ANNUAL ACCOUNTABILITY REPORT

FISCAL YEAR 1999

The Fiscal Year 1999 Annual Accountability Report can be accessed from our website: http://www.ed.gov/offices/OCFO

U.S. Department of Education
FY 1999
Accountability Report

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THE SECRETARY OF EDUCATION
WASHINGTON, D.C. 20202

February 29, 2000

Dear Colleagues in Education:

Americans consistently rank education as a top national priority. They recognize education as being crucial to securing jobs and becoming responsible, productive citizens. To ensure equal access to education and promote educational excellence throughout the nation, the Department's Strategic Plan includes four goals. Three of the goals address critical national education priorities and one focuses on making the Department more efficient and, thus a more effective partner with states, local communities, and higher education institutions in the pursuit of educational improvement. The Department's goals are:

- Help all students reach challenging academic standards so that they are prepared for responsible citizenship, further learning, and productive employment.
- Build a solid foundation for learning for all children.
- Ensure access to postsecondary education and lifelong learning.
- Make the Department a high-performance organization by focusing on results, service quality, and customer satisfaction.

This past year the Department built on previous successes as we continued to promote several critical priorities. We are working with states and communities to move academic standards for all students into the classroom and to create partnerships between schools and communities. Our programs and outreach efforts emphasize the importance of helping children to read well by the end of the third grade and to master challenging mathematics by the eighth grade. We are encouraging children and families to start planning early for college and we have expanded financial support for college students. We initiated new programs to promote professional development for teachers. In addition, our FY 2000 budget includes funds to reduce class size in the early grades as we begin to support the hiring of 100,000 quality teachers over the next six years.

We are committed to achieving our strategic goals and we look forward to continuing to work hand in hand with states and local communities to improve education for all.

Yours sincerely,

Dick Riley

Richard W. Riley

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

Dear Colleagues in Education:

FY 1999 saw the Department make significant process and system improvements designed to assist in financial statement preparation. Software was developed that allowed the Department to close the FY 1999 accounting records on schedule. Reporting and reconciliation tools were developed in-house that enhanced the Department's ability to produce accurate and timely financial statements. Financial statement training was conducted for Departmental staff. Guidance for year-end processing and financial statement production was adhered to and milestones were met. Clearly defined roles for Office of the Chief Financial Officer and Student Financial Aid personnel contributed to improved coordination of the financial statement process. Additional resources were dedicated to provide support for the FY 1999 financial statement and audit process. And investments were made to procure additional software tools and to train staff with an eye on long-term accounting and internal control requirements.

The culmination of all of these efforts, along with that of our independent auditors, is presented in this accountability report. The Department's financial statements audit was completed on time and eight months earlier than last year. Although the opinion the Department received on the statements falls short of our goal of an unqualified or "clean" opinion, it is a significant step forward.

Many challenges remain in our continuous effort to improve financial management. As described in detail in this report, our self-assessment required under the Federal Managers' Financial Integrity Act, and the internal control report from our auditors, identify a number of material weaknesses in financial and other management controls. We are committed to their correction. Among our concerns are improving financial reporting and reconciliations. During FY 2000 we plan to automate the Statement of Financing, enhance our monthly reconciliations with the Department of Treasury, and improve our daily reconciliations with Departmental feeder systems. We also plan to formalize the Department's fixed assets policy, improve our control of technology acquisitions, and validate our inventory of information technology assets.

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

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

Sincerely,

Thomas P. Skelly

Thomas P. Skelly

Education at a Glance

The original U.S. Department of Education began in 1867 with a budget of $15,000 and three employees to provide information to states to help them establish efficient school systems. While the agency's name and location within the Executive Branch have changed over the years, this role has steadfastly remained an important part of Education. As we enter the new century, the Department's support for learners in America remains a critical part of our Nation's success.

America's number one priority is Education. State, local, private and federal authorities share responsibility for this national priority. Combined spending from these authorities is nearly $600 billion a year at the elementary, secondary, and postsecondary levels. Federal funding amounts to about 9 percent of total education funding; yet strategically leveraged, federal spending plays an invaluable role in America's education programs.

Responsibilities

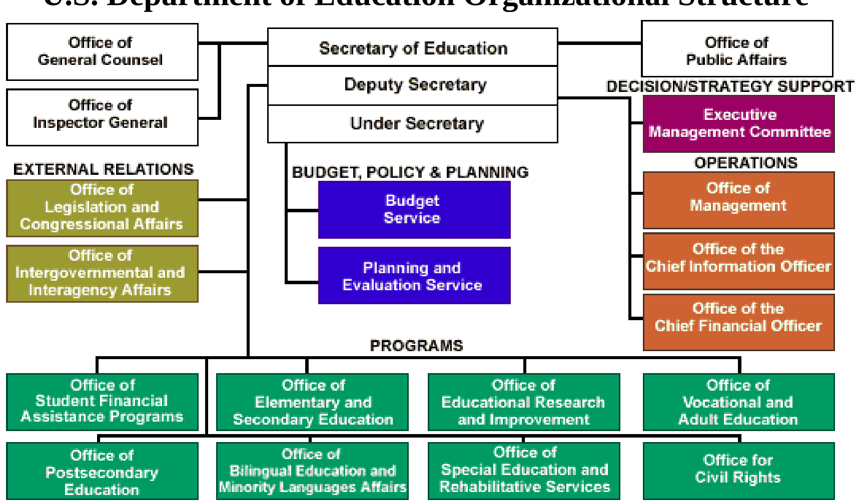
The Department of Education's responsibilities generally fall into six important areas:

1. **Providing national leadership and partnerships to address critical issues in American education.**
2. **Serving as a national clearinghouse of good ideas.**
3. **Helping families pay for college.**
4. **Helping local communities and schools meet the most pressing needs of their students.**
5. **Preparing students for employment in a changing economy.**
6. **Ensuring nondiscrimination by recipients of federal education funds.**

Organization

The Department is headquartered, and has most operations, in Washington, DC; additionally, about one third of the Department's employees are stationed in ten regional

U.S. Department of Education Organizational Structure



offices, making it easier to serve state and local educational systems. Regional staff are primarily involved in representing the Department's goals and views within the region, particularly in the areas of student financial assistance, civil rights enforcement, vocational rehabilitation services for the disabled, and Inspector General audits and investigations.

Mission

In accordance with the Government Performance and Results Act (GPRA) of 1993, the Department utilizes strategic planning. GPRA requires federal agencies to be accountable to Congress and the American people through strategic planning and performance reporting. A mission statement is the guiding standard that gives direction to all goals and objectives of the plan and hence all activities of the Department. The Department's mission is to:

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

The Department's strategic plan with its mission statement, goals, and objectives helps align the organization's programs, resources, and staff creating better leadership, management, and more effective service to America's learners.

Goals

The Department continually moves forward with its mission through the implementation of its four strategic goals. These four main goals align the Department's resources, programs, and staff into an effectively focused organization.

1. **Helping all students reach challenging standards.**
2. **Providing a solid foundation for learning.**
3. **Ensuring access to postsecondary education and lifelong learning.**
4. **Achieving a high-performing department.**

These goals are long-range and broad in vision. Each goal is comprised of several objectives (smaller target goals) with pre-defined indicators of performance that concretely define levels of achievement. Within the long-range mission and goals of the Department there are seven top priorities.

Seven Priorities

In order to prepare America for the 21st century, the Department has focused attention on the following seven areas. The first three priorities focus on specific results all students should achieve at critical points in their schooling.

1. **Read independently and well by the end of third grade;**
2. **Master challenging mathematics, including the foundations of algebra and geometry, by the end of eighth grade; and,**
3. **By eighteen years of age, be prepared for and be able to afford college.**

Priorities four through seven are key strategies to enable students to achieve these results.

4. **All states and their schools will have challenging and clear standards of achievement and accountability for all children and effective strategies for reaching these standards;**
5. **There will be a talented, dedicated and well-prepared teacher in every classroom;**
6. **Every classroom will be connected to the Internet by the year 2000, and all students will be technologically literate; and,**
7. **Every school will be strong, safe, drug-free and disciplined.**

Through each priority, parents and families will be encouraged to be involved in their children's education at school and at home.

The Department is constantly striving to ensure educational access and excellence for America's learners by carrying out its mission and adding value to America's educational system.

Inter-relationship of Strategic Plan Goals and Objectives

Program Goals

Goal 3: Ensuring access to postsecondary education and lifelong learning.
Information and support to prepare for postsecondary education; financial aid and support services to enroll and complete postsecondary education; efficient student aid delivery; lifelong learning.

Goal 2: Providing a solid foundation for learning.
Ensuring that all children enter school ready to learn; all children reading by the end of 3rd grade; all 8th-graders knowledgeable about math; and helping special populations.

Goal 1: Helping all students reach challenging standards.
Support for challenging academic standards; school-to-work systems; strong, safe & disciplined schools; talented teachers; meaningful family-school partnerships; greater public school choice; and education technology.

Administrative Goal

Goal 4: Achieving a high-performance Department.
Customer service; grantee support and flexibility; knowledge base to support reform and equity; effective use of information technology; skilled and high-performing employees; financial integrity; and performance management.

Goals, Programs and Results

Goal # 1: Help All Students Reach Challenging Standards so that they are Prepared for Responsible Citizenship, Further Learning, and Productive Employment.

A high quality education system is essential for America's future prosperity. Today's students will, within a few years, participate in our political system and our economy. To prepare them to make productive contributions, the Department will continue to assist educators, decision-makers, and families in reforming and revitalizing education at all levels.

So that all students will be prepared for responsible citizenship, further learning, and productive employment, the Department will continue to focus on the areas that are central to improving and maintaining high standards of learning for everyone. The Department is committed to pursuing strategies that help American schools provide students with equal opportunities to excel. This means ensuring that:

Goal # 1 objectives:

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

Goal # 2: Build a Solid Foundation for Learning for All Children.

In its pursuit of educational improvement, the Department concentrates on two interrelated aims; excellence and equity. As part of this effort, we have identified several areas that must be addressed in order to build a solid foundation of learning for all children. One is to focus on key transition points in a child's educational journey. In addition, we must ensure that students with special needs not only have those needs addressed, but also are held to high academic standards, along with other students, so that they, too, benefit from the emphasis on excellence. In this way, all students will be prepared for productive employment, further education, and full participation in our democracy.

We can achieve this goal by ensuring that:

Goal # 2 objectives:

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

The Department is deeply committed to achieving Goals # 1 and # 2 and the associated objectives in concert with state and local governments. This support of elementary and secondary education is primarily through grants targeted at high priority areas. These grants are designed to help all students and learners meet educational challenges and prepare for jobs. The major programs supporting Goals # 1 and # 2 are described below.

Title I of the Elementary and Secondary Education Act supports the education of over 10 million disadvantaged children in more than 50,000 schools nationwide--about half the public schools in the country. The majority of the Department's support for this program is directed in the form of grants to states to address areas where high levels of poverty have contributed to low academic achievement. This program has improved the basic reading and mathematics skills of disadvantaged children in school districts across the country and helped close the learning gap between those children and more advantaged students.

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

Rehabilitation Services and Disability Research programs provide assistance to one million adults with disabilities, most of them severe, in achieving successful employment outcomes and independent living. Each year, the programs successfully rehabilitate approximately 200,000 individuals with disabilities, of which 87% enter the competitive labor market or become self-employed. The Department administers these programs mostly through grants to states. States, in turn, develop, implement, and coordinate comprehensive programs of vocational rehabilitation and independent living for individuals with disabilities.

Vocational Education programs support training activities at both the secondary and postsecondary levels in accordance with state-developed plans. Adult Education programs provide assistance to approximately 4 million educationally disadvantaged adults to achieve literacy, certification of high school equivalency, and English language proficiency.

The Department's **Impact Aid** program provides assistance to states and local communities for whom Federal activities may present a hardship. The presence of a military base or Federal ownership of a significant proportion of local property, for example, may undercut the local tax base that ordinarily serves as the principal source of school funding. Impact Aid is intended to replace this lost revenue.

Professional Development funds support locally-guided teacher training in the core academic subjects. This investment is intended to ensure that teachers are prepared to teach to the high academic standards that states are developing.

The **Safe and Drug Free Schools** program responds to the continuing crisis of violence and drugs in our schools by supporting comprehensive school- and community-based drug abuse and violence prevention programs. This program helps school districts to design programs to meet their own unique needs.

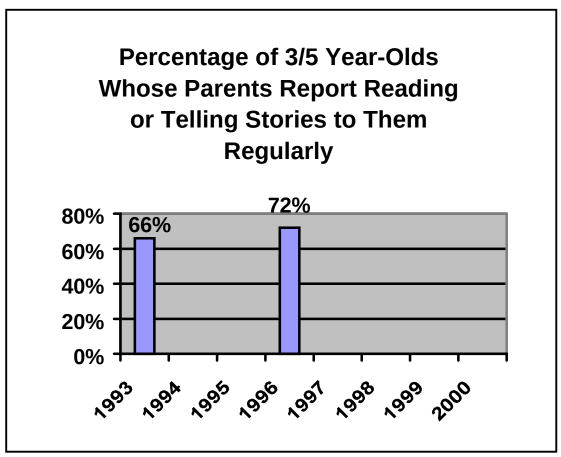
The Goals 2000 program helps schools, communities, and states develop and implement their own strategies--based on standards of excellence--for improving elementary and secondary education. These strategies center on the creation and implementation of high standards and challenging assessments in core academic subjects that define what all students should know and be able to do at various grade levels.

The **Research, Statistics and Dissemination** functions are just as important now as they were at the time of the Department's inception. This area has historically assisted educators and academics who look to the Department for guidance and leadership on a national level.

These elementary and secondary programs are having an effect on our schools. The following performance indicators, selected from the Department's FY 2000 Annual Plan, highlight the progress being made in meeting Goals # 1 and # 2.

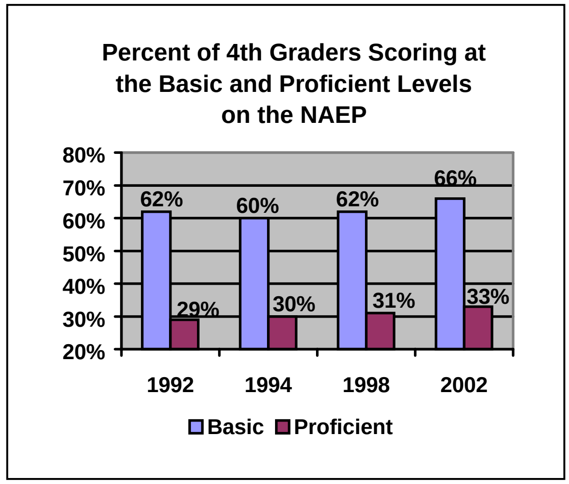
The percentage of 3-to-5-year-olds whose parents read to them or tell them stories regularly will continue to increase.

Reading to children helps them build their vocabularies, an important factor in school success. Thus, frequent reading by parents to their children is an important activity in preparing children for school. Only two-thirds of preschoolers were read to or told



stories regularly in 1993. By 1996, the proportion of preschoolers whose parents read to them or told them stories regularly had increased to 72 percent.

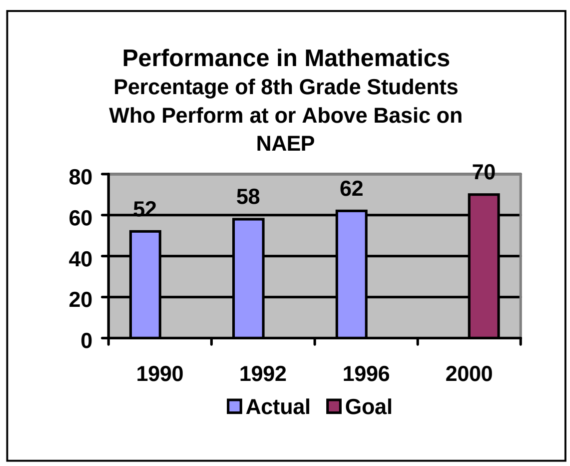
Increasing percentages of fourth-grade students will meet basic and proficient levels in reading on the National Assessment of Educational Progress (NAEP). By 2002, 66 percent of 4th grade students will score at or above the basic level in reading on the NAEP and 32 percent of 4th grade students will score at or above the proficient level in reading on the NAEP.



Over the last 30 years, NAEP scores for 4th graders have been relatively flat (around 60 percent at basic or higher levels). These statistics are disturbing because they indicate that, since the 1970's, around 40 percent of the 4th grade population cannot read at the basic level of proficiency.

Increasing percentages of eighth-graders reach the basic, proficient, and advanced levels in math on the National Assessment of Educational Progress (NAEP); on international assessments, at least 60 percent will score at the international average by 2002.

