS OF AUDIT RESULTS

Monmouth College was significantly in default on both the College Housing and Academic Facilities loans. Although continued deferrals for defaulted college housing payments were granted by HUD from fiscal years 1977 through 1980, no workout agreement or approved deferral has been in effect since June 30, 1980, when ED assumed administration of the College Housing Loan Program. With respect to the delinquent debt of the Academic Facilities Loan, a supplemental repayment schedule was executed by HEW in 1979. Monmouth College has generally complied with the terms and conditions of this agreement.

Our review disclosed that the College’s accounting system contained sufficient accounts to properly identify and segregate revenues and expenses attributable to each of the facilities pledged for the College Housing Loan. However, management attention is needed to correct problems related to (1) the revenue derived from the alternative use of a pledged facility, (2) the treatment of Federal loans relative to other long-term obligations, and (3) the execution of a workout agreement. Our findings are summarized in the following paragraphs and presented in detail in the Findings and Recommendations section of this report.

The College did not reimburse the Bond and Interest Sinking Fund, in the annual amount of $4,425 for the alternative use of one of the pledged facilities. Since HUD required the annual deposits to commence June 15, 1979, we are recommending that the College deposit the total amount due ($37,800 as of June 30, 1983) to the Bond and Interest Sinking Fund or apply it to the College Housing Loan.

Preferential treatment by the College has kept a private loan in current status, while allowing the Federal loans to remain past due. We recommend that the Federal loans receive treatment equal to that of other long term creditors.

Revenues produced from pledged facilities by the student enrollment is insufficient to meet Trust Indenture terms for retirement of the College Housing loan. The College, however, had demonstrated minimal interest in seeking alternative revenue proceeds, either from the pledged facilities or other institutional sources to reduce the outstanding College Housing debt. We recommend that Monmouth College take immediate action to negotiate a workout agreement with ED. The agreement should contain specific plans for reducing outstanding obligations and returning to the terms of the Bond Trust Indenture.

These conditions are discussed in detail in the Findings and Recommendations Section.

The only items tested pertained to those aspects of the administration of the College Housing and Academic Facilities Loans identified in the Scope of Audit Section. No information came to our attention to indicate that there were weaknesses in any untested aspects of the two programs.

Officials of Monmouth College, generally, did not concur with our findings and recommendations. Their comments are summarized at the end of each finding section and attached to the report as an Appendix.
FINDINGS AND RECOMMENDATIONS

ALTERNATE USE OF PLEDGED FACILITIES

The College did not reimburse the Bond and Interest Sinking Fund of the College Housing Loan, in the amount of $37,800 for the alternative use of a pledged facility. In fiscal year 1974, HUD authorized the College to use four rooms of Fulton Hall as a College Health Center. As compensation for the alternate use of Fulton Hall, HUD required the College to annually deposit $4,200 to the Bond and Interest Fund, commencing June 15, 1975. A college official stated that only the first payment was made. We could not find a receipt for that payment or evidence in the accounting records or Loan Management Reports that any of the other annual payments were either made to the fund or applied to the College Housing Loan. Consequently, the College’s liability to the Bond and Interest Fund totaled $37,800 as of June 30, 1983.

RECOMMENDATIONS

We recommend that the College:

1. Apply $37,800 to either the Bond and Interest Fund or the defaulted debt of the College Housing Loan or furnish the program officials reconstructed accounting records and revised Loan Management Reports which reflect the amount of general College funds which were applied to the alternate use of Fulton Hall. The identification of alternate use compensation transferred and applied each year should be restricted to the amount of alternate use revenue due for that year. The alternate use liability of $37,800 which remains unsupported must be applied to the defaulted debt.

2. Initiate procedures to properly record and report the annual compensation due from the alternate use of pledged facilities and deposit the amount in the Bond and Interest Fund.

College Comments

College officials believe that the annual compensation required by HUD was overstated by $1,800 because of a transposition error. Although the officials agree that the annual deposits were not made to the Bond and Interest Fund, they indicated that the College applied general operating funds to the CHL debt in seven of the past nine years. Since a portion of this transfer could have been identified and recorded as alternate use compensation, the College does not concur that it has an outstanding liability.

EP-OIG Response

Our contacts with Departmental program officials did not disclose any evidence that the amount of reimbursement required was incorrectly stated. Thus, the annual compensation for the alternate use of Fulton Hall is retained at $4,200 in the absence of evidence confirming an error in that amount. We have revised Recommendations No. 1 to provide consideration for acceptable evidence which may be submitted by the College to support a reduction of the outstanding liability for the alternate use of Fulton Hall.
PREFERENTIAL TREATMENT

The College has not been consistent or equitable in its repayment of debt to the Federal government. It made debt service payments (both principal and interest) to a commercial lender, while in arrears on its College Housing Loan. Further, Monmouth College has maintained much higher occupancy levels and thus generated more income for a commercial loan. Consequently, Federal loans have not received equal treatment relative to the other long-term obligations of the College.

Although no specific evidence was available to determine the cause for Monmouth College's inequitable treatment of Federal debt service payments, we believe the College pursued this policy because of BD's lenient loan policies, the low interest rate charged on outstanding principal amounts, and the absence of late payment penalties. As a result, the College has remained continuously in arrears on its Federal debt to the detriment of the Federal government.

In 1965, Monmouth College received a 5 1/2 percent, $700,000 30-year loan from the Life of Virginia Insurance Company for the construction of the Gibson Hall dormitory. The College complied with the loan terms, reducing the principal balance to less than $500,000. A college official stated that the Life of Virginia Insurance Company denied a request by the College to apply the private loan reserve fund of approximately $50,000 to the College Housing Loan. There is no evidence that the College sought financial relief from the private lender.

The occupancy pattern of the dormitory also exhibited preferential treatment. Gibson Hall, the private insurers pledged facility was kept at near capacity, while the Federal pledged facilities had low occupancy or were closed. Fiscal year 1982 revenue for Gibson Hall was $44,368, in comparison to a total of $56,554 for the eight dormitories pledged to the College Housing Loan. The College explained that situation by stating that Gibson Hall was the least expensive dormitory to operate and that it was the student's favorite residence hall due to its private room entrances. Gibson Hall net revenue, however, was not adequate to meet the fiscal year 1982 interest and principal payments of $51,170, so the College used $8,802 of general revenue to meet its obligation.

RECOMMENDATION

We recommend that the College take necessary action to ensure that Federal loans are given equal treatment to other long-term obligations of the institution.
College Comments

The College does not concur that preferential treatment was given to the private long-term loan. It contends that equal treatment was extended to both, the private and Federal lenders, since financial relief was requested from each of them. The College also objected to the base period selected by OIG for comparing the occupancy patterns and net revenues of the private and Federal facilities. The comments suggested that a seven year base period would provide a more objective approach for such comparison.

ED-OIG Response

It is the responsibility of College officials to obtain written representations from the Life of Virginia, which they indicate support deferral requests. In our opinion, preferential treatment is demonstrated when (1) relief is sought from Federal, but not private lenders, and (2) in the absence of deferral, full debt service payments are made to private but not Federal lenders. ED-OIG maintains that the College exhibited preferential treatment since it met payment obligations on a private long-term loan while allowing the Federal loan to remain past due. The timeframes used for comparison purposes were not arbitrary but corresponded to the audit scope which focused on recent operations of the College.
WORKOUT AGREEMENT

The College has not effectively sought a workout agreement with ED or developed specific plans to reduce the $378,500 College Housing Loan Default. An ED official verbally advised the College in February 1982, that (1) the College's proposed schedule of repayment was not acceptable, and (2) the Department would not grant the College financial relief until it developed and submitted plans to reduce the amount in default. The ED official is quoted, in the College's memorandum of telephone call, as stating that commitment and action to reduce the default rather than planned or proposed repayment schedules are required. Our contact with the ED official on June 17, 1983, disclosed that his position has not changed.

Because of the steep decline in enrollment from 1,357 in 1969 to 660 in 1975, Monmouth College entered a period of financial difficulty. Pledged facility gross revenues were further reduced by about $53,000 when Warren Achievement Industries terminated its lease on Graham Hall in March 1982. Current student enrollment is, in our opinion, unable to generate the net revenues required to retire the College Housing Loan in accordance with the Trust Indenture Terms. The College, therefore, has to aggressively develop alternate income producing uses of the dormant facilities or apply revenue from other College sources to the College Housing Loan.

The audited financial statements for the period ended June 30, 1982, show that the College's assets ($23 million) significantly exceed its liabilities ($4.5 million). The statements also disclosed unrestricted balances in the Current Fund and Quasi-endowment Fund totaling over $2.1 million. Thus the College appears to have the financial ability to meet the terms of a reasonable workout agreement. Further, it appears likely that ED foreclosure action could result in the recovery of the full amount of the loan. In the absence of a workout agreement, more aggressive action may have to be sought by ED to reduce or eliminate this debt.

RECOMMENDATION

We recommend that the College take immediate action to negotiate a workout agreement with ED by developing specific plans for bringing the outstanding obligation level of the College Housing Loan back to the original payment terms provided in the Bond Trust Indenture.

College Comments

The College indicates that it actively sought a workout agreement by responding to ED contacts, submitting a proposed schedule of payments and requesting debt service deferments. Further, they characterized a memorandum of phone conversation with an ED official as being not directly related to their proposed schedule of payments. Finally, the College indicated that the inability to achieve a workout agreement was attributable to communication difficulties with ED.

ED-OIG Response

Monmouth College is responsible for making payments in accordance with the Bond Trust Indenture. Consequently, it should develop specific plans to return to the original payment terms. In our view, at least some of the perceived communication difficulties with ED involved the interpretation placed by the College on the guidance it received.
# COLLEGE HOUSING AND ACADEMIC LOANS PROGRAM

**PRINCIPAL AND INTEREST IN DEFAULT AS OF JUNE 30, 1983**

## MONMOUTH COLLEGE

**MONMOUTH, ILLINOIS**

### COLLEGE HOUSING LOAN

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<tr>
<th>Years</th>
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### ACADEMIC FACILITIES LOAN

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<td></td>
<td>$211,000</td>
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January 18, 1984

Mr. Robert C. Seabrook
Regional Inspector General of Audit
United States Department of Education
Office of Inspector General - Region V
300 South Wacker Drive
Chicago, Illinois 60606

Re: Audit Control No. 05-30059

Dear Mr. Seabrook:

We have received your draft copy of the above referenced audit report. We appreciate the opportunity to make a written response to the report before being put in final form. We do not concur with all of the findings in the draft, as we will explain further. Before addressing the specific findings and recommendations, first allow us to make some technical corrections in the "Background" portion of the report as follows:

Page 1; paragraph 1 -

Because the report is based on information as of June 30, 1983, we feel the last sentence of the first paragraph should be changed to indicate an enrollment of 615 students. The actual full-time equivalent enrollment of 1982-83 was 614. We feel that an accurate indication of the College's enrollment situation is essential when considering any workout arrangement.

Page 1; paragraph 2 -

The first sentence indicates that the original College Housing loan awarded was $3,067,000. while this was the amount awarded, only $960,000 of the $995,000 Series D authorization was issued. Thus, the actual loan was originally $3,032,000.

The third sentence indicates that the loan was to finance construction of four projects. Actually, projects 1 and 2 were not for construction but were in exchange for previously issued construction bonds.

The last sentence again indicated that Series D was for $995,000. This should be changed to $960,000.

Page 1; paragraph 3 -

The second from the last sentence states, "As compensation for the four rooms, HUD agreed to the College's proposal to annually deposit $4,200 to the Bond and Interest Fund, starting June 15, 1975."
This statement is not entirely correct, in that the College proposed to annually deposit $2,400. We believe that the HUD response of July 31, 1974 was accepting our proposal, and that the person typing the HUD letter transposed the first two digits of $2,400 to make $4,200. Please note by the enclosed copy of our letter dated April 16, 1975, we deposited a prorated share of the first year's deposit. The prorated share of the first year was based on $2,400 and was brought to the attention of Mr. Robert Vladova at HUD. We received nothing from Mr. Vladova as follow-up to this letter indicating that we were not in agreement on $2,400.

Response to Findings and Recommendations

Response to Finding & Recommendation Concerning Alternate Use of Pledged Facilities

The amount of the annual deposit due the Bond and Interest fund is in question. In 1974, HUD responded to the College's proposal to use four rooms of Fulton Hall as a College Health Center with the College making annual compensation for such use of $2,400 per year. HUD responded, granting such permission, but the HUD letter used the figure $4,200 per year which we believe to be a simple transposition of figures on the part of the HUD typist. The College has no recollection of information that would indicate that HUD was not satisfied with the original $2,400 proposal. On April 16, 1975, the College addressed a letter to Mr. Robert Vladova at HUD indicating that $800 was being credited to Fulton Hall income as 1/3 of the annual deposit due. Mr. Vladova made no response, which would indicate the College had not made the proper proration. Thus, if the College agreed that it had not reimbursed the Bond and Interest Sinking Fund for the alternative use of Fulton Hall, the maximum amount due for such use would be $21,600 representing nine years at $2,400 per year.

The College feels that it has actually complied with the above requirements (with the possible exception of two years) making the importance of the above question moot. In seven of the past nine years the College Housing facilities have operated with net deficits. In each of those seven years the College has used general operating funds to make debt service payments, and thus met the requirement of transferring College funds to the Bond and Interest Sinking Fund. In eight years the College failed to properly identify a portion of the transfer as alternate use of funds. The College's only failure was in not breaking this transfer of general College funds into two separate transactions. The net increase in the amount paid toward the debt, even if properly accounted for, would be zero, with a possible exception in 1980 and 1981. During these two years the College did operate with net revenues on the facilities. The additional deposit of funds for these two years to the Bond and Interest Sinking Fund ($8,400 according to your report - $4,800 according to our information) are far more than offset by the College's deposit of operating funds during the other seven years.
In view of the above, the College does not concur that it has an outstanding liability for the Alternative use of Fulton Hall, and thus no action is needed. We will initiate procedures to ensure that future transfers from current operating funds to the Bond and Interest Sinking Fund of $2,400 annually for the alternative use of Fulton Hall are properly identified and recorded.

Response to Finding 6-Recommendation Concerning Preferential Treatment

(Correction - 1965 Life of Virginia Loan is at 5% not 3% as reported on page 6)

The College has not demonstrated preferential treatment toward this private loan as opposed to the Federal Loans. The College met its obligation of giving both lenders equal treatment by making requests for financial relief to both the Life of Virginia Company and the appropriate Federal offices. That the Federal offices approved deferments while the private lender did not, does not demonstrate any preferential treatment on the part of the College. The College did make request to Life of Virginia for financial relief. While evidence of such request was not available in College files, there is indeed evidence. Such requests for financial relief can be confirmed by directly contacting Mr. Daniel Belcore, Investment Officer, Fixed Income Division, Life of Virginia, Continental Financial Services, 6600 West Broad Street, Richmond, Virginia, 23230, Telephone (804) 281-6595.

The College did not exhibit preferential treatment in regards to occupancy pattern of the private dormitory. Contrary to the statement that Gibson Hall (the private lenders facility) was kept at near capacity, the actual average occupancy for the seven year period ending June 30, 1983 was only 55% of capacity. This compares with an average for all the federal facilities of 48% and thus a total difference of 7%. This difference represents about 11 students to be moved from the private facility to Federal facilities to make occupancy levels equal. This number would have no material effect on the financial operation of the Federal facilities and cannot be prudently used to charge preferential treatment on the part of the College. In addition we should note that guest and conference groups are normally housed in Federal facilities.

Selection of 1982 net revenue figures used to base a comparison between Gibson Hall and Federal facilities since 1981 have been arbitrarily made. 1981 net revenue figures would have shown $46,887 for Gibson Hall as compared to $119,078 for the federal facilities. While the 1983 report would show $33,301 for Gibson Hall compared to a deficit of $31,321 for the federal facilities. Selection of a single year for comparison purposes thus does not seem appropriate. A more objective approach to such a comparison would compare the 7 years of operation since requests were made for financial relief. Gibson Hall has not produced net project revenue after mandatory debt service transfer since the 1974-75 fiscal year, while federal facilities have produced net project revenue in two of those years resulting in additional debt service payments toward the Federal projects.
Further, terms of the bond indenture require that Gibson Hall become a pledged facility of the Federal Loans when the private bond is paid. Thus payment toward the private debt is not to the disadvantage of the Federal Loans.

The College feels that it has already taken all actions available to it to ensure that Federal Loans are treated equally with the College's private long-term obligations. There is no further action available to us.

Response to Finding 6 Recommendation Concerning Workout Agreement

The College has sought a workout arrangement with the ED although communications have been more difficult than with HUD and HEW previously. Although administration of the CHIP was transferred to the ED in May 1980, it was December 1980 before the College received any notification of this transfer. Per the instructions included in that notification, the College contacted Mr. Pat Romano of ED in January 1981 asking who the College should contact concerning a workout agreement. Mr. Romano indicated we were to continue to deal with our HUD representative until otherwise notified. It was not until June, 1981 that the College received any further communication from ED. That communication was only to request a copy of the College's Annual Audit and other financial information. This was provided in October 1981, and at this time the College included a proposed workout agreement which we felt met the requirements for such a request as outlined in the HUD College Housing Handbook dated July 1977. Thus, contrary to your opening statement, the College did actively seek a workout agreement with ED as soon as an address was provided to the College and we have continued to make such efforts. In fact, the College had already proposed a workout agreement with ED before HUD had even sent notification that they were no longer administering the CHIP.

In November 1981, Mr. Dave Burwell of ED called the College to indicate he had inherited the administration of these loans from HUD. He apparently did not have HUD files available to him as he requested copies of letters from our files. It was in this phone conversation that we were first asked by ED to submit a request for further deferments. Mr. Burwell did not have our request which we had submitted just one month before. On December 7, 1981 we resubmitted our request.

On December 23, 1981, the College wrote Mr. Burwell again indicating we would make our payment due January 1, 1982 in accordance with our proposed workout agreement, subject to ED approval. We were looking for some response from ED indicating what we should do.

In February, 1982, Mr. Burwell called the College from ED, however, contrary to your report, Mr. Burwell did not tell the College that the proposed repayment schedule was not acceptable, nor did he say that ED would not grant financial relief until the College developed and submitted plans to reduce the default, although the College had recognized the need for such a plan even back when HUD was administering the program. Indeed we had worked out such a plan with HEW.
It was the College's understanding from the February conversations that ED was now making a concentrated effort to look at all delinquent HUD debts as if new loans, and that a more strict requirement for adherence to the terms of the bond indenture could be expected. Mr. Burwell did not indicate that he was specifically responding to our previously proposed plan, nor did he mention that he had even seen our proposed plan. Mr. Burwell only indicated in a general fashion that the College needed to develop a specific plan for bringing the debt current. He did not state the plan we had submitted was not specific enough. The College would have naturally expected denial of such a proposal in writing.

Late in February, 1982, the College received a request from Mr. Edward Brantley of ED asking for an annual report, a proposed repayment schedule, etc., concerning the default. This seemed to be an appropriate follow-up to our previous phone conversations with Mr. Burwell. In March 1982, the College supplied the information requested in Mr. Brantley's letter, including a repayment schedule in the form of a Board Resolution. To date, the College has received neither written nor verbal response to this submission.

In summary, the College has continually made efforts to communicate our problems and proposals to ED and has actively sought a workout agreement with ED.

The College agrees that current student enrollment is unable to produce the net revenues required to retire the College Housing Loan in accordance with the terms of the bond indenture. Obviously the low enrollment has been the cause of the College's continued need to request financial relief.

Developing alternative income producing uses for dormant facilities, as the report has suggested, is not as easy as it sounds. Ironically, the leasing of Graham Hall to Warren Achievement Industries was terminated as a result of another HUD program. Also, as the report suggests, the College has been applying revenue from other College sources to the College Housing Loans for the past several years. The College has not felt it possible to use other College revenues to the extent that would be required to bring the debt current without seriously jeopardizing other programs essential to the existence and survival of the College.

The College's financial statements do display assets well in excess of liabilities, however, it should be noted that this was also the case in 1975. When reading the financial statements attention must be given to the restricted nature of most of the College's assets. Similarly, the financial statements do disclose unrestricted fund balances in the current and quasi-endowment funds. An unrestricted fund balance also existed in 1975. It must be noted that current operations rely heavily on investment earnings from such balances. 1983 operations reflected a $130,000 deficit, and reductions of unrestricted balances and the corresponding loss of revenue would only increase such a deficit. A deficit is also expected in 1984.
The College is anxious to reach an appropriate workout agreement with ED, and we believe we have demonstrated a sincere effort in that direction. The Inspector General's report has stated "Current student enrollment is, in our opinion, unable to generate the net revenue required to retire the College Housing Loan in accordance with the Trust Indenture Terms". Yet the report recommends that we do so anyway. This means the College must use revenues produced from other sources to retire the debt. The College has proposed to ED a repayment schedule which will not return the debt to its original terms, but will retire the debt within a shorter time period than the original schedule. To accomplish this the College has expected to continue to use a reasonable amount of revenues produced from other sources to apply to the debt. ED has not notified the College of its approval or disapproval of such a proposal.

Many of the conditions which prompted the original request for financial relief continue at the College today. The College feels that it has dealt in a prudent fashion with its financial affairs and has made fair, reasonable, and specific proposals to ED to which it has received no response. We will be pleased to continue to make efforts toward a satisfactory workout agreement.

Sincerely,

Don Gladfelt
Director of Finance & Business
April 16, 1973

Mr. Robert Vladova
Department of Housing & Urban Dev.
17 North Dearborn Street
Chicago, Illinois 60602

Dear Mr. Vladova:

Please find enclosed a copy of our Loan Management Report for the period July 1 through March 31.

Effective March 24, 1973 we began using the four rooms in Fulton Hall as a Health Center. Therefore, we are transferring $800.00 to Fulton Hall income which represents one-third of the annual rent.

If you have any questions, please let me know.

Sincerely,

James A. Blonder
Director of Finance & Business

JA8th

Enclosure
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Dear Sir:

Enclosed is a copy of the Inspector General's report entitled, "Audit of the College Housing and Academic Facilities Loan Programs at Shaw University, Raleigh, North Carolina, For the Period July 1, 1982, Through May 31, 1983."

Although your comments to the draft audit findings have been incorporated in this final audit report, please respond within 30 days from the date of this letter to each final finding and recommendation, presenting any comments or additional information that may have a bearing on the settlement of this audit. Your comments should be forwarded directly to the Department of Education official indicated below who is responsible for the final determination of corrective actions on deficiencies covered in this report including, where necessary, the determination of amounts that must be refunded to the Federal Government.

Revised 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.

PLEASE RESPOND DIRECTLY TO

Assistant Secretary
Office of Postsecondary Education
Department of Education
Room 4044, RDB-3
400 Maryland Avenue, S.W.
Washington, D.C. 20202

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to the exemptions in the Act.

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

Sincerely,

M. Bruce Westheuitt
Regional Inspector General for Audit
ED OIG Office of Audit, Region IV

Enclosure
AUDIT OF THE COLLEGE HOUSING
AND
ACADEMIC FACILITIES LOAN PROGRAMS
AT
SHAW UNIVERSITY
RALEIGH, NORTH CAROLINA
FOR THE PERIOD JULY 1, 1982, THROUGH MAY 31, 1983

DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT
REGION IV

Audit Control No. 04-30062
Shaw University is a private, non-profit institution of higher education that traces its origin back to 1865. The University offers Bachelor of Arts and Bachelor of Science Degrees and has a full-time enrollment of about 1,640 students. The main campus is located in Raleigh, North Carolina, with Centers for Alternative Programs in Education in several other cities. Shaw University is accredited by the Southern Association of Colleges and Schools.

Title IV of the Housing Act of 1950, as amended, created the College Housing Loan Program (CHLP) with the objective of assisting educational institutions in providing student and faculty housing and other facilities, such as student centers, health centers, and dining halls. Assistance is provided through direct loans at low interest rates for the construction or purchase of facilities. The Academic Facilities Loan Program (AFLP) was established by Congress under Title VII C of the Higher Education Act of 1965. The program provides long-term financing to institutions for construction of academic facilities such as classrooms and libraries.

The CHLP was managed by the Department of Housing and Urban Development (HUD) until May 1980 when the program was officially transferred to the Department of Education (ED). Under an agreement with ED, HUD continued to administer the program through April 1981. The AFLP was managed by the Department of Health, Education, and Welfare's Office of Education until May 1980 when the program was transferred to ED.

Two CHLP loans have been granted to Shaw University. The first, for $2,050,000, was in 1966 for the construction of a women's dormitory and student union building (Project NC-31-CH-120); the second, for $1,865,000 in 1979, was for the construction of a men's dormitory and infirmary (Project NC-32-CH-157). Both projects have been completed. At May 31, 1983, principal and interest in default on the CHLP loans totaled $440,000 and $556,409, respectively.

In June 1982 ED approved a workout agreement for paying the delinquent principal and interest. Additional conditions not contained in the trust indentures were included in the agreement. At June 30, 1983, the University was current in its payments under the workout agreement.

Shaw University received an AFLP loan of $287,000 in 1967 to aid in the construction of a library. Repayment of this loan had also fallen into default and a workout agreement was negotiated in November 1979. At May 31, 1983, principal and interest in default on the AFLP loan totaled $12,000 and $7,410, respectively. The University is current in its payments under the workout agreement.
SCOPE OF AUDIT

The purpose of our audit was to review selected aspects of the CHLP and APLP loans at Shaw University. Specifically, the objectives of the audit were to determine whether:

1. receipts and expenditures for CHLP-pledged facilities are being properly determined and reported to ED, and net revenues are properly accounted for and used to make payments on the loans;

2. the institution complied with the terms and conditions of the workout agreements;

3. the institution was current in making payments under the workout agreements; and

4. Federal loans had received equal treatment with other long-term obligations of the institution.

We reviewed the University's most recent audited financial statements, evaluated the University's accounting system and procedures for allocating revenues and expenditures to the projects, reviewed selected costs charged to pledged facilities, and evaluated the University's ability to pay current and past due obligations toward the retirement of the loans. Our audit was conducted in accordance with generally accepted government auditing standards appropriate to the limited scope audit described above. Audit work was conducted at Shaw University and the Nashville OIG Audit office during the period June 28, 1983, through October 24, 1983. Our examination included activities applicable to the loan during the period July 1, 1982, through May 31, 1983.

HIGHLIGHTS OF AUDIT RESULTS

Although Shaw University is current in its payments under its workout agreements, the University is not in compliance with several other provisions of the Trust Indentures and the workout agreement for the CHLP loans. Our audit showed that the University

--- did not use the proper Revenue Fund Accounts to deposit all project revenue and to pay all project expenses;

--- charged the projects for approximately $75,000 in costs that were reimbursed under the Federal College Work-Study program;

--- did not properly allocate maintenance and operating costs to each of the pledged facilities, and charged the projects $17,171 for costs that were not project-related; and

--- had not prepared and submitted the required quarterly Loan Management Reports to ED.

The University had no long-term obligations other than the CHLP and APLP loans. Shaw University's response to the finding is summarised at the end of the finding together with the auditor's comments as appropriate. The complete text of Shaw University's response is included as an Appendix to this report.

Except for the items highlighted above and the items detailed in the Finding and Recommendations section of this report, the tested items were in compliance with applicable laws and regulations. Nothing came to our attention as the result of audit tests that caused us to believe the untested items were not in compliance with applicable laws and regulations.
FINDING AND RECOMMENDATIONS

FINDING - NON-COMPLIANCE WITH TRUST INDENTURES AND THE AGREEMENT FOR REPAYMENT OF DELINQUENT PRINCIPAL AND INTEREST

Although current in its payments under the workout arrangement, Shaw University is not in compliance with several other provisions of the Trust Indentures and the Agreement For Repayment of Delinquent Principal and Interest (hereinafter referred to as the workout agreement) for the CHLP loans. The University has not properly maintained the required Revenue Fund Accounts in which all project revenue is to be deposited and used only to pay expenses of the projects. Costs that were reimbursed under another Federal program were charged to the projects. Other costs have also been inappropriately charged or allocated to the projects. In addition, the required quarterly Loan Management Reports have not been prepared and submitted to ED.

Project Revenue Not Deposited Into Revenue Fund Accounts.

Section 5.01 of the Trust Indenture for Project 120 (Women's Dormitory and Student Union Building) states that there shall be established a trust account called the Shaw University Dormitory and Student Union Building Bonds of 1966 Revenue Fund Account. After the date on which the project becomes revenue producing and continuing as long as any of the bonds are outstanding, all income and revenue arising out of the project or its operation shall be deposited without exception in the Revenue Fund Account. The Trust Indenture for Project 157 (Men's Dormitory) contains similar provisions.

Condition No. 1 of the workout agreement between the University and ED states that the Revenue Fund Account for each project must be in effect. The agreement further states that, for each project, revenues will be deposited in respective revenue bank account(s), and maintenance and operating expenses paid from that account. An additional requirement is that project funds will not be commingled with the institution's current fund.

Revenue fund bank accounts for each project have been established, but were not used as intended. Some project revenues were deposited into the University's General Fund instead of into the revenue fund bank accounts. Those project revenues that were deposited into the revenue fund bank accounts were immediately withdrawn and deposited into the University’s General Fund. In either case, project revenues ended up in the General Fund account, and project-related expenses were then paid from that account, along with other University expenses.

University officials stated they did not use the revenue fund accounts as required because it would be very cumbersome to deposit all revenues into each respective bank account due to the large amount of student account receivables carried during the
school year. Revenues are recognized as income to the projects as they are accrued rather than when the cash is received. According to the officials, deposits of actual cash into each account on a regular basis would require additional personnel to apply cash to various accounts as it is received.

Although some additional recordkeeping may be necessary to keep project funds separate, the separation is a basic requirement of the Trust Indenture and workout agreement. Further, the separation is essential to assure that these pledged funds are always identifiable and available to pay project costs.

Reimbursed Costs Charged to the Projects.

Costs of $95,916 were charged to the projects for student salaries which were funded through the College Work-Study Program (CWSP). However, only 20 percent of the $95,916 was actually paid by the CHLP project.

Under the CWSP, Federal grants are made to pay up to 80 percent of the direct wages paid to students working in eligible activities at the University. Accordingly, only 20 percent of the $95,916 was funded by the projects as the balance of $76,000 was paid by the CWSP. However, the project was charged the full amount. The Business Manager contends that such expenditures are allowable since the service provided by the students is an allowable expense regardless of the source of income.

In our opinion, only the portion actually paid by the project should be charged as an expense to the CHLP project.

Cost Allocation Procedures Not Adequate.

Section 5.01 of the Trust Indenture requires segregation of revenues and expenditures by project. Condition No. 2 of the workout agreement further stipulates that project revenues cannot be used for any purpose other than payment of direct project related maintenance and operating costs and debt service. The University had not established adequate procedures for allocating costs to each project in accordance with these requirements. As a result, the projects were charged for maintenance and operating costs that were not properly allocated between projects, or were not project-related.

Costs not Properly Allocated. Direct labor and fringe benefit costs of $58,287 were charged to the projects for custodial help and skilled labor; however, the allocation of cost between the pledged facilities was not based on effort attributable to each pledged facility. As an example, $37,180 of custodial/grounds salaries was charged to the Student Union Building; however, the Dean of Student Affairs, who is responsible for this activity stated that most of the work was attributable to the Men's and Women's Dormitories. These same people may also work in other
The University's accounting system is capable of providing separate accountability for revenues and expenditures associated with each pledged facility. However, accounting classification codes that record transactions separately for each pledged facility have only been established for revenue accounts; expenditures for the Men's Dormitory and Women's Dormitory are combined, even though these are two separate projects.

The University had combined the expenditures for these two projects because of their similar nature. However, as a result of not separating the expenditures for each facility as required by the Trust Indenture, the University did not have the information needed to manage the pledged facilities in a sound fiscal manner.

Unrelated Costs Charged to the Projects. Expenditures of $17,171 charged to the CHLP projects should have been charged to other accounts or projects because the costs were not related to the pledged facilities or their operations.

These charges included $1,780 in food services that should have been charged to the Upward Bound Program, $1,752 in books which were returned to the vendor, $7,958 in direct labor costs of Post Office employees that should have been charged to the general university administration, $268 for rental of equipment used exclusively for general university mailing, and $5,413 in postage which was not billed to the user departments.

Loan Management Reports (Form 4370). ED's Loan Management Branch, in its report on a visit to the University on September 29, 1981, stated that Loan Management Reports had not been submitted on a timely basis. The workout agreement between ED and the University required that a Loan Man-
agement Report with detail of maintenance and operating costs and a transcript of deposits and withdrawals to the Revenue Fund Account Bank Account, be submitted each quarter beginning with the 1982 fall semester.

The University has not submitted the required information and reports. The Business Manager at Shaw said he contacted ED officials about obtaining additional report forms and was told that a new Form 4370 was being developed and would be sent out when finalized and not to use the old form. The Business Manager said no new forms were received and, therefore, no Loan Management Report has been submitted since prior to the beginning of the 1982-83 fiscal year.

Although changes in the reporting forms are being considered by ED, the requirement for Shaw to submit Loan Management reports was never suspended. Shaw's failure to submit these reports hinders ED in monitoring the activities of the pledged facilities.

Recommendations

We recommend that the University:

1. deposit any project funds remaining in the University's general fund to the Revenue Fund accounts for the projects and, in the future, deposit all income and revenue derived from the CHLP projects into the appropriate Revenue Fund accounts;

2. show as an expenditure to the CHLP projects only the 20 percent of CWSP salaries actually paid by the projects;

3. adjust the financial records of the CHLP projects to eliminate non-project related costs which were charged to the project and to re-allocate costs which were applicable to more than one CHLP project and/or non-project related functions;

4. develop procedures to properly allocate costs which are applicable to more than one CHLP project and/or non-project related functions; and

5. prepare and submit to the ED Loan Management Branch the Loan Management Reports and other required information for each quarter completed since the last report and submit in a timely manner all reports required in the future.

Auditee's Response (Summary)

The University indicated that steps had been taken to comply with two of the recommendations; however, they disagreed with the remaining recommendations or provided reasons why they had not complied. Their comments to each recommendation were:
Recommendation No. 1 - The University stated that they did not have the manpower nor the accounting system to deposit all CHLP income and revenue into the appropriate Revenue Fund Accounts. To do this, they would have to write separate receipts for tuition, insurance, fees, room, board, and books every time a student paid any amount or was credited with financial aid on their account. In addition, a check would have to be issued to deposit the appropriate funds into the Revenue Fund Accounts. The University stated that all these receipts would be necessary because of the large amount of financial aid received by their students. Since financial aid is a continuous process during the fiscal years, receipts must be written daily. The University stated that no deposit was necessary since the CHLP projects were operating at break-even or at a loss.

