



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

FEB 28 2001

**MEMORANDUM**

TO: James Lynch  
Chief Financial Officer, Student Financial Assistance

Mark Carney  
Deputy Chief Financial Officer

FROM: Lorraine Lewis *Lorraine Lewis*

SUBJECT: FINAL AUDIT REPORTS  
Fiscal Year 2000 Annual Financial Statements  
Student Financial Assistance  
ED-OIG/A17-A0003

Attached are the subject final reports on the results of the audit of the Student Financial Assistance financial statements for the fiscal year ended September 30, 2000. The reports should be read in conjunction with the financial statements and notes of the Student Financial Assistance 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.

James Lynch  
Mark Carney  
Page 2

ED-OIG/A17-A0003

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:

Greg Woods – SFA  
Stephen Hawald – SFA  
Linda Paulsen – SFA  
Julie Bryant – SFA  
Ann Clough – SFA  
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US DEPARTMENT OF EDUCATION  
STUDENT FINANCIAL ASSISTANCE  
Audited Financial Statements  
Year Ended September 30, 2000

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**TABLE OF CONTENTS**

REPORT OF INDEPENDENT AUDITORS	SECTION 1
REPORT ON INTERNAL CONTROL	SECTION 2
REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS	SECTION 3
MANAGEMENT'S RESPONSE	SECTION 4
MANAGEMENT'S DISCUSSION AND ANALYSIS	SECTION 5
FISCAL YEAR 2000 FINANCIAL STATEMENTS AND NOTES	SECTION 6
SUPPLEMENTAL INFORMATION	SECTION 7

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**SECTION 1**

**REPORT OF INDEPENDENT AUDITORS**

## Report of Independent Auditors

To the Inspector General  
U.S. Department of Education

We have audited the accompanying consolidated balance sheet of the Student Financial Assistance (SFA), a performance-based organization 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 SFA'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.

SFA relies on the Department's Office of Chief Financial Officer (OCFO) to provide support for SFA's financial reporting needs, including utilizing the Department's Financial Management Service System (FMSS) to process transactions, and the Grant Administration Payment System (GAPS) to process grant and loan disbursements. These systems were implemented during fiscal year 1998. 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. FMSS 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

**Report of Independent Auditors**

Page 2

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.

SFA 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, we were unable to obtain sufficient evidence to support adjustments to beginning obligated and unobligated balances; nor were we able to satisfy ourselves as to these amounts by performing other auditing procedures.

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 Management Discussion and Analysis (MD&A) 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.

**Report of Independent Auditors**  
Page 3

In accordance with Government Auditing Standards, we have also issued our reports dated January 26, 2001, on our consideration of the SFA'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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**SECTION 2**

**REPORT ON INTERNAL CONTROL**

## Report on Internal Control

To the Inspector General  
U.S. Department of Education

We have audited the consolidated balance sheet of the Student Financial Assistance (SFA), a performance-based organization 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 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 SFA's internal control over financial reporting by obtaining an understanding of the SFA'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

**Report on Internal Control**

Page 2

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 Management Discussion and Analysis (MD&A) of the SFA'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 entity'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.

SFA relies on the Department's Office of Chief Financial Officer (OCFO) to provide support for SFA's financial reporting needs. Specifically, SFA has a memorandum of understanding (MOU) with OCFO that indicates that OCFO is responsible for the following: 1) preparing SFA's financial statements; 2) performing the daily operations of processing transactions in the general ledger; 3) preparing the required financial reporting to the Office of Management and Budget and the U.S. Department of the Treasury, such

**Report on Internal Control**

Page 3

as the SF-133 and the SF-224; and 4) developing and distributing accounting policies and procedures.

In addition, under the MOU, SFA is responsible for: 1) implementing accounting policies and procedures; 2) coordinating with OCFO and Budget Service on all financial reporting issues; and 3) reconciling subsidiary ledgers to supporting documentation and ledgers. SFA is in the process of developing and implementing a fully functional financial management system that will be integrated with the Department's general ledger.

**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 and SFA rely 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, SFA has made improvements to its financial reporting process and financial management activities during fiscal year 2000. For example, SFA:

- Prepared interim financial statements for the periods ended March 31, 2000, and June 30, 2000, which facilitated SFA's timely preparation of its year-end financial statements. The interim financial statement process used by SFA 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 and SFA performed procedures to align Grant Administration and Payment System (GAPS) subsidiary records and the Financial Management System Software (FMSS) general ledger, align budgetary sources

**Report on Internal Control**

Page 4

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, a steering committee was established that included employees from OCFO, Budget Service, and 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 SFA'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. In addition, SFA is in the process of developing and implementing a financial management system to support its financial reporting needs that will be integrated with the Department's general ledger. However, until the system is implemented, SFA will continue to rely on FMSS for the preparation of the financial statements. 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 SFA'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, a significant amount of resources must be devoted to preparing the 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. SFA has approximately 24 appropriations. The Department acquired a tool discussed below, the Visual Basic System, which was used to produce the financial statements at the reporting group and consolidated levels. The efforts of SFA have partially compensated for, but did not correct, certain aspects of the material weakness in the financial reporting process.

**Report on Internal Control**

Page 5

As previously noted, SFA 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, weaknesses continue to exist 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. As a result of these procedures, management 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, management 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 management. 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, SFA 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, OCFO 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, approximately 75 adjustments were posted in order to generate a trial balance for each of the approximately 24 appropriations.

The financial statements initially provided to us had line items with balances different

**Report on Internal Control**

Page 6

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. 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 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***

Management'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 SFA. However, we also noted additional room for improvement. For example, the original balance in other governmental liabilities covered by budgetary resources was nearly \$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.

**Report on Internal Control**

Page 7

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 SFA and OCFO performed periodic analysis of the 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 duplicate transactions were processed, 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 within the Department during fiscal year 2000, including an item for \$125 million in October 1999. Two of the duplicate payments pertained to the direct loan program. 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*

We noted that there is a lack of segregation of duties in the current OCFO 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, which 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. The Department 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. Inadequate segregation of duties in sensitive areas, such as payment processing, can greatly increase the risk of errors or irregularities, or result in noncompliance with the Department's policies and procedures, as well as Federal regulations. In fiscal year 2000, over \$40 billion of GAPS drawdown requests were transmitted to FRB for payments.



**Report on Internal Control**

Page 8

**Recommendations:**

We recommend that the Student Financial Assistance perform the following:

1. Coordinate with the Department to complete the implementation plan for the replacement of the general ledger and subsidiary ledger software packages and ensure the transition occurs in a timely and documented manner to address SFA's financial reporting needs.
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. Coordinate with the Department to 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. Coordinate with the Department to search for duplicate payments and research improper payments that are identified. In addition, enhance current control procedures to ensure that duplicate payments are prevented and/or detected in a timely manner.
5. Coordinate with the Department to review and enhance current policies and procedures for controlling disbursements made on behalf of SFA. 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. Coordinate with the Department to assess the roles and responsibilities of each Departmental office, including SFA, 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 SFA's accounting records. An adequate reconciliation provides the assurance that processed transactions are properly and timely recorded in SFA'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.

**Report on Internal Control**

Page 9

Strong internal control over the reconciliation process helps ensure the timely detection and correction of errors in underlying accounting records. OCFO's and SFA'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 proper or timely reconciliations of financial accounting records were not performed 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 management 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:

- Management 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, management 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, management 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 management 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 at the Department level was identified by management as excess cash from prior years as of September 30, 2000. Management plans to transfer the excess cash into a Treasury receipt account. These funds will be available until the end of fiscal year 2001, if management determines that adjustments are needed based on additional reconciliation efforts.

Although this issue remained a material weakness for fiscal year 2000, management has made progress in its reconciliation efforts. For example, a reconciliation tool was developed and implemented that facilitated the reconciliation process by identifying differences between FMSS and the U.S. Department of the Treasury. This assisted in

**Report on Internal Control**

Page 10

the overall reconciliation efforts of Fund Balance with Treasury. Specifically, this tool enabled OCFO to perform Fund Balance with Treasury reconciliations more efficiently during the fiscal year. Management 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 OCFO did not perform routine reconciliations of its grants subsidiary ledger, GAPS, with the FMSS general ledger during fiscal year 2000. Although OCFO did perform several reconciliations during the year, they were not performed routinely or timely, as procedures to reconcile 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, OCFO 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. Management 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 expense on the financial statements. As discussed earlier, management posted various manual entries in connection with the correction of errors from prior years. Certain of these manual entries flowed through grant expense.

Management 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. Management believes this resulted in the creation of negative undelivered orders. Some of the negative balances dated back to fiscal year 1992 appropriations. Management was unable to provide adequate evidence to support the validity of the receivable. An allowance account against the receivable has been established.

**Report on Internal Control**

Page 11

OCFO and SFA have not yet fully developed formal policies and procedures surrounding the processing of grant disbursements. In addition, management has not developed formal reconciliations and/or has not developed formalized supervisory reviews of GAPS information to certain feeder systems. For example, 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 management recorded adjustments of over \$880 million to beginning obligated balances and adjustments of over \$680 million to beginning unobligated balances. These prior period adjustments were the result of an analysis to align budgetary sources and uses performed by OCFO and SFA. 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, management 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.

**Recommendations:**

We recommend that SFA perform the following:

1. Update current policies and procedures surrounding reconciliations of all significant SFA accounts and programs, including SFA 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 SFA's personnel. SFA should review its policies and procedures on a regular basis to ensure that they remain

**Report on Internal Control**

Page 12

current and are achieving management's objectives. In addition, SFA should coordinate with OCFO on relevant reconciliations.

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, as appropriate, with OCFO's Financial Management Office in conjunction with SFA's memorandum of understanding with OCFO.
3. Coordinate with the Department to 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 SFA'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, management 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. For example, an IT architecture framework was implemented, the EDCAPS security plan was finalized, EDCAPS user revalidation procedures were initiated, monitoring of security parameters on EDCAPS servers was implemented, and logging and review of Oracle security events was enhanced. However, we find that continuous effort is needed to further address control weaknesses related to information technology and systems, particularly in the following

**Report on Internal Control**

Page 13

areas:

- Management 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 timely restoration of EDCAPS in the event of a disaster may not be possible, thereby preventing SFA from resuming business in an adequate manner.
- The Department, which includes systems that support SFA, 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.
- Management has not fully implemented the 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, which includes SFA, 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 data.

**Recommendations:**

We recommend that SFA perform the following:

1. Coordinate with the Department to 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. Coordinate with the Department to finalize the implementation of effective logging

**Report on Internal Control**

Page 14

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

3. Coordinate with the Department to strengthen the system software change management process to provide effective controls over authorization, testing and documentation of system software changes.
4. Coordinate with the Department to 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 management's efforts to correct its accounting records for

**Report on Internal Control**

Page 15

errors made in prior years, the adjustment was incorrectly classified in the current fiscal year's financial records.

As required under the Credit Reform Act, SFA 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. Notwithstanding 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, management 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 SFA's program budget, policy, and legislative development, which includes calculating the subsidy costs associated with SFA'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



**Report on Internal Control**

Page 16

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, management 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 SFA'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 SFA's accounting and loan subsidiary systems, provide a key detect control for management 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 SFA'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 SFA's records. While management 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.
- There is no 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 SFA and the Department. In addition, management 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 management, 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 and ensure that appropriate budget and accounting estimates are prepared.

**Recommendation**

We recommend that Student Financial Assistance 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 ensure to include a reconciliation between the general ledger account 2180 and the data submitted by the guaranty agencies.
2. Coordinate with the Department to 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 management 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.

**STATUS OF PRIOR YEAR FINDINGS**

In the reports on the results of the fiscal year 1999 audit of the Student Financial Assistance 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	Significant weaknesses exist in SFA's financial reporting processes. SFA does not have a general ledger system to	Improvements Noted – Repeat Condition

**Report on Internal Control**

Page 18

Weakness)	support its financial reporting and relies on the Department’s systems and processes. One of the significant weaknesses in the reporting process relates to the EDCAPS general ledger software package, Financial Management System Software (FMSS).	Material Weakness
Reconciliations Need to Be Improved (Material Weakness)	Proper and timely reconciliations of financial accounting records were not performed throughout the year.	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 Weakness)	SFA and the Department did not account for transactions in accordance with the Federal Credit Reform Act of 1990.	Improvements Noted – Considered a 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)	SFA needs to improve its communication and coordination efforts with Departmental 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	SFA and the Department need to improve 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

**Report on Internal Control**

Page 19

We have reviewed our findings and recommendations with SFA 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 SFA and 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.



January 26, 2001  
Washington, D.C.

**SECTION 3**

**REPORT ON COMPLIANCE WITH LAWS AND  
REGULATIONS**

## 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 Student Financial Assistance (SFA), a performance-based organization 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 SFA is responsible for complying with laws and regulations applicable to the entity. As part of obtaining reasonable assurance about whether the entity'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 SFA. 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 and SFA were 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

**Report on Compliance with Laws and Regulations**

Page 2

2000, the Office of the Chief Information Officer is continuing to implement the corrections identified in the corrective action plan designed to address the Department's noncompliance.

Under FFMIA, we are required to report whether the SFA'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. SFA relies on the Department's systems to provide support for SFA's financial reporting needs, including utilizing the Department's general ledger to process transactions. 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.

**Report on Compliance with Laws and Regulations**  
Page 3

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 SFA and 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.



**SECTION 4**

**MANAGEMENT'S RESPONSE**



# UNITED STATES DEPARTMENT OF EDUCATION

## *Student Financial Assistance*

February 26, 2001

Ms. Lorraine Lewis  
Inspector General  
U.S. Department of Education  
Washington, DC 20202

Dear Ms. Lewis:

This is in response to your request for Student Financial Assistance (SFA) comments on the Fiscal Year 2000 reports on Internal Controls and Compliance with Laws and Regulations.

As disclosed in the reports, SFA currently relies on a variety of alternative procedures and reporting processes to prepare its financial statements using a financial management system that is not fully integrated. While additional improvements are needed to address the weaknesses reported, as you have noted, SFA has made improvements to its financial reporting processes and financial management activities during fiscal year 2000. We also recognize that we received qualified opinions on all statements because of our inability to provide adequate documentation for prior period adjustments in the time allotted for the audit. We believe that the problematic manual adjustments made during FY 2000 are one-time adjustments and we do not anticipate significant manual adjustments during FY 2001, although some manual adjustments will continue because of some automated accounting entries that require correction. These occasional adjustments will continue to exist because SFA and the Department do not believe it is cost effective to make substantial changes to the existing financial management system, as we both are currently implementing more robust financial management systems. These systems are planned to be in use near the end of FY 2001.

It is important to note that the existence of these adjustments and the qualified opinion are not indicative of widespread fraud, waste or mismanagement in the SFA programs. Analysis and independent audits of institutions, lenders, guaranty agencies and third-party servicers have shown that SFA funds are materially spent in accordance with law and regulation. Improved gate-keeping legislation and regulation and a risk-based approach to oversight and monitoring processes are having a positive effect on SFA's accountability to the taxpayer, as is also evidenced by the Cohort Default rate falling to an all time low of 6.9 percent. In prior years, two standalone material weaknesses in monitoring and the oversight of SFA participants (institutions and FFEL participants) were reported in the annual audit reports. We are pleased that these are no longer being reported as weaknesses.

