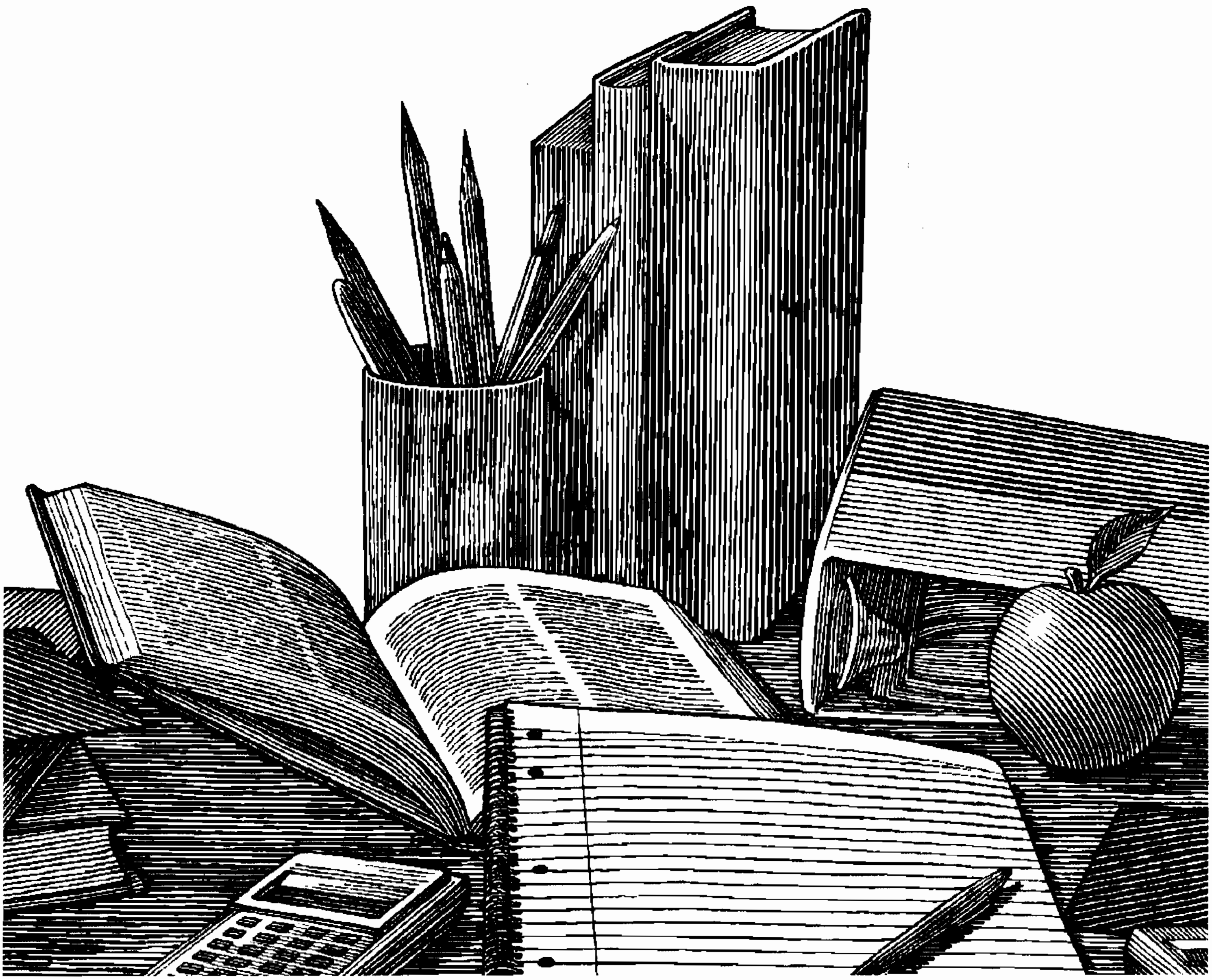
United States Department of Education
Financial Statements Report
Fiscal Year 2000



U.S. Department of Education
FY2000
Financial Statements

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

February 28, 2001

Dear Colleagues in Education:

FY 2000 saw the Department make significant progress toward its goal of receiving an unqualified audit or "clean" opinion. A major milestone in the process was our ability to analyze and correct problems in our prior years' accounting data. This included our reconciliation of variances that existed between grant and loan accounting feeder systems and our general ledger; our general ledger and our fund balances with the U.S. Treasury Department; and within our general ledger between budgetary and proprietary (cash) accounts. In some cases the Department had to use the best data available and make reasoned judgements when we processed a significant number of prior period adjustments.

Over the last year, we worked diligently to implement recommendations designed to correct deficiencies reported in prior financial audits. Moreover, the Department implemented numerous improvements designed to assist in the financial management of the Department. For example, the Department developed an online set of policies and procedures manuals to provide accounting employees with comprehensive, up-to-date guidance on how to perform their jobs. In addition, early this year we purchased a "state-of-the-art" general ledger software system. As a result of these efforts, we were able to close out 117 of the 139 recommendations included in financial audits dating back to 1995.

The culmination of all of these efforts, along with that of our independent auditors, is presented in this report. The Department's audited financial statements were completed and issued on time.

Many challenges remain in our continuous effort to improve financial management. Our self-assessment required under the Federal Managers' Financial Integrity Act and the internal control report from our auditors, identify a number of weaknesses in financial and other management controls. We are committed to their correction. During FY 2001 we plan to continue the phased implementation of our new general ledger software system and complete the implementation of a comprehensive disaster recovery plan for our core financial system.

The attached report describes the Department of Education - our history, mission, priorities and progress. The report highlights our major program and financial accomplishments and describes our future efforts to improve service to our customers. It includes a discussion of the Department's Strategic Plan goals, objectives and results. It contains the results of the Department-wide audit, and the auditors' reports. Finally, this report includes other reporting requirements on financial management: the overall condition of management controls, a progress report on audit follow-up, and a status report on the timeliness of the Department's vendor payments.

The Department recognizes the importance of public disclosure and accountability. This report is a demonstration of our commitment to fulfill our fiduciary responsibilities to the American taxpayer.

Sincerely,

Mark Carney

Mark Carney
Deputy Chief Financial Officer

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

INTRODUCTION

Overview of the Department of Education

These financial statements provide the President, the Congress and the American people an accounting of the financial performance of the Department during fiscal year (FY) 2000. It presents selected program initiatives highlighting what we have achieved and where we need to improve. It is submitted in response to various statutory reporting requirements, including those of the Government Performance and Results Act (GPRA) of 1993 (Public Law 103-62), the Federal Managers' Financial Integrity Act (FMFIA) of 1982 (Public Law 97-255), and the Government Management Reform Act of 1994 (Public Law 103-356).

Mission

Education is America's number one priority. The American people are constantly examining how education is organized, structured, delivered and assessed in order to improve quality and ensure equal access to all. While education is primarily a state and local community responsibility, private organizations and federal entities play an important role in improving education.

Within this context, the U.S. Department of Education carries out its mission in two major ways. First, the Secretary and the Department provide leadership responsibility in the ongoing dialogue over how to improve the results of our education system. Second, the Department pursues its goals of access and excellence through the administration of programs covering all areas of education from preschool to postdoctoral research.

In accordance with GPRA results-oriented management, the Department utilizes strategic planning and performance reporting. A mission statement is the guiding standard that gives direction to all goals and objectives of the plan and hence, all activities of the Department. The Department's mission is:

To ensure equal access to education and promote educational excellence throughout the nation.

Organization

The Department is headquartered, with most of its operations, in Washington, DC. Additionally, about one third of the Department's employees are stationed in ten regional offices, making it easier to serve state and local educational systems. Regional staff are primarily involved in representing the Department's goals and views within the region, particularly in the areas of student financial assistance, civil rights enforcement, vocational rehabilitation services for the disabled, and Inspector General audits and investigations. The organizational chart, which follows, shows the structure that carries out the day-to-day work.

Goals

Part I of this report illustrates how the Department pursues it mission of ensuring equal access and promoting excellence by focusing its activities on four strategic goals:

1. **helping all students reach challenging standards,**

2. **providing a solid foundation for learning,**

3. **ensuring access to postsecondary education and lifelong learning, and**

4. **achieving a high-performing department.**

Specifically, Part I presents the goals and objectives in place during FY 2000 along with selected indicators. When appropriate, this report will also include other descriptive information aimed at providing a richer and more complete picture of the initiatives and programs supported by the Department. Additionally, in compliance with FMFIA, it identifies major management challenges and describes ED's progress towards their resolution.

Part II of the report describes the Department's financial performance during fiscal year 2000. It includes the Department's 2000 consolidated financial statements and the report of the independent auditors.

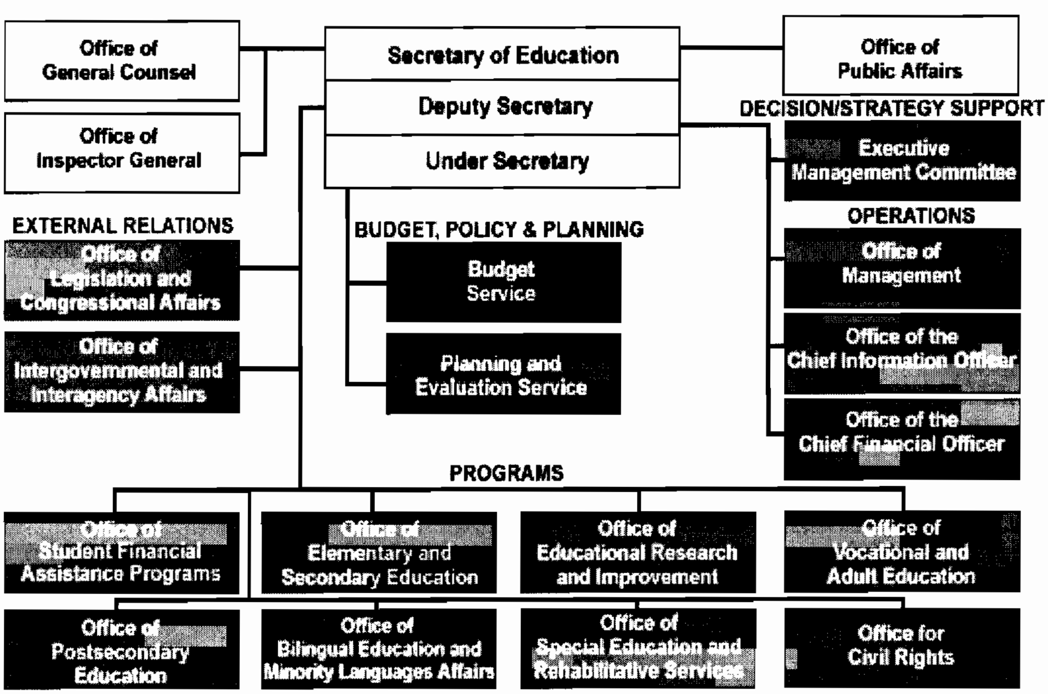
Two appendices include (A) a glossary of abbreviations and acronyms used in this report, and (B) a list of the Department of Education offices' web sites.

Financial Statement Highlights

The Department of Education's financial statements are prepared in conformity with Office of Management and Budget Bulletin No. 97-01, *Form and Content of Agency Financial Statements* as amended. The independent auditors expressed a qualified opinion of the Department's consolidated balance sheet, related consolidated statements of net cost and changes in net position, the combined statement of budgetary resources and the combined statement of financing for the year ended September 30, 2000.

Organizational Chart

U.S. Department of Education



PART I

Goals and Objectives

Highlights of Reporting Requirements

GOAL 1

Help all students reach challenging academic standards, so that they are prepared for responsible citizenship, further learning, and productive employment.

As we begin the 21^{st} century, educators in the United States are called on to meet the challenge of ensuring that *all* students in *every* school meet high expectations for achievement. The Department of Education assists state and local educators, decision-makers, and families in strengthening schools, improving the educational performance of all children, and reforming and revitalizing education at all levels. The Department will continue to concentrate on the areas that are central to improving and maintaining high standards of learning for everyone. This means ensuring that the following seven objectives are met:

1. **States develop and implement challenging standards and assessments for all students in the core academic subjects.**
2. **Every state has a school-to-work system that increases student achievement, improves technical skills and broadens career opportunity for all.**
3. **Schools are safe, disciplined and drug-free.**
4. **A talented and dedicated teacher is in every classroom of America.**
5. **Families and communities are fully involved with schools and school improvement efforts.**
6. **Greater public school choice will be available to students and families.**
7. **Schools use advanced technology for all students and teachers to improve education.**

GOAL 2

Build a solid foundation for learning for all children

In its pursuit of educational improvement, the Department concentrates on two interrelated aims: excellence and equity. As part of this effort, we have identified several areas that must be addressed in order to build a solid foundation for learning for all children.

One essential element is to close the achievement gap between disadvantaged students and their peers and to ensure that students meet high academic standards at essential transition points in their educational journey.

We can achieve this goal by ensuring that the following four objectives are met:

1. **All children enter school ready to learn.**
2. **Every child reads well and independently by the end of third grade.**
3. **Every eight-grader masters challenging mathematics, including the foundation of algebra and geometry.**
4. **Special populations participate in appropriate services and assessments consistent with high standards.**

To address these key areas, the Department must pursue strategies such as cooperation with state and local efforts to implement high academic standards and linked assessments, and financial support for innovative approaches to assist children with special needs. The Department of Education supports elementary and secondary education through funds specifically targeting high priority areas to help all students and learners meet educational challenges and prepare for jobs. The major programs supporting concurrently Goals 1 and 2 are the following:

Title I of the Elementary and Secondary Education Act

This act provides supplemental programs to enable educationally disadvantaged children, particularly those attending schools in high-poverty areas, to learn the core subjects to high standards.

With Title I, these children have the benefit of more individualized instruction, fundamental changes in the school to facilitate improved learning, and preschool education. Children of migrant agricultural workers, and students in State institutions for neglected and delinquent children and youth, also benefit from Title I services. Title I supports, in the form of grants to states and school districts, the education of over 12 million children in 44,000 schools across the country. States, school districts and schools are held accountable for spending the funds effectively and achieving results.

Special Education

The program assists approximately 6 million children with disabilities from birth through age 21 in meeting their developmental and educational needs. The Department's special education programs, delivered mostly in grants, assist states in providing early intervention services for infants, toddlers, children and youth with disabilities in order that they ultimately achieve full integration and enjoy equal opportunity and access to education and employment.

Impact Aid

The program provides support to school districts affected by Federal activities. The presence of a military base or Federal ownership of a significant part of local property, for instance, may undercut the local tax base that ordinarily serves as the principal source of school funding. Impact Aid is intended to replace this lost revenue.

Talented and Dedicated Teachers in Every Classroom

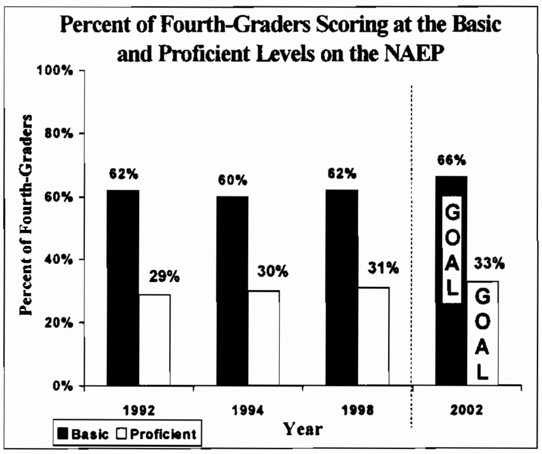
Teacher excellence is vital to achieving improvement in student achievement. Every child in America deserves a high quality teacher. To ensure that there is a talented and dedicated teacher in every American classroom, funds are provided to help prepare, recruit and train high quality teachers. Schools have the flexibility to set their own staff training and development priorities.

Safe and Drug Free Schools

This program is designed to help make our schools safe and drug-free by supporting comprehensive integrated approaches to drug and violence prevention. The program provides significant resources to help States and Local Educational agencies design programs to meet their own unique needs to motivate our youth to reject illegal drugs as well as the use of alcohol and tobacco.

Reading and Mathematics

Reading is the foundation of all other skills essential for learning, yet the National Assessment of Educational Progress (NAEP) reports that only 62 percent of fourth-graders read at the basic level or higher. Research shows that students who fail to read well by fourth grade are at greater risk of educational failure. Mastering basic skills such as reading are essential first steps to reaching challenging academic standards in all subjects.

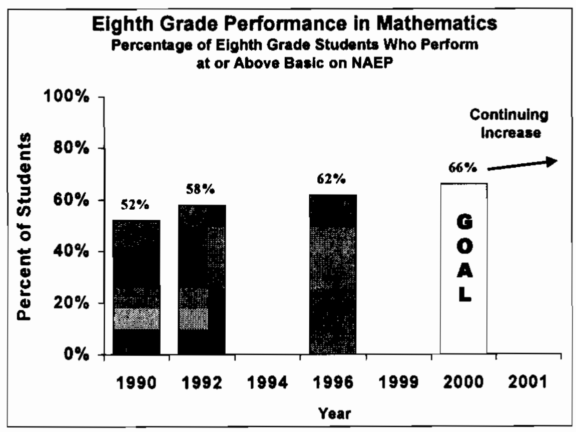


The Department of Education helps states, local school districts, and schools improve the teaching and learning of reading and promote research-based reading instructions and strategies.

Since the 1970's, NAEP scores for fourth-graders have been relatively flat (around 60 percent at basic of higher levels). These statistics are disturbing because they indicate that around 40 percent of the fourth-grade population continue to have difficulty reading at the basic level of proficiency.

To be prepared for postsecondary study and promising careers, students need to master advanced skills in mathematics, science, and technology. Mathematics also teaches ways of thinking that apply in the workplace and are essential for informed civic participation. Yet, far too many students finish high school without mastering the mathematics necessary for success in either higher education or our competitive knowledge-based economy.

U.S. fourth-graders perform above the international average, but mathematical performance begins to decline in the middle grades, and U.S. students perform significantly below the international average by the end of secondary school (Third International Mathematics and Science Study (TIMSS), 1997, 1998).



U.S. students have shown progress in their mathematics achievement on the NAEP since 1990, yet many still fail to achieve the high standards needed for future success in both education and work. The last data from NAEP, in 1996, show that 62 percent of students scored at or above the basic level of NAEP compared with 52 percent in 1990. Much smaller percentages of students perform at the proficient or advanced levels. If current trends continue in the 2000 results, we expect that 66 percent of eight-graders will perform at or above basic on NAEP.

GOAL 3

Ensure access to postsecondary education and lifelong learning

Postsecondary education is becoming increasingly important for the individual and for the nation's well being. Given current trends, at least two-years of postsecondary education will be increasingly necessary to gain higher earnings and improved job opportunities.

Although American higher education is the envy of the world, almost 40 percent of our own high school graduates do not immediately attend postsecondary education. Moreover, postsecondary enrollment and completion rates are significantly lower for blacks and Hispanics and for students in the lower-and middle-income families than for whites and those from higher-income families. Although enrollment rates have been rising in recent years, postsecondary education remains an elusive option for too many American high school graduates.

Besides helping to ensure access to postsecondary training for our young people, it is also essential that we encourage lifelong learning, whether it is graduate school or adult basic education, advanced technical training or training in job entry skills. This includes many for whom lifelong learning opportunities are of special importance, such as persons with disabilities, adults lacking basic skills, and those whose job skills need upgrading or who require retraining because of labor market changes. Persons with disabilities are at least twice as likely as people without disabilities to be unemployed which is estimated to cost society in excess of $2 billion annually.

To help guarantee access to postsecondary education and lifelong learning, we need to make progress in four areas, ensuring that:

1. **All students leave high school with the academic background and preparations to pursue postsecondary education.**
2. **All students motivated and academically ready to attend postsecondary education have the financial resources and support services needed to do so.**
3. **The student aid delivery system is efficient, financially sound, and customer-responsive.**
4. **Best practices are identified and performance data systems are updated.**

The Department of Education strongly supports Goal 3. The single largest category of investment the Department makes with the federal education dollar is in postsecondary education - helping families pay for college. More than 40 percent of the Department's budget is devoted to postsecondary education, most of which is used for student financial aid.

The history of federal financial assistance to college students goes back to the GI Bill of 1944, which served as the springboard to the middle class for millions of American servicemen and their families. Today, the federal government funds a large percentage of all student financial aid in the nation. The major programs supporting Goal 3 are described below.

The Pell Grant program helps ensure financial access to postsecondary education by providing grant aid to low- and middle-income undergraduate students. The most need-focused of the Department's student aid programs, Pell Grant awards, vary in proportion to the financial circumstances of students and their families. During fiscal year 2000, almost 4 million students received grants averaging $2,063.