Auditor's Comments

The Trust Indentures and the workout agreement require that project income and revenue be deposited into the Revenue Fund Account. The purpose of these requirements is to ensure that project funds are separately maintained and available to pay project expenses. When the funds are co-mingled with other University funds, the possibility exists that project funds could be used for non-project expenses. Separate receipts would not necessarily be needed as long as a single receipt provided for an allocation of the cash or credit between the two CHLP projects and non-CHLP functions. Deposits of CHLP revenue into the Revenue Fund Accounts could be made on reasonable intervals, such as weekly.

Recommendation No. 2 - The University disagreed with this recommendation. They stated that the CWSP funds would not be classified as revenue until the students use their CWSP wages to pay part of their charges owed to the University.

Auditor's Comments

Based on the University comments, we have revised our recommendation. Only that portion of the CWSP wages actually paid by the CHLP projects, i.e., the 20 percent, should be shown as a project expense.

Recommendation No. 3 - The University stated they have made the necessary adjustments to comply with this recommendation.

Recommendation No. 4 - The University stated they have developed and implemented the necessary procedures to properly allocate costs to the CHLP projects.

Recommendation No. 5 - The University stated that every effort was made to get the forms from ED but without success.

Auditor's Comments

This matter was discussed with ED officials on March 13, 1984. We were advised that copies of Form 4370, Loan Management Report, would be provided to the University. When received, the University will be able to comply with our recommendation.
In regard to the above captioned audit, I assure you that nothing would give us greater pleasure or more relief than to state that we are financially prepared to conform to the recommendations set forth in this document. Unfortunately, the scarcity and uneven flow of revenue precludes full compliance with these recommendations.

However, we feel that some aspects of the audit can be adhered to and we offer below an explanation of our position and solutions, which, we believe, would fairly and accurately present the status and accountability of these projects.

Revenues, cash flow: Shaw University is a small disadvantaged black institution, that directly and indirectly, in the form of grants and various student aid programs, has had to depend upon such federal aid for survival, in order for this university to remain operable and provide a unique service, for which there is a recognized need, funds from whatever source must be used to meet priority requirements of the university. More often than not, there has been a shortfall of funds, which results in current operating expenses of the university not being met.

At the beginning of each school semester, charges for room, board, tuition and fees are assessed to all students for the entire semester. Practically all students at Shaw receive financial aid and none are able to pay in advance the charges assessed. Summarily, Shaw realizes income from student sources by installment payments of accounts whereas nearly all schools realize and earn this income from the beginning of each semester. Not having the availability of the assessed income understandably restricts the apportionment of the limited income available.

We feel that the manipulation of funds between a current fund bank account and two or three revenue fund accounts serve no useful purpose, other than to be misunderstood. The obvious answer to this dilemma would be an importing of private funds sufficient to satisfy the current needs of the university.

Shaw University
Raleigh, North Carolina 27611
February 28, 1984

Mr. M. Bruce Nestlehutti
Regional Inspector General for Audit
ED OIG, Office of Audit, Region IV
101 Marietta Tower
Post Office Box 1508
Atlanta, GA 30301

Re: Audit Control Number 04-30067

Dear Mr. Nestlehuttti:

In regard to the above captioned audit, I assure you that nothing would give us greater pleasure or more relief than to state that we are financially prepared to conform to the recommendations set forth in this document. Unfortunately, the scarcity and uneven flow of revenue precludes full compliance with these recommendations.

However, we feel that some aspects of the audit can be adhered to and we offer below an explanation of our position and solutions, which, we believe, would fairly and accurately present the status and accountability of these projects.

Revenues, cash flow: Shaw University is a small disadvantaged black institution, that directly and indirectly, in the form of grants and various student aid programs, has had to depend upon such federal aid for survival, in order for this university to remain operable and provide a unique service, for which there is a recognized need, funds from whatever source must be used to meet priority requirements of the university. More often than not, there has been a shortfall of funds, which results in current operating expenses of the university not being met.

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We feel that the manipulation of funds between a current fund bank account and two or three revenue fund accounts serve no useful purpose, other than to be misunderstood. The obvious answer to this dilemma would be an importing of private funds sufficient to satisfy the current needs of the university.
Project accountability: We agree with your assessment that accountability for each project should be separate and distinct. We feel that this would provide greater clarity and better managerial control. We have, also, documented the allocation of charges for labor, utilities and any other charges where an acceptable formula of allocation is desirable. We would further propose to credit the respective project account with income accruals for room, board and other incomes. We feel such a system of accounting for the respective projects will accurately reflect the operation and management of the projects, although, the Loan Management Reports would omit the maintenance of bank accounts.

Mr. Neilshutt, we have tried to be perfectly frank regarding our handicapped position in conforming ideally to the requirements of the Trust Indenture. We further feel that if the University can continue to comply with the terms and conditions of the workout agreements; this demonstration of good faith should attest to our desire to comply as closely as possible, to that which is expected of us.

The ramifications of the whys and why nots are too numerous and complicated to detail in a letter. I believe a conference on this matter would be most beneficial in establishing what we realistically can or cannot do.

For further assistance in this matter, please contact me at (919) 755-4014.

Sincerely,

William E. Lowe
Business Manager
Recommendation

1. Deposit any project funds remaining in the University's General Fund to the Revenue Fund Accounts for the project and in the future deposit all income and revenue derived from CHLP Projects into the appropriate Revenue Fund Accounts.

Response

We sincerely wish that we had the manpower and/or the accounting system necessary to handle such a massive undertaking. To satisfy this recommendation we would have to do the following for all on campus students:

1. We would have to write the following receipts every time a student paid any amount or any financial aid was posted to his/her account.

   A. some amount for tuition
      some amount for insurance
      some amount for fees
      some amount for room
      some amount for board
      some amount for books

   B. transfer check to the Revenue Fund for room

   C. transfer check to the Revenue Fund for board

The reason for all these receipts is caused by the tremendous amount of financial aid received by our students. A large percentage of our student body is dependent on some form of student financial aid, (approximately 72%). Since student financial aid is a continuous process during the fiscal year, we must write receipts daily.

In addition to the above, the University has made it a practice to report all accrued income on the CHLP Projects. Since the collection of receivables is never a hundred percent, the CHLP Projects income is overstated by the uncollectable receivables.

The audit findings showed that the University was operating the CHLP Projects at about a break-even point or at a loss. In light of this, there is no revenue to transfer to these projects.
Recommendation

2. Credit Federal CWSP Funds of approximately $76,000 to the project account and, in the future, credit the projects for CWSP Funds received in behalf of the students charged to the projects or charge the projects only for that portion of CWSP salaries actually paid by the projects.

Response

We disagree with this recommendation entirely for the following reasons:

1. This money is not Shaw University's or the CHLP Projects', but student financial aid.
2. No student financial aid money can be classified as Revenue Fund Income.
3. The money does not become the University's until after a student has paid his/her bill.
4. It is after the students pay us that we pay the operation costs associated with the CHLP Projects.
5. The cost for custodial services and fringe benefits are greatly reduced by using student labor. This reduction in costs has enabled Shaw University to honor its agreement with the Department of Education.

Recommendation

3. Adjust the financial records of the CHLP Projects to eliminate non-project related costs which were charged to the project and to reallocate costs which were applicable to more than one CHLP Project and/or non-project related functions.

Response

The University has complied with this recommendation. The accounting firm of Garrett, Sullivan and Company, CPA's, made the recommended adjustments.

Recommendation

4. Develop procedures to properly allocate cost which are applicable to more than one CHLP Project and/or non-project related functions.

Response

The University has developed and implemented the necessary coding schemes to properly allocate costs to the CHLP Projects. This was implemented for the fiscal 1983-1984.

Recommendation

5. Prepare and submit to the Ed Loan Management Branch the Loan Management Reports and other required information for each quarter completed since the last report and submit in a timely manner all reports required in the future.

Response

The University has made every effort to get the forms from the Department of Education, but without success. I have talked with Mr. Walter Stevens, who handled our repayment 'workout' agreements, about not having the necessary forms. The guidelines nor the report forms for the CHLP Projects have not been printed as of this data.

We were instructed by the Department of Education not to use the old forms. If you wish to verify this, please call Mr. Walter Stevens at (202) 785-1843.
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Principal Action Official

Mr. Edward Elmendorf
Assistant Secretary
Office of Postsecondary Education
Department of Education
Room 4044, NDB-3
400 Maryland Avenue, S.W.
Washington, D.C. 20202

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Office of Inspector General

Mr. Frank Yanni, Chief
Postsecondary Education Audit Branch, Washington

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Chief, Contract Audit Branch, Washington

3

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RIGA, Region IV

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Office of Audit

REPORT ON LIMITED SCOPE AUDIT OF THE
COLLEGE HOUSING LOAN PROGRAM
FOR THE PERIOD
JULY 1, 1980 THROUGH JUNE 30, 1982
UNIVERSITY OF STEUBENVILLE
STEUBENVILLE, OHIO

NOTICE

"The designation of financial and/or managerial deficiencies or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions, observations and recommendations in this report, represent the opinion of the ED-OIG Office of Audit. Final determination on these matters will be made by appropriate ED operating or program officials."

Audit Control No. 05-30061

U.S. DEPARTMENT OF EDUCATION
March 20, 1984

Rev. Michael Scanlan, President
University of Steubenville
Franciscan Way
Steubenville, Ohio 43952

Dear Rev. Scanlan:

Enclosed is a copy of the Inspector General’s report on audit of the College Housing Loan Program for the period July 1, 1980 through June 30, 1982. Your comments have been incorporated into the final report. If you have any additional comments, please submit them within 30 days from the date of this letter to the following Education Department official:

Assistant Secretary
Office of Postsecondary Education
Room 4044, ROB-3
Washington, D.C. 20202

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

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), reports issued to the Department’s grantees and contractors are made 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.

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

Sincerely,

Robert G. Seabrooks
Regional Inspector General for Audit – Region V

Enclosure
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Scope of Audit

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FINDINGS AND RECOMMENDATIONS

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Revenue Fund Account not Funded
Need to Request Prior Approval for Costs

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Schedules for Period July 1, 1981 through June 30, 1982:

B-1 - Maintenance and Operation Costs
B-2 - Direct and Indirect Costs Allocable to Pledged Facilities
B-3 - Calculation of Unallowable Indirect Costs

Schedules for Period July 1, 1980 through June 30, 1981:

C-1 - Maintenance and Operation Costs
C-2 - Direct and Indirect Costs Allocable to Pledged Facilities
C-3 - Calculation of Unallowable Indirect Costs

APPENDIX

A - University Response to Draft Audit Report
INTRODUCTION

The University of Steubenville (University), a private, nonprofit Catholic liberal arts institution of higher education, was founded in 1946. The University offers associate, undergraduate and graduate degree programs.

A $900,000 College Housing Loan was awarded to the University in 1960 by the U. S. Department of Housing and Urban Development (HUD). Additional College Housing Loans were made in 1962, 1967, and 1970. The loans funded the construction of three student dormitories, a dining hall, and a student union building. The University did not participate in the Academic Facilities Loan Program. The principal amount of the loans consolidated in the April 1, 1970 Trust Indenture was $2,894,000 repayable over 40 years. The University issued bonds and pledged facilities and net revenues as security for the College Housing loan. The specific series and the rate of interest on the Dormitory and Auxiliary Facilities Construction and Refunding Bonds were: (i) Series A for $785,000 at 3 1/8 percent interest; (ii) Series B for $578,000 at 3 3/8 percent interest; (iii) Series C for $566,000 at 3 percent interest; and (iv) Series D for $965,000 at 3 percent interest. Administration of the College Housing Loan program was transferred from HUD to the U. S. Department of Education (ED) in May of 1980.

The pledged facilities for the College Housing Loan consist of the buildings constructed. The pledged revenues consist of net revenues from the operation of the pledged facilities and a student union fee of $50 per semester for each full time student enrolled at the University, during the period of audit.

The University maintained the College Housing Loan repayment schedule until 1978. The last principal payment was made on April 1, 1977, and the last interest payment on October 1, 1977. The University requested and received annual deferments for debt service payments from default through June 30, 1982. A Workout
Agreement was negotiated and executed on July 1, 1983. It provides that the University will: (1) begin immediate funding of the Revenue Fund Account as well as other accounts required by the Trust Indenture, (2) be granted a revised repayment schedule extending the loan payment period from forty to fifty years, (3) pay ED $30,000 by September 30, 1983 which will be applied to delinquent interest and make negotiable payments of no less than $30,000 annually towards delinquent interest, (4) immediately deposit $79,115 to the Bond and Interest Sinking Fund Account, and (5) request ED's prior approval for all costs of repair and maintenance and equipment replacement. As of April 1, 1983, delinquent principal and interest totaled $825,187.50 (Exhibit A).

SCOPE OF AUDIT

The purpose of our audit was to review selected aspects of the College Housing Loans at the University. Our specific objectives were to determine whether: (i) terms and conditions of the college housing Trust Indenture dated April 1, 1970, and Workout Agreement dated July 1, 1983, were complied with, (ii) the loan received equal treatment with other long-term obligations, and (iii) pledged revenues had been utilized for purposes other than the college housing loan.

We reviewed the University's Loan Management Reports for the Fiscal Years ended June 30, 1981 and 1982, tested selected items of receipts, evaluated allocation bases for claiming maintenance and operation expenses, and analyzed notes payable to the Federal Government. Our audit was conducted in accordance with generally accepted government auditing standards appropriate to the limited scope audit described above. Our audit did not include a comprehensive evaluation of the reasonableness of expenses claimed for maintenance and operation, or a review of the efficiency and economy of operations.

Audit field work was performed during the period July 25, 1983 through August 4, 1983 at the University of Steubenville, Steubenville, Ohio.
HIGHLIGHTS OF AUDIT REVIEW

The University generally did not comply with several of the terms and conditions of the Trust Indenture and Workout Agreement of the College Housing Loan program. Specifically, we found that the University:

--Overstated maintenance and operation costs of pledged facilities and accordingly, understated net revenues by $362,991 for the two-year audit period. We are recommending that (1) revised Loan Management Reports be submitted and (2) future reports be based on proper cost allocation methods and include only costs permitted by the Trust Indenture and Workout Agreement.

--Did not utilize the Revenue Fund Account to account for pledged facility monies and transactions but rather included them in the general fund. We recommend that the University deposit all pledged facility revenues into and pay applicable expenses from the Revenue Fund Account as required by the terms of the Trust Indenture.

--Failed to request prior approval for approximately $55,000 incurred for repair and maintenance and other anticipated costs as required by the terms of the Workout Agreement. We recommend that the University request SD approval for costs incurred and anticipated.

These conditions are discussed in detail in the Findings and Recommendations section.

The only internal control systems tested pertained to those aspects of the administration of the College Housing Loan as identified in the Scope of Audit section. No information came to our attention to indicate that there were weaknesses in any untested aspects of the College Housing Loan program.

The University officials generally agreed with the findings, but did not concur with the cost allocation process we used. The University's response is attached to this report as Appendix A.
FINDINGS AND RECOMMENDATIONS

OVERSTATE MAINTENANCE AND OPERATION EXPENSES INCLUDED ON THE LOAN MANAGEMENT REPORTS

The University overstated maintenance and operation costs and understated net revenue of pledged facilities by $362,991 for fiscal years 1981 and 1982. The overstated amounts were reported because: (1) costs unallowable per the Trust Indenture were included, and (2) indirect costs were allocated inequitably. As a result, ED was not informed as to the true amount of net revenues available to reduce debt service costs pertaining to the delinquent interest and principal of $825,187.

The University followed the same procedures for determining net revenues in periods prior to our audit period. Therefore, it is likely that net revenues were also understated during prior periods. These conditions have directly contributed to the University's apparent inability to make debt service payments and have led, erroneously to the subsequent loan default. The overstated costs reported to ED by fiscal year were:

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Overstated Costs</th>
<th>Exhibit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>$191,552</td>
<td>C-1</td>
</tr>
<tr>
<td>1982</td>
<td>171,439</td>
<td>B-1</td>
</tr>
<tr>
<td></td>
<td>$362,991</td>
<td></td>
</tr>
</tbody>
</table>

Certain of the indirect costs charged against the pledged facilities are not acceptable. Article V, Section 2 of the Trust Indenture dated April 1, 1970, states:

"...Current expenses shall include all necessary operation expenses, current maintenance charges, expenses for reasonable upkeep and repairs, properly allocated share of charges for insurance and all other expenses incident to the operation of the pledged facilities, but shall exclude depreciation, (and) all general administrative expenses of the borrower...."

Our review noted that the Loan Management Reports included the following costs which were not incidental to the operation of the pledged facilities, or for general administrative expenses of:

- Campus Ministry
- General Office
- Student Life
The University used unsupported percentages to allocate indirectly assigned maintenance and operating costs. Those percentages did not equitably assign costs to pledged facilities. In response to our inquiries about the percentages used (varying from 60 to 90 percent), the University's Controller stated that the percentages had been passed to her by the former Treasurer.

Since maintenance and operating costs (i.e. security, maintenance, and grounds) can generally be allocated based on space utilization; we apportioned those costs using the total square feet for all University buildings. Our calculations showed that pledged facilities were charged a disproportionate share of maintenance and operating costs while other facilities were undercharged or not charged at all. The overcharges to pledged facilities were $171,439, in fiscal year 1982 and $191,552 in fiscal year 1981. For details of our calculations, see Exhibit B-3, Note (a).

RECOMMENDATIONS

We recommend that the University:

1. Submit revised Loan Management Reports for fiscal years 1981 and 1982 that accurately reflect net revenues, and
2. Implement procedures to assure submission of accurate Loan Management Reports in the future.

University Comments

The University concurred that Loan Management reports need to be revised, however, it disagreed with the allocation percentage used in the audit report. The University believes that the OIG's allocation should consider unused space in a non-project dormitory. The University agreed that costs unallocable per the trust agreement were included on the Loan Management Reports.

OIG Response

The costs considered allocable (i.e. maintenance, security, and grounds) benefit both occupied and unoccupied space. Therefore, no changes are considered appropriate to the allocations contained in the audit report.
REVENUE FUND ACCOUNT NOT USED

The University, contrary to requirements of the Trust Indenture dated April 1, 1970 and Workout Agreement dated July 1, 1983, channeled funds applicable to pledged facilities through the general operating account instead of the required Revenue Fund Account. Use of the Revenue Fund Account is required to ensure that net revenues from the operation of pledged facilities are identified as available only for College Housing Loan obligations. This violation of loan terms was also cited in the University's fiscal year 1981 and 1982 certified audit reports.

RECOMMENDATION

We recommend the University begin using the Revenue Fund Account to deposit revenue and pay expenses related to the operation of pledged facilities.

University Comments

The University concurred and indicated that a Revenue Fund Account is currently being used to deposit revenues and pay expenses related to pledged facilities.

NEED TO REQUEST PRIOR APPROVAL FOR COSTS

The University expended approximately $55,000 during the period July 1, to August 11, 1983 for repair and maintenance of pledged facilities without requesting prior approval from ED. Additional expenditures are planned. These expenditures were contrary to a provision of the Workout Agreement dated July 1, 1983 which states:

...All maintenance, replacement of equipment, and repair work must be approved by the Department of Education...

ED officials confirmed that neither verbal nor written prior approval was granted. The University is required to adhere to all terms and provisions of the Workout Agreement. ED may reactivate Bondholder rights and exercise default remedies if the University fails to adhere to the terms and provisions of the Agreement. Failure to request approval places the University's risk, since such expenditures are not chargeable to pledged facility revenues without ED approval.

RECOMMENDATIONS

We recommend that the University:

1. Request ED's approval for maintenance, replacement of equipment, and repair costs incurred ($55,000) at the time of our on-site visit.
2. Obtain prior approval for future costs in accordance with the terms and conditions of the Workout Agreement.

University Comments

The University concurred with our findings and recommendations.

Robert O. Seabrooks
Regional Inspector General for Audit - Region V
## SCHEDULE OF PRINCIPAL AND INTEREST PAYMENTS

**PAST DUE AS OF APRIL 1, 1983**

**UNIVERSITY OF STEUBENVILLE**

**STEUBENVILLE, OHIO**

<table>
<thead>
<tr>
<th>Bond Series</th>
<th>Original Loan Amount</th>
<th>Balance Outstanding</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$ 785,000.00</td>
<td>$ 660,000.00</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>578,000.00</td>
<td>496,000.00</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>566,000.00</td>
<td>501,000.00</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>965,000.00</td>
<td>891,000.00</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,894,000.00</strong></td>
<td><strong>$2,548,000.00</strong></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bond Series</th>
<th>Past Due Principal</th>
<th>Interest</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$130,000.00</td>
<td>$113,437.50</td>
<td>$243,437.50</td>
</tr>
<tr>
<td>B</td>
<td>88,000.00</td>
<td>92,070.00</td>
<td>180,070.00</td>
</tr>
<tr>
<td>C</td>
<td>68,000.00</td>
<td>82,665.00</td>
<td>150,665.00</td>
</tr>
<tr>
<td>D</td>
<td>104,000.00</td>
<td>147,015.00</td>
<td>251,015.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$390,000.00</strong></td>
<td><strong>$435,187.50</strong></td>
<td><strong>$825,187.50</strong></td>
</tr>
</tbody>
</table>
EXHIBIT B-3

SCHEDULE OF MAINTENANCE AND OPERATION COSTS REPORTED AND THE AUDITOR’S RELATED RECOMMENDATIONS
FOR THE PERIOD
JULY 1, 1981 THROUGH JUNE 30, 1982

UNIVERSITY OF STEUBENVILLE
STEUBENVILLE, OHIO

<table>
<thead>
<tr>
<th>Pledged Facility</th>
<th>Reported (a)</th>
<th>Accepted</th>
<th>Overreported (b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marion Hall</td>
<td>$131,200</td>
<td>$65,839</td>
<td>$65,361</td>
</tr>
<tr>
<td>St. Francis Hall</td>
<td>$126,864</td>
<td>$61,410</td>
<td>$65,454</td>
</tr>
<tr>
<td>Trinity Hall</td>
<td>$145,476</td>
<td>$80,363</td>
<td>$65,113</td>
</tr>
<tr>
<td>Student Center</td>
<td>$367,028</td>
<td>$400,793</td>
<td>(13,765)</td>
</tr>
<tr>
<td>Antonian Hall (Dining)</td>
<td>$399,469</td>
<td>$410,193</td>
<td>(10,724)</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$1,090,037</strong></td>
<td><strong>$1,018,588</strong></td>
<td><strong>$71,439</strong></td>
</tr>
</tbody>
</table>

NOTES:

(a) Represents maintenance and operation costs for pledged facilities as reported in the Loan Management Report dated December 31, 1982.

(b) Represents maintenance and operation costs overreported because the University (1) included costs to be allocated to pledged facilities which were unallowable per the Trust Indenture and (2) used an inequitable allocation percentage to distribute costs to pledged facilities.

(c) Consists of:

- $948,795 – Directly assigned costs accepted in Exhibit B-2
- $69,803 – Indirectly assigned costs accepted in Exhibit B-3
- $1,018,598
<table>
<thead>
<tr>
<th>Expense Category</th>
<th>Directly Assigned Costs</th>
<th>Indirectly Assigned Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintenance</td>
<td>$76,642</td>
<td></td>
</tr>
<tr>
<td>Security</td>
<td>70,459</td>
<td>70,459</td>
</tr>
<tr>
<td>Grounds</td>
<td>8,084</td>
<td>8,084</td>
</tr>
<tr>
<td>Campus Ministry</td>
<td>73,338</td>
<td></td>
</tr>
<tr>
<td>General Office</td>
<td>29,177</td>
<td>29,177</td>
</tr>
<tr>
<td>Student Life</td>
<td>25,131</td>
<td>25,131</td>
</tr>
<tr>
<td>Health Center</td>
<td>12,140</td>
<td>12,140</td>
</tr>
<tr>
<td>Career Counseling</td>
<td>6,831</td>
<td></td>
</tr>
<tr>
<td>and Placement</td>
<td>2,888</td>
<td></td>
</tr>
<tr>
<td>Intramurals</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Subtotals</strong></td>
<td><strong>204,690</strong></td>
<td><strong>155,185</strong></td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$1,253,485</strong></td>
<td><strong>$1,103,980</strong></td>
</tr>
</tbody>
</table>

**NOTE:**

(a) Categories of expense were accepted, subject to allocation, as provided in the Trust Indenture.
CALCULATION OF UNALLOWABLE INDIRECT COSTS
FOR THE PERIOD
JULY 1, 1981 THROUGH JUNE 30, 1982
UNIVERSITY OF STEUBENVILLE
STEUBENVILLE, OHIO

<table>
<thead>
<tr>
<th>Pledged Facility</th>
<th>(1) Recommended Allocation (a)</th>
<th>(2) Accepted Indirect Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marian Hall</td>
<td>9.70%</td>
<td>$155,185</td>
</tr>
<tr>
<td>St. Francis Hall</td>
<td>9.64</td>
<td>155,185</td>
</tr>
<tr>
<td>Trinity Hall</td>
<td>9.86</td>
<td>155,185</td>
</tr>
<tr>
<td>Student Center</td>
<td>8.87</td>
<td>155,185</td>
</tr>
<tr>
<td>Antonian Hall</td>
<td>6.91</td>
<td>155,185</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pledged Facility</th>
<th>(3) Indirectly Assigned Costs</th>
<th>(4) Accepted</th>
<th>(5) Overreported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marian Hall</td>
<td>$80,414</td>
<td>$15,053</td>
<td>$65,361</td>
</tr>
<tr>
<td>St. Francis Hall</td>
<td>$80,414</td>
<td>14,960</td>
<td>65,454</td>
</tr>
<tr>
<td>Trinity Hall</td>
<td>$80,414</td>
<td>15,301</td>
<td>65,113</td>
</tr>
<tr>
<td>Student Center</td>
<td>80,414</td>
<td>13,765</td>
<td>(13,765)</td>
</tr>
<tr>
<td>Antonian Hall</td>
<td>80,414</td>
<td>10,724</td>
<td>(10,724)</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$241,242</strong></td>
<td><strong>$69,803</strong></td>
<td><strong>$171,439</strong></td>
</tr>
</tbody>
</table>
NOTES:

(a) Represents the auditor's recommended percentages to allocate indirect costs to pledged facilities. These percentages are based on square footage. As discussed further in the Findings and Recommendations section of the report, the University used arbitrary, and as a result, inequitable percentages to allocate indirect costs to pledged facilities. Calculation of the recommended percentages appears below:

<table>
<thead>
<tr>
<th>Pledged Facility</th>
<th>Sq. Ft.</th>
<th>Percentage</th>
<th>University's Percentage</th>
<th>Memo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marian Hall</td>
<td>29,071</td>
<td>9.70%</td>
<td>20-30%</td>
<td></td>
</tr>
<tr>
<td>St. Francis Hall</td>
<td>28,890</td>
<td>9.64%</td>
<td>20-30%</td>
<td></td>
</tr>
<tr>
<td>Trinity Hall</td>
<td>29,552</td>
<td>9.86%</td>
<td>20-30%</td>
<td></td>
</tr>
<tr>
<td>Student Center</td>
<td>26,600</td>
<td>8.87%</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Antonian Hall</td>
<td>20,710</td>
<td>6.91%</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>134,823</strong></td>
<td><strong>44.98%</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Pledged Facilities</td>
<td><strong>164,979</strong></td>
<td><strong>55.02%</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>299,702</strong></td>
<td><strong>100.00%</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## SCHEDULE OF MAINTENANCE AND OPERATION COSTS REPORTED AND THE AUDITOR'S RELATED RECOMMENDATIONS

### FOR THE PERIOD

**JULY 1, 1980 THROUGH JUNE 30, 1981**

### UNIVERSITY OF STEUBENVILLE

**STEUBENVILLE, OHIO**

<table>
<thead>
<tr>
<th>Pledged Facility</th>
<th>Reported</th>
<th>Accepted</th>
<th>Overreported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marian Hall</td>
<td>$114,827</td>
<td>$41,394</td>
<td>$73,433</td>
</tr>
<tr>
<td>St. Francis Hall</td>
<td>$108,385</td>
<td>34,842</td>
<td>73,543</td>
</tr>
<tr>
<td>Trinity Hall</td>
<td>130,257</td>
<td>57,113</td>
<td>73,144</td>
</tr>
<tr>
<td>Student Center</td>
<td>391,619</td>
<td>407,677</td>
<td>16,058</td>
</tr>
<tr>
<td>Antonian Hall</td>
<td>349,348</td>
<td>361,858</td>
<td>(12,510)</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>81,094,436</strong></td>
<td><strong>822,884</strong></td>
<td><strong>191,552</strong></td>
</tr>
</tbody>
</table>

### NOTES:

(a) Represents maintenance and operation costs for pledged facilities reported in the Loan Management Report filed for fiscal year ending June 30, 1981.

(b) See Exhibit B-1, Note (b).

(c) Consists of:

- $821,451 - Directly assigned costs accepted in Exhibit C-2.
- $81,433 - Indirectly assigned costs accepted in Exhibit C-3
- $902,884
### Schedule of Direct and Indirect Costs Allocable to Pledged Facilities and the Auditor's Related Recommendations

**For the Period:**
**July 1, 1980 Through June 30, 1981**

**University of Steubenville**
Steubenville, Ohio

<table>
<thead>
<tr>
<th>Expense Category</th>
<th>Allocation</th>
<th>Allocable</th>
<th>Unallocable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directly Assigned Costs</td>
<td>$821,451</td>
<td>$821,451</td>
<td>$</td>
</tr>
<tr>
<td>Indirectly Assigned Costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance</td>
<td>81,851</td>
<td>81,851</td>
<td></td>
</tr>
<tr>
<td>Security</td>
<td>73,926</td>
<td>73,926</td>
<td></td>
</tr>
<tr>
<td>Grounds</td>
<td>25,268</td>
<td>25,268</td>
<td></td>
</tr>
<tr>
<td>Campus Ministry</td>
<td>67,256</td>
<td></td>
<td>67,256</td>
</tr>
<tr>
<td>General Office</td>
<td>28,737</td>
<td></td>
<td>28,737</td>
</tr>
<tr>
<td>Student Life</td>
<td>36,325</td>
<td></td>
<td>36,325</td>
</tr>
<tr>
<td>Health Center</td>
<td>12,400</td>
<td></td>
<td>12,400</td>
</tr>
<tr>
<td>Career Counseling and Placement</td>
<td>17,045</td>
<td></td>
<td>17,045</td>
</tr>
<tr>
<td>Intramurals</td>
<td>3,101</td>
<td></td>
<td>3,101</td>
</tr>
<tr>
<td><strong>Subtotals</strong></td>
<td><strong>345,909</strong></td>
<td><strong>181,045</strong></td>
<td><strong>164,864</strong></td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$1,167,360</strong></td>
<td><strong>$1,002,496</strong></td>
<td><strong>$164,864</strong></td>
</tr>
</tbody>
</table>

**Note:**

(a) Categories of expense were accepted, subject to allocation, as provided in the Trust Indenture.
### Pledged Facility

<table>
<thead>
<tr>
<th>Pledged Facility</th>
<th>Recommended Allocation Percentage</th>
<th>Accepted Indirect Costs</th>
<th>Subject to Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marian Hall</td>
<td>9.70%</td>
<td>$181,045</td>
<td></td>
</tr>
<tr>
<td>St. Francis Hall</td>
<td>9.84%</td>
<td>181,045</td>
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<tr>
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<tr>
<td>Student Center</td>
<td>8.87%</td>
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<tr>
<td>Antonian Hall</td>
<td>6.91%</td>
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### Indirectly Assigned Costs

<table>
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<tr>
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**Totals:** $272,985 $181,433 $191,552

**NOTE:**

(a) Refer to Exhibit B-3, Note (a).
November 22, 1983

Robert G. Seabrooks
U.S. Department of Education
Office of Inspector General
300 South Wacker Drive
Chicago, IL 60606

Re: Audit Control Number 05-30061

Dear Mr. Seabrooks:

We are in receipt of your draft audit report dated October 29, 1983. We have reviewed this audit report and have the following concerns:

1. Overstated Maintenance/Operational Costs of Pledged Facility - We are agreeable that the Loan Management Reports need to be revised, however, we are not agreeable as to the percentage of the allocations stated in the audit report. We feel that the indirect cost allocation basis suggested has not taken into consideration the unused space in a non-project dormitory that is equally cost allocated as if it were occupied. Our percentage allocations take out this unused space. We are agreeable, however, that certain costs unallocable per the trust agreement were included. We will revise the Loan Management Reports accordingly.

2. Revenue Fund Account Not Used - The University entered into a new Workout Agreement dated July 1, 1983. With the implementation of this agreement, we are currently using a revenue fund to record and account for the net revenues from the operation of the pledged facilities.

3. Need to Request Prior Approval for Costs - The University had requested the approval of the Department of Education for maintenance and replacement costs and received this approval on August 29, 1983. We will be seeking future approval for all additional maintenance and replacement work that needs to be accomplished on these dormitories according to the Workout Agreement.

Hopefully, this answers your concerns on the audit report. If you have any questions, do not hesitate to write.

Sincerely,

John W. Green
Vice President for Administration and Treasurer

17

"A UNIVERSITY TO BELIEVE IN..."
A Franciscan liberal arts university committed to providing the resources for a Christian life.
<table>
<thead>
<tr>
<th>Action Official</th>
<th>No. of Copies</th>
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<td>Office of Postsecondary Education</td>
<td></td>
</tr>
<tr>
<td>Room 4044, ROB-3</td>
<td></td>
</tr>
<tr>
<td>Washington, D. C. 20202</td>
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</tr>
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</table>

| Auditee | |
|---------| |
| Rev. Michael Scanlan, President | 2 |
| University of Steubenville | |
| Franciscan Way | |
| Steubenville, Ohio 43952 | |

| Other Party | |
|-------------| |
| Secretary's Regional Representative Region V | 1 |

| Office of Inspector General | |
|-----------------------------| |
| Chief Postsecondary Education Audit Branch | 1 |
| Chief Contract Audits Branch | 3 |
| Audit Office Region X | 1 |
| Audit Office Region V | 5 |
REPORT ON SELECTED ASPECTS
OF THE COLLEGE HOUSING AND ACADEMIC
FACILITIES PROGRAMS
FOR FISCAL YEARS 1981 AND 1982

VITERBO COLLEGE
LA CROSSE, WISCONSIN

NOTICE

"The designation of financial and/or managerial deficiencies or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions, observations and recommendations in this report, represent the opinion of the ED OIG Office of Audit. Final determination on these matters will be made by appropriate ED operating or program officials."