However, we are concerned that the section entitled, "Review for Duplicate Payments," in finding number 1 will be misleading to the reader of the report. We believe that it is

important for the reader to understand that the two cited instances of direct loan duplicate payments amounted to \$6.5 million of the \$154 million identified in the report. These two duplicate payments, fully reimbursed back to SFA, resulted from SFA action. The balance of the \$154 million cited in the finding related to GAPS payment procedures and processes that were not under SFA's direct control. Although there could have been additional duplicate payments made through that process that affected SFA programs and dollars, the dollar amounts of those payments have not been specifically identified. However, all the funds have been properly accounted for and reflected in the financial statements. We fully recognize the importance of this issue. SFA and CFO have implemented or enhanced written internal control policies and procedures to eliminate duplicate payments in the future.

Please also note that SFA has implemented an Investment Review Process in accordance with the Clinger-Cohen legislation to ensure that our information technology investments make good business sense and meet our PBO objectives. To ensure that we get the returns on investment that we expect, we've been developing performance measurement baselines for all core business processes. We have measured and will continue to measure SFA's ability to improve customer and employee satisfaction and to reduce unit cost. OMB has called our process one of the best in government.

We are in general agreement with the issues and recommendations identified in the reports. We will continue our coordination with the Department to assure that the issues raised in the reports are appropriately addressed in comprehensive corrective action plans aimed at determining the best way to achieve the desired results.

SFA is committed to continuing efforts to improve management and accountability over SFA programs and to better serve students and taxpayers.

Sincerely,



James R. Lynch  
Chief Financial Officer  
Student Financial Assistance

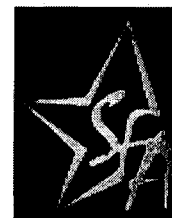
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**SECTION 5**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

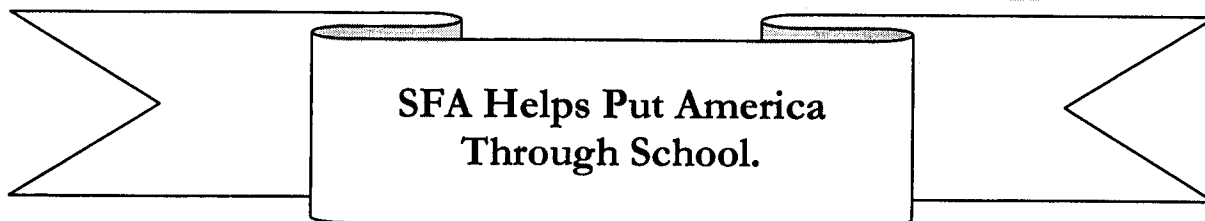


## Student Financial Assistance Management's Discussion and Analysis



This Management's Discussion and Analysis may be deemed to include forward-looking statements that involve risk and uncertainty as to outcome. Management believes that all forward-looking information is based on reasonable assumptions but can give no assurance that these expectations will be achieved. The following discussion and analysis relates to Student Financial Assistance's financial condition, budgetary status, and net cost of operations as of and for the year ended September 30, 2000.

### Mission and Organizational Structure



Student Financial Assistance's (SFA's) mission is to "help put America through school" by providing access to higher education through effective and efficient delivery of student aid. This access was expanded through:

- 1) Increasing investments in Pell Grants and College Work-Study,
- 2) Creating the Hope Scholarship and Lifelong Learning tax credits to help families meet the cost of college, and
- 3) Letting all Americans know that college is within their grasp.

Authorized by the Higher Education Amendments of 1998 (HEA), in December 1998 the Department of Education (the Department) announced the creation of the federal government's first-ever Performance-Based Organization, or PBO. The goal of the HEA legislation was to improve service and reduce cost. SFA, formerly the Office of Student Financial Assistance within the Office of

Postsecondary Education (OPE), became this PBO. SFA is now a principal operating component within the Department of Education, separate from OPE.

Like most successful businesses in the private sector, SFA is now organized into channels along customer lines to allow for continual customer feedback and tailoring of services to meet their needs. SFA is channel-driven, with student services, school services and financial partner services as channels operating under the Chief Operating Officer (COO).

The core of SFA's management team consists of General Managers for Students, Schools, and Financial Partners, along with the Chief Information Officer (CIO) and the Chief Financial Officer (CFO). The three general managers run basic program operations and determine what improvements are needed to keep pace with changing expectations.



## Student Financial Assistance Management's Discussion and Analysis



The General Manager (GM) for Students is charged with improving student and borrower awareness of financial aid options and ensuring the smooth and efficient processing of student transactions.

The GM for Schools provides assistance to schools to ensure they can meet program eligibility requirements, and oversees ongoing financial and other transactions with schools.

The GM for Financial Partners works with states, lenders and guaranty agencies, providing technical assistance, processing financial transactions, and collaborating on better ways to support the needs of students and schools.

The CIO provides technical support to:

- 1) GMs in the development of new program system applications
- 2) CFO in implementing an integrated financial management system that will monitor SFA's financial performance
- 3) Other operating units in designing efficient and effective systems to support operations.

The CFO provides Financial Management, Facilities Management, Portfolio Management, Internal Reviews, Travel Management, Budget and financial information analyses and reports to all areas of SFA and the Department of Education.

The CFO is responsible for the reconciliation of nearly a dozen accounting-related systems to ensure timely and reliable data for internal and external decision

making. The CFO is also responsible for preparing stand alone financial reports to the Department of Education, Treasury, OMB and Congress.

Other SFA business process managers that provide program support include:

- Human Resources Director,
- Acquisitions Director,
- Analysis Director,
- Communications Director,
- SFA University Director, and
- Ombudsman.

SFA delivers over \$50 billion in Federal aid annually to approximately 8 million students. Under the Federal Family Education Loan (FFEL) and Direct Loan programs, SFA oversees or directly manages over \$218 billion in outstanding loans, representing over 115 million individual student loans. SFA interacts with over 6,000 schools, over 4,000 lenders, 36 guaranty agencies, dozens of accrediting agencies, as well as secondary markets, third party servicers and other organizations.

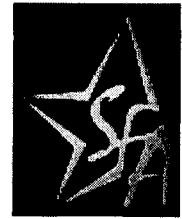
In accordance with the PBO model, SFA has outlined

- clear objectives,
- specific measurable goals,
- customer service standards, and
- targets for improved performance.

Interim performance objectives, modeling the PBO framework, were developed to guide SFA through the end of fiscal year 2000. In October 1999, a draft Five-Year



## Student Financial Assistance Management's Discussion and Analysis



Performance Plan with similar objectives was posted to SFA's web site.

As previously noted, the total portfolio of postsecondary aid programs run by the SFA 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. The following paragraphs briefly describe each of the major programs.

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 FY 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

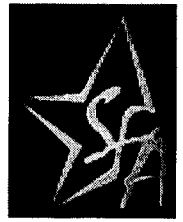
funds for the Direct Loan Program. Built with the newest technology in the mid-1990's, the Direct Loan Program is user-friendly for schools and students. The **Federal Family Education Loan Program** (the major loan program under which private lenders make Federally guaranteed loans to students) has made dramatic improvements in the services provided to schools and students over the last several years.

The Direct Loan Program offers borrowers a variety of repayment options including standard repayment, graduated repayment, and income contingent repayment. The income contingent repayment option encourages borrowers to consider lower-paying public careers such as teaching and law enforcement. Under legislative amendments enacted in Fall 1998, lenders participating in the Federal Family Education Loan Program now offer all the repayment options available in Direct Loans except for income contingent repayment.

The Department's **Campus-Based** programs provide funds to institutions which enables them to provide students employment, grants, and low interest loans on the basis of need.



# Student Financial Assistance Management's Discussion and Analysis







## Student Financial Assistance Management's Discussion and Analysis



### Performance Objectives and Goals

SFA's operations are shaped by a Five-Year Performance Plan and on accomplishing its three measures of success:

- Improving customer satisfaction,
- Reducing unit cost and
- Improving employee satisfaction.

The five-year goals are stated in terms of specific, quantifiable improvements in these three areas.

**Customer Satisfaction Measure:** We will let the customers be our judge. It is far too common for agencies to decide for themselves what customers want, and then measure performance on that. Using a Customer Service Task Force, we asked our customers before we devised our plan. We used the American Customer Satisfaction Index (ACSI), an annual survey done by the University of Michigan. Over the past several years, on a scale of 100, private sector index scores for the finance and insurance industry have been in the mid-70's. Public sector scores have been ten to fifteen points lower. Our goal is to achieve an ACSI score of not less than 74 by the year 2002. In FY 2000 we achieved an overall score of 72.9.

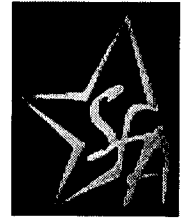
**Reducing Unit Cost:** Our total cost of operations is being pushed strongly upward by two forces – increases in our total workload, and shifts from less expensive work to more expensive work. Even though

given these two factors one would expect that the cost of operations would increase, we are held to basically a constant budget starting from FY 2001. As a result we will focus on reducing unit costs to perform more work, and more complex work for the same total budget. This reduction in unit costs is expected to be 19 percent by FY 2004. Our overall unit cost for FY 1998 was \$19.52 per aid recipient. We brought that down to \$18.72 in FY 1999, and due to modernization efforts, the unit costs for FY 2000 is \$19.08. Absent the modernization investment, the FY 2000 unit costs would have dropped to \$17.20. This modernization will take us forward to accomplish our overall goal of 19 percent reduction by FY 2004, to an estimated \$18.06 per aid recipient.

**Improving Employee Satisfaction:** Employee satisfaction is measured and affected at the SFA-level, not at the channel level, therefore we will address this issue first and then discuss goals and progress by channel below. SFA's goal is to raise the level of employee satisfaction. Three employee satisfactions surveys were conducted during FY 2000 – two were administered internally and the last one by the Gallup organization. According to the Gallup's measuring system, SFA employee satisfaction now stands at 3.5 – halfway between the government average and private financial services companies.



## Student Financial Assistance Management's Discussion and Analysis

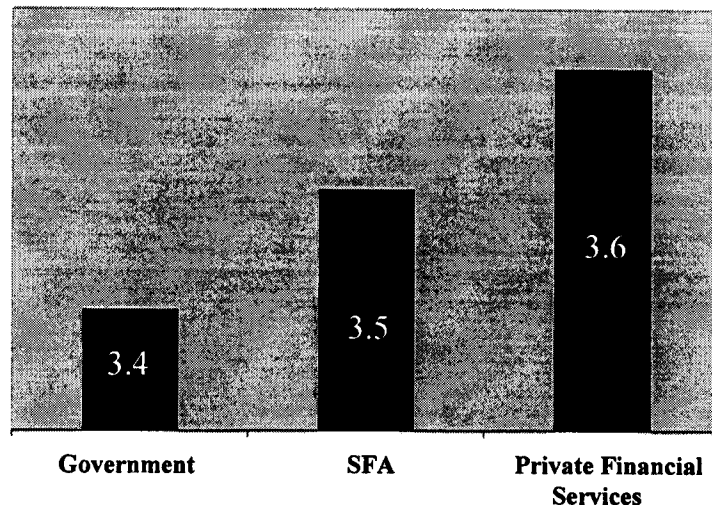


Over the last year, the PBO reported on the status of 75 performance plan indicators and has made significant strides in achieving these performance objectives. Students have access to more information about their loans and can do more with their loans than customers can do on Web sites of some of the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

The first two goals, customer satisfaction and reducing unit costs, are further described in the programs and the channel discussions below. However, employee satisfaction has been addressed on an SFA-wide basis.

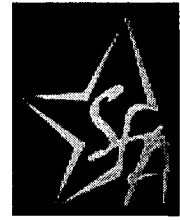
SFA has undertaken a number of innovative actions and programs to improve employee satisfaction. For example, SFA replaced regular timesheets with exception-based time and attendance reporting, created \$500 Learning Coupons to help staff stay up-to-date with new training, and created the Stars awards program to offer employees a chance to be recognized by fellow employees for great job performance. SFA has also developed mission-based job descriptions for all employees, launched SFA University to transform SFA into a learning organization, has plans to improve the performance evaluation process and allows for flexible workplace and flexible schedules. Our goal is to be one of the top five best federal agencies for which to work.

### Employee Satisfaction Gallup Q12 Grand Means





# Student Financial Assistance Management's Discussion and Analysis



## Student Channel

The Student Channel has identified its contributions toward achievement of overall SFA goals, such as:

- reducing cycle time for loan consolidations
- helping keep default rates low
- having the call center answer 95 percent of calls
- processing more electronic Free Applications for Federal Student Aid (FAFSA) as opposed to paper
- creating a student web site
- providing information to the physically challenged
- providing applications in Spanish.

The Student Channel has three business processes that serve students most directly – aid awareness, aid application, and loan repayment. The following table depicts what students think of our performance in each.

	Student Customer Satisfaction	Did SFA Improve?
Aid Awareness	82	Most didn't know
Aid Application	70	Most didn't know
Loan Repayment	74	36% said yes
Overall Service to Students	75.9	Most didn't know

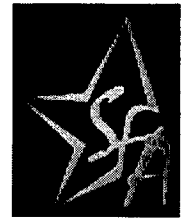
**Aid Awareness:** This encompasses outreach activities, operating our call center at 1-800-4FED-AID, and publications such as *The Student Guide*.

SFA invested more this year in getting information about student aid out to students and parents. Here are the specific projects that were completed:

- A high-quality SFA web site (<http://www.ed.gov/offices/OSFAP/Students/>) linked to the award-winning *students.gov* web site and the Department's "Think College Early" web site.
- Provided information in accessible formats for people with special needs, such as TTY for the hearing impaired, and tapes and CDs for the visually impaired.
- SFA collaborated with the Puerto Rican education community, translated more of our publications into Spanish, and posted them on a Spanish version of our web page.
- In SFA's first annual workshop to promote outreach partnerships, SFA strengthened our working relationship with the 2,500 youth counselors around the nation who work directly and intensely with underprivileged kids, rural and urban, to make sure they have the best possible chance of making their American dreams come true.



## Student Financial Assistance Management's Discussion and Analysis



- Set and achieved a goal for our toll-free line, 1-800-4-FED-AID, to answer more than 95% of all calls.

The 1-800-4-FED-AID call center is the primary source of initial information for most of our student customers or their parents. So SFA conducted an ACSI survey to see how well 1-800-4-FED-AID is satisfying callers. The satisfaction index score is very high at 84. Callers gave high marks to every aspect of the 1-800-4-FED-AID operation: the ease of getting through to an operator, 82; the professionalism of the operators, 88; getting the information and help they needed, 86. Most of the callers who had used the service before noticed an improvement this time, and 91% said they would call again or recommend it to friends who needed help with student aid.

An ACSI survey was conducted on users of *The Student Guide*, SFA's primary publication for students, to find out if it was easy to get, easy to understand, and whether it gave them the information they needed. Customers scored their satisfaction with *The Student Guide* at 81, but said they would have been more satisfied if the content was better tailored to their needs. Still, 88% said they would use the guide again, and 92% said they would recommend it to a friend.

The excellent scores for 1-800-4-FED-AID and the Student Guide combine to give the Aid Awareness business process a customer score of about 82.