U.S. students have shown progress in their mathematics achievement on the NAEP over the years, yet many still fail to achieve to the high standards needed for future success. In 1996, 62 percent of students scored at or above the basic level on NAEP compared with 52 percent in 1990. In 1995, 45 percent of U.S. eighth-graders scored at the international average on the Third International Mathematics and Science Study (TIMSS). Although U.S. 4th graders performed above the international average in math, our 8th graders and 12th graders scored below the international range.



Goal # 3: Ensure Access to Postsecondary Education and Lifelong Learning.

Postsecondary education is becoming increasingly important to both the individual and the nation's well being. Given current trends, at least two years of postsecondary education will be increasingly necessary in the next century to gain higher earnings and improved job opportunities. Although American higher education is the envy of the world, almost 40 percent of our own high school graduates do not immediately attend postsecondary education. Moreover, postsecondary enrollment and completion rates are significantly lower for blacks and Hispanics and for students from lower- and middle-income families than for whites and those from higher-income families. Although enrollment rates have been rising in recent years, postsecondary education remains an elusive option for too many American high school graduates.

Besides helping to ensure access to postsecondary training for our young people, it is also essential that we encourage lifelong learning, whether it be graduate school or adult basic education, advanced technical training or training in job entry skills. This includes many for whom lifelong learning opportunities are of special importance, such as persons with disabilities, adults lacking basic skills, and those whose job skills need upgrading or who require retraining because of labor market changes. Persons with disabilities are at least twice as likely as people without disabilities to be unemployed which is estimated to cost society in excess of $2 billion annually. In addition, the national Adult Literacy Survey of 1992 showed that at least 21 percent of adults age 16 and older lacked basic reading and math skills needed for well-paying jobs or entry into higher education.

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

Goal # 3 objectives:

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

The Department strongly supports Goal # 3. The single largest category of investment the Department makes with the federal education dollar is in postsecondary education - helping families pay for college. More than 40 percent of the Department's budget is devoted to postsecondary education, most of which is used for student financial aid. The history of federal financial assistance to college students goes back to the GI Bill of 1944, which served as the springboard to the middle class for millions of American servicemen and their families. Today, a large percentage of all student financial aid in the nation is funded by the federal government. The major programs supporting Goal # 3 are described below.

The **Pell Grant** program helps ensure financial access to postsecondary education by providing grant aid to low- and middle-income undergraduate students. The most need-focused of the Department's student aid programs, Pell Grant awards, vary in proportion to the financial circumstances of students and their families. During fiscal year 1999, almost 4 million students received grants averaging $1,935.

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. Providing direct loans reduces bureaucracy and cuts out the "middlemen" in the student loan process while providing better service to students and schools. Built with the newest technology in the mid-1990's, the Direct Loan Program is user-friendly for schools and students, using streamlined procedures that eliminate paperwork and the need for students to stand in lines. Because of these improvements, lenders participating in the **Federal Family Education Loan Program** (the second major loan program under which private lenders make Federally guaranteed loans to students) have made dramatic improvements in the services they provide 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 contingency repayment options. The income contingency 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 assistance to institutions which enables them to provide students employment, grants, and low interest loans on the basis of need. **Higher Education** programs support development and strengthening of programs at institutions and direct grants and fellowships to students in a variety of programs.

The total portfolio of postsecondary aid programs run by the Department generated over $50 billion in student aid (including Federal Family Education Loan capital, Perkins Loan capital from institutional revolving funds, and institutional and state matching funds) to almost 8.5 million postsecondary students and their families during FY 1999.

Performance Plan Progress

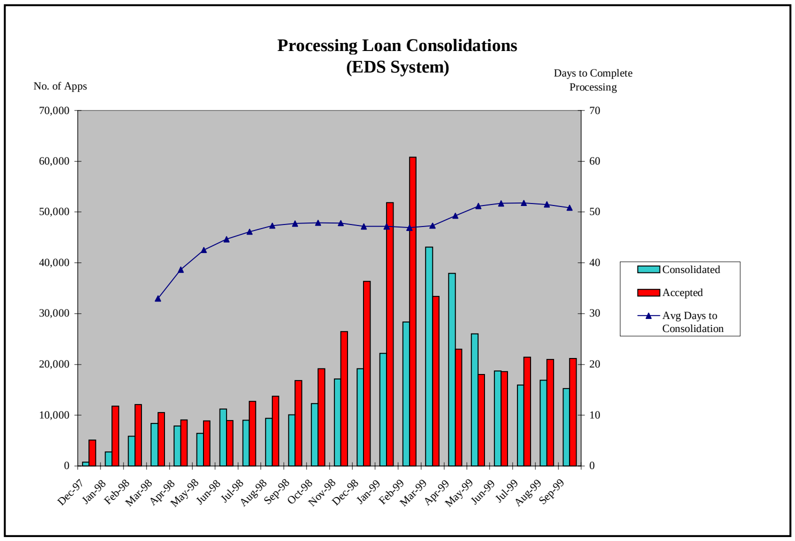
During FY 1999, the Department of Education worked with approximately 6,000 postsecondary institutions, 4,500 lenders, and 36 guaranty agencies to deliver grant, loan, and work-study assistance to students who rely on federal student aid to pay for college. The Department has identified the modernization of the student aid delivery system as one of its highest priority management objectives. This modernization will be managed by a newly authorized performance-based organization (PBO), Student Financial Assistance (SFA). The PBO resulted from a study by the National Partnership for Reinventing Government, which identified the need for a management structure driven by strong incentives to manage for results. SFA is now a principal operating component within the Department, separate from the Office of Postsecondary Education.

The newly created PBO's operations were guided by the FY 1999 Interim Performance Plan until the end of the fiscal year, September 1999. Consistent with the aim of the strategic plan, the interim plan centered on three basic objectives: improving customer service, reducing costs, and transforming Student Financial Assistance into a performance-based organization. The goals of the interim plan were essentially met. Now, the PBO is focused on its Five-Year Performance Plan and on accomplishing its three measures of success: improving customer satisfaction, reducing unit cost and improving employee satisfaction.

The following performance measures, selected from the plan, highlight the progress being made in meeting Goal # 3 and the ensuing objectives referenced above.

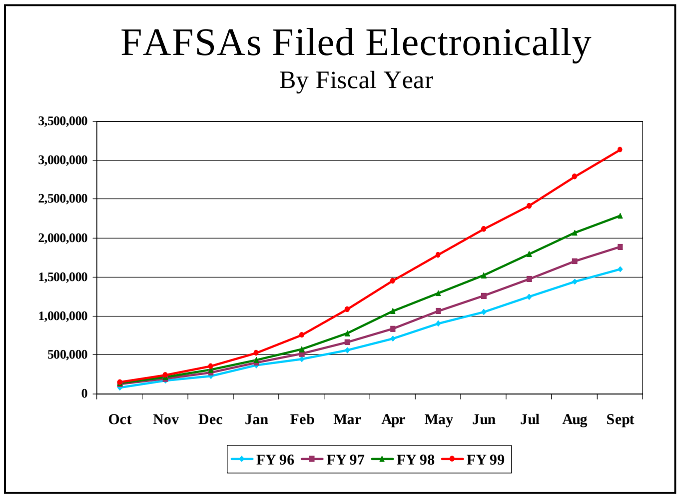
For Loan Consolidation into Direct Loans, process completed applications with an average turnaround time of 60 days or less (through September 30, 1999).

Both of the Department's contracted loan consolidators achieved the PBO goal of processing loan consolidation applications into Direct Loans within the established timeframes. As of September 30, 1999 applications were being completed in 51 days.



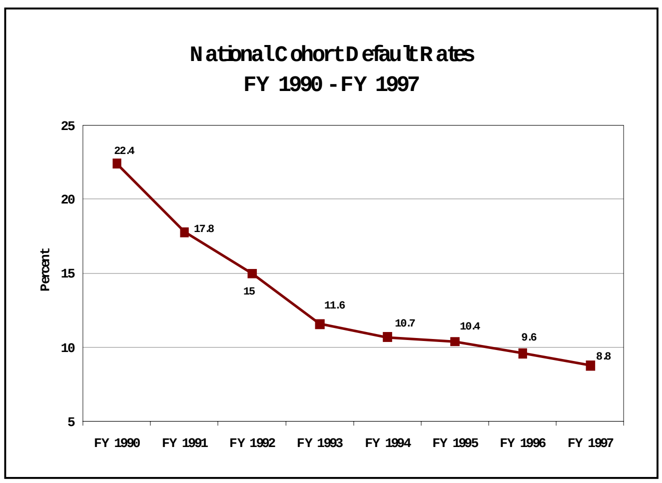
Attract three million electronic filings of the Free Application for Federal Student Aid (FAFSA) for the 12-month period ending September 30, 1999.

SFA met its goal of receiving 3 million electronic FAFSAs by the end of fiscal year 1999. The electronic application is faster and easier for the students to file and for the Department to process.



Maintain cohort default rate at ten percent or less.

Under statute, a key measure of student loan defaults is the "cohort default rate," which is the percentage of borrowers that 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, Congress and the Department have taken actions to reduce defaults -- including management reforms and increased attention to assist at-risk postsecondary institutions. This has allowed the Department to cut the default rate by more than half from 22.4 percent for FY 1990 to 8.8 percent for FY 1997 (the most recent cohort year available).



Progress is also being made in other areas moving Student Financial Assistance 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 all expected to increase customer service and decrease costs.

Goal # 4: Make the Department a High-Performance Organization by Focusing on Results, Service Quality, and Customer Satisfaction.

The Department's fourth goal cuts across all programs and is critical to all goals and objectives described in the Department's strategic plan. Goal 4 is organized around seven key themes: customer service, flexibility of programs, research, technology, employee development, financial management, and performance measurement.

Strategies in Goal 4 were developed from a variety of sources: results of employee surveys, feedback from external customers, effective practices outlined in management literature, reviews of successes achieved by government and industry, and reports from the General Accounting Office and the Office of Inspector General. During 1999, progress was made on each of the Goal 4 objectives:

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

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

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

4. **Technology.** Ensuring that the Department's systems are Year 2000 compliant remained a high priority. All of the Department's fourteen mission critical systems have completed their Y2K conversion. In addition, the Department is expanding its Internet presence and redesigning its Intranet to improve workflow processes and communications.

5. **Employee development.** During 1999, the Department continued to offer better training to employees. The Department's Training and Development Center benchmarked its operations with other high-performing organizations and identified strategies for greater effectiveness. A continuing dialogue on race relations in the Department provided insights about communications and employee life issues. Strategies to reinforce high organizational performance include increased management training and organization performance reviews.

6. **Financial management.** The Department completed the implementation of its new accounting system in 1998. During 1999, work focused on improving the delivery of timely and reliable financial information to better manage the Department and its programs. Improvements will continue in the contracts and purchasing processes to support strategic Departmental objectives.

7. **Performance measurement.** The Department's five-year Strategic Plan received high marks for being "user friendly" and for providing a coherent framework of goals, objectives and indicators to provide for the measurement of progress and accountability. The Department has implemented performance agreements with senior staff to hold them accountable for achieving the goals of the Strategic Plan.

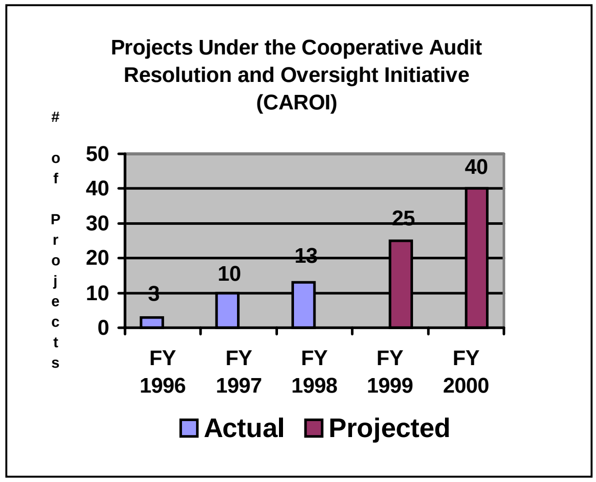
In addition to the initiatives outlined above, the following high visibility projects are contributing to the efforts to make the Department a high-performance organization.

Cooperative Audit Resolution and Oversight Initiative (CAROI)

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

Increased number of CAROI projects

At the end of fiscal year 1999, there were 29 CAROI projects in 22 states. The target level of participation is 40 projects by the end of 2000. CAROI serves as a collaborative method that links program, finance, auditing, and legal staffs at the federal and state levels to provide alternative and effective approaches to resolve findings and recurring problems identified through audits. The goal of CAROI is to improve education programs and the management of those programs at state and local levels through better use of audits, monitoring, and technical assistance. A primary objective of addressing issues in a straightforward and collaborative manner is to minimize costly litigation.



Recurring findings

Recurring findings identified during audits, such as those under the Single Audit Act, provide one measure of the success of corrective action taken by grantees to better manage federal education funds and adhere to grant terms. CAROI efforts to resolve audits to date, in specific states, have yielded reductions in instances of time distribution violations, and other significant recurring findings. The Department plans to continue to employ the CAROI approach to effectively address audit issues and prevent findings from recurring in subsequent years.

Improved Accountability

The Department continues to invest in technology to improve financial management and accountability for taxpayers dollars. Our new core financial management system, the Education Department Central Automated Processing System (EDCAPS), has been implemented. EDCAPS integrates the payments, grants and contracts, and accounting systems into one system that supports a streamlined grant process, facilitates improved procurement processes, and allows the Department to conduct business electronically. However, due to shortcomings in the ability of the general ledger portion of the system to support the production of accurate and timely financial statements, the Department has begun the process to replace that portion of the system.

During fiscal year 1999, the OCFO focused on procedures and system enhancements to assist in the production of accurate and timely financial statements, enhance the ability to perform proper and timely reconciliations of its financial accounting records and enhance the controls surrounding information systems. The Department will continue to focus on these concerns during fiscal year 2000 to enhance the data available to program and other managers to use in their day to day operations for decision-making and funds control.

Reporting Year 2000 (Y2K) Issues

The Department of Education completed its systems conversion effort with the last system being implemented on March 8, 1999. One hundred percent of the Department's 175 systems were either retired (28) or are Y2K compliant and fully implemented (147).

Mission Critical Systems

14 of the 14 mission critical systems (100 percent) have completed renovation, validation and implementation, including independent verification and validation (IV&V), and have been phased into production.

Non-Mission-Critical Systems

161 of the Department's 161 non-critical systems (100 percent) have either been retired (28) or completed renovation, validation and implementation (133) and have been phased into production.

Data Exchanges and End-to-End Testing

Data exchanges. Each system's data exchanges are considered integral components of the system. As such, checking on their Y2K compliance, and renovating them as needed, was part of the the Department's standard system conversion process. Data exchanges have been renovated, validated, and implemented as needed. The ability of each system to send and receive Y2K compliant data was tested during the validation phase for each system.

End-to-end testing. End-to-end testing involves: 1) internal system-to-system testing and testing with other Federal agencies, and 2) postsecondary institutional testing with Departmental systems. Internal system-to-system testing, testing with other agencies, and testing with postsecondary institutions has been completed.

Contingency Plans

General. We had an aggressive business continuity and contingency planning (BCCP) effort that started last summer with the Department applying the GAO's BCCP approach to its core business processes and related systems. Initial contingency plans for all core business processes and their related systems were completed and initially tested and reported to OMB on March 31, 1999. Contingency plans for all non-mission critical systems were completed and initially tested at that time as well. Further testing and refining of the mission critical contingency plans was completed in the fall of 1999.

Management consultant contractors. Firms experienced in BCCP and knowledgeable of the Department's systems, were hired to facilitate contingency planning team meetings, develop documents and provide substantive analysis and management advice on contingency planning.

Student financial aid. Because the Department's student financial aid business processes are highly dependent on education and financial institution partners, our contingency planning process involved substantial consultation with these communities.

Student aid BCCP teams, established in September 1998, were organized around eight core business processes: institutional eligibility, student aid application and eligibility, student aid origination and disbursement, enrollment tracking and reporting, student aid repayment and collection, lender and guaranty agency payments, lender and guaranty agency services, and customer service. These teams completed their detailed contingency plans and submitted them to OMB on March 31, 1999.

Impact Aid. A BCCP team was formed in early November 1998 with focus on the impact aid business process. This team completed its detailed contingency plan and testing by March 31, 1999.

Education Central Administrative Processing System (EDCAPS). In November 1998 six core business processes supported by EDCAPS were identified: grant/award, contracts and purchasing, accounts receivable, reporting, payments, and budget. The corresponding six BCCP teams completed their contingency plans and testing by March 31, 1999.

Education Network (EDNet). In November 1998 we established an EDNet BCCP team. This team completed the EDNet contingency plan and its testing by March 31, 1999.

Mission important/mission support systems. Last summer efforts began to prepare contingency plans for the 133 active mission important/mission support systems in the Y2K inventory. (Twenty-eight (161–133) of those in the original Y2K inventory do not need contingency plans because they were retired and are no longer in service.) All 133 contingency plans were completed and tested by March 31, 1999.