Audit Control No. 05-30060

U.S. DEPARTMENT OF EDUCATION
Dear Dr. Gibbons:

Due to some typographical errors in the audit report entitled "Report on Selected Aspects of the College Housing and Academic Facilities Loan Programs at Viterbo College for Fiscal Years 1981 and 1982," we have reissued that report. Your comments have been incorporated into the final report. If you have any additional comments, please submit them within 30 days from the date of this letter to the following Education Department official:

Assistant Secretary
Office of Postsecondary Education
Department of Education
Room 4907, ROB-3
Washington, D.C. 20202

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

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), reports issued to the Department's grantees and contractors are made 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.

Please refer to the above audit control number in all correspondence related to this report. We regret any inconvenience caused by the reissuance of this report.

Sincerely,

Robert G. Seabrook
Regional Inspector General
for Audit - Region V
BACKGROUND

Viterbo College, formerly St. Rose College, is a Catholic, liberal arts, coeducational college offering undergraduate degree programs. Organized by the Franciscan Sisters of Perpetual Adoration (FSPA) in 1890, the College currently operates as a nonprofit institution of higher education under the laws of the State of Wisconsin. The members of the corporation are four officers of St. Rose Convent, La Crosse and the President of Viterbo College.

A College Housing Loan (CHL) was awarded to St. Rose Convent for and on behalf of Viterbo College in 1964 under the College Housing Loan Program by the U. S. Department of Housing and Urban Development (HUD). The administration of the loan was transferred from HUD to the U. S. Department of Education (ED) in May 1980. The CHL program was established under Title IV of the Housing Act of 1950. The program originally provided long-term loans at 3 percent interest to educational institutions for student and faculty housing. The program was later broadened to include financing of other facilities such as student centers, health centers and dining halls. The CHL was executed with a trust indenture which states the rights and obligations of all parties to the loan.

The principal amount of the CHL was $1,158,000 repayable over 40 years. St. Rose Convent issued serial bonds (Series A for $358,000 at 2.75 percent interest and Series B for $800,000 at 3.75 percent interest) as security for the loan. The bonds are currently held by ED. The purpose of the loan was to (i) refinance the previous debt on the existing Marian Hall (known as the South Wing of Marian Hall) and (ii) construct a new dormitory for approximately 168 students and dining facilities for seating 390 persons (known as the North Wing of Marian Hall). The bonds are secured by (i) a first mortgage on the entire Marian Hall facility and site and (ii) a pledge of the net revenues of Marian Hall.
Viterbo College did not pay the CHL principal amount due October 1, 1973. They requested deferment of that payment and each subsequent payment through October 1, 1979. HUD granted the first request for deferment and several others on an intermittent basis. Viterbo College did not make principal payments or request deferment of payments due April 1, 1980 through October 1, 1982. As of July 15, 1983, past due principal payments on the CHL totaled $217,000 ($89,000 on Series A and $128,000 on Series B Bonds). Viterbo College made all required CHL interest payments.

An Academic Facilities Loan (AFL) was awarded to Viterbo College in 1970, under the Academic Facilities Loan (AFL) program by the U. S. Department of Health, Education and Welfare (HEW). The administration of the loan was transferred to ED in May 1980. The AFL program was established under Title VII C of the Higher Education Act of 1965. The program provides long-term financing to institutions for construction of academic facilities such as classrooms and libraries. The AFL was executed by a trust indenture which states the rights and obligations of all parties. The principal amount of the loan was $2,500,000, repayable over 40 years at 3 percent interest. The purpose of the loan was to provide partial payment for the construction costs of the Viterbo College Fine Arts Center (FAC). Viterbo College issued serial bonds for the loan amount. The bonds are secured by a first mortgage on the FAC and the College's general pledge to meet payments as they are due.

Viterbo College did not pay the AFL interest due May 1, 1972 and missed a number of interest, principal and reserve payments from that date through May 1, 1979. Requests for payment deferrals were granted by HEW. On November 14, 1979, a supplemental payment agreement was executed which requires interest payments graduating from $15,000 to $75,000 between 1979 and 1999. Viterbo College has made the interest payments specified in the supplemental payment agreement. The indenture agreement requires that those payments be applied to past due interest and then to past due principal starting with the amounts farthest in arrears. As of July 15, 1983, principal ($317,000) and interest ($540,000) were past due, and the required reserve ($120,000) had not been established.

SCOPE OF AUDIT

The purpose of our audit was to review selected aspects of the CHL and AFL at Viterbo College. Our specific objectives were to determine whether (i) pledged revenues were properly recorded, reported and applied to debt service payments on the CHL, (ii) a
Workout agreement for deferred loan payments was executed, and whether the College complied with the terms and conditions of the agreement, (iii) the CRH and AFL received equal treatment with other long-term obligations of the College, and (iv) debt service payments were current for the AFL.

We reviewed the College's Loan Management Reports for Fiscal Years ended June 30, 1981 and 1982, tested selected items of receipts, evaluated maintenance and operation expense and their bases of allocation and analyzed the status of the Federal loans and related trust indentures with the trustee, First Bank Minneapolis (formerly First National Bank of Minneapolis). Our audit was conducted in accordance with generally accepted governmental auditing standards appropriate to the limited scope audit described above. Our audit did not include an evaluation of the efficiency and economy of operation, nor did we review the records of St. Rose Convent, an entity closely affiliated with the College.

Audit field work was performed during the period June 21, 1983 through July 19, 1983 at Viterbo College in La Crosse, Wisconsin and the First Bank Minneapolis, in Minneapolis, Minnesota.
Viterbo College has not fully complied with the terms of its CHL trust indenture. The CHL requirements not met included (1) deposit of revenues in a separate bank account, (2) establishment of accounts and maintenance of required reserve balances with the Trustee, (3) accurate reporting of pledged revenue (under statement $50,338) and (4) deposit of pledged net revenue for fiscal year 1981 and 1982 ($76,066 including the understatement) with the trustee. The CHL Trust Indenture was not met in that a sinking fund was not established and annual deposits were not made to that fund. We attribute these conditions to the College’s lack of concern for adhering to terms and conditions it finds to be difficult or inconvenient.

We are recommending that (1) Loan Management Reports for fiscal years 1981 and 1982 be resubmitted to correct the $50,338 revenue understatement, (2) total CHL net revenue for the two years of $76,066 be deposited with the trustee, and applied to debt servicing, (3) improvements be made in the methods used for recording and reporting CHL project revenues, (4) required CHL and AFL accounts be established and deposits be made to keep the funds at appropriate levels.

While in default on the CHL and AFL loans, Viterbo College, prepaid other debt, acquired additional real estate, and made significant real property improvements. College officials did not view these activities as preferential treatment. In their opinion, prepayment through related organizations kept the College solvent, and property acquisitions and improvements benefitted the CHL and AFL loans by increasing the value of the school and increasing its revenue potential. We are recommending that CHL and AFL debt servicing payments be given equal treatment to that accorded other long term debt, and priority over real estate acquisitions and improvements.

These conditions are discussed in detail in the Findings and Recommendations section.

The only items tested pertained to those aspects of the administration of the College Housing and Academic Facility Loans identified in the Scope of Audit section. No information came to our attention to indicate that there were weaknesses in any untested aspects of the two Loan programs.

College officials have indicated they are rectifying the operational problems cited in the report. In addition, they are re-examining policy positions which created questions regarding the College’s intentions to resolve its default status. Comments of the officials are summarised at the end of each finding and their written response is attached to this report.
PLEDGED REVENUES (CHL)

Viterbo College has not fully complied with the terms of the trust indenture. We found that (i) a separate fund account was not used for the deposit of all pledged revenues, nor were the required reserve account balances maintained, (ii) net revenues of $126,004 reported on the Loan Management Reports for fiscal years 1981 and 1982 were understated by $50,338, and (iii) the net revenues totaling $76,066 ($176,342 ($126,004 + $50,338) less $100,276) for fiscal years 1981 and 1982 were not used for debt servicing.

Section 2, Article V of the trust indenture states:

The borrower covenants and agrees that as soon as the Bonds have been delivered, all rentals, charges, income and revenue arising from operations or ownership of the Pledged Facilities shall be deposited to the credit of a special fund, to be known as the "1964 Revenue Fund Account" and held in the custody of the Treasurer of the Borrower, separate and apart from all other funds. Such 1964 Revenue Fund Account shall be maintained as long as any bonds are outstanding in a bank which is a member of the Federal Deposit Insurance Corporation, and shall be expended and used by the Treasurer only in the manner and order specified below.

Sections 3, 4 and 5 provide, in order of precedence, that (1) current expenses of the pledged facility, as defined in the section, shall be payable, as a first charge from the revenue account, (2) a Bond and Interest Sinking Fund be established with the Trustee and maintained at the established level as long as any bonds are outstanding, and (3) a Repair and Replacement Reserve Account be established. Semi-annual deposits of at least $35,000 are required to the Bond and Interest Sinking Fund until funds and/or investments are sufficient to meet the interest due on the next interest payment date and one-half of the principal due within the succeeding twelve months, plus a debt service reserve of $72,000. Revenue account balances in excess of Sinking Fund deposit requirements are to be used to establish a $40,000 replacement reserve and an $8,000 repair reserve in the Repair and Replacement Reserve Account. The trust indenture also requires Viterbo College to report the results of operating the pledged facility and the status of the required accounts to HUD not later than 90 days after the close of each fiscal year using the Loan Management Report (HUD Form 4370).
Our review disclosed that Viterbo College had established adequate accounts in their accounting system to facilitate recording the revenues and expenses related to the CHL loan. However, we noted that the separate revenue fund account, the bond and interest sinking fund account and repair and replacement reserve accounts were either not established or not maintained at the required levels. Fiscal year 1981 and 1982 revenues were deposited in Viterbo College's general checking account. Since the Pledged Facility revenues were commingled with other College revenues, it is impossible to determine exactly how the funds were used. The bond and interest sinking fund account was established with the trustee. However, during FYs 1981 and 1982, Viterbo College did not maintain the required $72,000 reserve balance. The current balance in the account is approximately $31,000. The repair and replacement reserve account has not been established with the trustee.

College officials told us that it was not practical to establish a separate bank account for the revenue fund. Maintaining a separate account would require additional accounting entries as well as the reconciliation of another bank account. In their opinion, the present method accomplishes the same objective as a separate revenue fund account would without tying up cash that could be put to better use in the operation of the College.

The net revenues reported on the Loan Management Reports for FYs 1981 and 1982 were understated by $50,338. The difference between the reported and audited net revenues were due to several audit adjustments which both increased and decreased reported revenues and expenses. Our adjustments are presented in Exhibit III and summarized in the following paragraphs.

Reported Pledged Facility revenues were overstated by a net of $4,692 ($50,223 less $45,531). The net overstated amount consisted of unrecorded rental income of $8,673, inappropriate meal discounts of $22,000, unreported snack bar revenue of $14,858, for a total of $45,531, and food service expenses erroneously recorded as income of $50,223. Details are presented in the following paragraphs.

In 1975, Viterbo College requested and received approval to use the first floor of the South Wing of the Pledged Facility as a student commons area and College offices. The approval required Viterbo College to pay 25 percent of the residential rental rate for the rooms used as offices. Viterbo College has not complied with this requirement. We found that 14 rooms were used as college offices at the time of our audit. For FYs 1981 and 1982, the required rental fee at the 25 percent rate for the rooms was
and $4,543, respectively. We, therefore, added the rental fees of $8,673 to the reported net revenues. College officials stated they were aware of the conditions of the approval, but that the money for the rental fees was needed for the College’s general operations.

Viterbo College provided meals to 17 Sisters of St. Rose Convent in the Pledged Facilities at a rate significantly lower than that charged to students. We calculated that the difference in rates resulted in lost revenues of approximately $10,000 and $12,000 respectively for FYs 1981 and 1982. We, therefore, increased reported net revenues by $22,000 to adjust for the preferential treatment given to the Sisters. Viterbo College officials stated that the adjustment was inappropriate because the Sisters eat less than the students.

FY 1982 revenues of $14,858 recorded in the general ledger as generated by the snack bar in the Pledged Facility were not reported on the Loan Management Report. We, therefore, increased net revenues reported for FY 1982 by $14,858.

Food Service revenues of $50,223 were overstated in the Loan Management Report during FYs 1981 and 1982 due to account misclassifications recorded on adjusting journal vouchers. In an attempt to transfer costs of the Food Service Unit to the Snack Bar, the crediting entry was applied to the Food Service revenue account rather than the expenditure account. Consequently, the net revenues reported in the Loan Management Reports for FYs 1981 and 1982 were overstated by the snack bar expenses of $22,953 and $27,270, respectively. Therefore, we reduced the reported net revenues by $50,223.

Reported Pledged Facility expenses were overstated by a net of $55,030 consisting of a computational error resulting in the under reporting of recorded expenses, ($10,656). College Work Study wages funded under a Federal grant ($34,188), stipends paid to resident assistants not servicing the Pledged Facility ($9,158), administrative cost applicable to other residence halls ($3,442), and operating losses chargeable against the College’s general fund ($18,898). Details are presented in the following paragraphs:

Pledged Facility expenses recorded on Viterbo College’s General Ledger for fiscal year 1981 exceeded reported expenses by $10,656. Our review indicated that the difference was attributable to a computational error made in compiling the reported amount. Therefore, we adjusted reported net revenue downward by $10,656.
- Expenses for the Pledged Facility included 100 percent of the College Work Study (CWS) wages paid to students working in the facility. We found that 82.35 percent of the wages were provided under a Federal grant program ($18,089 for FY 1981 and $16,099 for FY 1982). Therefore, we adjusted reported net revenue upward by $34,188 ($18,089 plus $16,099).

- Stipends paid to fifteen resident assistants (RA) were reported as expenses of the Pledged Facility. We were informed that four of the RAs actually worked in other student residence facilities. We computed the prorated share of wages attributable to other facilities in FYs 1981 and 1982 as $3,208 and $5,950, respectively. Therefore, we adjusted reported net revenue upward by $9,158 ($3,208 plus $5,950).

- All costs attributable to the Office of the Director of Residence were reported as expenses of the Pledged Facility. We were informed that about 25 percent of office effort related to other student residences. We applied the 25 percent to the Office of Director costs charged against the Pledged Facility and identified overreported cost of $3,118 and $324 for FYs 1981 and 1982; respectively. Therefore, we adjusted reported net revenues upward by $3,442 ($3,118 plus $324).

- Pledged Facility operating losses were charged and reported as a CMH expense. HUD approved the request for alternative use of the first floor of the South Wing of the Pledged Facility in 1975. At that time, they specified that any operating revenue shall be considered CMH revenue and any losses from the commons area use shall be charged against the general fund of the College. We found that the snack bar, which operated in the commons area, incurred losses of $6,410 and $12,488 during the FYs 1981 and 1982, respectively. These losses were not recorded against Viterbo College's general funds but were included in determining the reported net revenues. Therefore, we adjusted reported net revenues upward by $18,898 ($6,410 plus $12,488).

The net overstatement of net revenue ($4,692) and net upward adjustment to reflect overstated cost ($55,030) discussed above resulted in a $50,338 increase in the previously reported net revenue of $126,004. We determined that debt service payments for the two years ended October 1, 1982 (this cut-off was used to allow for the difference between the College's fiscal period and the loan payment due dates) totaled $100,276. Thus, $76,066 ($126,004 plus $50,338 [$176,342 less $100,276]) should have been used for debt servicing. Application of all revenue to debt servicing would have reduced past due principal from $217,000 to $140,934 ($217,000 less $76,066).
The total net revenue earned in fiscal years 1981 and 1982 ($176,342) exceeded the debt servicing requirements ($127,275) for that period by $49,067. Viterbo College officials stated that they had not applied CHLP revenue to debt service payments because the College was experiencing financial difficulty and required the funds to provide for its continued existence.

As discussed below under "Preferential Treatment," Viterbo College acquired real estate adjacent to the campus during the audit period and undertook campus improvements subsequent to the audit period. Because separate bank accounts had not been established, we could not determine whether the excess revenues were used to support those transactions.

RECOMMENDATIONS

We recommend that Viterbo College:

1. Establish a separate bank account for pledged revenues as required by the indenture and deposit all revenue attributable to Marian Hall in the account.

2. Develop adequate cost accounting procedures to preclude charging costs attributable to other cost centers to the Pledged Facility.

3. Deposit $76,066 into the Bond and Interest Sinking Fund Account for the diverted fiscal year 1981 and 1982 pledged net revenues. Instruct the trustee to apply the funds currently in the Bond and Interest Sinking Fund to past due principal payments.

4. Assure that funds are transferred from the College's general fund to the revenue account in the future to cover:
   a. The rental fees due for the alternative use of the first floor of the South Wing of the Pledged Facility.
   b. The losses incurred due to the operation of the snack bar.
   c. The difference between the normal meal rate and the reduced rate charged to the Sisters of St. Rose Convent.

5. Use all pledged net revenues to meet current CHL debt service requirements and apply any excess net revenues to past due principal, Bond and Interest Sinking Fund Reserve, and the repair and replacement reserve in that order.
6. Develop written procedures to assure accurate compilation of the Loan Management Reports, and resubmit the fiscal year 1981 and 1982 reports to reflect additional revenue totaling $50,318.

Viterbo College Comments

Viterbo College stated that:

1. It's present accounting system, by clearly identifying and assigning transactions to Marian Hall, complies with the intent of the Trust Indenture. Establishing a separate bank account would seriously disrupt the college's accounting system.

2. It had not established required reserve accounts because CHL net reserves were more than offset by larger AFL deficits. Viterbo believes that disclosure of the AFL deficit on the college's financial statements would adversely affect philanthropic support.

3. It has historically provided the Sisters of St. Rose Convent with discounts on all services provided including meals at Marian Hall, in consideration of the vital support provided by the Order.

4. It had taken a number of steps to actively correct its default status on the AFL and CHL loans.

ED-OIG Response

ED-OIG response to the Colleges Comments 1 through 4 above follows:

1. The CHL Trust Indenture specifically provides for the establishment of a separate bank account. Questions about the efficacy of other methods of fund accountability are therefore irrelevant.

2. The CHL and AFL Trust Indentures each required the establishment of a separate reserve account. Transfer of reserves from one account to another is contrary to the agreed upon loan terms. Further, Viterbo does not explain why a reserve account was not established during the eight year period in which only the CHL was in force.

3. The historical practices of the college do not bind the Government to accept deposit of less revenue to the pledged revenue account than is appropriate. While Viterbo College may foster its relationship with the Sisters of St. Rose Convent in any manner it deems appropriate, the costs incurred must be borne from unpledged funds.

4. Application of net revenues derived from Marian Hall (pledged facility) in fiscal years 1981 and 1982 to CHL debt servicing would have been a further demonstration of good faith effort to correct the default.
SINKING FUND (AFL)

Viterbo College has not established a debt sinking fund to meet the annual debt service payments of approximately $330,000 required between 1999 and 2010 under the AFL supplemental payment agreement executed in November 1979. In our opinion, it is unlikely that Viterbo College will have sufficient resources to meet these payments unless an adequate debt sinking fund is established. While the supplemental agreement does not require, the establishment of a sinking fund good business practice would indicate that appropriate measures be taken to lessen the possibility of future defaults. Such action would reduce risk to the Federal government and maintain Viterbo's credit rating.

The supplemental payment agreement established the following repayment schedule for interest due on the $2,500,000 AFL:

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<tr>
<td>1984 -- 1989</td>
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<td>75,000</td>
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<tr>
<td>1999 -- 2010</td>
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<td>All outstanding principal and interest in equal annual payments.</td>
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We noted that Viterbo College has complied with the terms of the agreement by making the $15,000 annual payments since 1979. However, our analyses of the repayment schedule disclosed that 12 annual installments of approximately $330,000 will be required to pay all outstanding principal and interest between 1999 and 2010.

We were informed by Viterbo College officials that as of July 15, 1983, a debt sinking fund had not been established to meet the required payments. The officials stated that two organizational meetings were held to form a fund raising committee to meet the AFL debt service requirements. However, no feasible plans of action or fund raising activities were in progress at the time of our fieldwork. Since the amount of sinking fund deposits depend on the length of time and rate at which deposited funds are invested, delays in establishing the fund could raise required deposits to an unacceptable level. Our analysis indicates that annual bond sinking fund deposits of approximately $56,000 beginning in 1983 would be required to meet the payments due between 1999 and 2010. This amount is based on an assumed annual interest rate of 10 percent.

RECOMMENDATION

We recommend that Viterbo College take immediate action to establish and fund a debt sinking fund to meet the annual payments of about $330,000 required by the supplemental payment agreement between 1999 and 2010 or renegotiate the supplemental agreement with ED to increase the level of current payments and decrease the payments required during the last years of the repayment schedule.

Viterbo's Comments

Viterbo College's response to the draft report did not address this finding.
PREFERENTIAL TREATMENT

Viterbo College has not been consistent or equitable in its repayment of debt to the Federal government. It made debt service payments through St. Rose Convent (prepaying both principal and interest) and acquired real estate while in arrears on both its College Housing Loan (CHL) and its Academic Facilities Loan (AFL). Past due principal on the $1,150,000 College Housing Loan (CHL) currently totals $217,000. Past due principal and interest on the original trust indenture for the $2,500,000 Academic Facilities Loan (AFL) currently totals $857,000 ($317,000 principal and $540,000 interest).

Although no specific evidence was available to determine the cause for Viterbo’s inequitable treatment of Federal debt service payments, we believe the college pursued this policy because of ED’s lenient loan policies, the low loan interest rate charged on outstanding principal amounts, and the absence of late payment penalties. As a result, Viterbo has remained continuously in arrears on its Federal loans to the detriment of the Federal government.

While in default on the CHL, Viterbo College has remained current on the $1,300,000 debt to St. Rose Convent, and has continued real estate acquisition and improvement activity. In our opinion, ED’s debt service costs for providing the CHL to Viterbo College were unnecessarily increased due to the preferential treatment given to St. Rose Convent and the real estate transactions. The basis for our position is discussed in the following paragraphs.

Viterbo College’s audited financial statements for the year ended June 30, 1982, reflect approximately $5.1 million of long-term obligations. The debt consists of the $1,029,000 CHL balance, the $2,500,000 AFL balance, $924,827 owed to St. Rose Convent on three instruments, $419,934 on other college buildings, and $234,938 owed on four residential real estate properties.

The largest debt instrument due the Convent is a note with a remaining balance of $425,000 against an original loan of $1,300,000 through the Connecticut General Insurance Company. The reduction in the balance due was effected by two transactions. On October 25, 1973, Viterbo College transferred a stock portfolio (market value $354,058) and other investments with a total value of $444,408 to St. Rose Convent. In return, the Convent reduced the $1,300,000 balance of the loan by $500,000 to $800,000. The reduced principal balance was recognized in the College’s financial statement for the year ended June 30, 1974.
This transaction prepaid the installments due on the loan from St. Rose Convent from FY 1974 through FY 1978. On November 18, 1976, Viterbo College transferred $375,000 in cash to St. Rose Convent in exchange for an 8 percent demand note for the same amount. The demand note was recorded as a receivable in the College's plant fund. Beginning in FY 1979 through FY 1982, the College offset annual payments due to St. Rose Convent on the $1,300,000 loan against the 8 percent demand note due from the Convent. In substance, this transaction was a prepayment of the installments due to St. Rose Convent from FY 1979 to FY 1982.

The October 1973 prepayment occurred within one month of the first CHL principal default of $21,000 and the deferment of $37,500 of AFL interest due November 1, 1973. This deferment increased the total past due interest on the AFL to $112,500. In requesting these deferments, the College indicated they were experiencing financial difficulty. At the time of the second prepayment of $375,000 in November 1976, Viterbo College was prepaid on their debt to the Convent through FY 1978 but in arrears for $89,000 on CHL principal, $41,000 on AFL principal, and $225,000 on AFL interest.

We attribute this condition to (1) the close affiliation between the College and the Convent, (2) the opportunity to protect the Convents' credit rating, and (3) the interest rate spread on the indebtedness (2 3/4 to 3 3/4 percent on the Government loans as opposed to 9 1/4 percent on the commercial loan). College Officials disagreed stating that the transactions were necessary to assure the College's continued existence during a period of severe financial difficulty. The Officials added that Viterbo College did not have the capability to manage the transferred assets. St. Rose Convent (1) reduced the indebtedness to Connecticut General by $875,000, (2) credited the College for income earned on the $444,408 of transferred assets, and (3) paid 8 percent interest on the $375,000 demand note. The College's financial statements confirm operating deficits from fiscal year 1972 to 1978 and net revenues thereafter. The significance of the College's operating losses and gains is somewhat diminished by the materiality of related party transactions between Viterbo and St. Rose Convent.

From 1979 through July, 1983, the College acquired seven residential real estate properties near the campus. The total cost of these properties, including cash and notes payable, was $424,121. As of June 30, 1982, the outstanding obligations which related to four of the properties totaled $234,938. One property was received as a donation and generates sufficient rental income to service the $117,280 mortgage. The remaining three properties were purchased by Viterbo and have outstanding long term
obligations of $117,600. During our fieldwork, we noted the
College was improving the property adjacent to the Fine Arts
Center (FAC). College officials informed us that a parking lot
was being constructed, at a cost of approximately $123,000, net
of donated material. Because these real estate transactions
occurred while Viterbo College was in default on the CHL, the
transactions indicate the College gave priority to real estate
acquisitions and improvements over the repayment of CHL.

The College officials informed us that the real estate
transactions should not be considered preferential treatment
because the transactions were funded by Plant Renewal and
Replacement funds. The transactions also enhance the value of
the College in general and specifically the value of the FAC on
which ED holds a first mortgage. The Officials also expressed
the opinion that the FAC improvement would attract additional
revenue.

The actions taken by Viterbo to secure deferral of the Federal
debt, meet its property acquisition and construction goals, and
maintain debt service payments to commercial lenders may be
substantially benefitting the college. The benefit, however,
is being achieved at a substantial cost to the government. In
recent years, interest paid by the Federal government on pub-
licly held debt has ranged from 9 to 15 percent. Viterbo Col-
lege is obligated to repay the defaulted principal at the
original low rates and is not obligated to pay interest on the
defaulted interest. We estimated the excess cost to the
government of financing the deferred principal, none of which is
scheduled for repayment until 1999. At an estimated interest
rate of 10 percent per annum, the Federal Government will incur
over $2.2 million in interest charges to finance the principal
payments deferred by the AFL Supplemental Agreement.

RECOMMENDATIONS

We recommend that Viterbo College:

1. Treat the College Housing and the Academic Facilities loans
equal to other long-term debt.

2. Give the College Housing and the Academic Facilities debt
   service payments priority over real estate acquisitions and
   improvements.

Viterbo College Comments

The college contended that the property acquisitions and plant
improvements further secured the debt to ED. Furthermore,
failure to acquire the properties would have had a negative
impact on future philanthropic considerations. The college
also stated that the plant improvements were funded out of
restricted gifts. The special operational considerations
extended to the convent which is Viterbo's most important source
of gift revenue, were necessary in order to enhance its financial
posture and avoid deficit borrowing.

ED-OIG Response

The college is responsible for payment of its Federal loans.
It should therefore, assure that the CHL and AFL debts are
 treated equitably with other creditors and given priority over
campus expansion activities.
## EXHIBIT I

**SCHEDULE OF CHI PRINCIPAL AND INTEREST PAYMENTS**

**PAST DUE AS OF JULY 15, 1983**

**VITERBO COLLEGE**

**LA CROSSE, WISCONSIN**

<table>
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<tr>
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**Viterbo College**

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**Footnote**

(1) Payments made after the initial default were applied first to past due interest, then to past due principal beginning with amounts furthest in arrears.
### Exhibit II

**Schedule of Afl Principal and Interest Payments Past Due As of July 15, 1983**

**Viterbo College**  
**La Crosse, Wisconsin**

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<thead>
<tr>
<th>Due Date</th>
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<td>5/1/83</td>
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</table>

**Total**  $317,000  $540,000  $857,000

*Footnote (1)* Payments made after the initial default were applied to past due interest, then to past due principal beginning with amounts furthest in arrears.
**EXHIBIT III**

**SCHEDULE OF ADJUSTMENTS TO REPORTED MARIAN HALL NET REVENUES FOR FY'S 1981 AND 1982**

**VITERBO COLLEGE**  
**LA CROSSE, WISCONSIN**

<table>
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<th>FY 1982</th>
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<tr>
<td><strong>Net Revenue Per Loan Management Report</strong></td>
<td>$51,076</td>
<td>$74,928</td>
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<td><strong>Adjustments:</strong></td>
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<tr>
<td><strong>Revenue Increases:</strong></td>
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<td></td>
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<tr>
<td>1. Alternative Use Rent Not Paid</td>
<td>4,130</td>
<td>4,543</td>
<td>8,673</td>
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<tr>
<td>2. Revenue Lost Due to Reduced Meal Rate for Sisters of St. Rose Convent</td>
<td>10,000</td>
<td>12,000</td>
<td>22,000</td>
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<tr>
<td>3. Actual Snack Bar Revenue</td>
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<tr>
<td><strong>Revenue Decreases:</strong></td>
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<tr>
<td>1. Intra-Facility Transfer Recorded as Revenue</td>
<td>(22,953)</td>
<td>(27,270)</td>
<td>(50,223)</td>
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<td><strong>Expense Increases:</strong></td>
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<td></td>
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<tr>
<td>1. Difference Between Reported Expense and Expense Per General Ledger</td>
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<td>(10,656)</td>
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<tr>
<td><strong>Expense Decreases:</strong></td>
<td></td>
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<tr>
<td>1. Federal Share of College Work Study Wages Recorded as a Marian Hall Expense</td>
<td>18,089</td>
<td>16,099</td>
<td>34,188</td>
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<td>2. Resident Assistants Stipends not Allocable to Marian Hall</td>
<td>3,208</td>
<td>5,950</td>
<td>9,158</td>
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<td>3. Director of Residence Expenses not Allocable to Marian Hall</td>
<td>3,118</td>
<td>324</td>
<td>3,442</td>
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<tr>
<td>4. Snack Bar Loss</td>
<td>6,410</td>
<td>12,488</td>
<td>18,898</td>
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<tr>
<td><strong>Total Adjustments</strong></td>
<td>11,346</td>
<td>38,992</td>
<td>50,338</td>
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<tr>
<td><strong>Adjusted Net Revenues Per ED-OIG</strong></td>
<td>$62,422</td>
<td>$113,920</td>
<td>$176,342</td>
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</table>
Viterbo College

February 15, 1984

Robert C. Seabrook,
Regional Inspector General
for Audit - Region V
U.S. Department of Education
300 South Wacker Drive
Chicago, IL 60606

REF: Audit Control No. 05-30060

Dear Mr. Seabrook:

This is in response to your letter of December 22, 1983, accompanying the draft report entitled "Audit of Selected Aspects of College Housing and Academic Facilities Loan Program at Viterbo College for Fiscal Years 1981 and 1982."

Viterbo College is grateful for an opportunity to review the draft, make comments, and present clarification relative to the information contained therein. We are already taking steps to rectify operational errors cited by your auditors when they were on our campus and set forth now in the draft audit report; and we are in the process of reexamining policy positions which appear to have created a question as to the good faith and intentions of Viterbo College. It is disconcerting to read about "the college's lack of concern for adhering to terms and conditions it finds to be difficult or inconvenient" (page 4, para. 1), when we believe the opposite to be true. Viterbo College is greatly concerned about its failure to comply with some of the terms in the Trust Indentures under review. In the remarks which follow, we hope we can document our concern and demonstrate that the College's actions have greatly enhanced debt security for those funds owed to the United States Government.

The draft report is factual and accurate in the presentation of background information, and the two "Schedules of Principal and Interest Payments Past Due as of July 15, 1983" (Exhibit I and Exhibit II in the draft) are acknowledged to be correct. Likewise, most of the adjustments listed in Exhibit III are acknowledged to be the result of accounting errors by Viterbo College, and the procedures which produced them have already been corrected. We do not believe the adjustment labeled "Revenue Lost Due to Reduced Meal Rate for Sisters of St. Rose Convent" is appropriate, and we will explain our rationale later in this letter. One other factual error occurs in the statement at the top of page 4: "Viterbo College has not fully complied with the terms of its AFL trust indenture or its AFL Supplemental Agreement." The second part of this statement is not true. That Viterbo College has complied with the terms of the AFL Supplemental Agreement is acknowledged later in the draft report (page 10, line 15): "Viterbo College has complied with the terms of the agreement by making the $15,000 annual payments since 1979." In general, though, the factual content of the report, from the perspective of Viterbo College, is accurate.
However, we do not find the report to be complete or uniformly substantive in its analysis and interpretation of certain College actions or in its presentation of certain issues and explanations. Many places in the report comments are attributed to unidentified "College officials," but none of the statements so attributed represents clearly and completely the official position of Viterbo College on the issue being addressed. There are five issues in the draft report which we believe require further elaboration: (1) the establishment of a separate bank account and of a reserve account for net revenues; (2) property acquisitions; (3) plant improvements; (4) the College's relationship to the Franciscan Sisters of Perpetual Adoration; and (5) the College's efforts to respond to its default status in positive ways.

Separate Bank Account and Reserve Account

Viterbo College did not establish a separate bank account for College Housing Loan (i.e., Marian Hall) receipts and expenditures, but its accounting system, correctly implemented, clearly identifies such transactions and assigns them to the Marian Hall account. The effect desired in having a separate bank account has been achieved. Moreover, to establish the separate bank account would cause serious disruption to the College's accounting system, which we do not believe was intended by the terms of the Trust Indenture. The present accounting system of the College complies with the intent of the Trust Indenture regarding establishment of a separate bank account.

Property Acquisition

The draft report is accurate in noting, "From July 1979 through July 1984, the College acquired seven residential real estate properties near the campus"; but it does not reveal some material circumstances regarding the acquisition of these properties. These circumstances are delineated below.

1. One of the properties, an eight-plex at 119 South 10th Street, was a gift to Viterbo College. In accepting the $240,000 gift, Viterbo assumed a mortgage of $117,280. There was no cash outlay, and rental payments fully cover all costs of operation, including debt service.

2. Two of the properties, 948 Mississippi Street and 920 South 10th Street, had previously been owned by Viterbo College. During the years the College was having severe financial difficulty, the houses were sold and leased back to provide operating funds.
Terms of the leases included repurchase by the College. Repurchase of one of these properties was accompanied by an estate note which will have a long-term benefit for the College. Repurchase of the other may have the same long-term result. Viterbo College needs to capitalize on such opportunities when they present themselves.

