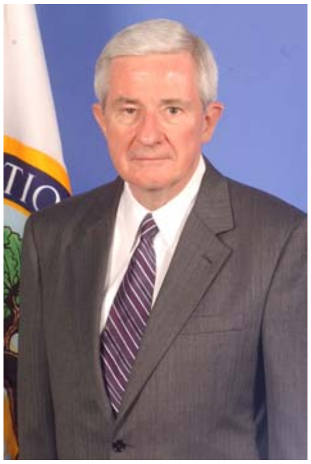
Financial Details



The Department of Education continued its high standard of financial management and reporting during fiscal year (FY) 2007. In this part of the *Performance and Accountability Report*, I have the pleasure of presenting to the President and the American people the financial details on the Department's stewardship and management of the public funds to which we have been entrusted.

The Department's impressive record of excellence in financial management has been a joint effort of its managers, employees, and business partners who make it a priority to ensure that the Department reports contains the highest quality financial data. Highlights of these successful efforts over the last year are as follows:

- Completed the implementation of an upgraded financial management system, in the first quarter of FY 2007;
- Received an unqualified opinion on the principal financial statements for the sixth consecutive year, demonstrating a clear pattern of financial accountability;
- Continued to have no material weaknesses identified as part of the Department's "Report on Internal Control" for the fifth consecutive year;
- Received a "green" status in Financial Management on the *President's Management Scorecard* for the fourth consecutive year;
- Continued to provide reasonable assurance of its internal controls over financial reporting.

In FY 2007, the Department furthered its efforts to correct the two reportable conditions identified by the auditors in the FY 2006 "Report on Internal Control." To address the reportable condition regarding the credit reform estimation the Credit Steering committee has worked diligently to continue to improve the process. In the first quarter of FY 2007, the Department instituted monthly meetings including personnel from the Office of the Chief Financial Officer, Budget Service, Federal Student Aid and Office of Management and Budget. Throughout the fiscal year the committee has addressed policy, cost and management issues that impact the loan programs. The Department also continued to address the other reportable condition regarding controls surrounding information systems.

During FY 2007, the Department conducted an assessment of the effectiveness of its internal control over financial reporting. This review was based upon the requirements of OMB Circular A-123 (Appendix A), *Management's Responsibility for Internal Control*. The Department is pleased to report that it can give an unqualified statement of assurance on its internal control over financial reporting. This examination has presented us the opportunity to further review and improve upon our internal controls and thereby continue to ensure the greatest integrity in our financial management and reporting.

Lawrence Warder
Chief Financial Officer
November 15, 2007

Financial Summary

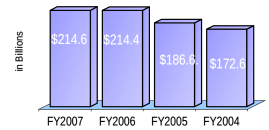
(Dollars in Millions)

At End of Year	% Change 2007 / 2006	FY2007	FY2006	FY2005	FY2004
Condensed Balance Sheet Data					
Fund Balance with Treasury	- 9%	$ 97,532	$ 107,053	$ 77,569	$ 66,371
Credit Program Receivables	+ 9%	115,904	106,728	107,937	104,966
Accounts Receivable	+ 20%	53	44	141	155
Other	+ 93%	1,149	596	920	1,117
**Total Assets*	-	$ 214,638	$ 214,421	$ 186,567	$ 172,609
Debt	- 1%	$ 104,287	$ 105,677	$ 104,597	$ 96,649
Other Intragovernmental Liabilities	+ 9%	6,746	6,182	6,146	6,051
Liabilities for Loan Guarantees	- 3%	50,874	52,453	30,611	23,329
Other Liabilities	- 5%	3,150	3,299	2,371	2,246
Total Liabilities	- 2%	165,057	167,611	143,725	128,275
*Unexpended Appropriations	-	52,047	51,812	47,288	47,285
Cumulative Results of Operations	- 51%	(2,466)	(5,002)	(4,446)	(2,951)
Total Net Position	+ 6%	49,581	46,810	42,842	44,334
**Total Liabilities and Net Position*	-	$ 214,638	$ 214,421	$ 186,567	$ 172,609

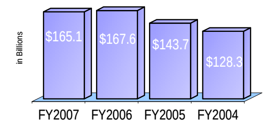
For the Year	% Change 2007 / 2006	FY2007	FY2006	FY2005	FY2004
Statement of Net Cost					
Total Cost	- 31%	$ 72,316	$ 104,699	$ 82,204	$ 70,187
Earned Revenue	+ 2%	(8,032)	(7,870)	(6,965)	(6,564)
Total Net Cost of Operations	- 34%	$ 64,284	$ 96,829	$ 75,239	$ 63,623
Net Cost by Strategic Goal					
Goal 2 Improve Student Achievement	- 2%	$ 36,838	$ 37,700	$ 36,415	$ 32,687
Goal 3 Develop Safe and Drug-Free Schools	- 13%	740	849	877	756
Goal 4 Transform Education into Evidence Based Field	- 13%	367	422	442	467
Goal 5 Enhance Quality of and Access to Postsecondary and Adult Education	- 55%	25,799	57,303	36,940	29,713
Goal 6 Management Excellence[1]	- 3%	540	555	565	-
	- 34%	$ 64,284	$ 96,829	$ 75,239	$ 63,623
Net Cost Percentages by Strategic Goal					
Goal 2 Improve Student Achievement	+ 47%	57.31%	38.90%	48.40%	51.38%
Goal 3 Develop Safe and Drug-Free Schools	+ 31%	1.15%	0.88%	1.17%	1.19%
Goal 4 Transform Education into Evidence Based Field	+ 30%	0.57%	0.44%	0.59%	0.73%
Goal 5 Enhance Quality of and Access to Postsecondary and Adult Education	- 32%	40.13%	59.18%	49.09%	46.70%
Goal 6 Management Excellence[1]	+ 40%	0.84%	0.60%	0.75%	N/A

* *Percentage changes less than 1% are not presented in this summary.*
[1] *In FY04 Goal 6 was not included in this summary.*

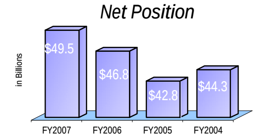
Total Assets



Total Liabilities

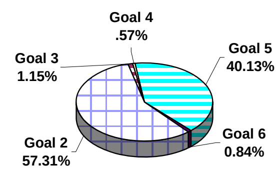


Net Position

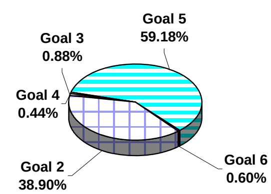


Net Cost by Strategic Goal

FY 2007



FY 2006



Limitations of Financial Statements

Management has prepared the accompanying financial statements to report the financial position and operational results for the U.S. Department of Education for fiscal years 2007 and 2006 pursuant to the requirements of Title 31 of the United States Code, section 3515(b).

While these statements have been prepared from the books and records of the Department in accordance with generally accepted accounting principles for federal entities and the formats prescribed by OMB, these statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

The statements should be read with the realization that they are a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities presented herein cannot be liquidated without the enactment of appropriations, and ongoing operations are subject to the enactment of future appropriations.

United States Department of Education
Consolidated Balance Sheet
As of September 30, 2007 and 2006

(Dollars in Millions)

	Fiscal Year 2007	Fiscal Year 2006
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 97,532	$ 107,053
Accounts Receivable (Note 4)	4	1
Total Intragovernmental	97,536	107,054
Cash and Other Monetary Assets (Note 5)	1,103	566
Accounts Receivable, Net (Note 4)	49	43
Credit Program Receivables, Net (Note 6)	115,904	106,728
General Property, Plant and Equipment, Net (Note 7)	46	29
Other Assets		1
Total Assets (Note 2)	**$ 214,638**	**$ 214,421**
Liabilities:		
Intragovernmental:		
Debt (Note 8)	$ 104,287	$ 105,677
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5)	1,103	566
Payable to Treasury (Note 6)	5,351	5,519
Other Intragovernmental Liabilities (Note 9)	292	97
Total Intragovernmental	111,033	111,859
Accounts Payable	913	859
Accrued Grant Liability (Note 10)	2,094	2,059
Liabilities for Loan Guarantees (Note 6)	50,874	52,453
Other Liabilities (Note 9)	143	381
Total Liabilities	**$ 165,057**	**$ 167,611**
Commitments and Contingencies (Note 17)		
Net Position:		
Unexpended Appropriations - Earmarked Funds (Note 16)		
Unexpended Appropriations - Other Funds	$ 52,047	$ 51,812
Cumulative Results of Operations - Earmarked Funds (Note 16)	39	61
Cumulative Results of Operations - Other Funds	(2,505)	(5,063)
Total Net Position (Note 11)	**$ 49,581**	**$ 46,810**
Total Liabilities and Net Position	**$ 214,638**	**$ 214,421**

The accompanying notes are an integral part of these statements.

United States Department of Education
Consolidated Statement of Net Cost
For the Years Ended September 30, 2007 and 2006
(Dollars in Millions)

	Fiscal Year 2007	Fiscal Year 2006
Program Costs		
Enhancement of Postsecondary and Adult Education		
Gross Costs	$ 31,924	$ 63,356
Less: Earned Revenue	7,933	7,790
Net Program Costs	23,991	55,566
Total Program Costs	**$ 23,991**	**$ 55,566**
Creation of Student Achievement, Culture of Achievement and Safe Schools		
Gross Costs	$ 23,368	$ 24,605
Less: Earned Revenue	78	60
Net Program Costs	23,290	24,545
Total Program Costs	**$ 23,290**	**$ 24,545**
Transformation of Education		
Gross Costs	$ 1,468	$ 1,363
Less: Earned Revenue	18	18
Net Program Costs	1,450	1,345
Total Program Costs	**$ 1,450**	**$ 1,345**
Special Education and Program Execution		
Gross Costs	$ 15,556	$ 15,375
Less: Earned Revenue	3	2
Net Program Costs	15,553	15,373
Total Program Costs	**$ 15,553**	**$ 15,373**
Grand Total Program Costs	**$ 64,284**	**$ 96,829**
Net Cost of Operations (Notes 12 and 15)	**$ 64,284**	**$ 96,829**

The accompanying notes are an integral part of these statements.

United States Department of Education
Consolidated Statement of Changes in Net Position
For the Years Ended September 30, 2007 and 2006
(Dollars in Millions)

	Fiscal Year 2007 Cumulative Results of Operations	Fiscal Year 2007 Unexpended Appropriations	Fiscal Year 2006 Cumulative Results of Operations	Fiscal Year 2006 Unexpended Appropriations
Beginning Balances				
Beginning Balances - Earmarked Funds	$ 61			
Beginning Balances - All Other Funds	$ (5,063)	$ 51,812	$ (4,446)	$ 47,288
Budgetary Financing Sources:				
Appropriations Received				
Appropriations Received - Earmarked Funds				
Appropriations Received - All Other Funds		$ 73,921		$ 102,139
Other Adjustments (rescissions, etc)				
Other Adjustments (rescissions, etc) - Earmarked Funds				
Other Adjustments (rescissions, etc) - All Other Funds		(1,090)		(1,509)
Appropriations Used				
Appropriations Used - Earmarked Funds				
Appropriations Used - All Other Funds	$ 72,596	(72,596)	$ 96,106	(96,106)
Donations and Forfeitures of Cash and Cash Equivalents				
Donations and Forfeitures of Cash and Cash Equivalents - Earmarked Funds			61	
Donations and Forfeitures of Cash and Cash Equivalents - All Other Funds				
Nonexpenditure Financing Sources - Transfers-Out				
Nonexpenditure Financing Sources - Transfers-Out - Earmarked Funds				
Nonexpenditure Financing Sources - Transfers-Out - All Other Funds	(27)		(36)	
Other Financing Sources:				
Imputed Financing from Costs Absorbed by Others - Earmarked Funds				
Imputed Financing from Costs Absorbed by Others - All Other Funds	$ 32		$ 31	
Others				
Others - Earmarked Funds				
Others - All Other Funds	(5,781)		111	
Total Financing Sources				
Total Financing Sources - Earmarked Funds			**$ 61**	
Total Financing Sources - All Other Funds	**$ 66,820**	**$ 235**	**$ 96,212**	**$ 4,524**
Net Cost of Operations				
Net Cost of Operations - Earmarked Funds	**$ (22)**			
Net Cost of Operations - All Other Funds	**$ (64,262)**		**$ (96,829)**	
Net Change				
Net Change - Earmarked Funds	**$ (22)**		**$ 61**	
Net Change - All Other Funds	**$ 2,558**	**$ 235**	**$ (617)**	**$ 4,524**
Ending Balances - Earmarked Funds (Note 11)	**$ 39**		**$ 61**	
Ending Balances - All Other Funds (Note 11)	**$ (2,505)**	**$ 52,047**	**$ (5,063)**	**$ 51,812**

The accompanying notes are an integral part of these statements.

United States Department of Education
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2007 and 2006

(Dollars in Millions)

	Fiscal Year 2007		Fiscal Year 2006	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:				
Unobligated balance, brought forward, October 1:	$ 5,221	$ 46,490	$ 2,137	$ 22,817
Recoveries of prior year Unpaid Obligations	1,968	3,043	1,434	3,450
Budgetary Authority:				
Appropriations	73,919	2	102,197	108
Borrowing Authority (Note 14)		20,037		35,089
Spending authority from offsetting collections (gross):				
Earned				
Collected	1,816	37,373	2,074	77,399
Change in Receivables from Federal Sources	3		1	
Change in unfilled customer orders				
Advance Received	(5)		9	
Without advance from Federal Sources	(3)	(30)	(1)	(4)
Subtotal	$ 75,730	$ 57,382	$ 104,280	$ 112,592
Permanently not available	(2,119)	(19,451)	(3,537)	(32,252)
Total Budgetary Resources (Note 14)	**$ 80,800**	**$ 87,464**	**$ 104,314**	**$ 106,607**
Status of Budgetary Resources:				
Obligations incurred: (Note 14)				
Direct	$ 75,435	$ 50,353	$ 99,001	$ 60,117
Reimbursable	93		92	
Subtotal	$ 75,528	$ 50,353	$ 99,093	$ 60,117
Unobligated Balances:				
Apportioned	3,093	321	4,081	
Subtotal	$ 3,093	$ 321	$ 4,081	
Unobligated Balance not available	2,179	36,790	1,140	46,490
Total Status of Budgetary Resources	**$ 80,800**	**$ 87,464**	**$ 104,314**	**$ 106,607**
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 50,210	$ 12,953	$ 48,213	$ 10,802
Uncollected customer payments from Federal Sources, brought forward, October 1	(3)	(30)	(3)	(34)
Total, unpaid obligated balance, brought forward, net	$ 50,207	$ 12,923	$ 48,210	$ 10,768
Obligation Incurred net (+/-)	75,528	50,353	99,093	60,117
Gross Outlays	(73,058)	(45,529)	(95,662)	(54,516)
Recoveries of prior year unpaid obligations, actual	(1,968)	(3,043)	(1,434)	(3,450)
Change in uncollected customer payments from Federal Sources (+/-)		30		4
Obligated Balance, net, end of period				
Unpaid Obligations	$ 50,712	$ 14,734	$ 50,210	$ 12,953
Uncollected customer payments from Federal Sources	(3)		(3)	(30)
Total, unpaid obligated balance, net, end of period	**$ $50,709**	**$ $14,734**	**$ $50,207**	**$ $12,923**
Net Outlays				
Net Outlays:				
Gross Outlays	$ 73,058	$ 45,529	$ 95,662	$ 54,516
Offsetting collections	(1,811)	(37,373)	(2,083)	(77,399)
Distributed Offsetting receipts	(173)	(4,700)	(51)	
Net Outlays (Note 14)	**$ 71,074**	**$ 3,456**	**$ 93,528**	**$ (22,883)**

The accompanying notes are an integral part of these statements.