**Aid Application:** This includes the acceptance and processing of Free Applications for Federal Student Aid (FAFSAs). Some of the projects completed

this year to improve service for applicants and to reduce the cost of processing applications:

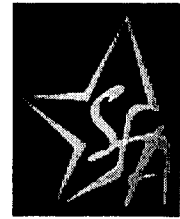
- SFA's goal was to process FAFSAs with an average turnaround time of eight days or less. SFA is averaging five days.
- SFA expanded FAFSA on the Web correction capabilities.
- SFA now notifies students electronically when their FAFSA has been received, and again when processing is complete.
- SFA gave students the ability to check the status of their applications on-line anytime.
- SFA redesigned our already award-winning FAFSA on the Web to make it user-friendlier.

Web applications are so important to SFA's mission that when SFA heard that students were having trouble using FAFSA on the Web, SFA sent a Mad Dog Team — SFA's term for a pack of experts who will stop at nothing to fix an important customer problem — rushing to hear their problems and quickly fix the flaws. The team did a good job because students were more satisfied this year with FAFSA on the Web than last year. Last year, when student satisfaction with FAFSA on the Web was the only thing SFA measured, the ACSI score was 63. This year, student users gave it almost a 10% boost to 70.

Perhaps the best statistical indication of customer satisfaction with FAFSA on the Web is a projected *quadrupling* of the number of applicants who chose to use it for the 2000-2001 school year instead of filling



# Student Financial Assistance Management's Discussion and Analysis



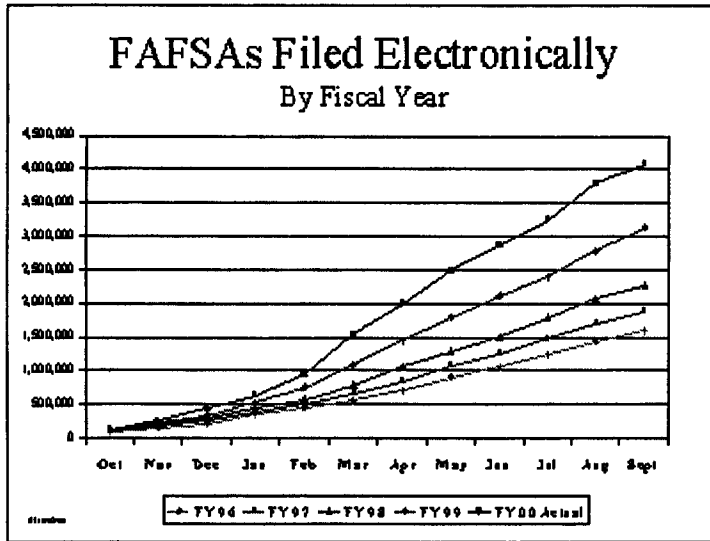
out the paper form. Before long, the goal is to get nearly all applications on the Web.

*Customer Satisfaction--Attract four million electronic filings of the Free Application for Federal Student Aid (FAFSA) for the 12-month period ending September 30, 2000.*

SFA met its goal of receiving 4 million electronic FAFSAs by the end of FY 2000. The electronic application is faster and easier for the students to file and for the Department to process.



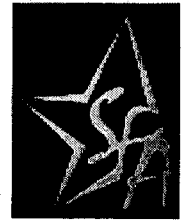
*Reduce cost--Maintain cohort default rate at ten percent or less.*



Under statute, a key measure of student loan defaults is the "cohort default rate." This rate is defined as the percentage of borrowers who entered into repayment on FFEL and Direct Loan Program loans during one fiscal year and defaulted on those loans in the same fiscal year they entered repayment or the next fiscal year. Because of concerns about high default rates and inadequate loan collections in the student aid programs, SFA has taken actions to reduce defaults -- including management reforms and increased attention to assist at-risk postsecondary institutions. This has cut the cohort default rate by more than two-thirds from 22.4 percent for FY 1990 to 6.9 percent for FY 1998 (the most recent cohort year available).



## Student Financial Assistance Management's Discussion and Analysis



**Reduce Cost—Try at least five new ways to make debt collection more effective, less costly, and more customer service oriented**

Debt collections increased dramatically during FY 2000. SFA exceeded its goal of \$1.2 billion in collections for FY 2000. As collections increase, collection agency costs decrease. The average cost per collection dropped nearly six percentage points in the last three years from 23 to 17 percent.

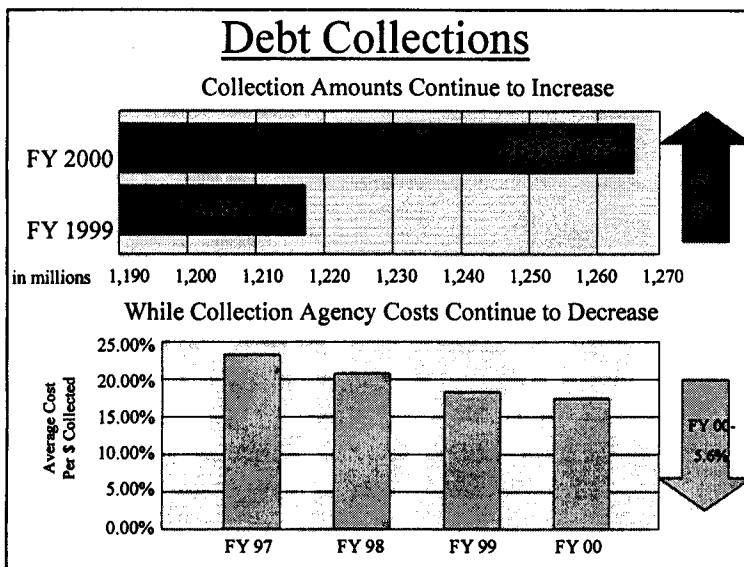
Progress is also being made in other areas moving SFA closer to achieving its planned objectives to improve customer service and reduce cost. Items such as incorporating performance-based components into contracts that are up for renewal, adding customer survey modules to our customer help lines, and providing electronic entrance counseling on the Web are some of the efforts made to be more performance based.

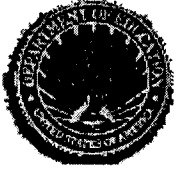
**Loan Repayment:** This encompasses billing and servicing our borrowers who are repaying one or more Direct Student Loans, and processing applications for borrowers who wish to consolidate previous student loans into one Direct Loan account.

A large improvement in service for those borrowers is our Direct Loan Servicing Web site ([www.eduserVICES.com/index.asp](http://www.eduserVICES.com/index.asp)) that went on line in July. It is a perfect example of the great new products and services SFA is offering.

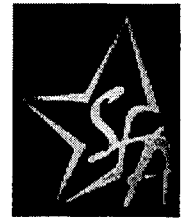
Using the modern technology of middleware, encryption, and the Internet, SFA delivers trustworthy, fully integrated, 24X7 service. Borrowers can see complete information on all their direct loans and most FFEL loans they might have. In addition, they can transact business. They can change payment plans — to help choose the right plan, the system shows the complete payment schedule under each option, starting with the next payment.

A student can also apply for forbearance or a deferment — the system even fills out most of the application for the customer. It is the best loan service Web site in business, as cited by *Government Executive Magazine*.





## Student Financial Assistance Management's Discussion and Analysis



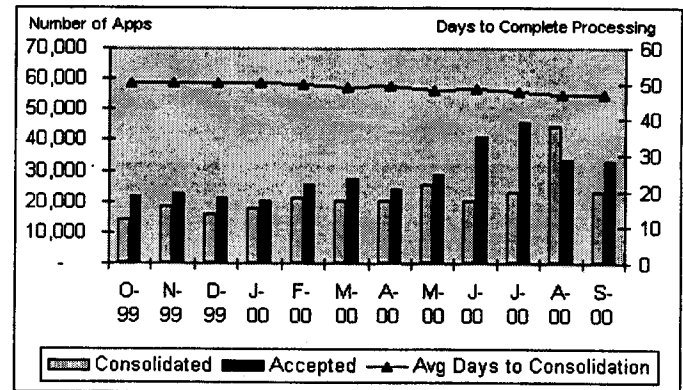
Since the new Web site has not been online long, not many of our Direct Loan borrowers have had occasion to use it. Therefore, the ACSI for direct loan billing and servicing, which mostly reflects satisfaction with the old system, was only 70. Customers surveyed said they would like more time between when the bill comes and the payment is due. In addition, they want more information about their accounts, information that is now readily available on the Web site. As more and more borrowers discover our new Web site, satisfaction scores will go higher.

Even before the new Web site, SFA had put forbearance and deferment application forms on-line and cut the turnaround time for processing them from ten days to under five days. The ACSI for forbearance and deferment processing was 78, with very high marks for staff professionalism (87).

SFA also put Loan Consolidation on the Web this year, (<https://loanconsolidation.ed.gov>). It is electronic except for one paper form that still requires an actual signature. SFA will eliminate that requirement by next year. Even with 20 to 30 thousand applications coming in each month, SFA beat the stated 60-day-or-less processing promise, averaging fewer than 50 days. SFA did an ACSI survey on our consolidation business process and customers scored it 74. The customers would like a simpler application and a lower interest rate (SFA does not set the interest rates) but they gave our folks an 80 for professionalism, and 83% of the applicants surveyed would recommend loan consolidations to friends.

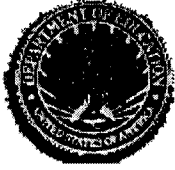
The weighted-average of student satisfaction with all the services SFA provides to them directly was 75.9.

Processing Loan Consolidations

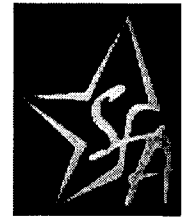


*Customer Satisfaction--For processing more than 510,000 Direct Loans Consolidations—completed applications with an average year-to-date turnaround time of less than 50 days (through September 30, 2000).*

Loan consolidators have exceeded the established timeframes and are currently averaging 46 days for processing consolidations. Once the new electronic application goes on-line, the average processing time could drop an additional 5-7 days.



# Student Financial Assistance Management's Discussion and Analysis



Direct Consolidation Loans - Welcome!!! - Microsoft Internet Explorer

File Edit View Go Favorites Help

Back Forward Stop Refresh Home Search Favorites History Channels Fullscreen Mail Print Edit

Address <http://loanconsolidation.ed.gov/>

CONSOLIDATION HOME | APPLICATION HOME | FORMS & PUBLICATIONS | FAQs | CONTACT US


## Direct Consolidation Loans

Welcome borrowers, lenders and schools to the...  
**Direct Consolidation Loans  
Information Center**

**BORROWER SERVICES**

**SCHOOL SERVICES**

**LOAN HOLDER SERVICES**

 Office of Student Financial Assistance Programs

**ED** HOME

Internet zone

Start | Inbox... | RE: P... | RE: P... | Direct... | Micros... | Direct... | Micros... | 12:08 PM





# Student Financial Assistance Management's Discussion and Analysis



## Schools Channel

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

SFA has four business processes that serve schools – loan origination and disbursement, program eligibility, program support, and financial transactions. The following table shows what schools think of SFA's performance in each.

	School Customer Satisfaction	Did SFA Improve?
Origination and Disbursement	79	65% said yes
Program Eligibility	83	73% said yes
Program Support	81	72% said yes
Financial Transactions	78	63% said yes
Overall Support for Schools	70.1	80% said yes

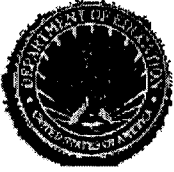
**Origination and Disbursement:** This encompasses the origination and disbursement of all Title IV aid. The ACSI

score of 79 is good but customers say there is plenty of room for improvement. In general, the customers gave our people good marks for courtesy (85), but lower marks for written instructions (71) and the ease of data submission (76). School administrators surveyed by SFA said things like:

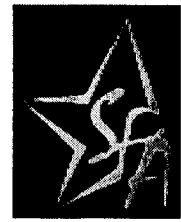
- “The Pell Grant disbursements and origination record is the worst thing I ever had to do. It has been the subject of much discussion of the colleges.”
- “It would be easier if they could put the origination and the disbursement in one step instead of two steps. Have one record for origination and disbursement. That is my only complaint.”
- “There's no clear instructions on how to do the origination and disbursement.”

SFA has a team at work right now designing a long-awaited, common origination and disbursement system that will solve those problems. SFA should get a much higher satisfaction score when it is completed.

**Program Eligibility:** Through initial certification and periodic recertification, SFA makes sure that participating schools are managing public funds properly and serving students well. Therefore, the process needs to be thorough. However, it should also be as simple and understandable as SFA can make it for schools. This year, SFA created an eligibility checklist, wrote simple instructions on how to begin to draw funds, and sent our experts if schools



## Student Financial Assistance Management's Discussion and Analysis



requested help. SFA also helped a number of non-compliant schools and schools on reimbursement get back on track.

SFA's work paid off with a strong ACSI score of 83, with a great majority of schools having seen an improvement. Again, customers gave us extremely high marks for courtesy (89). However, SFA got lower marks for clarity of instruction (77). In addition, a few of the customers SFA surveyed offered comments on aspects SFA had not asked about. For example, "As far as the recertification process, [SFA] could do a better job of letting you know where you stand in the process once you submit your application." And this from another school administrator, "Re-certification has been a big problem. They lost the application. The written application and the electronic. It took 18 months to answer me. They sent me the wrong ESAR twice. That was more than 12 months ago." Those comments offer some clear opportunities to improve an already high satisfaction score.

**Program Support:** This covers the broad range of work done by SFA's direct loan account managers, case management teams, and the technical support center, to help schools succeed in their environment. SFA people made some real strides this year tailoring products and services to fit differing sizes and kinds of schools. They have taken the "gotcha" mentality out of program reviews, making compliance, rather than enforcement, the goal. Our customers say they saw the changes and liked what they saw. They gave us a high satisfaction score of 81. They said they trusted what people told them (82), and praised their

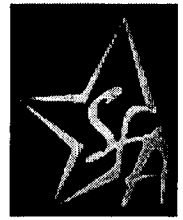
courtesy (88). However, schools do not always know who to call for help (68). It is a serious problem that one school administrator described like this: "I just don't want to even bother calling because I have to call so many people and I don't know if I'm going to get my answer. So, I just go about my own way of doing it."

SFA has a plan to solve that problem. First, the e-commerce strategy with user-friendly Web-based applications will eliminate many sources of confusion and questions. However, SFA knows our customers will still need a real person to help them sometimes. With our regional office in Atlanta leading the way, SFA has started giving each school the name and phone number of a single point of contact — someone who will work on their behalf to get any question answered, any problem solved.