3. Acquisition of the vacant lot adjacent to the Fine Arts Center (Lot 11 in Block 10 of Esperson-Burns Addition) was a long-standing College objective. The lot was an eyesore, ill-kept, and it precluded direct access from the Fine Arts Center parking lot to its main entrance. This acquisition was important to enhance Fine Arts Center operations and to increase the revenue potential of the facility.

4. The three other residential properties, 924 Mississippi Street, 814 S. 9th Street, and 914 S. 9th Street, are all adjacent to campus boundaries. Neighborhood properties become available approximately once in 15 years. For the sake of long-range campus development, such properties should be acquired by Viterbo College as they become available. The Viterbo College Board of Directors approved these acquisitions and made generous contributions to enable them.

Each of these acquisitions further secured the debt owed to the United States, because the failure to take action in these transactions would have conveyed a negative impression to Board members, other donors, and prospective donors that could have only an adverse effect on future philanthropic considerations.

Plant Improvements

The draft report notes (page 8, last paragraph) that "Viterbo College... undertook campus improvements during the audit period." We believe this statement is subject to misinterpretation. The campus improvements referred to were begun in June, 1983, while your auditors were on our campus; they did not occur during the period covered by the scope of the audit (FY 1981 and FY 1982).

More importantly, these improvements (demolition of nonfunctional residences, landscaping, and parking lot construction) were not funded out of current unrestricted revenues. Restricted gifts were made to the College to carry out this project, and parts of the project were donated by local contractors.

Relationship to Franciscan Sisters of Perpetual Adoration

Viterbo College was founded by the Franciscan Sisters of Perpetual Adoration in 1890 and was owned and operated solely by the FSPA for more than seventy years. In 1967 the first laymen were elected to the Board of Directors, and by 1973 lay men and women constituted a majority on the Board of Directors. This majority has continued and exists today.

Viterbo College
Until 1962, the faculty and administration of Viterbo College were entirely Franciscan Sisters of Perpetual Adoration. The first two lay faculty members were hired in 1962, and the first lay administrator in 1965. Over the past two decades, the percentage of lay teachers and administrators has grown gradually, and today 20% of the College's administrators and 28% of its faculty are FSPA's.

Until the mid-1960's, the Franciscan Sisters accounted for virtually 100% of the College's private philanthropic giving. With the gradual emergence of lay leadership on the Board of Directors and the implementation of a broad-based development program, the FSPA today account for just under half of the unrestricted annual revenues contributed to the College. In 1982-83, the FSPA contribution to the College was $403,799, which was 45% of Viterbo's gifts and a substantial 7% of its total Educational and General Revenues.

The historical and financial facts cited above are directly related to what the audit report characterizes as “preferential treatment” (pages 11-13). Because of more than 90 years of close affiliation between the Sisters and the College, there exists a fiscal interface which defies simplistic interpretation. The College extends special operational considerations to the FSPA, its most important source of gift revenue, in order to enhance its financial posture and avoid deficit borrowing. Because there is little that is obligatory in philanthropic benefaction, the College has always sought to preserve the integrated relationship with the FSPA and by such actions to enhance the security of the debts owed to the United States. This is one such action.

Related to these special operational considerations is the “Reduced Meal Rate for Sisters of Sr. Rose Current” cited in Exhibit III (page 16) of the draft report. While it is factual that the Sisters taking their meals in Marian Hall eat less than the students served there, it is also true that Viterbo College discounts all of its services to the FSPA: meals in Marian Hall, copy services, room rates in Murphy Center, and rent for college houses used for Sisters' residences.

In all these policies which reflect the historical affiliation with the FSPA, the College is both nurturing a vital part of its heritage and ensuring its survival. It is our belief that debt security to the Federal Government is gradually being enhanced through these policies.

Viterbo College Initiatives Regarding Default Status

During the period of time that the property acquisitions, plant improvements, and alleged preferential treatment of the FSPA were occurring, Viterbo College was also active in trying to correct its default status on the Academic Facilities Loan and College Housing Loan.

1. Viterbo College initiated negotiations which resulted in the Supplemental Repayment Schedule on the Academic Facilities Loan in 1979.

2. Viterbo College proposed a Supplemental Repayment Schedule on the College Housing Loan in a letter of May 15, 1981, to HUD officials (Milwaukee office).
3. In response to informal requests from David Burwell of the Department of Education, Viterbo College provided complete historical records to the Department of Education/Loan Management Division in 1982 after the transfer of the Loan Management Program authority to the Department of Education.

4. Early in 1983, prior to the commencement of this audit, Viterbo College submitted a proposal for a new Trust Indenture Agreement on the College Housing Loan to the Department of Education/Loan Management Division. It provides for a reasonable increase in the payment schedule based upon slowly improving fiscal conditions.

The draft audit report does not acknowledge these initiatives, but we hope that the final report will, for we believe they can help to establish the good faith of the College in meeting its obligations.

We hope that you will consider these comments in light of our intention, which is to enhance the accuracy of the final audit report. I will be happy to address any questions you may have in this regard, or to provide additional detail as necessary.

Sincerely yours,

Robert E. Gibbons
President

Viterbo College
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<td>Viterbo College</td>
<td></td>
</tr>
<tr>
<td>815 South 9th Street</td>
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Mr. Laine. We found three principal reasons why these institutions were in default on their loans. We found some of the institutions simply did not have the funds to meet payments due and past due. Other institutions were delinquent because of management decision to make payments on other long-term debt.

For example:

One institution never made payments on the principal and only made irregular payments on the interest on its college housing loan. Although the institution was delinquent about $481,000 on its college housing loan, it paid at least $263,000 on debts to private lending institutions. The interest rate paid on the non-Federal debt was significantly higher than the 3-percent college housing loan.

Another institution that was delinquent about $1.1 million in its payments for college housing and academic facilities loans gave preferential treatment to other debt. This institution also purchased real estate and made improvements to its facilities.

A third reason institutions were delinquent was that they chose not to pay on their loans even though they had funds to do so. One institution was about $1.1 million delinquent in its payments to ED. This institution had sold land for about $10.9 million and had received a $1 million nonrefundable downpayment and was about to receive an additional payment of $1 million at the time of our audit. As of April 30, 1984, according to OPE officials, the institution had not made any payments to ED to reduce its delinquency.

Our audits found significant problems in accounting for the pledged revenues and the operating expenses of the projects. Institutions had pledged project revenues and other revenues and were to have accounted for these revenues separately and deposited them in a separate fund. An institution can use these revenues to pay for only those expenses of the project specifically provided for in the agreement with ED. After paying the allowed expenses, the remaining revenues must be used to make debt service payments on the college housing and academic facilities loans and not used for other purposes, such as real estate acquisitions and improvements.

In addition to recommending improvements in these areas, we recommended that college housing and academic facilities loans be given equal treatment with other long-term debts of the institution. In our opinion, the problems we found existed, at least in part, because of loan policies, and practices that were in need of strengthening, and the absence of late payment penalties. As I indicated earlier, we are currently developing a report which will make recommendations to improve the management of the programs at institutions and at OPE.

Mr. Chairman, this completes my statement. I will be happy to answer any questions you may have.

Mr. Weiss. Thank you very much, Mr. Laine. We do have some questions.
I will be asking you about certain audits and investigations that you have referred to, which were conducted by your office. Those audits and certain investigative memoranda have been entered into the record already.

Based on your testimony, Mr. Laine, I gather that the Office of Inspector General believes that the College Housing and Academic Facilities Loan Programs need improvement. Is that a correct assumption?

Mr. Laine. Yes, sir, Mr. Chairman.

Mr. Weiss. I take it that your office believes that more audit work needs to be done on these programs; is that right?

Mr. Laine. That is correct, Mr. Chairman.

We plan to continue the work that we are doing at this point in time and issue a final report with recommendations and to consider this as a priority area for future years.

Mr. Weiss. I have examined all of your audit reports. The underlying finding in all of the audits is that the Department of Education has been lenient in its handling of delinquent colleges.

What evidence exists that the Department has been soft on delinquent borrowers?

Mr. Laine. Well, Mr. Chairman, if I might summarize, with respect, from our survey report——

Mr. Weiss. Please do.

Mr. Laine. The summary of the areas where we felt improvement was needed based on the results of our preliminary survey, which will, of course, be expanded upon when we issue our final report, includes the following.

We talked about the need to assure that the necessary documents to initiate billing and collection of the loans be provided to the fiscal agent, the Federal Reserve bank.

Of the 111 loans closed between May 1981, and February 1983, 27 may not be in pay status with the bank because original loan documents were either in the Education files or could not be located.

Of these 27 loans, 21 original loan documents, totaling $19.6 million, which are required by the Federal Reserve bank to initiate billing, were still in the Department's files. In addition, six original loan documents could not be located. Eleven of the twenty-one loans should have been in the billing and collection cycle and had payments past due. We could only determine the amount of the principal and interest payments past due on 6 of the 11 loans because ED's files did not have the information on the other five. The six loans totaled about $10 million with initial principal and interest payments totaling $231,967 past due.

Our recommendation in this area was that original loan documents be forwarded to the bank, that appropriate substitutes or missing documentation be located and forwarded to the Federal Reserve bank, that institutions be billed for all payments due, and that a complete inventory of all the College Housing Program loans be developed.

With respect to the issue of the audit inspection fees, we believe that the transfer of the College Housing Loan Program audit and inspection fees from the Department of HUD to Education needs to be actively pursued.
HUD had collected millions of dollars in fees from borrowers before the program was transferred. Contrary to Office of Management and Budget guidance in 1980, HUD has retained these fees. We recommended that the Assistant Secretary prepare a letter for the Secretary of the Department of Education formally requesting that HUD determine the amount of the fees that should be transferred and transfer such fees. Such a letter has been prepared and there is dialog in process at this time.

Institutions are not required to establish that a severe housing shortage exists at the time a loan is made nor do they have to begin construction within a specified period after they receive their loan reservation.

At one institution, changing conditions indicated that the housing shortage which existed at the time the loan reservation was made no longer existed at the time that the loan agreement was executed.

At another institution, College Housing Program loan funds had been obligated for 3.5 years before the institution began construction. We recommended that program regulations and loan agreements be revised to address this situation.

Mr. WEISS. Mr. Laine, how about the utilization of foreclosure and receivership on defaulted institutions?

Mr. LAINE. Well, Mr. Chairman, we had recommended that the policies be reviewed and within what is in the best interest of the Government and of economic benefit to the Government, that consideration be given to strengthening such procedures.

Mr. WEISS. Do you believe that the leniency exhibited by the Department, which, by the way, was also practiced by the Department of Housing and Urban Development when it ran the program, has given the colleges the impression that they can get away with not making loan payments?

Mr. LAINE. Well, Mr. Chairman, it is very hard to say specifically what the colleges are thinking in that regard, but we did note that there are instances in which the colleges and universities did pay off other long-term debts but did not pay off the College Housing Loan Program.

Mr. WEISS. Right. In fact, your testimony states that your audits discovered colleges that appeared financially able to pay their debts to the Department but chose not to; is that correct?

Mr. LAINE. That is correct, Mr. Chairman.

Mr. WEISS. And you also testified that colleges were paying their debts to private lenders at the same time that they refuse to pay their college housing and academic facilities loans; is that correct?

Mr. LAINE. That is correct, Mr. Chairman.

Mr. WEISS. Does the Department of Education have enforcement power to force collection of past-due debts?

Mr. LAINE. Mr. Chairman, my understanding is that there is such a process and with respect to the details, I can submit that for the record or have you ask the Assistant Secretary on that.

We would be happy to submit that in more detail for the record.

Mr. WEISS. Without objection, we will hold the record open to receive that material at this point in the record.

[Material to be supplied follows]
According to program officials, the Department has the legal authority of foreclosure or rent receivership.

Mr. Weiss. And, do you know, just generally, what enforcement tools are available to the Department?

Mr. Laine. I know, Mr. Chairman, that there are certain instances where there can be foreclosure but with respect to the specifics, not off hand, Mr. Chairman.

Mr. Weiss. Right. And, are you familiar with receivership and the seizing of reserve accounts, which are also available?

Mr. Laine. Those are available tools, right.

Mr. Weiss. So, at least in the cases that you have mentioned in your testimony, the Department has chosen not to use all of the enforcement tools at its disposal; is that right?

Mr. Laine. That is correct.

Mr. Weiss. You testified, Mr. Laine, that the Department is expending all of its staff resources in these programs on collection of loans from defaulted borrowers.

Do you see a danger that by neglecting the loans which are in current status, those that are paid up, that the Department may be threatened by even greater defaults in the long-term future?

Mr. Laine. Mr. Chairman, the concern we have in that area is that adequate technical assistance be provided to those institutions that appear to have the potential for default. While we do not disagree with the need to pursue defaulted loans, there is also a need to assure that a priority is also given to assure that future loans are not defaulted on also, Mr. Chairman.

Mr. Weiss. You testified that security for loans at four schools that you audited was questionable and that in the event of forfeiture, the Department may not be able to recover the $10.5 million on these four loans alone.

Could you elaborate on that point?

Mr. Laine. Yes, sir, Mr. Chairman.

The $10.5 million is made up of four institutions. Two schools, Hofstra University—$3.5 million—and Florida Memorial College—$1.5 million—constructed facilities on land donated under the Federal Real Property Assistance Program. There is some concern, because of the nature of the donation, that title to the building might not be secured to the Department in the event of the transfer of the property.

At Windham College, a loan of $1 million was for a library which has no separate heating facilities. The heating facilities are part of another building. And that, of course, is a concern. And, in the case of the University of Kentucky’s loan of $4.5 million, we were unable to locate the bonds.

Mr. Weiss. So that in some of these instances there has been a failure to secure title searches or title insurance or to have legal representation of the Department at the loan closings so that the problems did not become known to the Department as they should have in the normal legal process?

Mr. Laine. Mr. Chairman, as you did indicate, that is correct; and the concern is that, because certain actions may not have been taken before every loan executed, the Department and the Government’s interest might not be protected.
Mr. Weiss, your audits found that the Department does not have legal representation at loan closings. I understand that the Department relies on attorneys paid by the borrowers to represent the Federal Government's legal interest.

Do you see the potential for conflicts of interest in that situation?

Mr. Laine: Yes, we do, Mr. Chairman.

Mr. Weiss: Do you recommend that the Department have legal representation at loan closings?

Mr. Laine: Yes, we do. We believe to properly protect the Department's interest that a legal representative of the Department should be present.

Mr. Weiss: You also testified that your auditors discovered nearly $20 million in loan files that had not been forwarded to the Federal Reserve bank where the billing is initiated.

Are you saying that billing had not begun on these loans because the necessary documents were not forwarded by or at the behest of the Department as required?

Mr. Laine: That is correct, Mr. Chairman.

As we had indicated, because of the nature of the files, certain documents necessary to initiate collection proceedings had not been forwarded.

Mr. Weiss: Where did you discover those files?

Mr. Laine: Mr. Chairman, I could supply you this information for the record, if you so desire.

What we did in this instance was to look at 111 loans and we found that 21 original loan documents were not forwarded to the Federal Reserve bank.

Mr. Weiss: Right; and those were files located at the Department headquarters itself?

Mr. Laine: Yes, sir.

Mr. Weiss: The proper documentation to commence the billing to the colleges simply had not been forwarded to the Federal Reserve bank; is that correct?

Mr. Laine: Yes, Mr. Chairman; if I might elaborate.

We found that for 21 of the 111, that was the situation.

Mr. Weiss: Are you satisfied that this problem has been corrected?

Mr. Laine: Mr. Chairman, with respect to the corrective actions, most of the recommendations that we have made have been concurred with by the Office of Postsecondary Education. At this point in time, though, we have not had the opportunity to go back and verify what actions have been taken. We do, however, plan to do so.

Mr. Weiss: The basic premise of the College Housing Loan Program, as created by Congress, is that only schools with severe housing shortages are eligible to receive loans.

Is that also your understanding?

Mr. Laine: Yes, sir.

Mr. Weiss: Yet, you testified that "institutions are not required to establish that a severe housing shortage exists at the time of the execution of the loan agreement."

Are you saying that you know of schools that did not have housing shortages at the time that they received their loans?
Mr. Laine. Mr. Chairman, we are aware of a situation where, in our opinion, this was in fact the case.

Mr. Weiss. Let me discuss that case with you.

According to the Department's records, the University of Washington in Seattle received a $3.2 million college housing loan in 1982 but prior to the award of that loan an owner of student housing in Seattle complained to the Department that a housing shortage did not exist in Seattle and that the loan would be a waste of Federal funds.

As a result of that complaint, your office conducted a preliminary investigation; is that correct?

Mr. Laine. We did look into that situation; yes, Mr. Chairman.

Mr. Weiss. I have before me a memorandum from the Inspector General to Secretary Bell on this matter. The memorandum is dated June 25, 1982. It states that "we have been advised by the Office of General Counsel that ample availability of housing in Seattle at the present time does not impact on the decision to execute the loan agreement."

Mr. Laine, does that mean it is the Department's position that a loan must be awarded on the basis of the housing situation at the time of the application, regardless of how many years before the actual loan is awarded after the application was made?

Mr. Laine. That is our interpretation, Mr. Chairman.

Mr. Weiss. So, in the case of the University of Washington, which applied for its loan in 1980, you found no housing shortage at the time that the loan was actually awarded in 1982; is that correct?

Mr. Laine. That is correct.

Mr. Weiss. Is it the common practice of the Department to award loans based on old housing data?

Mr. Laine. Mr. Chairman, my understanding is that the norm is that the construction would normally be undertaken within 18 months but that extensions can be granted.

Mr. Weiss. The data that they use, though, is that which was submitted in the application, regardless of the timelag between the application and the execution of the loan; is that right?

Mr. Laine. Yes, sir.

Mr. Weiss. Do you recommend that the Department change its criteria for awarding loans?

Mr. Laine. Yes, sir. We believe that the situation should be looked at again before the loan is executed to assure that there is still a severe housing shortage.

Mr. Weiss. Mr. Laine, on February 8, 1983, the Office of Inspector General initiated an investigation involving a loan to Creighton University in Nebraska. Your investigation found that the school declared in its application for a loan that students living in a building only five blocks from the campus lived more than 1 hour away from the campus.

Your investigation further found that Department of Education officials advised the school to list the students as living more than an hour away because the school was about to lose its lease on the building in question and, therefore, the students could be considered living more than 1 hour away.

Based on that representation, was the loan awarded?
Mr. LAINE. Yes, Mr. Chairman.

Mr. WEISS. The Department, then, knowingly accepted information that was untrue, but more than that, did the Department attempt to see if there was available housing for the students living in the building five blocks from campus, and did the Department attempt to learn if other leasing arrangements could be made with the owners of the building?

Mr. LAINE. With respect to that, Mr. Chairman, I do not know the answer.

Mr. WEISS. You testified that your audits found that schools were diverting revenues from federally financed projects, revenues that were pledged to the Federal Government for loan repayment. Your audits also found that schools were attributing unallowable costs to these pledged projects. These schools have signed agreements with the Federal Government that those revenues will be used for debt repayment. Is that correct?

Mr. LAINE. Yes.

Mr. WEISS. If a school knowingly and willfully diverts or misrepresents those revenues in reports to the Department of Education, would you consider those intentional representations to be fraudulent?

Mr. LAINE. Mr. Chairman, with respect to the definition of fraud and with respect to defining criminal wrongdoing, the distinction between fraud and abuse—the line between them is not very clear. What we do in those instances where we feel there may be criminal wrongdoing is to do a preliminary inquiry and determine whether there may be a situation such that criminal wrongdoing has occurred.

Certainly, though, it is either abuse or fraud, one of the two, Mr. Chairman.

Mr. WEISS. Has the Office of Inspector General considered conducting criminal investigations of schools that send purposefully erroneous information to the Department of Education?

Mr. LAINE. Yes, sir; we have, and when appropriate we have conducted either a preliminary inquiry where we look further to see if there is a need to do a criminal investigation, or in a few of the cases, we have begun immediately doing a criminal investigation.

Mr. WEISS. Last year your office issued an audit report on Alaska Pacific University, a school that received a $2.9 million college housing loan. Your audit found that the school had diverted revenues pledged to the Department of Education.

Is that correct?

Mr. LAINE. Yes, Mr. Chairman; that is true. These revenues estimated at $136,000.

Mr. WEISS. Did your audit also find that the school attributed unallowable costs to the federally financed building?

Mr. LAINE. Yes, Mr. Chairman. The project had been allocated or charged about $110,000 more than what we determined to be its equitable share of such expenses.

Mr. WEISS. Did your audit find that the school had sufficient assets through a land sale to repay its debt to the Department?

Mr. LAINE. Mr. Chairman, we determined that the university had executed an agreement to sell land for about $10.9 million and
that a $1 million option payment was due at the time of our audit. We, in fact, did recommend that this money be used for this purpose.

Mr. Weiss. For repaying of its loan; is that right?

Mr. Laine. Yes, sir.

Mr. Weiss. Did your audit also find that Alaska Pacific University was leasing the federally financed building to the U.S. Geological Survey for $283,000 a year at the same time that the school was delinquent on its debt?

Mr. Laine. Mr. Chairman, offhand I am not sure on that item. We would be happy to respond for the record if you so desire.

Mr. Weiss. Well, perhaps you can check that and we will call you back before we terminate to get that answer into the record.

Mr. Laine. That would be fine, Mr. Chairman.

Mr. Weiss. Do you believe that the Department of Education should have attempted to collect the revenues and proceeds from the land sale? I believe you already testified yes to that.

Mr. Laine. Yes, we did recommend that in our audit report.

Mr. Weiss. Has the Department collected the full past-due amount on the loan?

Mr. Laine. To the best of our knowledge, Mr. Chairman, it has not.

Mr. Weiss. Your office audited loans to Florida Memorial College, which received more than $3 million in loans. Did your audit find that this school had not included at least $100,000 in revenues in its project funds?

Mr. Laine. That is correct, Mr. Chairman; $101,000 of student union fees were not credited to the project.

Mr. Weiss. Did your audit find the buildings financed by the Federal Government in that instance in disrepair?

Mr. Laine. That is correct, Mr. Chairman.

Mr. Weiss. Did the Department of Education defer past-due amounts on that loan and enter into a workout agreement with the school?

Mr. Laine. Let me just check that one, Mr. Chairman.

I am sorry, Mr. Chairman, could you repeat the question, please?

Mr. Weiss. Yes. Did the Department of Education defer past-due amounts on that loan and enter into a workout agreement with the school?

Mr. Laine. There was a workout agreement signed, Mr. Chairman, and in fact certain payments were deferred.

Mr. Weiss. Did your audit determine if the projects are generating sufficient revenues to pay the loans in that instance under the workout agreement?

Mr. Laine. Mr. Chairman, I don’t have that one offhand and, again, would be happy to submit that for the record.

Mr. Weiss. Without objection, the record will remain open to receive that information.

[The material follows:]

Our review found that the projects are generating sufficient revenues to pay maintenance and operating expenses and meet the payment schedule required under the workout agreement.
Mr. Weiss. Do you have information with you indicating whether Florida Memorial College adhered to all payments under the work-out agreement?

Mr. Laine. Yes, Mr. Chairman. They did not.

Mr. Weiss. They did not?

Mr. Laine. They did not.

Mr. Weiss. Your office also conducted an audit of more than $3 million in loans to Hawaii Loa College. Is this school in default on its loan?

Mr. Laine. Yes, Mr. Chairman.

Mr. Weiss. Did Hawaii Loa charge $80,000 in costs to a federally financed building that were not allowable?

Mr. Laine. Mr. Chairman, there were certain expenditures, as you indicated, charged that we felt were not allocated properly, that were improperly allocated.

Mr. Weiss. Right. And is that $80,000 figure accurate?

Mr. Laine. Mr. Chairman, I would want to check that for you for the record.

Mr. Weiss. OK.

Without objection, the record will remain open to receive that information at this point.

[The material follows:]

Our review found that about $42,000 in costs were allocated to the Federally financed building. We felt that these costs were not properly allocated. We also found other costs charged to the facilities which we believed were improperly allocated, but could not determine the proper allocation of these costs.

Mr. Weiss. Did the charging of those costs to the building cause the revenues from the building to be understated?

Mr. Laine. Yes, Mr. Chairman. If excess expenditures were allocated, the net revenues available to make the debt payments would not be available. That is correct.

Mr. Weiss. Did Hawaii Loa continue making payments to private creditors while it was in default on its Education Department loan?

Mr. Laine. Yes, Mr. Chairman.

Mr. Weiss. Did your audit state that the reason the school gave inequitable treatment to the Department was the Department's own lenient loan policies?

Mr. Laine. Mr. Chairman, our audit report stated that in our opinion that was the case. That contributed to this situation, yes, sir.

Mr. Weiss. Mr. Laine, your office conducted an audit of nearly $4 million in loans to Shaw University in North Carolina. Did the audit find that Shaw had improperly charged salaries and other school operations costs to the buildings financed with Federal funds?

Mr. Laine. Mr. Chairman, we found that certain costs were not properly charged and certain costs were not allocated properly, yes, sir.

Mr. Weiss. Did the audit also find that the school had not deposited revenues from pledged facilities in segregated accounts as required by the loan agreements?

Mr. Laine. Yes, Mr. Chairman, the proper revenue fund account was not used.
Mr. WEISS. Does the loan agreement require that all net revenues be paid to the Department of Education?

Mr. LAINE. Yes, Mr. Chairman.

Mr. WEISS. Your office conducted an audit of Steubenville University of Ohio which has received more than $2.8 million in loans. Did the audit find that net project revenues at the school had been understated by $362,000 because improper costs were charged to the federally financed facilities?

Mr. LAINE. That is correct, Mr. Chairman.

Mr. WEISS. Your office also conducted an audit of more than $3.5 million in loans to Viterbo College in Wisconsin. The audit found that more than $50,000 in pledged revenues were not reported to the Department of Education. The audit also found that the school made debt service payments on other loans and purchased real estate while its loan from the Department of Education was in arrears.

Is that correct?

Mr. LAINE. Yes, Mr. Chairman.

Mr. WEISS. Mr. Laine, were all of the audits conducted by your office only of loans that are in default?

Mr. LAINE. Yes, Mr. Chairman.

Mr. WEISS. And in every case audited, did your office determine that true net revenues of the schools were understated in reports to the Department of Education?

Mr. LAINE. Not in all, Mr. Chairman, but in many of the schools we audited we have indicated in our report that net revenues were understated.

Mr. WEISS. You conducted no audits of schools in current loan payment status; is that right?

Mr. LAINE. That is correct.

Mr. WEISS. To your knowledge, does the Department of Education verify that the buildings financed by loans which are in current payment status, that is those which are paid up to date, are indeed being used for educational purposes?

Mr. LAINE. Mr. Chairman, I am not able to comment on that at this time, although I do believe these types of issues will be commented on in our report that we are in the process of finalizing on the overall management of the program.

Mr. WEISS. Do you know of anyone who can assure this subcommittee that all those buildings are being used for educational purposes?

Mr. LAINE. I would defer that to the Assistant Secretary, Mr. Chairman.

Mr. WEISS. Before I ask counsel for the minority if she has some questions, we had asked before about the leasing of one of the buildings at Alaska Pacific to the U.S. Geological Survey. If you will look at your audit report on page 1, the fourth paragraph, do you have that with you?

Mr. LAINE. Yes, Mr. Chairman.

Mr. WEISS. Does that then refresh your recollection that the building which in fact was paid for by the Federal loan was then leased to the U.S. Geological Survey for annual payments of $283,945?

Mr. LAINE. Yes, it does.
Mr. Weiss. Thank you very much.
Now I will ask counsel for the minority if she has questions.
Ms. Morrison. Thank you, Mr. Chairman.
During the course of your review of the management of these programs by the Office of Postsecondary Education, did you receive any indications that some of the problems that you found had already been identified by the program staff?
Mr. Laine. Yes, we did.
Ms. Morrison. Did you receive any indications that remedial action was being contemplated?
Mr. Laine. In certain instances action was in process of being taken.
Ms. Morrison. How many loans are in default in the College Housing and Academic Facilities Programs? In total?
Mr. Laine. According to the information that I have available, in the College Housing Loan Program, the number of loans in default is 155, for the College Housing Loan Program, and 47 for the Academic Facilities Loan Program.
Ms. Morrison. What percent of the total number of loans would those numbers represent?
Mr. Laine. I do not have that number offhand. I would be happy to submit that for the record.
Ms. Morrison. OK.
Mr. Weiss. Without objection, the record will remain open to receive that answer.
[The material follows:]
According to program officials, the College Housing default rate is 3.8 percent and the Academic Facilities default rate is 9.2 percent.
Ms. Morrison. How do you define the term "default"?
In other words, if an institution missed a payment, would they be considered in default?
Mr. Laine. Yes.
Ms. Morrison. A single payment?
Mr. Laine. Yes.
Ms. Morrison. Would you have any idea of how many institutions that are presently listed in default might have just missed a single payment?
Mr. Laine. I would not know that offhand. Again, we could submit that for the record.
Ms. Morrison. OK.
Mr. Weiss. Without objection, the record will remain open to receive that answer.
[The material follows:]
According to Department officials, institutions are not shown as in default in official records unless they are delinquent in payments beyond a two-month period. Data is not immediately available to determine the number of schools delinquent only one payment.
Ms. Morrison. Do you believe that raising the interest rate on these programs closer to the prevailing market rates would help with future collections efforts?
Mr. Laine. One of our observations and recommendations was that late payment penalties be considered, but we also recommended that raising the interest rate be considered, yes.
Ms. MORRISON. Mr. Chairman, are we going to address any questions about the discount authority to the Inspector General’s Office?

Mr. WEISS. No. Of course, you may ask whatever questions you would like, but we will have those questions addressed I think most appropriately to the Assistant Secretary.

Ms. MORRISON. If you don’t mind, I have one I would like to ask now.

Mr. WEISS. Of course, go ahead.

Ms. MAROON. With respect to the new discount authority that the Secretary has just been given, what would you recommend be the policy with respect to defaulted institutions?

Mr. LAINE. Well, we have not had a chance to study in depth the regulations at this point in time; but with respect to the discount authority overall we are in favor of the basic concept of net present value discounting.

The application of that concept, however, to payments that are in arrears is something that we would want to look at very closely to assure that any such writeoffs are appropriately controlled and in the best interest of the Federal Government.

We have not, at this particular time, seen in detail the plans for dealing with discounting of payments in default, so I am unable to comment any further.

Ms. MORRISON. Thank you, Mr. Chairman.

Mr. WEISS. Thank you very much.

You will submit to us some of those open items which you did not have the information for at this time, we would appreciate it, and we may submit some further questions to you in writing.

Mr. LAINE. That will be fine, Mr. Chairman.

Mr. WEISS. Thank you for your testimony.

Mr. LAINE. Thank you.

Mr. WEISS. Our next witness will be Dr. Edward M. Elmendorf, Assistant Secretary for Postsecondary Education in the Department of Education, accompanied by some of his associates.

Dr. Elmendorf, if you would approach the witness table and before you take your seats, if you would identify your associates who are with you, we would appreciate that for the record.

STATEMENT OF DR. EDWARD M. ELMENDORF, ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION, DEPARTMENT OF EDUCATION, ACCOMPANIED BY DR. RONALD KIMBERLING, DEPUTY ASSISTANT SECRETARY FOR HIGHER EDUCATION PROGRAMS; DR. EDWARD BRANTLEY, DIRECTOR OF DIVISION OF FACILITIES AND GENERAL SUPPORT PROGRAMS; DR. RICHARD FAIRLEY, DIRECTOR OF INSTITUTIONAL SUPPORT PROGRAMS; CHRIS CONANAN, ATTORNEY, OFFICE OF GENERAL COUNSEL; AND THOMAS STACK, DIRECTOR, CREDIT MANAGEMENT IMPROVEMENT STAFF

Dr. Elmendorf, Mr. Chairman, to my right, I have Dr. Ron Kimberling, Deputy Assistant Secretary for Higher Education Programs; Mr. Conanan, Program Attorney for the College Housing Program.
Mr. WEISS. Would each of you raise your right hand?
Do you swear or affirm that the testimony that you are about to
give shall be the truth, the whole truth, and nothing but the truth?
[Chorus of “I do.”]
Mr. WEISS. Let the record show the responses are in the affirmative.

Before we start, Dr. Elmendorf, who is directly responsible for
running these specific programs and is that person in the witness room at this point?
Dr. ELMENDORF. The person in charge overall is Dr. Kimberling.
The person directly in charge of the loan program is Dr. Brantley who is present in the witness room.

Mr. WEISS. Well, suppose we have Dr. Brantley also with us at the witness table?
Dr. ELMENDORF. That would be fine, Mr. Chairman.
Mr. WEISS. Dr. Brantley, before you sit down, would you raise your right hand?
Do you swear or affirm that the testimony you are about to give
is the truth, the whole truth, and nothing but the truth?
Dr. BRANTLEY. I do.
Mr. WEISS. Thank you.

Dr. Elmendorf, we understand that you have been suffering from a cold and that you are having some difficulty talking. We appreciate your being with us today.

We have your full statement which will be entered into the record, without objection, and we would ask that you proceed as you deem it most convenient.

[Dr. Elmendorf’s prepared statement follows:]
TESTIMONY OF DR. EDWARD M. ELMENDORF
ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION
DEPARTMENT OF EDUCATION
BEFORE THE INTERGOVERNMENTAL RELATIONS
AND HUMAN RESOURCES SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

MAY 15, 1984
Mr. Chairman and Members of the Subcommittee:

Thank you for providing the Department with an opportunity to testify before this subcommittee on improvements in the administration of both the Academic Facilities and College Housing Loan Programs, and on our success in strengthening our collections efforts under both programs.

The Academic Facilities Program, which was originally authorized by the Higher Education Facilities Act of 1963, is now authorized under the provisions of Title VII of the Higher Education Act of 1965, as amended. Since the inception of the programs funds have been made available for the issuance of 576 loans. The majority of these funds were awarded for direct grants and annual interest grants for construction of undergraduate and graduate facilities.

The College Housing Loan Program was first enacted as Title IV of the Housing Act of 1950. This program was transferred from Department of Housing and Urban Development (HUD) to the Department of Education (ED) in 1980 under the Department of Education Organization Act. This Department first made loans under this program in fiscal year 1981 and began servicing loans in 1982. During the total life of this program 3,363 loans have been made, only 87 of which have been made since the transfer of the program to ED.
We believe that in the three years since the Department assumed responsibility for the College Housing Loan program, there have been significant improvements in its management.