Two major student loan programs account for most of the remainder of the Department's support for postsecondary education. The **Federal Direct Loan Program** lends funds directly to college students. The U.S. Treasury provides loan funds for the Direct Loan Program. The **Federal Family Education Loan Program** (FFEL) makes Federally guaranteed loans available to students through private lenders.

The Department's **Campus Based** programs provide assistance to institutions, which enables them to provide students with employment, grants, and low interest loans on the basis of need. **Higher Education** programs support development and strengthening of programs at institutions and direct grants and fellowships to students in a variety of programs.

The total portfolio of postsecondary aid programs run by the Department generated over $50 billion in student aid (including Federal Family Education Loan capital, Perkins Loan capital from institutional revolving funds, and institutional and state matching funds) to almost 8.4 million postsecondary students and their families during FY 2000.

Performance Plan Progress

During FY 2000, the Department of Education worked with approximately 6,000 postsecondary institutions, 4,000 lenders, and 36 guaranty agencies to deliver grant, loan and work-study assistance to students who rely on federal student aid to pay for college.

The Department has identified the modernization of the student aid delivery system as one of the highest priority management objectives. This modernization is managed by a performance-based organization (PBO), Student Financial Assistance (SFA).

The PBO was created to address the need for a management structure driven by strong incentives to manage for results. The PBO's operations are focused on its Five-year Performance Plan and on accomplishing its three measures of success: improving customer satisfaction, reducing unit cost and improving employees' satisfaction.

Over the last year, the PBO reported on the status of 75 performance plan indicators and has made significant strides in achieving these performance objectives. Students have access to more information about their loans and can do more with their loans – like change payment plans or request forbearance – than customers can do on the Web sites of some of the nation's biggest banks. Collections are up and costs are down.

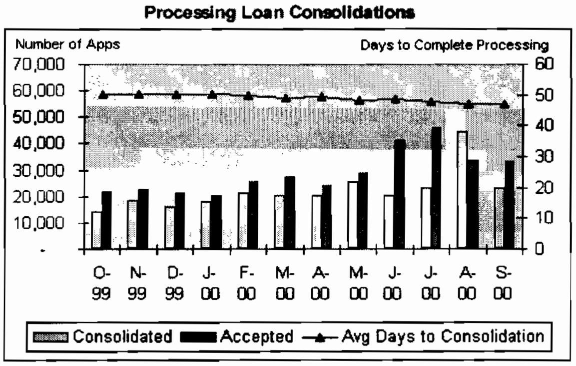
The updated version of the Modernization Blueprint includes more innovative ideas and suggestions to improve efficiency and achieve cost savings – in realization of the new SFA organization. All frontline workers completed training designed to focus on making SFA worthy of our customers' trust and renowned for our courtesy, great product and efficiency.

The following performance measures highlight the progress being made in meeting Goal 3 and the ensuing objectives referenced above.

Customer Satisfaction

While processing more than 510,000 Direct Loans Consolidations, SFA completed applications with an average year-to date turnaround time of less than 50 days (through September 30, 2000). Loan consolidators have exceeded the established timeframes and are currently averaging 46 days for processing consolidations.

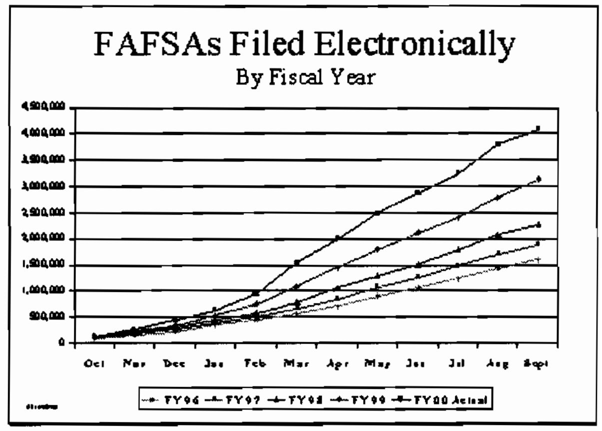
Processing Loan Consolidations



Once the new electronic application goes on-line, the average processing time could drop an additional 5-7 days.

SFA met its goals of receiving 4 million electronic Federal Applications For Student Aid (FASFAs) by the end of fiscal year 2000. The electronic application is faster and easier for the students to file and for the Department to process.

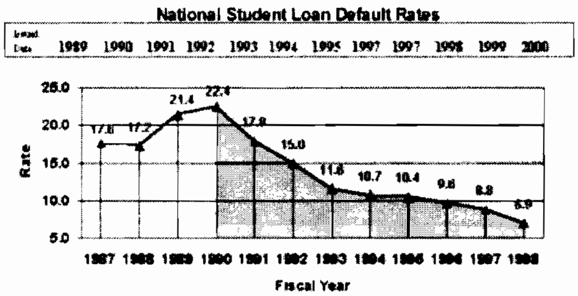
In June 2000, FAFSA on the Web was announced as a recipient of an E-Government 2000 Pioneer Award. This award recognizes e-government best practices that increase productivity, reduce costs, and improve quality, timeliness, and accuracy of services provided to the public.



Reduce Cost

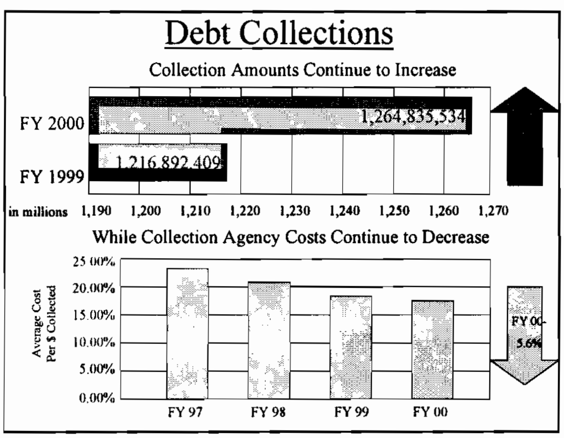
Under statute, a key measure of student loan default is the "cohort default rate," which is the percentage of borrowers that entered into the repayment of FFEL and Direct Loan Programs loans during one fiscal year and defaulted on those loans in the same fiscal years they entered into repayment or the next fiscal year.

Because of concern about high default rates and inadequate loan collections in the student aid programs, Congress and the Department have taken actions to reduce defaults – including management reforms and increased attention to assist at-risk postsecondary institutions. This allowed the Department to cut the default rate by more than half from 22.4 percent for FY 1990 to 6.9 percent for FY 1998 (the most recent cohort).



This is well below the cohort default rate goal of 10 percent.

During FY 2000, SFA tried new ways to make debt collection more effective, less costly, and more customer service oriented. As a result debt collection on defaulted loans has increased. SFA exceeded its goal of $1.2 billion in collections for fiscal year 2000. As collections increase, collection agency costs continue to decrease.



The average cost per collection dropped nearly six percentage points in the last three years.

GOAL 4

Make the Department a high-performance organization by focusing on results, service quality, and customer satisfaction.

The Department's fourth goal cuts across all programs and it is critical to all goals and objectives described in the Department's strategic plan.

Goal 4 is organized around seven themes: customer service, flexibility of programs, research, technology, employee development, financial management and performance measurement.

Strategies in Goal 4 were developed from a variety of sources: results of employee surveys, feedback from external customers, effective practices outlined in management literature, reviews of successes achieved by government and industries, and reports from the General Accounting Office and the Office of the Inspector General. Progress has been made on each of the Goal 4 objectives:

1. Customer Services. The Department improved its ability to deliver high-quality information services through its toll-free telephone numbers and Web sites. The Department also made substantial progress on improving its services to customers requesting published information through "ED Pubs," a centralized distribution system for Department publications featured in *Government Executive* magazine. In addition, grater emphasis was placed on developing customer feedback systems that are used to improve program management, services delivery, and policy development.

2. Flexibility of programs. Progress continued on finding ways for the Department to reduce its regulatory and paperwork burden on grantees and other customers without reducing the level of program performance. The Department also focused on writing regulations and policies in plain language, integrating program review and technical assistance across "stovepipe" programs, and building partnerships, where possible, to achieve critical program results.

3. Research. It is critical that the nation possess a healthy knowledge base to support systematic education reform and equity. Adequate capacity, a relevant research agenda, high quality research, and useful findings and products are necessary for a sustained knowledge base. The Department of Education supports research primarily through the Office of Educational Research and Improvement. Key strategies include forming partnerships with other agencies to conduct cutting edge research and focusing research on solving critical problems in education policy and practices.

4. Technology. The Department is expanding its Internet presence (for external customers) and is redesigning the Intranet (for internal users) to improve workflow processes and communications.

5. Employee development. During 2000, the Department continued to offer better training to employees. In addition to the mandatory 40 hour continuing professional development for all the Department's executives and managers, ED designed a 40 hour course emphasizing performance management for new supervisors and managers. The Department is also identifying skill gaps and potential staffing shortages in critical education program areas and is developing a targeted recruitment strategy to attract highly qualified candidates to its staff.

6. Financial management. During FY2000, the Department began the phased implementation of a new Joint Financial Management Improvement Program certified general ledger software system. Replacement of the Department's general ledger software system and improvement of internal controls will help achieve reductions in material weaknesses and reportable conditions as well as producing timely and accurate financial statements.

7. Performance measurement. The Department's five year Strategic Plan and it's Annual Plan have received high marks for providing a coherent framework of goals, objectives and indicators to provide for measurement of progress and accountability. The Department has phased in a data attestation process for our largest programs. This is part of our commitment to the strategic planning process and data integrity to ensure that the data provided by programs and offices are valid and can be relied on by policy makers, program administrators, and the Congress.

The Department Performance Plan is available online at http://www.ed.gov/pubs/planrpts.html.

In addition to the initiatives outlined above the following high visibility projects are contributing to the efforts to make the Department a high-performance organization.

Cooperative Audit Resolution and Oversight Initiative (CAROI)

The Department has been working with states and school districts to provide support and flexibility to implement legislative requirements without impairing accountability for results. Since its inception in July 1995, the Cooperative Audit Resolution and Oversight Initiative (CAROI) has used four strategies to advance this objective: (1) creating and maintaining dialogue with states, (2) working with states to address audit findings that are open or under appeal, (3) improving the process used in single audits of federal aid recipients (annual or biennial evaluations of financial operations and compliance requirements of all major programs in accordance with the Single Audit Act), and (4) coordinating within ED the resolution of audit findings with monitoring site visits and technical assistance. The CAROI program has been recognized by the Association of Government Accountants as a government-wide "Best Practice."

Increased number of CAROI projects. At the end of fiscal year 2000, ED had undertaken 39 CAROI projects in 25 states. CAROI serves as a collaborative method that links program, finance, auditing, and legal staffs at the federal and state levels to provide alternative and effective approaches to resolve findings and recurring problems identified through audits. The goal of CAROI is to improve education programs and the management of those programs at state and local levels through better use of audits, monitoring, and technical assistance.

In FY 2001, CAROI will concentrate its efforts on assisting two U. S. Territories, Puerto Rico and the Virgin Islands, to more efficiently and effectively manage its federal education funds. Through collaboration with our partners in Puerto Rico and the Virgin Islands, ED plans to identify significant recurrent programmatic and financial problems affecting elementary and secondary education, vocational and adult education, and special education programs. A department-wide team, comprised of staff from program offices and the Offices of the General Counsel and Inspector General, will work with their counterparts in the Territories.

Decreased number of recurring findings and audits under appeal. The record shows that, overall, the Department is experiencing a reduction in recurring findings each year as the innovative partnerships among federal, state and local officials, auditors, and program managers continue to increase and provide creative and practical approaches to resolving audit findings as well as their underlying causes.

We have also experienced a reduction in the number of states under litigation as a result of audit appeals (in 1993 there were approximately 22 state audits under appeal and only 2 in 2000), which is a substantial cost benefit both at the state and federal levels.

These reductions in recurring findings and state audits under appeal have been accomplished while at the same time ensuring that our recipients of federal education funds are not compromising the integrity, accountability, and purpose of those funds or, to put it simply, to ensure that students receive the maximum benefit of education programs.

Highlights of Reporting Requirements

Federal Managers Financial Integrity Act

To protect federal programs from fraud, waste and mismanagement, the Federal Managers' Financial Integrity Act (FMFIA) requires agency managers to conduct regular evaluations of management controls with special attention to accounting systems. FMFIA compliance is embodied in larger efforts to reform management processes at the Department of Education.

Overall Results

During FY 2000, Education had a net decrease of two (2) material weaknesses. That is, while 2 new material weaknesses were identified in FY2000, the Department, as a whole was able to downgrade four (4) material weaknesses.

FMFIA Section 2, Management Control

Of the 80 internal control weaknesses identified since the inception of the program, 76 have been corrected and closed, leaving 4 unresolved items as of 31 December 2000.

Number of Material Weaknesses

Period Reported	Nbr. Reported for the first time	For That Year nbr. corrected	For That Year number still pending
Prior Yrs	75	74	1
1998 Rpt	0	0	0
1999 Rpt	3	2	1
2000 Rpt	2	0	2
Total	80	76	4

Two of the four unresolved weaknesses were identified prior to the 2000 report. Specifically, the first of these prior years material weaknesses is listed as "Quality of Data Needed to Support Management Decision" and was first reported in 1995.

This material weaknesses deals with the Student Financial Assistance not having quality data to provide for effective management decision making. While the data quality issue was initially associated with the Federal Family Education Loan (FFEL) Program system it was then expanded to include all the Student Financial Assistance (SFA) systems. The Department understands that continued improvements are needed in the quality of data the Performance Based Organization relies on to make management decisions. ED has completed a considerable number of the planned corrective actions aimed at the resolution of this material weakness. The expanded corrective action plan includes long-term initiatives which involve coordinating with the Internal Revenue Service as well as the Department of Veterans Affairs and other agencies to obtain changes in legislation, policies and procedures to enable conducting routine data matches.

The other material weakness identified prior to the 2000 report involves the "Information Technology Security Program." This issue first reported in 1999 focuses on the strengthening of the Department's information technology (IT) system to comply with the Computer Security Act and OMB Circular A-130. ED is currently on schedule to complete the corrective action plan by the end of FY 2001. Among the milestones reached by the Department in addressing this issue were the establishment of a department-wide security team, the issuance of policies and procedures and the development of IT Security Awareness training.

Two new material weaknesses have been identified in 2000 and they involve the Recertification of Foreign Schools and weaknesses in the Student Financial Assistance's audit tracking and resolution process. Both issues' action plans are scheduled to be completed by the end of FY2001.

FMFIA Section 4, Financial Management Systems

Of the 95 financial management systems non-conformances identified since the beginning of the program two (2) remain unresolved. These two material non-conformances were reported prior to the FY2000 report.

Number of Material Non-Conformances

Period Reported	Nbr. Reported for the first time	For That Year nbr. corrected	For That Year number still pending
Prior Yrs	95	93	2
1998 Rpt	0	0	0
1999 Rpt	0	0	0
2000 Rpt	0	0	0
Total	95	93	2

The two material non-conformances currently outstanding encompass the following areas: The Federal Family Education Loan System - where the Department did not have a methodology for determining the loan loss of FFEL using validated data. This item was first identified as a material non-conformance in 1990. All but one major milestone to close this issue has been completed. The last action needed to resolve the corrective action plan – which is the implementation of the FFELP subsidiary ledger - will be completed during FY 2001.

The other area involved is the Department's Financial Management Systems. The legacy core financial management systems had numerous functional and technological problems. Conversion to a new system (EDCAPS) was completed during 1998. However, shortcomings of the financial management system software (FMSS) portion prevented ED from preparing timely financial statements. The selection, procurement and implementation of the new general ledger system to replace FMSS is scheduled for completion by September 2001.

Semi-Annual Report to Congress on Audit Follow-up

As required by the Inspector General Act Amendments of 1988, the Department reports on management actions in response to audit recommendations. Management is required to report on these three areas:

1. **Number of Audit Reports and the Dollar Value of Disallowed Cost**

Disallowed costs are questioned costs that management, in a management decision, sustained or agreed should be recovered by the federal government. The information contained in the table below represents audit reports for which receivables were established. During FY 2000, final action was taken on 60 percent (283 of 471) of the total number of reports which were pending final action. This represents a 23 percent reduction in the number of audits pending final action at year-end.

Final Actions on Audits with Disallowed Costs
For the Fiscal Year Ending September 30, 2000

	# of Reports	Disallowed Cost
Beginning Balance 10/1/99 +Management Decision	243 228	$ 200,116,777 32,451,241
Pending Final Action – Final Actions	471 283	232,568,018 79,697,956
Ending Balance as of 9/30/00	188	152,870,062

2. Number of Audit Reports and Dollar Value Recommendations that Funds be Put to Better Use

A recommendation that funds be put to better use implies that management's implementation of specific recommendations could result in more efficient use of funds. It is significant to note that of the six audit reports pending final action, four reports with a total value of more than $119.5 million were closed (final action taken). This represents a closure rate of greater than 50 percent better than the previous year.

Final Action on Audits with Recommendations that Funds be Put to Better Use
for Fiscal Period Ending September 30, 2000

	# of Reports	Disallowed Cost
Beginning Balance 10/1/99 +Management Decision	3 3	$ 111,110,667 43,100,000
Pending Final Action – Final Actions	6 4	154,210,667 119,510,667
Ending Balance as of 9/30/00	2	34,700,000

3. Reports Pending Final Action One Year or More after Issuance of a Management Decision

Disallowed Costs: OIG Audits: On September 30, 2000, the Department had a total of 10 OIG internal and nationwide audit reports on which final action was not taken within a year of the issuance of a management decision. Forty percent of the 10 reports were 1 to 2 years old. Twenty percent were 2 to 4 years old. The remaining 40 percent were 4 years old. Many corrective actions are dependent upon major system changes that are currently being implemented. For detailed information on these audits, refer to previously issued Semiannual Report to Congress on Audit Follow-up Number 22 and 23.

Disallowed Costs: All Other Audits: As of September 30, 2000, the Department had 220 reports with disallowed costs to $136 million (this number excludes appeals). A total of 81 reports were in appeal status during this period, amounting to $169 million. Reasons for final action not being completed after one year include: legal review in process, bankruptcy proceedings in process under review of the Debt Management Group; and billing cycle in process. For detailed information on these audits, refer to previously issued Semiannual Reports to Congress on Audit Follow–up Number 22 and 23.

Prompt Pay

The Prompt Pay Act requires agencies to report on their efforts to pay bills on time. In FY2000 ED processed 98 percent of its 21,989 payments on time, representing approximately $920 million. Late payment penalties were paid on 429 invoices.

Limitations of Financial Statements

The following limitations apply to the preparation of the FY2000 Financial Statements:

- The financial statements have been prepared to report the financial position and results of the operations of the entity pursuant to the requirement of 31 U.S.C. 3515(b).