**Financial Transactions:** These are the processes schools use to get the money for Pell Grants and Campus-Based aid programs. Our customer satisfaction score of 78 is good because SFA has worked hard to simplify the monthly reconciliation process for schools. However, SFA knows that we are still recovering from a serious customer service set back. SFA launched a new computer system to disburse Pell Grants. It is called RFMS and it was supposed to be much more efficient than the previous system. It was more efficient for us, but not for our customers. Schools had all kinds of technical difficulties operating their end of the system. School administrators surveyed told us:



## Student Financial Assistance Management's Discussion and Analysis

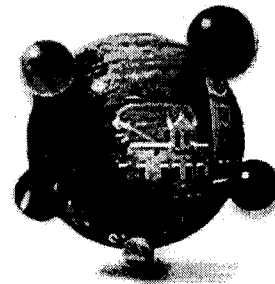


- “The RFMS for Pell transmission is unsatisfactory. This is the first year it has been in and there is much room for improvement. Particularly in the area of technical reference and instructions about how to do things could be improved significantly. The system itself for the RFMS is difficult to work with.”
- “The Pell stuff — I don't know what happened — SFA does not have a link between our software program for disbursement and SFA, end up running two systems and that's double the work. If they could get RFMS and Pell to do the same thing as direct lending, then I'd say 10 on everything.”
- “I think the move to customer service mode has been really great. But I have been very unhappy with the RFMS systems.”

SFA made sure that the schools got the money coming to them, and then sicced another Mad Dog team on the problem.

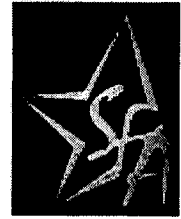
They visited schools, got a deep understanding of the problems, and have put solutions into motion that should improve satisfaction scores for next year.

Overall, an encouraging 80% of school administrators report that they have seen improvement in SFA this year. SFA is obviously on the right track. Employees have responded quickly to the opportunity presented by the PBO — the opportunity to prove that government can equal the best in business. Making systems simpler to understand and easier to use takes a bit longer. SFA's e-commerce strategy, with modern technology and Web applications, is the key to further improvement in customer satisfaction as well as reduced cost.





# Student Financial Assistance Management's Discussion and Analysis



## Financial Partners – Lenders and Guaranty Agencies

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

SFA has three business processes that serve our financial partners who participate in the FFEL Program (the Federal Family Education Loan) – program eligibility, program support, and financial transactions. The following table shows what some of our financial partners think of our performance. Unfortunately, their response rate to our customer satisfaction survey was too limited to let us conclude much about the details of the business processes that serve them. Therefore, although the scores appear relatively good, SFA believes it can do a lot more to improve the partnership.

	Financial Partners Customer Satisfaction	Did SFA Improve?
Program Eligibility	77	38% said yes
Program Support	85	48% said yes
Financial Transactions	82	48% said yes
Overall Support for Financial Partners	72.7	41% said yes

**Program Eligibility:** This serves a similar purpose as school program eligibility — to make sure that participating financial institutions are managing public funds properly and serving students well. Therefore, the process needs to be thorough, but simple and understandable. Here are the highlight of improvements SFA worked on this year to strengthen our eligibility process:

- SFA identified guaranty agencies and lenders that submit audit reports late and took appropriate action.
- SFA responded to internal audit reports more rapidly, and
- SFA created a rapid response team to identify and address serious administrative problems.

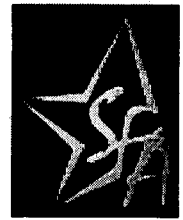
SFA designed all of these improvements to ease the administrative burden on the vast majority of our partners who try to comply with the regulations. They registered their satisfaction with a score of 77.

**Program Support:** SFA made a number of improvements in program support this year. For example, SFA:

- Assigned each financial partner a point of contact within a customer service team with the expertise and authority to get questions answered and problems solved.



## Student Financial Assistance Management's Discussion and Analysis



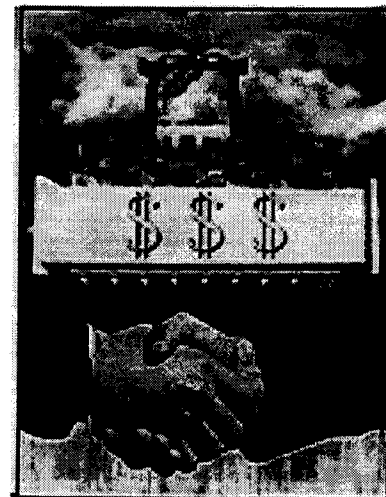
- Worked with guarantors and lenders to maintain the quality of data in NSLDS.
- Joined guaranty and lender groups to help develop guiding principles of quality service and technical training, and to develop operating rules to simplify transactions.

SFA surveyed our partners to see what they thought of our improved program support. Did they get the help they needed when they needed it? Were people courteous and knowledgeable? Did partners trust what SFA told them? Those that responded gave SFA an excellent score, 85, and nearly half of them said they noticed a marked improvement in program support this year.

**Financial Transactions:** Financial transaction was the area that our financial partners told us was most important to them. They say that so far SFA is doing well. They gave us an ACSI score of 82, among the highest of any of our core business processes.

In October — too late to affect the satisfaction score for 2000 — SFA launched new Web-based software, called Form 2000, for submitting applications for reimbursement. Working with the financial community, SFA has reduced financial reporting requirements from three reports to one. In addition, SFA has put the report online, which SFA expects will reduce error rates and speed up payment rates.

Overall, SFA's financial partners rated their satisfaction with our service at 72.7. As was the case with students and school customers, financial partners rated SFA's employees very high — upper 80's and even 90's for trustworthiness and courtesy. However, they gave lower scores to the aspects of service involving the simplicity of instructions, rules, and systems. The e-commerce strategy will soon solve those problems.





## Student Financial Assistance Management's Discussion and Analysis



### SFA Financial Analysis

For FY 2000, SFA prepared the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position on a consolidated basis. The Statement of Budgetary Resources and the Statement of Financing were prepared on a combined basis.

Consolidating statements eliminate inter-entity revenues, expenses, receivables, and payables while combined statements do not. An Independent Auditor appointed by the Office of the Inspector General audited these statements, and the Opinions on these statements are included in this Report. The preparation and audit of financial statements are significant functions demonstrating the strength of the financial information, financial systems, and internal controls maintained by SFA.

For fiscal year 1999, SFA received qualified opinions on four of its five financial statements, with a disclaimer of opinion on its Statement of Financing. SFA management is committed to a financial environment that would be considered "Best in Business" and stands ready to allocate the needed resources to achieve and maintain this goal.

SFA has substantial assets currently under its management. Of the \$99.1 billion in assets held by SFA as of September 30, 2000, \$78.9 billion consist of loan receivables held by the Direct Loan (DL) program and the Federal Family Education

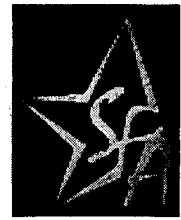
Loan (FFEL) program. DL holds \$58.5 billion or 74% of total loan receivables while FFEL holds \$20.3 billion or 26% of total loan receivables. (The FFEL portfolio consists of FFEL-defaulted loans that the Department owns itself.) These loan receivables are valued using present value methodology and the allowance for subsidy for the DL loan receivables is a negative \$2.6 billion indicating recoveries greater than outlays. The FFEL allowance is \$12.6 billion as of September 30, 2000 indicating outlays greater than recoveries. The significant asset of the Pell Grant Program is its Fund Balance with the U.S. Treasury (Treasury), which are unexpended appropriations, the majority of which have been obligated for disbursement to eligible students.

SFA's liabilities of \$90.1 billion as of September 30, 2000 consist mainly of \$65.3 billion in the Direct Loan Program borrowed from the Treasury to fund its loan program. The FFEL Program has \$13.7 billion in estimated loss for projected future defaults on loans in which it is the guarantor. In addition to these amounts, FFEL has \$2.2 billion payable to Treasury for amounts due from Guaranty Agencies, representing the amount in the Federal Funds held by guaranty agencies. These amounts, if collected, are immediately payable to Treasury.

SFA's net position consists of \$9 billion, 86% of which consists of Pell Grant



## Student Financial Assistance Management's Discussion and Analysis



Program unexpended appropriations, the majority of which have been obligated for future disbursement to eligible students.

SFA's net cost of operations for the year ending September 30, 2000 was \$6.2 billion. The Direct Loan Program's downward reestimate of subsidy expense contributed to the positive results of operations in that program. Subtracting the effects of negative subsidy expense, the Direct Loan Program had a net cost of operations of \$377 million. In the Pell Program, grant expense was approximately 99% of its net cost of operations. In the FFEL Program, net cost of operations was \$701 million and was comprised of \$296 million in subsidy expense with the remainder from other types of administrative and contractual service expenses. In addition, indirect costs incurred by the Department of Education are allocated to each SFA program for financial reporting purposes.

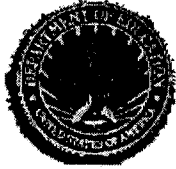
Appropriations are made at the beginning of each fiscal year to cover the estimated losses on loans to be made or guaranteed during that year, and for the Pell Grant program. Permanent indefinite appropriation authority is available to finance operations resulting from loan guarantees in years before FY 1992. For FFEL and Direct Loan, an amount to cover the subsidy cost of each program as well as an amount to cover administrative expenses is appropriated. The Pell Grant Program receives one appropriation that covers actual grant disbursements and the administrative costs of managing the program.

The FFEL and Direct Loan programs have authority to borrow from Treasury at interest rates determined by Treasury each year. These programs repay Treasury over time using principal and interest collected from borrowers. The Direct Loan Program may borrow from Treasury to finance direct loans and for downward revaluation of subsidy cost. The FFEL may borrow from Treasury to finance guaranteed loan obligations and for downward adjustments of subsidy cost. Borrowings may be repaid before maturity without penalty.

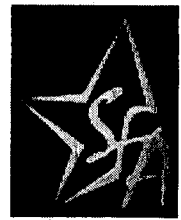
### Loan Consolidation System Enhancements

Recent changes in Federal regulations require all Government agencies to fund Government obligations using electronic payments. To comply with the new regulations, the Loan Consolidation System (LCS) implemented an electronic funds transfer (EFT) capability into its consolidation funding process. The goal of the EFT process is to automate many of the manual processes used to fund loan payoffs and use the secured communication Automated Clearing House (ACH)/FEDWIRE processes to electronically exchange funding payoffs and reconciliations.

The EFT process eliminates paper checks, paper manifests, letter notifications, and the manual labor associated with a paper-based system. It replaces them with an automated method to receive and respond to thousands of individual loan payoffs. The process benefits both the underlying loan holders and the LCS. Enhancements include:



## Student Financial Assistance Management's Discussion and Analysis



- The reduction of overpayments and underpayments by paying off loans on a predictable and tightly controlled schedule, with the loan payoff amounts calculated and generated with greater accuracy.
- Elimination of lost or stolen checks.
- Direct deposit of funds into loan holder accounts.
- Reduction of manual processes. Electronic manifests, paper notification of underpayments, and checks associated with payment, overpayment, and underpayment transactions will be exchanged between loan holders and LCS electronically reducing or eliminating the costs of posting and managing funding data exchanges.
- Elimination of individual checks for individual loans. All funds transferred will be cumulative for all loans held by the loan holder and eligible for payment during the LCS funding cycle.

### Activity Based Costing Initiative

A significant portion of SFA's performance plan addresses the need to reduce the organization's unit cost of administering its programs. Managers need to be able to track their unit cost for effective cost management. When fully implemented and deployed, Activity Based Costing (ABC) will allow managers to examine all aspects of their operations from a focused financial perspective.

SFA's CFO, with contractor assistance and participation of all SFA Channels, has implemented an Activity Based Cost System. The contractor and CFO personnel

worked as a team, consulting with the Channels, in completing this costing effort. What follows is the current approach to developing the requirements for developing SFA's ABC System:

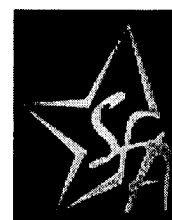
1. Phase I – Planning and Training: providing ABC awareness sessions for key SFA personnel; reviewing available data sources; clarifying project objectives and establishing modeling strategy.
2. Phase II – Model Development: defining resource values; developing an activity dictionary for the various business offices; defining cost object definitions; collecting appropriate resource and activity drivers; developing model architecture design, and the population of SFA's ABC model through automated processes.
3. Phase III – Validation and Analysis of ABC model output: developing cost reports; reviewing draft reports with key SFA employees in the Channel and Enterprise offices; verifying key drivers and assignments.
4. Phase IV – Final project reporting: this documenting the entire process in two written reports--one a general management report with executive summary results and a second a Technical report.

SFA will be able to use ABC for monitoring its transformation into a PBO and provide cost data to managers so they can make informed decisions on the operations of the





## Student Financial Assistance Management's Discussion and Analysis



organization. ABC is also a building block to implementing an Activity Based Management process, which is an integrated ongoing process management approach. The plan is to continue to work with management to achieve the 19 percent unit cost reduction goal.

### Loan Portfolio Management

Portfolio Management is one of the new divisions established within SFA CFO's office during FY 2000. Portfolio Management represents SFA in numerous interagency liaison roles involving portfolio management issues.

The goals of Portfolio Management are to provide evaluations of existing portfolio strategies and identify alternatives to further improve portfolio performance, and provide expert analyses and forecasts of loan and grant portfolios. The activities of Portfolio Management will primarily contribute to meeting the cost reduction goals of PBO.

### Student Loan Default Rate

The national student loan default rate was at its lowest point ever – 6.9 percent for FY 1998 – and two-thirds less than it was at its 22.4 percent peak eight years ago. This decline has been attributed to a robust economy, strong department management, tougher enforcement tools, and stepped up efforts by colleges, lenders, guaranty agencies and other participants in federal loan programs.

The default rate has declined every year since 1992 and the 1998 rate marks the third

consecutive year that it has remained below 10 percent. The FY 1997 rate was 8.8 percent. The number of loans doubled during the same period while the rate of defaults declined by more than two-thirds. In FY 1998, students took out 8.6 million loans worth \$35.7 billion, up from 4.1 million loans worth \$11.7 billion in FY 1990.

Schools with excessive default rates may be dropped from one or more federal student aid programs. Schools with default rates of 25 percent or higher for three consecutive years face loss of eligibility to participate in the loan and Pell Grant programs. Schools have appeal rights and can remain in the programs while an appeal is pending. Some 850 schools have lost student loan program eligibility since 1993, with the release of the FY 1991 cohort default rates. This year, 11 schools are faced with initial or extended loss of loan eligibility under this provision and three of these schools may also lose Pell grant eligibility.

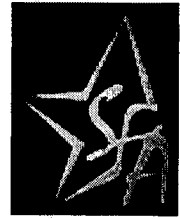
Borrowers who default on federal student loans face serious repercussions, such as the withholding of federal income tax refunds and other federal payments, wage garnishment, adverse credit bureau reports, denial of further student aid, and prosecution.

To avoid these sanctions, defaulters have the option to consolidate their loans and establish an income-based repayment plan that matches their ability to pay.

### New Financial Management System



## Student Financial Assistance Management's Discussion and Analysis



SFA does not currently have an integrated financial management system. Much of the information it needs to operate its programs is scattered among multiple and stand-alone program and financial management systems operated by SFA and the Department.

In order for SFA to perform competent financial management functions, SFA will deploy an SFA financial management system that will be appropriately integrated with the Department's general ledger. The SFA FMS will equate to financial management systems used by leading private sector financial institutions while meeting all SFA requirements and goals as well as the requirements for financial management systems' policies as established by OMB and the Joint Financial Management Improvement Program (JFMIP).

SFA's CFO is working with the SFA Modernization Partners to design, develop, implement and deploy an integrated FMS using an Oracle Federal commercial off the shelf system (COTS).