Notes to the Principal Financial Statements

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The U.S. Department of Education (the Department), a Cabinet-level agency of the Executive Branch of the U.S. Government, was established by the Congress on May 4, 1980, under the *Department of Education Organization Act of 1979* (Public Law 96-88). It is responsible, through the execution of its congressionally approved budget, for administering direct loans, guaranteed loans, and grant programs.

The Department administers the William D. Ford Federal Direct Student Loan (Direct Loan) Program, the Federal Family Education Loan (FFEL) Program, the Federal Pell Grant (Pell Grant) Program, and the campus-based student aid programs to help students finance the costs of higher education. The Direct Loan Program, authorized by the *Student Loan Reform Act of 1993*, enables the Department to make loans directly to eligible undergraduate and graduate students and their parents through participating schools. The FFEL Program, initially authorized by the *Higher Education Act of 1965 (HEA)*, as amended, cooperates with state and private nonprofit Guaranty Agencies to provide loan guarantees and interest subsidies on loans made by private lenders to eligible students. Under these programs, the loans are made to individuals who meet statutorily set eligibility criteria and attend eligible institutions of higher education—public or private two- and four-year institutions, graduate schools, and vocational training schools. Students and their parents, based on eligibility criteria, receive loans regardless of income or credit rating. Student borrowers who demonstrate financial need also receive federal interest subsidies.

Additionally, the Department administers numerous grant programs and facilities loan programs. Grant programs include grants to state and local entities for elementary and secondary education; special education and rehabilitative services; educational research and improvement; and grants for needs of the disadvantaged. Through the facilities loan programs, the Department administers low-interest loans to institutions of higher learning for the construction and renovation of facilities.

The Department is organized into 10 reporting organizations that administer the loan and grant programs. The financial reporting structure of the Department presents operations based on four major reporting groups. The reporting organizations and the major reporting groups are shown below.

Reporting Organizations

- Federal Student Aid (FSA)
- Office of Elementary and Secondary Education (OESE)
- Office of Special Education and Rehabilitative Services (OSERS)
- Office of Vocational and Adult Education (OVAE)
- Office of Postsecondary Education (OPE)
- Institute of Education Sciences (IES)
- Office of English Language Acquisition (OELA)
- Office of Safe and Drug-Free Schools (OSDFS)
- Office of Innovation and Improvement (OII)
- Office of Management (OM)

Major Reporting Groups

- Federal Student Aid
- Office of Elementary and Secondary Education
- Office of Special Education and Rehabilitative Services
- Other

The Other major reporting group includes the OVAE, OPE, IES, OELA, OSDFS, OII and OM reporting organizations and Hurricane Education Recovery activities. (See Notes 10, 12 and 16)

Basis of Accounting and Presentation

These financial statements have been prepared to report the financial position, net cost of operations, changes in net position, and budgetary resources of the U.S. Department of Education, as required by the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994*. The financial statements were prepared from the books and records of the Department, in accordance with accounting principles generally accepted in the United States of America for federal entities, issued by the Federal Accounting Standards Advisory Board (FASAB) and the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, revised as of June 29, 2007. These financial statements are different from the financial reports prepared by the Department pursuant to OMB directives that are used to monitor and control the Department's use of budgetary resources.

The Department's financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation providing resources and legal authority to do so.

The accounting structure of federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

Transactions and balances among the Department's entities have been eliminated from the Consolidated Balance Sheet.

In previous years, a reconciliation of Net Cost of Operations to Budget was accomplished by presenting the Statement of Financing, a basic financial statement. Effective for fiscal year 2007, OMB and the Chief Financial Officers' Council decided this reconciliation would be better placed and understood as a footnote rather than as a basic financial statement. (See Note 15)

Use of Estimates

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make assumptions and estimates that directly affect the amounts reported in the financial statements. Actual results may differ from those estimates.

The *Federal Credit Reform Act of 1990* (Credit Reform Act) underlies the proprietary and budgetary accounting treatment of direct and guaranteed loans. The long-term cost to the government for direct loans or loan guarantees, other than for general administration of the programs, is referred to as "subsidy cost." Under the Credit Reform Act, subsidy costs for loans obligated beginning in fiscal year 1992 are estimated at the net present value of projected lifetime costs in the year the loan is obligated. Subsidy costs are then revalued annually through the re-estimate process.

Estimates for credit program receivables and liabilities contain assumptions that have a significant impact on the financial statements. The primary components of this assumption set include, but are not limited to, collections (including loan consolidations), repayments, default rates, prevailing interest rates and loan volume. Actual loan volume, interest rates, cash flows and other critical components used in the estimation process may differ significantly from the assumptions made at the time the financial statements are prepared. Minor adjustments to any of these components may create significant changes to the estimate.

The Department estimates all future cash flows associated with the Direct Loan and FFEL programs. Projected cash flows are used to develop subsidy estimates. Subsidy cost can be positive or negative; negative subsidies occur when expected program inflows of cash (e.g., repayments and fees) exceed expected outflows. Subsidy cost is recorded as the initial amount of the loan guarantee liability when guarantees are made (the loan liability) or as a valuation allowance to government-owned loans and interest receivable (i.e., direct and defaulted guaranteed loans).

The Department uses a computerized cash flow projection Student Loan Model to calculate subsidy estimates for the Direct Loan and FFEL programs. Each year, the Department re-evaluates the estimation methods related to changing conditions. The Department uses a probabilistic technique to forecast interest rates based on different methods to establish the relationship between an event's occurrence and the magnitude of its probability. The Department's approach estimates interest rates under numerous scenarios and then bases interest rates on the average interest rates weighted by the assumed probability of each scenario occurring. Probabilistic methodology facilitates the modeling of the Department's unique loan programs.

For each program, cash flows are projected over the life of the loans, aggregated by loan type, cohort year, and risk category. The loan's cohort year represents the year a direct loan was obligated or a loan was guaranteed, regardless of the timing of disbursements. Risk categories include two-year colleges, freshmen and sophomores at four-year colleges, juniors and seniors at four-year colleges, graduate schools, and proprietary (for profit) schools.

Estimates reflected in these statements were prepared using assumptions developed for the fiscal year 2008 Mid-Session Review, a government-wide exercise required annually by OMB. Assumptions and their impact are updated after the Mid-Session Review to account for significant subsequent changes in activity. These estimates are based on the most current information available to the Department at the time the financial statements were prepared. Department management has a process to review these estimates in the context of subsequent changes in activity and assumptions, and to reflect the impact of these changes as appropriate.

The Department recognizes that the cash flow projections and the sensitivity of the changes in assumptions can have a significant impact on the estimates. Management has attempted to mitigate fluctuations in the estimate by using trend analysis to project future cash flows. Changes in assumptions could significantly affect the amounts reflected in these statements. For example, a minimal change in the projected long-term interest rate charged to borrowers could change the current subsidy re-estimate by a significant amount. (See Note 6)

Budget Authority

Budget authority is the authorization provided by law for the Department to incur financial obligations that will result in outlays. The Department's budgetary resources include (1) unobligated balances of resources from prior years, (2) recoveries of prior-year obligations, and (3) new resources—appropriations, authority to borrow from the U.S. Department of the Treasury (Treasury), and spending authority from collections.

Unobligated balances associated with resources expiring at the end of the fiscal year remain available for five years after expiration only for upward adjustments of prior year obligations, after which they are canceled and may not be used. Unobligated balances of resources that have not expired at year-end may have new obligations placed against them, as well as net upward adjustments of prior year obligations.

Authority to borrow from Treasury provides most of the funding for the loan principal disbursements made under the Direct Loan Program. Subsidy and administrative costs of the program are funded by appropriations. Budgetary resources from collections are used primarily to repay the Department's debt to Treasury. Major sources of collections include (1) principal and interest collections from borrowers or through the consolidation of loans to borrowers, (2) related fees, and (3) interest from Treasury on balances in certain credit program accounts that make and administer loans and guarantees.

Borrowing authority is an indefinite budgetary resource authorized under the Credit Reform Act, as amended. This resource, when realized, finances the unsubsidized portion of the Direct Loan portfolio. In addition, borrowing authority is requested in advance of expected collections to cover negative subsidy. Treasury prescribes the terms and conditions of borrowing authority and lends to the Direct Loan Financing Account amounts as appropriate. Amounts borrowed, but not yet disbursed, are included in uninvested funds and earn interest. Treasury uses the same weighted average interest rates for both the interest charged on borrowed funds and the interest earned on uninvested funds. The Department may carry forward borrowing authority to future fiscal years provided that cohorts are disbursing loans. All borrowings from Treasury are effective on October 1 of the current fiscal year, regardless of when the Department borrowed the funds, except for amounts borrowed to make annual interest payments.

Assets

Assets are classified as either entity or non-entity assets. Entity assets are those that the Department has authority to use for its operations. Non-entity assets are those held by the Department but not available for use in its operations. The Department combines its entity and non-entity assets on the face of the balance sheet and discloses its non-entity assets in the notes. (See Note 2)

Fund Balance with Treasury

The Fund Balance with Treasury includes general, revolving, trust, and other funds available to pay current liabilities and finance authorized purchases, as well as funds restricted until future appropriations are received. Treasury processes the cash receipts and cash disbursements for the Department. The Department's records are reconciled with those of Treasury.

A portion of the general funds is funded in advance by multi-year appropriations for expenditures anticipated during the current and future fiscal years. Revolving funds conduct continuing cycles of business-like activity and do not require annual appropriations. Their fund balance is derived from borrowings, and collections from the public and other federal agencies. Trust funds generally consist of donations for the hurricane relief activities. Other funds, which are non-budgetary, primarily consist of deposit funds, and suspense and clearing accounts.

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts that are not apportioned for obligation during the current fiscal year and expired appropriations no longer available to incur new obligations. Obligated balances not yet disbursed include undelivered orders and unpaid expended authority. (See Note 3)

Accounts Receivable

Accounts receivable are amounts due to the Department from the public and other federal agencies. Receivables from the public result from overpayments to recipients of grants and other financial assistance programs, and disputed costs resulting from audits of educational assistance programs. Amounts due from federal agencies result from reimbursable agreements entered into by the Department with other agencies for various goods and services. Accounts receivable are recorded at cost less an allowance for uncollectible amounts. The estimate of the allowance for loss on uncollectible accounts is based on the Department's experience in the collection of receivables and an analysis of the outstanding balances. (See Note 4)

Cash and Other Monetary Assets

Cash and Other Monetary Assets consist of Guaranty Agency reserves that represent the federal government's interest in the net assets of state and nonprofit FFEL Program Guaranty Agencies. Guaranty Agency reserves are classified as non-entity assets with the public (See Notes 2 and 5) and are offset by a corresponding liability due to Treasury. Guaranty Agency reserves include initial federal start-up funds, receipts of federal reinsurance payments, insurance premiums, Guaranty Agency share of collections on defaulted loans, investment income, administrative cost allowances, and other assets.

Section 422A of the HEA required FFEL Guaranty Agencies to establish a Federal Student Loan Reserve Fund (Federal Fund) and an Operating Fund by December 6, 1998. The Federal Fund and the non-liquid assets developed or purchased by a Guaranty Agency, in whole or in part with federal funds, are the property of the United States and reflected in the *Budget of the United States Government*. However, such ownership by the federal government is independent of the actual control of the assets. The net value of the Federal Fund will change from year to year. Recalls are payments to the Department from Guaranty Agency Federal Funds, which increase Fund Balance with Treasury; recalls were remitted to Treasury at fiscal year-end.

The Department disburses funds to a Guaranty Agency through its Federal Fund to pay lender claims and default aversion fees of a Guaranty Agency. The Operating Fund is the property of the Guaranty Agency except for amounts an agency borrows from the Federal Fund (as authorized under Section 422A of the HEA). The Operating Fund is used by the Guaranty Agency to fulfill responsibilities that include repaying money borrowed from the Federal Fund, and performing default aversion and collection activities.

Credit Program Receivables and Liabilities for Loan Guarantees

The financial statements reflect the Department's estimate of the long-term cost of direct and guaranteed loans in accordance with the Credit Reform Act. Loans and interest receivable are valued at their gross amounts less an allowance for the present value of the amounts not expected to be recovered and thus having to be subsidized—called "allowance for subsidy." The difference is the present value of the cash flows to and from the Department that are expected from the receivables over their projected lives. Similarly, liabilities for loan guarantees are valued at the present value of the cash outflows from the Department less the present value of related inflows. The estimated present value of net long-term cash outflows of the Department for subsidized costs is net of recoveries, interest supplements, and offsetting fees. The Department records all credit program loans and loan guarantees at their present values.

Components of subsidy costs for loans and guarantees include defaults (net of recoveries), contractual payments to third-party private loan collectors who receive a set percentage of amounts collected, and, as an offset, application and other fees to be collected. For direct loans, the difference between interest rates incurred by the Department on its borrowings from Treasury and interest rates charged to target groups is also subsidized (or may provide an offset to subsidy if the Department's rate is less). The corresponding interest subsidy in loan guarantee programs is the payment of interest supplements to third-party lenders in order to buy down the interest rates on loans made by those lenders. Subsidy costs are recognized when direct loans or guaranteed loans are disbursed to borrowers and are re-estimated each year. (See Note 6)

General Property, Plant and Equipment

The Department capitalizes single items of property and equipment with a cost of $50,000 or more that have an estimated useful life greater than two years. Additionally, the Department capitalizes bulk purchases of property and equipment with an aggregate cost of $500,000 or more. A bulk purchase is defined as the purchase of like items related to a specific project or the purchase of like items occurring within the same fiscal year that have an estimated useful life greater than two years. Property and equipment are depreciated over their estimated useful lives using the straight-line method of depreciation.