- While the statements have been prepared from the books and records of the entity in accordance with the formats prescribed by OMB, the 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 for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

PART II

Principal Financial Statements, Notes and Required Supplementary Information

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidated Balance Sheet
As of September 30, 2000
(Dollars in Thousands)

	Consolidated
Assets	
Entity Assets	
Intragovernmental Assets:	
Fund Balance with Treasury (Note 2)	$42,160,719
Interest Receivable	70,755
Governmental Assets:	
Accounts Receivable, Net (Note 3)	82,703
Credit Program Receivables, Net (Note 4)	74,162,004
Advances	38,739
Cash and Other Monetary Assets	14,132
Property and Equipment (Note 5)	1,307
Other Governmental Assets	236,363
Total Entity Assets	$116,766,722
Non-Entity Assets	
Guaranty Agency Federal & Restricted Funds Receivable (Note 3)	$2,231,814
Total Non-Entity Assets	$2,231,814
Total Assets	$118,998,536
Liabilities	
Liabilities Covered by Budgetary Resources	
Intragovernmental Liabilities:	
Accounts Payable	$6,647
Interest Payable	83,469
Borrowing from Treasury (Note 6)	65,715,386
Guaranty Agency Federal & Restricted Funds Due To Treasury (Note 3)	2,231,814
Payable to Treasury (Note 7)	7,860,621
Payable to Federal Financing Bank (Note 8)	20,699
Other Intragovernmental Liabilities (Note 9)	112,562
Governmental Liabilities:	
Accounts Payable	213,051
Accrued Grant Liability (Note 10)	2,006,129
Liabilities for Loan Guarantees (Note 4)	13,667,983
Other Governmental Liabilities (Note 9)	186,424
Total Liabilities Covered by Budgetary Resources	$92,104,785
Liabilities Not Covered by Budgetary Resources	
Intragovernmental Liabilities:	
Other Intragovernmental Liabilities (Note 9)	$250,261
Governmental Liabilities:	
Other Governmental Liabilities (Note 9)	44,734
Total Liabilities Not Covered by Budgetary Resources	$294,995
Total Liabilities	$92,399,780
Net Position	
Unexpended Appropriations (Note 11)	$26,722,760
Cumulative Results of Operations (Note 11)	(124,004)
Total Net Position	$26,598,756
Total Liabilities and Net Position	$118,998,536

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidated Statement of Net Cost
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Consolidated
Program Costs	
Intragovernmental	
Interest Expense, Federal (Note 12)	$4,993,313
Other Production Expense	434
Grant Expense	79,460
Contractual Service Expense	57,754
Salaries and Administrative Expense	147,010
Bad Debt & Write-offs	2,050
Other Program Expenses	800
Governmental	
Subsidy Expense (Note 4)	(3,637,993)
Grant Expense	34,715,035
Interest Expense, Non-Federal (Note 12)	305
Contractual Service Expense	827,976
Salaries and Administrative Expense (Note 13)	438,907
Bad Debt & Write-offs	14
Other Program Expenses	180,207
Total Program Cost	$37,805,272
Less: Earned Revenues	
Interest, Federal (Note 12)	$1,761,285
Interest, Non-Federal (Note 12)	3,234,323
Other Earned Revenue	90,840
Earned Revenues	$5,086,448
Net Program Cost	$32,718,824
Net Cost of Operations	$32,718,824

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidated Statement of Changes in Net Position
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Consolidated
Net Cost of Operations	$(32,718,824)
Financing Sources (Other than Exchange Revenues):	
Appropriations Used	$37,238,317
Donations (Non-exchange Revenue)	1,016
Imputed Financing (Note 14)	20,795
Future Transfers Out due to Downward Subsidy Re-estimate	(4,010,604)
Total Financing Sources	$33,249,524
Net Results of Operations	$530,700
Prior Period Adjustments (Note 15)	$(873,584)
Net Change in Cumulative Results of Operations	$(342,884)
Increase (Decrease) in Unexpended Appropriations	$(4,039,342)
Change in Net Position	$(4,382,226)
Net Position - Beginning of Period	$30,980,982
Net Position - End of Period	$26,598,756

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Combined Statement of Budgetary Resources
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Combined
Budgetary Resources	
Budget Authority	$56,900,834
Unobligated Balance-Beginning of Period (Adjusted) (Note 16)	13,864,271
Spending Authority from Offsetting Collections	21,346,713
Adjustments (Note 17)	(10,844,127)
Total Budgetary Resources (Note 17)	**$81,267,691**
Status of Budgetary Resources	
Obligations Incurred (Adjusted) (Note 16)	$74,707,704
Unobligated Balances-Available	1,822,381
Unobligated Balances-Not Available	4,737,606
Total Status of Budgetary Resources (Note 17)	**$81,267,691**
Outlays	
Obligations Incurred (Adjusted) (Note 16)	$74,707,704
Less: Spending Authority from Offsetting Collections and Adjustments	(21,916,198)
Obligated Balance, Net-Beginning of Period (Adjusted) (Note 16)	36,166,395
Less: Obligated Balance, Net-End of Period (Note 17)	(40,349,835)
Total Outlays (Note 17)	**$48,608,066**

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Combined Statement of Financing
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Combined
Obligations and Nonbudgetary Resources (Note 18)	
Obligations Incurred (Adjusted) (Note 16)	$74,707,704
Spending Authority from Offsetting Collections and Adjustments	(21,916,198)
Financing Imputed for Cost Subsidies (Note 14)	20,795
Financing Sources Transferred Out	(4,010,604)
Exchange Revenue Not In the Entity's Budget	4,366,080
Other	(23,089)
Total Obligations and Nonbudgetary Resources	$53,144,688
Resources That Do Not Fund Net Cost of Operations (Note 18)	
Change in Amount of Goods, Services, and Benefits Ordered But Not Yet Provided (Net Increases) Net Decreases	$2,423,469
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowance for Subsidy	8,996,426
Resources that Fund Expenses Recognized in Prior Periods	(33,759)
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(35,363,420)
Other Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	4,287,021
Total Resources That Do Not Fund Net Cost of Operations	$(19,690,263)
Costs That Do Not Require Resources (Note 18)	
Adjustments	$(360,763)
Total Costs That Do Not Require Resources	$(360,763)
Financing Sources Yet to be Provided (Note 18)	$(374,838)
Net Cost of Operations (Note 18)	$32,718,824

The accompanying notes are an integral part of these financial statements.

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The **U.S. Department of Education** (the Department) was established on May 4, 1980, by Congress, 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 loan, guaranteed loan, and grant programs.

Under the Higher Education Act Amendments of 1998, ***Student Financial Assistance*** (SFA) became a Performance Based Organization within the U.S. Department of Education. SFA is responsible for administering and reporting on the Federal Direct Student Loan Program, the Federal Family Education Loan (FFEL) Program, Pell Grants, and the Campus-Based Program. The ***Federal Direct Student Loan Program***, authorized by the Student Loan Reform Act of 1993, makes loans directly to eligible undergraduate and graduate students and their parents through participating schools. SFA borrows money from the Treasury Department to fund the loans. The ***Federal Family Education Loan (FFEL) Program***, authorized by the Higher Education Act (HEA) of 1965, 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. The ***Pell Grant*** and ***Campus-Based Programs*** provide educational grants and other financial assistance to eligible applicants.

The Department also administers numerous grant programs and the Facilities Loan Program. ***Grant*** programs include grants for the disadvantaged, elementary and secondary education, special education and rehabilitative services, and educational research and improvement. Under the ***Facilities Loan Program***, also authorized by the HEA of 1965, as amended, the Department administers low interest loans to institutions of higher education for the construction and renovation of facilities.

Basis of Accounting and Reporting

The financial statements present the financial position as of September 30, 2000, and the net cost, changes in net position, and budgetary resources for the year ended September 30, 2000, as required by the Chief Financial Officers Act of 1990 (Public Law 101-576), and the Government Management Reform Act of 1994 (GMRA). They were prepared from the books and records of the Department, in accordance with accounting principles generally accepted in the United States as promulgated by the Federal Accounting Standards Advisory Board (FASAB) and are presented in the format prescribed for form and content specified in Office of Management and Budget (OMB) Bulletin No. 97-01, as amended. These statements are, therefore, different from the financial reports, also prepared by the Department pursuant to other OMB directives, that are primarily used to monitor and control the use of budgetary resources. The Balance Sheet, Statement of Net Cost, and the Statement of Changes in Net Position consolidate the balances of 210 discrete appropriations that comprise 31 fund accounts within eight reporting groups. The Statement of Budgetary Resources and the Statement of Financing are presented as combined statements for the Department and as combining statements for the eight reporting groups. Interprogram transactions and balances are eliminated under the consolidated basis but not under the combined basis.

The reporting groups include: Student Financial Assistance (SFA); 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); Office of Educational Research and Improvement (OERI); Office of Bilingual Education and Minority Languages Affairs (OBEMLA); and Department Management (DM).

The accounting structure reflects both accrual and budgetary accounting transactions. Under accrual accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Under budgetary accounting, budgetary resources are obligated based on legal requirements, which may differ from when an accrual-based transaction is recorded.

Use of Estimates in Preparing Financial Statements

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

Credit Reform - Present Value Accounting

Beginning October 1, 1991, the Federal Credit Reform Act of 1990 (Public Law 101-508) requires agencies to measure the total costs of Federal credit programs at the time a loan is committed. The Federal Credit Reform Act of 1990, the FASAB's Statement of Federal Financial Accounting Standard (SFFAS) No. 2, Accounting for Direct Loans and Loan Guarantees, and related regulations and guidance, require recording subsidy costs (the present value of interest subsidies, defaults, fee offsets, certain administrative expenses and other cash flows) associated with direct loans and loan guarantees in the year loans are disbursed. In addition, subsidy costs are recorded as an allowance (reduction) for direct loans receivable or as a liability for loan guarantees. All credit program receivables are recorded at the principal and interest outstanding, net of the allowance for subsidy.

Subsidy costs are estimated based on the difference between the present values of expected government cash outflows (e.g. net interest expense and defaults) and inflows (e.g. collections), discounted by the interest rate earned on a Treasury debt instrument of similar term at the time loans are disbursed. Subsidy costs are recognized as an expense in the year loans are disbursed. Subsidy costs of credit program loans are re-estimated each year.

Budget Authority

Budget authority is the authorization provided by law for the Department to obligate for future outlays of Federal funds. The Department's budgetary resources as of September 30, 2000 include current authority (appropriations and borrowing authority) and unobligated balances remaining from annual, multi-year, and no-year budget authority received in prior years. Budgetary resources also include reimbursements received and other revenue (spending authority from offsetting collections credited to an appropriation account and recoveries of prior year obligations). Pursuant to Public Law 101-510, unobligated balances associated with appropriations expiring at the end of the fiscal year remain available only for obligation adjustment, until the account is cancelled after five years.

Borrowing from Treasury provides most of the funding for the loan principal disbursements made under the Federal Direct Student Loan Program. The costs of the Department's programs are generally funded with congressional appropriations. Revenues are recognized from other agencies and from the public in exchange for goods or services. Major sources of reported revenue include interest accrued from the Federal Direct Student Loan Program borrowers on outstanding loans receivable and interest accrued from Treasury on uninvested fund balances.

Property and Equipment

Previously, the Department expensed all property when it was purchased. In FY 2000, the Department elected to begin capitalizing bulk purchases of property and equipment with a total cost of $500,000 or more. A bulk purchase is defined as the purchase of like items related to a specific project or that occur within the same fiscal year, and have an estimated useful life greater than 2 years. In accordance with FASAB's Statement of Federal Financial Accounting Standard (SFFAS) No. 6, Accounting for Property, Plant, and Equipment, these assets are depreciated using the straight-line method. The Department has adopted the following useful lives for classes of depreciable property:

- 3-Year Property – Information Technology (IT) and Telecommunications equipment
- 5-Year Property – Furniture and Fixtures

Leases

The Department leases office space from the General Services Administration (GSA). Generally, leases are cancelable by either party without a penalty upon 120 days notice, and future lease payments are not accrued as liabilities. Lease costs for office space for FY 2000 amounted to approximately $48.8 million, of which $15.6 million was for non-GSA owned office space. Under existing commitments as of September 30, 2000, estimated future minimum lease payments are as follows:

Future Minimum Lease Payments (Dollars in Thousands)	
Fiscal Year End:	**Amount**
2001	$20,136
2002	19,974
2003	20,473
2004	20,985
After 2004	21,510
Total	**$103,078**

The Department does not have any capital leases.

Accounts Receivable

Accounts receivable are monies due from the public for items such as overpayments of educational assistance. In addition, the Department enters into agreements with other Federal agencies that result in amounts due the Department. Accounts receivable are estimated using the net realizable value methodology (see Note 3).

Credit Program Receivables

Credit program receivables are recorded at the principal and interest outstanding, net of allowances for subsidy. Allowances for subsidy represent the differences between the present values of estimated cash inflows and outflows of the underlying credit program loans held by the Department. The allowance for subsidy is amortized using the effective interest method based on the interest rate at the time the loans were disbursed. All credit program receivables are valued using net present value methodology (see Note 4).

Accounts Receivable - Guaranty Agency Reserves

Under Section 422A of the HEA of 1965, as amended, Guaranty Agencies were required to establish a Federal Student Loan Reserve Fund (the "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 reserve funds, regardless of who holds or controls the Federal reserve funds or assets, are the property of the United States.

The Federal Fund is to be used only to pay lender claims and default aversion fees into a Guaranty Agency's Operating Fund. The Operating Fund is the property of the Guaranty Agency except for funds an agency borrows from the Federal Fund under Section 422A of the HEA of 1965, as amended. The Operating Fund is used by the Guaranty Agency to fulfill its responsibilities. These include repaying money borrowed from the Federal Fund, default aversion and collection activities.

Guaranty Agency reserves consist of the Department's interest in the net assets of FFEL Program Guaranty Agencies. Guaranty Agency assets include initial Federal start-up funds (Guaranty Agency advances), receipts of Federal reinsurance payments, insurance premiums, Guaranty Agency share of collections on defaulted loans, investment income and administrative cost allowances, and other assets purchased out of reserve funds. Liabilities result from initial Federal start-up funds, lender claims, operating expenses and Federal reinsurance fees. Guaranty Agency reserves are recorded as a non-entity asset (see Note 3) and as a corresponding liability due Treasury.

Liabilities

Liabilities represent the amount of funds likely to be paid as a result of transactions or events which have already occurred. Liabilities without budget authority are classified as liabilities not covered by budgetary resources. Most of the FFEL and Federal Direct Student Loan Program liabilities result from entitlements covered by permanent indefinite budget authority.

Liabilities for Loan Guarantees

The estimated liability for loan guarantees under the FFEL Program is the estimated long-term cost to the Department of its loan guarantees calculated on a net present value basis, excluding administrative costs. Obligations for the subsidy cost will be recorded against budget authority when a loan guarantee commitment is made (see Note 4). Subsidy costs are recognized as expenses in the year loans are disbursed. This cost is re-estimated each year, which is recognized as an increase or decrease of subsidy expense.

Borrowing from Treasury

Programs are generally funded by congressional appropriations. However, borrowing from the U.S. Treasury provides most of the funding for loans made under the Federal Direct Student Loan Program and Facilities Loan Program. 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 the U.S. Treasury. Principal and interest payments are remitted to the U.S. Treasury annually.

Accrued Grant Liability

Disbursements of grant funds are made to recipients through a drawdown request using the Grants and Administrative Payment System (GAPS) and are recorded as expenditures at the time of disbursement. However, some recipients do not request funds until after they incur the expenditures. Therefore, the Department accrues a liability for those expenditures for which drawdowns have not yet been requested. The accrual amount is estimated based on a statistical sample.

Net Position

Net position consists of unexpended appropriations and cumulative results of operation. Unexpended appropriations include undelivered orders and unobligated balances, excluding activity of the liquidating and financing accounts required under the Federal Credit Reform Act of 1990. Cumulative results of operations represent the net result of operations since inception (i.e. the difference between the Department's financing sources and its expenses).

Prior Period Adjustments

Prior period adjustments are included in the calculation of the net change in cumulative results of operations to correct errors from prior periods and reflect accounting changes with retroactive effects.

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 Employee Benefits

Employees participate in either the Civil Service Retirement System (CSRS), a defined benefit plan, or the Federal Employees Retirement System (FERS), a defined benefit and contribution plan. For CSRS employees, the Department contributes 8.51 percent of pay. For FERS employees, the Department contributes 10.7 percent of pay to the defined benefit plan and 1 percent of pay to the thrift savings plan (a defined contribution plan), and matches employee contributions to the thrift savings plan up to an additional 4 percent of pay. For FERS employees, the Department also contributes the employer's share for Social Security (FICA) and Medicare.

SFFAS No. 5, Accounting for Liabilities of the Federal Government, requires government agencies to report the full cost of employee benefits for the CSRS, FERS, the Federal Employee Health Benefit (FEHB), and the Federal Employees Group Life Insurance (FEGLI) programs. The Department used the applicable cost factors provided by the Office of Personnel Management (OPM) in these financial statements.

Federal Employees Compensation Act

A portion of the estimated liability for disability benefits assigned to the Department under the Federal Employees Compensation Act (FECA), administered and determined by the Department of Labor (DOL) is accrued. The liability is based on the net present value of estimated future payments as determined by DOL.

Related Party Transactions

The Department's financial activities interact with and depend upon those of the Federal government as a whole. Specifically, the Department is subject to the financial decisions and management controls of OMB and the U.S. Treasury. As a result of the relationship with other Federal government entities, operations may not be conducted, nor financial position reported, as they would if the Department were a separate and unrelated party.

Note 2. Fund Balance with the U.S. Treasury

Fund Balance with the U.S. Treasury (Dollars in Thousands)	
Appropriated Funds	$29,993,164
Revolving Funds	12,104,012
All Other Funds	63,543
Total	**$42,160,719**

The Fund Balance with the U.S. Treasury represents appropriated funds and revolving funds, which include undisbursed U.S. Treasury borrowings that are available to pay current liabilities and finance loan programs. The Department has the authority to disburse the funds directly to agencies and institutions participating in its programs. The U.S. Treasury processes cash receipts and disbursements on behalf of the Department. The undisbursed account balances are entity assets.

A portion of the appropriated funds included at September 30, 2000, were 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 an annual appropriation. The Department also maintains undisbursed account balances with the U.S. Treasury in deposit funds that are not available to fund the activities of the Department. In FY 2000, these balances amounted to $216 million.

Note 3. Accounts Receivable

Accounts Receivable Net Amount Due (Dollars in Thousands)	
Entity Accounts Receivable	
Governmental	$ 82,703
Non-Entity Accounts Receivable	2,231,814
Total Accounts Receivable	**$2,314,517**

Entity accounts receivable represent balances due from recipients of grant and other financial assistance programs, and from other Federal agencies. They are recorded at their net realizable value. Estimates for the allowance for loss on uncollectible accounts are based on historical data.

Guaranty Agency reserves and Federal fund balances are recorded as a non-entity accounts receivable and as a liability due to the U.S. Treasury. Guaranty Agency reserves and Federal fund balances represent the Federal government's interest in the net assets of state and non-profit FFEL Program Guaranty Agencies.

Note 4. Credit Program Receivables and Liabilities for Loan Guarantees

The Department provides loans to students and parents through the Federal Direct Student Loan Program and the Federal Family Education Loan Program. The Department also administers low interest loans through the Facilities Loan Program to assist in the construction, reconstruction, or renovation of housing, academic facilities, and other educational facilities for students and faculty at institutions of higher education.

Under the Federal Direct Student Loan Program, the Federal government provides loans directly to qualified individuals through participating schools. Loans are available to students and their parents regardless of income, and student borrowers who demonstrate financial need receive Federal interest subsidies.

Under the FFEL Program, over 4,000 financial institutions make loans to students and parents. The Federal government guarantees these loans against default, with 36 state or private non-profit Guaranty Agencies acting as intermediaries in administering the guarantees. FFEL Program participants receive Federal interest and special allowance subsidies and the Guaranty Agencies receive administrative fee payments. All payments are set by statute. Lenders and Guaranty Agencies also share in the cost of defaulted loans.

The Federal Credit Reform Act of 1990 governs direct loan obligations and loan guarantee commitments, made after fiscal year 1991, and the resulting direct loans or loan guarantees. It provides that the subsidy costs associated with direct loans and loan guarantees be recognized as an expense in the year the direct or guaranteed loan is disbursed. The subsidy costs are revalued annually, and are calculated as a net present value of interest subsidies, defaults, fee offsets, certain administrative expenses, and other cash flows. Under credit reform, these subsidy cash flows exclude direct Federal administrative expenses. (For the student loan programs, an exception is made for contractual payments to third-party private loan collectors, who receive a set percentage of amounts they collect.)

The Federal Direct Student Loan Program and defaulted FFEL Program loan receivables are reported net of an allowance for subsidy computed at net present value. The FFEL program estimated loan liability is reported at the net present value of estimated net cash outflows. The

Department has elected to report its pre-fiscal year 1992 defaulted FFEL program loans and loan guarantee liabilities on a net present value basis.

The Department estimates all cash flows associated with loans made under the Federal Direct Student Loan and FFEL Programs, including the loss related to future defaults. Projected cash flows are used to develop subsidy estimates, which, as noted above, represent the net present value of future Federal costs associated with a cohort of loans. These estimates are recorded as a reduction of the direct loans and FFEL Program defaulted loans receivable outstanding, and as a liability for the FFEL Program guarantees. To comply with the Federal Credit Reform Act of 1990 and related requirements, the Department employs a cash flow projection model to compute the estimated subsidy cost. The Department estimates cash flows over the life of a loan, grouping the loans by loan type, cohort year, and risk group. The cohort year for a loan represents the year the direct loan is obligated or the FFEL Program loan is guaranteed. Risk groups include students at two-year colleges, four-year colleges, graduate schools, and proprietary schools.

In recent years, the consolidation of existing loans into new direct or guaranteed loans has increased significantly. Under the Federal Credit Reform Act of 1990 and guidance provided by OMB Circulars A-11 and A-34, the retirement of an existing loan through consolidation is considered a payment of principal and interest to the loan holder: either a private lender or, in the case of defaulted loans, the Department. One effect of this treatment is that Department collections on defaulted loans are significantly higher than they would have been in the absence of the increase in consolidations. Collections related to the disbursement of a new consolidation loan reduce the subsidy cost of the retired underlying loans.

The liability and net receivable apply only to currently existing loans. As noted above, borrowers may pre-pay and close out existing loans from capital raised through the disbursement of a new consolidation loan. The FY 2000 loan liability and net receivable include estimates of future prepayments of existing loans; they do not, however, reflect costs associated with these anticipated consolidation loans, which do not currently exist.