Phase II consists of the initial rollout and proof of concept of a business case(s) of the SFA FMS that is fully integrated with the FMS General Ledger and interfaced with EDCAPS.

The FMS allows for better trend analysis, budget formulation, liability estimates, and cost management within programs. FMS provides for:

- improved accountability,
- better control over accounting entries,

- improved reconciliation infrastructure,
- enabling SFA to obtain an unqualified audit opinion,
- full subsidiary ledger,
- calculation of status of funds,
- enhanced cash management,
- improved institution reconciliation and close-out processes,
- increased control and management of SFA budget forecasting, allocation, execution and reporting, and
- ability to fully comply with Federal Credit Reform Act requirements.

Overall the FMS will provide a single SFA-wide management tool for SFA and partners that will: (1) provide access to data, (2) provide timely and consistent data for strategic decisions, (3) provide increased reporting capability across organizational units, (4) provide appropriate security and controls, and (5) limit data redundancy.

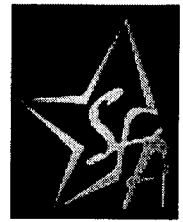
### **SFA Space Issues**

#### Current Space

The total SFA portfolio of space for the Washington, DC, operations was inventoried in August 2000 to determine available expansion space to accommodate growth. All expansion needs were coordinated with the program offices in September. An action plan was developed to fit the needs into existing vacant space in the two existing DC facilities. Execution of the plan is in progress through the Department's Quality Work Group (QWG). The QWG brings project management expertise to the plan for activities such as construction, telephones, IT equipment, furniture and moving.



## Student Financial Assistance Management's Discussion and Analysis



### New Space (Union Center Plaza)

The CFO is responsible for the new Washington, DC, building budget, provides advice on build-out and occupancy, and will operate the new facility once it is occupied. All planned activities for the new building have been identified and the budget estimates are refined on a continuous basis. The projected total budget is within allowance built into the General Services Administration's Memorandum of Understanding and the SFA funds set aside for the project.

The new office space will feature more meeting spaces and public areas. In addition to conference rooms, there will be team rooms, gathering areas and pantries. Natural light will be maximized to create a brighter work environment. No one will be farther than 40 feet away from a window.

The new facility for Washington, DC, operations will be available for occupancy in the summer of 2001.

### **Strengthening Financial Integrity**

Financial integrity is vitally important to producing reliable-relevant financial reports. The focus on increased financial integrity can best be described through examples, as follows. We closed 68 open internal control audit recommendations during FY 2000, and will close 13 of the remaining 16 by December 2000. We continue to work diligently to determine the scope of fraud in death and disability claims. We are focusing on preventing fraud involving foreign schools. In the debt collection area, SFA now has access to the National Directory of New Hires Database. This access allows SFA to build an electronic system that will more effectively locate defaulted borrowers. In total there are over 20 specific actions supporting strong program integrity.

*Analysis*



## Student Financial Assistance Management's Discussion and Analysis



### Systems, Controls and Legal Compliance

The PBO legislation requires SFA to implement an open, common, and integrated system for delivering student aid that contains complete, accurate, and timely data to ensure program integrity. To reduce costs, SFA is also developing a financial management system that will permit unit cost tracking and control in every segment of SFA's operations.

The **SFA Modernization Blueprint** <http://sfablueprint.ed.gov/> details steps SFA is taking to enhance the student financial aid delivery process. The goal is to transform SFA systems to make SFA processes Web-enabled, and our systems integrated and consolidated. This simplified business and technical model will allow students, schools, and financial partners to access the information they need, when they need it, on paper, by telephone, and over the Internet.

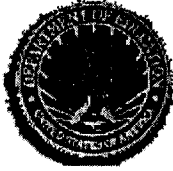
SFA is untangling the web of legacy systems by retiring redundant systems and putting in place new information technology architecture. SFA is also leveraging the Internet, cutting-edge technologies, and middleware. Moving to an e-government model will enable us to work more seamlessly, in real time, with our school and financial partners to improve the delivery of aid to students. At the same time, the cost and complexity of delivering financial aid will be reduced.

SFA is implementing a series of new technologies to move to this new, more

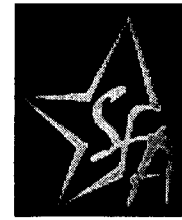
modernized environment. These include new Web-based products, better data integration, a customer relationship management system to link call center representatives to customer information, and enhanced security processes. Whenever possible, SFA is achieving cost and timesaving by implementing existing platforms and using COTS products.

SFA's efforts in the technology arena are designed to facilitate end-to-end customer service in a collaborative environment. SFA's business model - in which activities are grouped into key processes and functional areas - supports this technical architecture.

The Blueprint has an Integrated Sequencing Plan that contains the details of our modernization projects and initiatives. The material in the Blueprint highlights the projects SFA has undertaken or will undertake that deliver the most visible and direct impact for students, schools, and financial partners. These include enhanced loan servicing, to improve customer support and financial counseling and to implement flexible payment options and various repayment channels, and aid origination and disbursement to lower the unit cost to originate and disburse a Pell grant or direct loan. The initiatives detailed in the blueprint also include a datamart to provide financial partners with a single source of data to support key business functions.



## Student Financial Assistance Management's Discussion and Analysis

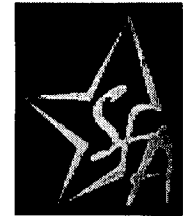


### FY 2000 Highlights of Modernization Progress

- Reviewed all of SFA's legacy contracts against the plans outlined in the Modernization Blueprint to ensure that our contracts are supporting our goals. Some contracts were extended or re-bid, and new performance measures have been added to improve accountability.
  - Signed a new "Share in Savings" contract with our modernization partner, Andersen Consulting, for the elimination of the Central Data System (CDS). This effort will eliminate one of our large legacy systems and begin the integration of direct loan data and processes. It will eliminate five redundant business functions and will integrate the seven remaining functions of CDS into other existing systems. These changes will improve processing time and reduce errors.
  - Completed a Security and Privacy program for SFA systems that meet OMB risk assessment requirements. All systems have now conducted OMB A-130 risk assessments, with results compiled into a single report to reduce paperwork and provide a comprehensive view of the risk.
  - Implemented an Investment Review Process in accordance with Clinger-Cohen legislation to ensure that our
- IT investments make good business sense and meet our PBO objectives.
- Established four critical technical architectures--Internet, Portal, Data Warehouse, and Security--to support SFA's efforts to evolve into an e-commerce government service organization. These technological advancements have allowed SFA to introduce a data warehouse datamart for financial analysis of SFA transactions, a content management capability for data published on SFA's new Web and portal sites, and an Intranet for employee news, training, and job opportunities.
  - Improved the Recipient Financial Management System (RFMS), which is used to process Pell Grants, by eliminating special disbursement records and improving document handling to facilitate quicker and cheaper reconciliation. SFA also made changes to the Direct Loan Origination system to reduce the time that is spent in reconciliation.
  - Doubled students' use of electronic filing of aid applications since last year by using SFA's Free Application for Federal Student Aid Web site ([www.fafsa.ed.gov](http://www.fafsa.ed.gov)). SFA sent out more than 12 million Personal ID numbers (PINs) to enable students to file FAFSAs electronically, putting us in the forefront of most government and private sector organizations in implementing the e-sign legislation.



## Student Financial Assistance Management's Discussion and Analysis



This site won the E-Gov 2000 Pioneer award by IT Direct and "Best Fed on the Web" by GovExec.com. This site allows students to submit applications instantly and cuts costly processing time for aid applications from three weeks to one week.

- Improved Direct Loan Servicing Web site for borrowers. Borrowers can now interactively obtain account information (payment and disbursement histories); send us e-mails; process requests for deferments and forbearances; use the site to estimate their repayment amounts; select repayment plans; choose the date they wish to receive their bills; complete exit counseling; research questions they may have; and complete a borrower satisfaction survey.
- Added a new Direct Loan Servicing Web site for schools. This site allows schools to access exit counseling completion reports and track borrowers who have completed their exit counseling sessions online.

### Financial Management System

SFA's FMS team completed Phase I of the financial management system (FMS) in March 2000. Phase I encompassed validation of the conceptual design and concept of operations. Phase I also defined an implementation plan of three succeeding phases to yield a fully integrated financial

management system that is JFMIP compliant and enables SFA to produce its own financial statements supportive of the goals of the PBO.

Phase II began in April 2000 and encompasses the replacement of the Guaranty Agency (GA) Payment system, Leveraging Educational Assistance Partnership Programs/Special Leveraging Educational Assistance Program and conversion of the ADP equipment inventory data base into the Oracle Fixed Assets module. The general ledger, accounts payable, and accounts receivable modules have been configured, tested, and were deployed on schedule by September 30, 2000.

The replacement of the GA Payment system is a major accomplishment and a culmination of two years work with the GA community. The deployment of the application allows SFA to close a number of long outstanding audit findings regarding the oversight and monitoring of the guaranty agency default receivables held and guaranty agency reserve and other fund balances.

The GA Payment system is the first production rollout of SFA's web-enabled financial management system and establishes the infrastructure needed to provide SFA with the information it needs to manage its operations. The FMS allows for better trend analysis, budget formulation, liability estimates, and cost management within programs. FMS provides for improved accountability, better control over



## Student Financial Assistance Management's Discussion and Analysis



accounting entries, and an improved reconciliation infrastructure.

In FY 2001, SFA will develop, test, implement, and deploy Phase III. Once operational (scheduled for October 2001), FMS will support full program functionality, which will allow us to prepare useful management and information reports (e.g., cost management and program funds, etc.). SFA will also gain the ability to prepare its own financial statements, management information system reports and reconciliations. Finally, SFA will complete the work necessary to have a fully functional SFA general ledger, which will provide SFA with better support and audit trail for SFA independent audits.

Ultimately, SFA will have a financial management system that will include subsidiary structures supporting all of the PBO's financial management and accounting requirements, as well as provide appropriate information to the Department's financial management system.

### Pell Program Improvements

The Federal Pell Grant Program's Recipient Financial Management System (RFMS) was implemented in the 1999-2000 award year for institutions to report student payment information and request funds. A COTS package (Oracle) was selected to provide the basic financial management infrastructure for RFMS processing.

The system provides institutions\* with the following benefits:

- All electronic process—so no more paper to submit;
- Speeds the processing of origination and disbursement records so that schools receive record acknowledgements within 24 hours and the goal is to process batches and make Pell Grant funds available within 24-36 hours after an institution's submission;
- Processes records several times a day rather than once a day; and
- Provides institutions with the ability to query RFMS' data through the Web.

\* Does not apply to processing disbursement records for those institutions on the reimbursement system of payment.

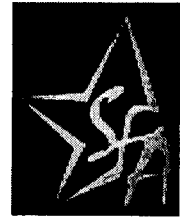
### FFEL Program Improvements

In 1999, SFA began to streamline reporting processes, improve payment processing and improve the quality and reliability of the information being submitted by guaranty agencies that the Department relies on for payment, monitoring and reporting to management and outside entities by completing work with guaranty agencies on the redesign of the FFEL guaranty agency forms—1189/1130.

In July 1999, SFA also sent lenders and servicers invitations to submit their requests for interest and special allowance payments electronically, using EDI transaction sets. This process will provide better and more timely information to the Department on which to make interest and special allowance payments. The Department is also now paying guaranty agencies loan



## Student Financial Assistance Management's Discussion and Analysis



processing and issuance fees based on disbursements reported to the NSLDS.

The Department has awarded 17 performance-based collection contracts aimed at improving collections of defaulted loans, while reducing private agency costs. On a quarterly basis, the performance of the contractors is reviewed and bonuses are based on their performance. These contracts will run until 2001.

Planned FY 2001 enhancements to the FFEL and defaulted loan debt collection systems include the following:

- Revising and implementing new FFEL reconciliations for redesigned forms and processes,
- Revising the appropriate audit guides to ensure that steps are included to audit the redesigned form amounts, particularly the loans receivable collections and reserve balances, and better aligned data submitted to NSLDS,
- Evaluate current defaulted loan collection strategies to expand student loan recoveries through either a structured sales transaction(s) or specialized servicing arrangement(s).
- Continue development of client server/distributed database technology for various applications on the FFEL System.
- Implement enhancements to the Debt Collection System to provide improved service to student debtors and increase collections.
- Continue analysis of the lender billing data elements and processing to support

streamlining and improved data quality and processing of the lender information.

### Direct Loan Program Improvements

During FY 2000, an automated approach to Direct Loan inter-system balancing was developed and implemented. The new automated approach provides for a daily and monthly reconciliation of financial transactions flowing between Direct Loan systems and reports total transactions sent, processed, and the corresponding dollar amounts.

SFA also developed and implemented a process for Certified Public Accountants to perform confirmations of essential data elements in the Direct Loan Servicing System when they conduct annual compliance audits of institutions participating in the Direct Loan Program.

For Academic Year 1999-2000, SFA began using the master promissory note for subsidized and unsubsidized Direct Loans. Therefore, borrowers can now sign one note for both an unsubsidized and a subsidized loan. During FY 2000, student borrowers at certain institutions were also able to use the multi-year functionality of the master promissory note.

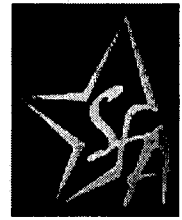
To encourage use of the Electronic Debit Account (EDA) payment method, a 0.25 percent discount was given to all Direct Loan borrowers to use it.

During FY 2001, a Program Year Closeout (PYCO) Team for the Direct Loan Program became operational to assist schools with





## Student Financial Assistance Management's Discussion and Analysis



their reconciliations of drawdowns and disbursements with Loan Origination Center.

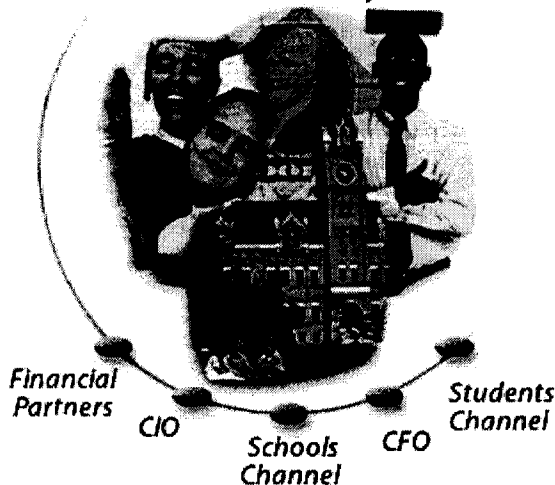
Other enhancements planned in FY 2001 include the following:

- Move the Direct Loan subsidiary ledger to a JFMIP approved COTS package in a summarized fashion that will better facilitate credit reform, internal and external reporting and management information needs.
- Continue to implement the Direct Loan automated systems balancing and reconciliation procedures across all systems affecting the Direct Loan program.
- Continue to implement improved procedures to assure appropriate monitoring of Direct Loan schools to include cash management and revised reconciliation processes.

Develop and implement an electronic Direct Consolidated Loan lender payment process to accurately and timely pay lenders.