Internal Use Software meeting the above cost and useful life criteria is also capitalized. Internal Use Software is either purchased off the shelf, internally developed, or contractor developed solely to meet the agency's internal needs. (See Note 7)

The Department adopted the following useful lives for its major classes of depreciable property and equipment:

Major Classes of Depreciable Property and Equipment	Years
Information Technology, Internal Use Software and Telecommunications Equipment	3
Furniture and Fixtures	5

Liabilities

Liabilities represent actual and estimated amounts to be paid as a result of transactions or events that have already occurred. However, no liabilities can be paid by the Department without budget authority. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources, and there is no certainty the appropriation will be enacted. The government acting in its sovereign capacity can abrogate liabilities that arise from activities other than contracts. FFEL Program and Direct Loan Program liabilities are entitlements covered by permanent indefinite budget authority enacted as of year-end.

Debt

The Department borrows to provide funding for direct loans to students, and for facilities loans. The liability to Treasury from borrowings represents unpaid principal on the loans at year-end. The Department repays the loan principal based on available fund balances. Interest on the debt is calculated at fiscal year-end using rates set by Treasury, with such rates generally fixed based on the rate for 10-year securities. In addition, the Federal Financing Bank (FFB) holds bonds issued by the Department on behalf of the Historically Black Colleges and Universities Capital Financing Program. The Department reports the corresponding liability for full payment of principal and accrued interest as a payable to the FFB. (See Note 8)

Accrued Grant Liability

Disbursements of grant funds are recognized as expenses at the time of disbursement. However, some grant recipients incur expenditures prior to initiating a request for disbursement based on the nature of the expenditures. A liability is accrued by the Department for expenditures incurred by grantees prior to their receiving grant funds to cover the expenditures. The amount is estimated using statistical sampling techniques. (See Note 10)

Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include undelivered orders and unobligated balances of appropriations, except for federal credit financing and liquidating funds, and trust funds. Cumulative results of operations represent the net difference since inception between (1) expenses and (2) revenues and financing sources. (See Note 11)

Earmarked Funds

Earmarked funds are recorded as specially identified revenues, often supplemented by other financing sources, which remain available over time. These funds are required by statute to be used for designated activities, benefits or purposes. The Department's earmarked funds are primarily related to the 2005 Hurricane Relief efforts. (See Note 16)

Personnel Compensation and Other Employee Benefits

Annual, Sick and Other Leave. The liability for annual leave, compensatory time off, and other leave is accrued when earned and reduced when taken. Each year, the accrued annual leave account balance is adjusted to reflect current pay rates. Annual leave earned but not taken, within established limits, is funded from future financing sources. Sick leave and other types of non-vested leave are expensed as taken.

Retirement Plans and Other Retirement Benefits. Employees participate in either the Civil Service Retirement System (CSRS), a defined benefit plan, or in the Federal Employees Retirement System (FERS), a defined benefit and contribution plan. For CSRS employees, the Department contributes a fixed percentage of pay.

FERS consists of Social Security, a basic annuity plan, and the Thrift Savings Plan. The Department and the employee contribute to Social Security and the basic annuity plan at rates prescribed by law. In addition, the Department is required to contribute to the Thrift Savings Plan a minimum of 1 percent per year of the basic pay of employees covered by this system and to match voluntary employee contributions up to 3 percent of the employee's basic pay, and one-half of contributions between 3 percent and 5 percent of basic pay. For FERS employees, the Department also contributes the employer's share of Medicare.

Contributions for CSRS, FERS and other retirement benefits are insufficient to fully fund the programs, which are subsidized by the Office of Personnel Management (OPM). The Department imputes its share of the OPM subsidy, using cost factors OPM provides, and reports the full cost of the programs related to its employees.

Federal Employees' Compensation Act. The *Federal Employees' Compensation Act* (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA Program is administered by the U.S. Department of Labor (Labor), which pays valid claims and subsequently seeks reimbursement from the Department for these paid claims.

The FECA liability consists of two components. The first component is based on actual claims paid by Labor but not yet reimbursed by the Department. The Department reimburses Labor for the amount of actual claims as funds are appropriated for this purpose. There is generally a two- to three-year time period between payment by Labor and reimbursement by the Department. As a result, a liability is recognized for the actual claims paid by Labor and to be reimbursed by the Department.

The second component is the estimated liability for future benefit payments as a result of past events. This liability includes death, disability, medical and miscellaneous costs. Labor determines this component annually, as of September 30, using a method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value using OMB economic assumptions for 10-year Treasury notes and bonds. To provide for the effects of inflation on the liability, wage inflation factors (i.e., cost-of-living adjustments) and medical inflation factors (i.e., consumer price index medical adjustments) are applied to the calculation of projected future benefit payments. These factors are also used to adjust historical benefit payments and to adjust future benefit payments to current year constant dollars. A discounting formula is also used to recognize the timing of benefit payments as 13 payments per year instead of one lump sum payment per year.

The estimated projections are evaluated by Labor to ensure that the resulting projections are reliable. The analysis is based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in charge-back year 2007 to the average pattern observed during the most current three charge-back years, and (4) a comparison of the estimated liability per case in the 2007 projection to the average pattern for the projections of the most recent three years.

Intragovernmental Transactions

The Department's financial activities interact with and are dependent upon the financial activity of the centralized management functions of the federal government. Due to financial regulation and management control by OMB and Treasury, operations may not be conducted and financial positions may not be reported as they would if the Department were a separate, unrelated entity.

Allocation Transfers

The Department is a party to allocation transfers with the Appalachian Regional Commission as a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. Treasury provides a separate fund account as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child are charged to this allocation account as the child executes the delegated activity on behalf of the parent entity. All financial activity related to these allocation transfers is reported in the financial statements of the Appalachian Regional Commission, from which the underlying legislative authority, appropriations, and budget apportionments are derived.

Note 2. Non-Entity Assets

(Dollars in Millions)	2007	2006
Non-Entity Assets		
Intragovernmental		
Fund Balance with Treasury	$ 33	$ 39
Total Intragovernmental	**33**	**39**
With the Public		
Cash and Other Monetary Assets	1,103	566
Accounts Receivable, Net	12	12
Credit Program Receivables, Net	188	192
Total With the Public	**1,303**	**770**
Total Non-Entity Assets	**1,336**	**809**
Entity Assets	213,302	213,612
Total Assets	$ 214,638	$ 214,421

Non-entity intragovernmental assets primarily consist of deposit fund balances. Non-entity assets with the public primarily consist of Guaranty Agency reserves and Perkins Program Loan Receivables. (See Notes 5 and 6)

Note 3. Fund Balance with Treasury

Fund Balances

(Dollars in Millions)	2007	2006
General Funds	$ 54,836	$ 54,790
Revolving Funds	42,625	52,176
Trust Funds	40	61
Other Funds	31	26
Fund Balance with Treasury	**$ 97,532**	**$ 107,053**

Status of Fund Balance with Treasury

(Dollars in Millions)	2007	2006
Unobligated Balance		
Available	$ 3,414	$ 4,081
Unavailable	37,866	47,063
Obligated Balance, Not Yet Disbursed	56,221	55,883
Non-Budgetary FBWT	31	26
Fund Balance with Treasury	**$ 97,532**	**$ 107,053**

Note 4. Accounts Receivable

	2007		
(Dollars in Millions)	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ 4	$ -	$ 4
With the Public	215	(166)	49
Accounts Receivable	**$ 219**	**$ (166)**	**$ 53**

	2006		
(Dollars in Millions)	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ 1	$ -	$ 1
With the Public	232	(189)	43
Accounts Receivable	**$ 233**	**$ (189)**	**$ 44**

Note 5. Cash and Other Monetary Assets

(Dollars in Millions)	2007	2006
Beginning Balance, Cash and Other Monetary Assets	**$ 566**	**$ 888**
Valuation Increase (Decrease) in Guaranty Agency Federal Funds	793	(29)
Less: Collections from Guaranty Agency Federal Funds		
Statutory Recall Amounts Collected from GAs	82	82
Excess Collections Remitted by GAs	174	211
Net Collections	256	293
Ending Balance, Cash and Other Monetary Assets	**$ 1,103**	**$ 566**

Cash and Other Monetary Assets consist of Guaranty Agency reserves and represent non-entity assets. The $537 million net increase in the Federal Fund from fiscal year 2006 to fiscal year 2007 reflects the impact of Guaranty Agencies' ongoing federal operations. Of this increase, $185 million represents the first full-year collection of the statutory 1 percent loan insurance premium by Guaranty Agencies. An additional $489 million reflects the clarification and refinement of the calculation of the allowance for loss on the Federal Fund. These increases are partially offset by amounts remitted to the Department by the Guaranty Agencies, which consist of statutory recall amounts and excess collections.

Changes in the valuation of the Federal Fund increase or decrease the Department's Cash and Other Monetary Assets with a corresponding change in the Payable to Treasury.

Note 6. Credit Programs for Higher Education

The federal government makes loans directly to students and parents through participating schools under the Direct Loan Program. Direct loans are originated and serviced through contracts with private vendors.

Private lender loans to students and parents are insured by the federal government under the FFEL Program. FFEL loans are guaranteed by the federal government against default with state or private nonprofit Guaranty Agencies acting as intermediaries in administering the guarantees.

Beginning with FFEL loans first disbursed on or after October 1, 1993, financial institutions became responsible for 2 percent of the cost of each default. Guaranty Agencies also began paying a portion of the cost (in most cases, 5 percent) of each defaulted loan from federal reserves they hold in trust. (See Note 5) FFEL lender participants receive statutorily set federal interest and special allowance subsidies. Guaranty Agencies receive fee payments as set by statute. In most cases, loan terms and conditions under the two programs are identical.

The FFEL estimated liability for loan guarantees is reported as the present value of estimated net cash outflows. Defaulted FFEL loans are reported net of an allowance for subsidy computed using net present value methodology, including defaults, collections, and loan cancellations. The same methodology is used to estimate the allowance on Direct Loan receivables.

The Department disbursed approximately $15.7 billion in direct loans to eligible borrowers in fiscal year 2007 and approximately $32.3 billion in fiscal year 2006. Loans typically are disbursed in multiple installments over an academic period; as a result, loan disbursements for an origination cohort year often cross fiscal years. Half of all loan volume is obligated in the fourth quarter of a fiscal year. Regardless of the fiscal year in which they occur, disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

As of September 30, 2007 and 2006, total principal balances outstanding of guaranteed loans held by lenders were approximately $363 billion and $325 billion, respectively. As of September 30, 2007 and 2006, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately $359 billion and $321 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the Guaranty Agencies, based on the appropriate reinsurance rates, which range from 100 to 95 percent. Any remaining insurance not paid as reinsurance would be paid to lenders by the Guaranty Agencies from their Federal Fund. Payments by Guaranty Agencies do not reduce government exposure because they are made from the Federal Fund administered by the agencies but owned by the federal government.

The Department accrues interest receivable and records interest revenue on its performing direct loans. Given the Department's substantial collection rates, interest receivable is also accrued and interest revenue recognized on defaulted direct loans. Guaranteed loans that default are initially turned over to Guaranty Agencies for collection, and interest receivable is accrued and recorded on the loans as the collection rate is substantial. After approximately four years, defaulted guaranteed loans not in repayment are turned over to the Department for collection. Accrued interest on the subrogated loan is calculated but only realized upon collection.

Approximately 7 percent of loan commitments made in an individual fiscal year are never disbursed due to the nature of the loan commitment process (for that portion of a loan cohort that does disburse, approximately 93 percent, will do so over two years). Schools establish a loan commitment upon receipt of an aid application. The loan commitment may occur before a student has been accepted by the school or begins classes. For direct loans committed in the 2007 cohort, an estimated $1.6 billion will never be disbursed; for guaranteed loans committed in the 2007 cohort, an estimated $10.4 billion will never be disbursed. Direct loan schools may originate loans through a cash advance from the Department, or by advancing their own funds in anticipation of reimbursement from the Department.

Loan Consolidations

The Department permits borrowers to prepay and close out existing loans without penalty from capital raised through the disbursement of a new consolidation loan. Under the Credit Reform Act and requirements provided by OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, the retirement of loans being consolidated is considered a receipt of principal and interest. This receipt is offset by the disbursement related to the newly created consolidation loan. The underlying direct or guaranteed loans, whether performing or nonperforming, in any given cohort are paid off in their original cohort, and new loans are opened in the cohort in which consolidation activity occurs. This consolidation activity is taken into consideration in establishing the subsidy rate for defaults. The effect of new consolidations is reflected in subsidy expense for the current year cohort, while the effect on prior cohorts is reflected in the re-estimate. The loan liability and net receivables include estimates of future prepayments of existing loans through consolidations; they do not reflect costs associated with anticipated future consolidation loans.

On July 1, 2007, variable student loan interest rates increased by 0.08 percentage points to 7.22 percent from 7.14 percent. This change in variable interest rate is applicable to loans first disbursed on or after July 1, 2007, and is insignificant compared to the prior year change of nearly 2 percentage points. As a result, the number of student loan consolidations decreased. Direct loan consolidation disbursements for fiscal year 2007 were $3.6 billion and for fiscal year 2006 were $19.9 billion.

Based on current estimates, the prepayment of the underlying FFEL loans produces significant savings through the elimination of future special allowance payments. New consolidations are reflected in the 2007 cohort resulting in increased prepayments of underlying loans from prior cohorts.

Credit Program Receivables, Net

(Dollars in Millions)	2007	2006
Direct Loan Program Loan Receivables, Net	$ 99,002	$ 92,603
FFEL Program Loan Receivables, Net	16,562	13,588
Perkins Program Loan Receivables, Net	188	192
Facilities and Other Loan Receivables, Net	152	345
Credit Program Receivables, Net	**$ 115,904**	**$ 106,728**

The following schedules summarize the Direct Loan and defaulted FFEL principal and related interest receivable, net or inclusive of the allowance for subsidy.

Direct Loan Program Receivables

(Dollars in Millions)	2007	2006
Principal Receivable	$ 102,440	$ 97,306
Interest Receivable	4,807	3,702
Receivables	**107,247**	**101,008**
Less: Allowance for Subsidy	8,245	8,405
Credit Program Receivables, Net	**$ 99,002**	**$ 92,603**

Of the $107.2 billion in Direct Loan receivables as of September 30, 2007, $9.3 billion in loan principal was in default and held at the Department's Borrowers Services Collections Group. As of September 30, 2006, $8.1 billion in loan principal was in default and held at the Department's Borrowers Services Collections Group out of the $101.0 billion total receivable.