Year 2000 Conversion Costs

The Department's total conversion cost estimate for FY 1996-FY 2000 is $44 million.

Post January 1, 2000 Update

None of the Department's systems experienced any material Y2K problems during or after the January 1 rollover.

Highlights of Reporting Requirements

Federal Managers Financial Integrity Act

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

As shown in the tables on the following pages, eight problem areas within the Department are considered serious or "material weaknesses or non-conformances" as defined by the Act.

THE SECRETARY OF EDUCATION
WASHINGTON, D.C. 20202

December 31, 1999

The President
The White House
Washington, DC 20500

Dear Mr. President:

In accordance with the requirements of the Federal Managers' Financial Integrity Act (FMFIA), we are constantly reviewing our progress to ensure that financial management within the Department contributes positively to our mission

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

I am pleased to report that the Department's systems of management, accounting and administrative control, taken as a whole, provide reasonable assurance that the objectives of Section 2 of the FMFIA have been achieved. Enclosure B indicates areas on which we are still working to make improvements.

The Department's accounting and financial systems covered under the provisions of Section 4 of the FMFIA, except for the general ledger portion of Education's Central Automated Processing System, generally conform to the Comptroller General's principles, standards and related requirements. The general ledger software system was unable to perform the year-end closing process or produce automated consolidated financial statements. These software limitations were a significant factor in the Department's inability to prepare accurate consolidated financial statements in a timely manner, and contributed to a disclaimer of opinion on the FY 1998 financial statements. Plans are in place to replace the general ledger software system. Enclosure C indicates areas on which we are still working to make improvements.

We are committed to resolving the issues addressed in this report and to maintaining a system of strong financial and administrative management controls. We have incorporated our plans for corrective action in our budget proposals for FY 2000 and FY 2001.

Yours sincerely,

Dick Riley

Richard W. Riley

Summary Tables of Management Control Issues

Material Weakness	Fiscal Year Identified	Fiscal Year To Be Corrected
Student Financial Aid Audit Reports - The Department did not assure that all schools submitted audit reports, or that it recovered all misspent funds. Institutional Participation and Oversight Service (IPOS) has eliminated the backlog of audits and is now current in issuing and resolving audits. In addition, IPOS has identified all schools that are delinquent in submitting audits and has mailed a letter requesting those audits. The final piece of this process, referring non-respondents for administrative action, will be implemented during FY 2000.	1991	2000
Quality of Data Needed to Support Management Decisions - Student Financial Aid does not have quality data to provide for effective management decisions. Student Financial Aid is analyzing and evaluating systems which will provide common data elements, common transaction processing, consistent internal controls and efficient transaction entry.	1995	2001
ADP Inventory Control - The Department's inventory controls on office automation equipment are unable to track office automation equipment moves, excesses, replacements, and installs. The correction plan provides for an inventory process and implementation of a new Client/Server Commercial Off-The-Shelf software application system in accordance with the strategic goals of the Department.	1994	2000
Information Technology Security Program - The security of EDs information technology (IT) systems needs to be strengthened to comply with the Computer Security Act and OMB Circular A-130. In particular, the following issues will be addressed; ED IT security guidance is incomplete; ED staff have not been briefed on IT security awareness; security training is out of date; internal EDNET security controls are insufficient; security plans and review have not been completed for six mission-critical systems; lack of a process to ensure resolution of identified security deficiencies; and ED has not taken steps to ensure that all appropriate personnel are screened.	1999	2001
Financial Reporting/Financial Statement Preparation – The Chief Financial Officers Act and OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, require that financial statements be the culmination of a systematic accounting process. EDs process for FY 1998 contained deficiencies in the quality review of the financial statements, reconciliation to the trial balances, tracking and support for adjustments to the financial statements, and the guidance available to personnel responsible for the preparation of the statements.	1999	2001
Financial Reconciliations - A periodic reconciliation of the EDs accounting records ensures the integrity of the underlying accounting data supporting the financial statements. EDs reconciliation process for the fund balance with Treasury, grant expenditures and other general ledger accounts and subledgers contained deficiencies in the policies and procedures surrounding reconciliations, timeliness of the reconciliations, researching and resolving reconciling items, and support for certain adjustments.	1999	2000

Non Conformance	Fiscal Year Identified	Fiscal Year To Be Corrected
Federal Family Education Loan System – The Department did not have a methodology for determining the loan loss for Federal Family Education Loans using validated data. The Department established this liability during 1998 using validated data. One action item, establishing FFELP subsidiary ledgers remains to be completed.	1990	2001
Financial Management Systems – The legacy core financial management systems had numerous functional and technological problems. Conversion to the a new system (EDCAPS) was completed during 1998. However, shortcomings of the financial management system software (FMSS) portion of the system prevented ED from preparing timely financial statements and the FMSS will be replaced. In addition, EDs controls surrounding information systems contained deficiencies in the EDCAPS disaster recovery plan, implementation of EDCAPS user account and password standards, information technology architecture, granting access to computing resources, and physical and environmental controls over computer rooms.	1989	2001

Semi-Annual Report to Congress on Audit Follow-up

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

I. Number of Audit Reports and the Dollar Value of Disallowed Cost

Disallowed costs are questioned costs that management, in a management decision, sustained or agreed should be recovered by the federal government. The information contained in the table below represents audit reports for which receivables were established. During FY 1999, final action was taken on 59 percent (353 of 596) of the total number of reports which were pending final action. This represents a 21 percent reduction in the number of audits pending final action at year-end.

Management Report on Final Action Audits with Disallowed Costs
For the Fiscal Year Ending September 30, 1999

	Number of Reports	Disallowed Costs
Beginning Balance 10/1/98	308	$241,885,258
+ Management Decisions	288	64,358,104
Pending Final Action	596	306,243,362
- Final Action	353	106,126,585
Ending Balance 9/30/99	243	$200,116,777

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

A recommendation that funds be put to better use implies that management's implementation of specific recommendations could result in more efficient use of funds. It is significant to note that of the six audit reports with Better Use of Funds (BUF), three reports with a total value of more than $5.8 million were closed (final action taken). This represents a closure rate of 50 percent better than the previous year.

Management Report on Final Action with Recommendations That Funds be Put to Better Use
For the Fiscal Period Ending September 30, 1999

	Number of Reports	Dollar Value of BUF
Beginning Balance 10/1/98	4	$113,110,667
+ Management Decisions	2	3,891,552
Pending Final Action	6	117,002,219
- Final Action	3	5,891,552
Ending Balance 9/30/99	3	$111,110,667

III. Reports Pending Final Action One Year or More After Issuance of a Management Decision

Disallowed Costs: OIG Audits: On September 30, 1999, the Department had a total of 11 OIG internal and nationwide audit reports on which final action was not taken within one year of the issuance of a management decision. Eighteen percent of the 11 reports were 1 to 2 years old. Thirty-six percent were 2 to 4 years old. The remaining 46 percent were over 5 years old. Implementation of corrective actions that would close the audit reports extend to late in fiscal year 2000. Many corrective actions are dependent upon major system changes that are currently being implemented. Two of these 11 reports contained BUF findings amounting to $111 million. For detailed information on these audits, refer to previously issued Semiannual Report to Congress on Audit Follow-up Numbers 20 and 21.

Disallowed Costs: All Other Audits: As of September 30, 1999, the Department had 139 reports with disallowed costs amounting to $106 million (this number excludes appeals). A total of 55 reports were in appeal status during this period, amounting to $85 million. Reasons for final action not being completed after one year include: legal review in process; bankruptcy proceedings in process; under the review of the Debt Management Group; and billing cycle in process. For detailed information on these audits, refer to previously issued Semiannual Reports to Congress on Audit Follow-up Numbers 20 and 21.

Prompt Pay

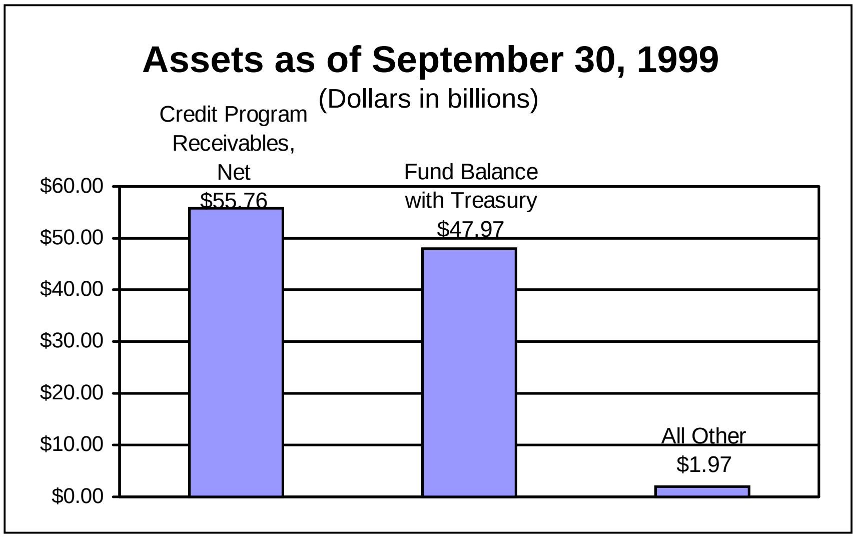
The Prompt Pay Act requires agencies to report on their efforts to pay bills on time. In FY 1999, ED processed 97 percent of its 22,757 payments on time, representing approximately $825 million. Late payment penalties were paid on 745 invoices.

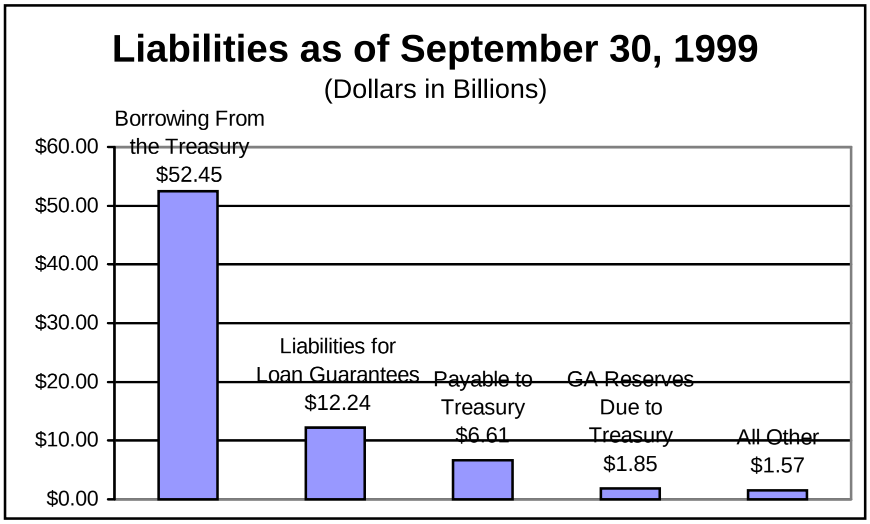
With respect to the electronic funds transfer (EFT) requirement of the Debt Collection Improvement Act, the Department of Education, in FY 1999, made approximately 84 percent of its payments electronically. In fact, the Department's performance has surpassed Treasury's FY 2000 EFT goal of 75 percent. Recipients of these payments include institutions, businesses, corporations, and individuals.

Financial Statement Highlights

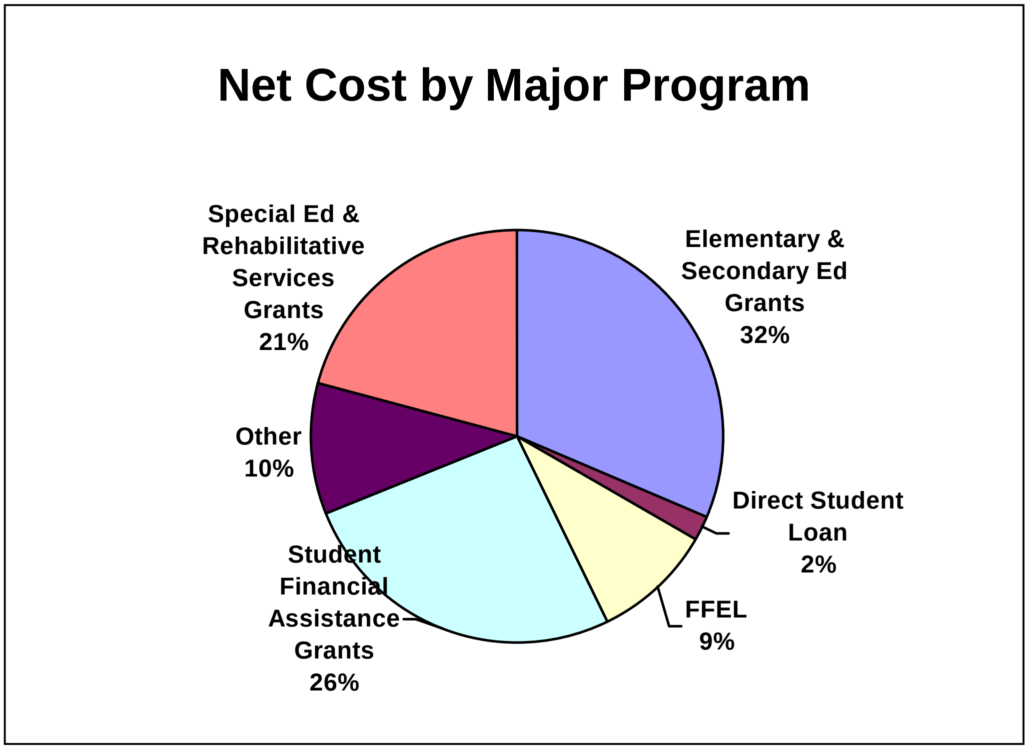
Assets and Liabilities

The following charts provide a summary of the Department's composition of assets and liabilities as of September 30, 1999.





The following chart depicts the net cost relationship of the Department's major programs as documented by the Consolidated Statement of Net Cost in the attached financial statements.



Limitations of Financial Statements

The following limitations apply to the preparation of the FY 1999 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.

Principal Financial Statements,

Notes, and

Required Supplementary Information

The accompanying notes are an integral part of these statements.

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidated Balance Sheet
As of September 30, 1999
(Dollars in Thousands)

	Consolidated
Assets	
Entity Assets	
Intragovernmental Assets:	
Fund Balance with Treasury (Note 2)	$47,975,719
Accounts Receivable, Net (Note 3)	5
Governmental Assets:	
Accounts Receivable, Net (Note 3)	14,135
Credit Program Receivables, Net (Note 4)	55,755,754
Advances	38,998
Other Assets	69,550
Total Entity Assets	$103,854,161
Non-Entity Assets	
Accounts Receivable-Guaranty Agency Reserves (Note 3)	$1,846,880
Total Non-Entity Assets	$1,846,880
Total Assets	$105,701,041
Liabilities	
Liabilities Covered by Budgetary Resources	
Intragovernmental Liabilities:	
Accounts Payable	$2,473
Interest Payable	9,208
Borrowing from the Treasury (Note 5)	52,449,309
GA Reserves Due to Treasury	1,846,880
Payable to Treasury (Note 7)	6,613,900
Governmental Liabilities:	
Accounts Payable	138,352
Accrued Grant Liability (Note 8)	926,751
Liabilities for Loan Guarantees (Note 4)	12,238,085
Other Governmental Liabilities (Note 9)	386,816
Total Liabilities Covered by Budgetary Resources	$74,611,774
Liabilities Not Covered by Budgetary Resources	
Intragovernmental Liabilities:	
Other Intragovernmental Liabilities (Note 9)	$85,721
Governmental Liabilities:	
Other Governmental Liabilities (Note 9)	22,565
Total Liabilities Not Covered by Budgetary Resources	$108,286
Total Liabilities	$74,720,060
Net Position	
Unexpended Appropriations (Note 11)	$30,739,303
Cumulative Results of Operations (Note 11)	241,678
Total Net Position	$30,980,981
Total Liabilities and Net Position	$105,701,041

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

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidated Statement of Net Cost
For the Year Ended September 30, 1999
(Dollars in Thousands)

	Consolidated
Program Costs	
Intragovernmental	
Production	
Interest Expense, Federal (Note 6)	$4,033,232
Contractual Service Expense	28,205
Salaries and Admin Expense	67,028
Bad Debt and Writeoffs	73
Other Program Expenses	27
Public	
Production	
Subsidy Expense (Note 4)	3,491,375
Grant Expense	31,075,354
Interest Expense, Non-Federal	142
Contractual Service Expense	444,513
Salaries and Admin Expense	386,176
Bad Debt & Write-offs	1,320
Other Program Expenses	1,869
Total Program Cost	$39,529,314
Less: Earned Revenues	
Interest, Federal (Note 6)	$1,612,567
Interest, Non-Federal (Note 6)	2,416,174
Other Earned Revenue	50,269
Earned Revenues	$4,079,010
Net Program Cost	$35,450,304
Costs Not Assigned to Programs	$198,417
Less: Earned Revenues not Attributable to Programs	307
Net Cost of Operations	$35,648,414