When the operations of the College Housing Loan program were transferred from HUD in 1981, there were a number of problems that had been identified by the General Accounting Office in its reports of 1980 and 1981. These reports were constructive in identifying the areas where we should focus immediate attention in terms of administrative improvements. Most of the recommendations made by the GAO in its reports, and by our own Inspector General, have been successfully implemented. At the same time, the procedures governing loans under both programs have been revised to ensure conformity in the handling of loans.

The College Housing Loan Program

The major management improvements we have implemented since the program was transferred from HUD, include:

- Loan origination regulations were completely re-written and simplified to ensure a fair and thorough evaluation of an institution’s loan application.

Included was a prohibition against the making of a College Housing loan to an institution in default on another College Housing or Academic Facilities...
loan.

- Procedures were established for verifying data submitted with an institution's application. This was one of the key GAO and IG recommendations.

- The loan application procedure was improved by substituting a single, simplified application form for two complex applications.

- The files of more than 3,000 loans issued by HUD which were received from HUD's central office, its 10 regional, and 43 area offices have been centralized and are being reviewed and brought up to date. Many of the files we received when the program was transferred were incomplete.

- A review of the HUD files found 81 institutions in default on 211 loans. The Department immediately began negotiating with these institutions. As a result, the number of institutions in default has been reduced to 67 and negotiated and implemented work-out agreements have been made with 49 of these institutions. These institutions are now making annual, agreed upon payments, to eliminate their defaults and have resumed making current payments. We are continuing to work with the remaining institutions.
In carrying out these activities, the Department not only reduced the number of defaulted borrowers, but also succeeded in collecting $5.7 million from these borrowers in FY 1982, $6.7 million in FY 1983, and is projecting a collection of approximately $8 million in FY 1984.

We have completed the systems design for a computerized management information system that will allow us to develop financial profiles of all institutions receiving loans and to provide readily accessible, accurate information on the status of loan accounts.

We signed an interagency agreement with the General Services Administration in 1983 to dispose of repossessed properties. This agreement results in the effective utilization of the expertise found in each agency to maximize Federal resources.

We have also signed an interagency agreement with the Department of Health and Human Services Regional Operations for Facilities Engineering and Construction, to provide architectural and engineering review services on all active projects.

**Academic Facilities**

Authorization to grant moratoria on loan repayments was added to the academic facilities statute in 1976. The loans in moratorium status have been reviewed in the last three years resulting in 28 institutions signing
work-out agreements or refinancing their loans. The $3.4 million collected as a result of this action is included in the collection totals stated above.

Approaches to Loan Management

The Department considers protecting the Federal financial interest to be its primary responsibility in the management of these loan programs. Yet responsible loan management would not be complete unless the financial health of the loan recipient is also considered. The collections process is unproductive, both for the Federal government and for colleges and universities, if collection remedies jeopardize the continued existence of the loan recipients.

In dealing with an institution in financial difficulty, we consider the factors which contribute to the institution's instability, and cooperatively develop a plan to "work-out" its financial obligations to the Federal government. Such plans may include:

- Deferment for a limited period of payment of principal or interest or both;
- The lease or sale of facilities for educational or alternative uses; and
- Refinancing of loan obligations.
In addition, there are also legal remedies for default incorporated in the original loan document. These remedies include rent receivership and foreclosure. However, our experience with these procedures is that they are the least cost effective for protecting the Government's financial interest.

In addition, Pub.L. 98-139, enacted October 31, 1983, provides another option to institutions to meet their loan obligations. The Department is authorized to accept in full payment of any outstanding college housing loan, a prepayment in the amount that represents the present value of the loan discounted at current Treasury interest rates for loans of comparable maturities. The formula used in determining the discount is the same one used by the Department of Treasury, and is based upon Net Present Value of the outstanding loan, thus contributing to the Federal deficit.

We are pleased that this discount provision has been provided because the cost to the Government of subsidizing the difference between the 7% interest rate the institutions pay and the current interest rate is excessive. In fact, at current rates we project that the Federal government will pay more in subsidized interest than it will receive in payments from loan recipients.

While we take considerable satisfaction in the progress we have made, there are still problems to be addressed. We have solicited help in our
efforts including, for example, requesting our Inspector General to audit
a number of problem institutions which we identified. We believed the audits
would assist our collection efforts by revealing the actual roadblocks to
collection and what actions detrimental to the Government’s financial interests
were being taken by loan recipients, e.g. paying off loans to other entities
rather than paying our loans. Our loan servicing specialists currently are
vigorously following up on the recommendations.

We appreciate the fact that you share our interest in the effective
management of this program and will be pleased to respond to questions.
Dr. ELMENDORF. Thank you, Mr. Chairman. I do appreciate this opportunity. I would like to take 5 or 10 minutes and just summarize the testimony.

Mr. WEISS. Fine. The microphone is not very sensitive, so you almost have to swallow it to be heard through it.

Dr. ELMENDORF. We have approached the testimony that we have provided to you in a report-card format. We believe that the Department's administration of the program has focused on accomplishments and measurable objectives that will give our successors a chance to look back and have benchmark data. That is an opportunity we did not have when we took over this program from the Department of Housing and Urban Development [HUD].

The College Housing Program is 33 years old. It was transferred to the Department of Education from HUD in 1980. It had about a $3 billion outstanding balance, about 3,363 loans to 1,216 institutions.

Since the Department has had the program, we have issued 87 loans to institutions. None of these loans are in default.

We have cooperated with the IG and the GAO. Most of the reports they have issued were done on the program either before it came from HUD or while it was in the period of transition. As the Inspector General testified, the majority of the recommendations made by the IG and GAO have been implemented or are well on their way to being implemented.

We have made some major improvements in the management of the program. We have developed loan-origination regulations, which are simpler and tougher than the regulations used by HUD. We, for example, do not allow institutions in default to participate in the program.

We have files that came from 10 regional offices and 43 area offices, many incomplete and outdated. If you wish, Mr. Chairman, I have a letter and internal memorandums documenting the status of those files when they came to the Department which would show the condition of the files when the Department received them.

We have reduced the number of institutions in default to 67 and 49 of those 67 are in repayment. In fact, we have exceeded both departmental and OMB target collection goals on defaulted loans, col-

Additionally, we have developed financial profiles on institutions which we expect to have computerized. We have also negotiated interagency agreements with GSA and HHS to utilize their services in areas to which they bring particular expertise.

Let me go back to an earlier statement, Mr. Chairman, that you made about leniency in the Academic Facilities Program. That lenient attitude was not something uniquely developed by HUD and carried on by the Department of Education. It was recommend in a Senate appropriation report by Senator Magnuson on June 8, 1971. The language regarding this program reads as follows: "The committee urges the department to be more liberal in the using of the academic facilities loan authority. It also urges the Secretary to coordinate efforts with the Secretary of HUD and other areas so that the policies are similar."

And, that in fact was done.

With more recent instruction from Congress, we have been a great deal less lenient, bringing those HUD moratoria loans on the academic facilities—20 of them into repayment agreements, so we think we have both simpler and tougher requirements.

In my testimony I have included a history of the collections within the Department, and that simply tells the story of increased collections each year while the Department has had the program. I also might add that the majority of the increase in delinquencies that you cited occurred between 1977 and 1980. There was a 200-percent increase in delinquencies in the College Housing Loan Program, a 350-percent increase in Academic Facilities. However, since 1981 to 1983, there has been less than a 15-percent increase in defaults in the housing program, and I think it is between 20 and 25 percent in the Facilities Program.

Our approach to loan management is to protect the Federal interest without unnecessarily jeopardizing the continued existence of loan recipients.

As you may be aware, Mr. Chairman, there are no winners in bankruptcy, and, frankly, there is not a very good market in used college campuses these days.

For those that we find to be in financial difficulty, we have tools to use that go from deferment to sale or lease of a facility to a refinancing arrangement, and we have seen fit to use all three.

Insofar as legal remedies are concerned, rent receivership and foreclosure are two options which we have, but only after authority is given or delegated from Justice. In both cases, these are least desirable options. They have been least successful. I give you the example of a campus in my home state of Vermont which had a loan for $3.4 million. Its assessed value was $3.1 million. The Department, after foreclosing on it, sold it for $400,000, and ended up paying $274,000 to maintain that facility, netting out about $130,000 on a $3.4 million purchase.

We also now have the option of Public Law 98-139, discounting which we think will give us some additional leverage to bring those in default either in repayment or out of the program altogether.

Finally, I would like to address myself to the fact that we think that the audits done by GAO and the IG on the program primarily
when it was with HUD have helped us immensely in getting the program up to speed. We also have our own internal department A-123 system of checks and balances.

We have an OMB circular on debt collection which also encourages the use of discounting to pay off obligations. We believe that your guidance and your suggestions today will also help us or assist us in improving even more the significant accomplishments in the program, and I would also like to bring to your attention the fact that to demonstrate the sincerity of our commitment we have encouraged and allowed your staff to have open, unrestricted, unconditional access to all of the files in both of our programs for the entire period that they desired.

Mr. Weiss. Dr. Elmendorf, let me just stop you right there.

That is not as a matter of favor or courtesy to us; that is a congressional right.

Dr. Elmendorf. Yes, sir.

Mr. Weiss. Thank you.

Dr. Elmendorf. I just wanted to put on the record that that was not something that was controlled or even suggested to be controlled by the Department of Education.

Mr. Weiss. I don't want to get into a hassle with you on access, but if you will check—and we will give it to you after the hearing—as a matter of fact we did have some difficulty with some of your people in getting access to some material.

Dr. Elmendorf. Thank you, Mr. Chairman, that does conclude my statement.

For the record, I will try to answer any policy questions. For questions on individual institutions and data, I will defer to Dr. Kimberling.

Mr. Weiss. Thank you very much.

Dr. Elmendorf. Most of the loans made under the College Housing and Academic Facilities Loan Programs are current; is that correct?

Dr. Elmendorf. Yes, sir.

Mr. Weiss. In February 1983 you received a memorandum from Dr. Brantley on the future of the programs. The memorandum stated that college enrollments are declining and, as a result, "It is becoming increasingly difficult for the colleges and universities to generate income to pay their debts."

Given this fact, it is more important than ever to make sure that the schools which are current on their debts remain so.

Do you agree?

Dr. Elmendorf. Yes, sir.

Mr. Weiss. Witnesses from the Department of Education Inspector General's Office just testified about the findings of their investigations and audits of the College Housing and Academic Facilities Loan Programs. You heard their testimony, I believe, yes?

Dr. Elmendorf. Yes, sir.

Mr. Weiss. In essence, do you agree with the Inspector General's findings and testimony?

Dr. Elmendorf. In general, I would agree that those conditions did exist at a time in the evolution of the program. Most of those findings were at a time when the program was in transition transferring from HUD to the Department of Education, and I do agree.
with the Inspector General that our staff did in fact identify many of those deficiencies first and bring them to the attention of the Inspector General. We were well underway to correcting most of the deficiencies in the program.

Mr. Weiss. You testified that collections have been increasing under the College Housing and Academic Facilities Loan Programs. However, since 1977 the delinquencies in the College Housing Loan Program have increased from $10.9 million in 1977 to $24 million today, and the delinquencies in the Academic Facilities Loan Program have increased from $2.5 million in 1975 to $10.6 million today.

You may be collecting more, but the delinquency rate is also rising. How do you explain that?

Dr. Elmendorf. Mr. Chairman, I have some charts. I would be happy to submit for the record. There was a growth in the defaults in the program from—

Mr. Weiss. I am sorry, I am having difficulty in hearing you.

Dr. Elmendorf. I will give this one to Dr. Kimberling.

Mr. Weiss. OK.

Without objection, we will insert those charts into the record at this point.

[The charts follow:]
COLLEGE HOUSING LOAN DELINQUENCIES

TOTAL INCLUDES DEBTS FROM CLOSED SCHOOLS
- MISSED PAYMENTS

SOURCES: 1977-78, 1982-83, ED PROGRAM DATA

Total nine closed INES
ACADEMIC FACILITIES LOAN DELINQUENCIES

(TOTAL INCLUDES DEBTS FROM CLOSED SCHOOLS)

MISSED PAYMENTS

SOURCE: ED PNCRAI: DATA
Dr. Kimberling. Mr. Chairman, your figures are substantially correct. In the College Housing Program in 1977 there were $10.9 million, as you have stated, delinquent. The actual figure for 1983 is $25.5 million, according to our records. But we are looking at the slope of the curve here.

From 1977 to 1980, the delinquencies rose from $10.9 to $22.2 million. In the last 3 years they have risen from $22.2 to $25.5 million.

That was an increase of 204 percent during the period when the program was administered by HUD, as opposed to 15 percent during our administration.

Now, let me also point out that these rates include the sum of missed payments for closed schools, where in many cases, we are proceeding with court action and foreclosure. When you subtract that from the current total, it comes down to $20.1 million that is delinquent. That is out of a total of $3 billion outstanding in the program.

With academic facilities, it rose from $2.5 to $8.5 million from the period 1975 to 1980, for a 340-percent growth record during that decade. From 1980 to 1983, it rose from $8.5 to $10.5 million or 29 percent increase. If you subtract the closed institutions where the clock is still ticking on missed payments, and we don't have the writeoff authority, it goes down to $9 million.

Again, putting into perspective those figures against the $576 million outstanding in the program, we don't feel that any amount of delinquencies are tolerable and we share your concern for getting a handle on this, but we would point out that the growth rate in delinquencies has been slowed down, that it is nowhere near the growth rate that was experienced in the 1970's, and that it still represents a fractional portion of the total outstanding balances in the program.

Mr. Weiss. The numbers don't seem to indicate your conclusion, but be that as it may.

You also testified, Dr. Elmendorf, that when the Department inherited the program in 1980 you discovered 81 schools in default but now only 67 are in default.

Did the 14 schools you say are no longer in default pay off all past-due principal and interest?

Dr. Elmendorf. Mr. Chairman, 20 of those schools were brought current. In the interim period, some schools closed, but Dr. Kimberling has the precise breakdown of the 67, 49 of which I testified are in current repayment now; only 18 of which are not.

Dr. Kimberling. Mr. Chairman, the period between January 1982 and April 1984 includes 93 institutions that were in default at some period of time during that timeframe. Of the 93, 20 have become current, that is to say, either through a workout agreement with us or through the use of reserve funds that we have asked the institutions to draw down upon, they are now current and out of default completely in their payments.

There are 49 with workout agreements, making payments on those agreements. Eleven schools have been sold and 15 schools are what we would call the hardcore. These borrowers have either refused or been unable to identify workout agreements with us.
I should point out that two of the closed schools had workout agreements, so while your figures may add up to 95, there is a bit of an overlap, and they come to 93.

We think that the fact that 20 institutions with workout agreements have now become current on their loans supports our general practice of workouts where the institutions make accelerated payments in order to meet their current debt service and to chip away proactively at the defaulted amounts.

Mr. WEISS. Is it your testimony that where you enter into a workout agreement that the workout agreement by itself brings the situation into current status?

Dr. KIMBERLING. All of our workout agreements are intended to bring an institution into current status over a set period of time through accelerated—

Mr. WEISS. I know, but my question is: Is it your position that when you have a workout agreement entered into that simply the signing of that agreement brings it into current status?

Dr. KIMBERLING. No, Mr. Chairman, our position is that in 5 out of 7 cases, the workout agreements have proven to be effective, and insofar as they are an effective tool, we believe that they are a valuable tool. In the cases where they are not proving effective, we have no recourse but to take more stringent action, such as working with our Inspector General to conduct a more detailed audit.

I would remind the chairman that the Inspector General has testified that the selection of the institutions that they visited was done in conjunction with our program staff. These were institutions that our program staff had identified in most instances as hardcore defaulters, and we had conducted five site visits of our own prior to the Inspector General's audit. We feel that we have a good relationship with our IG, that they have the kind of audit expertise that can give us a more pinpointed set of information on the situation at these institutions that we have identified.

Mr. WEISS. The Federal Reserve bank delinquency report for April of this year lists 107 schools in default for both programs.

Is that an accurate figure?

Dr. KIMBERLING. I don't know whether it is accurate or not, but I can describe a process which occurs about every 6 months and hopefully will put this into perspective.

Typically, the payment schedules that were set up for HUD are semiannual, the payments falling due in October and April. That is because these are revenue-producing facilities. Colleges typically receive money in August or September that they can deposit in October or in the spring semester, in February and March that they can deposit in April.

If an institution is late just a few days and if you are receiving a report done shortly after the due date, it has sometimes been the case that the Federal Reserve bank will report institutions that are technically in default.

A couple of years ago, for example, it showed Johns Hopkins University in default technically. It turned out that their payment was about 2 weeks late and well within the grace period that banks normally allow.

So, when you get past a 30-day period or so beyond the normal payment date, the number of institutions really and truly in de-
fault shakes down to the kind of numbers we are talking about—67.

Mr. Weiss. In an audit of one defaulted school—Hawaii Loa College—the Inspector General found that the school was paying its private debts but was not paying its debt to the Department of Education. The audit stated that the "school pursued this inequitable repayment policy because of ED's lenient loan policy."

I might add that the IG made this conclusion in several audits. Do you believe that that conclusion is correct?

Dr. Kimberling. I don't know under what circumstances the school was characterizing our lenient loan policies. It is very possible, Mr. Chairman, that they were referring to the artificially low 3 percent interest rate charged in this program, and I think if you or I had—

Mr. Weiss. No; they were talking about the fact that they were making payments to their private lenders but they were not making payments to the Federal Government.

Dr. Kimberling. Yes, sir. And, those interest rates and private loans, as we know, are typically 12, 15, 18 percent.

This school, by the way, is on our list of hardcore problem cases, and one of the followup actions that we deemed necessary was to get the kind of detailed audit information—

Mr. Weiss. Would you like to try to answer the question that I asked you?

The audit stated that the school pursued this inequitable repayment policy because of ED's lenient loan policies. Do you believe that that conclusion is correct?

Dr. Kimberling. No, sir.

Mr. Weiss. Dr. Elmendorf, has the Department of Education ever foreclosed on a defaulted school that had not already declared bankruptcy?

Dr. Elmendorf. Yes; we have foreclosed on schools, contrary to the operation of the program under HUD when no foreclosures of any kind were made.

I cannot tell you whether or not bankruptcy proceedings had started, but Windham College is an example of one case where we did foreclose, and I went through that scenario with you.

Mr. Weiss. But, again, if you would like to try to answer my question.

Has the Department of Education ever foreclosed on a defaulted school that had not already declared bankruptcy?

Dr. Elmendorf. Let me ask Mr. Conanan to respond to that.

Mr. Weiss. Thank you.

Mr. Conanan. I believe the Department of Education did foreclose on a school which did not declare bankruptcy, and that school was Milton College in Wisconsin.

Mr. Weiss. Milton College in Wisconsin?

Mr. Conanan. Yes.

I will check the records that the Department possesses, but I believe, to the best of my knowledge, that Milton College did not go into regular bankruptcy proceedings under Federal district court or supervision.

Mr. Weiss. Any other school?
Mr. CONANAN. I cannot recall, but again, I will check the records to see if there is any information concerning whether Education or HUD foreclosed on a school that did not go into bankruptcy or reorganization proceedings.

By the way, we did recommend foreclosure recently in the matter of Eisenhower College. That school closed down in 1979 and was taken over by Rochester Institute of Technology and recently Rochester Institute of Technology decided not to maintain and continue Eisenhower College or the campus facility at Seneca Falls, and the General Counsel of the Department of Education recommended to the U.S. Justice Department to pursue or consider foreclosure on some of the campus facilities that were located on that campus. Justice did not go along with our recommendation, by the way.

Mr. WEISS. Is there somebody back at the office who could give you the information as to whether and when Milton College was foreclosed upon?

Mr. CONANAN. Well--

Mr. WEISS. Is there somebody here on your staff who is sitting in the audience who could check with the office and get us that information before we conclude this morning?

Mr. CONANAN. Yes, there is.

Mr. WEISS. Would you ask them to please do that?

Mr. CONANAN. Yes, I will.

Mr. WEISS. Thank you.

An alternative collection enforcement method at your disposal is to put the buildings constructed with loan proceeds in receivership until the defaulted loan is brought current. Is that correct?

Dr. ELMENDORF. Yes, sir.

Mr. WEISS. How often has the Department used receivership on defaulted schools?

Dr. KIMBERLING. We have not used that procedure yet, Mr. Chairman. We are contemplating it with a couple of the schools that the IG has audited.

Mr. WEISS. Iowa Wesleyan College received a $1.5 million college housing loan in 1965. The loan has a $602,000 delinquency. A July 27, 1982, internal Department memorandum concerning this school stated that the college was giving the Federal Government "secondary consideration" and that the school was charging unallowable costs to its federally financed buildings, thus causing its true revenues to be understated. On June 3, 1982, the Department notified the school that the building would be placed in receivership unless the delinquent debt was satisfied.

In response to this notification a school official sent a memorandum to other school administrators stating "the general feeling is that this is bluster and that in actuality nothing would be gained by placing the residence halls into receivership."

Did the Department, in fact, place the buildings in receivership?

Dr. KIMBERLING. No, Mr. Chairman.

Mr. WEISS. Is it correct that the Department is more likely to defer payments, grant moratoriums, or recast loans rather than foreclose on schools or place buildings in receivership?
Dr. Kimberling. It is more likely that we would recast loans or execute a workout agreement. In the late 1970's, acting under the instructions from the Senate Appropriations Committee that Dr. Elmendorf read, a more liberal moratorium policy was followed by the Office of Education in the Academic Facilities Program, and the College Housing Program in HUD.

That was at the expressed desire of the Congress. Since that time, in the 1980's, I think we have all realized the need to be more aggressive in our debt-collection efforts, so if you look back in time, a more liberal policy toward moratoria and deferments was in fact followed upon the advice of the Congress. That policy—

Mr. Weiss. You are not suggesting, Dr. Kimberling, that the Congress told you to overlook the manipulation of revenues and the charging of inappropriate expenses or any of those kinds of things. That is not what Congress told you to do, is it?

Dr. Kimberling. No, sir.

Mr. Weiss. Right.

I want to ask you about the attitude of some of the colleges that participate in these loan programs. I have the minutes of a meeting of presidents and other officials from schools which have defaulted on their Federal loans. The meeting took place on February 22, 1982, and was conducted by the Conference of Small Private Colleges.

The meeting attendees were advised then—and I am quoting directly from the minutes—"defaulting institutions should stay low key and wait until the Federal Government makes the first move. However, once the Government does move, the colleges should be prepared with workout agreements but save their 'big guns' (that is, influential Congressmen) until last."

Are you aware of this strategy to avoid repaying loans?

Dr. Kimberling. We are very disturbed by this strategy, Mr. Chairman. We are very disturbed when any group or association talks about such strategies.

I would quote from the same memorandum, however, where it says as follows:

Sheldon Steinbach made the group aware of the new Federal image. He said that we are in a whole new ballgame, that is, we should throw out everything said before January 1981. Right now the pressure is on. The Federal Government is serious about debt collection.

I can furnish a complete copy of this memo for the record.

Mr. Weiss. We have it. Thank you.

One of the college officials at this meeting stated, and, again, I am quoting directly from the minutes:

We have had annual deferments in our academic facilities loans and some deferments on our HUD loans. With respect to academic facilities, we made an agreement which would make us current on our debt due in 1996. We do not expect to abide by this agreement, but we had to agree to something in order to survive.

Have you found that colleges do not abide by their workout agreements and original loan agreements?

Dr. Kimberling. We have found that some colleges are not abiding by their workout agreements, and we take this action very seriously.

Approximately two out of seven do not abide by their workout agreements.
Clearly, any institution which is delinquent or in default in its loan is not abiding by the terms of its original loan agreement, and so we have 67 institutions out of the 1,300 that have not abided by those agreements either.

Mr. Weiss. The minutes go on to discuss how the defaulted colleges should not be too cooperative with Federal auditors and should not notify the Department of Education of defaults but should let the departments try to catch them first.

What is your view of that kind of attitude, Dr. Elmendorf?

Dr. Elmendorf. I would answer that, Mr. Chairman, by saying that they don't have a choice in that matter. Every college is required to have an audit every other year. That audit is to cover the entire operation of the university. The audit is submitted directly to the Inspector General. The Inspector General then submits those that deal with student financial assistance to the other half of the student aid program for a resolution. The same action ought to be taken by the Inspector General to have those audits reviewed from that perspective, as well.

Mr. Weiss. When did those minutes of February 1982 first come into your possession?

Dr. Kimberling. Yesterday.

Mr. Weiss. Without objection, those minutes will be entered into the record at this point.

[The material follows:]
March 15, 1982

MEMORANDUM

TO: PRESIDENTS/COLLEGES WITH HUD OR HEW FACILITIES DEBT DEFERMENT

FROM: JOSEPH P. O'NEILL

SUBJ: HANDLING REQUESTS FOR DEBT REPAYMENT

A number of colleges have called me to say they've received letters from the Department of Education denying further debt deferments and asking for a repayment plan within 30 days.

I have prepared a brief paper which may be of help in preparing your presentation. If you plan to meet with Department officials in Washington, I suggest that you not go in alone. We'll try to arrange for an official from a Washington-based organization to attend the meeting with you.

Also included are the minutes of the February 22 meeting.

/jc
enc.

PO BOX 24 PRINCETON, NEW JERSEY 08540  809/924-4364
Public Policy on Debt Deferral for Higher Education Facilities Loans

Background

As of August, 1981, 87 higher education institutions had defaulted on 211 federal housing and academic facilities loans. Their defaults represent a total of $19.8 million in delinquent payments. With the exception of Lincoln University in Missouri, an historically black, publicly supported institution, all of the defaulters are private institutions. At least 29 of the colleges in default have histories of delinquent payments that begin before 1976.

The new effort to collect on delinquent payments was the result of Office of Budget and Management (OMB) Bulletin No. 81-17 (April, 1981) requiring of all departments of government "a productive and aggressive program" of debt collection. In a press release from Mr. Stockman's office, dated May 7, 1981, OMB calculated that "more than $25 billion of the $176 billion in debts owed to the federal government were either delinquent or in default as of September 30, 1979."

In the President's Budget Message to Congress of February 8, 1982, the intent to collect on overdue debt was again underlined. "A comprehensive effort to collect $33 billion in delinquent debts had been launched and will recover $1.5 billion in 1982 and $4 billion in 1983."

OMB has asked each department of government to set a goal for the collection of back debts for the loan program it administers. The 1982 goal for the Department of Education's facilities loan program is $6.8 million. This represents approximately one-third of the delinquent payments outstanding or an average of $78,000 for each of the 87 delinquent institutions.
Prior Policy on Debt Deferment

The official HUD policy on the college housing program limits a deferment of debt payments (e.g., non-payment of interest and/or principal, or failure to make reserve fund deposits) to a period not to exceed one year. In practice, some colleges have had debt deferments for ten years or more without the Department taking action to foreclose or assess penalties.

Debt deferment on academic facilities loans (Title VII) is not bound by a defined time limit. The Code of Federal Regulations 45, 170.66 gives the Commissioner of Education the authority to approve a moratorium "if the borrower can demonstrate a temporary inability to make those payments without undue financial hardship."

Proposes New Actions on Debt Collection

The Department of Education's response of OMB bulletin 81-17 has taken form in five proposals:

--assess penalties for late payment
--rent receivership
--selective foreclosure
--offset, i.e., withhold monies due to the college from other federal grants or contracts
--denial of eligibility for federal grants and contracts to institutions in default.

Of the five proposals, rent receivership and offset would be the most damaging to a college's financial health and the least amenable to a "political" solution. (Sympathy can be generated against foreclosure, but seizure of rent that is due the government would be harder to attack.) It should also be noted that rent receivership would apply only to the college housing program while offset would apply to loans as well. Denial of eligibility is already in effect for the facilities loan program.

Foreclosure and sale of a building to satisfy debt makes sense only if a potential buyer is at hand. Selective foreclosure is a more rational strategy in urban/suburban settings than in rural ones. Finally, assessing penalties for late payment is unlikely to affect colleges which are unable to keep current on the original payments. Penalties are useful only where there is wilful disregard of an obligation when one has the financial resources to make current payments.

Some institutions have already been called in by the Department. Letters will go out to other colleges in the near future. The following are suggestions to prepare for a meeting with officials from the Department:

1. Wait for them to come to you. If you have filed a request for a debt moratorium or for a new repayment schedule and they have not answered, you are not obliged to contact them again.

2. If they do ask for information, provide it. These
requests may prove annoying since you have probably already filed the information they are asking for. But provide it again.

3. If you are called in for a meeting, bring two Xeroxed sets of all correspondence dealing with your facilities loans. The Department's staff is frequently unable to find past correspondence. Your copies may be the only ones available.

4. Bring with you your most recent certified audit. Be prepared to prove that net revenues from your dormitories and/or student union are inadequate to meet the actual costs of utilities, maintenance and debt service.

5. If you are renting any portion of a federally financed facility to a group or agency that is not part of the college, have your attorney and your auditor review the arrangement before you meet with Department officials. Department regulations require that all net revenues from the leased facility be applied to the outstanding loan balance. If you wish to apply some net revenues of a leased facility to the college's operations be prepared to defend that request.

6. If you are asked to present a repayment plan for your federal loans, analyze beforehand which of the following strategies best suit your financial conditions:
--take the total of the delinquent payments due and spread them out over the entire life of the loan.
--do the same as above, but extend the life of the loan 10 years.
--assess your ability to make some payment irrespective of the amount due.

If you ask for a debt deferment, remember that they can more easily grant a multi year moratorium for the academic facilities loan program than the college housing loans.
The housing loan regulations allow a one year deferment.
The one year rule, however, is a matter of regulation, not legislation, and can be waived.

Public Policy Questions on Debt Collection

The Reagan Administration's debt collection ignores several fundamental distinctions:

--Profit versus Non-Profit: While all government loan programs are initiated to fulfill some public purpose, loans to individuals or profit-making corporations result in a direct economic benefit to the individuals or shareholders involved.

Loans to non-profit colleges and hospitals are more akin to grant programs in that the loan is meant to benefit third parties, i.e., students or patients, and not the recipient.

--Public Policy versus Private Initiative: Colleges and universities were encouraged by Congress to meet the educational needs of post World War II veterans and the subsequent "baby boom" generation of students. Congressional encouragement took the form of low interest/long-term loans for dormitory and academic facilities.

Now that the need for these facilities has passed, the government may not treat debts incurred to implement public policy as if they were the result of merely a private initiative. The federal government was more a partner than a banker in the college housing program. It must share the risks as well as the rewards of partnership.
Taxable versus Tax-Exempt: Colleges and universities, as tax-exempt institutions, cannot by definition benefit directly from any supply-side stimulus based on decreased tax liabilities. Do they play the same supply-side role in boosting productivity and innovation for the tax-exempt sector as a reduction of tax liabilities will do for the tax-paying sector?

A New Public Policy on Debt Deferral

Rational public policy making should take into account the following:

- There will be 735,000 fewer 18-24 year olds in 1990 than there were in 1980. It is this age group, and no other, that occupies the nation's 1.4 million college dormitory "beds."
  A reasonable estimate is that some 350,000 "beds" will be in surplus by 1990.
- The loss of anticipated revenue to colleges and universities at $1,000 per bed would be $350 million a year. Much of this loss would be absorbed by the private college sector.
- In the short term, the federal government should fashion a policy of debt deferral geared to alleviate the problems of colleges which serve a high proportion of low-income students.
  There is a precedent in the current college loan facilities program for granting special consideration to institutions eligible for Title III grants. This precedent could usefully be applied in the granting of debt deferrals as enrollments decline or shift away from residential students.
- In the longer run, a significant portion of college housing facilities should be directed to non-educational uses, e.g., housing for the elderly. A program of debt deferral linked to remodeling facilities for other uses would allow the government to both recoup its investments and serve policy goals at the same time.
MINUTES OF FEBRUARY 22, 1962 MEETING WITH PRESIDENTS AND OTHER ADMINISTRATORS OF DEFAULTING INSTITUTIONS AND REPRESENTATIVES OF HIGHER EDUCATION ASSOCIATIONS.

PURPOSE:

The Department of Education has become well organized in its dealings with colleges and universities which are in default. The purpose of this meeting is to make defaulting institutions equally as well organized in their dealings with the federal government. Also, it is hoped that an interchange of ideas from those present can be useful in influencing future federal policy.

ORGANIZATION OF THE MINUTES:

For easier reading, I have divided this report into three distinct sections. They are: the experiences of defaulting institutions, what the federal government is doing and what the institutions should do, and future assignments for associations and individuals.
I. THE EXPERIENCES OF DEFAULTING INSTITUTIONS

A. TRINITY COLLEGE (WASHINGTON, D.C.)

We requested our first deferment in the mid 1970's and we have continued requesting deferments through the present. In 1978 we sold prime real estate at a price of $3,000,000. John Pisano called us after the sale, and asked us to use this money to repay our past due account. However, we were able to convince him that if we gave HUD a substantial amount of the money at once, Trinity would go out of business. As a result, we worked out a six year repayment schedule for past due principal and interest. But it should be noted that we had only a verbal acceptance of the six year schedule from HUD. We were granted a series of one year deferments in writing. Finally, on January 18, 1982, we received a written letter of acceptance of our repayment schedule.

Observation: John Pisano is a reasonable man. (This is confirmed by other college experiences.) It appears that he did not believe foreclosure was the answer to the default problem. Rather, he attempted to make a series of private deals tailored to meet the needs of the individual institutions, and hoped that these deals ultimately would become mutually beneficial. However, John Pisano is no longer with the Department.

Also, there was a reluctance among HUD officials to accept long term commitments in writing. But, as will be discussed in the next section, this attitude appears to be changing with the current administration.
We were not required to put up reserves or collateral for our HUD loans. Over the past several years, we have asked for deferments. Our greatest difficulty has been that we keep asking the government for deferments, but have not had a written response since 1979. We assume silence means consent, and therefore, we recognise annual deferments as footnotes in our annual reports. I have, with me part of a file which contains a record of letters and telephone conversations asking for deferments. I have talked with many different individuals about this. But there have been so many changes in personnel in the Department, it makes it very difficult to find anyone who is familiar with our particular case.

Observation: Perhaps "silence is golden" can be used to describe the Keuka experience. It was suggested by Sheldon Steinbach that defaulting institutions should stay low keyed and wait until the federal government makes the first move. However, once the government does move, the colleges should be prepared with workout agreements, but save their "big guns" (i.e. influential Congressmen) until last. This strategy will be described more fully in the next section.