FFEL Program Receivables

	2007			2006		
(Dollars in Millions)	Pre-1992	Post-1991	Total	Pre-1992	Post-1991	Total
Principal Receivable	$ 8,208	$ 13,324	$ 21,532	$ 8,730	$ 10,263	$ 18,993
Interest Receivable	224	1,957	2,181	336	1,823	2,159
Receivables	**8,432**	**15,281**	**23,713**	**9,066**	**12,086**	**21,152**
Less: Allowance for Subsidy	4,396	2,755	7,151	4,717	2,847	7,564
Credit Program Receivables, Net	**$ 4,036**	**$ 12,526**	**$ 16,562**	**$ 4,349**	**$ 9,239**	**$ 13,588**

Loan Modifications

According to OMB Circular No. A-11, any government action that differs from actions assumed in the baseline estimate of cash flows and changes the estimated cost of an outstanding direct loan or loan guarantee is defined as a modification. Loan modifications are recognized under the same accounting principle for upward or downward adjustments to subsidy cost and for the recordation of modification adjustment transfer gains or losses. Separate amounts are calculated for modification costs and modification adjustment transfers. Modification adjustment transfers are required to adjust for the difference between current discount rates used to calculate modification costs and the discount rates used to calculate cohort interest expense and revenue.

2006 Modification

The *Deficit Reduction Act of 2005* (P.L. 109-171) (Deficit Reduction Act) included provisions revising the payment of account maintenance fees, Guaranty Agency retention on default collections, and an expansion of deferment eligibility for military borrowers performing eligible service. The Deficit Reduction Act shifts the payment of account maintenance fees, authorized under Section 458 of the HEA, to subsidy cost from administration funds or from the Federal Fund.

Beginning October 1, 2006, the Deficit Reduction Act requires Guaranty Agencies to return to the Department a portion of collection charges on defaulted loans paid off through consolidation equal to 8.5 percent of the outstanding principal and interest. Beginning October 1, 2009, Guaranty Agencies will be required to return the entire 18.5 percent on collections through consolidation that exceed 45 percent of their overall collections. In addition, the new military deferment provisions provide a maximum three-year deferment for soldiers serving in a war zone who have outstanding loans originated after July 1, 2001.

The FFEL Program recognized $1.7 billion and the Direct Loan Program recognized $7 million in modification costs in fiscal year 2006. The FFEL Program also recognized a net modification adjustment transfer gain of $94 million, while the Direct Loan Program recognized a net gain of $134 thousand.

Direct Loan Program Reconciliation of Allowance for Subsidy

(Dollars in Millions)	2007	2006
Beginning Balance, Allowance for Subsidy	**$ 8,405**	**$ 2,132**
Components of Subsidy Transfers		
Interest Rate Differential	(846)	(601)
Defaults, Net of Recoveries	422	1,226
Fees	(398)	(403)
Other	1,117	1,566
Current Year Subsidy Transfers	**295**	**1,788**
Components of Subsidy Re-estimates		
Interest Rate Re-estimates[1]	(311)	(339)
Technical and Default Re-estimates	(483)	5,199
Subsidy Re-estimates	**(794)**	**4,860**
Components of Loan Modifications		
Loan Modification Costs	-	7
Modification Adjustment Transfers	-	-
Loan Modifications	**-**	**7**
Activity		
Fee Collections	448	473
Loan Cancellations[2]	(154)	(100)
Subsidy Allowance Amortization	435	(406)
Other	(390)	(349)
Total Activity	**339**	**(382)**
Ending Balance, Allowance for Subsidy	**$ 8,245**	**$ 8,405**

[1] The interest rate re-estimate relates to subsidy associated with establishing a fixed rate for the Department's borrowing from Treasury.

[2] Loan cancellations include write-offs of loans because the primary borrower died, became disabled, or declared bankruptcy.

Direct Loan Financing Account Interest Expense and Interest Revenue

(Dollars in Millions)	2007	2006
Interest Expense on Treasury Borrowing	$ 5,675	$ 6,505
Interest Expense	**$ 5,675**	**$ 6,505**
Interest Revenue from the Public	$ 4,859	$ 4,173
Amortization of Subsidy	(435)	406
Interest Revenue on Uninvested Funds	1,251	1,926
Interest Revenue	**$ 5,675**	**$ 6,505**

The Direct Loan financing account borrows from Treasury to fund the unsubsidized portion of its lending activities. As required, the Department calculates and pays Treasury interest at the end of each year. Interest is earned on the outstanding Direct Loan portfolio during the year and on its weighted average Fund Balance with Treasury at year-end.

Subsidy amortization is calculated, as required in Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees*, as the difference between interest revenue and interest expense. The allowance for subsidy is adjusted with the offset to interest revenue.

Payable to Treasury

(Dollars in Millions)	2007	2006
Future Liquidating Account Collections, Beginning Balance	$ 4,555	$ 3,411
Valuation of Pre-1992 Loan Liability and Allowance	288	2,036
Capital Transfers to Treasury	(735)	(892)
Future Liquidating Account Collections, Ending Balance	**4,108**	**4,555**
Collections on Guaranty Agency Federal Funds	2	13
Direct Loan Downward Subsidy Re-estimate	498	-
FFEL Downward Subsidy Re-estimate	743	951
Payable to Treasury	**$ 5,351**	**$ 5,519**

The liquidating account, based on available fund balance each year, liquidates the Fund Balance with Treasury. The FFEL and Direct Loan financing accounts pay the liability related to downward subsidy re-estimates upon budget execution.

FFEL Program Reconciliation of Liabilities for Loan Guarantees

(Dollars in Millions)	2007	2006
Beginning Balance, Liability for Loan Guarantees	**$ 52,350**	**$ 30,500**
Components of Subsidy Transfers		
Interest Supplement Costs	7,580	18,268
Defaults, Net of Recoveries	885	1,665
Fees	(5,052)	(7,859)
Other[1]	2,967	4,264
Current Year Subsidy Transfers	**6,380**	**16,338**
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	1,286	90
Technical and Default Re-estimates	(2,782)	9,924
Subsidy Re-estimates	**(1,496)**	**10,014**
Components of Loan Modifications		
Loan Modification Costs	-	1,710
Modification Adjustment Transfers	-	94
Loan Modifications	**-**	**1,804**
Activity		
Interest Supplement Payments	(10,991)	(8,925)
Claim Payments	(5,924)	(4,345)
Fee Collections	4,036	3,799
Interest on Liability Balance	1,616	1,110
Other[2]	4,760	2,055
Total Activity	**(6,503)**	**(6,306)**
Ending Balance, Liability for Loan Guarantees	**50,731**	**52,350**
FFEL Liquidating Account Liability for Loan Guarantees	143	103
Liabilities for Loan Guarantees	**$ 50,874**	**$ 52,453**

[1] Subsidy primarily associated with debt collections and loan cancellations due to death, disability, and bankruptcy.

[2] Activity primarily associated with the transfer of subsidy for defaults; loan consolidation activity; and loan cancellations due to death, disability, and bankruptcy.

The FFEL liquidating account liability for loan guarantees is included in the total Liabilities for Loan Guarantees as shown in the FFEL Program Reconciliation of Liabilities.

Subsidy Expense

Direct Loan Program Subsidy Expense

(Dollars in Millions)	2007	2006
Components of Current Year Subsidy Transfers		
Interest Rate Differential	$ (846)	$ (601)
Defaults, Net of Recoveries	422	1,226
Fees	(398)	(403)
Other	1,117	1,566
Current Year Subsidy Transfers	**295**	**1,788**
Subsidy Re-estimates	(794)	4,860
Loan Modification Costs	-	7
Direct Loan Subsidy Expense	**$ (499)**	**$ 6,655**

In the 2007 re-estimates, Direct Loan subsidy expense was decreased by $794 million. Changes in the income-contingent repayment assumption increased subsidy expense by $1 billion. This increase was more than offset by decreases in subsidy cost related to loan volume of $(924) million, statutory loan discharges of $(544) million, interest rates of $(348) million and other factors. The subsidy rate is sensitive to interest rate fluctuations; for example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan costs by $955 million.

In the 2006 re-estimates, Direct Loan subsidy expense was increased by $4.9 billion. Several factors accounted for this increase. Changes in the assumptions for the collections of defaulted loans contributed approximately $3.3 billion to the increase in subsidy expense. Other changes in assumptions for variables (such as assumed term and maturity, loan volume, and prepayment rates) increased subsidy expense by $1.4 billion. A refinement of the Department's forecast using interest rate scenarios provided by OMB in a probabilistic approach accounted for an increase of $230 million.

FFEL Program Loan Guarantee Subsidy Expense

(Dollars in Millions)	2007	2006
Components of Current Year Subsidy Transfers		
Interest Supplement Costs	$ 7,580	$ 18,268
Defaults, Net of Recoveries	885	1,665
Fees	(5,052)	(7,859)
Other	2,967	4,264
Current Year Subsidy Transfers	**6,380**	**16,338**
Subsidy Re-estimates	(1,496)	10,014
Loan Modification Costs	-	1,710
FFEL Loan Guarantee Subsidy Expense	**$ 4,884**	**$ 28,062**

In the 2007 re-estimates, FFEL subsidy expense was decreased by $1.5 billion. Changes in the federal cost of loan deferments and forbearance increased subsidy expense by $2.3 billion. This increase was more than offset by changes in subsidy cost related to statutory loan discharges of $(1.4) billion, loan maturity and repayment rates of $(1.5) billion, loan volume of $(890) million and other factors. The subsidy rate is sensitive to interest rate fluctuations; for example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by $11.1 billion.

In fiscal year 2007 the Department restated the eligibility requirements specified by the HEA for lenders to receive special allowance payments at the 9.5 percent minimum return rate on loans made or purchased with funds derived from tax exempt obligations issued before October 1993, and implemented certain processes to validate eligibility. Pending obtaining definitive information regarding which loans will continue to qualify to receive such special allowances, it is not possible at this time to determine the potential reduction, if any, in the Department's subsidy estimates.

In the 2006 re-estimates, FFEL subsidy expense was increased by $10.0 billion. Changes in interest rates account for an $8.9 billion increase in subsidy expense. Of this $8.9 billion increase, $6.2 billion is attributed to the change in interest supplement costs associated with higher than originally forecasted loan consolidations which occurred in late fiscal year 2006. In addition, the refinement of the Department's forecasting methodology, as noted above, accounted for an additional $1.8 billion to the increase in subsidy expense. Other changes in assumptions for variables (such as assumed term and maturity, loan volume, and prepayment rates) decreased subsidy expense by $700 million on a net basis.

Subsidy Rates

The subsidy rates applicable to the 2007 loan cohort year were as follows:

Subsidy Rates—Cohort 2007

	Interest Differential	Defaults	Fees	Other	Total
Direct Loan Program	(5.41%)	2.41%	(2.30%)	6.78%	1.48%
	Interest Supplements	**Defaults**	**Fees**	**Other**	**Total**
FFEL Program	7.45%	0.85%	(5.02%)	3.00%	6.28%

The subsidy rate represents the subsidy expense of the program in relation to the obligations or commitments made during the fiscal year. The subsidy expense for new direct or guaranteed loans reported in the current year relate to disbursements of loans from both current and prior years' cohorts. Subsidy expense is recognized when direct loans are disbursed by the Department or third-party lenders disburse guaranteed loans. These subsidy rates cannot be applied to direct or guaranteed loans disbursed during the current reporting year to yield the subsidy expense, nor are these rates applicable to the portfolio as a whole.

The costs of the Department's student loan programs, especially the Direct Loan Program, are highly sensitive to changes in actual and forecasted interest rates. The formulas for determining program interest rates are established by statute; the existing loan portfolio has a mixture of borrower and lender rate formulas. Interest rate projections are based on probabilistic interest rate scenario inputs developed and provided by OMB.

Administrative Expenses

	2007		2006	
(Dollars in Millions)	**Direct Loan**	**FFEL**	**Direct Loan**	**FFEL**
Operating Expense	$ 397	$ 232	$ 342	$ 224
Other Expense	16	9	15	8
Administrative Expenses	**$ 413**	**$ 241**	**$ 357**	**$ 232**

Perkins Loan Program

The Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. In some statutorily defined cases, funds are provided to schools so that student loans may be cancelled. For certain defaulted loans, the Department reimburses the originating school and collects from the borrowers. These collections are transferred to Treasury. At September 30, 2007 and 2006, loans receivable, net of an allowance for loss, were $188 million and $192 million, respectively. These loans are valued at historical cost.

Facilities Loan Programs

The Department administers the College Housing and Academic Facilities Loan Program, the College Housing Loan Program, and the Higher Education Facilities Loan Program. From 1952 to 1993, these programs provided low-interest financing to institutions of higher education for the construction, reconstruction, and renovation of housing, academic, and other educational facilities.

The Department also administers the Historically Black Colleges and Universities (HBCU) Capital Financing Program. Since 1992, this program has given HBCUs access to financing for the repair, renovation, and, in exceptional circumstances, the construction or acquisition of facilities, equipment, and infrastructure through federally insured bonds. The Department has authorized a designated bonding authority to make the loans to eligible institutions, charge interest, and collect principal and interest payments. In compliance with statute, the bonding authority maintains an escrow account to pay the principal and interest on bonds for loans in default.

Facilities Loan Program Receivables

(Dollars in Millions)	2007	2006
Principal Receivable	$ 553	$ 428
Interest Receivable	6	6
Receivables	**559**	**434**
Less: Allowance for Subsidy	407	89
Credit Program Receivables, Net	**$ 152**	**$ 345**

Hurricane Relief Loans

In fiscal year 2006, Congress passed the *Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery* (P.L. 109-234). Section 2601 of this act created a new sub-program within the HBCU Capital Financing Program that would provide loans on advantageous terms to HBCUs affected by Hurricanes Rita and Katrina. Under this sub-program, the interest rate charged on loans is capped at 1 percent, fees associated with the program are less than those associated with the rest of the program, and institutions are not required to participate in the program's pooled escrow account. In addition, principal and interest payments on loans already made to affected HBCUs can be deferred for up to 3 years, with the Department making any payments that come due during this period. The statute gives the Department authority to make loans under the new sub-program in excess of the overall program loan caps. The Department has made four loans under the new sub-program and has assumed one default and no recoveries in making initial subsidy estimates. In light of these forecast assumptions and the expected cashflows for the new sub-program, OMB's Credit Subsidy Calculator estimates the subsidy rate for the program to be 76.21 percent. The current subsidy estimate for the sub-program is $304 million on a loan volume of $400 million.