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

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidated Statement of Changes in Net Position
For the Year Ended September 30, 1999
(Dollars in Thousands)

	Consolidated
Net Cost of Operations	$(35,648,414)
Financing Sources (Other than Exchange Revenues):	
Appropriations Used	$34,386,003
Donations (Non-exchange Revenue)	692
Imputed Financing (Note 14)	20,635
Total Financing Sources	$34,407,330
Net Results of Operations	$(1,241,084)
Prior Period Adjustments (Note 1)	$(5,016,761)
Net Change in Cumulative Results of Operations	$(6,257,845)
(Increase) Decrease in Unexpended Appropriations	$(1,104,435)
Change in Net Position	$(7,362,280)
Net Position - Beginning of Period	$38,343,261
Net Position - End of Period	$30,980,981

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

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Combined Statement of Budgetary Resources
For the Year Ended September 30, 1999
(Dollars in Thousands)

	Combined
Budgetary Resources	
Budget Authority	$55,549,967
Unobligated Balance-Beginning of Period	12,789,961
Spending Authority from Offsetting Collections	17,344,168
Adjustments	(6,628,340)
Total Budgetary Resources (Note 15)	$79,055,756
Status of Budgetary Resources	
Obligations Incurred	$65,795,752
Unobligated Balances-Available (Note 11)	6,790,683
Unobligated Balances-Not Available (Note 11)	6,469,321
Total Status of Budgetary Resources	$79,055,756
Outlays	
Obligations Incurred	$65,795,752
Less: Spending Authority from Offsetting Collections and Adjustments	(18,072,014)
Obligated Balance, Net-Beginning of Period	32,859,538
Less: Obligated Balance, Net-End of Period	(35,368,025)
Total Outlays (Note 15)	$45,215,251

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

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Combined Statement of Financing
For the Year Ended September 30, 1999
(Dollars in Thousands)

Unaudited

	Combined
Obligations and Nonbudgetary Resources	
Obligations Incurred	$65,795,752
Spending Authority for Offsetting Collections and Adjustments	(18,072,014)
Nonbudgetary Resources Used to Finance Activities	2,770,460
Total Obligations and Nonbudgetary Resources	$50,494,198
Resources That Do Not Fund Net Cost of Operations	
Change in Amount of Goods, Services, and Benefits Ordered But Not Yet Provided Net Increases (Net Decreases)	$(1,399,981)
Costs Capitalized	(28,587,682)
Resources that Fund Expenses Recognized in Prior Periods	(11,313)
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowance for Subsidy	11,347,966
Other Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	2,218,761
Total Resources That Do Not Fund Net Cost of Operations	$(16,432,249)
Costs That Do Not Require Resources	
Depreciation, Amortization, and Credit Program Costs	$525,641
Total Costs That Do Not Require Resources	$525,641
Financing Sources Yet to be Provided	$1,060,824
Net Cost of Operations (Note 16)	$35,648,414

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

1 *Summary of Significant Accounting Policies*

Reporting Entity

The U.S. Department of Education (Department), established on May 4, 1980 by Congress under the Department of Education Organization Act of 1979 (Public Law 96-88), is responsible for administering its congressionally approved budget for its direct loan, guaranteed loan, and grant programs. The Federal Direct Student Loan Program, authorized by the Student Loan Reform Act of 1993, lends funds directly to postsecondary students through borrowing from the U.S. Department of the Treasury. The Federal Family Education Loan Program (FFELP), authorized by the Higher Education Act (HEA) of 1965, as amended, operates with state and private nonprofit guaranty agencies to provide loan guarantees and interest supplements through permanent budget authority on loans provided by private lenders to eligible students attending participating postsecondary schools. The Department also provides grants to students for elementary, secondary, and post-secondary education, special education, rehabilitation services and disability research, vocational education, bilingual education and minority languages programs.

The Higher Education Act Amendments of 1998 (Public Law 105-244) amended the HEA of 1965 and established the Student Financial Assistance (SFA) as a performance-based organization within the Federal government, and re-authorized the Title IV student financial assistance programs. Under these amendments, SFA is directly responsible for administering and reporting on the Federal Direct Student Loan Program, FFELP, Pell Grant Program, and Campus-Based Programs.

Basis of Accounting and Reporting

The accompanying financial statements present the financial position, net costs, changes in net position, and status of budgetary resources of the Department, as required by the Chief Financial Officers Act of 1990 (Public Law 101-576) and the Government Management Reform Act of 1994 (GMRA). These financial statements have been prepared from the accounting records of the Department in conformity with generally accepted accounting principles (GAAP), and the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin No. 97-01, as amended. GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which was recently designated the official accounting standards-setting body for the Federal government by the American Institute of Certified Public Accountants. These statements are different from the financial reports, also prepared by the Department, pursuant to OMB directives that are used to monitor and control the Department's use of budgetary resources.

The Department's principal financial statements include the accounts of all the appropriated funds, revolving funds, and other fund types under its control. The Department's financial activity has been classified and reported by the following programs: SFA programs; Office of Elementary and Secondary Education (OESE) programs; Office of Special Education and Rehabilitative Services (OSERS) programs; Office of Vocational and Adult Education (OVAE) programs; Office of Postsecondary Education (OPE) programs; Office of Educational Research and Improvement (OERI) programs; and Office of Bilingual Education and Minority Languages (OBEML) programs. SFA's financial activity has been classified and reported by the following programs: Federal Direct Student Loan Program; FFELP; and Grant programs. All interprogram balances within the Department have been eliminated. The Department's principal financial statements do not include centralized management functions of the Federal government which are undertaken for the benefit of the whole Federal government. However, liabilities for certain employee benefits that are specifically allocable to the Department are included in the Department's principal financial statements.

The Department generally records transactions on an accrual basis, recognizing revenues when earned and expenses when incurred, without regard to receipt or payment of cash.

Credit Reform Accounting and Subsidy Estimates and Reestimates

Beginning October 1, 1991, the Federal Credit Reform Act of 1990 (Public Law 101-508) requires agencies to measure the total costs of Federal credit programs at the time a loan is committed. The Federal Credit Reform Act of 1990, the FASAB's Statement of Federal Financial Accounting Standard (SFFAS) No. 2, Accounting for Direct Loans and Loan Guarantees, and related regulations and guidance, require recording the net present value of 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, the net present value of these subsidy costs are recorded as an allowance (reduction) for direct loans receivable or as a liability for loan guarantees. All credit program receivables are recorded at the principal outstanding, net of allowances for subsidy cost or uncollectible receivables (net present value).

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 U.S. 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 reestimated each year which is recognized as an increase or decrease of subsidy expense.

The major sources of pre-Credit Reform activity are collections and permanent indefinite appropriations, and are recorded in the liquidating account.

Budgets and Budgetary Accounting

Budget authority is the authorization provided by law for the Department to obligate for future outlays of federal funds. The Department's budgetary resources as of September 30, 1999 include current authority (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 income (spending authority from offsetting collections credited to an appropriation or fund account) and adjustments (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 canceled five years after it expires.

Financing Sources and Program Revenues

The Department's programs are generally funded with Congressional appropriations. Borrowing from the U.S. Treasury provides most of the funds for loans made under the Federal Direct Student Loan Program and Facilities Loan Program. Other revenues are recognized when payments become payable to the Department from other agencies and from the public in exchange for goods or services rendered to others. Major sources of reported revenue include interest accrued from the Federal Direct Student Loan Program borrowers on outstanding loans receivable and interest accrued from the U.S. Treasury on uninvested fund balances. Fees received on loans, such as loan origination fees, are offset against the subsidy costs.

Prior Period Adjustment

In prior years, the consolidated financial statements did not comply with the requirements of the Federal Credit Reform Act of 1990 and Statement of Federal Financial Accounting Standard No. 2, Direct Loans and Loan Guarantees, as it related to the Federal Family Education Loan Program. Had the requirements of the Federal Credit Reform Act been complied with, the Department's cumulative results of operations as of September 30, 1998 would have been $5.1 billion lower than the amount reflected in the fiscal year 1998 consolidated unaudited financial statements. Accordingly, the $5.1 billion is reflected on the statement of changes in net position as a prior period adjustment.

Fund Balance with the U.S. Treasury

The Fund Balance with the U.S. Treasury are revolving funds, appropriated funds and undisbursed U.S. Treasury borrowings available to pay current liabilities and to finance loan programs. The Department has the authority to disburse the U.S. Treasury funds directly to agencies and institutions participating in its programs. Other cash receipts and disbursements are processed by the U.S. Treasury. A portion of the appropriated funds included at September 30, 1999 were forward-funded by multi-year appropriations for expenditures anticipated during the year ended September 30, 1999. Fund Balances with the U.S. Treasury do not include any non-entity finds.

Credit Program Receivables

All credit program receivables are recorded at the principal balance outstanding, net of allowances for subsidy cost or uncollectible receivables (net present value). Credit programs include the FFELP, the Federal Direct Student Loan Program, and the Facilities Loan Program. Allowances for subsidy cost represent the differences between the present values of estimated net cash inflows and outflows of the underlying credit program loans. The allowance for subsidy cost is amortized using the effective interest method based on the interest rate at the time credit program loans were disbursed.

Accounts Receivable

Accounts receivable are due from recipients of grant and other financial assistance programs, and other federal agencies. Accounts receivable are recorded at the net realizable amounts.

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 non-liquid assets developed or purchased by an 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 the agency's Operating Fund. The Operating Fund is considered the property of the guaranty agency except for funds an agency borrows from the Federal Fund under Section 422A of the HEA. This fund shall be used by the guaranty agency to fulfill its responsibilities under the HEA. These responsibilities include repaying money borrowed from the Federal Fund, application processing, loan disbursement, default aversion, and collection activities.

Guaranty agency reserves consist of the Department's interest in the net assets of state and non-profit FFEL program guaranty agencies. Guaranty agency assets include initial federal start-up funds (guaranty agency advances), receipts of federal reinsurance payments, insurance premiums, guaranty agency share of collections on defaulted loans, investment income and administrative cost allowances and other assets purchased out of reserve funds. Liabilities result from lender claims, operating expenses and federal reinsurance fees. Guaranty agency reserves are recorded as a non-entity receivable asset and as a liability due to the U.S. Treasury.

<u>Liabilities</u>

Liabilities represent the amount of funds or other resources likely to be paid by the Department as a result of transactions or events which have already occurred. No liability can be paid by the Department, absent an appropriation or budgetary authority. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources. Most of FFELP and the Federal Direct Student Loan Program liabilities result from entitlements covered by permanent authority and the Department is required to pay these liabilities if all eligibility requirements are met. Any non-entitlement liability of the Department, such as federal administrative costs, not arising from contracts, and entitlements not yet vested, can be abrogated by the government acting in its sovereign capacity.

Liabilities for loan guarantees under the FFELP include provisions for payment of loan defaults, interest subsidies, lender compensation for below market interest rates administrative expense allowances, supplemental preclaims assistance and interest expense. These liabilities are offset by estimated future collections on defaulted loans, loan origination fees paid by borrowers and fees paid by lenders.

<u>Accrued Grant Liability</u>

Disbursements of grant funds are made when requested by recipients through a drawdown request from the Grants and Administrative Payment System (GAPS). However, recipients may not request funds in advance of incurring the related expenditures. Therefore, an accrued grant liability is estimated at September 30, 1999, which represents estimated amounts of authorized expenditures which a drawdown has not yet been requested although the expenditure has been incurred. The accrued grant liability is estimated based on a sampled approach.

Borrowing from the U.S. Treasury

Borrowings from the U.S. Treasury provide funding for loans in the Federal Direct Student Loan Program and Facilities Loan Programs. Principal repayments are made to the U.S. Treasury based on the schedules of the underlying loans. Borrowings from the U.S. Treasury are also reduced by authorized write-offs of loans receivable. Interest is paid to the U.S. Treasury based on a weighted average rate determined at the end of each fiscal year. Principal repayment and interest is calculated after the year-end and funds are remitted to the U.S. Treasury in accordance with the U.S. Treasury's Treasury Financial Manual (TFM) guidance.

Annual, Sick and Other Leave

Annual leave is accrued as it is earned and reduced as leave is taken. Each year, the balance to the accrued annual leave account is adjusted to reflect current pay rates. Annual leave earned but not taken, within established limits, is funded from future financing sources. Sick leave and other types of nonvested leave are expensed as taken.

Retirement Plans and Other Employee Benefits

The majority of the Department's employees participate in the contributory Civil Service Retirement System (CSRS), to which the Department makes matching contributions equal to seven percent of pay, or the Federal Employees Retirement System (FERS), offering a savings plan, which automatically contributes one percent of pay and matches any employee contribution up to an additional four percent of pay. In addition, for employees covered under FERS, the Department also contributes the employer's matching share for Social Security. The Department does not report CSRS or FERS assets for its employees. Liabilities not covered by budgetary resources are reported for the accrued normal service cost accruing for current employees.

Federal Employees Compensation Act

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

Net Position

Net position is the residual difference between assets and liabilities. It is comprised of unexpended appropriations and cumulative results of operations. Unexpended appropriations include undelivered orders and unobligated balances, excluding activity of the liquidating and financing accounts required under the Federal Credit Reform Act of 1990.

Grant Expenditures

Disbursements of grant funds are made when requested by recipients and recorded as expenditures upon disbursement.

2 *Fund Balances with the U.S. Treasury*

Fund Balances with the U.S. Treasury represent all undisbursed account balances for the Department with the U.S. Treasury. As reflected on the Department's Consolidated Balance Sheet as of September 30, 1999, all undisbursed account balances with the U.S. Treasury are entity assets and are comprised primarily of appropriated and revolving fund types. The total of all undisbursed account balances with the U.S. Treasury as of September 30, 1999, summarized by fund type, are as follows:

Fund Balances with the U.S. Treasury
(Dollars in Thousands)

Fund Type	Total
Appropriated Funds	$ 32,283,170
Revolving Funds	15,421,882
All Other Funds	270,667
Total	$ 47,975,719

3 Accounts Receivable

The Department records all its accounts receivable at their net realizable amounts. The Department estimates its allowance for loss on uncollectible accounts based on historical data. The Department reported both entity and non-entity accounts receivable as of September 30, 1999. Total entity asset accounts receivable for the Department amounted to $489.9 million gross accounts receivable, $475.8 million in allowances for accounts receivable, and $14.1 million net accounts receivable. Of the $14.1 million net accounts receivable, $4.8 thousand is related to intragovernmental accounts receivable. The Department also reported non-entity accounts receivable totaling $1.8 billion for guaranty agency reserves as of September 30, 1999. These guaranty agency reserves consist of the Federal government's interest in the net assets of state and non-profit Federal Family Education Loan Program guaranty agencies.

4 Direct Loans and Loan Guarantees, Non-Federal Borrowers

The Department provides loans to students and parents under both the Federal Direct Student Loan Program and the Federal Family Education Loan Program (FFELP). Loans are made to individuals who meet statutorily set eligibility criteria and attend eligible institutions of higher education, which 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, and student borrowers who demonstrate financial need receive Federal interest subsidies. The Facilities Loan Program also provides low-interest loans to assist in the construction, reconstruction, or renovation of housing, academic facilities, and other educational facilities for students and faculty at institutions of higher education.

Under the FFELP, over 4,800 private lenders 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. (Lenders 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.) FFELP lenders receive statutorily set Federal interest subsidies. Guaranty agencies receive administrative fee payments as set by statute.

Under the Federal Direct Student Loan Program, the Federal government provides loan capital directly to students and parents through participating schools. The Department began issuing direct loans in 1994 under the Student Loan Reform Act of 1993. Direct loan obligations and loan guarantee commitments made after fiscal year 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act of 1990. The Act provides that the present value of the subsidy costs associated with direct loans and loan guarantees be recognized as a cost in the year the direct or guaranteed loan is disbursed. Subsidy costs associated with direct loans and loan guarantees arise from interest rate differentials, interest subsidies, delinquencies and defaults, fee offsets, and other cash flows. Direct loans are reported net of an allowance for subsidy at present value, and loan guarantee liabilities are reported at present value.

The Department estimates the amount of loss it will incur on future defaults of FFELP and Federal Direct Student Loan Program loans. These estimates are recorded as an allowance for subsidy cost a reduction of the direct loans outstanding and as a liability for the guaranteed loans. To comply with the Federal Credit Reform Act of 1990 and related requirements, the Department employs a computer-based cash flow projection model to compute the FFELP loan guarantee liability, the Federal Direct Student Loan Program allowance for subsidy cost, and the net present value of the defaulted FFELP loans receivable. The Department estimates cash flows over the life of a loan, by loan type, aggregating the loans by loan type, cohort year, and risk group. Cohort year for the loan represents the year the direct loan is obligated or the loan is guaranteed. Risk groups include students at two-year colleges, four-year colleges, graduate schools, and proprietary schools.