The credit program receivables at September 30, 2000, are comprised of Direct Loans, defaulted FFEL Program loans, and related interest receivable net of the allowance for subsidy. The credit program receivables, presented by credit program, are summarized as follows:

Credit Program Receivables (Dollars in Thousands)					
		Defaulted FFEL Loans			
	Direct Loans	**Pre 1992**	**Post 1991**	**Facilities Loans**	**Total**
Loans Receivable	$58,522,455	$14,986,951	$5,341,825	$504,976	$79,356,207
Interest Receivable	1,707,927	2,006,678	1,188,792	9,342	4,912,739
Gross Program Receivables	$60,230,382	$16,993,629	$6,530,617	$514,318	$84,268,946
Less: Allowance for Subsidy	2,585,250	(14,086,594)	1,502,777	(108,375)	(10,106,942)
Net Credit Program Receivables	**$62,815,632**	**$2,907,035**	**$8,033,394**	**$405,943**	**$74,162,004**

The FY 2000 allowance for subsidy in Direct Loans and post-1991 FFEL loans have positive balances. This is a function of the high collection rate on Department receivables and the estimates that total future collections of principal and interest will exceed the current receivable for these loans.

It is important to recognize that the credit program receivables, net amount, is not the same as the proceeds that the Department would expect to receive from selling the loans. The proceeds the Department would expect to receive would be determined by the marketplace.

As of September 30, 2000, total outstanding loan guarantees under FFEL were approximately $139 billion. If all the loans currently guaranteed defaulted, the Department would not pay the full guaranteed amount to the Guaranty Agencies. Instead, it would pay an amount ranging from 75 to 95 percent based on reinsurance rates and the default rate of the Guaranty Agency.

The present value of estimated losses on guaranteed loans as of September 30, 2000, is shown below:

Liability for Loan Guarantees (Dollars in Thousands)	
Pre-1992 Guarantees, Present Value	$443,713
Post-1991 Guarantees, Present Value	13,224,270
Total Loan Guarantee Liability	**$13,667,983**

Loan liabilities and net receivables represent the net present value of future projected cash flows, including principal and interest repayments. As such, these estimates vary significantly with changes in forecasting assumptions, particularly involving the interest rates charged to students, paid to loan holders, and used for discounting cash flows. The FY 2000 liability was calculated using government-wide interest rate projections provided by the Office of Management and Budget on November 21, 2000. The Bush Administration, which entered office, January 20, 2001, may issue revised interest rate forecasts that could produce a significantly different liability estimate. As a result, the President's FY 2002 budget, which will reflect any revised interest rate assumptions provided by the new Administration, may include a liability estimate that differs from that included in the FY 2000 financial statements.

Total Direct Student Loan and FFEL Program subsidy expenses for the period ended September 30, 2000, are shown below:

Subsidy Expense (Dollars in Thousands)

	Direct Student Loan Program	FFEL Program	Total
Loan Defaults (Net of Recoveries)	$ 453,467	$ 1,262,779	$1,716,246
Interest Subsidies	(1,880,221)	2,815,910	935,689
Fees	545,993	(1,067,831)	(521,838)
Other Write-offs	(187,889)	519,276	331,387
Total Current Year Subsidy Transfers	$(1,068,650)	$ 3,530,134	$2,461,484
Re-estimates	(2,864,278)	(3,234,603)	(6,098,881)
Total Subsidy Expense	**$(3,932,928)**	**$ 295,531**	**$(3,637,397)**

The Facilities Loan Program incurred a negative subsidy expense of $596 thousand for FY 2000.

Note 5. Property and Equipment

Property and equipment includes computer software for a new financial accounting system. As of September 30, 2000, the acquisition cost was $1.3 million. Since the system was not yet in service at the end of FY 2000, no amortization has been recognized.

Note 6. Borrowing from Treasury

Status of Debt to the U.S. Treasury (Dollars in Thousands)

	Direct Student Loans	Facilities Loans	Total
Beginning Balance	$52,069,506	$379,803	$52,449,309
New Borrowing	16,346,598	0	16,346,598
Repayments	(3,069,223)	(298)	(3,069,521)
Reclassified as a Payable to FFB		(11,000)	(11,000)
Ending Balance	**$65,346,881**	**$368,505**	**$65,715,386**

The Department's debt to the U.S. Treasury was $65.7 billion as of September 30, 2000. The funds were borrowed to provide funding for the direct loan and facilities loan programs. The borrowing is authorized through indefinite permanent authority at interest rates set each year by the U.S. Treasury. In FY 2000, the Department reclassified the debt related to the Historically Black Colleges and Universities (HBCU) Capital Financing Program as a Payable to the Federal Financing Bank (see Note 8).

Note 7. Payable to Treasury

At September 30, 2000, the Department reported $7.9 billion as a payable to the U.S. Treasury. $3.9 billion is associated with the FFEL Program liquidating fund and will be repaid from future excess liquidating fund receivable collections. $4.0 billion represents a downward subsidy re-estimate in the FFEL program fund. This amount will be repaid in FY 2001.

Note 8. Payable to Federal Financing Bank

Public Law 102-325, the Higher Education Amendments of 1994, authorized the Department to issue bonds on behalf of the HBCU Capital Financing Program. To date, all bonds issued under this program have been purchased by the Federal Financing Bank (FFB). The Department reports the corresponding liability for full payment of principal and interest as a payable to the FFB under rules established by the Credit Reform Act of 1990.

Payable to Federal Financing Bank (Dollars in Thousands)	
Reclassified from Borrowing from Treasury	$11,000
New Borrowing	9,796
Repayments	(97)
Ending Balance	**$20,699**

Note 9. Other Liabilities

Other liabilities covered by budgetary resources include contractual services, administrative services, interagency agreement accruals, and suspense account balances. Other liabilities not covered by budgetary resources include accrued annual leave and FECA disability benefits.

Other Liabilities (Dollars in Thousands)	
Other Liabilities Covered by Budgetary Resources:	
Intragovernmental	$ 112,562
Governmental	186,424
Total	$ 298,986
Other Liabilities Not Covered by Budgetary Resources:	
Intragovernmental	$ 250,261
Governmental	44,734
Total	$ 294,995
Total Other Liabilities	**$ 593,981**

Note 10. Accrued Grant Liability

The Department's accrued grant liability of $2 billion represents an estimate of the expenses incurred by grantees that have not yet been reimbursed. The total liability is allocated among the reporting groups based on the grant balance available at September 30, 2000. The accrued grant liability by reporting group is shown below:

Accrued Grant Liability (Dollars in Thousands)	
Reporting Group	**Allocated Grant Liability**
SFA	$319,376
OESE	752,098
OSERS	486,687
OVAE	137,219
OPE	179,749
OERI	80,245
OBEMLA	50,755
Total	**$2,006,129**

Note 11. Net Position

Net Position is composed of two elements – unexpended appropriations and cumulative results of operations. Unexpended appropriations represent appropriations not yet expended, which have not lapsed, been withdrawn, or rescinded. The Department's unexpended appropriations consist of unobligated balances – available, unobligated balances – not available, and undelivered orders. The Department's unexpended appropriations as of September 30, 2000, are summarized as follows:

Unexpended Appropriations (Dollars in Thousands)	
Unobligated	
Available	$ 1,795,131
Not Available	566,462
Undelivered Orders	24,361,167
Total	**$ 26,722,760**

Unexpended appropriations do not include any funding activity for which appropriations have not been received. Therefore, the unobligated balances and undelivered orders for financing funds are not included in unexpended appropriations. As a result, unexpended appropriations reported in the Consolidated Balance Sheet will not agree with the balances of budget authority.

Cumulative results of operations represent the net result of operations since inception. As of September 30, 2000, the Department's cumulative results of operations amounted to a $124 million deficiency (i.e. expenses exceeded financing). The deficiency consists primarily of unfunded expenses for certain payroll accruals and a subsidy re-estimate for the Federal Direct Student Loan Program that will be executed in FY 2001. These expenses are funded from future appropriations and the cumulative results of operations will be reversed through the normal accounting process when funding occurs.

Note 12. Interest Revenue and Expense

The interest revenues and expenses directly attributable to the Federal Direct Student Loan Program, the FFEL Program, and other remaining programs are summarized below:

Interest Revenue and Expenses
(Dollars in Thousands)

	Federal Direct Student Loan Program	FFEL Program	Other Programs	Total
Interest Revenue				
Federal	$1,261,281	$499,843	$ 161	$1,761,285
Non-Federal	3,211,256		23,067	3,234,323
Total Interest Revenue	**$4,472,537**	**$499,843**	**$ 23,228**	**$4,995,608**
Interest Expense				
Federal	$4,472,537	$499,843	$ 20,933	$4,993,313
Non-Federal	115	109	81	305
Total Interest Expense	**$4,472,652**	**$499,952**	**$ 21,014**	**$4,993,618**

Note 13. Allocation of Direct and Indirect Cost

The reported salaries and administrative expenses include the allocation of direct and indirect administrative costs among the reporting groups. The distribution was made in accordance with the FASAB's Statement of Federal Financial Accounting Standard (SFFAS) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, and is calculated based on a combination of full time employees and program costs.

Allocation of Administrative Expenses (Dollars in Thousands)			
Reporting Group	**Direct Costs**	**Indirect Costs**	**Total Costs**
SFA	$ 50,580	$ 63,131	$113,711
OSERS	32,182	22,628	54,810
OCR	0	30,076	30,076
OERI	34,806	14,304	49,110
OESE	23,304	23,124	46,428
OPE	25,878	12,468	38,346
OBEMLA	3,729	2,569	6,298
OVAE	9,943	7,077	17,020
Total	**$180,422**	**$175,377**	**$355,799**

Note 14. Imputed Financing

The Statement of Changes in Net Position recognizes an imputed financing source of $20.8 million for the period ended September 30, 2000. A corresponding post-employment benefit expense is recognized on the Statement of Net Cost as a program cost under salaries and administrative expense. The imputed financing source represents annual service costs not paid by the Department or employee contributions to the Civil Service Retirement System. No imputed financing source is recognized for the Federal Employee Retirement System, since it is a fully funded retirement service plan. The post-employment benefit expense represents the Department's estimate of the funds necessary to pay employees future pension, life, and health benefits.

Note 15. Prior Period Adjustments

During FY 2000, the Department performed various analyses of its account balances in an effort to improve the financial data recorded in its accounting records. Adjustments were made to Fund Balance with Treasury, Loan Guarantee Liability, Disbursements in Transit, and other financial statement accounts. Items of income and expense related to prior periods were recorded as prior period adjustments and Net Position was amended to reflect the adjustments.

Prior Period Adjustments (Dollars in Thousands)				
Reporting Group	**Equity and Loan Guarantee Liability Adjustment in FFEL Financing Fund**	**Adjustments Related to GAPS Subsidiary System and Proprietary And Budgetary Account Reconciliation**	**Other Adjustments**	**Total**
FFEL	$820,123	$12,805	$(8,283)	$824,645
DL			20,694	20,694
SFA Grants		85,716		85,716
OESE		3,701		3,701
OSERS		(63,372)		(63,372)
OVAE		(3,824)		(3,824)
OPE		(27,925)	87,556	59,631
OERI		(27,935)		(27,935)
OBEMLA		10,191		10,191
DM		(35,863)		(35,863)
Total Adjustments	**$820,123**	**$(46,506)**	**$99,967**	**$873,584**

The Department performed a detailed review of the FFEL financing fund to identify prior year transactions that created cumulative results of operations as of Fiscal Year 1999 year-end. Under Federal Credit Reform accounting, financing funds do not generate net costs or cumulative results of operations. Prior period adjustments were made to comply with current credit reform accounting practices which resulted in corrections to the Loan Guarantee Liability account and Net Position.

The Department performed the following analyses during FY 2000 that resulted in prior period adjustments related to its grant and loan programs:

- Analysis of undelivered order balances between the GAPS payment system (subsidiary system) and the general ledger.
- Reconciliation of transactions recorded in the Disbursement in Transit Account, dating back to Fiscal Year 1997, when the Department converted to its current accounting system.
- Relationships between Fund Balance with Treasury and budgetary accounts comprising unobligated balances, undelivered orders, and accounts payable and receivable.

The adjustments resulted in changes to Fund Balance with Treasury, Unexpended Appropriations, Undelivered Orders, and Unobligated Balances.

Other prior period adjustments were made to correct transactions posted in prior years.

Note 16. Unobligated and Obligated Balances – Beginning of Period

During FY 2000, the Department performed a review of Fiscal Year 1999 ending balances and recorded adjustments to correct account balances. The adjustments were made to Obligations Incurred and beginning Obligated and Unobligated balances. The Statement of Budgetary Resources reflects the adjusted beginning Unobligated and Obligated balances. The reconciliation is shown below.

Unobligated Balances – Beginning of Period (Dollars in Thousands)

Reporting Group	Fiscal Year 2000 Beginning Balance (Unadjusted)	Adjustments	Fiscal Year 2000 Beginning Balance (Adjusted)
FFEL	$7,771,917	$498,922	$8,270,839
DL	29,794		29,794
SFA Grants	4,720,204	182,208	4,902,412
OESE	349,420	(43,763)	305,657
OSERS	176,630	(7,741)	168,889
OVAE	68,870	(9)	68,861
OPE	80,431	(986)	79,445
OERI	22,278	(120)	22,158
OBEMLA	3,682		3,682
DM	30,209	(17,675)	12,534
Total	**$13,253,435**	**$610,836**	**$13,864,271**

Obligated Balances – Beginning of Period (Dollars in Thousands)

Reporting Group	Fiscal Year 2000 Beginning Balance (Unadjusted)	Adjustments	Fiscal Year 2000 Beginning Balance (Adjusted)
FFEL	$3,060,836	$745,255	$3,806,091
DL	6,907,766		6,907,766
SFA Grants	2,807,498	143,208	2,950,706
OESE	9,751,345	(76,228)	9,675,117
OSERS	7,868,327	(3,320)	7,865,007
OVAE	1,912,742	11	1,912,753
OPE	1,572,427	(4)	1,572,423
OERI	704,807	(10,610)	694,197
OBEMLA	529,117		529,117
DM	253,153	65	253,218
Total	**$35,368,018**	**$798,377**	**$36,166,395**

Note 17. Statement of Budgetary Resources

The Statement of Budgetary Resources compares budgetary resources with the status of those resources. As of September 30, 2000, budgetary resources outstanding were $81.3 billion and outlays for the year were $48.6 billion. The Department had $33.1 billion in net budgetary resources obligated for undelivered orders at September 30, 2000, consisting of $16.2 billion for SFA, $8.1 billion for OESE, $4.6 billion for OSERS, $1.8 billion for OPE, $1.1 billion for OVAE, and $1.3 billion for all other programs. An undelivered order is an amount of goods and services ordered from another Federal agency or the public but not yet received, i.e., the amount of orders for goods and services outstanding for which the liability has not yet accrued.

Borrowing authority is a budgetary resource used to fund loans made under the Federal Direct Student Loan Program. Borrowing authority is authority granted to a Federal entity to borrow and to obligate and expend the borrowed funds. This program may borrow from Treasury to fund loans originated during the year. The available borrowing authority remaining for loans originated during FY 2000 was $3.3 billion. Borrowings may be repaid to Treasury at any time without penalty and funds not expended accrue interest as uninvested funds. The majority of the funds used to repay Treasury borrowings are from collections on outstanding loans.

The Federal Direct Student Loan Program and the FFEL Program were granted permanent indefinite appropriation budget authority through previously enacted legislation. The following legislation pursuant to the HEA of 1965 (Part D of the William D. Ford Federal Direct Loan Program and Part B of the Federal Family Education Loan Program) pertains to the existence, purpose, and availability of the permanent indefinite appropriation authority:

"**Federal Direct Student Loan Program:** In General-There are hereby made available, in accordance with the provisions of this part, such sums as may be necessary to make loans to all eligible students (and the eligible parents of such students) in attendance at participating institutions of higher education selected by the Secretary, to enable such students to pursue their course of study at such institutions during the period beginning July 1, 1994."

"**Federal Family Education Loan Program:** Authorization of appropriations for the purpose of carrying out this part - there are authorized to be appropriated to the student loan insurance fund (established by section 431) (A) the sum of $ 1,000,000 and (B) such further sums, if any as may become necessary for the adequacy of the student loan insurance fund."

The majority of the "Adjustments" line item on the Statement of Budgetary Resources consists of repayments of borrowings, negative subsidy returns, and excess collections returned to Treasury. In addition, adjustments were made in preparing the fiscal year 2000 Statement of Budgetary Resources. The beginning obligated and unobligated balances were incorrect due to systemic problems in the general ledger closing process and other accounting errors that occurred in prior years. The Beginning Unobligated Balance was adjusted upward by $611 million while the Beginning Obligated Balance was adjusted upward by $798 million (see Note 16).

The Statement of Budgetary Resources is presented as a combined statement for the Department and as a combining statement for its major programs. The budgetary resources obligated balances, by reporting group, as of September 30, 2000, are summarized below:

Obligated Balances (Dollars in Thousands)	
Reporting Group	**Amount**
SFA	$21,629,148
OESE	8,825,209
OSERS	5,118,981
OVAE	1,271,965
OPE	1,994,678
OERI	732,133
OBEMLA	557,130
Department Management	220,591
Total	**$40,349,835**

Note 18. Statement of Financing

The major resources that do not impact net cost of operations for the Department result from loan guarantee and direct loan activities that fall under the purview of the Credit Reform Act of 1990. Most cash flows that are normally recorded as an expense or revenue in accrual accounting are recorded to liability for loan guarantees or the allowance for subsidy under present value accounting. In addition, special circumstances surround unfunded expenses such as upward subsidy re-estimates, accrued annual leave, and other payroll-related accruals. These unfunded expenses affect the Statement of Net Cost but are not covered by budgetary resources, i.e. do not give rise to a budgetary accounting event. Liabilities not covered by budgetary resources were $295 million as of September 30, 2000.

The Statement of Financing is presented as a combined statement for the Department and as a combining statement for its major programs. For the period ended September 30, 2000, the net cost of operations, by reporting group, is shown below:

Net Cost of Operations (Dollars in Thousands)	
Reporting Group	**Amount**
SFA	$ 6,234,813
OESE	13,828,926
OSERS	8,176,263
OVAE	1,608,749
OPE	1,542,678
OERI	715,758
OBEMLA	409,166
Department Management	202,471
Total Cost of Operations	**$32,718,824**

Note 19. Cost and Revenue by Budget Function

The Department's costs and revenue, by budget function, are presented below:

Cost and Revenue by Budget Function
(Dollars in Thousands)

Budget Function	Gross Costs	Earned Revenue	Net Costs
Education, training, employment, and social services	$37,666,354	$5,086,278	$32,580,076
Administration of justice	138,918	170	138,748
Total	**$37,805,272**	**$5,086,448**	**$32,718,824**

Note 20. 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 Loans Reserve Funds

The Perkins Loan Program is a campus-based program providing financial assistance to eligible post-secondary school students based on financial need. The Department provides about 86 percent of the capital used to make loans to eligible students. The remaining 14 percent is provided by the institution. For the latest academic year (ended June 30, 2000) there were approximately 653,000 loans made, totaling $1.1 billion at approximately 1,817 institutions, averaging $1,700 per loan. As of September 30, 2000, the Department's share of the Perkins Loan Program was approximately $6.2 billion.

Perkins Loan borrowers who meet statutory eligibility requirements--such as service as a teacher in low-income areas, as a Peace Corp or VISTA volunteer, in the military, or in law enforcement, nursing, or family services--may receive partial loan forgiveness for each year of qualifying service. In these circumstances, the Department compensates Perkins Loan institutions for the cost of lost borrower repayments.

Borrower Class Actions

The Department is involved in pending litigation challenging the enforceability of FFEL Program loans made to students who attended various closed trade schools. In most instances, a large percentage of the loans in question are in default and have been acquired by Guaranty Agencies and/or the Department. No provision has been made in the principal statements for any potential reductions in estimated future collections related to the outcome of these suits, since the Department's potential loss exposure is uncertain.

Other Matters

The Department is involved in various other claims and legal actions related to its programs, arising in the ordinary course of business. In addition, some portion of current year financial assistance expenses (grants) may include funded recipient expenditures which were 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 statements.

INVESTMENT IN HUMAN CAPITAL

The U. S. Department of Education (ED) executes programs under the Education, Training, Employment and Social Services function established by Congress in the Budget Act of 1974. This report presents Human Capital activity related to the execution of the ED's congressionally approved budget and programs.