Note 7. General Property, Plant and Equipment

(Dollars in Millions)	2007 Asset Cost		2007 Accumulated Depreciation		2007 Net Asset Value	
Information Technology, Internal Use Software and Telecommunications Equipment	$	129	$	(84)	$	45
Furniture and Fixtures		3		(2)		1
General Property, Plant and Equipment	**$**	**132**	**$**	**(86)**	**$**	**46**

(Dollars in Millions)	2006 Asset Cost		2006 Accumulated Depreciation		2006 Net Asset Value	
Information Technology, Internal Use Software and Telecommunications Equipment	$	102	$	(74)	$	28
Furniture and Fixtures		3		(2)		1
General Property, Plant and Equipment	**$**	**105**	**$**	**(76)**	**$**	**29**

The majority of the asset costs relate to financial management systems and other information technology and communications improvements.

Leases

The Department leases office space from the General Services Administration (GSA). The lease contracts with GSA for privately and publicly owned buildings are operating leases. Future lease payments are not accrued as liabilities, but expensed as incurred. Estimated future minimum lease payments for the privately owned buildings are presented below.

2007

(Dollars in Millions)

Fiscal Year	Lease Payment	
2008	$	47
2009		48
2010		52
2011		56
2012		63
After 2012		65
Total	**$**	**331**

2006

(Dollars in Millions)

Fiscal Year	Lease Payment	
2007	$	46
2008		47
2009		49
2010		53
2011		56
After 2011		58
Total	**$**	**309**

Note 8. Debt

	2007				
	Treasury				
(Dollars in Millions)	Direct Loans	Facilities Loans	Total	FFB	Total
Beginning Balance	**$ 105,430**	**$ 93**	**$ 105,523**	**$ 154**	**$ 105,677**
New Borrowing	17,892	-	17,892	170	18,062
Repayments	(19,429)	(12)	(19,441)	(11)	(19,452)
Ending Balance	**$ 103,893**	**$ 81**	**$ 103,974**	**$ 313**	**$ 104,287**

	2006				
	Treasury				
(Dollars in Millions)	Direct Loans	Facilities Loans	Total	FFB	Total
Beginning Balance	**$ 104,372**	**$ 100**	**$ 104,472**	**$ 125**	**$ 104,597**
New Borrowing	33,278	-	33,278	44	33,322
Repayments	(32,220)	(7)	(32,227)	(15)	(32,242)
Ending Balance	**$ 105,430**	**$ 93**	**$ 105,523**	**$ 154**	**$ 105,677**

The level of repayments on borrowings to Treasury is derived from many factors. For instance, beginning of the year cash balance, collections, and new borrowings have an impact on the available cash to repay Treasury. Also, cash is held to cover future liabilities, such as contract collection costs and disbursements in transit.

Note 9. Other Liabilities

(Dollars in Millions)	2007		2006	
Other Liabilities	Intragovern-mental	With the Public	Intragovern-mental	With the Public
Liabilities Covered by Budgetary Resources				
Current				
Advances From Others	$ 87	$ -	$ 95	$ -
Employer Contributions and Payroll Taxes	3	-	3	-
Liability for Deposit Funds	(1)	35	(4)	30
Accrued Payroll and Benefits	-	15	-	15
Deferred Credits	-	-	-	1
Contractual Services	-	46	-	83
Total Other Liabilities Covered by Budgetary Resources	**89**	**96**	**94**	**129**
Liabilities Not Covered by Budgetary Resources				
Current				
Accrued Unfunded Annual Leave	-	31	-	31
Non-current				
Accrued Unfunded FECA Liability	3	-	3	-
Liabilities in Miscellaneous Receipt Accounts	200	-	-	204
Accrued FECA Actuarial Liability	-	16	-	17
Total Other Liabilities Not Covered by Budgetary Resources	**203**	**47**	**3**	**252**
Other Liabilities	**$ 292**	**$ 143**	**$ 97**	**$ 381**

Other liabilities include current and non-current liabilities. The non-current liability primarily relates to the student loan receivables of the Perkins Loan Program, which once collected, will be returned to the General Fund of Treasury.

Liabilities not covered by budgetary resources include liabilities for which congressional action is needed before budgetary resources can be provided. Although future appropriations to fund these liabilities are likely, it is not certain that appropriations will be enacted to fund these liabilities. Liabilities not covered by budgetary resources totaled $250 million and $255 million as of September 30, 2007 and 2006, respectively.

Liabilities covered by budgetary resources as of September 30, 2007 and 2006, totaled $164.8 billion and $167.3 billion, respectively.

Note 10. Accrued Grant Liability

The accrued grant liability by major reporting groups is shown in the table below.

(Dollars in Millions)	2007	2006
FSA	$ 1,030	$ 1,250
OESE	348	258
OSERS	478	171
Other	238	380
Accrued Grant Liability	**$ 2,094**	**$ 2,059**

Note 11. Net Position

Unexpended Appropriations (Dollars in Millions)		**2007**		**2006**
Unobligated Balances				
Available	$	3,084	$	4,056
Not Available		892		316
Undelivered Orders, end of period		48,071		47,440
Unexpended Appropriations	**$**	**52,047**	**$**	**51,812**

The Cumulative Results of Operations - Earmarked Funds of $39 million as of September 30, 2007, and $61 million as of September 30, 2006, represent donations from foreign governments, international entities and individuals to support Hurricane Katrina relief and recovery efforts that have not yet been used. (See Note 16)

The Cumulative Results of Operations - Other Funds of $(2,505) million as of September 30, 2007, and $(5,063) million as of September 30, 2006, consist mostly of net investments of capitalized assets and unfunded expenses, including upward subsidy re-estimates for loan programs.

Note 12. Intragovernmental Cost and Exchange Revenue by Program

As required by the *Government Performance and Results Act of 1993*, each of the Department's Reporting Organizations has been aligned with the major goals presented in the Department's *Strategic Plan 2002-2007*.

Net Cost Program	Reporting Organizations	Strategic Goal
Enhancement of Postsecondary and Adult Education	FSA OPE OVAE	5. Enhance the Quality of and Access to Postsecondary and Adult Education
Creation of Student Achievement, Culture of Achievement and Safe Schools	OESE OELA OSDFS	2. Improve Student Achievement 3. Develop Safe and Drug-Free Schools
Transformation of Education	IES OII	4. Transform Education into an Evidence-Based Field
Special Education and Program Execution	OSERS	Cuts across Strategic Goals 2, 3, 4, and 5

The Department considers Strategic Goal 1, Create a Culture of Achievement, a synopsis of the four pillars on which educational excellence is established, and Strategic Goal 6, Establish Management Excellence, which emphasizes administrative and oversight responsibilities, to be high-level premises on which the Department bases its foundation for each of the other four strategic goals. These two strategic goals support our programmatic mission, and, as a result, we do not assign specific programs to either of these strategic goals for presentation in the Statement of Net Cost. Goals 2 through 5 are sharply defined directives that guide divisions of the Department to carry out the vision and programmatic mission, and the Net Cost programs can be specifically associated with these four strategic goals.

The following table presents the gross cost and exchange revenue by program for the Department for fiscal years 2007 and 2006. Gross costs and earned revenue are classified as intragovernmental (exchange transactions between the Department and another entity within the federal government) or with the public (exchange transactions between the Department and a non-federal entity). The Department reclassified fiscal year 2006 FFEL interest expense to conform to the fiscal year 2007 presentation.

Gross Cost and Exchange Revenue by Program

2007					
(Dollars in Millions)	FSA	OESE	OSERS	Other	Total
Enhancement of Postsecondary and Adult Education					
Intragovernmental Gross Cost	$ 5,561	$ -	$ -	$ 82	$ 5,643
Gross Costs with the Public	21,858	-	-	4,423	26,281
Total Program Costs	27,419	-	-	4,505	31,924
Less: Intragovernmental Earned Revenue	3,452	-	-	-	3,452
Earned Revenue from the Public	4,459	-	-	22	4,481
Total Program Revenue	7,911	-	-	22	7,933
Creation of Student Achievement, Culture of Achievement and Safe Schools					
Intragovernmental Gross Cost	-	142	-	17	159
Gross Costs with the Public	-	21,279	-	1,930	23,209
Total Program Costs	-	21,421	-	1,947	23,368
Less: Intragovernmental Earned Revenue	-	-	-	78	78
Earned Revenue from the Public	-	-	-	-	-
Total Program Revenue	-	-	-	78	78
Transformation of Education					
Intragovernmental Gross Cost	-	-	-	76	76
Gross Costs with the Public	-	-	-	1,392	1,392
Total Program Costs	-	-	-	1,468	1,468
Less: Intragovernmental Earned Revenue	-	-	-	4	4
Earned Revenue from the Public	-	-	-	14	14
Total Program Revenue	-	-	-	18	18
Special Education and Program Execution					
Intragovernmental Gross Cost	-	-	82	-	82
Gross Costs with the Public	-	-	15,474	-	15,474
Total Program Costs	-	-	15,556	-	15,556
Less: Intragovernmental Earned Revenue	-	-	3	-	3
Earned Revenue from the Public	-	-	-	-	-
Total Program Revenue	-	-	3	-	3
Net Cost of Operations	**$19,508**	**$21,421**	**$15,553**	**$7,802**	**$64,284**

2006					
(Dollars in Millions)	FSA	OESE	OSERS	Other	Total
Enhancement of Postsecondary and Adult Education					
Intragovernmental Gross Cost	$ 6,747	$ -	$ -	$ 81	$ 6,828
Gross Costs with the Public	52,056	-	-	4,472	56,528
Total Program Costs	58,803	-	-	4,553	63,356
Less: Intragovernmental Earned Revenue	3,131	-	-	1	3,132
Earned Revenue from the Public	4,641	-	-	17	4,658
Total Program Revenue	7,772	-	-	18	7,790
Creation of Student Achievement, Culture of Achievement and Safe Schools					
Intragovernmental Gross Cost	-	172	-	20	192
Gross Costs with the Public	-	21,754	-	2,659	24,413
Total Program Costs	-	21,926	-	2,679	24,605
Less: Intragovernmental Earned Revenue	-	-	-	60	60
Earned Revenue from the Public	-	-	-	-	-
Total Program Revenue	-	-	-	60	60
Transformation of Education					
Intragovernmental Gross Cost	-	-	-	81	81
Gross Costs with the Public	-	-	-	1,282	1,282
Total Program Costs	-	-	-	1,363	1,363
Less: Intragovernmental Earned Revenue	-	-	-	4	4
Earned Revenue from the Public	-	-	-	14	14
Total Program Revenue	-	-	-	18	18
Special Education and Program Execution					
Intragovernmental Gross Cost	-	-	151	-	151
Gross Costs with the Public	-	-	15,224	-	15,224
Total Program Costs	-	-	15,375	-	15,375
Less: Intragovernmental Earned Revenue	-	-	2	-	2
Earned Revenue from the Public	-	-	-	-	-
Total Program Revenue	-	-	2	-	2
Net Cost of Operations	**$51,031**	**$21,926**	**$15,373**	**$8,499**	**$96,829**

Note 13. Interest Expense and Interest Revenue

	Direct Loan Program		FFEL Program		Other Programs		Total	
(Dollars in Millions)	2007	2006	2007	2006	2007	2006	2007	2006
Federal	$ 5,675	$ 6,505	$ -	$ -	$ 15	$ 15	$ 5,690	$ 6,520
Non-federal	-	-	1,616	1,110	-	-	1,616	1,110
Interest Expense	**$ 5,675**	**$ 6,505**	**$ 1,616**	**$ 1,110**	**$ 15**	**$ 15**	**$ 7,306**	**$ 7,630**
Federal	$ 1,251	$ 1,926	$ 1,616	$ 1,110	$ -	$ -	$ 2,867	$ 3,036
Non-federal	4,424	4,579	-	-	24	19	4,448	4,598
Interest Revenue	**$ 5,675**	**$ 6,505**	**$ 1,616**	**$ 1,110**	**$ 24**	**$ 19**	**$ 7,315**	**$ 7,634**

For the Direct Loan Program, federal interest expense is recognized on the Department's outstanding debt. Non-federal interest revenue is earned on the individual loans in the loan portfolio, while federal interest is earned on the uninvested fund balance with Treasury. For the FFEL Program, federal interest revenue is earned on the uninvested fund balance with Treasury in the financing account. The Department reclassified fiscal year 2006 FFEL program interest expense to conform to the fiscal year 2007 presentation.

Note 14. Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) compares budgetary resources with the status of those resources. As of September 30, 2007, budgetary resources were $168,264 million and net outlays were $74,530 million. As of September 30, 2006, budgetary resources were $210,921 million and net outlays were $70,645 million.

Permanent Indefinite Budget Authority

The Direct Loan Program and the FFEL Program have permanent indefinite budget authority through legislation. Part D of the William D. Ford Federal Direct Loan Program and Part B of the Federal Family Education Loan Program, pursuant to the HEA, pertain to the existence, purpose, and availability of this permanent indefinite budget authority.

Reauthorization of Legislation

Funds for most Department programs are authorized, by statute, to be appropriated for a specified number of years, with an automatic one-year extension available under Section 422 of the *General Education Provisions Act*. Congress may continue to appropriate funds after the expiration of the statutory authorization period, effectively reauthorizing the program through the appropriations process. The current *Budget of the United States Government* presumes all programs continue per congressional budgeting rules.

Apportionment Categories of Obligations Incurred

(Dollars in Millions)	2007	2006
Direct:		
Category A	$ 1,303	$ 1,298
Category B	124,472	157,644
Exempt from Apportionment	13	176
	125,788	159,118
Reimbursable:		
Category A	-	-
Category B	-	-
Exempt from Apportionment	93	92
	93	92
Apportionment Categories of Obligations Incurred	**$ 125,881**	**$ 159,210**

Category A apportionments are those resources that can be obligated without restriction on the purpose of the obligation, other than to be in compliance with legislation underlying programs for which the resources were made available. Category B apportionments are restricted by purpose for which obligations can be incurred. In addition, some resources are available without apportionment by OMB.

Unused Borrowing Authority

(Dollars in Millions)	2007	2006
Beginning Balance, Unused Borrowing Authority	$ 7,248	$ 5,481
Current Year Borrowing Authority	20,037	35,089
Funds Drawn From Treasury	(18,062)	(33,322)
Ending Balance, Unused Borrowing Authority	**$ 9,223**	**$ 7,248**

The Department is given authority to draw funds from Treasury to finance its direct lending activity. Unused Borrowing Authority is a budgetary resource and is available to support obligations. The

Department periodically reviews its borrowing authority balances in relation to its obligations and may cancel unused amounts.