Net credit program receivables were $55.8 billion as of September 30, 1999, including $46.2 billion for direct loans, $9.2 billion for defaulted guaranteed loans, and $424.8 million for facilities loans. An analysis of the credit program receivables for the Federal Direct Student Loan Program, FFELP, and Facilities Loan Program is provided in the following tables.

The credit program receivables table below also depicts the pre-1992 liquidating amounts and the post-1992 financing amounts for the defaulted FFELP loans. It is important to recognize that the credit program receivables, net amount, and the value of assets presented below related to direct loans are not the same as the proceeds that the Department would expect to receive from selling the loans.

Credit Program Receivables
(Dollars in Thousands)

	Direct Loans	Defaulted FFELP Loans Pre-1992	Defaulted FFELP Loans Post-1992	Facilities Loans
Loans Receivable	$ 46,516,368	$ 17,908,561	$ 5,782,893	$ 523,673
Interest Receivable	1,194,048	1,407,183	432	8,794
Gross Program Receivables	$ 47,710,416	$ 19,315,744	$ 5,783,325	$ 532,467
Less: Allowance for Subsidy/Loss	(1,557,854)	(15,920,687)	(0)	(107,657)
Net Credit Program Receivables	$ 46,152,562	$ 3,395,057	$ 5,783,325	$ 424,810

The loan guarantee subsidy expenses for the fiscal year ended September 30, 1999 were as follows:

Loan Guarantee Subsidy Expenses
(Dollars in Thousands)

Provisions for Loan Defaults (Net of Recoveries)	$ 2,759,594
Provision for Interest Subsidies	(6,102)
Fees	10
Mandatory Administrative Expense	130,374
Total Current Year Estimate	2,883,876
Add: Total Reestimates	226,188
Total Loan Guarantee Subsidy Expense	$ 3,110,064

As of September 30, 1999, total outstanding guarantees were approximately $127.0 billion. If all the loans currently guaranteed defaulted, the Department would not pay the full guaranteed amount to the guaranty agencies. Instead, it would actually 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.

Currently, guaranty agencies are reimbursed at the 95 percent reinsurance rate. The present value of estimated losses on guaranteed loans as of September 30, 1999, was as follows:

Estimated Loss on Guaranteed Loans (Dollars in Thousands)	
Pre-1992 Guarantees, Present Value	$ 405,661
Post-1991 Guarantees, Present Value	11,832,424
Total Loan Guarantee Liability	**$ 12,238,085**

Total direct loan subsidy expenses amounted to $381.0 million for the fiscal year ended September 30, 1999, as shown below:

Direct Loan Subsidy Expenses (Dollars in Thousands)	
Loan Defaults (Net of Recoveries)	$ 886,541
Interest Subsidies	(1,084,814)
Fees	(392,024)
Other Subsidy	293,696
Total Current Year Estimate	(296,601)
Add: Total Reestimates	677,591
Total Direct Loan Subsidy Expense	**$ 380,990**

Total facilities loan subsidy expenses amounted to $321.2 thousand for the fiscal year ended September 30, 1999.

5 *Borrowing from the U.S. Treasury*

The Department reported debt of $52.4 billion as of September 30, 1999 comprised of borrowing from the U.S. Treasury. The borrowing from the U.S. Treasury was incurred to provide funding for direct loan, guaranteed loan, and facilities loan programs administered by the Department. The borrowing is authorized through an indefinite permanent authority at interest rates set each year by the U.S. Treasury. The interest rate for borrowing as of September 30, 1999 was 5.67 percent.

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

	Direct Student Loans	FFELP Loans	Facilities Loans
Borrowing from the U.S. Treasury, Beginning	$ 35,097,256	$ 116,771	$ 400,778
New Borrowings	21,571,334	0	11,073
Repayments	(4,599,084)	(116,771)	(32,048)
Borrowing from the U.S. Treasury, Ending	$ 52,069,506	$ 0	$ 379,803

On September 30, 1992, the FFELP borrowed $2.09 billion from the U.S. Treasury for non-contractual modifications made to its loan guarantees. The non-contractual modifications were: (a) the Emergency Unemployment Compensation Act (EUCA) of 1991 authorized the Department to continue collecting on defaulted loans through the Internal Revenue Service (offsetting income tax refunds) and through the use of wage garnishment as a collection tool for defaulted loans; and (b) the HEA Amendments of 1992 eliminated the statute of limitations on collection activities for certain student loans.

The FFELP repaid the borrowing, at an annual interest rate of 7.37 percent, with increased collections on defaulted loans resulting from the non-contractual modifications. During the fiscal year ended September 30, 1999, the Department submitted the final payment on the outstanding loan balance to the U.S. Treasury.

The Facilities Loan Program interest rates for borrowings for its College Housing and Facilities Loan (CHAFL) Program and its Historically Black College and University (HBCU) Program were 6.11% and 5.66%, respectively, during fiscal year 1999.

Fund Balance with the U.S. Treasury was reduced by approximately $4.6 billion as a result of principal repayments of borrowing made to the U.S. Treasury pertaining to the Direct Loan Student Program. The Budgetary Resources on the Statement of Budgetary Resources reflected the actual principal repayment of $4.6 billion to the U.S. Treasury. The SF-1151 Nonexpenditure Transfer Authorizations for these repayments were submitted to the U.S. Treasury subsequent to September 30, 1999 but prior to the U.S. Treasury deadline of October 12, 1999. U.S. Treasury regulations require agencies to transmit their SF 1151s by October 12, 1999 to meet year-end reporting deadlines. Additionally, Fund Balance with the U.S. Treasury was reduced by $3.4 billion in interest expense and increased by $1.1 billion in interest revenue pertaining to the interest calculations of Direct Loans. The Net Cost Statement reflected this $3.4 billion of interest expense as well as the interest revenue on uninvested funds of $1.1 billion. The Statement of Budgetary Resources reflected an expenditure and outlay of $3.4 billion as well as increased spending authority for offsetting collections and decreased outlays for $1.1 billion. This interest expense and revenue consisted of SF-1081s that were submitted in October 1999. U.S. Treasury regulations require interest payments to be paid to the U.S. Treasury annually, as of the last day of the fiscal year, and are due to the U.S. Treasury no later than the third workday after the close of the fiscal year.

The Education Department reduced their Fund Balance with the U.S. Treasury in the general ledger in compliance with U.S. Treasury regulations and within standard governmental practice. Current U.S. Treasury guidance and regulations that addresses this issue are as follows:

- TFM Bulletin 99-04, Yearend Closing Bulletin paragraph 31 states, “The dates in attachment 1, unless otherwise indicated, represents the dates reports are due to the U.S. Treasury. Coordinate reporting to permit agency books to remain open for as long as possible.” Attachment 1 of this bulletin reflects the deadline for hand carrying or mailing the SF 1151 Nonexpenditure Transfer Authorizations to the U.S. Treasury is October 12th.

- Transmittal Letter 570, Revisions to Volume 1 TFM 2-4600, Section 4635.20 states, “Interest Payments on the unpaid principal balance of each financing account are required to be paid to the U.S. Treasury annually, as of the last day of the fiscal year (September 30). Interest payments are due to the U.S. Treasury no later than the 3rd workday after the close of the fiscal year. If an agency borrows funds to make an interest payment owed to the U.S. Treasury, the borrowing will be dated September 30. This method will alleviate recalculating the interest payment owed to the U.S. Treasury and the interest on uninvested funds."

- TFM, February 1999, Section 2035.6-Preparing and Distributing SF1151: Nonexpenditure Transfer Authorization states, "Agencies should record the transaction (SF 1151 transaction) in the same month as processed by the U.S. Treasury."

The principal repayment transactions were submitted to the U.S. Treasury after September 30, 1999 but were dated September 30, 1999 and reflected on the September 30, 1999 U.S. Treasury TFS-6653 (Undisbursed Appropriation Account Ledger). The interest transactions were processed as well using September 30 dates and reflected on the September SF 224.

6 Interest Revenue and Expense

Total interest revenues were $4.0 billion for the year ended September 30, 1999, consisting of $1.6 billion for Federal interest revenue and $2.4 billion for non-federal interest revenue. Total interest expenses for this same period were $4.0 billion. The interest revenues and expenses directly attributable to the Federal Direct Student Loan Program, the FFELP, and all other programs for the Department are summarized in the following table:

Interest Revenues and Expenses (Dollars in Thousands)

	Federal Direct Student Loan Program	FFELP Loan Program	All Other Programs
Interest Revenues, Federal	$ 1,087,918	$ 524,171	$ 478
Interest Revenues, Non-federal	2,394,939		21,235
Total Interest Revenues:	$ 3,482,857	$ 524,171	$ 21,713
Interest Expense, Federal	$ 3,482,857	$ 532,777	$ 17,598
Interest Expense, Non-federal	34	89	19
Total Interest Expense:	$ 3,482,891	$ 532,866	$ 17,617

7 *Payable to the U.S. Treasury*

The Department reclassified a total of $7.7 billion from Net Position to Payable to the U.S. Treasury on the Balance Sheet for its FFELP liquidating fund. A total of $1.1 billion of the payable was repaid to the U.S. Treasury in FY1999 and is reflected in these statements. As a result of the repayment, the Department reports $6.6 billion as a Payable to the U.S. Treasury as of September 30, 1999. Education anticipates returning approximately $2.7 billion to the U.S. Treasury in fiscal year 2000. The remaining balance of $3.9 billion in Payable to the U.S. Treasury will be paid from future receivable collections in excess of expenses for the liquidating account.

8 *Accrued Grant Liability*

The Department recognized an accrued grant liability totaling approximately $926.8 million as of September 30, 1999. The accrued grant liability represents an estimate of amounts expended by grantees for which the Department has not yet reimbursed the grantee. The allocation of the total liability to each reporting group was based on the percentage of fiscal year 1999 expenditures for each reporting group. The allocation of the accrued grant liability by reporting group was as follows: $312.6 million for OESE; $284.3 million for SFA grant programs; $224.1 million for OSERS; $49.4 million for OVAE; $35.3 million for OPE; $11.3 million for OERI; and $9.8 million for OBEML.

9 *Other Liabilities*

Other liabilities covered by budgetary resources amounted to $386.8 million as of September 30, 1999, consisting entirely of governmental liabilities. Other liabilities covered by budgetary resources include contractual services, administrative services, interagency agreement accruals, and suspense account balances.

Other liabilities not covered by budgetary resources amounted to $108.2 million as of September 30, 1999. Of this amount, $85.7 million was comprised of intragovernmental liabilities with the remaining $22.5 million classified as governmental liabilities. Liabilities not covered by budgetary resources include accrued annual leave, which is accrued as it is earned and reduced as leave is taken, and FECA liabilities for disability benefits.

10 *Federal Employee Benefits*

The Department'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 also 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 (CSRDF), which is administered by the Office of Personnel Management (OPM). The Department does not report FERS or CSRS assets or accumulated benefits applicable to its employees since this information is reported in total by OPM.

Employees hired prior to January 1, 1984 are covered by the CSRS, which provides a basic annuity and medicare coverage. The Department contributed an amount equal to 8.51 percent of the employee's basic pay to the CSRS during fiscal year 1999. Participating employees contributed 7.25 percent of their basic pay during fiscal year 1999. The Department and the employee also contribute to Medicare at the rate prescribed by law. The Department does not match contributions to the Thrift Savings Plan for employees who participate in the CSRS.

Employees who were hired between January 1, 1984 and January 1, 1987 were covered by the CSRS Interim Service. CSRS Interim Service employees were converted to either the CSRS or FERS coverage on the first day of the first pay period beginning in 1987. Employees hired on or after January 1, 1987 are covered by FERS. In addition, employees hired before January 1, 1984 could choose during certain periods in 1987, 1988, and 1989 to participate in the FERS. FERS consists of Social Security, a basic annuity plan, and a Thrift Savings Plan. The Department contributed to the basic annuity plan an amount equal to 10.7 percent of each employee's basic pay during fiscal year 1999. Participating employees contributed 1.05 percent of their basic pay during fiscal year 1999. The Department and the employee also contribute to Social Security and Medicare at the rates prescribed by law. In addition, the Department 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 Department's contributions for CSRS and FERS employees were $27.4 million for fiscal year 1999.

11 *Net Position*

The Department'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 financing sources over expenses for that account since its inception. The Department's cumulative results of operations amounted to $241.7 million as of September 30, 1999.

The Department's unexpended appropriations are comprised of unobligated balances-available, unobligated balances-unavailable, and undelivered orders. The Department's unexpended appropriations amounted to $30.7 billion as of September 30, 1999 and are comprised of the following:

Unexpended Appropriations (Dollars in Thousands)	
Unobligated	
Available	$ 5,022,112
Unavailable	466,390
Undelivered orders	25,250,801
Total	**$ 30,739,303**

Since unexpended appropriations do not include funding activity for which appropriations have not yet been received, unexpended appropriations reported in the Consolidated Balance Sheet will not agree with the balances of budget authority. The unobligated balances and undelivered orders for the Department's financing funds, $7.8 and $9.9 billion respectively, which are funded through Permanent Indefinite Authority, are not included in unexpended appropriations.

12 *Cost and Revenue by Budget Function*

The Department's total gross costs less earned revenue totaled $35.6 billion for the year ended September 30, 1999. These costs are presented, by budget function, in the table below. For fiscal year 1999, the Department's activities were classified under education, training, employment, and social services or administration of justice budget function categories.

Cost and Revenue by Budget Function (Dollars in Thousands)			
Budget Function	Gross Cost	Earned Revenue	Net Cost
Education, training, employment, and social services	$ 39,644,904	$ 4,079,369	35,565,535
Administration of justice	82,828	(51)	82,879
Total	$ 39,727,732	$ 4,079,318	$ 35,648,414

13 *Allocation of Direct and Indirect Cost*

In accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, the Department allocated its direct and indirect costs. For fiscal year 1999, the Department determined the amount of costs to be allocated to SFA, with the remaining costs reported by Department Management. Total costs to be allocated between Department Management and SFA amounted to $308.2 million for fiscal year 1999. Of this amount, $138.8 million ($34.0 million in direct costs and $104.8 million in indirect costs) was allocated to SFA, with the remaining $169.4 million reported under Department Management as costs not assigned to other programs.

14 *Imputed Financing*

The Statement of Changes in Net Position recognizes an imputed financing source of $20.6 million for fiscal year 1999, and 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 Department or employee contributions to the Civil Service Retirement System. No imputed financing source is recognized for the Federal Employee Retirement System, since it is a fully funded retirement service plan. The post-employment benefit expense represents the Department's estimate of the funds necessary to pay employees future pension, life, and health benefits.

15 Statement of Budgetary Resources

The Statement of Budgetary Resources is presented as a combined statement for the Department and as a combining statement for its major programs--as such, intra-agency transactions have not been eliminated. The total budgetary resources available amounted to $79.1 billion and total outlays amounted to $45.2 billion for the year ended September 30, 1999. Adjustments in the amount of $6.6 billion were made to Department's budgetary resources during fiscal year 1999 to account for recoveries and funds to be returned to the U.S. Department of the Treasury.

The budgetary resources obligated balances as of September 30, 1999 amounted to $35.4 billion, comprised of the following: $12.8 billion for SFA; $9.7 billion for OESE; $7.9 billion for OSERS; $1.9 billion for OVAE; $1.6 billion for OPE; $704.8 million for OERI; $529.1 million for OBEML; and 253.2 million for Department Management. In addition, the net amount of budgetary resources obligated for undelivered orders for the Federal Direct Student Loan Program and the FFELP were $7.0 billion and $2.8 billion, respectively, as of September 30, 1999. The available borrowing authority for the Federal Direct Student Loan Program was $1.5 billion at the end of fiscal year 1999.

The Department sites the following legislation pursuant to the *Higher Education Act of 1965* (Part D of the William D. Ford Federal Direct Loan Program and Part B of the Federal Family Education Loan Program) as it relates to the existence, purpose and availability of its permanent indefinite appropriations:

- "**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."

- "**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."

16 *Statement of Financing (Unaudited)*

The Statement of Financing is presented as a combined statement for the Department and as a combining statement for its major programs--intra-agency transactions have not been eliminated. For the year ended September 30, 1999, the net cost of operations amounted to $35.6 billion. Of this amount, $13.5 billion was attributable to SFA, $11.2 billion was attributable to OESE programs, $7.4 billion was attributable to OSERS programs, $1.5 billion was attributable to OVAE programs, $1.0 billion was attributable to OPE programs, $488.3 million was attributable to OERI, $319.6 million was attributable to OBEML, and $198.1 million for Department Management.

17 *Related Party Transactions*

The Department's financial activities interact with and are dependent upon those of the Federal government as a whole. Specifically, the Department is subject to financial decisions and management controls of OMB and the U.S. Treasury. As a result of the Department's relationship with other Federal government entities, the Department's operations may not be conducted, nor its financial position reported, as they would if the Department were a separate and unrelated party. As indicated in Note 5, principal and interest payments to the U.S. Treasury are recorded in accordance with the U.S. Treasury's TFM guidance.