NARRATIVE DISCUSSION

The Department of Education's mission is to ensure equal access to education and to promote educational excellence throughout the nation. To carry out this mission, the Department works in partnership with states, schools, communities, institutions of higher education, and financial institutions--and through them with students, teachers and professors, families, administrators, and employers. Key functions of the partnership are:

- Leadership to address critical issues in American education.
- Grants to education agencies and institutions to strengthen teaching and learning and prepare students for citizenship, employment in a changing economy, and lifelong learning.
- Student loans and grants to help pay for the costs of postsecondary education.
- Grants for literacy, employment, and self-sufficiency training for adults.
- Monitoring and enforcement of civil rights to ensure nondiscrimination by recipients of federal education funds.
- Support for statistics, research, development, evaluation, and dissemination of information to improve educational quality and effectiveness.

The Department promotes educational excellence for all students by providing financial support to states and local agencies, promoting challenging standards, getting families and communities involved in schools, providing information on the best educational practices, ensuring that postsecondary education is affordable, and providing high-quality statistics and evaluations on federal programs.

HUMAN CAPITAL PROGRAMS

Federal investment in Human Capital comprises those expenses for general public education and training programs that are intended to increase or maintain national economic productive capacity. Concern over America's ability to compete in world markets has highlighted the relationship between education and economic growth. The Department of Education's Human Capital programs include Elementary and Secondary, Postsecondary, Student Financial Assistance, Special and Rehabilitative Education, Research and Improvement, Bilingual and Minority Languages, and Vocational and Adult Education.

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 maintenance and improvement of both public and private preschool, elementary, and secondary education.

Compensatory Education Programs provide financial assistance to State and local education agencies and other institutions to support services for children in high poverty schools, institutions for neglected and delinquent children, homeless children, and certain Indian children.

The Comprehensive School Reform Demonstration Program provides grants to States to help public schools adopt or develop effective comprehensive school reforms with an emphasis on basic academics and parental involvement. State educational agencies are encouraged to place emphasis on schools with low levels of student achievement and high dropout rates.

Goals 2000 Programs provide grants to support State and local district efforts to improve schools and parental involvement in schools so all children can reach challenging academic standards. The Parental Assistance Program helps parents better understand their children's educational needs and strengthens the partnerships between parents and schools. The State and Local Education Systemic Improvement Program assists States in developing plans to improve teaching and learning through long-term and broad-based efforts to help students achieve higher standards of learning. The Technology Literacy Challenge Fund supports State, local and private sector partnerships focused on integrating technology into teaching and learning.

The Impact Aid Program provides financial assistance for the maintenance and operations of school districts in which the Federal Government has acquired substantial real property. It provides direct assistance to local educational agencies that educate substantial numbers of federally connected pupils (children who live on, or whose parents work on, federal property).

Indian Education supports the efforts of local educational agencies, Indian tribes, and other entities to meet the academic needs of American Indians and Alaska Natives so these students can achieve to the same State performance standards as all students. Programs include professional development programs designed to increase the number of Indian individuals in designated professions, a fellowship program for undergraduate and graduate study, programs for the gifted and talented, adult education, and national research activities.

Migrant Education Programs support high-quality comprehensive educational programs for migratory children to address disruptions in schooling and other problems that result from repeated moves. States use funds to design programs to help migratory children overcome academic, cultural, and language barriers, social isolation, health-related problems, and other factors that hinder academic achievement.

Safe and Drug-Free Schools Programs provide leadership to ensure that all schools are free of drugs and violence and the unauthorized presence of firearms and alcohol and that all schools offer a disciplined environment that is conductive to learning. Students at all levels of education, from elementary school through college, are supported by such programs as: Elementary School Counseling and Demonstration, Middle School Coordinators, Alternative Strategies, and Alcohol and Other Drug Prevention Models On College Campuses.

School Improvement Programs provide financial assistance to State and Local Educational Agencies, institutions of higher education, and other public and private nonprofit organizations for general assistance, projects to meet special educational needs of target children, and teacher development.

Class Size Reduction Program - Research demonstrates that students attending small classes in the early grades make more rapid educational progress than students do in larger classes. These achievement gains persist well after students move on to larger classes in later grades. The Class-Size Reduction Program is an initiative to help schools improve student learning by hiring additional, highly qualified teachers so children — especially those in the early elementary grades — can attend smaller classes. Through this program, classes in grades K-3 will be reduced to a nationwide average of 18 students. The fiscal year 2000 budget allowed for $1.3 billion dollars to be used for this purpose.

The 21st Century Community Learning Centers Program is a key in the effort to keep children safe and to provide academic enrichment and other recreational and enrichment opportunities such as band, drama, art, and other cultural events for children. It also provides life-long learning opportunities for community members.

The Community Technology Centers Program expands access to information technology and learning services by creating computer learning centers in low-income communities. The centers are used for pre-school preparation, workforce development, after-school enrichment, and adult and continuing education.

The Reading Excellence Program helps children learn to read through instruction based on research, professional development, family literacy, and extended learning activities.

Postsecondary Education

The Office of Postsecondary Education formulates policy and coordinates programs that assist postsecondary educational institutions and students pursuing a postsecondary education.

Policy, Planning, and Innovation supports The Fund for the Improvement of Postsecondary Education, which provides grants to colleges and universities to promote reform, innovation, and improvement in postsecondary education.

Higher Education Programs (HEP) administer discretionary funds and provide support services that improve student access to postsecondary education and foster excellence in institutions of higher education. Program funds are awarded to elementary, secondary, and postsecondary education institutions and non-profit organizations that assist in the distribution and administration of federal funds. HEP also administers several fellowship programs to graduate and undergraduate students in targeted areas of study.

Learning Anytime Anywhere Partnerships (LAAP) - The Office of Postsecondary Education supports partnerships among colleges, businesses, and other organizations to promote technology-mediated distance education that is not limited by time or place. LAAP improves access to lifelong learning and promotes coordination and resource sharing among distance education providers.

Student Financial Assistance (SFA) Programs

SFA administers need-based financial assistance programs for students pursuing postsecondary education. ED makes available federal grants, loans and work-study funding to eligible undergraduate and graduate students.

ED's two major loan programs are the Federal Family Education Loan Program (FFELP) and the William D. Ford Direct Student Loan Program. The FFELP operates with State and private nonprofit guaranty agencies to provide loan guarantees and interest supplements through permanent budget authority on loans by private lenders to eligible students. The William D. Ford Direct Student Loan Program is a direct lending program in which loan capital is provided to students by the Federal Government through borrowing from the U.S. Treasury.

Special Education and Rehabilitative Services

The Office of Special Education and Rehabilitative Services supports programs that assist in educating children with special needs. It provides for the rehabilitation of youth and adults with disabilities and supports research to improve the lives of individuals with disabilities.

The Office of Special Education Programs administers programs and projects relating to the free public education of all children, youth, and adults with disabilities from birth through age 21. Most special education funds provide grants to states and territories to assist them in providing education to all children with disabilities. The early intervention and preschool grant programs provide grants to each state for children with disabilities from birth through age five.

Rehabilitation Services Administration (RSA) oversees programs such as counseling, medical and psychological services, job training, and other individualized services that help individuals with physical or mental disabilities to obtain employment. RSA provides funds to State vocational rehabilitation agencies to provide employment-related services for individuals with disabilities, giving priority to severely disabled individuals.

The National Institute on Disability and Rehabilitation provides leadership and support for a comprehensive program of research related to the rehabilitation of individuals with disabilities.

Educational Research and Improvement

The Office of Educational Research and Improvement (OERI) is responsible for expanding America's fundamental knowledge and understanding of education through research and development. OERI promotes excellence and equity in American education by conducting research and demonstration projects that help improve education, collecting statistics on the status and progress of schools, and distributing information and providing technical assistance to those working to improve education.

Media and Information Services (MIS) provides leadership in developing effective media and information services for OERI. MIS responds to customer needs through its outreach and publication activities, ensuring all OERI media products are of the highest quality in terms of content, format, and suitability for intended audiences.

The National Center for Education Statistics fulfills a Congressional mandate to collect, collate, analyze, and report complete statistics on the condition of American education, conduct and publish reports, and review and report on education activities internationally.

The National Institute on Early Childhood Development and Education administers a comprehensive program of research and development to improve early childhood development and education. These activities improve the learning, cognitive and social-emotional development, and general well being of children from birth through age eight and their families.

The National Institute on the Education of At-Risk Students administers a comprehensive program of research and development for the improvement of education for at-risk students. At-Risk Students are defined as those who because of limited English proficiency, poverty, race, geographic location, or economic disadvantage face a greater risk of low education achievement or reduced academic expectations.

The National Institute on Educational Governance, Finance, Policymaking, and Management develops and disseminates information to guide the design and implementation of effective governance strategies, coherent policy information, reasonable management decisions, and equitable finance allocations to support high levels of learning by all students.

The National Institute on Postsecondary Education, Libraries, and Lifelong Learning provides information about the education and training of adults in a variety of settings including postsecondary institutions, community-based education programs, libraries, and the workplace. It conducts research and development activities promoting quality and access to education and training for adults.

The National Institute on Student Achievement, Curriculum, and Assessment administers a comprehensive program of research and development to provide leadership for states and localities striving to improve student achievement in core content areas and working to integrate these areas to enhance student learning.

The National Library of Education (NLE) is the largest federally funded library devoted entirely to education. NLE serves in three areas: Reference and Information Services, which responds to telephone, mail, electronic, and other inquiries for education information; Collection and Technical Services, which directs the acquisition, preparation, and assessment of all collections; and Resource Sharing and Cooperation, which develops and maintains a network of national education resources.

The Office of Reform Assistance and Dissemination supports comprehensive education reform by linking teachers, administrators, parents, policymakers, and the public with the best knowledge from education research, statistics, and practice. Responsibilities include providing technical and financial assistance for development, conducting research on models for successful uses of knowledge, providing training for putting in place exemplary education programs, connecting schools and teachers with appropriate sources of assistance, and disseminating useful research findings.

Bilingual Education and Minority Language Affairs

Congress passed the Bilingual Education Act in 1968 in recognition of the growing number of linguistically and culturally diverse children enrolled in schools who, because of their limited English proficiency, were not receiving an education equal to their English-proficient peers. The Office of Bilingual Education and Minority Languages Affairs helps school districts meet their responsibility to provide equal education opportunity to limited English proficient children.

Office of Vocational and Adult Education

The Office of Vocational and Adult Education provides funds for vocational-technical education for youth and adults. Most of the funds are awarded in the form of grants to State education agencies. These grants are allotted according to a formula based on States' populations in certain age groups and their per capita income.

STEWARDSHIP EXPENSES

In the Department of Education, discretionary spending constitutes approximately 91 percent of the budget and includes nearly all programs, the major exceptions being student loans and rehabilitation services.

The Federal Government is mandated by law to cover the cost of guaranteeing and directly making loans to students. The variable costs of the student loan programs are largely beyond control, and the costs fluctuate based on the number of students who borrow or default and the prevailing interest rates. The only other significant mandatory funding in ED is for Rehabilitation Act programs. The Rehabilitation Act mandates that the appropriation for State grants must increase each year at the rate of change in the Consumer Price Index.

While 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 - for example, Impact Aid, Vocational Education, Special Education, Pell Grants, Research, and Statistics.

Fiscal Year 2000 Summary of Human Capital Expenses
(Dollars in Thousands)

Student Financial Assistance	
Direct Loan Subsidy Expense	$ (3,932,928)
Guaranteed Loan Subsidy Expense	295,531
Grant Program Expense	8,960,280
Salaries & Administrative Expense	273,866
Subtotal	$ 5,596,749
Other Departmental	
OESE Grant Expense	$ 13,773,266
OSERS Grant Expense	8,104,963
Other Departmental Program Expense	3,955,390
Salaries & Administrative Expense	312,051
Subtotal	$ 26,145,670
Grand Total	$ 31,742,419

Intra-governmental Amounts

Intra-governmental amounts by trading partner include assets and liabilities. Assets primarily consist of $42.2 billion in fund balance with the Treasury. Liabilities to the Treasury include the following: borrowings of $65.7 billion, payables of $7.9 billion, and Guaranty Agency Federal & Restricted Funds of $2.2 billion. Payables due to the Federal Financing Bank amount to $20.7 million. Accounts payable, interest payable, and other intra-governmental liabilities covered by budgetary resources due to other federal agencies amount to $6.6 million, $83.5 million, and $112.6 million, respectively. Other intra-governmental liabilities not covered by budgetary resources due to other federal agencies total $250.3 million.

PROGRAM OUTPUTS

Education is primarily a State and local responsibility in the United States. States and communities, as well as 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. Combining ED's expenditures of roughly $42 billion a year with funding from all other federal agencies, such as the Department of Health and Human Services' Head Start program and the Department of Agriculture's School Lunch program, the Federal Government contributes approximately 9 percent of total national expenditures on education. The remaining 91 percent come from State, local, and private sources. That $42 billion is less than 2 percent of the Federal Government's $1.8 trillion budget.

ED currently administers 174 programs affecting every area and level of education. The Department's elementary and secondary programs annually serve more than 15,000 school districts and more than 50 million students attending almost 90,000 public schools and more than 27,000 private schools. Department programs also provide grant, loan, and work-study assistance to more than 8 million postsecondary students.

While ED's programs and responsibilities have grown substantially over the years, the Department itself has not. In fact**,** ED's fiscal year 2000 full time equivalent staff ceiling of 4,717 is nearly 37 percent below the 1980 employee level of 7,528. 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. This means that ED delivers more than 98 cents on the dollar in education assistance to States, school districts, postsecondary institutions and students.

PROGRAM OUTCOMES

Education is the stepping stone to higher living standards for American citizens. Education is key 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. Recently, 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:

- **Employment Rate:** Between 1971 and 1998, the employment rate of male and female 25- to 34-year-olds was generally higher among those individuals with a higher level of education. The employment rate of males ages 25-34 decreased for those who had not finished high school and those with a high school diploma or GED, and remained relatively constant for those with some college and those with a bachelor's degree or higher. The employment rate of females ages 25-34 increased across all education levels. However, the rate of increase for females who did not complete high school was lower than the rate of increase for females who attained higher levels of education.

- **Annual Earnings:** In 1997, the median annual earnings of adults ages 25-34 who had not completed high school were substantially lower than those of their counterparts who had done so (29 and 37 percent lower for males and females, respectively). Adults ages 25-34 who had completed a bachelor’s degree or higher earned substantially more than those who had earned no more than a high school diploma or GED (50 and 91 percent more for males and females, respectively).

These returns of investing in education directly translate into the advancement of the American economy as a whole.

Supplementary Information

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidating Balance Sheet
As of September 30, 2000
(Dollars in Thousands)

	Consolidated	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Assets									
Entity Assets									
Intragovernmental Assets:									
Fund Balance with Treasury (Note 2)	$42,160,719	$22,758,091	$9,003,038	$5,406,604	$1,362,026	$2,065,328	$755,684	$560,225	$249,723
Interest Receivable	70,755	70,755							
Governmental Assets:									
Accounts Receivable, Net (Note 3)	82,703	10,351	56,518		50	1,498			14,286
Credit Program Receivables, Net (Note 4)	74,162,004	73,756,061				405,943			
Advances	38,739	38,739							
Cash and Other Monetary Assets	14,132	1,302				3,542			9,288
Property and Equipment (Note 5)	1,307								1,307
Other Governmental Assets	236,363	236,363							
Total Entity Assets	$116,766,722	$96,871,662	$9,059,556	$5,406,604	$1,362,076	$2,476,311	$755,684	$560,225	$274,604
Non-Entity Assets									
Guaranty Agency Federal & Restricted Funds Receivable (Note 3)	$2,231,814	$2,231,814							
Total Non-Entity Assets	$2,231,814	$2,231,814							
Total Assets	$118,998,536	$99,103,476	$9,059,556	$5,406,604	$1,362,076	$2,476,311	$755,684	$560,225	$274,604
Liabilities									
Liabilities Covered by Budgetary Resources									
Intragovernmental Liabilities:									
Accounts Payable	$6,647	$1,623	$3,766	$241	$54	$70	$50	$6	$837
Interest Payable	83,469	70,755				12,714			
Borrowing from Treasury (Note 6)	65,715,386	65,346,881				368,505			
Guaranty Agency Federal & Restricted Funds Due To Treasury (Note 3)	2,231,814	2,231,814							
Payable to Treasury (Note 7)	7,860,621	7,860,621							
Payable to Federal Financing Bank (Note 8)	20,699					20,699			
Other Intragovernmental Liabilities (Note 9)	112,562	4					10,627		101,931
Governmental Liabilities:									
Accounts Payable	213,051	168,103	50	11,812	1,256	6,452	11,815	695	12,868
Accrued Grant Liability (Note 10)	2,006,129	319,376	752,098	486,687	137,219	179,749	80,245	50,755	
Liabilities for Loan Guarantees (Note 4)	13,667,983	13,667,983							
Other Governmental Liabilities (Note 9)	186,424	145,759	9,152	1,616	1,825	1,116	25,683	1,273	
Total Liabilities Covered by Budgetary Resources	$92,104,785	$89,812,919	$765,066	$500,356	$140,354	$589,305	$128,420	$52,729	$115,636
Liabilities Not Covered by Budgetary Resources									
Intragovernmental Liabilities:									
Other Intragovernmental Liabilities (Note 9)	$250,261	$237,682	$267	$356	$134	$509	$356	$45	$10,912
Governmental Liabilities:									
Other Governmental Liabilities (Note 9)	44,734	9,342	2,748	3,613	1,292	3,787	3,764	456	19,732
Total Liabilities Not Covered by Budgetary Resources	$294,995	$247,024	$3,015	$3,969	$1,426	$4,296	$4,120	$501	$30,644
Total Liabilities	$92,399,780	$90,059,943	$768,081	$504,325	$141,780	$593,601	$132,540	$53,230	$146,280
Net Position									
Unexpended Appropriations (Note 11)	$26,722,760	$9,253,010	$8,233,684	$4,900,368	$1,220,037	$1,847,841	$623,875	$507,496	$136,449
Cumulative Results of Operations (Note 11)	(124,004)	(209,477)	57,791	1,911	259	34,869	(731)	(501)	(8,125)
Total Net Position	$26,598,756	$9,043,533	$8,291,475	$4,902,279	$1,220,296	$1,882,710	$623,144	$506,995	$128,324
Total Liabilities and Net Position	$118,998,536	$99,103,476	$9,059,556	$5,406,604	$1,362,076	$2,476,311	$755,684	$560,225	$274,604

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidating Statement of Net Cost
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Consolidated	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Program Costs									
Intragovernmental									
Interest Expense, Federal (Note 12)	$4,993,313	$4,972,380				$20,918			$15
Other Production Expense	434	150	$184						100
Grant Expense	79,460		76,459				$3,001		
Contractual Service Expense	57,754	5,015	9,292	$2,178	$768	1,036	28,029	$297	11,139
Salaries and Administrative Expense	147,010	66,181	1,965	1,357	954	1,959	3,759	165	70,670
Bad Debt & Write-offs	2,050	235	789	2			325		699
Other Program Expenses	800						230		570
Governmental									
Subsidy Expense (Note 4)	(3,637,993)	(3,637,397)				(596)			
Grant Expense	34,715,035	8,960,280	13,696,807	8,104,963	1,576,520	1,493,112	447,378	397,481	38,494
Interest Expense, Non-Federal (Note 12)	305	224	8	1		43	4		25
Contractual Service Expense	827,976	452,277	56,249	16,805	12,919	15,537	185,168	4,721	84,300
Salaries and Administrative Expense (Note 13)	438,907	207,685	48,159	56,180	19,272	41,904	52,709	6,502	6,496
Bad Debt & Write-offs	14					14			
Other Program Expenses	180,207	180,163	44						
Total Program Cost	$37,805,272	$11,207,193	$13,889,956	$8,181,486	$1,610,433	$1,573,927	$720,603	$409,166	$212,508
Less: Earned Revenues									
Interest, Federal (Note 12)	$1,761,285	$1,761,124				$161			
Interest, Non-Federal (Note 12)	3,234,323	3,211,256				23,067			
Other Earned Revenue	90,840		$61,030	$5,223	$1,684	8,021	$4,845		$10,037
Earned Revenues	$5,086,448	$4,972,380	$61,030	$5,223	$1,684	$31,249	$4,845		$10,037
Net Program Cost	$32,718,824	$6,234,813	$13,828,926	$8,176,263	$1,608,749	$1,542,678	$715,758	$409,166	$202,471
Net Cost of Operations	$32,718,824	$6,234,813	$13,828,926	$8,176,263	$1,608,749	$1,542,678	$715,758	$409,166	$202,471