Undelivered Orders at the End of the Period

	2007		2006	
(Dollars in Millions)	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Undelivered Orders	**$ 48,235**	**$ 14,217**	**$ 47,630**	**$ 12,472**

Undelivered orders at the end of the year, as presented above, will differ from the undelivered orders included in the Net Position, Unexpended Appropriations. Undelivered orders for trust funds, reimbursable agreements, and federal credit financing and liquidating funds are not funded through appropriations and are not included in Net Position. (See Note 11)

Explanation of Differences Between the Statement of Budgetary Resources and the *Budget of the United States Government*

The *Fiscal Year 2009 Budget of the United States Government* (President's Budget) presenting the actual amounts for the year ended September 30, 2007, has not been published as of the issue date of these financial statements. The fiscal year 2009 President's Budget is scheduled for release in February 2008. A reconciliation of the fiscal year 2006 SBR to fiscal year 2008 President's Budget (fiscal year 2006 actual amounts) for budgetary resources, obligations incurred, distributed offsetting receipts, and net outlays is presented below.

(Dollars in Millions)	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Combined Statement of Budgetary Resources	$ 210,921	$ 159,210	$ 51	$ 70,645
Expired Funds	(713)	(424)	-	-
Amounts included in the President's Budget	5,210	5,209	-	-
Funds excluded from President's Budget and Rounding	5	1	-	(1)
Distributed Offsetting Receipts	-	-	93	51
Budget of the United States Government	**$ 215,423**	**$ 163,996**	**$ 144**	**$ 70,695**

The President's Budget includes a public enterprise fund that reflects the gross obligations by the FFEL Program for the estimated activity of the consolidated Federal Funds of the Guaranty Agencies. Ownership by the federal government is independent of the actual control of the assets. Since the actual operation of the Federal Fund is independent from the Department's direct control, budgetary resources and obligations are estimated and disclosed in the President's Budget to approximate the gross activities of the combined Federal Funds. Amounts reported on the fiscal year 2006 Statement of Budgetary Resources for the Federal Fund are compiled through combining all Guaranty Agencies' Annual Reports to determine a net valuation amount for the Federal Fund.

Note 15. Reconciliation of Net Cost of Operations to Budget

The Reconciliation of Net Cost of Operations (proprietary) to Budget provides information on the total resources used, both those received through budgetary resources and those received through other means during the reporting period. The schedule presented in this footnote reconciles these resources with the net cost of operations by (1) removing resources that do not fund net cost of operations and (2) including components of net cost of operations that did not generate or use resources during the year.

Offsetting Receipts, a component of Resources Used to Finance Activities, include downward re-estimates for the Direct Loan and FFEL Programs. OMB Circular No. A-11, revised as of November 2006, requires that downward subsidy re-estimates in guaranteed and direct loan programs be paid from the financing accounts to general fund receipt accounts beginning in fiscal year 2007. In fiscal year 2006 and prior years, the downward subsidy re-estimates were paid to the related program accounts.

Components Requiring or Generating Resources in Future Periods primarily result from subsidy expense recognized for financial statement re-estimate purposes as required by the Statement of Federal Financial Accounting Standards No. 2. Re-estimates published in the President's Budget, when executed, generate or require resources.

Reconciliation of Net Cost of Operations to Budget

Resources Used to Finance Activities	**2007**	**2006**
Obligations Incurred	$ (125,881)	$ (159,210)
Spending Authority from Offsetting Collections and Recoveries	44,165	84,362
Offsetting Receipts	4,873	(51)
Imputed Financing from Costs Absorbed by Others	(32)	(31)
Total Resources Used to Finance Activities	**(76,875)**	**(74,930)**
Resources Used to Finance Items Not Part of Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but Not Yet Provided (+/-)	(2,343)	(2,946)
Resources that Fund Expenses Recognized in Prior Period	(3,345)	(2,840)
Credit Program Collections which Increase/Decrease Liabilities for Loan Guarantees, or Credit Program Receivables, Net including Allowances for Subsidy	34,261	73,723
Resources Used to Finance the Acquisition of Fixed Assets, or Increase/Decrease Liabilities for Loan Guarantees or Credit Program Receivables, Net in the Current or Prior Period	(39,979)	(48,328)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**(11,406)**	**19,609**
Components Not Requiring or Generating Resources		
Depreciation and Amortization	(445)	400
Other (+/-)	907	(94)
Total Components of the Net Cost of Operations that Will Not Require or Generate Resources	**462**	**306**
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	(31)	(31)
Upward/Downward Re-estimates of Credit Subsidy Expense	(1,354)	(4,200)
Increase in Exchange Revenue Receivable from the Public	2,302	1,603
Other (+/-)	(194)	32
Total Components of the Net Cost of Operations that Will Require or Generate Resources in Future Periods	**723**	**(2,596)**
Net Cost of Operations	**$ (64,284)**	**$ (96,829)**

Note 16. 2005 Hurricane Relief

On August 29, 2005, Hurricane Katrina struck the Gulf Coast, resulting in widespread catastrophic damage to the coastal regions of Louisiana, Mississippi and Alabama. Immediately following Katrina, Hurricane Rita struck the same region, adding Texas to the states already catastrophically damaged and hindering the recovery efforts. The death toll, property damage, dislocation of families, and destruction of the infrastructure of the communities and economies of the Gulf Coast represent a humanitarian crisis that will affect these areas for many years to come.

The Department quickly responded by accelerating the application process for the region's loan applicants, students, borrowers, Guaranty Agencies, educational institutions and other program participants to expedite education-related relief. In addition, the Secretary was authorized to waive or modify statutory or regulatory provisions as applicable for student financial assistance programs. While this provided some relief for the coastal regions, it was apparent that the damage to the affected communities required significant financial support to rebuild the educational systems and return students and teachers to their classrooms.

Funds Appropriated for Hurricane Relief

The *Hurricane Education Recovery Act* (P.L. 109-148, Division B, Title IV) was enacted on December 30, 2005. The act appropriated $1.6 billion to the Department. This funding provides needed assistance to reopen schools and help educate the 370,000 students affected by Hurricanes Katrina and Rita. In June 2006, an additional $285 million was appropriated to the Department to assist with the relief efforts. In June 2007, the *U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007*, authorized an additional $60 million appropriation for continued relief efforts. As of September 30, 2007, $1.9 billion in aid has been obligated to assist local educational agencies and non-public schools, and approximately $1.6 billion has been expended.

(Dollars in Millions)	Appropriated	Obligated	Expended
Emergency Impact Aid for Displaced Students (Impact Aid) Program	$ 880	$ 878	$ 842
Immediate Aid to Restart School Operations (Restart Aid) Program	750	750	492
Higher Education Relief	280	280	220
Special Compensation for Education Personnel	30	30	-
Assistance for Homeless Youth (Homeless Aid) Program	5	5	3
2005 Hurricane Disaster Relief	**$ 1,945**	**$ 1,943**	**$ 1,557**

Earmarked Funds Donated for Hurricane Relief

In the aftermath of Hurricane Katrina, a number of foreign governments, international entities and individuals made donations of financial assistance to the U.S. Government to support Katrina relief and recovery efforts. These donations were received by the U.S. Department of State as an intermediary. Subsequently, $61 million was transferred to the Department to finance educational initiatives in Louisiana and Mississippi under a Memorandum of Understanding issued in March 2006. As of September 30, 2007, $61 million has been obligated from the earmarked funds to assist in the relief and recovery efforts and $22 million has been expended.

Note 17. Contingencies

Guaranty Agencies

The Department can assist Guaranty Agencies experiencing financial difficulties by advancing funds or by other means. No provision has been made in the principal statements for potential liabilities related to financial difficulties of Guaranty Agencies because the likelihood of such occurrences is uncertain and cannot be estimated with sufficient reliability.

Perkins Loan Reserve Funds

The Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. In fiscal year 2007, the Department provided funding of 84.3 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 15.7 percent of program funding. For the latest academic year ended June 30, 2007, approximately 722,003 loans were made, totaling approximately $1.6 billion at 1,636 institutions, averaging $2,230 per loan. The Department's share of the Perkins Loan Program was approximately $6.5 billion as of June 30, 2007.

In fiscal year 2006, the Department provided funding of 84.6 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 15.4 percent of program funding. For the academic year ended June 30, 2006, approximately 727,546 loans were made, totaling $1.6 billion at 1,666 institutions, averaging $2,178 per loan. The Department's share of the Perkins Loan Program was approximately $6.5 billion as of June 30, 2006.

Perkins Loan borrowers who meet statutory eligibility requirements—such as service as a teacher in low-income areas, as a Peace Corps or VISTA volunteer, in the military or in law enforcement, in nursing, or in family services—may receive partial loan forgiveness for each year of qualifying service. In these circumstances, a contingency is deemed to exist. The Department may be required to compensate Perkins Loan institutions for the cost of the partial loan forgiveness.

Litigation and Other Claims

The Department is involved in various lawsuits incidental to its operations. Judgments resulting from litigation against the Department are paid by the Department of Justice. In the opinion of management, the ultimate resolution of pending litigation will not have a material effect on the Department's financial position.

Other Matters

Some portion of the current year financial assistance expenses (grants) may include funded recipient expenditures that are subsequently disallowed through program review or audit processes. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Department's financial position.

Note 18. Subsequent Events

The College Cost Reduction and Access Act of 2007 (CCRAA), P.L. 110-84, was passed by Congress, signed by the President, and became effective October 1, 2007. No part of this act was effective during fiscal year 2007, nor were any budgetary resources provided by Treasury or apportioned by OMB. Consistent with instructions received from OMB regarding the application of OMB Circular No. A-11 and Statement of Federal Financial Accounting Standard No. 2, cost adjustments to the outstanding student loan portfolio incurred as a result of the CCRAA will be apportioned, executed, and recognized in fiscal year 2008.

The CCRAA contains a number of provisions that will affect the cost of outstanding loans and loan guarantees. The modification costs resulting from the Act is estimated to require approximately $1.5 billion in budget authority based on 2008 President's Budget assumptions. The modification will be recalculated and executed based on updated 2009 budget assumptions in February 2008.

Required Supplementary Information

United States Department of Education
Combined Statement of Budgetary Resources
For the Year Ended September 30, 2007
(Dollars in Millions)

	Combined		Federal Student Aid		Office of Elementary & Secondary Education		Office of Special Education & Rehabilitative Services		OTHER	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
Budgetary Resources:										
Unobligated balance, brought forward, October 1:	5,221	46,490	4,387	46,490	283		183		368	
Recoveries of prior year Unpaid Obligations	1,968	3,043	1,356	3,043	470		47		95	
Budgetary Authority:										
Appropriations	73,919	2	29,484		21,328		15,226		7,881	2
Borrowing Authority		20,037		19,570						467
Spending authority from offsetting collections (gross):										
Earned										
Collected	1,816	37,373	1,691	37,019					125	354
Change in Receivables from Federal Sources	3						3			
Change in unfilled customer orders										
Advance Received	(5)				(1)		2		(6)	
Without advance from Federal Sources	(3)	(30)		(30)			(3)			
Subtotal	75,730	57,382	31,175	56,559	21,327	0	15,228	0	8,000	823
Nonexpenditure transfers, net, anticipated and actual			(1)						1	
Permanently not available	(2,119)	(19,451)	(1,845)	(19,429)	(145)		(27)		(102)	(22)
Total Budgetary Resources	**80,800**	**87,464**	**35,072**	**86,663**	**21,935**	**0**	**15,431**	**0**	**8,362**	**801**
Status of Budgetary Resources:										
Obligations incurred:										
Direct	75,435	50,353	30,623	49,871	21,491		15,320		8,001	482
Reimbursable	93				(1)		2		92	
Subtotal	75,528	50,353	$30,623	$49,871	$21,490	$0	$15,322	$0	$8,093	$482
Unobligated Balances:										
Apportioned	3,093	321	2,504	321	332		79		178	
Exempt from apportionment										
Subtotal	3,093	321	2,504	321	332		79		178	
Unobligated Balance not available	2,179	36,790	1,945	36,471	113		30		91	319
Total Status of Budgetary Resources	**80,800**	**87,464**	**35,072**	**86,663**	**21,935**	**0**	**15,431**	**0**	**8,362**	**801**
Change in Obligated Balance:										
Obligated balance, net										
Unpaid obligations, brought forward, October 1	50,210	12,953	11,584	12,941	18,044		10,617		9,965	12
Uncollected customer payments from Federal Sources, brought forward, October 1	(3)	(30)		(30)			(3)			
Total, unpaid obligated balance, brought forward, net	50,207	12,923	$11,584	$12,911	$18,044	$0	$10,614	$0	$9,965	$12
Obligation Incurred net (+/-)	75,528	50,353	30,623	49,871	21,490		15,322		8,093	482
Gross Outlays	(73,058)	(45,529)	(28,366)	(45,344)	(21,251)		(15,139)		(8,302)	(185)
Recoveries of prior year unpaid obligations, actual	(1,968)	(3,043)	(1,356)	(3,043)	(470)		(47)		(95)	
Change in uncollected customer payments from Federal Sources (+/-)		30		30						
Obligated Balance, net, end of period										
Unpaid Obligations	50,712	14,734	12,485	14,425	17,813		10,753		9,661	309
Uncollected customer payments from Federal Sources	(3)						(3)			
Total, unpaid obligated balance, net, end of period	**50,709**	**14,734**	**12,485**	**14,425**	**17,813**	**0**	**10,750**	**0**	**9,661**	**309**
Net Outlays										
Net Outlays:										
Gross Outlays	73,058	45,529	28,366	45,344	21,251		15,139		8,302	185
Offsetting collections	(1,811)	(37,373)	(1,691)	(37,019)	1		(2)		(119)	(354)
Distributed Offsetting receipts	(173)	(4,700)	(35)	(4,700)					(138)	
Net Outlays	**$71,074**	**$3,456**	**$26,640**	**$3,625**	**$21,252**	**$0**	**$15,137**	**$0**	**$8,045**	**($169)**

Required Supplementary Stewardship Information

Stewardship Expenses

In the Department of Education, discretionary spending constitutes approximately 85 percent of the budget and includes nearly all programs, the major exceptions being student loans and rehabilitative services. Although spending for entitlement programs is usually a function of the authorizing statutes creating the programs and is not generally affected by appropriations laws, spending for discretionary programs is decided in the annual appropriations process. Most Department programs are discretionary.