Also, Keuka probably like many other colleges, has become frustrated with the heavy turnover of employees servicing college loans. However, this may have changed. That is, it appears that the "cast of characters" is now set, at least for the next two years.
Finally, Keuka was not required to put up collateral and reserves for its loans while other colleges had to do this. It was mentioned by Janet Jackley that different colleges had different loan agreements. Thus, the terms of the loans depended, in part, on the individual set of circumstances.

C. MOUNT SCENARIO

Our college experienced a number of deficits over the past years, and we have not been able to service out debt. We have had annual deferments on our academic facilities loans and some deferments on our HUD loans. With respect to academic facilities, we made an agreement which would make us current on our debt due in 1996. We do not expect to abide by this agreement, but we had to agree to something in order to survive. Also, the government would not agree to stretch-out the loan period beyond 1996. With respect to HUD, we met with John Pisano in 1981 and we received a deferment in writing until the end of 1982.

Observation. Agreements with government officials have been made, but none of them have included stretch-outs of the loan periods. Perhaps the President of Mount Scenario would have considered his agreement doable if stretch-outs were included. A further discussion of stretch-outs will be found in the next section. Also, we again see HUD putting only one year agreements in writing.
D. BARAT COLLEGE

We have requested deferments on principal and interest on our HUD loans for 1979, 1980, 1981 and 1982, and we have had a series of no answers from the government officials. We once got a verbal OK for a 2 year deferment from John Pisano, but nothing in writing. However, the longer I don’t hear, the better I feel. The footnotes in our annual report state that we have approval for the loan deferments.

Observation: Again we see a reluctance on the part of HUD to put multiple year agreements in writing. In addition, there persists an inability among college administrators to obtain responses from the federal officials.

E. SHAW COLLEGE

We have been in default for a number of years. I suspect that John Pisano did a lot of things he should not have done. But I think he was trying to be cooperative.

Observation: John Pisano is gone. How cooperative will the new “cast of characters” be?
II. WHAT THE FEDERAL GOVERNMENT IS DOING AND WHAT THE INSTITUTIONS SHOULD DO:

This section was obtained through a discussion among college administrators and representatives of attending associations. The comments are summarized as follows:

A. Proposed new federal activity on debt collection and the new federal image.

Joe O'Neill described the new federal plan for dealing with defaulting institutions. It included penalties for late payments, rent receivership and selective foreclosure. In addition, it is possible that other federal monies would be withheld.

Sheldon Steinbach made the group aware of the new federal image. He said that we are in a whole new ball game. That is, we should throw out everything said before January, 1991. Right now the pressure is on — the federal government is serious about debt collection. Bureaucrats have signed 248 letters, and these are ready to be sent out to institutions in default. These letters will be asking for a game plan.

He also mentioned that the "cast of characters" is in place. Important members include Mr. Fairly and Mr. Brantly.

B. How to deal with the federal government.

Sheldon Steinbach gave the group some helpful suggestions. He said that first, do not stick your head above the water. Let the federal government find you. Second, while you are
waiting, begin to develop a workout agreement. Bureaucrats are looking in terms of multiple year agreements that make sense. Stretch-outs of the loan terms might be considered. However, there are problems with stretching out loans due to increased costs (such as additional legal fees) and a legal limitation of 50 years. Also, when developing your plan, make sure there is some room left for negotiation. Third, the federal government would like to see some cash up front. This will show that you are in good faith. Realize that after your plan is approved, if you send in something less than the required amount, the government probably will cash your check. Even a token amount will suggest that your institution is committed to its plan. Fourth, hold your big guns until later. As long as negotiations can be considered reasonable, do not call in your Congressman. However, it is the time to call him in when things become outrageous.

Sheldon Steinbach also stated that the government appears reasonably open to new ideas. Bureaucrats have been looking at a college's entire financial picture. Thus, even if a workout agreement results in a college becoming an entrepreneur and making a profit on a HUD financed building, a college-wide operating deficit will be considered. Therefore, it is unlikely that all profits from a building will be demanded by the government to repay delinquent loans. Instead, compromises probably will be worked out to benefit both parties.
C. Innovative ways to deal with delinquent loans.

Joe O'Neill suggested several innovative ideas which should be considered. For example, he mentioned that dormitories can be renovated and changed into housing for the elderly. However, he warned that it may be difficult for colleges to find alternative uses for facilities financed by state bonds. This is because certain alternative uses can make bonds in some states lose their tax exempt status. Therefore, it was suggested that institutions instead consider finding alternative uses for facilities financed by federal resources.

Also, he mentioned the possibility that colleges eligible for Title III money use this eligibility as a lever for longer deferments. However, this idea was not well received by the college administrators. They feared that Title III funds might be cut if the government began to link the Title III program with delinquent academic facilities and college housing loans.

Last, Joe O'Neill introduced the idea of a five year moratorium on debt collection to the college administrators. This class action would be in response to Reagan's supply-side economics. Such a moratorium could be used to increase the productivity of colleges much the same as accelerated depreciation is used to increase the productivity of industry. However, Robert Atwell stated that this class action would not wash too well with the bureaucrats. In addition, others questioned whether supply-side economics now stood with the Reagan people.

D. Auditors as spies.

Sheldon Steinbach warned administrators to be careful if an auditor comes to their college representing another federal program. Although he may be auditing a different college unit, the fact is that the government auditors do talk to each other. Thus, if you are delinquent in your housing loans, you might get a student aid review. Beware!
III. FUTURE ASSIGNMENTS FOR ASSOCIATIONS AND INDIVIDUALS:

The future assignments determined at this meeting include:

A. Robert Atwell said that Dr. Melady has shown an interest in helping colleges in default. Perhaps, he does not want to do down in history as the one to blame for closing many small independent colleges. Robert Atwell will write a memo to Dr. Melady suggesting activities to be carried out by government officials. These activities would be mutually beneficial to the government and to the defaulting institutions. The memo will follow this outline:

1. Only 1% of college loans are in default — an excellent record.

2. This is a bad time for accelerated debt collection activity on the part of the federal government. Colleges are being squeezed from all sides. In addition to debt collection, they are responding to inflation, proposed cutbacks in student aid and a temporary decline in the number of 18 year olds.

3. The workout agreements should consider stretch-outs of the loan terms and token cash payments.

4. The federal government should forego against "capital punishment". That is, they should not go after certain pledged collateral such as endowment and certain buildings because it would mean sure death to some colleges.

5. The federal government actively should aid defaulting institutions by offering them technical assistance.
6. The federal government should not say to developing institutions that they cannot obtain their Title III funds until they become current with delinquent loans.

7. Each school is a different set of circumstances, and therefore, solutions cannot be painted with a broad brush. Government officials should realize this when they deal with the defaulting institutions.

B. Sheldon Steinbach will be available to counsel institutions that have been called in to meet with government officials on an ad hoc basis.

C. Joe O'Neill and Roberta Cable will do the following:

1. Distribute the minutes of the February 22 meeting to presidents of institutions in default.
2. Develop a model plan to deal with delinquent loans.
3. Research and circulate information on how the federal government has dealt with institutions in default. It would be beneficial for college presidents to know what the federal government is doing with other institutions when developing a strategy.
4. Joe O'Neill will distribute information on the alternative uses of space for colleges and universities.

Roberta J. Cable
Mr. WEISS. How would you compare the policy of the Department in the Housing Loan Program with the college student loan collections policy?

Dr. ELMENDORF. Mr. Chairman, let me just give you a sense of magnitude. The total amount owed the Government by students in the Guaranteed Student Loan Program and the National Direct Student Loan Program that is currently in default using that definition is nearly as much as the total amount of money that has been loaned in the history of both of these programs. The default rate is nearly two and a half times as great as the default rate in these programs. The effort to collect is a combined use of private sector debt collectors along with the Federal Government collectors for the Department of Education residing in Atlanta, Chicago, and San Francisco.

The Debt Collections Act of 1982, passed by Congress, gave the Government some tools it did not have before to collect these loans. For example, we were prohibited from referring defaulted student loans to a credit bureau. We, in fact, could not do much with the Internal Revenue Service. We now think we have some tools and we take our responsibility very seriously and perhaps as a part of these hearings we might be able to recommend some additional collection tools that could provide better enforcement in this program as well.

Mr. WEISS. You are not suggesting that because the total amount of the loans made by the Housing and Academic Facilities Loan Programs and the total amount of them in default, compared to the student loan programs, is much smaller and, therefore, there is no urgency in ferreting out fraud, waste, or abuse are you?

Dr. ELMENDORF. No, sir. It is a very different type of a program. In one case you are going after individuals and in the second case you are going after institutions. There is a completely different set of mechanisms and collection tools available in one sector and not available in the other. The most serious problem we have in defaulted student loans is finding the student. That is not a problem in this program.

Mr. WEISS. Right. The reason I am asking the question is that you seem much more understanding of the defaults on the part of the institutions than you do on the part of the students. I can understand wanting to go after the students who have made an obligation. That is the law. They ought to be held accountable to it.

I don't understand why you don't take the same tough attitude as far as the institutions are concerned.

Dr. ELMENDORF. Well, let me tell you that there is a comparable analogy between this situation with the student and an institution, in this regard.

We will not get—once we find the student—the full payment from that student. Once we locate a student, we have to go through the same process of developing a workout agreement. This is the same type of arrangement that we work out with the institutions. You have to find out how much they can pay.

The key is to find them, first; then, second, get them in repayment; and, third, continue to assure ourselves that the payments are made.
It is the same general collection strategy that is used by the private sector, and is used for collecting defaulted student loans and is also used in collecting institutional loans.

Mr. Weiss. Are colleges required to forward loan documents to the Federal Reserve Bank of Richmond so billing and collection can begin?

Dr. Elmendorf. Yes, sir.

Mr. Weiss. In 1978 Jamestown College in North Dakota received a $1.2 million college housing loan. There is no record of this loan at the Federal Reserve bank which maintains all billing and collection records.

Do you know why?

Dr. Kimberling can report on the status of Jamestown, please.

Dr. Kimberling. Mr. Chairman, when we received the program from HUD, we were very disturbed to find that HUD failed to complete the closeout of the loan by forwarding these documents to the Federal Reserve bank so that billing could be started.

When we attempted to forward the documents to the Federal Reserve bank, Jamestown College was already in default, and the Federal Reserve bank refused collection. Therefore, we had to set up a special billing account for that institution because of FRB's refusal to bill.

Mr. Weiss. What has happened as a result?

Dr. Kimberling. What has happened is that we have recently completed a workout agreement which requires $5,000 per month from May to December of this year.

Jamestown has informed us that they are expecting a large bequest from a private donor in December of this year and that by January 1985 they can completely liquidate their delinquencies.

We are—

Mr. Weiss. Between 1978 and May 1984 they made no payments at all?

Dr. Kimberling. Let me verify that, if I may, for a moment.

No, they did remit $72,368 in March 1983. They have not made a payment since that time.

Mr. Weiss. And they made no payments between 1978 and 1983?

Dr. Kimberling. As far as I can tell; no. If there is any discrepancy in this, the answer is no. If there is, I will furnish that for the record.

Mr. Weiss. Should that be necessary, the record will receive that answer at this point.

[The material follows:]

Jamestown College has made a total of $72,369.42 in payments between 1978 and 1983.

Mr. Weiss. I understand that the loan was already $133,000 in arrears before your Department discovered that FRB was not billing Jamestown.

Is that true?

Dr. Kimberling. Before the file came over to us from HUD in the transfer of the program, they were that far in arrears, yes, sir. They are current, by the way, on three issues, three other loan.
issues. This is an energy loan, and they are only in default on this one.

Mr. WEISS. Have similar instances happened?

Dr. KIMBERLING. I think as the Inspector General indicated our program staff had identified in the process of transfer of documents from HUD that there were approximately 27 institutions that had not had their billing and collection paperwork forwarded to the FRB. We have completed all of our action. We were in the process of completing action on this at the time of the Inspector General’s review, so some of these pipeline projects that we did get from HUD, bearing in mind that we got them from 53 separate field offices used by HUD in administering the program, were not in proper shape, yes, sir.

Mr. WEISS. If I understand correctly then, according to the IG’s testimony, of 111 college housing loans closed between May 1981 and February 1983—now that is all during the time that the program was under your jurisdiction; is that correct?

Dr. KIMBERLING. The closing of the loans was under our jurisdiction, yes.

Mr. WEISS. Right.

Of those 111 college housing loans between those dates, 27 were not in pay status at the Federal Reserve bank. According to a 1983 Inspector General audit, 21 of the loan files were found within the Department of Education and had not been sent to the Federal Reserve bank. Six of the loans were worth a total of $10 million and were already $230,000 past due.

Is that true, Dr. Elmendorf or Dr. Kimberling?

Dr. KIMBERLING. Yes, at the time of the IG audit. The chronology is important here, Mr. Chairman.

The program was officially transferred in May of 1980 with the creation of the Department. Under an interagency agreement HUD continued to administer the program through the end of that fiscal year. Under a subsequent second agreement between HUD and the new Department, from September of 1980 to April 24, 1981, HUD continued to have administrative control of the entire program. Through the remainder of fiscal year 1981, HUD made the new loan originations, but in May of 1981—and you correctly quoted that date—we did assume responsibility for previous loan reservations made by HUD. As we began to systematically go through all of these projects, we discovered that some of the paperwork had not been properly transferred to the Federal Reserve bank.

We have taken two corrective actions. With respect to the 21 loans 18 of them are currently with the Federal Reserve bank in proper pay status. Two of the projects were listed in error. One of the projects has not been completed and, thus, the total loan has not been disbursed.

With respect to the six files that could not be located, those files have been reconstructed, and they are all in current pay status. That covers the 27 in question.

Mr. WEISS. Right.

Six more of the loan files could not be located at all, and you have had to reconstruct those files; is that right?

Dr. KIMBERLING. Yes, sir; we have now reconstructed them. They are in the FRB. We have shortened the pipeline, by the way. The
documents used to go through the finance office. They now go straight from our program office to the FRB, cutting out an extra layer of bureaucracy that we feel might have contributed to this kind of problem.

Mr. Weiss. Can you assure us today that no loan, no additional loan documents are missing and that the Federal Reserve bank has complete records on all loans?

Dr. Kimberling. I can assure you that the Federal Reserve bank, with the exception of Jamestown, as I previously indicated, has all loans that have been closed.

I cannot assure you that no loan documents are missing because we are still in the process of verifying the many files we received from HUD and rebuilding some of them.

Mr. Weiss. So, you are telling us that there may be loans out there that the FRB has no record of and that are not being paid. Is that correct?

Dr. Kimberling. With the exception of Jamestown, no, sir.

Mr. Weiss. After inheriting the College Housing Loan Program from HUD, did Department of Education officials order that all loan files in current status be purged of all records except loan agreements and trust indentures?

Dr. Kimberling. I am sorry, Mr. Chairman, could you repeat that question.

Mr. Weiss. After inheriting the College Housing Loan Program from HUD, did Department of Education officials order that all loan files in current status—that is, paid up—be purged of all records except loan agreements and trust indentures?

Dr. Kimberling. Not to my knowledge.

Mr. Weiss. Do all of you at the witness table have that same impression—you have no recollection at all?

Dr. Kimberling. Mr. Chairman, I believe Dr. Brantley can respond.

Mr. Weiss. Dr. Brantley, please.

Dr. Brantley. Mr. Chairman, what happened was this. When we received the records from HUD, they came to us from 54 different offices. They came to us in boxes, and so we had boxes all over the corridor.

What our staff did was that they went through these boxes, took out the pertinent important documents and filed them. Where there were papers that we did not need, they were purged. We did not throw away any documents that we needed for our files.

So, that is what they might be referring to if they are talking about the purging.

We did go through and purge those boxes because many of the papers in there were not needed for our work.

Mr. Weiss. I assume, again, that that did not happen just at the whim of employees who were about to file away those boxes.

Dr. Brantley. No, no. That was done under the direction of the people in charge of the program.

Mr. Weiss. Right. And those people in charge of the program made a determination and gave an order that all loan files that were paid up, that were in current status be purged, that is, have
removed from them all records except loan agreements and trust indentures.

Is that correct?

DR. BRANTLEY. Mr. Chairman, at the time that we were filing our records, we did not know those institutions that had paid up. We did not have that knowledge.

MR. WEISS. I have a report from the Office of Management and Budget from 1982. On page 18, referring to loan management branch files, they say the following:

Boxes of files were stacked along three halls of the third-floor corridor creating a fire hazard and much antagonism. With no cabinets to put the files in and no space in which to store the boxes, a decision was made to purge the files of nondelinquent borrowers, keeping only the loan agreements and trust indentures. The files of defaulted borrowers were kept in their entirety. This may well cause future legal difficulties. Current nondelinquent borrowers could go into default at any time. Programmatically, there will be little historical record of the relationship with the institution. Legally documents may be requested if a case is brought to court. Most of these documents, including all correspondence, no longer exist.

That means that all memoranda, correspondence, and legal documents are no longer in those files; right?

MR. CONANAN. Mr. Chairman, I would like to respond to that for a second.

In any of these enforcement actions, by the way, or in any litigation the key documents are the trust indenture instruments and the loan agreements. It is not necessary to really have all correspondence between the institution and the Department of Education in the event that an institution has missed payment on its loan amount, on its loan.

MR. WEISS. Mr. Conanan, what is your title?

MR. CONANAN. I am an attorney with the Office of General Counsel.

MR. WEISS. Then the Office of Management and Budget is incorrect in their characterization which I just read?

MR. CONANAN. Well, I think they are speculating to a certain extent, and it is speculation based on not much evidence. I believe that in most cases when you sue or when you seek to recover payments under a loan, the critical document that you have to file in court is the loan agreement and the trust indenture instrument.

MR. WEISS. How about correspondence which relates to deferments or insistence that payments be made?

MR. CONANAN. Well, in this case, as I understand it, the documents, if they were purged or destroyed, were documents that only concerned nondelinquent borrowers, so there would not have been any correspondence of that nature at all.

MR. WEISS. Supposing in fact they were current at the time but that there had been prior defaults or deferments?

MR. CONANAN. Again, it is mere speculation to believe that those documents might be critical. They may be critical to some defense, but I don't know what exactly an institution would defend or have grounds to defend on.

MR. WEISS. So, the Office of Management and Budget doesn't know what they are talking about?

MR. CONANAN. I am not suggesting that. I believe it is speculation, however, to say cases may be prejudiced because certain correspondence is missing from a file.
I know for a fact, however, that the key critical documents are the trust indenture instrument or the loan agreements.

Mr. Weiss. In the event that the Department must take legal action against them, none of the other information would be essential or helpful, is that right?

Mr. Conanan. I think we would be speculating again because it is difficult to figure out what defenses or what grounds an institution may contest or have some legal defense on.

By the way, I think with respect to institutions that have been involved in this program the Department has never lost any legal case, to our knowledge.

Mr. Weiss. Again, just to summarize, obviously, the Department of Education and the Office of Management and Budget have an entirely different view because OMB believes, shown in the section that I read, that the Department may have eliminated substantial protection to the Government.

You disagree with that?

Dr. Elmendorf. Mr. Chairman, I refer in my testimony to an internal memorandum that we had written by the Deputy Assistant Secretary for Institutional Support on June 30, 1981, where they outlined or described the program at that time and the condition of the files.

Although it makes no reference to specific key documents as part of the status report, this is inserted:

Key documents and entire parts of files are missing. There is duplication, even triplication of certain files, within files making it impossible in some cases to determine the current status of the project. These documents should have been in safe keeping, and they have been loose in files among large amounts of extraneous correspondence.

Without trying to do hindsight, that may have been a reason to purge unnecessary documents from the files, but I do know one of the major things that the then-Assistant Secretary did was to put in a significant purchase order to try to get file storage space in order to get those files out of the hall and into files where they could be monitored and updated on a regular basis. That was done, Mr. Chairman.

Mr. Weiss. Well, it seems to me that it is one thing to suggest that duplicate materials be removed from files, or triplicate materials, but that it is quite another to direct that all materials except the loan agreements and the trust documents be removed.

Let me at this point ask if Mr. Walker has any questions.

Mr. Walker. Mr. Chairman, let me begin by asking a couple of questions about the perspective here in which we deal with the program.

As I understand it, there have been over 3,000 loans made, according to your testimony, in the life of the program. Am I correct from this statement here that only 87 of these have been made since the Department of Education took over the program?

Dr. Elmendorf. Yes, sir.

Mr. Walker. Are any of those 87 in default?

Dr. Elmendorf. Not a one.

Mr. Walker. So, all the defaults occurred during the period of time that HUD managed the program; is that correct?

Dr. Elmendorf. Yes, sir.
Mr. WALKER. Am I correct that during a period of time in the 4 years prior to the takeover of the program by HUD, in a period of 1977 to 1980, that the default rate went up substantially? That that was a period of time where we showed a rather enormous increase in default rates?

Dr. ELMENDORF. If you don't mind, Mr. Walker, I will have Dr. Kimberling answer that question.

Dr. KIMBERLING. Mr. Walker, there is a difference between the total amount of money delinquent and the default rate, which is the total amount in default over the total amount loaned out.

The default rate climbed but not as steeply. However, the total amount delinquent climbed quite steeply during that time period.

Mr. WALKER. So, in other words, some of the institutions that were already in default simply were in default for more money during that period of time?

Dr. KIMBERLING. Absolutely.

Mr. WALKER. As I understand it, the default rate went in the one program from about $11 million up to $22 million for about a 200-percent increase?

Dr. KIMBERLING. Yes, sir.

Mr. WALKER. And in another program we had about a 350-percent increase in the default rate during that period of time?

Dr. KIMBERLING. We had a 340-percent increase in academic facilities from $2.5 to $8.5 million.

Mr. WALKER. What has been the default rate in the period 1983-84?

Dr. KIMBERLING. The current amount of money delinquent in the academic facilities is $10.5 million; in college housing it is $25.5 million. The current default amounts include the total amount in default, both payment and principal. For example, if I billed you tomorrow for everything you owed me, if you missed a $50 payment on your credit card and you owed $1,000 in balance, it is $1,000 that would be considered in default. We treat it just as banks and the private sector does.

Mr. WALKER. Sure.

Dr. KIMBERLING. Using those figures, we have a default rate in college housing of 3.81 percent. In academic facilities it is 9.28 percent—for an overall rate of 4.43 percent.

Mr. WALKER. Well, what I am trying to get is a comparison between where we are today and where we were in that 1977 to 1980 time period. At that time we saw the delinquency rate or the default rate go up by 204 percent during that period of time. Now, where are we in this period of time that would be a number that would be equal to that 204 percent?

Dr. KIMBERLING. Then I will go back to my previous numbers. We have numbers in 1980, 1982, and 1983. In college housing it was $22.2 million in 1980; $24 million in 1982; and $25.5 million in 1983.

One of the key factors here is that until a closed institution is completely settled out, we continue to accrue delinquencies in those institutions. When you take the institutions which have closed and you subtract that amount from the current delinquencies, the number goes down to $20.1, so there is a slight decrease.
Mr. Walker. Well, I just want to put this into some kind of perspective.

In other words, since the Department of Education took over the program, we have gone from a 204-percent default rate down to a 15-percent default rate?

Dr. Kimberling. No, the default rate climb has been lowered to the 15-percent climb.

Mr. Walker. OK. The climb in it has been lowered to 15 percent?

Dr. Kimberling. Right. It was going up like that [indicating], and now it is going up a little bit closer to flat.

Mr. Walker. And my figure of 204 percent is really a climbing rate figure, too——

Dr. Kimberling. Yes, sir——

Mr. Walker [continuing]. So the comparison between those two is that in fact whatever management practice you put into place, be it perfect or imperfect, has not settled the problem at this point but has substantially ameliorated the problem of the climbing default rates; is that an accurate representation of what has gone on?

Dr. Kimberling. I think that is accurate.

Mr. Walker. What percentage of the institutions that we are talking about are essentially minority-based institutions?

Dr. Kimberling. Well, of the 67 institutions currently in default, 8 of them are historically black colleges and universities. Of those eight, one is closed; seven are in current work-out status.

Mr. Walker. I noticed also that there were some women's colleges on the list, too.

Dr. Kimberling. There was a Colorado women's college, now absorbed by the University of Denver, yes, sir.

Mr. Walker. What percentage of them are community-based colleges?

Dr. Kimberling. Mr. Walker, I don't have that information and would have to furnish that for the record.

Mr. Weiss. Without objection; the record will remain open to receive that answer at this point in the record.

[The material follows:]

Community-based colleges represent 298% of the total number of defaulted institutions. They are Alpena College, Alpena, Michigan; Southeast Community College—Fairbury, Fairbury, Nebraska.

Mr. Walker. Are a number of these colleges relatively new colleges?

Dr. Kimberling. It is a mixed bag. Some are relatively new; some have undergone a transformation. They had been sold to new owners or are operating under new management.

Again, I would have to go back and get those figures.

Mr. Weiss. Again, the record, without objection, will remain open to receive that answer.

[The material follows:]

Three of the colleges presently in default are relatively new.

Mr. Walker. Among the 67 colleges, is there any distinguishing characteristic other than the fact that they are having a tough financial situation, evidently? But is there some characteristic of
them that would give us some reason to be able to know whether there is a likelihood of default or not?

Dr. Kimberling. Yes, sir; typically these are small private 4-year liberal arts colleges serving predominately rural populations with enrollments hovering around 500 or less. These are precisely the kinds of institutions that have been targeted in nationwide reports since the 1970's as extremely vulnerable to the decline in the numbers of 18 to 22 year olds as a result of the baby boom generation growing up.

Mr. Walker. So, we are in the case of this program then talking about a program which served some of the more vulnerable of our higher institutions—

Dr. Kimberling. Yes, sir. It is important to note that in the early days of the Housing Program, the general purpose of the statute from 1950 to 1973 was to help accelerate construction for all of higher education. There was not a requirement of housing shortage at that time, so dormitories were being built by HUD all over the country. Only in 1977 when the law was renewed was the structure of the program changed so that the construction activities were targeted on institutions with severe housing shortages.

Mr. Walker. The GAO criticized HUD in 1980 and 1981 for careless procedures in verifying student enrollment and housing shortages before making awards.

What steps have you taken to correct those problems?

Dr. Kimberling. We have taken several steps, Mr. Walker. In fact, one of the key things that we focused on when the program first came over was the GAO criticism of HUD. They largely were criticisms of what I call the “front-end management,” the making of the loans, making sure that the loans required need assessment, that enrollement numbers were verified, et cetera.

We took two actions. We revised and published new regulations in May 1982. As an example, for the first time we required, we made sure that an institution in default under the College Housing Program or the Academic Facilities Program, could not borrow again. Strange as it may seem, that requirement had never been in the HUD regulations.

We also tightened up our application form. We tightened up our verification procedures. We feel that the letter from the GAO in 1982 indicating their satisfaction with the progress we made in addressing the findings of 1980 and 1981 showed that we had, in fact, made progress on that front end.

From 1982 to the present, our efforts, in conjunction with the help that we have been given by our IG, have focused on the back end or loan collection phase.

Mr. Walker. It sounds to me as though as part of this investigation that we need to have another hearing where we get the Carter administration officials in here, who ran this program in the 1977 to 1980 time period, to come in and tell us why all these problems developed.

Why hasn't the Department collected the audit collection fees still held by HUD, especially since this problem was identified in the Inspector General's report?

Dr. Kimberling. Well, Mr. Walker, our Office of the Comptroller has been in touch a number of times with the financial people at
HUD. Apparently when they collected these revenues, they com-
ingled it into a general purpose fund, so it has been a difficult
audit process for them. We certainly would like to see a terminus
point to it, but it has been somewhat difficult for them to go
through 10, 12 years of back records and break out income generat-
ed from the field expenses collections and separately break out the
expenditures under these funds.

I am assured by our Comptroller that HUD has now come forth
with their accounting of the funds available and the transfer is ex-
pected to take place shortly.

We welcome this. It has been a long time coming—too long, we
feel, but it has been a tedious accounting process for the HUD offi-
cials.

Mr. Walker. I understand that earlier while I was at the Repub-
lican Conference that the chairman did ask you some questions
about the foreclosure situation, but why don't you consider foreclo-
sure action more frequently?

Dr. Kimberling. Well, we have foreclosed in instances where col-
leges have themselves closed down.

With respect to other colleges, this is our measure of last resort,
and before we get to foreclosure, we would like to do what we have
done—work in cooperation with our IG, get a more detailed audit,
turn the screw a little bit tighter, if you will. This is exactly the
same as a bank would do if you had missed a few payments on the
mortgage. They are not going to come in and immediately take
your house away.

Why? It is an expensive option. There is no guarantee that the
taxpayers will get their money back if we foreclose. I can cite you
the example of Windham College which was essentially a white ele-
phant on our hands. It took us a long time to sell that. If nobody
bids higher than the Department of Education at a sheriff's foreclo-
sure sale, then we are stuck with the property and all the liabil-
ities, all the costs of maintaining the property, and in this case we
had spent approximately $150,000 just to keep security and mainte-
nance for the college. The building ultimately sold under our inter-
agency agreement with GSA for property disposal for $400,000.

So, foreclosure has the risk of shutting down a college or univer-
sity providing education in the local community. We would have to
look at the percent in delinquent status versus the total amount
owed, and in most cases if we can work with a college or university
and tighten the screw bit by bit to get that money flowing back in,
it is better to have our full investment repaid than to run a heavy
risk with referral to the Department of Justice and administrative
expenses. That is a gamble in terms of return to the taxpayer.

Mr. Walker. In testimony that you all presented here today, you
said that there is another legal remedy that might be available—
rent receivership.

Why not consider that one?

Dr. Kimberling. Mr. Walker, I had indicated to the chairman
that we are considering rent receivership in a couple of instances
where the IG's office has completed its audits.

Rent receivership also does not guarantee that the Government
is going to get any more money than we are getting right now.
Rent receivership involves placing management, say, of a dormito-
ry in the hands of a third party, a bank, a CPA, some other outside official. That party acts as the landlord, collecting the rents and raking off a management fee on top of that. It is not clear in most cases that after they deduct their management fees and after we go through the tedium of dealing with the third party that we are going to get any more money than we are going to get if we tighten that screw bit by bit and pin the institution to a more severe work-out agreement.

Mr. WALKER. Thank you, Mr. Chairman.

Mr. WEISS. Thank you very much, Mr. Walker.

Let me just say by way of comment that our thrust here has not been to characterize all the schools as having created problems. Indeed, I have repeatedly laid and framed my questions to indicate that most of the schools have in fact maintained their obligations.

The remarkable thing to me is that such a large percentage have maintained those obligations, given the mismanagement that has occurred from the very inception of this program.

I hold no brief for mismanagement that occurred under Democratic administrations any more than I hold brief for mismanagement under Republican administrations. This program goes back to the Truman administration. It has been mismanaged under Truman, Eisenhower, Kennedy, Johnson, Nixon, Ford, Carter, and Reagan. I think this has been a sorry example of a bureaucracy which has forgotten, if it ever knew, what its responsibilities were.

I don't want to sit here to excuse anybody's role in this thing. I think there is lots of blame to go around. What we are trying to do is to make sure that it doesn't continue. That is really what this hearing is all about.

Mr. WALKER. If the gentleman will yield, let me say that the gentleman is absolutely right. I think there are a number of problems that go over a long history of the program, and I think that it is important to deal with the program in that light.

I would say, though, that the officials that we have brought before us today seem to have at least stemmed the flood to some extent and that there is a reason to take a look at the 1977 to 1980 time period when the default rates shot up so dramatically.

I mean, there was a tremendous, dramatic increase in the default rate that took place during that period of time—

Mr. WEISS. If the gentleman will allow me, I was not the Chair of this subcommittee during that time. I am now. I think, as I say, there was a lot of mismanagement from the word "go."

It just amazes me that when we hear all the rhetoric about fraud and abuse and waste in the Federal bureaucracy, when you have a situation that just about jumps up and bites you in the neck—and I am using the "you" generally, not you specifically, Mr. Walker.

In fact, there seems, at least on the part of the bureaucracy, an inclination to say "not us; there is no waste or abuse here."

Mr. WALKER. Well, if the gentleman will yield again, once again I agree thoroughly that anywhere that you have waste, fraud, and abuse that we ought to be ferreting it out, but I think that we also have to lend a note of perspective, that that appears to be what is happening right now in the Department of Education, that the delinquency rate has dropped from a 204-percent rate between 1977 and 1980 to a 15-percent rate at the present time.
While the rate of growth is still there, it is a dramatically lower rate of growth, and I think it does symbolize that at least an attempt is being made. It ought to be redoubled. If these hearings serve the purpose of making certain that the Department of Education knows that this subcommittee is interested in a redoubling of those efforts, it would have served a very, very good purpose, and the chairman is to be congratulated for making certain that that kind of emphasis is there.

But the perspective is certainly needed.

Mr. WEISS. I thank the gentleman.

Dr. ELMENDORF. I assume that the Department considers it important to regularly inspect buildings financed with Federal loan proceeds. Is that your position?

Dr. ELMENDORF. As resources permit, yes, sir. We try to do that through an agreement with HHS right now on architectural and engineering reports for new construction projects.

Mr. WEISS. I take it then that the Department knows the condition of all of the buildings financed under the programs?

Dr. ELMENDORF. No, there is no way to know that, except through what might be noted in an audit report submitted every other year as a problem on a particular campus. That would be the way to do it, through a process that institutions now already go through, which is the independent audit required for colleges to continue to receive Title IV student financial aid funds.

Mr. WEISS. How does the Department know for a fact that the buildings financed by loans still outstanding no matter when they were granted—these are 30-, 40-year loans—are being used for educational purposes?

Dr. ELMENDORF. We have no way at this time. We have taken some steps to place monitors in each of our 10 regional offices to review each of the higher education programs, not just these programs, but Title III and other programs as well.

This had not been done before. It had been recommended by several GAO reports. We took the initiative to not only reorganize the higher education programs but to put regional on-site monitors in the offices who could go out with program review teams when they look at campuses' financial aid files to also look at other programs on that campus.

We are beginning that program now and will begin it full time in the fall. We would hope that some of the revenues that will come back from HUD might be used to strengthen the onsite review process on the campuses.

Mr. WEISS. I understand that the Department had no inspection at all for the first 15 months after the program was transferred from HUD to DOEd; is that correct?

Dr. ELMENDORF. I would have to ask Dr. Kimberling to answer that.

Mr. WEISS. Dr. Kimberling?

Dr. KIMBERLING. There had been an agreement that lapsed. The inspection occurs with respect to new construction. We do now have an agreement with HHS for ROFEC engineers that is fully in place.

There was a gap in that, yes, sir.
Mr. Weiss. Were the buildings constructed during that time inspected by Federal engineers at all?