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidating Statement of Changes in Net Position
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Consolidated	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Net Cost of Operations	$(32,718,824)	$(6,234,813)	$(13,828,926)	$(8,176,263)	$(1,608,749)	$(1,542,678)	$(715,758)	$(409,166)	$(202,471)
Financing Sources (Other than Exchange Revenues):									
Appropriations Used	$37,238,317	$10,673,739	$13,844,701	$8,061,335	$1,588,542	$1,502,313	$641,152	$412,691	$513,844
Donations (Non-exchange Revenue)	1,016								1,016
Imputed Financing (Note 14)	20,795	117,570	47,676	56,474	17,644	40,725	50,773	6,506	(316,573)
Future Transfers Out due to Downward Subsidy Re-estimate	(4,010,604)	(4,010,604)							
Total Financing Sources	$33,249,524	$6,780,705	$13,892,377	$8,117,809	$1,606,186	$1,543,038	$691,925	$419,197	$198,287
Net Results of Operations	$530,700	$545,892	$63,451	$(58,454)	$(2,563)	$360	$(23,833)	$10,031	$(4,184)
Prior Period Adjustments (Note 15)	$(873,584)	$(931,055)	$(3,701)	$63,372	$3,824	$(59,631)	$27,935	$(10,191)	$35,863
Net Change in Cumulative Results of Operations	$(342,884)	$(385,163)	$59,750	$4,918	$1,261	$(59,271)	$4,102	$(160)	$31,679
Increase (Decrease) in Unexpended Appropriations	$(4,039,342)	$476,516	$(1,015,575)	$(2,961,739)	$(709,500)	$318,867	$(61,897)	$(14,106)	$(71,908)
Change in Net Position	$(4,382,226)	$91,353	$(955,825)	$(2,956,821)	$(708,239)	$259,596	$(57,795)	$(14,266)	$(40,229)
Net Position - Beginning of Period	$30,980,982	$8,952,180	$9,247,300	$7,859,100	$1,928,535	$1,623,114	$680,939	$521,261	$168,553
Net Position - End of Period	$26,598,756	$9,043,533	$8,291,475	$4,902,279	$1,220,296	$1,882,710	$623,144	$506,995	$128,324

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Combining Statement of Budgetary Resources
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Combined	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Budgetary Resources									
Budget Authority	$56,900,834	$34,511,961	$13,033,740	$5,146,399	$890,750	$1,825,415	$597,260	$406,000	$489,309
Unobligated Balance-Beginning of Period (Adjusted) (Note 16)	13,864,271	13,203,045	305,657	168,889	68,861	79,445	22,158	3,682	12,534
Spending Authority from Offsetting Collections	21,346,713	21,187,709	61,373	5,223	1,784	75,142	5,064	359	10,059
Adjustments (Note 17)	(10,844,127)	(10,938,820)	148,459	(10,812)	(5,403)	(21,539)	(15,339)	(1,386)	713
Total Budgetary Resources (Note 17)	$81,267,691	$57,963,895	$13,549,229	$5,309,699	$955,992	$1,958,463	$609,143	$408,655	$512,615
Status of Budgetary Resources									
Obligations Incurred (Adjusted) (Note 16)	$74,707,704	$52,125,416	$13,355,736	$5,023,659	$866,304	$1,839,813	$602,564	$405,808	$488,404
Unobligated Balances-Available	1,822,381	1,491,844	68,164	140,033	86,325	33,749	2,072	194	
Unobligated Balances-Not Available	4,737,606	4,346,635	125,329	146,007	3,363	84,901	4,507	2,653	24,211
Total Status of Budgetary Resources (Note 17)	$81,267,691	$57,963,895	$13,549,229	$5,309,699	$955,992	$1,958,463	$609,143	$408,655	$512,615
Outlays									
Obligations Incurred (Adjusted) (Note 16)	$74,707,704	$52,125,416	$13,355,736	$5,023,659	$866,304	$1,839,813	$602,564	$405,808	$488,404
Less: Spending Authority from Offsetting Collections and Adjustments	(21,916,198)	(21,364,303)	(397,591)	(28,647)	(8,547)	(84,548)	(7,867)	(6,388)	(18,307)
Obligated Balance, Net-Beginning of Period (Adjusted) (Note 16)	36,166,395	13,664,563	9,675,117	7,865,007	1,912,753	1,572,423	694,197	529,117	253,218
Less: Obligated Balance, Net-End of Period (Note 17)	(40,349,835)	(21,629,148)	(8,825,209)	(5,118,981)	(1,271,965)	(1,994,678)	(732,133)	(557,130)	(220,591)
Total Outlays (Note 17)	$48,608,066	$22,796,528	$13,808,053	$7,741,038	$1,498,545	$1,333,010	$556,761	$371,407	$502,724

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Combining Statement of Financing
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Combined	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Obligations and Nonbudgetary Resources (Note 18)									
Obligations Incurred (Adjusted) (Note 16)	$74,707,704	$52,125,416	$13,355,736	$5,023,659	$866,304	$1,839,813	$602,564	$405,808	$488,404
Spending Authority from Offsetting Collections and Adjustments	(21,916,198)	(21,364,303)	(397,591)	(28,647)	(8,547)	(84,548)	(7,867)	(6,388)	(18,307)
Financing Imputed for Cost Subsidies (Note 14)	20,795	117,570	47,676	56,474	17,644	40,725	50,773	6,506	(316,573)
Financing Sources Transferred Out	(4,010,604)	(4,010,604)							
Exchange Revenue Not In the Entity's Budget	4,366,080	4,352,527				13,553			
Other	(23,089)					(23,089)			
Total Obligations and Nonbudgetary Resources	$53,144,688	$31,220,606	$13,005,821	$5,051,486	$875,401	$1,786,454	$645,470	$405,926	$153,524
Resources That Do Not Fund Net Cost of Operations (Note 18)									
Change in Amount of Goods, Services, and Benefits Ordered But Not Yet Provided (Net Increases) Net Decreases	$2,423,469	$(2,390,955)	$1,248,891	$3,009,917	$729,006	$(269,679)	$41,951	$13,506	$40,832
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowance for Subsidy	8,996,426	8,951,690				44,736			
Resources that Fund Expenses Recognized in Prior Periods	(33,759)	(4,104)	(1,959)	(2,983)	(1,014)	(4,091)	(3,352)	(357)	(15,899)
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(35,363,420)	(35,333,600)	6			(28,519)			(1,307)
Other Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	4,287,021	4,287,223				(202)			
Total Resources That Do Not Fund Net Cost of Operations	$(19,690,263)	$(24,489,746)	$1,246,938	$3,006,934	$727,992	$(257,755)	$38,599	$13,149	$23,626
Costs That Do Not Require Resources (Note 18)									
Adjustments	$(360,763)	$(80,868)	$(426,848)	$113,873	$3,919	$8,184	$27,569	$(10,426)	$3,834
Total Costs That Do Not Require Resources	$(360,763)	$(80,868)	$(426,848)	$113,873	$3,919	$8,184	$27,569	$(10,426)	$3,834
Financing Sources Yet to be Provided (Note 18)	$(374,838)	$(415,179)	$3,015	$3,970	$1,437	$5,795	$4,120	$517	$21,487
Net Cost of Operations (Note 18)	$32,718,824	$6,234,813	$13,828,926	$8,176,263	$1,608,749	$1,542,678	$715,758	$409,166	$202,471

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Student Financial Assistance
Consolidating Balance Sheet
As of September 30, 2000
(Dollars in Thousands)

	Consolidated	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs
Assets				
Entity Assets				
Intragovernmental Assets:				
Fund Balance with Treasury	$22,758,091	$12,069,409	$2,483,770	$8,204,912
Interest Receivable	70,755		70,755	
Governmental Assets:				
Accounts Receivable, Net	10,351	8,414	1,937	
Credit Program Receivables, Net	73,756,061	10,940,429	62,815,632	
Advances	38,739	38,739		
Cash and Other Monetary Assets	1,302	150		1,152
Other Governmental Assets	236,363			236,363
Total Entity Assets	$96,871,662	$23,057,141	$65,372,094	$8,442,427
Non-Entity Assets				
Guaranty Agency Federal & Restricted Funds Receivable	$2,231,814	$2,231,814		
Total Non-Entity Assets	$2,231,814	$2,231,814		
Total Assets	$99,103,476	$25,288,955	$65,372,094	$8,442,427
Liabilities				
Liabilities Covered by Budgetary Resources				
Intragovernmental Liabilities:				
Accounts Payable	$1,623		$1,623	
Interest Payable	70,755		70,755	
Borrowing from Treasury	65,346,881		65,346,881	
Guaranty Agency Federal & Restricted Funds Due To Treasury	2,231,814	$2,231,814		
Payable to Treasury	7,860,621	7,860,621		
Other Intragovernmental Liabilities	4	4		
Governmental Liabilities:				
Accounts Payable	168,103	69,642	40,850	$57,611
Accrued Grant Liability	319,376			319,376
Liabilities for Loan Guarantees	13,667,983	13,667,983		
Other Governmental Liabilities	145,759	103,044	42,715	
Total Liabilities Covered by Budgetary Resources	$89,812,919	$23,933,108	$65,502,824	$376,987
Liabilities Not Covered by Budgetary Resources				
Intragovernmental Liabilities:				
Other Intragovernmental Liabilities	$237,682	$806	$252	$236,624
Governmental Liabilities:				
Other Governmental Liabilities	9,342	6,415	2,927	
Total Liabilities Not Covered by Budgetary Resources	$247,024	$7,221	$3,179	$236,624
Total Liabilities	$90,059,943	$23,940,329	$65,506,003	$613,611
Net Position				
Unexpended Appropriations	$9,253,010	$1,355,847	$124,869	$7,772,294
Cumulative Results of Operations	(209,477)	(7,221)	(258,778)	56,522
Total Net Position	$9,043,533	$1,348,626	$(133,909)	$7,828,816
Total Liabilities and Net Position	$99,103,476	$25,288,955	$65,372,094	$8,442,427

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Student Financial Assistance
Consolidating Statement of Net Cost
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Consolidated	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs
Program Costs				
Intragovernmental				
Interest Expense, Federal	$4,972,380	$499,843	$4,472,537	
Other Production Expense	150	72	78	
Contractual Service Expense	5,015	2,714	2,301	
Salaries and Administrative Expense	66,181	36,274	29,907	
Bad Debt & Write-offs	235	150	85	
Governmental				
Subsidy Expense	(3,637,397)	295,531	(3,932,928)	
Grant Expense	8,960,280			$8,960,280
Interest Expense, Non-Federal	224	109	115	
Contractual Service Expense	452,277	212,812	217,717	21,748
Salaries and Administrative Expense	207,685	67,096	33,440	107,149
Other Program Expenses	180,163	86,562	93,601	
Total Program Cost	$11,207,193	$1,201,163	$916,853	$9,089,177
Less: Earned Revenues				
Interest, Federal	$1,761,124	$499,843	$1,261,281	
Interest, Non-Federal	3,211,256		3,211,256	
Earned Revenues	$4,972,380	$499,843	$4,472,537	
Net Program Cost	$6,234,813	$701,320	$(3,555,684)	$9,089,177
Net Cost of Operations	$6,234,813	$701,320	$(3,555,684)	$9,089,177

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Student Financial Assistance
Consolidating Statement of Changes in Net Position
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Consolidated	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs
Net Cost of Operations	$(6,234,813)	$(701,320)	$3,555,684	$(9,089,177)
Financing Sources (Other than Exchange Revenues):				
Appropriations Used	$10,673,739	$4,719,882	$(3,114,938)	$9,068,795
Imputed Financing	117,570	9,246	1,175	107,149
Future Transfers Out due to Downward Subsidy Re-estimate	(4,010,604)	(4,010,604)		
Total Financing Sources	$6,780,705	$718,524	$(3,113,763)	$9,175,944
Net Results of Operations	$545,892	$17,204	$441,921	$86,767
Prior Period Adjustments	$(931,055)	$(824,645)	$(20,694)	$(85,716)
Net Change in Cumulative Results of Operations	$(385,163)	$(807,441)	$421,227	$1,051
Increase (Decrease) in Unexpended Appropriations	$476,516	$220,738	$(14,237)	$270,015
Change in Net Position	$91,353	$(586,703)	$406,990	$271,066
Net Position - Beginning of Period	$8,952,180	$1,935,329	$(540,899)	$7,557,750
Net Position - End of Period	$9,043,533	$1,348,626	$(133,909)	$7,828,816

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Student Financial Assistance
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Combined	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs
Budgetary Resources				
Budget Authority	$34,511,961	$5,073,056	$19,993,905	$9,445,000
Unobligated Balance-Beginning of Period (Adjusted)	13,203,045	8,270,839	29,794	4,902,412
Spending Authority from Offsetting Collections	21,187,709	10,087,354	11,100,355	
Adjustments	(10,938,820)	(4,442,433)	(6,579,933)	83,546
Total Budgetary Resources	$57,963,895	$18,988,816	$24,544,121	$14,430,958
Status of Budgetary Resources				
Obligations Incurred (Adjusted)	$52,125,416	$14,825,659	$24,521,127	$12,778,630
Unobligated Balances-Available	1,491,844			1,491,844
Unobligated Balances-Not Available	4,346,635	4,163,157	22,994	160,484
Total Status of Budgetary Resources	$57,963,895	$18,988,816	$24,544,121	$14,430,958
Outlays				
Obligations Incurred (Adjusted)	$52,125,416	$14,825,659	$24,521,127	$12,778,630
Less: Spending Authority from Offsetting Collections and Adjustments	(21,364,303)	(10,073,625)	(11,100,581)	(190,097)
Obligated Balance, Net-Beginning of Period (Adjusted)	13,664,563	3,806,091	6,907,766	2,950,706
Less: Obligated Balance, Net-End of Period	(21,629,148)	(7,903,642)	(7,230,143)	(6,495,363)
Total Outlays	$22,796,528	$654,483	$13,098,169	$9,043,876

The accompanying notes are an integral part of these financial statements.

UNITED STATES DEPARTMENT OF EDUCATION
Student Financial Assistance
Combining Statement of Financing
For the Year Ended September 30, 2000
(Dollars in Thousands)

	Combined	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs
Obligations and Nonbudgetary Resources				
Obligations Incurred (Adjusted)	$52,125,416	$14,825,659	$24,521,127	$12,778,630
Spending Authority from Offsetting Collections and Adjustments	(21,364,303)	(10,073,625)	(11,100,581)	(190,097)
Financing Imputed for Cost Subsidies	117,570	9,246	1,175	107,149
Financing Sources Transferred Out	(4,010,604)	(4,010,604)		
Exchange Revenue Not In the Entity's Budget	4,352,527	1,660,245	2,692,282	
Total Obligations and Nonbudgetary Resources	$31,220,606	$2,410,921	$16,114,003	$12,695,682
Resources That Do Not Fund Net Cost of Operations				
Change in Amount of Goods, Services, and Benefits Ordered But Not Yet Provided (Net Increases) Net Decreases	$(2,390,955)	$5,704	$1,111,665	$(3,508,324)
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowance for Subsidy	8,951,690	4,106,394	4,845,296	
Resources that Fund Expenses Recognized in Prior Periods	(4,104)	(3,553)	(551)	
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(35,333,600)	(10,097,280)	(25,236,569)	249
Other Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	4,287,223	4,306,136	(18,913)	
Total Resources That Do Not Fund Net Cost of Operations	$(24,489,746)	$(1,682,599)	$(19,299,072)	$(3,508,075)
Costs That Do Not Require Resources				
Adjustments	$(80,868)	$(32,500)	$50,062	$(98,430)
Total Costs That Do Not Require Resources	$(80,868)	$(32,500)	$50,062	$(98,430)
Financing Sources Yet to be Provided	$(415,179)	$5,498	$(420,677)	
Net Cost of Operations	$6,234,813	$701,320	$(3,555,684)	$9,089,177

The accompanying notes are an integral part of these financial statements.

Attachments

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

FEB 28 2001

MEMORANDUM

TO: Mark Carney
Deputy Chief Financial Officer

James Lynch
Chief Financial Officer, Student Financial Assistance

FROM: Lorraine Lewis Lorraine Lewis

SUBJECT: FINAL AUDIT REPORTS
Fiscal Year 2000 Annual Financial Statements
U.S. Department of Education
ED-OIG/A17-A0002

Attached are the subject final reports on the results of the audit of the Department's fiscal year 2000 financial statements. 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.

You have been designated as the action officials responsible for the resolution of the findings and recommendations in this report. We have discussed the findings with you or appropriate members of your staffs at various times throughout the audit.

Please provide us with your combined final responses to each recommendation within 60 days of the date of this letter indicating what corrective actions you have taken or plan, and related milestones.

In accordance with Office of Management and Budget Circular A-50, we will keep the reports on the OIG list of unresolved audits until all open issues have been resolved. Any reports unresolved after 180 days from the date of issuance will be shown as overdue in the OIG's Semiannual Report to Congress.

Please provide the Financial Improvement and Post Operation/Post Audit Group and the Office of Inspector General/Audit Services with quarterly reports on promised corrective actions until all such actions have been completed or continued follow-up is unnecessary.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act. Copies of these reports have been provided to the offices shown on the distribution list.

We appreciate the cooperation given us and Ernst & Young, LLP, during the audit. Should you have any questions concerning the reports, please contact me or Thomas A. Carter at 205-5439 or 205-9327, respectively.

Attachments

Distribution List:

Craig Luigart, – OCIO
Terry Bowie – OCFO
Danny Harris – OCFO
Greg Woods – SFA
Stephen Hawald – SFA
Linda Paulsen – SFA
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Report of Independent Auditors

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2000, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources and financing for the fiscal year 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 audit.

Except as discussed in the following two paragraphs, 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 Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.* These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

During fiscal year 1998, the Department implemented a new accounting system. As noted in prior audit reports, the internal control of the Department is evolving, and the financial reporting process of the accounting system as implemented has several limitations. That accounting system is in the process of being replaced. During fiscal year 2000, the Department processed a significant number of manual adjustments in an effort to correct errors from prior fiscal years and to correct deficiencies in the postings of certain current year transactions to the existing general ledger system. Due to the condition of the available records, in some cases these adjustments were made based on the best available data. Management made reasoned judgments on the most likely cause of the discrepancies in the accounts and proposed adjustments intended to correct the balances to conform to management's expectations based on what management believes the accounts should reflect. While this adjustment process appears to have been a pragmatic solution, the Department was unable to provide sufficiently definitive documentation to support these adjustments. The efforts of the Department, including emerging account analysis and reconciliation processes, have partially compensated for, but did not correct, certain aspects of the material weaknesses in the Department's financial reporting process in fiscal year 2000.

The Department was unable to provide adequate documentation to support certain amounts reported in net position included in the consolidated balance sheet, and prior period adjustments included in the consolidated statement of changes in net position; nor were we able to satisfy ourselves as to these amounts by performing other auditing procedures. In addition, the Department inconsistently processed certain transactions related to prior years as fiscal year 2000 activity and was unable to provide adequate documentation that these manual transactions were properly reflected in the appropriate period. We were unable to obtain sufficient evidence or to otherwise satisfy ourselves that the Department's process to adjust its records to reflect the transactions in the proper period was fully effective in ensuring that certain costs and obligations reported by the Department were related to fiscal year 2000 rather than prior years activity; nor were we able to satisfy ourselves with respect to the adjustments to beginning obligated and unobligated balances.

In our opinion, except for the adjustments to the consolidated balance sheet, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources and financing, if any, that might have been determined to be necessary had we been able to examine sufficient evidence regarding certain amounts and balances referred to above as of and for the year ended September 30, 2000, the consolidated balance sheet and related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources and financing referred to above present fairly, in all material respects, the financial position as of September 30, 2000, and net cost, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statements referred to in the first paragraph. The information presented in the Overview of the U.S. Department of Education and the Supplemental Information is not a required part of the principal financial statements, but is supplementary information required by Office of Management and Budget Bulletin No. 97-01, *Form and Content of Agency Financial Statements*. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated and combined financial statements, and accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our reports dated January 26, 2001, on our consideration of the U.S. Department of Education's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Ernst + Young LLP

January 26, 2001
Washington, D.C.

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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, 2000, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources and financing for the year then ended, and have issued our report thereon dated January 26, 2001. The report noted certain matters that resulted in a qualification of our opinion on the consolidated balance sheet, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources and financing.

Except for the matters discussed in the third and fourth paragraphs of the Report of Independent Auditors, 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. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the Department's internal control, determined whether this internal control had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal control relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act (FMFIA) of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Management is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that: assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting principles generally accepted in the United States; and data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Because of inherent limitations in any internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In addition, with respect to internal control related to performance measures reported in the Overview 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. 01-02. 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.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards issued by the American Institute of Certified Public Accountants and OMB Bulletin No. 01-02. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. The remainder of this report details the reportable conditions, the first three of which are considered material weaknesses as defined above.