Education in the United States is primarily a state and local responsibility. States, communities, and public and private organizations establish schools and colleges, develop curricula, and determine requirements for enrollment and graduation. The structure of education finance in America reflects this predominantly state and local role. It is estimated that roughly $1 trillion will be spent nationwide on education at all levels for the school year 2007–2008, with Department of Education expenditures, as well as loans and other aid made available as a result of the Department's student financial aid programs. The Department's FY 2007 appropriations of more than $67 billion represents about 2.4 percent of the federal government's $2.8 trillion FY 2007 budget. The federal contribution includes education expenditures not only from the Department of Education, but also from other federal agencies such as the Department of Health and Human Services' Head Start Program and the Department of Agriculture's School Lunch Program.

Investment in Human Capital

Office of Federal Student Aid. The Office of Federal Student Aid administers need-based financial assistance programs for students pursuing postsecondary education and makes available federal grants, direct loans, guaranteed loans, and work-study funding to eligible undergraduate and graduate students.

Office of Elementary and Secondary Education. The Office of Elementary and Secondary Education provides leadership, technical assistance, and financial support to state and local educational agencies for the maintenance and improvement of preschool, elementary, and secondary education. Financial assistance programs support services for children in high-poverty schools, institutions for neglected and delinquent children, homeless children, certain Native American children, children of migrant families, and children who live on or whose parents work on federal property. Funding is also provided to increase the academic achievement of students by ensuring that all teachers are highly qualified to teach.

Office of Special Education and Rehabilitative Services. The Office of Special Education and Rehabilitative Services supports state and local programs that assist in educating children, youth, and adults with special needs to increase their level of employment, productivity, independence, and integration into the community. Funding is also provided for research to improve the quality of their lives.

Office of Safe and Drug-Free Schools. The Office of Safe and Drug-Free Schools supports efforts to create safe and violence-free schools, respond to crises, prevent drug and alcohol abuse, ensure the health and well-being of students, and teach students good citizenship and character. Special character and civic education initiatives are funded to reach those in state and local correctional institutions. Grants emphasize coordinated, collaborative responses to develop and maintain safe, disciplined, and drug-free learning environments.

Office of Innovation and Improvement. The Office of Innovation and Improvement makes strategic investments in educational practices through grants to states, schools, and community and nonprofit organizations. The office leads the movement for greater parental options such as charter schools. The office also supports special grants designed to raise student achievement by improving teachers' knowledge and understanding of and appreciation for traditional U.S. history.

Institute of Education Sciences. The Institute of Education Sciences compiles statistics; funds research, evaluations, and information dissemination; and provides research-based guidance to further evidence-based policy and practice focused on significant education problems. Research programs examine empirically the full range of issues facing children and individuals with disabilities, parents of children with disabilities, school personnel, and others. The National Library of Education is the largest federally funded library devoted entirely to education and provides reference and information services, collection and technical services, and resource sharing and cooperation.

Office of English Language Acquisition. The Office of English Language Acquisition directs programs designed to enable students with limited English proficiency to become proficient in English and meet state academic content and student achievement standards. Enhanced instructional opportunities are provided to children and youths of Native American, Alaska Native, Native Hawaiian, Pacific Islander, and immigrant backgrounds. Grants pay the federal share of the cost of model programs for the establishment, improvement, or expansion of foreign language study in elementary and secondary schools.

Office of Vocational and Adult Education. The Office of Vocational and Adult Education provides leadership, technical assistance, and funding for adult education and career and technical education to state and local agencies to help students improve their literacy skills and prepare them for postsecondary education and careers through strong high school programs and career and technical education. The office ensures the equal access of minorities, women, individuals with disabilities, and disadvantaged persons to career and technical education and adult education and ensures that career and technical education students are held to the same challenging academic content and academic achievement standards established by the state under the *No Child Left Behind Act of 2001*. Funding is also provided to promote identification and dissemination of effective practice in raising student achievement in high schools, community colleges and adult education programs, and lead targeted research investments.

Office of Postsecondary Education. The Office of Postsecondary Education provides grants to colleges and universities to: promote reform, innovation, and improvement in postsecondary education; increase access to and completion of postsecondary education by disadvantaged students; strengthen the capacity of colleges and universities that serve a high percentage of minority and disadvantaged students; and improve teacher and student development resources. The international programs promote international education and foreign language studies and research. The office administers the accrediting agency recognition process and coordinates activities with states that affect institutional participation in federal financial assistance programs.

Program Inputs

The Department currently administers programs affecting every area and level of education. In SY 2006–07 the Department's elementary and secondary programs served an estimated 49.6 million public school students and 6.1 million private school students. Department programs also provide grant, loan, and work-study assistance to an estimated 18 million postsecondary students.

While the Department's programs and responsibilities have grown substantially over the years, the Department itself has not. Since the *No Child Left Behind Act* was enacted in 2001, the Department's current staff of approximately 4,073 has decreased 11 percent below the 4,566 employees who administered federal education programs in 2001. At the same time, the Department manages 40 percent more in funds in 2007 than it did in 2001 when its human capital investment was only $38.7 billion. These staff reductions, along with a wide range of management improvements, have helped limit administrative costs to less than 2 percent of the Department's budget, ensuring that the Department delivers about 98 cents on the dollar in education assistance to states, school districts, postsecondary institutions, and students.

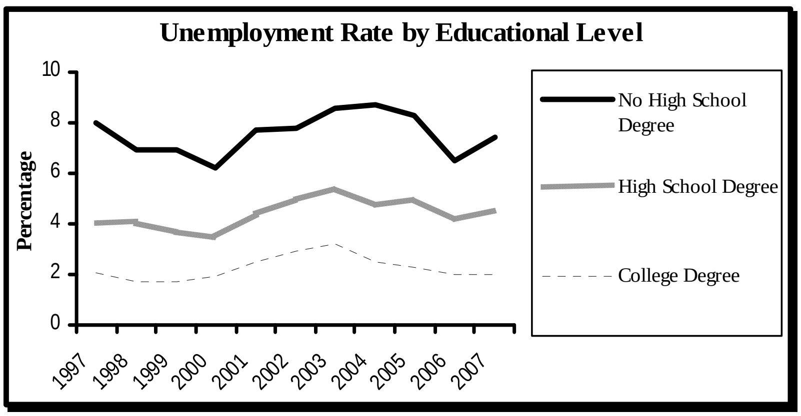
Summary of Human Capital Expenses

(Dollars in Millions)	2007	2006	2005	2004	2003
Federal Student Aid Expense					
Direct Loan Subsidy	$ (499)	$ 6,655	$ 5,211	$ (543)	$ 4,716
Guaranteed Loan Subsidy	4,884	28,062	9,863	8,516	2,509
Grant Programs	15,092	15,447	15,070	14,943	13,836
Salaries and Administrative	173	172	164	186	179
Subtotal	**19,650**	**50,336**	**30,308**	**23,102**	**21,240**
Other Departmental					
Elementary and Secondary Education	21,199	21,710	22,940	21,188	19,493
Special Education and Rehabilitative Services	15,402	15,215	13,995	12,687	11,529
Other Departmental Programs	5,109	5,353	6,067	5,160	4,828
Salaries and Administrative	467	467	486	448	395
Subtotal	**42,177**	**42,745**	**43,488**	**39,483**	**36,245**
Grand Total	**$ 61,827**	**$ 93,081**	**$ 73,796**	**$ 62,585**	**$ 57,485**

Program Outcomes

Education is the stepping stone to higher living standards for American citizens, and it is vital to national economic growth. But education's contribution is more than increased productivity and incomes. Education improves health, promotes social change, and opens doors to a better future for children and adults.

Economic outcomes, such as wage and salary levels, historically have been determined by the educational attainment of individuals and the skills employers expect of those entering the labor force. Both individuals and society as a whole have placed increased emphasis on educational attainment as the workplace has become increasingly technological, and employers now seek employees with the highest level of skills. For prospective employees, the focus on higher-level skills means investing in learning or developing skills through education. Like all investments, developing higher-level skills involves costs and benefits.



Returns, or benefits, of investing in education come in many forms. While some returns accrue for the individual, others benefit society and the nation in general. Returns related to the individual include higher earnings, better job opportunities, and jobs that are less sensitive to general economic conditions. Returns related to the economy and society include reduced reliance on welfare subsidies, increased participation in civic activities, and greater productivity.

Over time, the returns of developing skills through education have become evident. Statistics illustrate the rewards of completing high school and investing in postsecondary education.

Unemployment Rate. Individuals with lower levels of educational attainment are more likely to be unemployed than those who had higher levels of educational attainment. The September 2007 unemployment rate for adults (25 years old and over) who had not completed high school was 7.4 percent, compared with 4.6 percent for those with four years of high school and 2.0 percent for those with a bachelor's degree or higher. Younger people with only high school diplomas tended to have higher unemployment rates than adults 25 and over with similar levels of education.

Annual Income. As of September 2007, the annualized median income for adults (25 years and over) varied considerably by education level. Men with a high school diploma earned $36,244, compared with $65,000 for men with a college degree. Women with a high school diploma earned $26,624, compared with $48,776 for women with a college degree. Men and women with college degrees earned 78 percent more than men and women with high school diplomas. Earnings for workers with college degrees have increased in the past year by 12.45 percent for women and 9.87 percent for men. These returns of investing in education directly translate into the advancement of the American economy as a whole.

Report of the Independent Auditors

NOV 15 2007

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

Honorable Margaret Spellings
Secretary of Education
Washington, D.C. 20202

Dear Madam Secretary:

The enclosed reports present the results of the annual audits of the U.S. Department of Education's financial statements for fiscal years 2007 and 2006, to comply with the Government Management Reform Act of 1994 (GMRA). The reports should be read in conjunction with the Department's financial statements and notes to fully understand the context of the information contained therein.

We contracted with the independent certified public accounting firm of Ernst & Young, LLP (Ernst & Young) to audit the financial statements of the Department as of September 30, 2007 and 2006, and for the years then ended. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards; OMB's bulletin, *Audit Requirements for Federal Financial Statements*; and the GAO/PCIE *Financial Audit Manual*.

In connection with the contract, we monitored the performance of the audits, reviewed Ernst & Young's reports and related documentation, and inquired of its representatives. Our review was not intended to enable us to express, and we do not express, an opinion on the Department's financial statements, or conclusions about the effectiveness of internal control, whether the Department's financial management systems substantially complied with the Federal Financial Management Improvement Act of 1996, or on compliance with laws and regulations.

Ernst & Young is responsible for the attached auditor's report and the conclusions expressed in the related reports on internal control and compliance with laws and regulations. Our review disclosed no instances where Ernst & Young did not comply, in all material respects, with U.S. generally accepted government auditing standards.

Sincerely,

John P. Higgins, Jr.

Enclosures

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

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Report of Independent Auditors

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheets of the U.S. Department of Education (the Department) as of September 30, 2007 and 2006, and the related consolidated statements of net cost, and changes in net position, and the combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Department's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As further discussed in Note 1 to the financial statements, pursuant to guidance issued by the OMB, certain information reconciling the net cost of operations to budgetary obligations which was previously reported in a consolidated statement of financing for the fiscal year ended September 30, 2006, has been presented in the notes to the financial statements along with the corresponding amounts for the fiscal year ended September 30, 2007.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of September 30, 2007 and 2006, and its net costs, changes in net position, and budgetary resources, for the years then ended, in conformity with accounting principles generally accepted in the United States.

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Report of Independent Auditors
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Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information presented in the Management's Discussion and Analysis, required supplementary stewardship information, required supplementary information, and other accompanying information is not a required part of the basic financial statements but is supplementary information required by OMB Circular No. A-136, *Financial Reporting Requirements*. The other accompanying information has not been subjected to the auditing procedures applied in our audits of the basic financial statements and, accordingly, we express no opinion on it. For the remaining information, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 13, 2007, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Ernst + Young LLP

November 13, 2007

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Report on Internal Control

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2007, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 13, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements.*

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

In addition, we considered the Department's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the agency's internal control, determined whether internal control had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 07-04 and not to provide assurance on internal control. Accordingly, we do not provide an opinion on such controls.

With respect to internal control related to performance measures reported in the Management's Discussion and Analysis of the Department's consolidated and combined financial statements, we obtained an understanding of the design of significant internal control relating to the existence and completeness assertions, as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

Our consideration of internal control over financial reporting was for the limited purposes described in the preceding paragraphs and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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Report on Internal Control
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A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described below to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described above and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe none of the significant deficiencies described below is a material weakness.

SIGNIFICANT DEFICIENCIES

1. Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Modified Repeat Condition)

The Federal Credit Reform Act of 1990, as amended, was enacted to require agencies to more accurately measure and budget for the cost of federal loan programs. In implementing the requirements of the Credit Reform Act, and in complying with Federal accounting standards, agencies are required to estimate the net cost of extending credit over the life of a direct loan or guaranteed loan based on the present value of estimated net cash flows, excluding certain administrative costs. Such costs are also re-estimated on a periodic basis. While improvements have been made over the last several years, we noted that internal controls and processes surrounding the calculation and reporting of the loan liability activity and subsidy estimates should be further refined to ensure that appropriate estimates are prepared.

During FY 2007, we noted that the Department made significant progress on certain aspects of this significant deficiency, including further documentation of the inputs to the Department's computer based cash flow projection model, and further refinement of the process used to analyze the products of the newly instituted cohort level analytic tools and comparison of general ledger activity to model cash flows. These are significant steps in enhancing the Department's knowledge.

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The Credit Reform Workgroup (CRW) was created in FY 2004 to improve the credit reform estimation process. During FY 2007, senior management of the CRW continued to meet regularly to discuss the direction of credit reform efforts. Concurrently, the Department streamlined the three sub-groups of the CRW into monthly integrated loans program meetings. Managers from the Office of the Chief Financial Officer (OCFO), Federal Student Aid (FSA), Budget Service, Office of Postsecondary Education (OPE), and OMB established a series of monthly meetings to review reports developed to enhance credit reform discussions and to discuss key internal issues and trends related to the portfolios. Information and analyses were reviewed as inputs into the assumptions to the credit reform models. The group recommended development of improved processes, procedures, and sources of information to enhance the credit reform estimation process.