18 *Contingencies*

Guaranty Agencies

The Department can assist guaranty agencies experiencing financial difficulties with advancement of funds and 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 based on financial need. The Department provides funds to participating schools to provide about 86 percent of the capital used to make loans to eligible students at 5 percent interest. The other 14 percent of program funding is provided by the institution. For the latest academic year (ended June 30, 1999) there were approximately 666,000 loans made, totaling $1.1 billion at approximately 1,867 institutions, averaging $1,600 per loan. As of June 30, 1999, the Department's share of the Perkins Loan Program was approximately $6.1 billion.

Borrower Class Actions

The Department is involved in pending litigation challenging the enforceability of FFELP loans made to students who attended various closed trade schools. In most instances, a large percentage of the loans in question are in default and have been acquired by guaranty agencies and/or the Department. No provision has been made in the principal statements for any potential reductions in estimated future collections related to the outcome of these suits, since the Department’s potential loss exposure is uncertain and cannot be estimated with sufficient reliability.

Other Matters

The Department is involved in various other claims and legal actions related to its programs, arising in the ordinary course of business. In addition, some portion of current year financial assistance expenses (grants) may include funded recipient expenditures which were subsequently disallowed through program review or audit processes. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Department’s financial statements.

HUMAN CAPITAL

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

Narrative Discussion:

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

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

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

Human Capital Programs:

Federal investment in Human Capital comprises those expenses for general public education and training programs that are intended to increase or maintain national economic productive capacity. It does not include expenses for internal Federal education and training. The Department's Human Capital programs include: Elementary and Secondary; Postsecondary; Student Financial Assistance; Special and Rehabilitative

Education; Research and Improvement; Bilingual and Minority Languages; and Vocational and Adult education.

Elementary and Secondary Education

The Office of Elementary and Secondary Education (OESE) includes eight program offices that provide financial assistance to State and local educational agencies for maintenance and improvement of both public and private preschool, elementary, and secondary education.

Compensatory Education Programs (includes Title I)

Compensatory Education Programs (CEP) provide financial assistance to State and local education agencies and other institutions to support services for children in high poverty schools, institutions for neglected and delinquent children, homeless children and certain Indian children. The programs are designed to meet the special education needs of such children and to aid in their teachers' continued professional development to enable these children to achieve the State's high, challenging academic standards set for all children. Under Title I of the Improving America's Schools Act of 1994 (IASA), CEP administers the Title I Program of supplementary instruction and other services; the Prevention and Intervention Programs for Children Who are Neglected, Delinquent, or At-Risk of Dropping Out; the Demonstrations of Effective Practices Program, and the Innovative Elementary School Transition Projects Program. In addition, CEP administers three related discretionary programs; Even Start for Indian Tribes and Tribal Organizations, Even Start Family Literacy in Women's Prisons, and the Statewide Family Literacy Program. It also manages the Training in Early Childhood Education Violence Counseling program authorized by Section 596 of the Higher Education Amendments of 1992; and the Education for Homeless Children and Youth program authorized by the Steward B. McKinney Homeless Assistance Act (P.L. 100-77).

Comprehensive School Reform Demonstration (CSRD) Program

The Comprehensive School Reform Demonstration program provides overall leadership and direction for CSRD as established in Public Law 105-78. CSRD provides grants to States to assist public schools across the country to implement effective, comprehensive school reforms that are based on reliable research and effective practices, and that include an emphasis on basic academics and parental involvement.

Congress appropriated $120 million for Fiscal Year 1998, to support comprehensive reforms in schools eligible for Title I funds. An additional $25 million was made available to all public schools, including those eligible for Title I. Funds became available to States on July 1, 1998, and will remain available for obligation by States and school districts through September 30, 2000.

Goals 2000 Program

Goals 2000 provides grants to States to develop and carry out comprehensive reform plans based on setting challenging content and performance standards in core academic areas, by describing system reforms to bring all children to the high standards, and developing sets of assessments that will measure progress of all children toward reaching the standards.

The Technology Literacy Challenge Fund, a new Goals 2000 program, was established to help stimulate State, local, and private sector partnerships focused on fully integrating technology into teaching and learning to help ensure that all students are technologically literate by the 21st century.

Impact Aid Program

Impact Aid provides financial assistance for the maintenance and operations of school districts in which the Federal government has acquired substantial real property, and to local educational agencies providing education for substantial numbers of federally connected pupils.

Office of Indian Education

Under Title IX of the Elementary and Secondary Education Act of 1965 (ESEA), Indian Education programs are authorized to support the efforts of local educational agencies, Indian tribes, and other entities to meet the special educational and culturally related academic needs of American Indians and Alaska Natives. The programs include: formula grants to local educational agencies covering a range of supplemental activities for targeted youth; demonstration programs for improving educational opportunities for Indian Children; professional development programs for increasing the number of Indian individuals in designated professions; a fellowship program for undergraduate and graduate study; programs for the gifted and talented and adult education; and national research activities.

Office of Migrant Education

The Office of Migrant Education (OME) administers programs that meet the special educational needs of migrant children. Currently, OME operates 5 programs: a formula grant to States for educational services to migrant children ages 3-21 (Title I, Part C); discretionary grants that promote inter- and intra-State coordination of services for migrant children, including the transfer of student educational and health records; discretionary grants for Migrant Even Start projects serving children 0-8 and their parents who have low levels of literacy; the High School Equivalency (HEP) program of discretionary grants to Institutes for Higher Education (IHE) for educational and support services to enable migrants 16 and older to obtain a high school diploma or General Education Degree (GED); and the College Assistance Migrant Program (CAMP) of discretionary grants to IHEs to assist migrants enrolled in college or university to complete their freshman year.

Safe and Drug-Free Schools Programs

Safe and Drug-Free Schools Programs provide leadership for ED efforts to achieve the Seventh National Education Goal, that by the year 2000 all schools will be free of drugs and violence and the unauthorized presence of firearms and alcohol and will offer a disciplined environment that is conductive to learning. The program administers a state formula grant program, discretionary grant competitions, and engages in extensive interagency collaboration.

School Improvement Programs

The School Improvement Programs (SIP) Office administers a large number of programs authorized by the Improving America's schools Act of 1994, including the Eisenhower Professional Development Program, Innovative Education Program Strategies (formerly known as Chapter 2), Public Charter Schools, and Magnet Schools Programs. These programs provide financial assistance to State and Local Educational Agencies, institutions of higher education, and other public and private nonprofit organizations for general assistance, special projects, projects to meet special educational needs of target children, and for teacher development.

Postsecondary Education (OPE)

The Office of Postsecondary Education (OPE) is responsible for formulating policy, directing and coordinating programs for assistance to postsecondary educational institutions and students pursuing a postsecondary education. The major OPE program-related components are:

Policy, Planning, and Innovation (PPI)

The Fund for the Improvement of Postsecondary Education (FIPSE) provides grants to colleges and universities to promote reform, innovation and improvement in postsecondary education.

Higher Education Programs (HEP)

HEP administers discretionary funds and provides support services designed to both improve student access to postsecondary education and foster excellence in institutions of higher education. Program funds are awarded usually in the form of grants to institutions across the country, which include postsecondary education institutions, elementary and secondary institutions, and non-profit organizations that assist in the distribution and administration of federal funds. HEP also administers several fellowship programs, which provide award funds to graduate and undergraduate students in targeted areas of study.

Student Financial Assistance (SFA) Programs

SFA administers those activities of the Department that provide need-based financial assistance to students pursuing a postsecondary education. Annually, ED makes available federal grants, loans and work-study funding to eligible undergraduate and graduate students attending institutions nationwide.

Education's two major loan programs are the Federal Family Education Loan Program (FFELP) and William D. Ford Direct Student Loan Program. The FFELP, authorized by the Higher Education Act of 1965, as amended (HEA), operates with state and private nonprofit guaranty agencies to provide loan guarantees and interest supplements through permanent budget authority on loans by private lenders to eligible students attending participating postsecondary schools. The William D. Ford Direct Student Loan Program, authorized by the Student Loan Reform Act of 1993, is a direct lending program in which loan capital is provided to individual students by the federal government through borrowing from the U.S. Treasury.

Special Education and Rehabilitative Services

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

To carry out these functions, OSERS consists of three program-related components: the Office of Special Education Programs (OSEP); the Rehabilitation Services Administration (RSA); and the National Institute on Disability and Rehabilitation Research (NIDRR).

Office of Special Education Programs

The Office of Special Education Programs (OSEP) has primary responsibility for administering programs and projects relating to the free appropriate public education of all children, youth and adults with disabilities, from birth through age 21. The bulk of special education funds are administered by OSEP's Division of Assistance to States, which provides grants to states and territories to assist them in providing a free, appropriate public education to all children with disabilities. The early intervention and preschool grant programs provide grants to each state for children with disabilities, from birth through age five.

Rehabilitation Services Administration

The Rehabilitation Services Administration (RSA) oversees programs that help individuals with physical or mental disabilities to obtain employment through the provision of such supports as counseling, medical and psychological services, job training, and other individualized services. RSA's major formula grant program provides funds to state vocational rehabilitation agencies to provide employment-related services for individuals with disabilities, giving priority to individuals who are severely disabled.

National Institute on Disability and Rehabilitation Research

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

Other Human Capital Programs:

Educational Research and Improvement

The Office of Educational Research and Improvement (OERI) provides national leadership for educational research and statistics. OERI strives to promote excellence and equity in American education by: conducting research and demonstration projects funded through grants to help improve education; collecting statistics on the status and progress of schools and education throughout the nation; and distributing information and providing technical assistance to those working to improve education.

OERI offers a variety of services to customers through its institutes and program-specific offices. The major OERI program-related components include: Media and Information Services; National Center for Education Statistics; National Institute on Early Childhood

Development and Education; National Institute on the Education of At-Risk Students; National Institute on Educational Governance, Finance, Policymaking, and Management; National Institute on Postsecondary Education, Libraries, and Lifelong Learning; National Institute on Student Achievement, Curriculum, and Assessment; National Library of Education; and Office of Reform Assistance and Dissemination.

Media and Information Services

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

National Center for Education Statistics

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

National Institute on Early Childhood Development and Education

The National Institute on Early Childhood Development and Education (ECI) was created to carry out a comprehensive program of research, development, and dissemination to improve early childhood development and education. The Institute sponsors coordinate comprehensive research, development, and dissemination activities that investigate factors, including services and support, in order to improve the learning, cognitive, and social-emotional development, and general well-being of children from birth through age eight, and their families.

The National Institute on the Education of At-Risk Students

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

The Institute provides national leadership and support for the expansion of research-based knowledge and strategies that promote excellence and equity in the education of children and youth placed at risk of educational failure.

The National Institute on Educational Governance, Finance, Policymaking, and Management

The National Institute on Educational Governance, Finance, Policymaking, and Management (GFI) is responsible for developing and disseminating information that will help guide the design and implementation of policy and management decisions that support elevated levels of learning by students. GFI carries out cohesive, integrated programs of research, development, evaluation, and dissemination in and across governance, finance, policy, and management.

The National Institute on Postsecondary Education, Libraries, and Lifelong Learning

The National Institute on Postsecondary Education, Libraries, and Lifelong Learning (PLLI) seeks to expand knowledge about the education and training of adults in a variety of settings, including postsecondary institutions, community-based education programs, libraries and the workplace. The Institute conducts research and development activities designed to promote quality and access the education and training received by adults. The work is concentrated in postsecondary education, adult literacy, libraries and community-based education, and special mission institutions such as tribal colleges.

National Institute on Student Achievement, Curriculum, and Assessment

The purpose of the National Institute on Student Achievement, Curriculum, and Assessment (SAI) is to carry out a coordinated and comprehensive program of research and development. The Institute provides research-based leadership to the United States as states and localities strive to improve student achievement in core content areas and work to integrate these areas to enhance student learning.

National Library of Education

The National Library of Education (NLE) is the largest federally funded library devoted entirely to education. It is the federal government's principal center for one-stop information and referral on education. The NLE serves in three areas: Reference and Information Services responds to telephone, mail, electronic, and other inquiries for education information; Collection and Technical Services directs the acquisition, preparation, and assessment of all collections in all formats; and Resource Sharing and Cooperation develops and maintains a network of national education resources.

Office of Reform Assistance and Dissemination

The Office of Reform Assistance and Dissemination (ORAD) supports comprehensive education reform by linking teachers, administrators, parents, policymakers, and the public with the best knowledge from education research, statistics, and practice. ORAD helps develop the capacity of schools and school districts to continuously improve through the use of proven knowledge. Major responsibilities include: providing technical and financial assistance for development; conducting research on models for successful uses of knowledge; providing training for putting in place exemplary and promising education programs; connecting schools and teachers with appropriate sources of assistance; and disseminating useful research findings.

Bilingual and Minority Languages

Congress passed the Bilingual Education Act in 1968 in recognition of the growing number of linguistically and culturally diverse children enrolled in schools who, because of their limited English proficiency, were not receiving an education equal to their English-proficient peers. The purpose of this Act was, and continues to be, aligned with Title VI of the Civil Rights Act of 1964. Established in 1974 by Congress, the Office of Bilingual Education and Minority Languages Affairs helps school districts meet their responsibility to provide equal education opportunity to limited English proficient children.

Office of Vocational and Adult Education

The Office of Vocational and Adult Education helps fund vocational-technical education through the Carl D. Perkins Vocational and Applied Technology Education Act, Public Law 101-392. Under the Perkins Act, Federal funds are made available to help provide vocational-technical education programs and services to youth and adults. The vast majority of funds appropriated each year under the Perkins Act are awarded in the form of grants to State education agencies. These grants are usually identified as State Basic Grants and are allotted according to a formula based on States' populations in certain age groups and their per capita income.

Stewardship Expenses:

In the Department of Education, discretionary spending constitutes approximately 75 to 85 percent of the budget and includes nearly all programs, the major exceptions being student loans and rehabilitation services.

REQUIRED SUPPLEMENTARY INFORMATION

For the Year Ended September 30, 1999

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

While spending for entitlement programs is usually a function of the authorizing statutes creating the programs, and is not generally affected by appropriations laws, spending for discretionary programs is decided in the annual appropriations process. Most Department programs (accounting for about 84 percent of our funds in 1998 and about 86 percent of our funds in 1999), are discretionary--for example, Title I, Impact Aid, Vocational Education, Special Education, Pell Grants, Research, and Statistics. This is quite different from funds government-wide, for which only about 34 percent of Federal spending is controlled by the Appropriations Committees.

The following is a summary of stewardship expenses for the U. S Department of Education (ED), for the fiscal year ended September 30, 1999. Expense data are expressed in nominal dollars.

Human Capital Expenses (in thousands):

	1999
Student Financial Assistance	
Direct Loan Subsidy Expense	$ 380,990
Guaranteed Loan Subsidy Expense	3,110,064
Grants	9,382,038
Salary and Administrative	433,300
Sub Total	$ 13,306,392
Other Departmental	
Elementary and Secondary Grants	$ 11,208,106
Postsecondary Education	1,024,116
Special Education & Rehabilitative Service Grants	7,401,466
Other Grants	2,059,949
Salary and Administrative	19,904
Sub Total	$ 21,713,541
Grand Total	$ 35,019,933

Program Outputs:

Education is primarily a State and local responsibility in the United States. It is States and communities, as well as public and private organizations, that establish schools and colleges, develop curricula, and determine requirements for enrollment and graduation. The structure of education finance in America reflects this predominant State and local role. Of the nearly $600 billion spent nationwide on education at all levels each year, 91 percent comes from State, local, and private sources.

That means the Federal contribution to national education expenditures is about 9 percent. However, this 9 percent includes educational expenditures from other Federal agencies, such as the Department of Health and Human Services' Head Start program and the Department of Agriculture's School Lunch program. Subtract these dollars, and ED is left with only about 6 percent of total education spending, or roughly $35 billion a year. That $35 billion is less than 2 percent of the Federal Government's $1.8 trillion budget.

ED currently administers a budget of over $30 billion per year and operates some 170 programs that touch on every area and level of education. The Department's elementary and secondary programs annually serve 15,000 school districts and more than 50 million students attending over 85,000 public schools and more than 26,000 private schools. Department programs also provide grant, loan, and work-study assistance to nearly 8 million postsecondary students.

While ED's programs and responsibilities have grown substantially over the years, the Department itself has not. In fact, ED's 1999 full time equivalent (FTE) staff ceiling of 4,694 is nearly 38 percent below the 1980 employee level of 7,528, who administered education programs when the Department was created. These staff reductions, along with a wide range of management improvements, have helped limit administrative costs to about 1.2 percent of the Department's budget. This means that ED delivers over 98 cents on the dollar in education assistance to States, school districts, postsecondary institutions, and students.