MATERIAL WEAKNESSES

1. Financial Management Systems and Financial Reporting Need to Be Strengthened (Modified Repeat Condition)

Background

The Chief Financial Officers (CFO) Act and, in particular, OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, require that financial statements be the culmination of a systematic accounting process. The statements are to result from an accounting system that is an integral part of a total financial management system containing sufficient structure, effective internal control, and reliable data. The Department relies on a variety of work-around procedures to prepare financial statements, including significant manual adjustments, due to deficiencies in the current general ledger system and the lack of a fully integrated financial management system.

Significant Progress Noted, but Additional Improvement Needed

Although this material weakness from prior years remains outstanding, the Department has made improvements to its financial reporting process and financial management activities during fiscal year 2000. For example, the Department:

- Prepared interim financial statements for the periods ended March 31, 2000, and June 30, 2000, which facilitated the Department's timely preparation of its year-end financial statements. The interim financial statement process used by the Department assisted in analyzing balances in anticipation of preparing the financial statements at year-end.
- Performed extensive analysis of general ledger account balances in an effort to resolve errors that existed in prior years and correct deficiencies in the postings of certain current year transactions to the existing general ledger system. Specifically, the Department performed procedures to align Grant Administration and Payment System (GAPS) subsidiary records and the Financial Management System Software (FMSS) general ledger, align budgetary sources and uses, and remove incorrect transactions from the undelivered orders and Fund Balance with Treasury account balances.
- Enhanced communication among the various Department offices responsible for providing information in support of financial reporting. Specifically, the Department established a steering committee that included employees from Office of the Chief Financial Officer (OCFO), Budget Service, and Student Financial Assistance (SFA) to be responsible for making decisions on financial statement preparation and supporting the audit process.

While progress has been made, significant financial management issues continue to impair the Department's ability to accumulate, analyze, and present reliable financial information. These weaknesses are primarily due to the absence of certain components of a fully integrated financial management system. Specifically, FMSS is not used to produce a general ledger trial balance at the reporting group level or at a consolidated level, and certain transactions continue to be recorded in FMSS to incorrect general ledger accounts. To address the weaknesses identified with FMSS, the Department is in the process of implementing a replacement for the general ledger software package. In the interim, the Department has had to rely on manual adjustments to correct discrepancies and has acquired a tool to assist in consolidating and reporting financial results.

It was noted that the Department no longer identified the financial reporting weakness as material in its Federal Managers' Financial Integrity Act (FMFIA) report for fiscal year 2000; however, the financial management system was identified as a material non-conformance. We continue to believe that until a new financial management system is fully operational and working effectively, additional focus on financial reporting is needed.

The following provides examples of issues encountered during our review of the Department's financial statements and the related process surrounding the preparation of its financial statements:

General Ledger

As discussed in prior reports, one of the significant weaknesses in the reporting process relates to the Education Central Automated Processing System (EDCAPS) general ledger software package, FMSS. As a result of system deficiencies, the Department must devote a significant amount of resources to preparing its financial statements. FMSS is not used to produce a trial balance by reporting group or at the consolidated level. Instead, FMSS generates trial balances at the appropriation level. The Department has approximately 200 appropriations. The Department acquired a tool, the Visual Basic System, which was used to produce the financial statements at the reporting group and consolidated levels. The efforts of the Department have partially compensated for, but did not correct, certain aspects of the material weakness in the financial reporting process.

As previously noted, the Department performed extensive analysis of general ledger account balances during fiscal year 2000 in an effort to resolve errors that existed in prior years. In addition, the Department continues to experience weaknesses in the FMSS Document Type Standard Accounting Event (DOC SAE), which is a set of accounting code combinations used to facilitate correct posting. These weaknesses were also addressed through manual entries prepared by the Department. As a result of these procedures, the Department prepared a large number of manual adjustments to correct balances reported in the general ledger. We were unable to obtain a log prepared during the year of all manual adjustments that were prepared and proposed for posting to FMSS during fiscal year 2000.

Since adequate historical records were not always available, in some cases adjustments were made based on the best available data and management's reasoned judgment as to the most likely cause of the discrepancies. While this adjustment process appears to have been pragmatic given the circumstances, the Department was unable to provide sufficient documentation to support the adjustments. In addition, the use of manual adjustments increases the risk that errors may occur. For example, we noted errors in certain manual adjustments that had been processed and approved by the Department. These errors resulted in additional manual adjustments being posted to the financial statements to correct errors made in other manual adjustments, calling into question the sufficiency of the adjustment preparation, review, and approval process.

Financial reporting is a key management control. OMB Circular A-123, *Management Accountability and Control*, defines management controls as "the organization, policies, and procedures used to reasonably ensure that (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported and used for decision making." Given the system weaknesses identified above, the Department needs to strengthen its financial reporting in order to ensure full compliance with OMB Circular A-123.

Financial Statement Preparation

As discussed earlier, due to the general ledger deficiencies described above, the Department developed an in-house product termed the Visual Basic System to interface with FMSS and provide the Department with the capability of producing financial statement reports at both the major reporting group and consolidation levels. The financial statement balances from the Visual Basic System were then transferred to a spreadsheet, which was used to prepare all the required statements under OMB Bulletin No. 97-01. Within Visual Basic, the Department posted over 275 adjustments in order to generate a trial balance for each of the approximately 200 appropriations.

The financial statements initially provided to us had line items with balances different from that which would normally be anticipated. For example, initially, cash and other monetary assets on the balance sheet reported a credit balance when the account normally would be expected to have a debit balance, while other governmental liabilities and cumulative results of operations reflected unusually large balances. In addition, other program expenses on the statement of net cost reported a credit balance when the account would normally be expected to have a debit balance. Adjustments were made to the financial statements to correct those line items that reflected balances different than anticipated. In some instances, we also noted that adjustments pertaining to prior year activity were posted as current fiscal year activity in the financial statements. Management did not sufficiently research the cause behind those balances that were being reported differently than normally anticipated on the financial statements. Unusual balances may indicate that transactions were not posted correctly to the accounting records.

OMB Circular A-123 states: "Transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

Additional Compensating Controls Need to be Strengthened

The U.S. General Accounting Office's *Standards for Internal Control in the Federal Government* states that internal control activities help ensure that management's directives are carried out. The control activities should be effective and efficient in accomplishing the agency's control objectives. Examples of control activities include: top level reviews of actual performance, reviews by management at the functional or activity level, segregation of duties, proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal control.

Since significant weaknesses exist in the Department's general ledger system, management must compensate for the weaknesses by implementing and strengthening additional controls to ensure that errors and irregularities are detected in a timely manner. Management has taken additional steps to compensate for system weaknesses, but further efforts are needed as discussed below.

Account Analysis and Reconciliations

The Department's procedures for account analysis and reconciliations are evolving. We noted improvements for fiscal year 2000, such as the analysis of general ledger account balances performed by the Department. However, we also noted additional room for improvement. For example, the original balance in other governmental liabilities covered by budgetary resources was approximately $900 million, which represented a significant increase over the prior year balance. The majority of this amount, which pertained to the Federal Family Education Loan (FFEL) Program, should have been classified as a payable to Treasury. As a result of our audit, adjustments were made to reclassify the account balances reported on the balance sheet to the proper line items. Had the Department performed periodic analysis of its general ledger accounts, this error could have been identified and corrected by management. Additional issues with respect to reconciliations are discussed in greater detail in the material weakness regarding reconciliations.

Review for Duplicate Payments

The Grant Administration and Payment System (GAPS) is used by grantees to submit drawdown requests, via the Internet, to the Department. The transactions are electronically accumulated and transmitted to FMSS, the Department's general ledger system. We were informed by management that the Department processed duplicate transactions, causing payments to be issued twice for the same funding request. Management indicated that there were six known instances of duplicate payments totaling $154 million during fiscal year 2000, including an item for $125 million in October 1999. In addition, one known immaterial duplicate payment has occurred in fiscal year 2001. The funds have been accounted for in these instances and appropriately reflected in the financial statements. The Department's Office of Inspector General (OIG) is performing additional work to identify possible duplicate payments from the inception of GAPS in May 1998 through September 2000. In addition, the General Accounting Office is currently conducting a series of procedures intended to help identify improper payments.

Segregation of Duties

In the prior year, we noted that several individuals within the Impact Aid Grant Program were able to process drawdown requests for funds and subsequently approve their own processing of the drawdown request. This year we noted that one individual retained these multiple conflicting functions. One individual does have the capability to initiate payment requests, approve payment requests, and subsequently batch the requests and authorize payment by the finance department. This individual is also responsible for providing users with access to the Impact Aid feeder system. Inadequate segregation of duties in sensitive areas, such as payment processing, can greatly increase the risk of errors or irregularities, result in noncompliance with the requirements of the Impact Aid program under Title VIII of the Elementary and Secondary Education Act, as amended, or result in noncompliance with the Department's policies and procedures, as well as Federal regulations.

In addition, we noted that there is a lack of segregation of duties in the current procedures to transfer GAPS drawdown requests to the Federal Reserve Bank (FRB) via the "Fedline" system. GAPS drawdown requests are compiled and transferred to a diskette that is then transmitted to the FRB for payment. Through discussion with Department personnel, we noted that five employees are able to perform each of the following functions: creating the diskette, reviewing the file, transmitting the file to the FRB, and reconciling GAPS activity to the FRB. Management is not aware of any instances where these employees have performed these incompatible functions at one time. Additionally, the diskette is not protected from alteration; any of the file contents can be changed by the user, including bank account information. The Department is exploring a "write-once" technology for payment transfer that would reduce exposure in this area. Also, we observed a control log and noted that employees frequently signed for other employees. As previously noted, inadequate segregation of duties and unauthorized access can greatly increase the risk of errors or irregularities. In fiscal year 2000, over $40 billion of GAPS drawdown requests were transmitted to FRB for payments.

Recommendations:

We recommend that the Department of Education perform the following:

1. Complete the implementation plan for the replacement of the general ledger software package and ensure the transition occurs in a timely and documented manner. In addition, the Department should ensure that the new general ledger software package will meet its financial reporting needs, including an automated closing process and interim reporting capabilities, thereby facilitating the preparation of financial statements by reporting group and at the consolidated level.

2. Develop and enhance procedures for account analysis to ensure that periodic analyses are completed that will detect errors and irregularities in a timely manner.

3. Enhance policies and procedures surrounding the preparation and review of adjustments and provide training to ensure that individuals preparing and reviewing the adjustments receive sufficient guidance to meet financial reporting objectives.

4. Search for duplicate payments and research improper payments that are identified. In addition, the Department should enhance its current control procedures to ensure that duplicate payments are prevented and/or detected in a timely manner.

5. Review and enhance current policies and procedures for controlling the disbursement process. The policies and procedures should ensure that an adequate segregation of duties exists, supervisory reviews are appropriately implemented, and all transactions are properly processed and supported with documentation.

6. Assess the roles and responsibilities of each Departmental office (including OCFO, SFA, and Budget Service) involved with the financial reporting process to ensure that appropriate resources and tools are available to achieve the financial reporting objectives established by management.

2. Reconciliations Need to be Improved (Repeat Condition)

A major objective of internal control is to ensure the integrity of the underlying accounting data supporting the financial statements. An important control in this regard is the reconciliation of the Department's accounting records. An adequate reconciliation provides the assurance that processed transactions are properly and timely recorded in the Department's accounting records and financial statements, which then allows management the ability to analyze its financial condition and results of operations on a routine basis.

Strong internal control over the reconciliation process helps ensure the timely detection and correction of errors in underlying accounting records. The Department's performance of reconciliations in fiscal year 2000 was inconsistent. For example, while reconciliation processes appear to be better developed for the Direct Loan area, we noted other areas in which the Department did not perform proper or timely reconciliations of its financial accounting records throughout fiscal year 2000. In addition, evidence of supervisory review was not always documented on the reconciliations that were performed. In some instances, we noted that the Department adjusted its general ledger to reflect the balances per the subsidiary records, without sufficiently researching the cause of the differences. The following provides examples in which reconciliations were not performed properly or on a timely basis:

- The Department has had difficulty identifying and resolving differences between its accounting records and cash transactions reported by the U.S. Department of the Treasury for several years. In addition, during fiscal year 2000, the Department processed a significant number of manual adjustments in an effort to correct errors and unreconciled differences from prior fiscal years. Since adequate historical records were not always available, in some cases adjustments were made based on the best available data and management's reasoned judgment as to the most likely cause of the discrepancies. While this adjustment process appears to have been pragmatic given the circumstances, the Department was unable to provide sufficient documentation to support the adjustments.

  Certain unreconciled differences continue to remain unresolved in fiscal year 2000. Consistent with the prior year, the Budget Clearing account (F3875), which reflects a credit balance of approximately $63 million as of September 30, 2000, and the suspense account (91F3885), which reflects a debit balance of $117 million as of September 30, 2000, have not been fully reconciled as of the date of this report. Although the Department indicates that the activity in these accounts relates to reclassifications of amounts between appropriations and timing differences, the documentation provided to support these differences was not sufficient. Management has not yet determined the final resolution of these amounts. In addition, based on the Department's reconciliation of its general ledger to subsidiary records, a net amount of $213 million was identified by management as excess cash from prior years as of September 30, 2000. The Department plans to transfer the excess cash into a Treasury receipt account. These funds will be available to the Department until the end of fiscal year 2001, if the Department determines that adjustments are needed based on additional reconciliation efforts. Also, as of the date of this report, the Department is unable to resolve or provide adequate explanation for deficiencies of $56 million in three appropriations. The Department believes that the deficiencies may be associated with the unreconciled amounts in the Budget Clearing account and the suspense account. The Department does not believe that it is anti-deficient.

Although this issue remained a material weakness for fiscal year 2000, the Department has made progress in its reconciliation efforts. For example, the Department developed and implemented a reconciliation tool that facilitated the reconciliation process by identifying differences between FMSS and the U.S. Department of the Treasury. This assisted in the overall reconciliation efforts of Fund Balance with Treasury. Specifically, this tool enabled the Department to perform Fund Balance with Treasury reconciliations more efficiently during the fiscal year. The Department also began performing some reconciliations periodically during fiscal year 2000, subsequent to the implementation of the reconciliation tool.

- The Grant Administration and Payment System (GAPS) is used by grantees to submit drawdown requests, via the Internet, to the Department. The transactions are electronically accumulated and transmitted to FMSS, the Department's general ledger system. Accordingly, the expenditure and drawdown data reported in GAPS should be equal to the expenditures and drawdown amounts reflected in FMSS. However, during our testing of grant expenditures, we noted that the Department did not perform routine reconciliations of its grants subsidiary ledger, GAPS, with the FMSS general ledger during fiscal year 2000. Although the Department did perform several reconciliations during the year, they were not performed routinely or timely, since procedures for reconciling GAPS to FMSS were evolving and have not yet been fully developed or implemented. In addition, we noted that as of the date of this report, reconciliations for October and November 2000 had not been completed. However, the Department did implement automated transaction comparison checks for discrepancies between GAPS and FMSS beginning July 31, 2000.

  As part of our review of the reconciliation of GAPS to FMSS, we compared total fiscal year 2000 grant expenditures recorded in GAPS to the total grant expenditures recorded in FMSS for financial statement preparation purposes. We noted a difference between grant expenditures recorded on GAPS and those recorded on the financial statements. The Department indicated that certain grant transactions that affect the financial statements are not recorded in GAPS, that some grant activity does not flow through GAPS, and that some GAPS activity does not affect grant expenses on the financial statements. As discussed earlier, the Department posted various manual entries in connection with the correction of errors from prior years. Certain of these manual entries flowed through grant expense.

  The Department recorded approximately $100 million in accounts receivable for several appropriations that reflected negative undelivered orders balances. These negative balances were carried forward from the predecessor system to GAPS, the Payment Management System (PMS). Unlike GAPS, PMS allowed grantees to draw down funds in excess of available obligated balances. The Department believes this resulted in the creation of negative undelivered orders. Some of the negative balances dated back to fiscal year 1992 appropriations. The Department was unable to provide adequate evidence to support the validity of the receivable. The Department has established an allowance account against the receivable.

The Department has not yet fully developed formal policies and procedures surrounding the processing of grant disbursements. In addition, the Department has not developed formal reconciliations and/or has not developed formalized supervisory reviews of GAPS information to certain feeder systems. For example, the Impact Aid system has informal, ad hoc reconciliations performed with no review process, while the reconciliations for the Campus Based system and the discretionary grant system are prepared on a regular basis but include no formal review and approval process.

- For fiscal year 2000, a comparison of the loans receivable balance in the general ledger to the balance in the Debt Collection Management System was performed by management, which resulted in an immaterial difference. Although reconciliations have been performed, formal policies and procedures are not in place to assure the reconciliations are performed on a routine basis.

- The statements of budgetary resources and financing are two of the principal statements required by OMB Bulletin No. 97-01. As disclosed in the notes to the financial statements, we noted that the Department recorded adjustments of approximately $800 million to beginning obligated balances and adjustments of over $600 million to beginning unobligated balances. These prior period adjustments were the result of an analysis to align budgetary sources and uses performed by the Department. As previously stated, adequate historical records were not always available, so in some cases adjustments were made based on the best available data and management's reasoned judgment as to the most likely cause of the discrepancies. While this adjustment process appears to have been pragmatic given the circumstances, the Department was unable to provide sufficient documentation to support the adjustments.

  Although the amounts were smaller than in prior years, we also noted differences between balances recorded in budgetary accounts and their related proprietary accounts. For example, we initially noted differences between unexpended appropriations on the balance sheet and related budgetary accounts. Management has recorded adjustments to align the account balances, although sufficient documentation to support the differences was not provided as of the date of this report.

It was noted that the Department no longer identified the reconciliation weakness as material in its Federal Managers' Financial Integrity Act (FMFIA) report for fiscal year 2000.

Recommendations:

We recommend that the Department of Education perform the following:

1. Update current policies and procedures surrounding reconciliations of all significant accounts and programs, including budgetary accounts and the reconciliation of subsidiary ledgers or feeder systems to FMSS. These policies and procedures should be specific in order to provide sufficient guidance to the Department's personnel. The Department should review its policies and procedures on a regular basis to ensure that they remain current and are achieving management's objectives.

2. Perform reconciliations of all significant accounts and programs, both proprietary and budgetary, on at least a monthly basis. Reconciliations should also be performed between subsidiary ledgers or feeder systems and FMSS on a monthly basis. The reconciliations should include documentation of the research performed and the resolution of the issue. All differences identified should be researched and resolved in a timely manner. In addition, a supervisory review of the reconciliations should be performed. Pertinent reconciliations performed by SFA and other Department offices should be coordinated with the Financial Management Office within OCFO.

3. Resolve unreconciled differences specific to the Budget Clearing and suspense accounts on a timely basis. In addition, determine the disposition of the funds that will be placed in the Treasury receipt account.

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

In connection with the annual audit of the Department's fiscal year 2000 financial statements, we conducted a controls review of the information technology (IT) processes related to the significant accounting and financial reporting systems. These systems included: Education Central Automated Processing System (EDCAPS), National Student Loan Data System (NSLDS), Direct Loan Servicing System (DLSS), Federal Family Education Loan System (FFEL) and the Campus Based System (CBS). 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.

During fiscal year 2000, the Department has made progress in strengthening controls over information technology processes. The implementation of new controls and the reinforcement of existing controls increased the effectiveness of internal controls in areas such as IT planning and security management. Among others, the Department has implemented its IT architecture framework, finalized the EDCAPS security plan, initiated EDCAPS user revalidation procedures, implemented monitoring of security parameters on EDCAPS UNIX servers, and enhanced logging and review of Oracle security events. However, we find that continuous effort is needed to further address control weaknesses related to information technology and systems, particularly in the following areas:

- The Department has not finalized the development, documentation, and testing of the disaster recovery plan, which is a critical subset of a comprehensive business continuity plan, for the EDCAPS related business processes and systems. Without documented and tested business continuity and disaster recovery plans, the Department may experience difficulties in the timely restoration of EDCAPS, thereby preventing resumption of business in an adequate manner.

- The Department has not implemented comprehensive logging and monitoring controls for the Windows NT platform that supports EDCAPS. Without an effective security monitoring process, unauthorized access or other security relevant events may not be detected and resolved timely.

- The Department has not fully implemented a system software change management process. Without effective controls over system software changes, there is an increased risk that modifications are not adequately authorized, tested, and documented.

- As reported in its Federal Managers' Financial Integrity Act Report (FMFIA) for fiscal year 2000, the Department needs to strengthen its Information Technology Security Program to address security weaknesses identified in audits conducted by the OIG, including an audit of the Department's network infrastructure. Specifically, the Department needs to complete its corrective action plan to ensure that all mission critical systems have adequate security plans and that corrective actions are taken to mitigate known exposures identified in OIG and management security reviews.