However, after identifying the key improvements made or currently being made by the Department during our testing of loan guarantees, allowance for subsidy, and subsidy cost estimates, we noted the following items that indicate management controls and analysis can be strengthened:

- The long-term cost for the credit programs is reflected in the financial statements through periodic charges for subsidy costs, adjustments or re-estimates to those subsidy costs, and loan activity, which is all recognized in the allowance for the direct loan (DL) receivable and liability for the guaranteed loan (FFEL) program. The Department uses a computer-based cash flow projection model (i.e., Student Loan Model, or SLM) and OMB calculator to calculate subsidy estimates related to the loan programs that are then recorded in the allowance for subsidy or liability account. The model uses multiple sources of loan data and hundreds of assumptions. In order to perform a check of estimates resulting from the SLM and OMB calculator, the Department prepares a backcast, which compares the model's estimates to actual activity for the current and prior fiscal years. The SLM also produces a forecast of the expected cash flows in the current year for the outstanding loans which, when discounted, can be used to compare to the recorded activity in the general ledger. The new data analysis tools prepared by the Department support more disaggregated reviews of data by cohort. The Department's financial systems are not configured to account for cash flows on a rigorous cohort level. Accurate cohort-level data is increasingly important to ensure that estimates in the subsidy models are appropriately adjusted as cohorts from the early 1990s wind down, and cash flows from default activities create temporary demands for cash that are currently funded on an aggregate basis across cohorts. The Department's efforts in this regard are evolving, particularly in capturing the value of the new data analysis tool. These efforts have highlighted differences between recorded activity by cohort in the Department's records as compared to expected cash flows or cash flows derived from credit systems which merit further investigation.

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- The Department continues to be challenged in estimating lender and borrower behavior, and relies significantly on prior patterns to estimate future activity. There may be situations, however, in which a refinement of such estimates should be made if circumstances suggest that the pattern may not repeat. To the extent that lender or borrower behavior appears likely to have changed, or be changing, deviations from the use of historical data, or introduction of additional assumptions to capture the impact of such changes may be warranted in developing credit reform estimates. For example, pending obtaining definitive participant information regarding which program participants will continue to bill for special allowances related to loans funded by tax-exempt obligations issued before October 1, 1993, the Department, while adjusting assumptions to reflect the Department's settlement activity, has largely continued to project such cash flows as occurring based on historical experience in developing its estimates for the FFEL program. There are indications that not all such lenders will continue to pursue such payments.

  Similarly, the last few months have seen a considerable change in the housing and mortgage lending markets. Increasing delinquencies and stagnating home prices have led to concerns about not just the state of these markets, but also concerns about effects on the broader economy. These events may have an impact on student loan borrowers and consequently on the Department's credit reform results.

  Since the Department's approach to estimating deferment, forbearance, and default rates includes unemployment and inflation rates for selected loan products, and since forecasts of these external factors are used in arriving at the projected deferment, forbearance, and default amounts, the Department's estimates would be expected to capture some of the indirect impact of the credit and housing market deterioration. However, since the models are estimated using data that largely do not reflect recessionary conditions, and since the external factors are not included in all models, the Department could gain additional insights by performing stress-testing around its estimates. This could be achieved by, for example:

  - *Cohort Analysis.* Since differences may exist in how the events in the housing market and broader economy impact borrowers at various points in their career, examining deferment, forbearance, and default rates by cohort may be beneficial. This could be achieved by comparing the rates at the same point in repayment for newer loans to those of older loans. This exercise would provide information regarding the extent to which there may be differences in performance across cohorts. Obtaining credit rating data for a subset of borrowers may also be useful in furthering analysis and tracking borrowers' ability to pay over time.

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- *Examining Behavior During Previous Periods of Economic Stress.* Though the data used in the Department's estimation generally reflects good economic conditions, they also cover at least two periods of economic changes from which information may be gathered to assess the potential impact of the current situation. The housing market downturn in the late 1980s and early 1990s may provide insights into the effect, if any, that housing market conditions may have on the deferment, forbearance, and default rates of student loans. Similarly, the economic effects of the bursting of the dot com bubble in the early 2000s may be illustrative of the impact of a potential economic slowdown. Although neither one of these events is a perfect analog to the current situation, they may provide useful information for stress-testing the Department's deferment, forbearance, and default estimates.

Recommendations:

We recommend that the Department of Education perform the following:

1. Continue to improve the analytical tools used for the loan estimation process and in periodic meetings of the Credit Reform Workgroup. Ensure that all analytical tools reconcile with one another to allow for their use as detect controls for loan program cost estimates.
2. Continue efforts to more fully implement cohort reporting with specific research on whether balances in the Department's financial records are supported by estimates, by cohort, from the SLM and the newly developed cohort analysis tool and that remaining credit reform estimates for each cohort are appropriate in relation to the remaining outstanding loans for such cohorts.
3. Document the consideration and ultimate resolution, in detail, of scenarios under which deviation from patterns of prior cash flows may be appropriate in developing credit reform estimates.

2. Additional Focus on Program Monitoring Activities is Needed

Renewed focus is warranted regarding monitoring activities for various Departmental loan and grant programs. Several audits and inspections were conducted by the Department's Office of Inspector General (OIG) in FY 2006 and 2007 of participants in the Department's programs and oversight and monitoring performed by the Department for such programs. These audits and inspections identified issues regarding potential noncompliance with program requirements and deficiencies in program oversight processes. In some cases the focus on such programs has led to changes in how programs are administered; and settlements have occurred with program participants including, in 2007, activity related to the Department's refinement of the eligibility requirements specified by the Higher Education Act of 1965, as amended, for receiving tax-exempt special allowance payments.

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The OIG reports include suggestions for improvements in areas such as policy development and dissemination, program monitoring and oversight of guaranty agencies, lenders and servicers that participate in the Federal Family Education Loan (FFEL) program, and also noted matters for improvement in program monitoring for grant programs. Certain potential non-compliance issues in the OIG reports are currently under consideration by Department management. In some instances, management informed us that corrective actions had been implemented or were in the process of being implemented to address some of the issues raised by the OIG.

The overarching theme in these reports suggests that the Department and FSA should revisit and reinvigorate as appropriate the processes they use to monitor their programs. Funding, disbursements, and loan portfolio balances for certain grant and loan programs have all increased over the past several years, which also suggests a need for additional monitoring and revisiting periodic risk assessments for each unique program.

Recommendations:

We recommend that the Department of Education perform the following:

1. The Department and FSA should continue to re-assess oversight and monitoring practices to include a specific focus on the risks of each program in connection with its evaluation and assessment of internal control. This process should also address risks identified in other assessment, audit and inspection activities. The identified risks and the controls identified to mitigate such risks, both of which should be thoroughly documented, serve as a starting point for identifying appropriate improvement initiatives. The Department and FSA should continue and refine efforts we were informed are underway to identify and implement, as appropriate, additional changes needed in the approach to program management, including procedures for performing program and monitoring reviews, and reviews of payments to FFEL lenders and guaranty agencies prior to disbursement as appropriate.

3. Controls Surrounding Information Systems Need Enhancement (Modified Repeat Condition)

In connection with the annual audit of the Department's FY 2007 financial statements, we conducted a controls review of the information technology processes related to the significant accounting and financial reporting systems. OMB Circular A-130, *Management of Federal Information Resources*, requires: (1) standard documentation and procedures for certification and accreditation of systems; (2) records management programs that provide adequate and proper documentation of agency activities; (3) agencies to develop internal information policies and procedures and oversee, evaluate, and otherwise periodically review agency information resource management activities; and (4) agency plans to assure that there is an ability to recover and provide service sufficient to meet the minimal needs of users of the system.

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The Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* identifies five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communications, and Monitoring. With respect to the Control Environment and Monitoring components, the GAO publication states that:

- "management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control and conscientious management," and
- "internal control monitoring should assess the quality of performance over time and ensure that the findings of audit and other reviews are promptly resolved."

While the Department has worked towards strengthening and improving controls over information technology processes during FY 2007, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems that need to be addressed. The OIG has identified deficiencies for the Department in its 2007 Federal Information Security Management Act (FISMA) report in the areas of (1) FSA's management control structure in incident handling and intrusion detection systems which restrict its ability to reasonably identify and report suspicious activity; (2) FSA's configuration management program that restricts its ability to reasonably maintain security over its systems in a consistent manner; (3) FSA's oversight of contractors supporting select systems; and (4) the Department's safeguarding of personally identifiable information. Comments were also noted regarding the Certification and Accreditation process, risk assessments and security status of interconnected systems, and an assessment that in some instances the Department had not conducted oversight commensurate with the potential risks to the Department.

More specifically, based on our work and the findings of the OIG, the Department should: (1) strengthen access controls to protect mission critical systems (e.g. user provisioning process, periodic access revalidation, timely removal of user access, physical data center access controls); (2) improve the configuration management process to ensure consistent security configuration of servers and mainframe security packages across the organization and improve configuration settings to comply with best practices; (3) enforce the use of complex passwords in all systems across the organization and two factor authentication as appropriate; (4) comprehensively review technical security weaknesses identified in prior audits in order to determine whether security controls have been fully implemented or adequately address the security weaknesses across the organization; (5) strengthen security incident handling procedures and intrusion detection systems; (6) consistently perform risk assessments and Certification and Accreditation on its new systems and new environments, especially after migrating to a new location, upgrading to a new system, or every three years as required by National Institute of Standards and Technology (NIST) guidance; (7) improve controls over the protection of personally identifiable information (PII) (e.g. encryption of backup data and monitoring of contractors who may have access to PII);

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(8) enhance monitoring of its security training and awareness program, specifically around completion of such training by all employees and contractors; (9) ensure that all personnel, employees and contractors, undergo appropriate background investigation checks and formally acknowledge the Department's rules of behavior prior to gaining access to any Department system or facility; (10) implement standards around the logging of privileged user access and activities and establish controls over the monitoring of that access, and (11) update its contingency planning and disaster recovery planning documentation.

The number of repeat conditions noted in our work and in the OIG's audit reports is an indication that the control environment and monitoring components of internal controls at the Department require additional focus.

Recommendation:

1. Applications and related infrastructure are supported by a number of separate groups within the Department and FSA. While these groups have attempted to implement controls promulgated by Department, FSA, OMB, and NIST guidelines, control processes and practices have been implemented in a disparate manner across these groups. In addition, audit resolution activities have traditionally been performed by each separate group and have largely focused around addressing the immediate security and control weaknesses identified by audit reports rather than a detailed evaluation of the root cause for the identified weaknesses. We recommend that the Department continue its efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness uniformly across the organization, which should decrease the likelihood of a similar weaknesses being identified in future audit assessments and internal self-assessments. Examples of addressing root causes may include, but are not limited to, additional training for the information technology professionals within the organization, updates to procedures to ensure proper configuration of servers against documented hardening standards at the time of deployment, and auditing performance-based contracts of vendors providing system support services to the Department.

STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the FY 2006 audit of the Department of Education's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

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Summary of FY 2006 Reportable Conditions

Issue Area	Summary Control Issue	FY 2007 Status
Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Reportable Condition)	Management controls and analysis need to be strengthened over credit reform estimation and financial reporting processes.	Improvements noted – Modified Repeat Condition classified as a Significant Deficiency
Controls Surrounding Information Systems Need Enhancement (Reportable Condition)	Improvements are needed in overall information technology security management.	Improvements noted – Modified Repeat Condition classified as a Significant Deficiency

We have reviewed our findings and recommendations with Department management. Management generally concurs with our findings and recommendations and will provide a corrective action plan to the OIG in accordance with applicable Department directives.

In addition to the significant deficiencies described above, we noted certain other matters involving internal control and its operations that were reported to management in a separate letter dated November 13, 2007.

This report is intended solely for the information and use of the management of the Department, OMB, Congress, and the Department's OIG, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 13, 2007

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Report on Compliance with Laws and Regulations

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2007, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 13, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements.*

The management of the Department is responsible for complying with laws and regulations applicable to the Department. As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this reporting requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed instances in which the Department's financial management systems did not substantially comply with certain requirements discussed in the preceding paragraph. We have identified the following instance of noncompliance:

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While the Department has worked towards strengthening and improving controls over information technology processes during FY 2007, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems that need to be addressed. More specifically the Department should: (1) strengthen access controls to protect mission critical systems (e.g. user provisioning process, periodic access revalidation, timely removal of user access, physical data center access controls); (2) improve the configuration management process to ensure consistent security configuration of servers and mainframe security packages across the organization and improve configuration settings to comply with best practices; (3) enforce the use of complex passwords in all systems across the organization and two factor authentication as appropriate; (4) comprehensively review technical security weaknesses identified in prior audits in order to determine whether security controls have been fully implemented or adequately address the security weaknesses across the organization; (5) strengthen security incident handling procedures and intrusion detection systems; (6) consistently perform risk assessments and Certification and Accreditation on its new systems and new environments, especially after migrating to a new location, upgrading to a new system, or every three years as required by National Institute of Standards and Technology (NIST) guidance; (7) improve controls over the protection of personally identifiable information (PII) (e.g. encryption of backup data and monitoring of contractors who may have access to PII); (8) enhance monitoring of its security training and awareness program, specifically around completion of such training by all employees and contractors; (9) ensure that all personnel, employees and contractors, undergo appropriate background investigation checks and formally acknowledge the Department's rules of behavior prior to gaining access to any Department system or facility; (10) implement standards around the logging of privileged user access and activities and establish controls over the monitoring of that access, and (11) update its contingency planning and disaster recovery planning documentation.

The Report on Internal Control includes additional information related to the financial management systems that were found not to comply with the requirements of FFMIA relating to information technology security and controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMIA, and our recommendations related to the specific issues. We have reviewed our findings and recommendations with management of the Department. Management concurs with our recommendations and, to the extent findings and recommendations were noted in prior years, has provided a proposed action plan to the OIG in accordance with applicable Department directives. We did not audit management's proposed action plan and accordingly, we express no opinion on it.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

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This report is intended solely for the information and use of the management of the Department, OMB, Congress, and the Department's OIG, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 13, 2007

UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202-_______

NOV 9 2007

MEMORANDUM

TO: John P. Higgins, Jr.
Inspector General

FROM: Lawrence A. Warder
Chief Financial Officer

Bill Vajda
Chief Information Officer

SUBJECT: DRAFT AUDIT REPORTS
Fiscal Years 2007 and 2006 Financial Statement Audit
U.S. Department of Education
ED-OIG/A17H0003

Please convey our sincere thanks and appreciation to everyone on your staff who worked diligently on this financial statement audit. The Department has reviewed the draft Fiscal Years 2007 and 2006 Financial Statement Audit Reports. Without exception, we concur and agree with the Report of Independent Auditors and the Report on Internal Control. We also concur and agree with the Report on Compliance with Laws and Regulations.

We will share the final audit results with responsible senior officials, other interested program managers, and staff. At that time we will also request that they prepare corrective action plans to be used in the resolution process.

Again, please convey my appreciation to everyone on your staff whose efforts permitted the Department to complete the audit within the accelerated timeframe. Please contact Gary Wood at (202) 401-0862 with questions or comments.

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