- Improve schools' Web access to the Loan Origination System.
- Simplify funds flow and the reconciliation and reporting processes.
- Repayment incentives will be offered to Direct Loan and consolidation borrowers who make their payments on time.
- Direct Consolidation Loan borrowers who consolidate during FT 2001 will receive an interest rate cut of 0.80 percent on all loans made during this period.
- Customer service will be improved through use of Web-based and interactive voice response technologies.
- Begin implementation of e-signatures for applications, promissory notes, and forms.
- Provide online status check capability for consolidation applications.

*We Help Put America  
Through School*





## Student Financial Assistance Management's Discussion and Analysis



### Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements 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.

**SECTION 6**

**FISCAL YEAR 2000 FINANCIAL STATEMENTS  
AND NOTES**

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

	<b>Consolidated</b>
<b>Assets</b>	
<b>Entity Assets</b>	
<b>Intragovernmental Assets:</b>	
Fund Balance with Treasury (Note 2)	\$22,758,091
Interest Receivable	70,755
<b>Governmental Assets:</b>	
Accounts Receivable, Net (Note 3)	10,351
Credit Program Receivables, Net (Note 4)	73,756,061
Advances	38,739
Cash and Other Monetary Assets	1,302
Other Governmental Assets	236,363
<b>Total Entity Assets</b>	<b>\$96,871,662</b>
<b>Non-Entity Assets</b>	
Guaranty Agency Federal & Restricted Funds Receivable (Note 3)	\$2,231,814
<b>Total Non-Entity Assets</b>	<b>\$2,231,814</b>
<b>Total Assets</b>	<b>\$99,103,476</b>
<b>Liabilities</b>	
<b>Liabilities Covered by Budgetary Resources</b>	
<b>Intragovernmental Liabilities:</b>	
Accounts Payable	\$1,623
Interest Payable	70,755
Borrowing from Treasury (Note 5)	65,346,881
Guaranty Agency Federal & Restricted Funds Due To Treasury (Note 3)	2,231,814
Payable to Treasury (Note 6)	7,860,621
Other Intragovernmental Liabilities (Note 7)	4
<b>Governmental Liabilities:</b>	
Accounts Payable	168,103
Accrued Grant Liability (Note 8)	319,376
Liabilities for Loan Guarantees (Note 4)	13,667,983
Other Governmental Liabilities (Note 7)	145,759
<b>Total Liabilities Covered by Budgetary Resources</b>	<b>\$89,812,919</b>
<b>Liabilities Not Covered by Budgetary Resources</b>	
<b>Intragovernmental Liabilities:</b>	
Other Intragovernmental Liabilities (Note 7)	\$237,682
<b>Governmental Liabilities:</b>	
Other Governmental Liabilities (Note 7)	9,342
<b>Total Liabilities Not Covered by Budgetary Resources</b>	<b>\$247,024</b>
<b>Total Liabilities</b>	<b>\$90,059,943</b>
<b>Net Position</b>	
Unexpended Appropriations (Note 9)	\$9,253,010
Cumulative Results of Operations (Note 9)	(209,477)
<b>Total Net Position</b>	<b>\$9,043,533</b>
<b>Total Liabilities and Net Position</b>	<b>\$99,103,476</b>

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

	<b>Consolidated</b>
<b>Program Costs</b>	
<b>Intragovernmental</b>	
Interest Expense, Federal (Note 10)	\$4,972,380
Other Production Expense	150
Contractual Service Expense	5,015
Salaries and Administrative Expense	66,181
Bad Debt & Write-offs	235
<b>Governmental</b>	
Subsidy Expense (Note 4)	(3,637,397)
Grant Expense	8,960,280
Interest Expense, Non-Federal (Note 10)	224
Contractual Service Expense	452,277
Salaries and Administrative Expense (Note 11)	207,685
Other Program Expenses	180,163
<b>Total Program Cost</b>	<b>\$11,207,193</b>
<b>Less: Earned Revenues</b>	
Interest, Federal (Note 10)	\$1,761,124
Interest, Non-Federal (Note 10)	3,211,256
<b>Earned Revenues</b>	<b>\$4,972,380</b>
<b>Net Program Cost</b>	<b>\$6,234,813</b>
<b>Net Cost of Operations</b>	<b>\$6,234,813</b>

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

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

	<b>Consolidated</b>
<b>Net Cost of Operations</b>	<b>\$(6,234,813)</b>
<b>Financing Sources (Other than Exchange Revenues):</b>	
Appropriations Used	\$10,673,739
Imputed Financing (Note 12)	117,570
Future Transfers Out due to Downward Subsidy Re-estimate	(4,010,604)
<b>Total Financing Sources</b>	<b>\$6,780,705</b>
<b>Net Results of Operations</b>	<b>\$545,892</b>
<b>Prior Period Adjustments (Note 13)</b>	<b>\$(931,055)</b>
<b>Net Change in Cumulative Results of Operations</b>	<b>\$(385,163)</b>
<b>Increase (Decrease) in Unexpended Appropriations</b>	<b>\$476,516</b>
<b>Change in Net Position</b>	<b>\$91,353</b>
<b>Net Position - Beginning of Period</b>	<b>\$8,952,180</b>
<b>Net Position - End of Period</b>	<b>\$9,043,533</b>

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

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

	<b>Combined</b>
<b>Budgetary Resources</b>	
Budget Authority	\$34,511,961
Unobligated Balance-Beginning of Period (Adjusted) (Note 14)	13,203,045
Spending Authority from Offsetting Collections	21,187,709
Adjustments (Note 15)	(10,938,820)
<b>Total Budgetary Resources (Note 15)</b>	<b>\$57,963,895</b>
<b>Status of Budgetary Resources</b>	
Obligations Incurred (Adjusted) (Note 14)	\$52,125,416
Unobligated Balances-Available	1,491,844
Unobligated Balances-Not Available	4,346,635
<b>Total Status of Budgetary Resources (Note 15)</b>	<b>\$57,963,895</b>
<b>Outlays</b>	
Obligations Incurred (Adjusted) (Note 14)	\$52,125,416
Less: Spending Authority from Offsetting Collections and Adjustments	(21,364,303)
Obligated Balance, Net-Beginning of Period (Adjusted) (Note 14)	13,664,563
Less: Obligated Balance, Net-End of Period	(21,629,148)
<b>Total Outlays (Note 15)</b>	<b>\$22,796,528</b>

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

	<b>Combined</b>
<b>Obligations and Nonbudgetary Resources</b>	
Obligations Incurred (Adjusted) (Note 14)	\$52,125,416
Spending Authority from Offsetting Collections and Adjustments	(21,364,303)
Financing Imputed for Cost Subsidies	117,570
Financing Sources Transferred Out	(4,010,604)
Exchange Revenue Not In the Entity's Budget	4,352,527
<b>Total Obligations and Nonbudgetary Resources</b>	<b>\$31,220,606</b>
<b>Resources That Do Not Fund Net Cost of Operations</b>	
Change in Amount of Goods, Services, and Benefits	
Ordered But Not Yet Provided (Net Increases) Net Decreases	\$(2,390,955)
Credit Program Collections that Increase	
Liabilities for Loan Guarantees or Allowance for Subsidy	8,951,690
Resources that Fund Expenses Recognized in Prior Periods	(4,104)
Resources that Finance the	
Acquisition of Assets or Liquidation of Liabilities (Note 16)	(35,333,600)
Other Resources that Finance the	
Acquisition of Assets or Liquidation of Liabilities (Note 16)	4,287,223
<b>Total Resources That Do Not Fund Net Cost of Operations</b>	<b>\$(24,489,746)</b>
<b>Costs That Do Not Require Resources</b>	
Adjustments	\$(80,868)
<b>Total Costs That Do Not Require Resources</b>	<b>\$(80,868)</b>
Financing Sources Yet to be Provided	\$(415,179)
<b>Net Cost of Operations (Note 16)</b>	<b>\$6,234,813</b>

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



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**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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**Note 1 - Summary of Significant Accounting Policies**

**A. Description of Entity**

Student Financial Assistance (SFA) was created as a Performance Based Organization (PBO) within the Department of Education (the Department) under the Higher Education Act of 1965 (HEA) amendments enacted in 1998. SFA is following the mandates of a PBO by developing a management structure driven by strong incentives to manage for results. One of SFA's goals is to help overcome the financial barriers that make it difficult for lower- and middle-income students to attend and complete postsecondary education. SFA administers its appropriations for Title IV Student Financial Assistance Programs to accomplish this goal.

SFA's three major programs are as follows:

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 Treasury to fund the loans. The program provides interest subsidies for eligible borrowers.

The **Federal Family Education Loan (FFEL) Program**, authorized by the Higher Education Act of 1965, as amended, operates with guaranty agencies to provide loan guarantees on loans made by private lenders to eligible students. The program provides interest subsidies to lenders for eligible borrowers.

The **Pell Grant and Campus-Based Programs** provide aid that is not repaid to the Federal Government. The Pell Grant Program provides grant aid to low- and middle-income undergraduate students. Awards vary in proportion to the financial circumstances of students and their families. The Campus-Based Programs provide educational grants and other financial assistance to eligible applicants. These include the Supplemental Educational Opportunity Grant, Work-Study, and Perkins Loan programs. Campus-Based programs are not material to these statements and therefore are reported under Grants.

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**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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**B. Basis of Accounting**

The financial statements are presented in accordance with accounting principles generally accepted in the United States and follow the guidance provided by the Office of Management and Budget's Bulletin No. 97-01, *Form and Content of Agency Financial Statements*.

SFA's 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 accrual-based transactions are recorded.

**C. Use of Estimates**

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 SFA financial statements. Actual results may differ from those estimates.

**D. Principles of Consolidation**

The Balance Sheet, Statement of Net Cost, and the Statement of Changes in Net Position were prepared on a consolidated basis. The Statement of Budgetary Resources and the Statement of Financing were prepared on a combined basis. Inter-program transactions and balances are required to be eliminated for SFA's three designated programs under the consolidated basis but not under the combined basis.

**E. Credit Reform - Present Value Accounting**

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 Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 2, Accounting for Direct Loans and Loan Guarantees, and related regulations and guidance, require recording subsidy costs (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 allowances (reductions) for loan receivables or as liabilities for loan guarantees. All credit program receivables are recorded at the principal and interest outstanding, net of the allowances for subsidy.

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**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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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 by a Treasury debt instrument of similar term at the time loans are disbursed. Subsidy costs are recognized as expenses in the year loans are disbursed. Subsidy costs of credit program loans are re-estimated each year.

**F. Budget Authority**

Budget authority is the authorization provided by law for SFA to obligate for future outlays of Federal funds. SFA's budgetary resources as of September 30, 2000 include current authority (e.g. appropriations and borrowing authority) and unobligated balances remaining from multi-year and no-year budget authority received in prior years. Budgetary resources include reimbursements received and other revenue (e.g. 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 loans' principal made under the Federal Direct Student Loan Program. The costs of SFA'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. Fees received on loans, such as loan origination fees, are components of subsidy expense.

**G. Fund Balance with Treasury**

Fund Balance with Treasury is the aggregate amount of funds in accounts with Treasury for which SFA is authorized to make expenditures and pay liabilities (see Note 2). Fund Balance with Treasury is an asset because it represents SFA's claim to Federal Government resources. SFA has the authority to disburse Treasury funds directly to agencies and institutions participating in its programs. Treasury processes cash receipts and disbursements on behalf of SFA.

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**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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**H. Credit Program Receivables**

Credit program receivables are recorded at the principal and interest outstanding, net of allowances for subsidy (see Note 4). Credit programs include the FFEL Program and the Federal Direct Student Loan Program. Allowances for subsidy represent the differences between the present values of estimated cash inflows and outflows of the underlying credit program loans held by SFA. 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 present value methodology (see Note 4).

Subsidy expense is computed based on the estimated difference between the present values of expected cash outflows (e.g. net interest expense and defaults) and inflows (e.g. loan collections and fees). The cash flows are discounted using the interest rate earned by a Treasury debt instrument of similar terms as those of the loans, at the time the loans were disbursed. Subsidy costs are recognized in the year loans are disbursed and are re-estimated each year. These re-estimates increase or decrease the cost of the program.

**I. Accounts Receivable**

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

**J. Accounts Receivable - Guaranty Agency Reserves**

Under Section 422A of the HEA, 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, 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 activities, and collection activities.

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**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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Guaranty Agency reserves consist of SFA's interest in the net assets of FFEL Program Guaranty Agencies. Guaranty Agency's 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.

**K. Liabilities**

Liabilities represent the amount of funds likely to be paid by SFA resulting from transactions or events that have already occurred. SFA may not pay a liability absent budget authority to liquidate the payable. Liabilities for which budget authority has not been enacted are classified as liabilities not covered by budgetary resources. Most of FFEL Program and Federal Direct Student Loan Program liabilities result from entitlements covered by permanent indefinite budget authority.

**L. Liabilities for Loan Guarantees**

The estimated liability for loan guarantees under the FFEL Program is the estimated long-term cost to SFA of its loan guarantees calculated on a net present value basis, excluding administrative costs (see Note 4). Obligations for the subsidy cost will be recorded against budget authority when a loan guarantee commitment is made. 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.

**M. Accrued Grant Liability**

Disbursements of grant funds are made to recipients through a draw down request. Recipients may not request funds in advance of incurring the related expenditures. Therefore, an accrued grant liability is estimated at September 30, 2000, which represents estimated amounts of authorized expenditures, where a draw down has not yet been requested although the expenditure has been incurred (see Note 8). The accrued grant liability is estimated using statistical sampling methodology.

**N. Borrowing from Treasury**

Borrowings from Treasury provide funding for loans made under the Federal Direct Student Loan Program. Principal repayments are made by SFA to Treasury based on

**Student Financial Assistance**

**Notes to Financial Statements**

**September 30, 2000**

**T. Related Party Transactions**

SFA's financial activities interact with and are dependent upon those of the Federal Government as a whole. Specifically, SFA is subject to financial decisions and management controls of the Department of Education, the Office of Management and Budget, and the Department of the Treasury. Because of SFA's relationship with other Federal Government entities, SFA's operations may not be conducted, nor its financial position reported, as they would if SFA were a separate and unrelated party.

**Note 2 - Fund Balance with Treasury**

Fund Balance with Treasury represents all undisbursed account balances for SFA that are held by Treasury. All undisbursed account balances with Treasury are entity assets and primarily consist of appropriated and revolving funds. Revolving funds conduct continuing cycles of business-like activity and do not require an annual appropriation. SFA's fund balances with Treasury as of September 30, 2000 were as follows (dollars in thousands):

<b>Fund Balance with Treasury</b>	
<b>Fund Type</b>	<b>Total</b>
Appropriated Funds	\$ 10,718,303
Revolving Funds	12,039,310
Other Funds	478
<b>Fund Balance with Treasury</b>	<b>\$ 22,758,091</b>

The Fund Balance with Treasury within the financing accounts of the Direct Loan and FFEL programs represent SFA's Revolving funds. Appropriated funds receive periodic, usually annual, appropriations.

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**Student Financial Assistance**

**Notes to Financial Statements**

**September 30, 2000**

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**Note 3 - Accounts Receivable and Guaranty Agency Reserves**

Accounts receivable is recorded at the net realizable amount. SFA estimates an allowance for loss on uncollectible accounts based on historical data. Entity accounts receivable of \$10.4 million represent balances due from recipients of financial assistance and for other operational activities.