The material weaknesses previously discussed regarding financial management systems, financial reporting, and reconciliations indicate that internal control within the Department is evolving and requires additional improvement. The lack of compensating manual controls increases the need for strong information technology controls to ensure the integrity and security of the Department's data.

Recommendations:

The Department of Education should perform the following:

1. Finalize development of the business continuity and disaster recovery plans for the EDCAPS applications and the underlying infrastructure. Once developed, the plans

should be tested and updated regularly to assess their effectiveness.

2. Finalize the implementation of effective logging and monitoring controls for the Windows NT platform that supports EDCAPS to allow effective detection and resolution of security relevant events.

3. Strengthen the system software change management process to provide effective controls over authorization, testing and documentation of system software changes.

4. Complete corrective actions on the information technology security program noted in the fiscal year 2000 FMFIA report.

REPORTABLE CONDITIONS

4. Improvement of Financial Reporting Related to Credit Reform is Needed (Modified Repeat Condition)

The Federal Credit Reform Act of 1990, as amended, was enacted to require agencies to more accurately measure an agency's cost of federal loan programs. As part of implementing the requirements of the Credit Reform Act, 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. The estimated cost is referred to as the subsidy cost, which is reported as part of the allowance under the Direct Loan program or part of the loan liability estimate for the FFEL program. For the Department and SFA, the subsidy costs, and related allowance and loan liability estimates are significant amounts. As a result of our testing, we noted that the management controls surrounding the calculation and reporting of the loan liability activity and subsidy estimates could be improved. OMB Circular A-123 defines management controls as "the organization, policies, and procedures used to reasonably ensure that (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported and used for decision making."

During our testing of the loan liability and subsidy costs estimates, we noted the following items that indicate management controls need to be strengthened:

- An adjustment for approximately $751 million was needed to record a payable to Treasury. However, this amount was inappropriately recorded in a different liability account and identified during our review of the other account balances in the financial statements. As noted above, this item should have been detected and corrected earlier through an effective financial statement development and review process, an effective review of loan program accounts and analysis of expected general ledger account relationships, particularly activity reflected in the FFEL liability accounts (general ledger account 2180). In the Department's efforts to correct its accounting records for errors made in prior years, the Department incorrectly classified the amount in the current fiscal year's financial records.

As required under the Credit Reform Act, the Department maintains a program account, a financing account, as well as a liquidating account. The financing account (X4251) consists of cash collected from subsidy transfers, offsetting collections, and earned interest retained for future program claims. The liquidating account pertains to cash flows for loans that were made prior to fiscal year 1992. The $751 million should have been reported in the liquidating account in the prior fiscal year. Under the Credit Reform Act of 1990, as amended, unobligated balances of liquidating funds that are in excess of current needs are to be returned to the U.S. Department of Treasury as of September 30 each year. However, the Department is unable to support the fact that the Department does not need the funds and therefore, based on OMB instruction, the funds should not yet be returned to the Department of Treasury. For financial reporting purposes, the Department has established a payable to the Department of Treasury for this amount. Additionally, excess funds of $889 million in the FFELP liquidating account were identified subsequent to the last cash transfer returned to Treasury for fiscal year 2000. In consultation with its General Counsel and OMB, the Department concluded that the delay in repayment to Treasury did not constitute a violation of the Credit Reform Act. Not withstanding such determination, as noted earlier, effective financial reporting and reconciliation activities are needed to identify such amounts on a timely basis.

OMB Circular No. A-123 also requires that "documentation for transactions, management controls, and other significant events must be clear and readily available for examination." If management performed a regular review of the activity in this account and reconciled activity by object class to subsidiary records, the Department would be better positioned to identify, explain, and support any adjustments made to the loan liability estimate. This process becomes increasingly important as management has begun recording changes and new subsidy estimates for current year activity rather than reflecting the aggregate subsidy in liability and allowance general ledger accounts as the product of the subsidy model on a cumulative basis for all future periods.

- Existing policies and procedures, specific to the calculation of the subsidy costs and the related allowance and loan liability estimates, do not clearly define roles and responsibilities of each organization (OCFO, SFA, and Budget Service) involved in the financial reporting of these amounts. For example, although it is clear that Budget Service is responsible for managing the Department's program budget, policy, and legislative development, which includes calculating the subsidy costs associated with the Department's loan programs, it is unclear as to which organization is monitoring the activity of the general ledger account, performing routine reconciliations of account activity to loan program systems or extracts, preparing supporting documentation for adjustments, or providing the explanations with regard to changes that occur from one year to the next year in the loan liability estimate. Without formalized written policies and procedures documenting each aspect of the estimation process, and without the use of quality assurance and validation checks for all aspects of the estimation process, the Department increases its risk that the estimation process may not be performed in a consistent manner, thereby increasing the likelihood for errors to occur. In light of interrelationships between activity reflected in the accounting and loan subsidiary records and amounts used in the development and recording of subsidy estimates, each of the above organizations must understand the subsidy estimation process, and the inputs to the Department's records, to ensure that the financial reporting and model estimating processes are appropriately executed in order to achieve management's objectives.

- The estimates of cash flows developed by the subsidy models can, when critically assessed against actual data in the Department's accounting and loan subsidiary systems, provide a key detect control for the Department in assessing not only the quality of subsidy estimates and emerging trends but also provide information useful in determining whether further research into the appropriateness of cash flow and other data in the Department's records is needed. For example, the estimated defaults projected under the FFEL program for fiscal year 2000 based on the subsidy models are significantly higher than the defaults reflected in the Department's records. While the Department is continuing to research relationships in the data developed on an aggregate basis in "back casting" the subsidy estimates against actual results, a standard actuarial technique, analysis of the data on a disaggregated basis is less well developed and may be key in determining the reasons for variances from expected relationships in the data. Fully implementing back casting analysis of the subsidy estimates on a disaggregated basis, with OCFO, SFA, and Budget Service working together to analyze the results is appropriate.

- The Department does not have significant history of repayment data or historical trend analysis available to support the assumptions used for defaults, repayments, and other cash flows for loans that have been classified as consolidated. This is mainly attributable to the fact that consolidated loans are relatively new to the Department. In addition, the Department is not easily able to identify all cash flows related to consolidations in order to sufficiently develop the payment history of these loans. While not readily quantified by the Department, the cash flows from consolidations appear to have played a significant role in the reestimate process. Changes in these assumptions may have a significant impact on the estimate in the future as additional data is developed. Early identification of trends, particularly in moving borrowers between the FFEL and Direct Loan programs and information regarding default risks of the consolidations is important. Data on the types of loans that are being consolidated, and whether there are trends developing which could significantly impact the subsidy projections is needed to help manage risks to the Department and ensure that appropriate budget and accounting estimates are prepared.

Recommendation

We recommend that the Department perform the following:

1. Perform a detailed analysis and review of the activity that flows through the general ledger accounts specific to the subsidy costs and related allowance and loan liability estimates. Such analysis should be performed on a quarterly basis and should include a reconciliation between the general ledger account 2180 and the data submitted by the guaranty agencies.

2. Enhance the current formal written policies and procedures to include documentation of roles and responsibilities of each organization, OCFO, SFA and Budget Service, involved with the financial reporting process of the subsidy costs and the related loan liability and allowance estimates.

3. Incorporate the backcast process into periodic comprehensive analyses of the subsidy estimates to be performed on a disaggregated basis with OCFO, SFA, and Budget Service working together to analyze the results of all aspects regarding the subsidy estimates, including the cash flows projected and recorded from the loan programs and their impact on any comparison between the programs.

4. Gather data in a manner that will enable the Department to better monitor and report on consolidations.

5. Emphasize in appropriate external communications regarding the subsidy estimates, including significant financial and budgetary reports and presentations, the sensitivity of the estimates to changes in assumptions, and the need to fully understand the impact that projected consolidations can have on the estimates and cash flows from the loan programs and their impact on any comparison between the programs.

5. Reporting and Monitoring of Property and Equipment Needs to Be Improved (Modified Repeat Condition)

We noted improvement in several items identified in the prior year reportable condition. For example, the Department began phasing in a capitalization policy for property and equipment. For fiscal year 2000, the Department implemented the bulk purchases portion of the capitalization policy. The policy requires bulk purchases with an acquisition cost of $500,000 or more to be capitalized, with costs depreciated over the useful life of the purchases. Beginning in fiscal year 2001, the Department will implement a capitalization policy for single item purchases.

However, we continued to note several issues surrounding the monitoring and reporting of property and equipment. For example, it appears that the Department may not be adequately capturing all items that should be capitalized. The Department reviewed capitalized equipment object class expense categories to calculate the amount of property, plant and equipment recorded on the financial statements. However, the Department did not review expenditures classified as "equipment not capitalized," incurred for the purchase of property and equipment, to determine if these items should have been capitalized.

Consistent with the prior year, we noted several internal control issues surrounding the Department's efforts in safeguarding and reporting of property and equipment; however, the Department has made improvement in some areas. For example, we noted in the prior year that the Department had not taken a complete, comprehensive physical inventory of property and equipment for at least the past two years. During fiscal year 2000, the Department hired an outside contractor to perform a comprehensive inventory observation as of September 30, 2000; however, as of the date of this report, unreconciled differences remain between the results of the inventory observation and the Department's records maintained in the Asset Management System (AMS) and Asset Inventory Management System (AIMS), and we were unable to obtain a reconciliation as of the end of our fieldwork.

The Department implemented the AMS inventory tracking software package during FY 2000. Because the software is in the beginning stages, inventory controls for property and equipment have not yet been fully implemented. For example, no purchase price information or purchase order documentation is currently recorded in the system, although the Department plans to begin recording this information in FY 2001. Additionally, the Department does not have standardized policies and procedures in place for the receipt of property and equipment, which potentially increases the risk that assets will not be appropriately accounted for or tracked.

According to OMB Circular A-123, "Management controls must provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. Management controls developed for agency programs should be logical, applicable, reasonably complete, and effective and efficient in accomplishing management objectives." The full implementation of a capitalization policy and the performance of an annual physical inventory would strengthen the Department's adherence with the requirements of OMB Circular A-123.

Recommendations:

We recommend that the Department of Education perform the following:

1. Perform a comprehensive review of all expense categories related to property and equipment to ensure that all items are appropriately capitalized in accordance with the Department's capitalization policy. In conjunction with this review, determine whether any contractor-held property must be tracked for accountability purposes or recorded as an asset.

2. Perform annual physical inventories of all accountable property and reconcile any discrepancies between the inventory results and the Department's internal records. Develop policies and procedures to adequately document the results of this process.

3. Develop and implement standard Department-wide policies and procedures for the receipt and tracking of property and equipment to ensure that the Department maintains adequate accountability over assets.

STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the fiscal year 1999 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:

Figure 1: Summary of FY 1999 Material Weaknesses and Reportable Conditions

Issue Area	Summary Control Issues	FY 2000 Status
Financial Reporting Needs to Be Strengthened (Material Weakness)	Significant weaknesses in the Department's financial reporting processes existed as a result of the EDCAPS general ledger software package, Financial Management System Software (FMSS).	Improvements Noted – Repeat Condition Material Weakness
Reconciliations Need to Be Improved (Material Weakness)	The Department did not perform proper or timely reconciliations of its financial accounting records.	Improvements Noted - Repeat Condition Material Weakness
Controls Surrounding Information Systems Need Enhancement (Material Weakness)	Improvements are required in security over financial systems and in disaster recovery capabilities.	Improvements Noted – Repeat Condition Material Weakness
Improvement of Credit Reform Reporting is Needed (Material	The Department did not account for transactions in accordance with the Federal Credit Reform Act of 1990.	Improvements Noted – Considered a

Weakness)		Reportable Condition
Documentation Supporting Obligations, Undelivered Orders and Unobligated Balances Needs to be Improved (Reportable Condition)	Balances reported in subsidiary records for allotments, obligations incurred, undelivered orders, and the unobligated balances of funds were inconsistent with balances reported on the financial statements.	Not Considered Reportable Condition – Issues Reported in the Management Letter
Communication and Coordination Efforts Need to be Improved for Financial Management (Reportable Condition)	The Department needs to improve its communication and coordination efforts among offices that are responsible for providing information in support of financial reporting.	Not Considered a Separate Reportable Condition – Integrated within other internal control issues as appropriate
Documentation Supporting Accounts Payable, Accrued Liabilities, and Expenditures Needs to be Improved (Reportable Condition)	The Department needs to improve its supporting documentation over liabilities and expenditures, subsidiary ledger system requirements, and refine the grant liability estimation methodology.	Not Considered Reportable Condition – Issues Reported in the Management Letter
Reporting and Monitoring of Property and Equipment Needs to be Improved (Reportable Condition)	The Department does not capitalize purchases of property and equipment and software. In addition, there are several internal control issues surrounding the Department's efforts in safeguarding and reporting property and equipment.	Improvements Noted – Repeat Condition Reportable Condition

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 reportable conditions described above, we noted certain other matters involving internal control and its operations that were reported to management in a separate letter dated January 26, 2001.

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

January 26, 2001
Washington, D.C.

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Report on Compliance with Laws and Regulations

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2000, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources and financing for the fiscal year then ended, and have issued our report thereon dated January 26, 2001. The report noted certain matters that resulted in a qualification of our opinion on the consolidated balance sheet, and related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources and financing.

Except for the matters discussed in the third and fourth paragraphs of the Report of Independent Auditors, 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. 01-02, *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. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department. We caution that noncompliance may occur and not be detected by the tests performed and that such testing may not be sufficient for other purposes.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed the following instance of noncompliance with laws and regulations that is required to be reported under Government Auditing Standards and OMB Bulletin No. 01-02.

The Department was not in full compliance with the Information Technology Management Reform Act (ITMRA – Clinger-Cohen Act). Specifically, the Department has not fully implemented a capital planning and investment process. As of September 2000, the Office of the Chief Information Officer is continuing to implement the corrective actions identified in the corrective action plan designed to address the Department's noncompliance.

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 instances of noncompliance:

- Material weaknesses identified in the Department's current financial management system impair the Department's ability to accumulate, analyze, and present reliable financial information. These weaknesses are primarily due to the absence of certain components of a fully integrated financial management system, and include deficiencies in the current general ledger system and manual adjustment process. Certain other financial management controls, such as reconciliation processes, are continuing to evolve.

- The Department has not finalized comprehensive business continuity and disaster recovery plans for the Education Central Automated Processing System (EDCAPS). In addition, as reported in its Federal Managers' Financial Integrity Act (FMFIA) report for fiscal year 2000, the Department needs to strengthen its Information Technology Security Program to address security weaknesses identified in audits conducted by the Office of Inspector General. These weaknesses are significant departures from requirements specified in OMB Circular A-130, *Management of Federal Information Resources*.

The Report on Internal Control includes information related to the financial management systems and accounting standards that were found not to comply with the requirements of FFMIA. 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 generally concurs with our findings and recommendations and to the extent findings and recommendations were noted in prior years has provided a proposed action plan to the Office of Inspector General in accordance with applicable Department directives.

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.

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

January 26, 2001
Washington, D.C.

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

FEB 26 2001

MEMORANDUM

To: Lorraine Lewis
Inspector General

From: Mark Carney Mark Carney
Deputy Chief Financial Officer

Subject: DRAFT AUDIT REPORTS
Fiscal Year 2000 Consolidated Financial Statement Audit
ED-OIG/A17-A0002

On behalf of the Department of Education (Department), I would like to thank you for the opportunity to review copies of the subject draft reports prepared by Ernst & Young LLP. We thoroughly reviewed and held conversations with Ernst & Young LLP on the documents. Our questions and concerns were resolved to everyone's satisfaction.

Therefore, in my capacity as the Deputy Chief Financial Officer, performing the duties of the Chief Financial Officer, I concur with the audit findings and related recommendations.

Please convey my sincerest appreciation to everyone on your staff who worked so diligently on this year's audit of the Department's Financial Statements. Certainly, under the circumstances, we are pleased with the overall outcome, but realize there is more to be done.

We will share the audit results with responsible senior officials, other interested program managers, and staff while requesting their corrective action plans for the resolution of the material weaknesses cited in the report.

Again, thank you for all the work that brought us to a timely audit conclusion. Please feel free to contact me at 401-3892 if you have any questions.

Cc: Philip Link, Executive Secretariat, Office of the Secretary
Thomas P. Skelly, Director of Budget Service, Office of the Under Secretary
William Graham, Director of Cost Estimation and Analysis Division
Greg Woods, Chief Operating Officer, Office of Student Financial Assistance
James Lynch, Chief Financial Officer, Office of Student Financial Assistance
Linda Paulsen, Deputy Chief Financial Officer, Office of Student Financial Assistance
Craig Luigart, Chief Information Officer, Office of the Chief Information Officer
Willie Gilmore, Director, Office of Management
Terry Bowie, Director of Financial Management Operations, Office of the Chief Financial Officer

APPENDIX A

Glossary

BUF	Better Use of Funds
CAMP	College Assistance Migrant Program
CAROI	Cooperative Audit Resolution and Oversight Initiative
CHAFL	College Housing and Facilities Loan Program
CSRD	Comprehensive School Reform Demonstration
CSRS	Civil Servant Retirement System
DLP	Direct Loan Program
DOL	Department of Labor
ECI	Early Childhood Development and Education
ED	U.S. Department of Education
EDCAPS	Education Central Administrative Processing System
EDNet	Education Network
EFT	Electronic File Transfer
ESEA	Elementary and Secondary Education Act
EUCA	Emergency Unemployment Compensation Act
FAFSA	Free Application for Federal Student Aid
FASAB	Federal Accounting Standard Advisory Board
FDLP	Federal Direct Loan Program
FECA	Federal Employees Compensation Act
FERS	Federal Employment Retirement System
FFEL	Federal Family Education Loan
FFELP	Federal Family Education Loan Program
FIPSE	Fund for the Improvement of Postsecondary Education
FMFIA	Federal Managers Financial Integrity Act
FMSS	Financial Management System Software
GAAP	Generally Accepted Accounting Principles
GAO	General Accounting Office
GAPS	Grant and Administrative Payment System
GED	General Education Degree
GMRA	Government Management Reform Act
GPRA	Government Performance and Results Act
HBCU	Historically Black College and University
HEA	Higher Education Act
IASA	Improving America's Schools Act
IPOS	Institutional Participation and Oversight Service
IT	Information Technology
MIS	Media and Information Services
NAEP	National Assessment of Educational Progress
NIDRR	National Institute on Disability and Rehabilitation Research
NLE	National Library of Education

NPRG	National Partnership for Reinventing Government
OBEMLA	Office of Bilingual Education and Minority Languages Affairs
OESE	Office of Elementary and Secondary Education
OERI	Office of Educational Research and Improvement
OIG	Office of the Inspector General
OMB	Office of Management and Budget
OME	Office of Migrant Education
OPE	Office of Postsecondary Education
ORAD	Office of Reform Assistance and Dissemination
OSEP	Office of Special Education Programs
OSERS	Office of Special Education and Rehabilitative Services
OVAE	Office of Vocational and Adult Education
PBO	Performance Based Organization
PPI	Policy Planning and Innovation
PUBS	Publications
RSA	Rehabilitation Services Administration
SIP	School Improvement Programs
SFA	Student Financial Assistance
TFM	Treasury Financial Manual
TIMSS	Third International Mathematics and Science Study

APPENDIX B

Index of U.S. Department of Education Offices Web Sites:

Office of the General Counsel	http://www.ed.gov/offices/OGC/
Office of Inspector General	http://www.ed.gov/offices/OIG/
Office of Legislation and Congressional Affairs	http://www.ed.gov/offices/OLCA/
Budget Office	http://www.ed.gov/offices/OUS/budget.html
Office of the Under Secretary Planning and Evaluation Services	http://www.ed.gov/offices/OUS/PES/
Office of Management	http://www.ed.gov/offices/OM/
Office of the Chief Information Officer	http://www.ed.gov/offices/OCIO/
Office of the Chief Financial Officer	http://www.ed.gov/offices/OCFO/
Office of Student Financial Assistance Program	http://www.ed.gov/offices/OSFAP/
Direct Loans	http://www.ed.gov/offices/OSFAP/DirectLoan/
Direct Consolidation Loan Program	http://loanconsolidation.ed.gov
Office of Elementary and Secondary Education	http://www.ed.gov/offices/OESE/
Office of Educational Research and Improvement	http://www.ed.gov/offices/OERI/
Office of Vocational and Adult Education	http://www.ed.gov/offices/OVAE/
Office of Postsecondary Education	http://www.ed.gov/offices/OPE/
Office of Bilingual Education and Minority Languages Affairs	http://www.ed.gov/offices/OBEMLA/
Office of Special Education and Rehabilitative Services	http://www.ed.gov/offices/OSERS/
Office for Civil Rights	http://www.ed.gov/offices/OCR/

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