Program Outcomes:

Education has been, and continues to be, the stepping stone to higher living standards for American citizens. Concern over America’s ability to compete in world markets has highlighted the relationship between education and economic growth. But education’s contribution is more than increased productivity and incomes. Education improves health, promotes social change and opens doors to a better future for children and adults.

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

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

Over time, as the costs and returns of developing skills through education change, the incentive for individuals to participate in education also changes. This section presents recent studies/data that illustrate the rewards of completing high school and the rewards of investing in postsecondary education.

Employment of Noncollege Youth

The transition from high school to work can be difficult. Without proper job experience or specialized training, school leavers may have difficulty finding jobs. Comparing the employment rates of high school completers with those of dropouts indicates the employment advantage noncollege high school completers have over high school dropouts.

- In 1997, 67 percent of recent high school completers not enrolled in college were employed, compared with 45 percent of recent high school dropouts.
- Since 1972, the employment rates for both recent high school completers not enrolled in college and recent high school dropouts have declined, on average, by approximately 0.3 percentage points per year. These declines were greater for males than for females.
- Since 1972, the employment rates for black recent high school dropouts have been 25 percentage points lower than the rates for their white counterparts, on average. In 1997, the employment rate for black recent high school dropouts was 17 percent.
- Between 1960 and 1997, the gap in employment rates between male and female recent high school completers narrowed.

REQUIRED SUPPLEMENTARY INFORMATION
For the Year Ended September 30, 1999

Employment of Young Adults, by Educational Attainment

Many factors affect employment rates among adults. Some factors influence the willingness of employers to offer jobs to individuals with different levels of education at the going wage rate, whereas others influence the willingness of individuals to take jobs at this wage rate. The percentage of young adults who are employed is an indication of both the skill levels required by employers and the advantages employment offers to individuals relative to other pursuits.

- The employment rate of male and female 25- to 34-year-olds was generally higher among those individuals with a higher level of education between 1971 and 1998. For example, in 1998, males and females ages 25-34 with a bachelor’s degree or higher were more likely to be employed than their peers who had lower levels of educational attainment.
- Between 1971 and 1998, the employment rate of males ages 25-34 decreased for those who had not finished high school and those with a high school diploma or GED, and remained relatively constant for those with some college and those with a bachelor's degree or higher.
- Between 1971 and 1998, the employment rate of females ages 25-34 increased across all education levels. However, the rate of increase for females who did not complete high school was lower than the rate of increase for females who attained higher levels of education.

Annual Earnings of Young Adults, by Educational Attainment

Many factors influence wages and salaries, including employer’s perceptions of the productivity and availability of workers with different levels of education and prevailing economic conditions. The ratio of annual earnings of high school dropouts or college graduates to the annual earnings of high school completers measures the earnings disadvantage of not finishing high school and the earnings advantage of completing college.

- In 1997, the median annual earnings of young adults ages 25-34 who had not completed high school were substantially lower than those of their counterparts who had done so (29 and 37 percent lower for males and females, respectively). Young adults who had completed a bachelor’s degree or higher earned substantially more than those who had earned no more than a high school diploma or GED (50 and 91 percent more for males and females, respectively).
- Between 1980 and 1997, the earnings of those with a bachelor's degree or higher rose faster than the earnings of those who had completed only high school for both males and females.

- Gaps in earnings between males and females decline with increasing levels of education: as educational attainment increases, the ratio of median annual earnings of male to female wage and salary workers decreases. However, the association between education and the male/female earnings gap has lessened over time. That is, earnings of women achieved greater parity with the earnings of men in recent years, regardless of level of educational attainment.

Educational Attainment and Employment Status 4 Years After College Graduation

Some bachelor degree recipients go directly into the labor force, while others pursue further education, often combining school and work. A snapshot of labor market status and educational outcomes of college graduates 4 years after graduation illustrates graduates' paths to employment and further schooling. It also provides an opportunity to see the extent to which these paths are related to borrowing for undergraduate education.

- In 1997, the majority (79 percent) of 1992-93 graduates were neither enrolled in an advanced degree program nor had attained an advanced degree. Ten percent had attained an advanced degree and were not enrolled in school; another 10 percent were enrolled and had not attained an advanced degree; and 1 percent were enrolled and had attained an advanced degree.
- College graduates with parents who had an advanced degree were more likely than students whose parents had a bachelor's degree or less to have attained an advanced degree or to be enrolled in school in 1997.
- Graduates who used federal loans to finance their undergraduate education were slightly less likely than those who had not used these loans to have attained an advanced degree or to be enrolled in school in 1997.
- By 1997, most 1992-93 bachelor's degree recipients were employed: 76 percent were working and not enrolled in school and another 13 percent were combining school and work. Five percent were enrolled but not working, and 6 percent were neither working nor enrolled.

Intra-governmental Amounts

Intra-governmental amounts by trading partner include assets and liabilities. Assets consist primarily of approximately $48 billion in fund balance with Treasury. Liabilities to Treasury consist of the following: Borrowings of $52.4 billion, GA Reserves of $1.8 billion, Accounts Payable of $6.6 billion, and Interest Payable of $9 million. Accounts Payables due to other federal agencies totals $2.5 million. In addition, Intra-governmental Liabilities Not Covered by Budgetary Resources due to federal agencies totals $85.7 million.

Supplementary Information

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidating Balance Sheet
As of September 30, 1999
(Dollars in Thousands)

	Consolidated	Student Financial Assistance	Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Assets									
Entity Assets									
Intragovernmental Assets:									
Fund Balance with Treasury	$47,975,719	$24,987,593	$9,559,425	$8,106,052	$1,981,325	$1,632,384	$722,357	$532,813	$453,770
Accounts Receivable, Net	5								5
Governmental Assets:									
Accounts Receivable, Net	14,135	2,137	4,297	18		1,537			6,146
Credit Program Receivables, Net	55,755,754	55,330,944				424,810			
Advances	38,998	38,992	6						
Other Assets	69,550	66,769							2,781
Total Entity Assets	$103,854,161	$80,426,435	$9,563,728	$8,106,070	$1,981,325	$2,058,731	$722,357	$532,813	$462,702
Non-Entity Assets									
Accounts Receivable-Guaranty Agency Reserves	$1,846,880	$1,846,880							
Total Non-Entity Assets	$1,846,880	$1,846,880							
Total Assets	$105,701,041	$82,273,315	$9,563,728	$8,106,070	$1,981,325	$2,058,731	$722,357	$532,813	$462,702
Liabilities									
Liabilities Covered by Budgetary Resources									
Intragovernmental Liabilities:									
Accounts Payable	$2,473					$2,246		$5	$222
Interest Payable	9,208					9,208			
Borrowing from the Treasury	52,449,309	$52,069,506				379,803			
GA Reserves Due to Treasury	1,846,880	1,846,880							
Payable to Treasury	6,613,900	6,613,900							
Governmental Liabilities:									
Accounts Payable	138,352	102,391		$17,586	$625	6,050	$4,968	1,457	5,275
Accrued Grant Liability	926,751	284,338	$312,628	224,122	49,365	35,231	11,318	9,749	
Liabilities for Loan Guarantees	12,238,085	12,238,085							
Other Governmental Liabilities	386,816	92,952	1,852	2,280	1,798	487	21,780		265,667
Total Liabilities Covered by Budgetary Resources	$74,611,774	$73,248,052	$314,480	$243,988	$51,788	$433,025	$38,066	$11,211	$271,164
Liabilities Not Covered by Budgetary Resources									
Intragovernmental Liabilities:									
Other Intragovernmental Liabilities	$85,721	$65,948	$163	$260	$98	$390	$293	$33	$18,536
Governmental Liabilities:									
Other Governmental Liabilities	22,565	7,135	1,785	2,723	904	2,202	3,059	308	4,449
Total Liabilities Not Covered by Budgetary Resources	$108,286	$73,083	$1,948	$2,983	$1,002	$2,592	$3,352	$341	$22,985
Total Liabilities	$74,720,060	$73,321,135	$316,428	$246,971	$52,790	$435,617	$41,418	$11,552	$294,149
Net Position									
Unexpended Appropriations	$30,739,303	$8,776,494	$9,249,259	$7,862,107	$1,929,537	$1,528,974	$685,772	$521,602	$185,558
Cumulative Results of Operations	241,678	175,686	(1,959)	(3,008)	(1,002)	94,140	(4,833)	(341)	(17,005)
Total Net Position	$30,980,981	$8,952,180	$9,247,300	$7,859,099	$1,928,535	$1,623,114	$680,939	$521,261	$168,553
Total Liabilities and Net Position	$105,701,041	$82,273,315	$9,563,728	$8,106,070	$1,981,325	$2,058,731	$722,357	$532,813	$462,702

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

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidating Statement of Net Cost
For the Year Ended September 30, 1999
(Dollars In Thousands)

	Consolidated	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Program Costs									
Intragovernmental									
Production									
Interest Expense, Federal	$4,033,232	$4,015,634				$17,598			
Contractual Service Expense	28,205	3,284	$6,827	$2,916	$317	937	$13,924		
Salaries and Admin Expense	67,028	56,789	2,088	1,647	1,067	1,073	4,156	$208	
Bad Debt & Write-offs	73	6	64		1		2		
Other Program Expenses	27	9				18			
Public									
Production									
Subsidy Expense	3,491,375	3,491,054				321			
Grant Expense	31,075,354	9,382,038	11,208,106	7,401,466	1,440,542	1,023,795	301,340	318,067	
Interest Expense, Non-Federal	142	123	1	7			11		
Contractual Service Expense	444,513	193,063	47,745	14,555	9,444	4,951	173,466	1,289	
Salaries and Admin Expense	386,176	376,511	4,041	462	1,660	1,135	2,350	17	
Bad Debt & Write-offs	1,320	3,788				(2,468)			
Other Program Expenses	1,869	1,571	249		5		44		
Total Program Cost	$39,529,314	$17,523,870	$11,269,121	$7,421,053	$1,453,036	$1,047,360	$495,293	$319,581	
Less: Earned Revenues									
Interest, Federal	$1,612,567	$1,612,089				$478			
Interest, Non-Federal	2,416,174	2,395,762				20,412			
Other Earned Revenue	50,269		$40,470	$2,354		502	$6,943		
Earned Revenues	$4,079,010	$4,007,851	$40,470	$2,354		$21,392	$6,943		
Net Program Cost	$35,450,304	$13,516,019	$11,228,651	$7,418,699	$1,453,036	$1,025,968	$488,350	$319,581	
Costs Not Assigned to Programs	$198,417								$198,417
Less: Earned Revenues not Attributable to Programs	307								307
Net Cost of Operations	$35,648,414	$13,516,019	$11,228,651	$7,418,699	$1,453,036	$1,025,968	$488,350	$319,581	$198,110

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

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Consolidating Statement of Changes in Net Position
For the Year Ended September 30, 1999
(Dollars in Thousands)

	Consolidated	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Net Cost of Operations	$(35,648,414)	$(13,516,019)	$(11,228,651)	$(7,418,699)	$(1,453,036)	$(1,025,968)	$(488,350)	$(319,581)	$(198,110)
Financing Sources (Other than Exchange Revenues):									
Appropriations Used	$34,386,003	$12,119,981	$11,227,454	$7,416,623	$1,452,339	$1,041,989	$484,571	$319,360	$323,686
Donations (Non-exchange Revenue)	692								692
Imputed Financing	20,635	142,264	1,032	1,651	619	2,476	1,857	206	(129,470)
Total Financing Sources	$34,407,330	$12,262,245	$11,228,486	$7,418,274	$1,452,958	$1,044,465	$486,428	$319,566	$194,908
Net Results of Operations	$(1,241,084)	$(1,253,774)	$(165)	$(425)	$(78)	18,497	$(1,922)	$(15)	$(3,202)
Prior Period Adjustments	$(5,016,761)	$(5,024,242)				$7,481			
Net Change in Cumulative Results of Operations	$(6,257,845)	$(6,278,016)	$(165)	$(425)	$(78)	$25,978	$(1,922)	$(15)	$(3,202)
(Increase) Decrease in Unexpended Appropriations	$(1,104,435)	$(53,380)	$(2,419,337)	$669,306	$79,352	$409,602	$162,522	$42,582	$4,918
Change in Net Position	$(7,362,280)	$(6,331,396)	$(2,419,502)	$668,881	$79,274	$435,580	$160,600	$42,567	$1,716
Net Position - Beginning of Period	$38,343,261	$15,283,576	$11,666,802	$7,190,218	$1,849,261	$1,187,534	$520,339	$478,694	$166,837
Net Position - End of Period	$30,980,981	$8,952,180	$9,247,300	$7,859,099	$1,928,535	$1,623,114	$680,939	$521,261	$168,553

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

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Combining Statement of Budgetary Resources
For the Year Ended September 30, 1999
(Dollars in Thousands)

	Combined	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Budgetary Resources									
Budget Authority	$55,549,967	$33,875,014	$8,985,754	$8,124,371	$1,539,247	$1,524,806	$656,867	$380,000	$463,908
Unobligated Balance-Beginning of Period	12,789,961	11,721,255	675,623	171,391	59,007	57,436	50,260	18,977	36,012
Spending Authority from Offsetting Collections	17,344,168	17,217,123	40,470	2,354		76,101	6,993		1,127
Adjustments	(6,628,340)	(6,686,977)	143,148	22,264	(3,746)	(60,672)	(6,295)	(15,820)	(20,242)
Total Budgetary Resources	$79,055,756	$56,126,415	$9,844,995	$8,320,380	$1,594,508	$1,597,671	$707,825	$383,157	$480,805
Status of Budgetary Resources									
Obligations Incurred	$65,795,752	$43,604,248	$9,495,574	$8,143,750	$1,525,638	$1,510,918	$685,547	$379,475	$450,602
Unobligated Balances-Available	6,790,683	6,415,208	143,085	121,906	60,073	41,573	1,547	677	6,614
Unobligated Balances-Not Available	6,469,321	6,106,959	206,336	54,724	8,797	45,180	20,731	3,005	23,589
Total Status of Budgetary Resources	$79,055,756	$56,126,415	$9,844,995	$8,320,380	$1,594,508	$1,597,671	$707,825	$383,157	$480,805
Outlays									
Obligations Incurred	$65,795,752	$43,604,248	$9,495,574	$8,143,750	$1,525,638	$1,510,918	$685,547	$379,475	$450,602
Less: Spending Authority from Offsetting Collections and Adjustments	(18,072,014)	(17,579,670)	(310,644)	(56,152)	(3,798)	(123,219)	(10,997)	(2,237)	14,703
Obligated Balance, Net-Beginning of Period	32,859,538	10,221,265	11,420,066	7,006,459	1,866,741	1,194,928	538,747	462,677	148,655
Less: Obligated Balance, Net-End of Period	(35,368,025)	(12,776,100)	(9,751,345)	(7,868,327)	(1,912,742)	(1,572,427)	(704,807)	(529,117)	(253,160)
Total Outlays	$45,215,251	$23,469,743	$10,853,651	$7,225,730	$1,475,839	$1,010,200	$508,490	$310,798	$360,800

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

UNITED STATES DEPARTMENT OF EDUCATION
Departmentwide Combining Statement of Financing
For the Year Ended September 30, 1999
(Dollars in Thousands)

Unaudited

	Combined	Student Financial Assistance	Office of Elementary & Secondary Education	Office of Special Education & Rehabilitative Services	Office of Vocational & Adult Education	Office of Postsecondary Education	Office of Educational Research & Improvement	Office of Bilingual Education & Minority Languages	Department Management
Obligations and Nonbudgetary Resources									
Obligations Incurred	$65,795,752	$43,604,248	$9,495,574	$8,143,750	$1,525,638	$1,510,918	$685,547	$379,475	$450,602
Spending Authority for Offsetting Collections and Adjustments	(18,072,014)	(17,579,670)	(310,644)	(56,152)	(3,798)	(123,219)	(10,997)	(2,237)	14,703
Nonbudgetary Resources Used to Finance Activities	2,770,460	2,890,500	1,032	1,651	620	3,448	1,857	206	(128,854)
Total Obligations and Nonbudgetary Resources	$50,494,198	$28,915,078	$9,185,962	$8,089,249	$1,522,460	$1,391,147	$676,407	$377,444	$336,451
Resources That Do Not Fund Net Cost of Operations									
Change in Amount of Goods, Services, and Benefits Ordered But Not Yet Provided Net Increases (Net Decreases)	$(1,399,981)	$(1,674,815)	$1,790,616	$(663,387)	$(45,301)	$(414,998)	$(183,826)	$(58,346)	$(149,924)
Costs Capitalized	(28,587,682)	(28,636,252)				48,570			
Resources that Fund Expenses Recognized in Prior Periods	(11,313)	(387)	(277)	(446)	(178)	(2,162)	(502)	(72)	(7,289)
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowance for Subsidy	11,347,966	11,347,508				382	50		26
Other Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	2,218,761	2,218,834				(73)			
Total Resources That Do Not Fund Net Cost of Operations	$(16,432,249)	$(16,745,112)	$1,790,339	$(663,833)	$(45,479)	$(368,281)	$(184,278)	$(58,418)	$(157,187)
Costs That Do Not Require Resources									
Depreciation, Amortization, and Credit Program Costs	$525,641	$298,041	$251,908	$(7,563)	$(24,202)	$2,072	$(4,722)	$469	$9,638
Total Costs That Do Not Require Resources	$525,641	$298,041	$251,908	$(7,563)	$(24,202)	$2,072	$(4,722)	$469	$9,638
Financing Sources Yet to be Provided	$1,060,824	$1,048,012	$442	$846	$257	$1,030	$943	$86	$9,208
Net Cost of Operations	$35,648,414	$13,516,019	$11,228,651	$7,418,699	$1,453,036	$1,025,968	$488,350	$319,581	$198,110