Dr. Kimberling. I don't believe so.

Mr. Weiss. The fact is that they were not; is that right?

The Department of Education relied on local architects and engineers hired by the school to inspect the buildings; isn't that right?

Dr. Kimberling. I believe so.

Mr. Weiss. How many buildings were constructed without Federal engineering inspections?

Dr. Kimberling. I would have to get that number and furnish it for the record, sir.

Mr. Weiss. Without objection, that answer will be inserted into the record at this point.

[The material follows:]

The Department of Education became responsible for the College Housing Loan Program in 1980. From 1980–83, 63 buildings have been approved for construction.

Nine of the 19 buildings which were approved for construction in 1980 have been closed without Federal inspection. The Department did not obtain engineering services until 1982.

There remains 54 additional buildings to be closed; all of these buildings will receive Federal inspection.

Mr. Weiss. Would more site inspections better protect the Government's interest in these loans?

Dr. Kimberling. Yes, sir; that is why we do have this agreement in place with ROFEC engineers, and we won't close out a project without their signoff.

We feel it is a very important service.

Mr. Weiss. I understand, Dr. Elmendorf, that your Department, and HUD before it, collected audit and inspection fees from borrowers. These fees are then used to pay for site visits by Department officials to the schools for the purposes of inspecting the buildings and the finances of the colleges. Is that correct?

Dr. Elmendorf. I missed the first part of your question, Mr. Chairman.

Mr. Weiss. I understand that your Department and HUD before it collects audit and inspection fees from borrowers. Those fees are used to pay for site visits by Department officials to the schools for the purpose of inspection of the buildings and the finances of the colleges?

Dr. Elmendorf. Yes, that is the procedure.

Mr. Weiss. Did OMB order that the fees held by HUD be transferred to the Department of Education?

Dr. Elmendorf. Yes, there was a final determination by OMB to HUD on that.

Mr. Weiss. When was the order given to HUD?

Dr. Elmendorf. I would have to ask Dr. Kimberling to give the chronology on that.

Mr. Weiss. Dr. Kimberling, when was that ordered by OMB?

Dr. Kimberling. That determination order was dated in 1980 when the program was officially transferred—

Mr. Weiss. 1980.

When did the transfer take place?

Dr. Kimberling. It has not taken place.
Mr. Weiss. Now it is 1984. Have you aggressively tried to obtain those fees?

Dr. Kimberling. We have had, as I indicated earlier, several contacts with HUD at the level of our Comptroller. The HUD account that the funds had been placed in was a commingled account, and they were not able to identify all of the deposits into that account that had been made over a 10-year period from 1970 to 1980 without going through a detailed audit of their own account.

They have subsequently completed that. We have been after them for the last couple of years, since I have been in Postsecondary Education. It has taken them some time to reconstruct all of those accounts, and they have now done so. We expect the transfer to take place shortly.

In the meantime, we have been collecting the fee on our own loans. The field inspection fee account has a balance of $52,000, and we have been able to fund our own site visits and inspections from the fees that we have collected.

Mr. Weiss. You notified the Inspector General in September 1983, Dr. Elmendorf, that the Department was vigorously pursuing the transfer of the audit inspection fees. What have you done to implement the transfer?

Dr. Elmendorf. The matter of the transfer is being handled at a level in the Department where financial accounts are managed. The Comptroller's Office is negotiating with HUD for the Department of Education.

I think Dr. Kimberling can explain the efforts on our behalf. We did not go into HUD and try to reconstruct their records for them. We placed what pressure we could on them to do that at the earliest possible time. It will result in an amount of money coming to the Department that will be used for better monitoring and enforcement. That is where we would use it.

Mr. Weiss. I don't know about useful; what I am asking is what steps did you guys take to vigorously pursue the transfer of those moneys?

Dr. Elmendorf. I would have to ask Mr. Stack who is a representative of the Comptroller's Office to come forward. He is prepared to respond to that question.

Mr. Weiss. Mr. Stack.

Before you testify, do you swear or affirm that the testimony that you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. Stack. I do.

Your question, sir?

Mr. Weiss. What steps—

Mr. Stack [continuing]. Is as to what steps have been done—

Mr. Weiss [continuing]. To try to get that transfer completed.

Mr. Stack. We have corresponded several times and met several times with HUD's Office of Budget.

The commingled funds, in order to get at the records, we had to have HUD go down to the Federal Records Center and go through boxes, again, down there. They found no evidence that was very helpful, so it was decided that what we would do is that we would try to compute the amount of money that was most likely deposited
in that fund and the amount of money that was most likely expended.
We have assurances from the staff level at HUD that a memorandum for their Office of Budget Director has been prepared and is ready for his signoff whereby those funds would be transferred to the Department.

Mr. Weiss. Couldn’t you in 4 years time have communicated with the colleges and universities, which in fact made these payments to begin with to reconstruct the amount?

Mr. Stack. No, that would not have been possible because they were all Federal expenditures, sir.

The historical background, if I may——

Mr. Weiss. The fees are paid by the colleges.

Mr. Stack. Yes, the fees are paid by the colleges, and then one-eighth of 1 percent is placed into a fund.

It was about 2 years ago, when reviewing the administrative requirements of this program, we found that such a fund existed. We did not know that when the program was transferred to the Department. It was through a consultant who found this information that we asked HUD if such a thing existed.

Mr. Weiss. When did you make that discovery?

Mr. Stack. It was about 2 years ago.

In other words, we didn’t know about it when the Department was established or when the program was sent from HUD to the Department of Education, and HUD did not tell us and it was only through our review of the legislative authorities and regulations that we found such a regulation where an eighth of 1 percent could be taken.

When we found that regulation, we asked HUD, “Did you in fact do that?” They said, “Yes.” We then asked for the money. They said, “Let’s see what the records show.”

The records showed that it had gone into a rather large general purpose fund and then we asked them to get us the specific records. They went down to New Orleans and went through records and found no evidence that would support the precise amount of money.

Based on that, we had to develop a methodology to compute the amount of money that was due to the Department, and that is what has taken so long—records centers not knowing and that sort of thing.

Mr. Weiss. In the meantime, no inspections were taking place?

Dr. Kimberling. No, Mr. Chairman, inspections were taking place under——

Mr. Weiss. No inspections were taking place by HUD, certainly, before they transferred to you; isn’t that correct?

Dr. Kimberling. There were no inspections made by HUD after the transfer.

The information we have been given is that there were inspections through the 1970′s by HUD using those funds.

Mr. Weiss. According to your Inspector General, there may be as much as $4.9 million in fees owed to the Education Department.

Do you have any reason to disagree with that?

Mr. Stack. Yes, we do. The range, I think, was between $1.6 million and $4 million. That was a guesstimate made by the Inspector
General. It is our estimate right now, working with the HUD staff, that it will be slightly less than a million dollars.

Mr. Weiss. Great management.

Mississippi Industrial College is one of the schools that received its loan proceeds before construction was completed on its buildings. According to your Department's files, Mississippi Industrial College received a college housing loan and an academic facilities loan for a total of a little more than $1 million.

Is it Department policy to wait until the buildings are completed before issuing final payments to borrowers?

Dr. Kimberling. No, Mr. Chairman, final payment usually occurs after a building is 80 percent complete.

Mr. Weiss. Do you see any danger in disbursing all the loan proceeds before the buildings are completed?

Dr. Kimberling. We have not experienced any danger with any of the loans that were originated by our Department.

Mr. Weiss. You think that because it is now your Department rather than HUD that the 80-percent rule works better under you than it worked under them?

Dr. Kimberling. I am not certain if HUD had the 80-percent rule, sir.

Mr. Weiss. On December 12, 1980, Mississippi Industrial College lost its accreditation; is that correct?

Dr. Kimberling. To the best of my knowledge, yes, sir.

Mr. Weiss. When a school loses it accreditation, is it still eligible for Federal education assistance?

Dr. Kimberling. No, sir.

Mr. Weiss. I understand that the Department did not learn that the school lost its accreditation until October 1981; is that correct?

Dr. Kimberling. That is correct. The Southern Association of Colleges and Schools took 10 months to notify us.

Mr. Weiss. When the Department learned that the school had lost its accreditation, the final loan proceeds had not been awarded, but 1 month after learning that Mississippi Industrial College lost its accreditation, final loan proceeds of $402,000 were disbursed to the school.

Is that correct?

Dr. Kimberling. I believe the timeframe was very close here. The Southern Association notified our eligibility and agency evaluation staff. They are responsible for the process of maintaining eligibility records on institutions of higher education.

My understanding is that information came to them at just about the time that the final payment was being made under a trust indenture signed in May of 1981 and the two documents essentially crossed in the bureaucracy. That is clearly troublesome. I think the most troublesome part of it all is that the Department was informed late by a recognized accrediting agency of the loss of accreditation that could have prevented the entire situation.

Mr. Weiss. I know what you have just told us. I assume that you believe it to be possibly so.

Are you sure that in fact that you did not know a month before, that is, that your Department did not know a month before the $402,000 was disbursed that accreditation had been lost?
Dr. Kimberlin. The part of the Department dealing with accreditation and eligibility did know in October. The dispersal is made in November. I don't believe it was a full month, and, obviously, that information did not travel to the program people making that dispersal in a timely enough fashion to prevent it.

Mr. Weiss. How have you remedied the system or corrected the system so that that kind of thing can't happen again?

Dr. Elmendorf. Let me try that, Mr. Chairman.

We have had one other report of failure of an accreditation association to adequately notify us so that the information can be passed along to the various constituents that need to know. It was in title IV, not in title VII.

We have just consummated the purchase of a mini-computer which will put all of these offices up on a database which allows them to update and pass that information along electronically and query it on a daily basis. The one way that I can assure you that that will help us is that at least within the Department the offices that need to know will know at the same time.

How we deal with those outside that are responsible to notify us is another matter. The best way we can deal with that problem is that if we have repeated failures by an accrediting association to notify us in a timely way, we have the right to question whether we ought to renew them as an accrediting association. We do not accredit institutions—

Mr. Weiss. Well, I have a problem with that, too.

But I have a greater problem with the fact that the information actually reaches the Department, and then, because of a lack of a system, the Department's one hand doesn't know what the other hand knows.

Dr. Elmendorf. I am saying that when you have the manual transfer of papers among offices, I would say that that is a possibility across Government, not just in the Department of Education.

I think and I hope and I believe that the implementation that we fought so hard for in the way of computer updates bringing the Department to a level of twentieth century electronic technology will reduce, if not eliminate, those problems.

Mr. Weiss. Thank God the computers were invented.

According to an internal memorandum from the College Facilities Branch, the Department does not know the disposition of all the funds that were loaned to Mississippi Industrial College.

Is that true?

Mr. Conanan. Mr. Chairman, I should mention that Mississippi Industrial College is on pending investigation, I believe, by a number of other agencies, including this Department and we are still trying to ferret out sufficient information about the disposition of funds, not just related to college housing loans but also related to student financial assistance and some other funds that were given by another agency in the Department.

I have been in communication with the assistant U.S. attorney in Mississippi representing the Department in court litigation concerning the college housing loan or academic facilities loan and we are still trying to ferret out sufficient information at this particular time so that the Government's interest in all these loan funds and programs would be adequately protected.
I don't think it would be in the best interest of the Government at this particular point in time to comment extensively on the nature of some of these investigations that are pending.

I should just mention that there are other agencies involved, not just the Department of Education.

Mr. Weiss. I also understand that the buildings financed with Federal loans at Mississippi Industrial College are incomplete and deteriorating and that the college itself is closed.

Is that correct?

Mr. Conanan. That is correct, and there is court litigation involved and the Department is being represented by the Justice Department in that litigation. We are trying also to negotiate a settlement with some of the other parties that are involved in that litigation.

Mr. Weiss. This all happened on your watch; right? This doesn't go back to anybody else's? The disbursements took place while you guys were in charge; is that right?

Dr. Kimberling. The disbursements took place; the loan reservations were made on the other guy's watch.

Mr. Weiss. Right.

In the case of Mississippi Industrial College, do you believe that the Department did all it could to protect the Government's interest?

Mr. Conanan. Could you repeat the question, please?

Mr. Weiss. Do you believe that in the case of Mississippi Industrial College that the Department did all it could to protect the Government's interest?

Mr. Conanan. The Department of Education is doing all it can right now to protect the Government's interest.

Mr. Weiss. Thank you—did, not is doing.

Dr. Kimberling. Given, the adequacy of our data systems support, or lack thereof, yes, sir.

Mr. Weiss. In light of this case, do you think the Department's policy of disbursing Federal proceeds prior to the completion of construction is wise?

Dr. Kimberling. I believe if you look at this as an isolated example, you might have the telescope turned around backward. It is absolutely necessary for construction to proceed on any construction project that some disbursements be made and verified as they are being made. That is our procedure.

Mr. Weiss. Total disbursements.

Dr. Kimberling. Before 100 percent completion?

Mr. Weiss. Yes.

Dr. Kimberling. I am not an expert in that, Mr. Chairman, and I think those who are expert with construction projects can place before you better arguments than I can, about why it is wiser to disburse with 80 percent completion.

Mr. Weiss. OK.

Do Department regulations stipulate that revenues from the projects to be constructed be used for repayment of the loan?

Dr. Kimberling. Yes, sir.
Mr. Weiss. If a school does not use revenues from the pledged project to repay its loan, does the school violate its agreement with the Federal Government?

Dr. Kimberling. Yes, sir.

Mr. Weiss. What does the Department do when it discovers that schools are not using revenues to repay their loans?

Dr. Kimberling. We take a number of steps. Initially we would write a letter to the institution asking that those identified revenues be put to use to pay back the loan. If that doesn't work, then we will attempt to identify more precisely those revenues through an Inspector General audit. Again, working with our Inspector General, that was one of the reasons why the 11 schools that they selected jointly with us were selected because we suspected that many of these schools would be in violation of the regulations.

Generally if you flash a Department of Education employee card in somebody's face, they will react one way. They get a little more nervous when they see an Inspector General's card flashed in their face. I think the memorandum that you quoted earlier indicates that healthy respectful fear of the audit function.

If the institutions are not forthcoming in responding positively to those audit findings, we can take a number of other steps. We can go all the way to receivership or foreclosure. Our feeling is that there is one area, a very significant area where we currently lack authority and where the Congress might provide us some relief and that would be authority to offset against other drawdowns against Government accounts that the institutions might be making.

We have examined our authority currently and find that because of the trust indentures terms, there is no offset authority against other grants or against administrative cost disbursements under the student aid programs. We would suggest to the Congress that authorities of that nature, to offset other Federal disbursements, if enacted into law, would give us some very strong teeth to go after this kind of fraud, waste, and abuse.

Mr. Weiss. Have you made that recommendation?

Dr. Kimberling. We have not formally made that recommendation, but we are examining together with our student financial aid office exactly how we would frame that kind of a recommendation to the Congress.

Mr. Weiss. An audit was prepared by the Department's Inspector General of a $3 million college housing loan to Alaska Pacific University. That loan is approximately $1.8 million delinquent. The audit found that $136,000 in revenues that should have been used to pay the school's Federal debt were diverted elsewhere and that $110,000 in improper costs were charged to federally financed buildings, thus reducing the true revenues of the project.

Do Department regulations prohibit this kind of activity?

Dr. Kimberling. Yes, sir.

Mr. Weiss. The IG audit states that the school's assets exceed its liability. In fact, the audit notes that Alaska Pacific was to receive $10 million from a land sale. The Inspector General recommends that the Department demand that the $10 million be used to bring that loan current.

Was that recommendation accepted?
Dr. Kimberling. Mr. Chairman, we concur with the Inspector General's recommendation that this would be a good course of action. Unfortunately, we lack the legal authority to enforce the recommendation. We can only go after assets that are part of the trust indentures or mortgages to the institutions. These assets were not covered by the trust indenture or mortgage.

This would be another area where we would like to explore some additional authorities for this program. Right now, it is a recommendation that makes perfect sense. If we try to seize assets of an institution not covered by trust indentures as collateral, we would be highly vulnerable; and I think our attorney would concur with that.

Mr. Weiss. So, now 30-some-odd years after the onset of the program, you think that the law ought to be amended to give you that kind of protection?

Dr. Kimberling. Well, we certainly wish that these ideas had come forward in the past. They have not come forward, and no time like now is the right time to—

Mr. Weiss. Have you made this a legislative recommendation?

Dr. Kimberling. No, sir; not yet.

Mr. Weiss. The Inspector General's audit also found that the school had been leasing a building financed by the College Housing Loan Program to the U.S. Geological Survey for $283,000 a year since 1979.

Were all the leasing revenues used for debt repayment?

Dr. Kimberling. I do not believe so. Some of the revenues were used in deferment workout agreements for 2 consecutive years in 1982 and 1983, but not all of those revenues have been applied to payment of this loan.

Mr. Weiss. Doesn't the loan agreement require that all revenues from the federally financed projects be used to repay the college housing loans?

Dr. Kimberling. Yes, sir.

Mr. Weiss. As a matter of fact, if you had the 5 years of $283,000 a year from the U.S. Geological Survey, you would practically have no deficiency at all; isn't that correct?

Dr. Kimberling. Well, I haven't tallied up the numbers, but it could be the case.

Mr. Weiss. The Department did try to help Alaska Pacific. Deferments were granted and the Department entered into a workout agreement which further deferred the loan. Has Alaska Pacific also defaulted on its workout agreement?

Dr. Kimberling. If I might be precise in the terminology, Mr. Chairman, there is a difference between a workout agreement and a deferment agreement.

A workout agreement is a sustained plan of paybacks designed to cure the default status over a period of years. Deferments by law and regulation can only be granted in the College Housing Program for a 1-year period. In this case, the deferment included a payment schedule during that year. The same schedule was adhered to in a second deferment agreement, which accelerated payments and, therefore, reduced the total amount of default. It wasn't the same as a total workout, which is a plan of action to reduce the entire default.
Mr. Weiss. Were you aware of the U.S. Geological Survey lease for $283,000 a year when that deferral agreement was agreed to made?

Dr. Kimberling. My understanding is that the deferral agreement amounts approximated the amounts of revenue that the institution was receiving from the lease to the U.S. Geological Survey, and that it was those revenues that were used for paying back, on an accelerated basis, on the defaulted amount.

Mr. Weiss. Department regulations, I understand, state that the Secretary of Education: "does not grant a deferment if the borrower proposes to use pledged revenues for any purpose or purposes other than that provided in the loan agreement."

Given the Inspector General's finding that Alaska Pacific already was not using pledged revenues for authorized purposes, why did you grant deferments to the school?

Dr. Kimberling. The Inspector General's audit occurred after the two deferments had been granted. The deferments were granted in, I believe, 1981 to 1982 and 1982 to 1983, prior to the Inspector General's audit.

Mr. Weiss. You are not telling me that until the Inspector General's audit you had no idea that in fact Alaska Pacific was using the funds for wrongful, for inappropriate purposes are you?

Dr. Kimberling. We had no audit reports indicating that this was so, yes, sir. We had no idea of the degree, the magnitude, and the precise nature of those diverted uses.

Mr. Weiss. As a result of the audit of Alaska Pacific, the case was referred to the Inspector General's Office of Investigations, but on April 2, 1984, the investigation was closed because, according to the closing memorandums, Alaska Pacific was going to exercise its option under the Department's discount plan.

Would you at this point explain the discount plan to us?

Dr. Kimberling. I would be happy to, Mr. Chairman.

Discounting essentially takes into account the concept of net present value over time, and it is a principle that those in accounting and finance use all the time.

Let me cite for you a specific example so that we can compare the same numbers, and I believe it may be the same example that was used earlier.

If we have a loan, say, for $4 million—running a period of 30 years—that capital is in the hands of the institutions for their use. It is not in the hands of the Federal Government for use.

With 3 percent interest, the Government would receive $6.1 million total over 30 years.

If we had access to those funds right now, and we were private investors, we could put them in 30-year bonds sold by the Treasury Department with a guaranteed interest rate currently of 12.25 percent. If we had $4.5 million, we would, at the end of the 30-year period, have in excess of $15 million in hand.

Since we are not private borrowers but we are the Federal Government, what we really are doing in this program is trying to reduce the off-budget subsidy costs in the program. We do that by telling the institution what amount of money it would take for them if they invested it in 30-year bonds to come up to that same
$6.1 million amount that they would be spending over the same
time in paying back the Government.

When you run the standard present value formula, that amount
comes to approximately $1.8 million. In other words, if you have
$1.8 million today, you invest it in 30-year bonds at 12.25 percent,
then you would receive $6.1 million for your investment. That $1.8
million is equal to $6.1 million over the 30-year period of time.

When you give that money to the Federal Government instead,
essentially this is a financial hedge against outyear deficits that we
are all concerned about. If we received $1.8 million today, that is
$1.8 million less that the Treasury has to lend out in the form of
bond borrowing, and over that same period of time, it is $6.1 mil-
lion less that the Treasury has to pay out to the bearer of those
bond certificates.

In fact, currently, for the loss of capital over time, we would be
losing $15 million on the $4.5 million paid us.

I think this chart displays the picture a little bit more clearly.
And, it is a complex finance concept, but it is one that is standard
practice.

Mr. Weiss. Without objection, a copy of that chart will be placed
in the record at this point.

[The chart follows:]

[The chart follows:]
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4.05 Million Balance

| (projected income) | 1,805,345 | 15,117,770 |
| (payoff amount)     | new loan at 12.25 | (potential loan revenue) |

* Current portfolio is at 6
Projected portfolio is at 12.25
Net present value at 12.54
Dr. Kimberling. The green numbers represent the total amount of payments that an institution, using these numbers that I have been citing with the $4 million debt, would be paying into the Government over the entire 30-year period, and it comes out to about $6.1.

However, the cost of borrowing the money from the Treasury, the off-budget cost of borrowing for that same amount of $4 million capital rises for a total of $15.1 million. The red shows the net loss to the Government over that time. It is a net loss of $9 million in off-budget spending because these are low-interest 3 percent loans, and they are not close to today's market rates.

By discounting these loans, we would in fact be collecting all of the amount or saving the Government all of the amount covered by the green area, and the red area would be spending that we would avoid. So, there would be a net savings to the taxpayers of $9 million.

I would be very happy to work with you and your staff in running through some other examples and explaining the part of this scenario, the off-budget expenditures, which we are very concerned about.

As Dr. Elmendorf explained, this is a standard strategy used by the banking industry in a time when you have got a large portfolio of low-interest loans and market rates that are substantially higher, banks have long realized that it is to their financial advantage to offer a present value discount in exchange for getting rid of the debt servicing costs over time of that kind of portfolio.

Mr. Weiss. We will explore that issue further when we return. There is a vote on the floor of the House at this point, so we will take a break for about 10 minutes, and then we will resume.

The subcommittee stands in recess.

[Recess taken.]

Mr. Weiss. The subcommittee will come to order.

We heard an explanation before the break of the Department's discount plan. Legislatively, I understand that under Public Law 98-139 the Secretary of Education is authorized to accept discounted prepayments of college housing loans.

That legislation emanated in the Senate, was agreed to in conference, and then finally adopted.

On April 20, 1984, the Department published a regulation for comment that outlines a formula for the discount plan. The discount, I understand, will depend on the Treasury rate on the day of application. Department officials have told us that the discount will be as high as 55 percent but could also be lower depending on the loan circumstances. If the 55-percent figure holds across the board, the Department could discount as much as $1.5 billion in loan funds.

Dr. Elmendorf, or Dr. Kimberling, do you plan to grant a discount to Alaska Pacific?

Dr. Kimberling. That decision has not been made, Mr. Chairman. In our published, in our notice of proposed rule we specified that we would examine separately the cases of institutions in default. The reason for this is that those institutions not in default—some 1,230 institutions out of the 1,300 in the program—would have a very simple formulaic computation.
We have not determined final policy. We are anxiously awaiting public comment on the notice of proposed rule as to exactly how, or if at all, we should extend the discount provision to institutions in default.

They are eligible and certainly I don’t think anyone would quarrel with the concept of applying the discount formula to those payments which have not yet come due. But for Alaska Pacific or for any other institution that has delinquent payments, we would want to examine that very carefully.

Mr. WEISS. Do you believe that a school that has been delinquent on its debt and has hidden revenues owed to the Federal Government should be rewarded with a 53-percent discount?

Dr. KIMBERLING. I don’t believe that the discount provision should reward misbehavior.

I do believe that the discount provisions should protect the Government’s best financial interests and that the decision to discount should be made on the basis of that cost-benefit analysis as required by the law.

Mr. WEISS. I had indicated in my summary a moment ago that the discount regulation was published for comment on April 20, 1984. Is that correct?

Dr. KIMBERLING. Yes, sir.

Mr. WEISS. It is normally the position, I understand, of Federal agencies that regulations, when in draft form, are sensitive matters and are not disseminated to interested parties outside the Department.

Is that the policy of the Department of Education?

Dr. KIMBERLING. Yes, sir.

Mr. WEISS. Therefore, I would assume that you would not be discussing draft regulations with colleges that could financially benefit from them. I assume that is your position.

Dr. KIMBERLING. In the process of regulatory development, we would be discussing the concept of regulations with any interested party. We feel that is part of good government that you don’t want to have the rules made up by those who are not aware of the circumstances in the real world where the regulations affect those actions.

Mr. WEISS. I understand that Dr. Fairley is in the room; is that correct?

Dr. ELMENDORF. Yes, sir.

Mr. WEISS. I wonder, if for the purposes of the next question, if Dr. Fairley could come to the witness table, if that is all right with you, Dr. Elmendorf?

Dr. ELMENDORF. That will be fine.

Mr. WEISS. Before you sit down, Dr. Fairley, would you raise your right hand and do you swear or affirm that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Dr. FAIRLEY. I do.

Mr. WEISS. I have a memorandum, Dr. Fairley, from you regarding Dr. Kimberling’s instructions to begin negotiations regarding the draft discount regulation with Alaska Pacific University. It responds to a control memo of November 2, 1983. I will read a portion: “Your control memo of November 2, 1983, requested the fol-
lowing: to begin negotiations with attorney Silver of Alaska Paci-

Why, Dr. Kimberling, were you negotiating or directing nego-
tiations with Alaska Pacific University in November of 1983, 6
months before the regulation on discounting was even published
for public comment?

Dr. KIMBERLING. Mr. Chairman, Alaska Pacific had expressed an
interest in the discount provision. My understanding at the time of
that memorandum was that the basic statute would give us author-
ity to apply the discount provision.

After I issued that memorandum, anxious to get on with the
show now that the law had been passed, I was informed that we
did in fact have to go through the regulatory procedure. I was
under the mistaken impression that the law itself, that the basic
statute, was clear enough that we did not have to go through the
process of developing regulations.

As soon as we learned that regulations needed to be developed,
we did not negotiate. We have not reached any kind of a settle-
ment. We have not finalized anything with Alaska Pacific Univer-
sity. My training is not in law, and I was less informed of the pro-
cedures than I perhaps should have been. I was not aware that reg-
nulations needed to be issued in this case.

Mr. WEISS. Did you in fact negotiate with Alaska Pacific as to
the content of those to-be-proposed regulations?

Dr. KIMBERLING. No, sir.

Mr. WEISS. Which other colleges, if any, did the Department ne-
gotiate with before publishing the proposed regulations?

Dr. KIMBERLING. We did not negotiate with any college, sir. We
have had a number of colleges express an interest, prior to publica-
tion of the regulations, in the discount authority.

Lincoln University has expressed an interest. Dr. Brantley re-
ceived a letter from representatives of, I believe, five colleges in
Oregon who have borrowed under this program. The professional
associations—NACUBO—has expressed an interest and shared
with us their views. I think it is not uncommon in the process of
regulatory development to receive public views from members of
the public who are interested parties even though you are not run-
ning an official public comment period. This is particularly true of
an organization representing the Nation's college and university
business officers would have an interest in conveying their views to
the Department.

So, we are happy to receive public views on any proposed policy.

Mr. WEISS. How were the negotiations with Alaska Pacific initi-
ated?

Dr. KIMBERLING. Mr. Chairman, I indicated that we have not ne-
gotiated any settlement on the discount provision with Alaska Pa-
cific.

Mr. WEISS. I know, but I am asking you what induced you to sug-
gest to Dr. Fairley or direct Dr. Fairley to begin negotiations with
Alaska Pacific?

Dr. KIMBERLING. Alaska Pacific was the very first institution
back in the late summer of 1983 to bring to our attention the fact
that there had been a discounting provision in title VII of the
Higher Education Act governing the academic facilities program.
This was a flat 25-percent discount. The authority expired in the 1970's, but during that time 17 institutions took advantage of that discounting authority.

As you know, the Housing Act of 1950 is the legislation governing the College Housing Program. Alaska Pacific's attorney, Mr. Silver, initially met with our program staff and Dr. Brantley and Dr. Fairley and pointed out that those two pieces of legislation did not, were not congruent. He asked if the Department would be willing to consider seeking legislative authority for a discount provision under the College Housing Program.

After our General Counsel reviewed the provision, he decided that the Secretary lacked authority under the college housing legislation to grant a discount on his own authority, after running through in consultation with some financial experts the cost-benefit analysis that I presented earlier showing that discounting would be to the best advantage of the Government and also receiving an OMB circular which asked every Federal agency to try to liquidate assets that were losses over a period of time, the Department developed its proposal in conjunction with Senator Stevens' office.

My instruction, after this legislation had been passed by both Houses of Congress and signed into law by the President, since Alaska Pacific had been the first institution to initiate an inquiry, and as soon as we had the legislative authority that we ought to get to the business of sound management and begin to recapture some of our losses.

Mr. Weiss. Adult student housing of Tennessee received a $2.9 million college housing loan on which it is $222,000 delinquent. Five months ago, the Department received a letter from that borrower applying for the discount. The letter contains the amount of the discount based on the formula that the Department was then formulating.

Do you know how this borrower had such specific information about the discount regulation a full 5 months before it was to become public?

Dr. Kimberling. No, I don't, although I would point out that the formula used is a standard Treasury Department formula and accountants who have talked with me about it characterize it as a textbook example.

Mr. Weiss. Will all schools with loans be eligible for the discount?

Dr. Kimberling. All schools with loans will be eligible for the discount, yes, sir.

Mr. Weiss. Will the determination then be a blanket determination for all schools or will it be determined on a case-by-case basis?

Dr. Kimberling. Well, I can't guess what the shape of our final regulations will be until we have passed the public comment period. We are anticipating a blanket application of the discount provision to institutions not in default, and that have been good borrowers over the years, the vast majority of schools.

We have proposed a separate review process for delinquent or defaulted borrowers, and, as I indicated earlier, that process will have to take into account the costs and the benefits of a particular situation. It would depend upon the school's willingness to come cur-
rent; it could depend on the number of years remaining; just a whole host of factors.

There are very good arguments for not applying the discount to defaulted institutions. One of the most compelling of which is that it might serve as an incentive to others to default, and we certainly don't want to do that.

But there are other arguments that bankers and other lending institutions have conveyed to our program staff as we have attempted to learn how the private marketplace handles similar situations. They have indicated that, in many cases, with troubled loans over the long haul where there is a high risk that they will never get a return on their investment, if they can calculate $1 in savings, they might offer the discount.

At this time we are seeking public comment. We do not have final regulations. We are earnestly discussing the pros and the cons, and, in any case, I can assure you that we will separately review on an individual basis with intense scrutiny each and every application from a defaulted institution.

Mr. Weiss. Do the proposed regulations include a different treatment for schools which have been delinquent?

Dr. Kimberling. They do not propose a blueprint for a separate treatment. They indicate that they will be reviewed separately. We are eagerly awaiting public comment on what kinds of factors should be taken into consideration. We would be happy to have your views, those of your colleagues, those of any member of the public who has experience in dealing with these issues.

Mr. Weiss. If I understand your testimony, you have told us that the original idea for the discount legislation or proposal emanated from counsel for Alaska Pacific; that after the legislation was adopted, because of your misinterpretation of what followup regulatory provisions had to be promulgated, you directed Dr. Fairley to undertake negotiations with Alaska Pacific; that both at the time that the Department was first approached by counsel for Alaska Pacific and at the time that the directive for commencing the negotiations was undertaken, you were aware of the fact that Alaska Pacific in fact had been delinquent, and had evaded some of the requirements of the law as far as attributing resources and expenses were concerned.

Yet, now you are saying that in fact you are going to be reviewing on a case-by-case basis as to whether delinquent institutions should or should not be included.

I am not sure that I can trace consistency in that testimony.

Could you clarify that for us?

Dr. Kimberling. Yes, I would be happy to, Mr. Chairman.

At that time the Inspector General's report had not made its way through to me. I was not aware of their audit findings showing inconsistencies in their use of project revenues, and I would simply say that a good idea is a good idea, regardless of who proposes it.

We think that discounting over the long haul is going to save the taxpayers an awful lot of money, and we haven't made any final determination of whether we are going to treat delinquent schools as a class or whether we are going to treat them separately on a case-by-case basis.

Mr. Weiss. Dr. Kimberling, I am a little bit confused.
I have an audit report from the Office of the Inspector General dated June 10, 1983. That certainly is prior to your control memo of November 2, 1983, to which Dr. Fairley responds.

So, I think that part of your response is not valid. Your recollection may be inaccurate as to why you felt that it was appropriate to commence negotiations with a school which in fact had been delinquent and where all of their various manipulations had been already audited and reported by the Inspector General.

Dr. Kimberling: Mr. Chairman, my recollection may indeed be faulty. I would point out that the Inspector General’s audit reports, once completed, in their normal procedures are forwarded in draft form to the institution and to the program offices for response.

I stand in a management hierarchy a couple of levels above that program office, and so I do not recall seeing the audit report from the Inspector General, even though it may have been conducted at that earlier date. I have no recollection of seeing it prior to November.

If I did, it nevertheless behoves me to stimulate discussion of how the discount provision would apply to any institution seeking to exercise the discount authority.

Mr. Weiss. Will you be encouraging schools to take advantage of the discount?

Dr. Kimberling: We will be encouraging all of the nondefaulting borrowers to take advantage of the discount.

We will be accepting applications from defaulted borrowers and reviewing them in accordance with whatever procedures appear in our final regulations after we have sifted through public comment.

Mr. Weiss. As a matter of fact, the Department intends to hold workshops on June 4, 5, and 6 in various locations across the country in order to assist borrowers in using the discount; isn’t that correct?

Dr. Kimberling. Yes, sir. We have received a number of inquiries, and we feel that it is most cost effective to share that information with institutions in a group session rather than one by one.

Mr. Weiss. Do you find it equitable to provide discounts to schools that are in default as well as to schools that have always been current on their loans?