Non-entity accounts receivable of \$2.2 billion relates to the Guaranty Agency reserves. These Guaranty Agency reserves represent the Federal Government's interest in the net assets of state and non-profit FFEL Program Guaranty Agencies. In addition, since these monies are due Treasury once received, a corresponding payable was recorded.

**Note 4 - Credit Program Receivables and Liabilities for Loan Guarantees**

SFA operates the Federal Direct Student Loan Program and the Federal Family Education Loan (FFEL) Program. Loans are made to individuals who meet statutorily set eligibility criteria and attend eligible institutions of higher education. Eligible institutions include public and private two and four year institutions, graduate schools, and vocational training schools. Loans are available to students and their parents regardless of income. Student borrowers who demonstrate financial need may receive Federal subsidized 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 net present value of subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the direct or guaranteed loan is disbursed. The subsidy costs are revalued annually, and consist 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.)

Federal Direct Student Loan Program and defaulted FFEL Program loan receivables are reported net of an allowance for subsidy computed using net present value methodology. The FFEL Program estimated loan liability is reported at the net present value of estimated net cash outflows. SFA has elected to report its pre-fiscal year 1992 defaulted FFEL Program loans and loan guarantee liability on a net present value basis.

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**Student Financial Assistance**

**Notes to Financial Statements**

**September 30, 2000**

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SFA estimates all cash flows associated with loans made under the FFEL Program and Federal Direct Student Loan Program, 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 subsidy estimates are recorded as a reduction of the direct and defaulted FFEL Program loans receivable outstanding, and a liability for the guaranteed loans. SFA employs a computer-based cash flow projection model to compute the subsidy estimates for direct and defaulted FFEL Program loans and the FFEL Program loan guarantee liability. SFA estimates cash flows over the life of a loan, aggregating the loans by loan type, cohort year, and risk category. The cohort year for the loan represents the year the direct loan was obligated or the loan was guaranteed, regardless of the timing of disbursements. Risk categories include students at two-year colleges, four-year colleges, graduate schools, and proprietary schools.

Under the FFEL Program, over 4,000 financial institutions make loans directly to students and parents. These loans are guaranteed by the Federal Government against default, with 36 State or private non-profit Guaranty Agencies acting as intermediaries in administering the guarantees. The financial institutions are responsible for a share of the cost of each default (2 percent); Guaranty Agencies also pay a portion of the cost of each defaulted loan from Federal funds they hold in trust (in most cases 5 percent). FFEL Program participants receive statutorily set Federal interest and special allowance subsidies when eligible borrowers are in school and during grace and deferment periods. Guaranty Agencies receive fee payments as set by statute.

As of September 30, 2000, the total principal balance outstanding of guaranteed loans held by lenders was approximately \$139 billion. If all loans currently guaranteed were to default, SFA would not pay the full guaranteed amount to the Guaranty Agencies. Instead, SFA would pay a smaller amount due to the reinsurance rates, which range from 75 to 95 percent of the amount paid to the lender, depending on the default rate for the Guaranty Agency.

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 through consolidation of an existing loan is considered a payment of principal and interest to the loan holder: either a



**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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 previously noted, borrowers may pre-pay and close out existing loans from capital raised through the disbursement of a new consolidation loan. The fiscal year 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.

**A. Credit Program Receivables**

The credit program receivables as of 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 as of September 30, 2000 were as follows (dollars in thousands):

<b>Credit Program Receivables</b>				
	Direct Loans	Defaulted FFELP Loans		Total
		Pre-1992	Post-1991	
Loans Receivable	\$58,522,455	\$14,986,951	\$5,341,825	\$ 78,851,231
Interest Receivable	1,707,927	2,006,678	1,188,792	4,903,397
Sub-total	60,230,382	16,993,629	6,530,617	83,754,628
Allowance for Subsidy	2,585,250	(14,086,594)	1,502,777	(9,998,567)
<b>Credit Program Receivables, Net</b>	<b>\$62,815,632</b>	<b>\$2,907,035</b>	<b>\$8,033,394</b>	<b>\$73,756,061</b>

The fiscal year 2000 allowance for subsidy in Direct Loans and post-1991 FFELP 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.

**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

It is important to recognize that the credit program receivables net amount is not the same as the proceeds that SFA would expect to receive from selling the loans. The value SFA would expect to receive from selling the loans would be determined by the market place.

**B. Liabilities for Loan Guarantees**

As of September 30, 2000, total outstanding loan guarantees under FFEL were approximately \$139 billion. The FFEL Program loan guarantee liability, as of September 30, 2000, was as follows (dollars in thousands):

<b>Liabilities for Loan Guarantees</b>	
Pre-1992 Guarantees, Present Value	\$ 443,713
Post-1991 Guarantees, Present Value	13,224,270
<b>Liabilities for Loan Guarantees</b>	<b>\$ 13,667,983</b>

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 fiscal year 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 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 fiscal year 2000 financial statements.

**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

**C. Subsidy Expense**

Direct Loan and FFEL Program loan guarantee subsidy expenses for the fiscal year ended September 30, 2000 were as follows (dollars in thousands):

<b>Direct Loan Subsidy Expense</b>	
Loan Defaults (Net of Recoveries)	\$ 453,467
Interest Subsidies	(1,880,221)
Fees	545,993
Other	(187,889)
<b>Current Year Subsidy Transfers</b>	<b>\$ (1,068,650)</b>
Total Reestimates	(2,864,278)
<b>Direct Loan Subsidy Expense</b>	<b>\$ (3,932,928)</b>

<b>FFEL Program Loan Guarantee Subsidy Expense</b>	
Loan Defaults (Net of Recoveries)	\$ 1,262,779
Interest Subsidies	2,815,910
Fees	(1,067,831)
Other	519,276
<b>Current Year Subsidy Transfers</b>	<b>\$ 3,530,134</b>
Total Reestimates	(3,234,603)
<b>FFEL Loan Guarantee Subsidy Expense</b>	<b>\$ 295,531</b>

**Student Financial Assistance**

**Notes to Financial Statements**

**September 30, 2000**

**Note 5 - Borrowing from Treasury**

Borrowing from Treasury funds the majority of the loans made under the Direct Loan Program. The Interest rate is set each year by Treasury. Borrowing from Treasury as of September 30, 2000 was as follows (dollars in thousands):

<b>Borrowing from Treasury</b>	
Borrowing from Treasury, Beginning	\$ 52,069,506
New Borrowing	16,346,598
Repayments	( 3,069,223)
<b>Borrowing from Treasury, Ending</b>	<b>\$ 65,346,881</b>

Fund Balance with Treasury was reduced by approximately \$3.1 billion because of principal repayments of borrowing made to Treasury pertaining to the Direct Loan Program. The Statement of Budgetary Resources reflects the budgetary impact of the principal repayment to Treasury. The SF-1151 (Non-expenditure Transfer Authorization) for the repayment was submitted to Treasury after September 30, 2000 but before the October 31, 2000 deadline. Treasury regulations require agencies to transmit their SF-1151s by October 31, 2000 to meet year-end reporting requirements.

Additionally, Fund Balance with Treasury was reduced by \$4.5 billion of interest expense and increased by \$1.3 billion of interest revenue, pertaining to the interest calculations of the Direct Loan Program. The Statement of Net Cost reflects the \$4.5 billion of interest expense as well as the interest revenue on uninvested funds of \$1.3 billion. The Statement of Budgetary Resources reflects an expenditure and outlay of \$4.5 billion as well as increased spending authority for offsetting collections and decreased outlays for \$1.3 billion. This interest expense and revenue consisted of expenditure transactions (SF-1081) that were submitted in October 2000 and were reflected on the September Statement of Transactions (SF-224). Treasury regulations require interest payments to be paid to Treasury annually, as of the last day of the fiscal year, and are due to Treasury no later than the third workday after the close of the fiscal year. SFA reduced Fund Balance with Treasury in the general ledger in compliance with Treasury regulations that address this issue.

**Student Financial Assistance**

**Notes to Financial Statements**

**September 30, 2000**

**Note 6 - Payable to Treasury**

At September 30, 2000, SFA reported \$7.9 billion as a payable to the U.S. Treasury. Of this amount, \$3.9 billion is associated with the FFEL Program liquidating account and will be paid from future excess liquidating account credit program receivable collections. In addition, \$4 billion represents a downward subsidy re-estimate to the FFEL program account, which will be paid in fiscal year 2001.

**Note 7 - Other Liabilities**

Other liabilities covered by budgetary resources include contractual services, administrative services, and interagency agreement accruals. Other liabilities not covered by budgetary resources include unfunded expenses that will be paid out of future budgetary resources. SFA's other liabilities as of September 30, 2000 were as follows (dollars in thousands):

<b>Other Liabilities</b>	
<b>Other Liabilities Covered by Budgetary Resources:</b>	
Intragovernmental	\$ 4
Governmental	145,759
<b>Total - Covered</b>	<b>\$ 145,763</b>
<b>Other Liabilities Not Covered by Budgetary Resources:</b>	
Intragovernmental	\$ 237,682
Governmental	9,342
<b>Total -Not Covered</b>	<b>\$ 247,024</b>
<b>Total</b>	<b>\$ 392,787</b>

Other liabilities not covered by budgetary resources include accruals for Federal employee benefits. SFA's employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS), based upon the starting date of their employment with the Federal Government. Employees may participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan. Employee and employer contributions are made to the Civil Service Retirement and Disability Fund, which is administered by the Office of Personnel

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**Student Financial Assistance**

**Notes to Financial Statements**

**September 30, 2000**

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Management (OPM). SFA does not report FERS or CSRS assets or accumulated benefits applicable to its employees since this information is reported in total by OPM. SFA's contributions for CSRS and FERS employees were \$7 million for fiscal year 2000.

Employees hired before January 1, 1984 are covered by the CSRS, which provides a basic annuity and Medicare coverage. SFA contributed an amount equal to 8.51 percent of the employee's basic pay to the CSRS during fiscal year 2000. Participating employees contributed 7.25 percent of their basic pay during fiscal year 2000. SFA and the employee also contribute to Medicare at the rate prescribed by law. SFA does not match contributions to the Thrift Savings Plan for employees who participate in the CSRS.

FERS consists of Social Security, a Basic Annuity Plan, and the Thrift Savings Plan. SFA contributed to the basic annuity plan an amount equal to 10.7 percent of each employee's basic pay during fiscal year 2000. Participating employees contributed 1.05 percent of their basic pay during fiscal year 2000. SFA and the employee also contribute to Social Security and Medicare at the rates prescribed by law. In addition, SFA automatically contributes one percent of basic pay to the Thrift Savings Plan and matches a voluntary employee contribution up to 3 percent of the employee's basic pay, and 50 percent of a contribution between 3 percent and 5 percent of basic pay.

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to cover Federal employees injured on the job or who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to job related injury or occupational disease. The Department of Labor (DOL) administers the FECA Program. DOL pays valid claims and bills the employing Federal agency. DOL calculates the actuarial liability for future workers' compensation benefits and reports to each agency its share of the liability.

**Note 8 - Accrued Grant Liability**

Disbursements of grant funds are made to recipients through a draw down request. Since some recipients did not request funds in advance of incurring related grant expenditures, an accrued grant liability of \$319 million was estimated for September 30, 2000. This represents the estimated amount of authorized expenditures, where a draw down was not requested although the expenditure has been incurred. The accrued grant liability is

**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

estimated using statistical sampling methodology and represents 15.9 percent of fiscal year 2000 grant expenditures.

**Note 9 - Net Position**

SFA's net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent amounts not yet expended, which have not lapsed, been rescinded, or been withdrawn. Cumulative results of operations represent the excess of expenses over revenues for an account since its inception.

SFA's unexpended appropriations are comprised of unobligated balances-available, unobligated balances-unavailable, and undelivered orders. Since unexpended appropriations do not include funding activity for which appropriations have not yet been received, unexpended appropriations reported on the Balance Sheet will not agree with the balances of budget authority. The unobligated balances and undelivered orders for SFA's financing and liquidating accounts are not included in unexpended appropriations. Total unobligated balances not included in unexpended appropriations include \$4.2 billion for the FFEL Program and \$17 million for the Direct Loan Program. The FFEL Program had undelivered orders in its liquidating account of \$165 million and \$1.5 billion in its financing account. The Direct Loan Program had \$7 billion in undelivered orders in its financing account. SFA's unexpended appropriations as of September 30, 2000 are comprised of the following (dollars in thousands):

<b>Unexpended Appropriations</b>	
Unobligated Balance	
-Available	<b>\$1,491,476</b>
-Unavailable	<b>174,625</b>
Undelivered orders	<b>7,586,909</b>
<b>Unexpended Appropriations</b>	<b>\$ 9,253,010</b>

SFA's cumulative results of operations consist primarily of unfunded expenses for certain payroll accruals and a subsidy re-estimate for the Direct Loan Program that will be

**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

executed in fiscal year 2001. These expenses are funded from future appropriations and the cumulative results of operations will be reversed when funding occurs.

**Note 10 - Interest Revenue and Expense**

Interest revenue was earned on the individual loans in the portfolios of the direct loan and FFEL programs. In addition, interest is earned on the uninvested fund balances with Treasury. Interest expense was incurred on SFA's borrowings from Treasury for the Direct Loan Program. The interest revenues and expenses for fiscal year 2000 attributable to the Federal Direct Student Loan and FFEL programs follow (dollars in thousands):

<b>Interest Revenues and Expenses</b>			
	<b>Federal Direct Student Loans</b>	<b>FFELP Loans</b>	<b>Total</b>
Interest Revenues, Federal	\$1,261,281	\$499,843	\$1,761,124
Interest Revenues, Non-Federal	3,211,256	0	3,211,256
<b>Interest Revenues</b>	<b>\$ 4,472,537</b>	<b>\$499,843</b>	<b>\$4,972,380</b>
Interest Expense, Federal	\$ 4,472,537	\$499,843	\$4,972,380
Interest Expense, Non-Federal	115	109	224
<b>Interest Expense</b>	<b>\$ 4,472,652</b>	<b>\$ 499,952</b>	<b>\$4,972,604</b>

**Note 11 - Allocation of Direct and Indirect Cost**

Total program cost of \$11.2 billion includes \$63.1 million in allocated indirect departmental expenses. The Department, in support of SFA programs, incurs expenses for salaries and administrative activities that are allocated to SFA based on full time employee counts and program dollars.



**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

**Note 12 - Imputed Costs and Financing Sources**

The Statement of Changes in Net Position recognized an imputed financing source of \$117.6 million for fiscal year 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 SFA 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 SFA's estimate of the funds necessary to pay employees future pension, life, and health benefits.

**Note 13 - Prior Period Adjustments**

During fiscal year 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)				
Program	Equity and Loan Guarantee Liability Adjustment in FFEL Financing Account	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	0	0	20,694	20,694
Grants	0	85,716	0	85,716
<b>Total Adjustments</b>	<b>\$ 820,123</b>	<b>\$ 98,521</b>	<b>\$ 12,411</b>	<b>\$ 931,055</b>

The Department performed a detailed review of the FFEL financing account to identify prior year transactions that created cumulative results of operations as of fiscal year 1999 year-end. Under Federal Credit Reform accounting, financing accounts 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.