Dr. Kimberling. I do not find it equitable to take a course of action which would encourage any school which is not in default to go into default, and inasmuch as we have to look at matters of public policy and assure that we are not providing incentives for that kind of situation, I would absolutely want to see equitable procedures.

Insofar as we are dealing with millions of dollars that the Government is losing and insofar as we can employ management and administrative strategies to recapture those funds or to prevent against future losses, I think we do need to look long and hard in the instance of defaulted schools, and I can assure you that it is not going to be the personal who is reviewing it. This kind of issue is reviewed by budget people, by attorneys, and by decisionmakers throughout the Federal Government.

Mr. Weiss. Does the Department of Education intend to use the money you collect under the discounts to make new loans?
Dr. Kimberling. We have asked for no new loan authority under this program for the past 8 years. We would hope that the money can be used to help serve as a hedge against the increasing national debt.

Mr. Weiss. I understand from officials of the Department and at OMB that you plan to use the funds repaid under the discount plan to pay off the Department’s liability on Treasury borrowings and Government National Mortgage Association certificates.

Do you plan to also continue making new loans?

Dr. Kimberling. We are under instructions from the Congress to make $40 million in new loans this year. That is the limit of our authority. We would make new loans to the extent that the Congress would require us to use funds from the revolving fund for this purpose. We do have a major debt coming due on these Treasury Department sales of Ginny Mae participation certificates, dating back to 1967, 1968.

Those certificates were valued at $451 million in the College Housing Program. We have been making steady payments on that over the last few years and have reduced our total obligation to Ginny Mae down to $308 million. That is still a large debt that is due by 1987, and we want to be certain that there are sufficient resources in the revolving fund so that we are not placed in the unfortunate position 2 years hence of having to seek a special one-time appropriation from the Congress in this huge amount. We think that the discounting provision would gain us the short-term capital needed to prevent this kind of large on-budget appropriation in the next couple of fiscal years.

Dr. Elmendorf. Mr. Chairman, may I just make a correction for the record?

Mr. Weiss. Yes, Dr. Elmendorf.

Dr. Elmendorf. We also asked the Congress for language to implement a rescission of that $40 million so that it would not have to be loaned out.

I might add that we have also asked the Congress for an extension of the deadline date of the loan discount provision to September 1985, rather than September 1984.

Mr. Weiss. So, what you have told us is that you do not intend to make new loans with the money collected on the discount, is that correct?

Dr. Kimberling. That is correct.

Mr. Weiss. If Congress continues to authorize proceeds from the revolving fund to be used for new loans, where would you get the money from?

Dr. Kimberling. I am sorry. Could I have that question again?

Mr. Weiss. If Congress continues to authorize proceeds from the revolving fund to be used for new loans, where would you get the money for those new loans?

Dr. Kimberling. Well, any collections from the application of the discount authority would be placed in the revolving fund, so insofar as Congress would direct us to make new loans, we would be required to make those new loans from the Revolving Fund, which would include those assets.

We have been required in appropriations language the last couple of years by both the House and the Senate to file a plan of
action for retiring the Ginny Mae debt, and those plans are on file with the Appropriations Committee. So, that is a large priority in the view of the committee chairpersons.

Mr. Weiss. According to the budget officials of your Department, the College Housing Loan Program owes approximately $2.8 billion in Treasury borrowings and another $451 million on Government National Mortgage Association certificates when they mature.

Now, if you provide discounts on $3 billion in loans outstanding, theoretically you could collect as much as $1.5 billion.

Where will the Department get the remaining funds to pay off the liability to Treasury and to Ginny Mae?

Dr. Elmendorf. Mr. Chairman, I think that the assumption that 50 percent of the schools would participate in this program is at best optimistic. When the provision was available under the Academic Facilities Program, we had only 17 takers. Looking at the financial profiles at the institutions out there, whom you have acknowledged are in default, we don't find they have resources to take advantage of the discount provision even if it were on a case-by-case analysis.

Dr. Kimberling. Mr. Chairman, I would like to add to that.

I believe that the costs to the Treasury of subsidizing this program are precisely because they are multiyear, 3 percent loans. We are essentially paying the spread between 3 percent interest and market rate.

If all institutions, hypothetically, were to take advantage of the discount, then we would have no need to pay that money to the Treasury at all. That would be the type of savings that we are talking about realizing.

Mr. Weiss. Do you not in fact have $2.8 billion that were borrowed from the Treasury to institute the program and isn't that repayable?

Dr. Kimberling. Mr. Chairman, I would have to get some input from our budget officials on that number.

Mr. Weiss. Well, I can appreciate that, but I get distressed when you give me such firm, clear-cut answers on the one hand, and then when I ask you a specific question about how much is outstanding and how much is repayable, you say that you have to check that with your people. It just seems to me that you may not have sufficient information to be so precise.

Dr. Kimberling. I will have our Office of Planning, Budget, and Evaluation submit a detailed analysis of those figures, sir.

Mr. Weiss. Thank you.

Without objection, we will insert that analysis into the record at this point.

[The material follows:]

HUD borrowed $2.811 billion from the Treasury to finance College Housing projects. The Department of Education has since assumed the responsibility for repayment of these loans. The current outstanding balance is $2,667,324,866. A partial payment of $123,675,134 was made in April 1979.

Mr. Weiss. Dr. Elmendorf, you were quoted on April 16, 1984, in the Education Daily story about Fisk University as saying, "I don't envision this Government getting into the business of bailing out colleges."

Was that an accurate quotation?
Dr. ELMENDORF. That sounds like something I would have said, Mr. Chairman.

Mr. WEISS. Do you think that the discount regulation will amount to a bailout of colleges?

Dr. ELMENDORF. Well, I would like to make one point relevant to Fisk. Fisk at one time was in default and through a workout plan has brought itself current in all of these programs. They are no longer a defaulted institution.

I don't know how much I can share with you about the fiscal condition of Fisk except to say that they could not find the resources needed to allow them to take advantage of this provision. That is what I think I was trying to get to earlier. I just don't see a lot of funds lying around that institutions can use to take advantage of this provision.

Mr. WEISS. Husson College and I think I am pronouncing it correctly—of Maine received a college housing loan and an academic facilities loan totaling more than $6 million. Both loans are in default with a total of $2 million in past-due principal and interest.

Since 1979, Husson has been leasing a building financed by a Federal loan to the Job Corps for $184,000 a year.

Have all the lease revenues been applied to the delinquent debt?

Dr. KIMBERLING. I believe, Mr. Chairman; the IG's audit report indicates they have not.

Mr. WEISS. Kittrell College in North Carolina received three college housing loans totaling $1.4 million. The loans are $236,000 in arrears. In 1975 Kittrell closed down as a college. I understand that the third loan Kittrell received was never closed and, as a result, Kittrell has not begun paying on that loan.

Is that correct?

Dr. KIMBERLING. Yes, sir.

Mr. WEISS. Since 1978 the Job Corps of the Labor Department has been leasing the Kittrell facilities for $60,000. The Job Corps also spent $500,000 in Federal funds to refurbish the building.

Why hasn't the Department of Education demanded that the lease revenues be used to repay the past-due debt?

Dr. KIMBERLING. Mr. Chairman, we are receiving lease revenues from the Job Corps for their lease on the Kittrell facilities.

Mr. WEISS. How much of that are you receiving?

Dr. KIMBERLING. The figures I have show $7,000 per month—I am sorry—$70,000 per year, it looks like.

I would have to——

Mr. WEISS. Would you doublecheck that and submit the information to us?

Dr. KIMBERLING. The information I am given says that we are receiving Job Corps leasing funds.

Mr. WEISS. Without objection, we will insert into the record your answer concerning the exact figure.

[The material follows:]

The first lease agreement was consummated in 1978 and Kittrell paid $5,000 monthly or $60,000 annually. In July 22, 1982, the leasing agreement was revised, and ED received payment of $77,000 annually. Kittrell requested a moratorium on January 31, 1984 on payments for one year so that extensive repairs could be made to damaged facilities. However, Kittrell has agreed to make a $19,000 payment on interest in 1984.
Mr. WEISS. How long have you been receiving those funds?

Dr. KIMBERLING. The dates I have here show that we contacted them in 1982. They made a payment of $70,000 in December 1982. We had meetings and followup letters in 1983 and 1984. Negotiations are still underway on that, but we have received some of the Job Corps funds.

I would have to verify that for you, Mr. Chairman.

Mr. WEISS. In essence, they made a one-time payment; is that correct?

Dr. KIMBERLING. That is the information that I have, Mr. Chairman.

Mr. WEISS. Do you consider it proper for schools that are in default on their loans to be leasing federally financed buildings to other Federal agencies and to continue not paying their debt to the Department of Education?

Dr. KIMBERLING. No, sir.

Mr. WEISS. How many other schools participating in the loan program are leasing buildings to Federal agencies?

Dr. KIMBERLING. I would have to go back and get records on that. I would imagine that in addition to leases with respect to defaulted institutions that there are other approved leases with respect to nondefaulted institutions, and I would have to get the numbers on that.

Mr. WEISS. Would you get that information to us and submit it in as much detail as you can to the committee?

Dr. KIMBERLING. Yes, sir.

Mr. WEISS. Without objection, the material will be inserted into the record at this point.

[The material follows:]

Daniel Payne College, Birmingham, Alabama, $2,500 monthly.

Mr. WEISS. The Inspector General's audits have found that delinquent schools are diverting revenues in order to hide the true profits generated by buildings financed by Federal loans. In the course of the investigation of this program, subcommittee staff discovered a memorandum from one school that the Inspector General did not audit. The school is Ottawa University of Kansas. Ottawa received four loans totaling $2.4 million and is delinquent by $386,000. Ottawa has also been diverting revenues from its pledged projects to its general operational fund. An internal school memorandum states that—

In order to avoid showing artificial profit on the operation, we have for some years allocated financial aid expense and administrative costs to those operations. If we do not recognize these allocations we show a profit of approximately $100,000 on operations and HUD will certainly expect us to make substantial debt-service payments.

What are you doing to prevent this kind of manipulation, Dr. Elmendorf?

Dr. ELMENDORF. In this particular case, Mr. Chairman, I would have to go back to that statement of using resources that we have available. We do have independent auditors who are required to look at the total assets and liabilities of every institution every other year on the title IV programs. That is information that is being submitted now to the Department of Education, and I believe...
in conjunction with the Inspector General who gets the report, we ought to work out a better way of doing an accounting analysis on other higher education programs so that it can be given to the program office for followup.

That has worked quite well in student financial aid programs, and I think it can be done in this program, as well.

Mr. Weiss. Dr. Kimberling, will Ottawa University be eligible for a discount?

Dr. Kimberling. All institutions will be eligible for a discount, but in light of some of the serious violations that we have seen here, if those violations are upheld and proven—and we do believe in the due process right of any entity that has been audited to respond to the audit with documentary evidence—and once that due process is complete we would have some reservations about offering a discount to an institution that has violated the Federal regulations.

Mr. Weiss. The Inspector General audits found that schools that were delinquent on their Department of Education loans were current on their private loans.

For example, the Inspector General noted that Viterbo College of Wisconsin "has not been consistent or equitable in its repayment of debt to the Federal Government. It made debt-service payments and acquired real estate while in arrears on both its Federal loans."

This school has a total delinquency of more than $1 million. Does this example indicate to you that some of these schools view the Federal Government's interest as secondary to those of a local bank, for instance?

Dr. Elmendorf. Mr. Chairman, I would try to answer that question by saying that I think the institutions looking at their own best interests are going to pay off the highest interest rate loans. I don't think we can tolerate that, and one of the things that we might propose is offsetting legislation. Such legislation could provide a negative enforcement tool that would restrict the continuous flow of student financial aid dollars to an institution that finds itself in the position of choosing to pay private creditors rather than meeting their obligation to pay the Department of Education.

Mr. Weiss. Tennessee Wesleyan College is another example of inequitable treatment of Federal loans. The school has received $1.3 million in construction loans under these programs. Since 1976 the school has not made any principal payments on these loans, yet during that same period Tennessee Wesleyan paid regular payments on a loan from a county development board.

Moreover, the school's financial statements indicate net revenues from the pledged facilities amounted to $96,000 from 1981 through 1983.

Would you know why you haven't tried to collect from those revenues?

Dr. Kimberling. You are talking about—

Mr. Weiss. Tennessee Wesleyan.

Dr. Kimberling. Revenues that are actually placed in a reserve account?

Mr. Weiss. Net revenues from pledged facilities.
Mr. CONANAN. Mr. Chairman, is this a public institution or a private institution, by the way?

Mr. WEISS. It is a private institution, but I am not sure what difference that makes.

Mr. CONANAN. Well, in some of the agreements the Housing and Urban Development Department entered into—or HEW—under agreements with public institutions, revenues, net revenues from the dormitory facility had to be deposited in certain accounts and were pledged as security for the indebtedness.

With respect to private institutions, however, generally there was no requirement that net revenues be pledged as security. In most cases, the Government just took out a mortgage lien on the facility instead of requiring pledged revenues from the facility.

Dr. KIMBERLING. Mr. Chairman, I——

Mr. WEISS. But it is clear that the revenues from those pledged facilities were in fact required to be paid back to the Federal Government. Isn't that correct?

Mr. CONANAN. Well, for a public institution, that is the security for the indebtedness in the event the public institution defaults on the loan.

However, with respect to a private institution, there is generally no requirement that the private institution pay from net project revenues. The institution can pay from other sources.

Dr. KIMBERLING. Mr. Chairman, I do have information that in 1981 they were cited by our Department for not applying the net revenues to their debt service reserve account. This is one of the reserve accounts set up under the program.

They claimed ineligible costs of $9,800, and they submitted a check for that amount to us in November of 1981. The recent financial reports indicate that they are running deficits due to a lack of occupancy in their facilities.

Mr. WEISS. Regardless of what some general propositions state, Mr. Conanan, these IG audits indicated that most of these schools were private institutions to begin with, and that in fact they were pledged facilities and they were required to pay those moneys, so I am not sure what the theoretical discussion you are engaged in says to us.

Mr. CONANAN. Let me just clarify something. These private institutions may be required to pay into reserve accounts, but they are not required to pay from those reserve accounts the principal and interest on the loan. Only the event of a default are they required to make those payments from the debt service reserve account.

Mr. WEISS. Well, but you have defaults here. That is the finding in these instances.

When the Department finalizes or closes a loan, do you have a legal representative from the Department at the loan closing?

Dr. KIMBERLING. I believe our attorney, Mr. Conanan, can answer that.

Mr. CONANAN. There isn't an official or legal official from the Office of General Counsel at the loan closing.

However, there is a bond counsel generally available who represents the institution and the trustee bank, which are signatories to the instrument under which the mortgage lien or whatever other
obligations are created. Many of the agreements that are negotiated between the bank, the Government, as well as the institution are standard-form agreements which were previously approved by HUD or other attorneys at the Office of General Counsel in the Department of Education.

Mr. WEISS. Who then represents the Department's/legal interest at the closing?

Mr. CONANAN. The closing itself is—no real title is being conveyed at that particular point in time at the closing, and it is not necessary for a lawyer from the Department of Education to actually be present at the closing, but I think the lawyers at the Department of Education are constructively present in the sense that in case there is a problem or in case an issue arises from the closing the lawyers from the Department would be immediately notified.

Mr. WEISS. Who pays the trustee and bond counsel?

Mr. CONANAN. I believe the institution itself.

Mr. WEISS. The borrower?

Mr. CONANAN. Yes.

Mr. WEISS. Do you believe that the Department's interests are adequately protected by attorneys who are paid by the borrower?

Mr. CONANAN. Well, it may not be a question of adequately protected. I believe that there isn't that much of a risk of something going wrong in these closings because you have standard-form agreements that are being negotiated, and because at the end of the closing the institution must file with the Department of Education a certified recorded copy of any instrument or lien on the project facility, so we get that information so we have evidence that all recording steps have been taken.

Mr. WEISS. Do you see any potential for conflict of interest?

Mr. CONANAN. Well in many States the code of professional responsibility expressly allows attorneys to represent three parties. For example, in Virginia the code of professional responsibility allows a lawyer to represent the borrower, the seller, and the financial institution.

Mr. WEISS. Well, are they your representatives, the counsel for the trustee and the bond counsel?

Mr. CONANAN. Well, they are not official representatives.

Mr. WEISS. Right.

Mr. CONANAN. But the point that I think we are trying to make here is that there may not be any need to have someone present at these closings because of the nature of the risks that are involved. They are very, very small because all of the agreements are standard-form agreements, in essence.

Dr. KIMBERLING. Mr. Chairman, if there should be any codicils or modifications to those agreements as they come back to us, they are then transmitted to our Office of the General Counsel. So, our attorneys would review them if they vary from the boilerplate language that, as our counsel has indicated, is preapproved and legally binding.

We also verify that the documents are properly recorded and properly filed and would have counsel present if there were any discrepancies—
Mr. WEISS. We had testimony in the course of today's hearing that some of the documentation is never forwarded to the Federal Reserve bank and, therefore, payments don't commence because the FRB is not aware of it.

Dr. KIMBERLING. We are talking about different sets of documents. These are the trust indentures and the mortgages which preserve and protect the Government's right to title in the event of private institutions—

Mr. WEISS. We are talking about all the Government's interests. It seems to me that if you had your own counsel there that at least he or she would get a copy of the instruments and would know that the matter is closed and would forward it to the FRB or to you to forward to the FRB.

Dr. KIMBERLING. But we do get copies of the instruments available. They are reviewed and counsel is brought in whenever they vary from any standard form.

Mr. WEISS. The current regulations by which the College Housing Program operates were published in final form, I understand, on May 20, 1982.

Is that correct, Dr. Elmendorf? Or Dr. Kimberling?

Dr. KIMBERLING. Yes.

Mr. WEISS. The regulations contain no loan management requirements.

I have before me draft loan management regulations that I understand were supposed to be included in the final 1982 regulations. They are not.

Can you tell me why these regulations were not published?

Dr. ELMENDORF. These regulations, Mr. Chairman, are about to be published. There was a great deal of controversy in the Department relative to some of the provisions. We go through an elaborate review process, but I do expect to see those regulations published in the near future.

Mr. WEISS. I understand that the regulations were inadvertently left out.

Dr. KIMBERLING. Mr. Chairman, if I can recall the history here correctly, it was the opinion in the Department that the new regulations pertaining to the loan origination and construction management processes were indeed necessary in order to follow up on some of the items on the 1980 and 1981 GAO reports.

Our understanding initially was that the loan management regulations provided for under the old HUD regulations were still good for our Department because the procedures did not vary from the loan management procedures covered under the basic statute.

I understand that in publishing the new regulations, which abolished the old HUD regulations, the loan management regulations were inadvertently included.

We, therefore, at the advice of the Office of General Counsel, proceeded with reviewing and tightening up our own loan management regulations, and those are the regulations to which you are referring that are in the clearance process.

Because we have been able to exercise our authority under the basic law under the terms of the old HUD regulations, which have been sustained and under the provisions of the Education Department General Administrative Regulations—the so-called EDGAR
regulations—which have provided us with sufficient authority, we haven't had any negative impact on our ability to exercise any of our enforcement tools.

We do await the publication of our new regulations because we think they will give us a little bit stronger platform to stand on.

Mr. Weiss. When is that intended to take place?

Dr. Kimberling. Those are now in final departmental clearance. I don't believe I have a due date, but they are in final review.

Mr. Weiss. Dr. Elmendorf, you testified in your opening statement that most of the recommendations of the Inspector General and the General Accounting Office have been implemented by the Department of Education.

I would like to go over those recommendations with you now.

The Inspector General recommended that the audit and inspection fees fund be transferred to the Education Department from HUD. We have already established that that has not been done. The Inspector General recommended that a specific length of time be established through regulation for the start and completion of construction.

Has that been done?

Dr. Elmendorf. There are two basic things.

No, sir. We do not completely agree with the Inspector General. The 18-month provision we now have in place we feel is satisfactory and does allow for sufficient protection.

Dr. Kimberling. Excuse me, Mr. Chairman.

We agree with a portion of the Inspector General's recommendation, the portion that there must be a fixed time limit prior to, between loan reservation and construction.

We are currently enforcing an 18-month time period. The Inspector General has indicated that they are fully satisfied with that portion.

They also recommended a reevaluation of housing shortage prior to the final construction commencement; in other words, 18 months after the application review.

Our view differs from the Inspector General with respect to that proviso. We feel the main problem in the past is that there was no enforcement of any time line for startup of construction and that 18 months is a reasonable timeframe.

We also feel that, just as economic conditions in localities can change one way within an 18-month timeframe, they can change another way in another 18-month timeframe. But the Government does have a commitment to go ahead with construction, and shortages have adequately been noted through the application process which we have tightened up, and, therefore, there is no need for a second evaluation a scant 18 months later.

Mr. Weiss. The Inspector General recommended that a regulation be issued that provides for the cancellation of a loan. That is just what you referred to——

Dr. Kimberling. Yes, our policy that we have been enforcing is to cancel the loans if construction does not commence within 18 months.

We do that on the basis of EDGAR [Education Department General Administrative Regulations].
Mr. WEISS. The Inspector General recommended that the Department have legal representation at loan closings. Has that been done?

Dr. KIMBERLING. Well, the Inspector General recommended that the Department have adequate representation and coverage. We have made sure that we have representation by the ROFEC engineers in terms of engineering inspection. We do not have our own counsel present at the closings. I think, as our attorney has indicated, we do not feel that it is necessary at the time of closing with the signing and notarizing of——

Mr. WEISS. OK, so you disagree with the Inspector General's recommendation on that?

Dr. KIMBERLING. In short and in that regard, yes.

Mr. WEISS. OK.

The GAO recommended in its 1982 discussion paper sent to the Department that financial penalties be used against defaulted institutions.

Is that being done?

Dr. KIMBERLING. Mr. Chairman, we do not have legal authority to assess penalties in these programs. That is certainly an idea that should be explored more. It is one of the extra set of teeth that I think would be very helpful in this program.

Mr. WEISS. Have you had under active consideration the recommendation of such legislative sanction?

Dr. KIMBERLING. I am quite certain that as a result of this hearing, we will definitely have it under active consideration.

Mr. WEISS. The GAO recommended that delinquent borrowers be ineligible for all other Federal assistance.

Is that being done?

Dr. KIMBERLING. Delinquent borrowers are ineligible for assistance under the housing programs. We have had the ability to put that into our regulations. We do not have sufficient legal authority, we feel, to apply that across the board, but we are pursuing the notion of either offsetting in order to bring delinquencies back into current status or having some other kinds of prohibitions.

By the way, we are currently preparing final regulations in our Title III Endowment Program, and we envision those regulations barring participation by any school in delinquency on a housing loan.

Mr. WEISS. Before we conclude the hearing, is there anything further that you, Dr. Elmendorf, or any of your associates want to say for the record?

Dr. ELMENDORF. No, sir. We appreciate the opportunity to be heard.

Mr. WEISS. Well, I thank you very much for coming at a time when I gather it has presented some difficulty to you physically and personally.

Mr. CONANAN. Mr. Chairman, excuse me for a second.

Mr. WEISS. Yes.

Mr. CONANAN. You had asked us before when the Department of Education had foreclosed on Milton College.

Mr. WEISS. Right.

Mr. CONANAN. That was a private institution and foreclosure took place on November 10, 1982. The college was not in bank rupt-
or not in any State receivership proceedings. Judgment was—I think the foreclosure sale occurred, however, on December 29, 1988.

Mr. Weiss. But isn't it a fact that when you commenced that foreclosure proceeding that the college had already closed its operations as a college?

Mr. Conanan. Yes.

Mr. Weiss. So, you had really not very much choice about that. It was tantamount to worse than bankruptcy.

If there are no further statements, let me just again without objection indicate that we have a series of statements that have been referred to—if we have not received specific authorization—that will be entered into the record. We may, both on the majority and minority side, have occasion to submit some further questions to you in writing. We would appreciate your responding to those as quickly as you can. We have a number of instances in which you sought permission to submit information for the record, and I hope that you will do that as expeditiously as possible.

The subcommittee at this point is adjourned subject to the call of the Chair.

[Whereupon, at 1:20 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]
May 21, 1984

The Honorable Ted Weiss
United States House of Representatives
H372 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

The May 16 Washington Post "Federal Report" article "Much Delinquency Found in College Building Loans" conveyed the erroneous impression—generated in a hearing of your Intergovernmental Relations and Human Resource Subcommittee—that there is a major delinquency problem in the federal college facilities loan programs.

The fact is that of $3.37 billion in outstanding loans to 1,308 colleges and universities, only 67 institutions are not current in their payments to the federal government. Of these 67 colleges, 49 have made loan repayment arrangements with the Department of Education and only 18 are in actual default. Currently, the sum of all missed payments, including those colleges that are making payments under special agreements, is $36.1 million. This is less than 1.1 percent of the total outstanding, a figure clearly not in keeping with the "much delinquency" stated in the Washington Post headline.

The two loan programs mentioned in the article have helped many of the nation's institutions of higher education provide their students with needed facilities in which to live and receive an education. The federal government has not made any new loans under the Academic Facilities Program since 1973, and the College Housing Program provides new loans from a revolving account of repaid loans.

Our association is distressed that the report of the hearings would foster the incorrect impression that colleges are abusing these beneficial federal programs. The facts do not support such a contention. Although a few colleges have fallen behind in their debt payments during periods of financial difficulty, nearly 99 percent of the colleges are fulfilling their commitment to the federal government. It is inappropriate to castigate the vast majority of colleges based on the problems of a very few.
We would appreciate it if this letter could be included in the record of the May 15 subcommittee hearing.

Sincerely,

D. F. Finn
Executive Vice President

cc: Members of the Subcommittee on Intergovernmental Relations and Human Resources
    Members of the House Subcommittee on Postsecondary Education
May 29, 1984

The Honorable Ted Weiss
United States House of Representatives
B372 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Weiss:

I currently serve as Liaison to the College Housing Loan Program for the Association of College and University Housing Officers—International. Our Association members are most upset by recent newspaper articles reporting on the hearings your committee conducted and the false impression that has been conveyed that there is a major delinquency problem with the program. Please let me help you set the record straight.

More than $5 billion has been loaned to universities since approval and funding of the College Housing Loan Program in the 1950s. Of the 1308 loans still outstanding only 18 schools are in actual default. About 1% of the funds loaned are in default—99% of the outstanding loans are current. Any banker in the country would be delighted if their own portfolio was in such good shape.

The College Housing Loan Program is one of the best federal programs ever devised—one that helps people and is fully repaid with interest. It may well be an example of one of the best financial aid programs available for college students. On my own campus, Central Michigan University, we just obtained a $2.47 million loan for energy conservation projects that will save our students $20 million over the next 10 years. We actually reduced our room and board rates last year.

Also, we couldn’t be happier with the current administration of the program by the Department of Education. Originally, the program was administered by HHFA in the 50s and 60s, and later by HUD. The Department of Education began administering the program in June, 1981, and have done, in my opinion an outstanding job for which they should be complimented rather than criticized. I have worked with the program since 1963 and I thought another view might be useful to your committee.

Please make this letter a part of the record of the May 15 subcommittee hearing. We want to do what we can to set the record straight—the program has been well managed, it is an excellent federal program and residence halls are an important and integral part of the total educational growth and development of students. The residence hall role on campuses is one of “Education for Living”. I sometimes wonder if anything is more important than learning to work and live with all people. Any support your committee can give this program will be greatly appreciated by America’s college students.

Sincerely,

Terry Quick
Liaison, College Housing Loan Program
Association of College and University Housing Officers—International

Jerry Quick
Liaison, College Housing Loan Program
Association of College and University Housing Officers—International

JQ/bln
College Housing Loan Program: Past, Present, and Future

JERRY QUICK

Title IV of the Housing Act of 1950, as amended, authorized the federal government to assist institutions of higher education, through long-term federal loans (of up to forty years), in the construction or rehabilitation of residence halls, dining halls, student unions, infirmaries, and family housing. This provision allowed university administrators to consider five types of financing for housing and food service facilities: (1) government appropriations, (2) gifts and grants, (3) revenue bonds, (4) federal loans, and (5) a combination of these sources. In 1956, President Eisenhower advised the Housing and Home Finance Agency (HHFA), which later became the Department of Housing and Urban Development (HUD), to enforce new policies. In this case, again, federal advances for construction should be used to the extent necessary to accomplish this purpose. This sense of urgency on the part of President Eisenhower, as well as the rapidly expanding enrollments at colleges and universities across the country, led to rapid construction of housing and food service facilities in the 1950s and 1960s. The program, generally known as the College Housing Loan Program, was originally administered under the Housing and Home Finance Agency (HHFA), which later became the Department of Housing and Urban Development (HUD). This past year, the program was transferred to the new federal Department of Education. However, HUD will continue to enforce new policies until such time as the Department of Education is prepared to absorb the function. The complete transfer is anticipated to take place in June, 1981.

Under the direct loan program, the Secretary of the Department of Housing and Urban Development, utilizing borrowing authority from the Treasury Department, purchases revenue bonds issued by eligible borrowers, as defined in Title IV. Generally, the loans are amortized over forty years with a 3% interest rate and can cover 100% of the cost of a project. HUD requires and obtains all pledges and securities customarily associated with private-market bond financing. Many of the bonds originally purchased by HUD were later resold on the private market.

In the case of a private school, security is generally satisfied by a mortgage on the completed project, and/or land when deemed necessary, and by a pledge of project revenues and/or other revenues. In addition, there is a general obligation on the part of the borrowing institution. Public schools usually pledge only project revenues, since the good faith and credit of the state is considered sufficient security for the investment.

After HUD purchases the bonds—single, registered, or coupon—this is sold to the Federal Reserve Bank in Richmond, Virginia, for safekeeping. The Federal Reserve Bank also acts as fiscal agent for HUD by sending bills and collecting payments, and it provides reports on the status of the program and bonds on a monthly and quarterly basis.

The controlling loan documents used are: (1) trust indentures, for private schools, which require a trustee bank; (2) bond resolutions, for public schools; with the treasurer of the school as trustee; (3) loan agreements, for both private and public schools; and (4) a note-mortgage, which, in some cases, may be used to secure the loan. These documents specify the terms and conditions of the loan and are binding on all parties concerned. In addition, HUD has issued a College Housing Handbook and has published regulations to clarify the policies and procedures. For example, HUD exercises the right to remedy defaults in loan modifications through the trustee bank, and only the central office has the authority to approve such actions.

Many universities make use of what is commonly known as "pyramidal financing." This is really systemwide financing, or open-end financing, through which all of the existing housing facilities on a campus or in a multicampus system, debt free and otherwise, are brought under a single operating system, with the earnings of the system, including those of the proposed projects, pledged to secure the bonds. Both the bonds sold privately and the issues sold to the government have equal claim on the revenue of the entire system. Another important feature of this form of financing is that provision is made for future bonds to be issued under what is known as "open-end indenture." Whenever the financial position of the operating system will permit, it is this latter feature that provided the feasibility colleges and universities needed to meet the demand for housing and dining facilities as enrollments kept increasing in the 1950s and 1960s.

Through the year 1977, the direct loan program had a bond portfolio that consisted of approximately 1,250 borrowers, with

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I, 2,734 loans having an outstanding balance of $33-billion. The public sector had 2,554 loans valued at $31.2-billion, and the private sector had 2,255 loans valued at $15.6-billion. These loans represented 25,000 residence hall units and 29,000 hospital units (food-service and student-union facilities are not included in these figures). Since 1977, no new federal monies have been appropriated for loans, but $445-million has been made available from repayments received on previous loans.

Lender the direct loan program, approximately $160-million in principal and interest is paid back annually to the Treasury. There is no legislative authority to forgive any part of the indebtedness, to write down the loan, or to discount the bonds. In recent years, approximately one half of the amount of the annual repayments has been made available for new loans. The balance of the repayments has been used to retire outstanding bonds and to offset cost of administering the College Housing Loan Program. Congress has to authorize the revolving-fund use of the repayments for loan purposes each year. It has the option, of course, of having the entire $160-million repaid directly to the Treasury.

The default rate on the direct loan program has been less than 1%. Colleges and universities have an excellent history of repayment—probably the highest of any group in a federal loan program. Currently, the total amount of loans outstanding exceeds $3-billion, with only $20-million in loans overdue (0.7%).

In addition to the direct loan program, there are some 450 interest grants (interest subsidies) in support of some $560-million in private market bond sales. Grant payments are made semiannually and total $22-million a year. The grant agreements have a recall provision that the government can exercise in order to obtain more favorable interest rates. The borrowing authority for this program was rescinded in fiscal year 1974. Up to 25% of the $85-million available for college housing loans in fiscal 1980 was reserved for rehabilitation to reduce fuel consumption or other operating costs of existing eligible housing and related dining facilities. The balance went for new construction or for the acquisition or rehabilitation of student housing and related dining facilities to alleviate a current student-housing shortage. If any money remained after the above two priority categories were filled, provision was made for the construction, acquisition, and rehabilitation of faculty housing. In the category of new construction or acquisition of student housing, up to 30% of the loan funds were reserved for institutions with full-time enrollments of fewer than 3,000; 20% for institutions with enrollments of 3,000-4,999; 15% for institutions with enrollments of 5,000-9,999, and 10% for institutions with enrollments of 10,000 or more. Not less than 10% of the total funds available were reserved for historically black colleges.

What is the future of the College Housing Loan Program? Energy conservation and rehabilitation of facilities will continue to be the emphasis of the program, since the age of most of higher education’s facilities is approaching twenty years. The real future of the program may be determined by how well housing officers across the country articulate their needs and concerns to the Department of Education and to their senators and representatives in Congress. It is important to point out that no new money is required—it is only necessary to recycle the existing money that is being repaid by universities. Current interest rates prohibit most schools from borrowing money on the open market for new construction or rehabilitation. Significant sums of money are going to be required in the future to rehabilitate buildings that are twenty years old or older. Buildings are also going to require extensive remodeling to meet the changing needs of the students of the 1980s. Unfortunately, too, most residences and dining facilities were built during an era of cheap energy and will require much retrofitting to meet the current need for energy conservation.

The College Housing Loan Program is existing now only because housing officers have been vocal in their support of the program. It is essential that they be even more aggressive in expressing their strong support and urgent need for continuation of the program. There is a new Department of Education, and a new appropriations subcommittee to educate, and housing officers must do the educating. The continuation of the College Housing Loan Program is vital to satisfying the housing needs of students in the 1980s. It is perhaps one of the best federal programs ever devised—one that helps people and is fully repaid with interest. Housing officers must show strong support for the program if they expect it to be continued.