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**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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The Department performed the following analyses during fiscal year 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, Net Position, and Undelivered orders. Other prior period adjustments were made to correct transactions posted in prior years.

**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

**Note 14 – Adjusted Unobligated and Obligated Balances**

Fiscal year 1999 ending Unobligated and Obligated balances were incorrect due to systemic problems in the general ledger closing process and accounting errors that occurred in prior years. During fiscal year 2000, the Department of Education performed a review of fiscal year 1999 ending balances and recorded adjustments to correct the account balances. The Statement of Budgetary Resources reflects the following adjusted beginning Unobligated and Obligated balances (dollars in thousands):

	Fiscal Year 2000 Beginning Balance (Unadjusted)	Adjustments	Fiscal Year 2000 Beginning Balance (Adjusted)
<b>Unobligated Balances</b>			
FFEL	\$ 7,771,917	\$ 498,922	\$ 8,270,839
DL	29,794	0	29,794
Grants	4,720,204	182,208	4,902,412
<b>Total</b>	<b>\$ 12,521,915</b>	<b>\$ 681,130</b>	<b>\$ 13,203,045</b>
<b>Obligated Balances</b>			
FFEL	\$ 3,060,836	\$ 745,255	\$ 3,806,091
DL	6,907,766	0	6,907,766
Grants	2,807,498	143,208	2,950,706
<b>Total</b>	<b>\$ 12,776,100</b>	<b>\$ 888,463</b>	<b>\$ 13,664,563</b>

**Note 15 - Statement of Budgetary Resources**

The Statement of Budgetary Resources compares budgetary resources with the status of those resources. The Statement of Budgetary Resources is a simplified version of the statutory "Report on Budget Execution" (SF-133) that is required to be submitted to Treasury on a quarterly basis. The Report on Budget Execution is used annually to prepare the President's Budget and it is integral to Federal budgeting. SFA's budgetary resources consist of budget authority, unobligated balances, transfers of monies, collections, and recoveries of prior year obligations, which is net of amounts temporarily

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**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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or permanently not available. SFA's budget authority is authority provided by law for SFA to incur financial obligations that will result in outlays or expenditures.

Budgetary resources outstanding as of September 30, 2000 were \$58 billion and outlays for the year were \$22.8 billion. At September 30, 2000, SFA had \$16.2 billion in net budgetary resources obligated for undelivered orders consisting of \$2.9 billion in the Federal Family Education Loan (FFEL) Program and \$7.2 billion in the Federal Direct Student Loan Program, and \$6.1 billion in the Pell Grant Program. 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 Direct Loan Program. Borrowing authority is authority granted to a Federal entity to borrow and to obligate and expend the borrowed funds. The Direct Loan Program may borrow from Treasury to fund loans originated during the year. The available borrowing authority remaining for Direct Loan Program for loans originated during fiscal year 2000 was \$3.3 billion. Borrowing from Treasury cannot exceed the amount apportioned by the Office of Management and Budget during a given year. 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 collections on outstanding loans.

The Federal Direct Loan Program and Federal Family Education Loan Program were granted permanent indefinite appropriation budget authority through previously enacted legislation. The following legislation pursuant to *the Higher Education Act of 1965, as amended*, (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 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.”

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**Student Financial Assistance**

**Notes to Financial Statements**

**September 30, 2000**

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**“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 \$681 million while the beginning obligated balance was adjusted upward by \$888 million (see note 14).

**Note 16 - Statement of Financing**

“The Statement of Financing provides information on the total resources used by an agency—both those received through the budget and those received through other venues—during the reporting period. It then explains how they were used in agency operations to finance orders for goods and services not yet delivered, to acquire assets and liabilities, and to fund the entity’s net cost of operations (expenses less exchange revenue, or earned, revenues from providing goods and services). Importantly, it also demonstrates that an agency’s financial management systems can generate budgetary data on resources and status of resources and proprietary data on assets, liabilities, and net position that are commensurate with each other<sup>1</sup>.”

The major resources that do not impact net cost of operations for SFA result from loan guarantee and direct loan activities that fall under the purview of Credit Reform Act of 1990. Most cash flows that normally are 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-

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<sup>1</sup> Luter, FASAB News Special Edition 1, August 1998

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**Student Financial Assistance**  
**Notes to Financial Statements**  
**September 30, 2000**

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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 \$247 million as of September 30, 2000.

**Note 17 - Contingencies**

**Guaranty Agencies**

SFA may 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 postsecondary school students. SFA provides funds to participating schools to provide about 86 percent of the capital used to make loans to eligible students at five percent interest. The remaining 14 percent of program funding is provided by the school. For the latest academic year ended June 30, 2000, there were approximately 653,000 loans made, totaling approximately \$1.1 billion at approximately 1,817 institutions, averaging \$1,700 per loan. SFA's share of the Perkins Loan Program was approximately \$6.2 billion as of September 30, 2000.

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, SFA compensates Perkins Loan institutions for the cost of lost borrower repayments.

**Borrower Class Actions**

SFA 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 SFA. A provision has not been made in the principal statements for any potential reductions in estimated future collections related to the outcome of these suits, since SFA's potential loss exposure is uncertain and cannot be estimated with sufficient reliability.

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**Student Financial Assistance**

**Notes to Financial Statements**

**September 30, 2000**

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**Other Matters**

SFA 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 SFA's financial statements.

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**SECTION 7**

**SUPPLEMENTAL INFORMATION**



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

Assets	Consolidated	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs
<b>Entity Assets</b>				
<b>Intragovernmental Assets:</b>				
Fund Balance with Treasury (Note 2)	\$22,758,091	\$12,069,409	\$2,483,770	\$8,204,912
Interest Receivable	70,755		70,755	
<b>Governmental Assets:</b>				
Accounts Receivable, Net (Note 3)	10,351	8,414	1,937	
Credit Program Receivables, Net (Note 4)	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
<b>Total Entity Assets</b>	<b>\$96,871,662</b>	<b>\$23,057,141</b>	<b>\$65,372,094</b>	<b>\$8,442,427</b>
<b>Non-Entity Assets</b>				
Guaranty Agency Federal & Restricted Funds Receivable (Note 3)	\$2,231,814	\$2,231,814		
<b>Total Non-Entity Assets</b>	<b>\$2,231,814</b>	<b>\$2,231,814</b>		
<b>Total Assets</b>	<b>\$99,103,476</b>	<b>\$25,288,955</b>	<b>\$65,372,094</b>	<b>\$8,442,427</b>
<b>Liabilities</b>				
<b>Liabilities Covered by Budgetary Resources</b>				
<b>Intragovernmental Liabilities:</b>				
Accounts Payable	\$1,623		\$1,623	
Interest Payable	70,755		70,755	
Borrowing from Treasury (Note 5)	65,346,881		65,346,881	
Guaranty Agency Federal & Restricted Funds Due To Treasury (Note 3)	2,231,814	\$2,231,814		
Payable to Treasury (Note 6)	7,860,621	7,860,621		
Other Intragovernmental Liabilities (Note 7)	4	4		
<b>Governmental Liabilities:</b>				
Accounts Payable	168,103	69,642	40,850	\$57,611
Accrued Grant Liability (Note 8)	319,376			319,376
Liabilities for Loan Guarantees (Note 4)	13,667,983	13,667,983		
Other Governmental Liabilities (Note 7)	145,759	103,044	42,715	
<b>Total Liabilities Covered by Budgetary Resources</b>	<b>\$89,812,919</b>	<b>\$23,933,108</b>	<b>\$65,502,824</b>	<b>\$376,987</b>
<b>Liabilities Not Covered by Budgetary Resources</b>				
<b>Intragovernmental Liabilities:</b>				
Other Intragovernmental Liabilities (Note 7)	\$237,682	\$806	\$252	\$236,624
<b>Governmental Liabilities:</b>				
Other Governmental Liabilities (Note 7)	9,342	6,415	2,927	
<b>Total Liabilities Not Covered by Budgetary Resources</b>	<b>\$247,024</b>	<b>\$7,221</b>	<b>\$3,179</b>	<b>\$236,624</b>
<b>Total Liabilities</b>	<b>\$90,059,943</b>	<b>\$23,940,329</b>	<b>\$65,506,003</b>	<b>\$613,611</b>
<b>Net Position</b>				
Unexpended Appropriations (Note 9)	\$9,253,010	\$1,355,847	\$124,869	\$7,772,294
Cumulative Results of Operations (Note 9)	(209,477)	(7,221)	(258,778)	56,522
<b>Total Net Position</b>	<b>\$9,043,533</b>	<b>\$1,348,626</b>	<b>\$(133,909)</b>	<b>\$7,828,816</b>
<b>Total Liabilities and Net Position</b>	<b>\$99,103,476</b>	<b>\$25,288,955</b>	<b>\$65,372,094</b>	<b>\$8,442,427</b>

**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
<b>Program Costs</b>				
<b>Intragovernmental</b>				
Interest Expense, Federal (Note 10)	\$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	
<b>Governmental</b>				
Subsidy Expense (Note 4)	(3,637,397)	295,531	(3,932,928)	
Grant Expense	8,960,280			\$8,960,28
Interest Expense, Non-Federal (Note 10)	224	109	115	
Contractual Service Expense	452,277	212,812	217,717	21,74
Salaries and Administrative Expense (Note 11)	207,685	67,096	33,440	107,14
Other Program Expenses	180,163	86,562	93,601	
<b>Total Program Cost</b>	<b>\$11,207,193</b>	<b>\$1,201,163</b>	<b>\$916,853</b>	<b>\$9,089,17</b>
<b>Less: Earned Revenues</b>				
Interest, Federal (Note 10)	\$1,761,124	\$499,843	\$1,261,281	
Interest, Non-Federal (Note 10)	3,211,256		3,211,256	
<b>Earned Revenues</b>	<b>\$4,972,380</b>	<b>\$499,843</b>	<b>\$4,472,537</b>	
<b>Net Program Cost</b>	<b>\$6,234,813</b>	<b>\$701,320</b>	<b>\$(3,555,684)</b>	<b>\$9,089,17</b>
<b>Net Cost of Operations</b>	<b>\$6,234,813</b>	<b>\$701,320</b>	<b>\$(3,555,684)</b>	<b>\$9,089,17</b>

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
<b>Net Cost of Operations</b>	\$(6,234,813)	\$(701,320)	\$3,555,684	\$(9,089,177)
<b>Financing Sources (Other than Exchange Revenues):</b>				
Appropriations Used	\$10,673,739	\$4,719,882	\$(3,114,938)	\$9,068,795
Imputed Financing (Note 12)	117,570	9,246	1,175	107,149
Future Transfers Out due to Downward Subsidy Re-estimate	(4,010,604)	(4,010,604)		
<b>Total Financing Sources</b>	\$6,780,705	\$718,524	\$(3,113,763)	\$9,175,944
<b>Net Results of Operations</b>	\$545,892	\$17,204	\$441,921	\$86,767
<b>Prior Period Adjustments (Note 13)</b>	\$(931,055)	\$(824,645)	\$(20,694)	\$(85,716)
<b>Net Change in Cumulative Results of Operations</b>	\$(385,163)	\$(807,441)	\$421,227	\$1,051
<b>Increase (Decrease) in Unexpended Appropriations</b>	\$476,516	\$220,738	\$(14,237)	\$270,015
<b>Change in Net Position</b>	\$91,353	\$(586,703)	\$406,990	\$271,066
<b>Net Position - Beginning of Period</b>	\$8,952,180	\$1,935,329	\$(540,899)	\$7,557,750
<b>Net Position - End of Period</b>	\$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
<b>Budgetary Resources</b>				
Budget Authority	\$34,511,961	\$5,073,056	\$19,993,905	\$9,445,000
Unobligated Balance-Beginning of Period (Adjusted) (Note 14)	13,203,045	8,270,839	29,794	4,902,411
Spending Authority from Offsetting Collections	21,187,709	10,087,354	11,100,355	
Adjustments (Note 15)	(10,938,820)	(4,442,433)	(6,579,933)	83,541
<b>Total Budgetary Resources (Note 15)</b>	<b>\$57,963,895</b>	<b>\$18,988,816</b>	<b>\$24,544,121</b>	<b>\$14,430,951</b>
<b>Status of Budgetary Resources</b>				
Obligations Incurred (Adjusted) (Note 14)	\$52,125,416	\$14,825,659	\$24,521,127	\$12,778,633
Unobligated Balances-Available	1,491,844			1,491,844
Unobligated Balances-Not Available	4,346,635	4,163,157	22,994	160,483
<b>Total Status of Budgetary Resources (Note 15)</b>	<b>\$57,963,895</b>	<b>\$18,988,816</b>	<b>\$24,544,121</b>	<b>\$14,430,951</b>
<b>Outlays</b>				
Obligations Incurred (Adjusted) (Note 14)	\$52,125,416	\$14,825,659	\$24,521,127	\$12,778,633
Less: Spending Authority from Offsetting Collections and Adjustments	(21,364,303)	(10,073,625)	(11,100,581)	(190,091)
Obligated Balance, Net-Beginning of Period (Adjusted) (Note 14)	13,664,563	3,806,091	6,907,766	2,950,700
Less: Obligated Balance, Net-End of Period	(21,629,148)	(7,903,642)	(7,230,143)	(6,495,361)
<b>Total Outlays (Note 15)</b>	<b>\$22,796,528</b>	<b>\$654,483</b>	<b>\$13,098,169</b>	<b>\$9,043,871</b>

**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
<b>Obligations and Nonbudgetary Resources</b>				
Obligations Incurred (Adjusted) (Note 14)	\$52,125,416	\$14,825,659	\$24,521,127	\$12,778,631
Spending Authority from Offsetting Collections and Adjustments	(21,364,303)	(10,073,625)	(11,100,581)	(190,082)
Financing Imputed for Cost Subsidies	117,570	9,246	1,175	107,144
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	
<b>Total Obligations and Nonbudgetary Resources</b>	<b>\$31,220,606</b>	<b>\$2,410,921</b>	<b>\$16,114,003</b>	<b>\$12,695,665</b>
<b>Resources That Do Not Fund Net Cost of Operations</b>				
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	\$(3,508,322)
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 (Note 16)	(35,333,600)	(10,097,280)	(25,236,569)	24
Other Resources that Finance the				
Acquisition of Assets or Liquidation of Liabilities (Note 16)	4,287,223	4,306,136	(18,913)	
<b>Total Resources That Do Not Fund Net Cost of Operations</b>	<b>\$(24,489,746)</b>	<b>\$(1,682,599)</b>	<b>\$(19,299,072)</b>	<b>\$(3,508,072)</b>
<b>Costs That Do Not Require Resources</b>				
Adjustments	\$(80,868)	\$(32,500)	\$50,062	\$(98,433)
<b>Total Costs That Do Not Require Resources</b>	<b>\$(80,868)</b>	<b>\$(32,500)</b>	<b>\$50,062</b>	<b>\$(98,433)</b>
Financing Sources Yet to be Provided	\$(415,179)	\$5,498	\$(420,677)	
<b>Net Cost of Operations (Note 16)</b>	<b>\$6,234,813</b>	<b>\$701,320</b>	<b>\$(3,555,684)</b>	<b>\$9,089,171</b>

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