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

UNITED STATES DEPARTMENT OF EDUCATION
Student Financial Assistance
Consolidating Balance Sheet
As of September 30, 1999
(Dollars in Thousands)

	Consolidated	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs
Assets				
Entity Assets				
Intragovernmental Assets:				
Fund Balance with Treasury	$24,987,593	$11,603,266	$5,484,909	$7,899,418
Accounts Receivable, Net				
Governmental Assets:				
Accounts Receivable, Net	2,137	1,372	765	
Credit Program Receivables, Net:	55,330,944	9,178,382	46,152,562	
Advances	38,992	38,743		249
Other Assets	66,769			66,769
Total Entity Assets	$80,426,435	$20,821,763	$51,638,236	$7,966,436
Non-Entity Assets				
Accounts Receivable-Guaranty Agency Reserves	$1,846,880	$1,846,880		
Total Non-Entity Assets	$1,846,880	$1,846,880		
Total Assets	$82,273,315	$22,668,643	$51,638,236	$7,966,436
Liabilities				
Liabilities Covered by Budgetary Resources				
Intragovernmental Liabilities:				
Accounts Payable				
Interest Payable				
Borrowing from the Treasury	$52,069,506		$52,069,506	
GA Reserves Due to Treasury	1,846,880	$1,846,880		
Payable to Treasury	6,613,900	6,613,900		
Governmental Liabilities:				
Accounts Payable	102,391	6,476	38,320	$57,595
Interest Payable				
Accrued Grant Liability	284,338			284,338
Liabilities for Loan Guarantees	12,238,085	12,238,085		
Other Governmental Liabilities	92,952	60,195	31,400	1,357
Total Liabilities Covered by Budgetary Resources	$73,248,052	$20,765,536	$52,139,226	$343,290
Liabilities Not Covered by Budgetary Resources				
Intragovernmental Liabilities:				
Other Intragovernmental Liabilities	$65,948	$338	$215	$65,395
Governmental Liabilities:				
Other Governmental Liabilities	7,135	4,283	2,852	
Total Liabilities Not Covered by Budgetary Resources	$73,083	$4,621	$3,067	$65,395
Total Liabilities	$73,321,135	$20,770,157	$52,142,293	$408,685
Net Position				
Unexpended Appropriations	$8,776,494	$1,097,613	$176,602	$7,502,279
Cumulative Results of Operations	175,686	800,873	(680,659)	55,472
Total Net Position	$8,952,180	$1,898,486	$(504,057)	$7,557,751
Total Liabilities and Net Position	$82,273,315	$22,668,643	$51,638,236	$7,966,436

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

UNITED STATES DEPARTMENT OF EDUCATION
Student Financial Assistance
Consolidating Statement of Net Cost
For the Year Ended September 30, 1999
(Dollars in Thousands)

	Consolidated	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs	Department Management Allocation
Program Costs					
Intragovernmental					
Production					
Interest Expense, Federal	$4,015,634	$532,777	$3,482,857		
Contractual Service Expense	3,284	1,461	1,823		
Salaries and Admin Expense	56,789	22,752	34,037		
Bad Debt & Write-offs	6			$6	
Other Program Expenses	9	9			
Public					
Production					
Subsidy Expense	3,491,054	3,110,064	380,990		
Grant Expense	9,382,038			9,382,038	
Interest Expense, Non-Federal	123	89	34		
Contractual Service Expense	193,063	27,023	163,566	2,474	
Salaries and Admin Expense	376,511	116,159	121,596		$138,756
Bad Debt & Write-offs	3,788	3,788			
Other Program Expenses	1,571	102	180	1,289	
Total Program Cost	$17,523,870	$3,814,224	$4,185,083	$9,385,807	$138,756
Less: Earned Revenues					
Interest, Federal	$1,612,089	$524,171	$1,087,918		
Interest, Non-Federal	2,395,762		2,394,939	$823	
Earned Revenues	$4,007,851	$524,171	$3,482,857	$823	
Net Program Cost	$13,516,019	$3,290,053	$702,226	$9,384,984	$138,756
Costs Not Assigned to Programs					
Less: Earned Revenues not Attributable to Programs	$0	$0	$0	$0	$0
Net Cost of Operations	$13,516,019	$3,290,053	$702,226	$9,384,984	$138,756

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, 1999
(Dollars in Thousands)

	Consolidated	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs	Department Management Allocation
Net Cost of Operations	$(13,516,019)	$(3,290,053)	$(702,226)	$(9,384,984)	$(138,756)
Financing Sources (Other than Exchange Revenues):					
Appropriations Used	$12,119,981	$3,054,403	$(317,886)	$9,383,464	
Imputed Financing	142,264	2,146	1,362		$138,756
Total Financing Sources	$12,262,245	$3,056,549	$(316,524)	$9,383,464	$138,756
Net Results of Operations	$(1,253,774)	$(233,504)	$(1,018,750)	$(1,520)	
Prior Period Adjustments	$(5,024,242)	$(5,024,242)			
Net Change in Cumulative Results of Operations	$(6,278,016)	$(5,257,746)	$(1,018,750)	$(1,520)	
(Increase) Decrease in Unexpended Appropriations	$(53,380)	$74,512	$(15,956)	$(111,936)	
Change in Net Position	$(6,331,396)	$(5,183,234)	$(1,034,706)	$(113,456)	
Net Position - Beginning of Period	$15,283,576	$7,081,720	$530,649	$7,671,207	
Net Position - End of Period	$8,952,180	$1,898,486	$(504,057)	$7,557,751	

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, 1999
(Dollars in Thousands)

	Combined	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs
Budgetary Resources				
Budget Authority	$33,875,014	$4,137,502	$20,389,512	$9,348,000
Unobligated Balance-Beginning of Period	11,721,255	8,587,489	6,390	3,127,376
Spending Authority from Offsetting Collections	17,217,123	8,370,393	8,846,544	186
Adjustments	(6,686,977)	(1,650,786)	(5,314,287)	278,096
Total Budgetary Resources	$56,126,415	$19,444,598	$23,928,159	$12,753,658
Status of Budgetary Resources				
Obligations Incurred	$43,604,248	$11,674,280	$23,896,513	$8,033,455
Unobligated Balances-Available	6,415,208	1,778,766	30,073	4,606,369
Unobligated Balances-Not Available	6,106,959	5,991,552	1,573	113,834
Total Status of Budgetary Resources	$56,126,415	$19,444,598	$23,928,159	$12,753,658
Outlays				
Obligations Incurred	$43,604,248	$11,674,280	$23,896,513	$8,033,455
Less: Spending Authority from Offsetting Collections and Adjustments	(17,579,670)	(8,370,393)	(8,856,494)	(352,783)
Obligated Balance, Net-Beginning of Period	10,221,265	195,842	5,629,346	4,396,077
Less: Obligated Balance, Net-End of Period	(12,776,100)	(3,018,665)	(6,949,937)	(2,807,498)
Total Outlays	$23,469,743	$481,064	$13,719,428	$9,269,251

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

UNITED STATES DEPARTMENT OF EDUCATION
Student Financial Assistance
Combining Statement of Financing
For the Year Ended September 30, 1999
(Dollars in Thousands)

Unaudited

	Combined	Federal Family Education Loan Program	Direct Student Loan Program	Grant Programs	Department Management Allocation
Obligations and Nonbudgetary Resources					
Obligations Incurred	$43,604,248	$11,674,280	$23,896,513	$8,033,455	
Spending Authority for Offsetting Collections and Adjustments	(17,579,670)	(8,370,393)	(8,856,494)	(352,783)	
Nonbudgetary Resources Used to Finance Activities	2,890,500	582,426	2,168,853	465	$138,756
Total Obligations and Nonbudgetary Resources	$28,915,078	$3,886,313	$17,208,872	$7,681,137	$138,756
Resources That Do Not Fund Net Cost of Operations					
Change in Amount of Goods, Services, and Benefits Ordered But Not Yet Provided Net Increases (Net Decreases)	$(1,674,815)	$(1,899,806)	$(1,473,397)	$1,698,388	
Costs Capitalized	(28,636,252)	(6,625,519)	(22,010,733)		
Resources that Fund Expenses Recognized in Prior Periods	(387)	(387)			
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowance for Subsidy	11,347,508	5,402,349	5,944,973	186	
Other Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	2,218,834	2,204,896	13,938		
Total Resources That Do Not Fund Net Cost of Operations	$(16,745,112)	$(918,467)	$(17,525,219)	$1,698,574	
Costs That Do Not Require Resources					
Depreciation, Amortization, and Credit Program Costs	$298,041	$292,945	$(177)	$5,273	
Total Costs That Do Not Require Resources	$298,041	$292,945	$(177)	$5,273	
Financing Sources Yet to be Provided	$1,048,012	$29,262	$1,018,750		
Net Cost of Operations	$13,516,019	$3,290,053	$702,226	$9,384,984	$138,756

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

Attachments

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

FEB 28 2000

Honorable Richard W. Riley
Secretary of Education
Washington, D.C. 20202

Dear Mr. Secretary:

The enclosed reports present the results of the audit of the Department's annual financial statements for the fiscal year ended September 30, 1999, to comply with the Government Management Reform Act of 1994 (GMRA). The reports should be read in conjunction with the Department's financial statements and notes to fully understand the context of the information contained therein.

The Office of Inspector General (OIG) contracted with Ernst & Young, LLP, Certified Public Accountants, to perform the audit. The OIG monitored the progress and completion of the work to ensure compliance with *Government Auditing Standards*.

The results of the audit were discussed with Department officials throughout the audit. The Office of the Chief Financial Officer and Student Financial Assistance responded to the findings and recommendations presented in the draft reports and changes were incorporated as appropriate.

During the course of the audit, Ernst & Young, LLP, identified other matters which are not reportable but nevertheless warrant management's attention. These are being communicated in a separate letter for management's consideration.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued by the OIG 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.

We appreciate the cooperation given us and Ernst & Young, LLP, during the audit.

Sincerely,

Lorraine Lewis

Lorraine Lewis

Enclosures

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

FEB 28 2000

MEMORANDUM

TO: Thomas P. Skelly
Acting Chief Financial Officer

James Lynch
Chief Financial Officer, Student Financial Assistance

FROM: Lorraine Lewis Lorraine Lewis

SUBJECT: FINAL AUDIT REPORTS
Fiscal Year 1999 Annual Financial Statements
U.S. Department of Education
ED-OIG/S1790019

Attached are the subject final reports on the results of the audit of the Department's fiscal year 1999 annual financial statements. The reports should be read in conjunction with the Department's financial statements and notes to fully understand the context of the information contained therein.

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

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

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

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

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

We appreciate the cooperation given us and Ernst & Young, LLP, during the audit. Should you have any questions concerning the reports, please contact me or Steven A. McNamara at 205-5439 or 205-9604, respectively.

Attachments

Distribution List:

Mark Carney – OCFO (1)
Maureen Harris – OCFO (1)
Linda Paulsen – SFA (1)
Craig Luigart – OCIO (1)

ERNST & YOUNG LLP
1225 Connecticut Avenue, N.W.
Washington, D.C. 20036
Phone: 202 327 6000

Report of Independent Auditors

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 1999, 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. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following three paragraphs, we conducted our audit in accordance with generally accepted auditing standards, 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. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

During fiscal year 1998, the Department implemented a new accounting system. As noted in prior audit reports, the internal control of the Department is evolving, and the financial reporting process of the accounting system as implemented has several limitations, including an inability to perform a year-end closing process or produce automated consolidated trial balances and financial statements. During fiscal year 1999, the Department engaged contractors to assist in the preparation of the consolidated trial balances, and to reconcile the consolidated financial statements to the consolidated trial balances and reconcile other accounting information. The efforts of the Department and its contractors have partially compensated for, but did not correct, certain aspects of the material weaknesses in the Department's financial reporting process. In addition, during fiscal year 1999, the Department encountered significant turnover in financial management, which also contributed to the overall weaknesses in financial reporting.

The Department was unable to provide adequate documentation to support certain amounts reported in the September 30, 1999 net position included in the consolidated balance sheet and the consolidated statement of changes in net position; nor were we able to satisfy ourselves as to the net position by performing other auditing procedures. In addition, the Department initially processed many transactions related to prior years as fiscal year 1999 activity and manually adjusted its records in an effort to properly reflect the transactions in the appropriate period. However, we were unable to obtain sufficient evidence or to otherwise satisfy ourselves that the Department's process to adjust its records to reflect the transactions in the proper period was fully effective in ensuring that certain costs and obligations reported by the Department were related to fiscal year 1999 rather than prior years activity; nor were we able to satisfy ourselves with respect to beginning balances of accounts payable and related accruals.

The Department did not adequately perform reconciliations and present supporting documentation specific to the combined statement of financing on a timely basis. As such, we were unable to obtain sufficient evidential support for the amounts presented in the combined statement of financing for the year ended September 30, 1999.

Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the combined statement of financing for the year ended September 30, 1999.

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 statement of budgetary resources, if any, that might have been determined to be necessary had we been able to examine sufficient evidence regarding certain amounts in net position as of September 30, 1999 and costs and obligations that might have been incurred by the Department during the year ended September 30, 1999, the consolidated balance sheet and related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources referred to above present fairly, in all material respects, the financial position as of September 30, 1999 and net cost, changes in net position, and budgetary resources for the year ended September 30, 1999 in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the financial statements referred to in the first paragraph. The information presented in the Overview of the U.S. Department of Education and the Supplemental Statements 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 financial statements, and accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our reports dated February 2, 2000 on our consideration of the U.S. Department of Education's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Ernst + Young LLP

February 2, 2000
Washington, D.C.

ERNST & YOUNG LLP
1225 Connecticut Avenue, N.W.
Washington, D.C. 20036
Phone: 202 327 6000

Report on Internal Control

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 1999, 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 February 2, 2000. The report states that because of matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the combined statement of financing for the year ended September 30, 1999. The report further noted certain matters that resulted in a qualification of our opinion on the consolidated balance sheet, and the related consolidated statements of net cost and changes in net position, and combined statement of budgetary resources.

Except for the matters discussed in the third through the fifth paragraphs of the Report of Independent Auditors, we conducted our audit in accordance with generally accepted auditing standards; 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. 98-08, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the Department's internal control, determined whether this internal control had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. 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 generally accepted accounting principles; and data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Because of inherent limitations in any internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In addition, with respect to internal control related to performance measures reported in the Overview of the Department's consolidated financial statements, we obtained an understanding of the design of significant internal control relating to the existence and completeness assertions, as required by the OMB Bulletin No. 98-08. 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. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. 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 four of which are considered material weaknesses as defined above.

MATERIAL WEAKNESSES

1. Financial Reporting Needs to Be Strengthened (Repeat Condition)

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.

Although this material weakness from fiscal year 1998 remains outstanding for fiscal year 1999, the Department has made some improvements to its financial reporting process. For example, the Department produced interim financial statements for the period ended June 30, 1999, which facilitated the Department's timely preparation of its year-end financial statements.

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 below, the Department needs to strengthen its financial reporting in order to ensure full compliance with OMB Circular A-123.

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

General Ledger

One of the significant weaknesses in the reporting process relates to the Education Central Automated Processing System (EDCAPS) general ledger software package, Financial Management System Software (FMSS). Specifically, FMSS, as implemented, does not allow the user to perform a year-end closing process. In addition, FMSS does not allow the Department to produce a general ledger trial balance at the reporting group level or at a consolidated level. Instead, FMSS can only generate trial balances at the appropriation level. The Department has approximately 200 appropriations.

As a result of the system deficiencies, the Department must devote a significant amount of resources to preparing its financial statements. In addition, the preparation of the financial statements involves manual intervention rather than relying on an integrated system process. The Department demonstrated improvement in its preparation of the fiscal year 1999 financial statements as compared to the process for the preparation of the fiscal year 1998 financial statements. The Department worked with a contractor to automate the reporting process to enable the Department to produce a pre-close and post-close trial balance at the appropriation level for approximately 200 appropriations. However, FMSS still is not able to produce a trial balance by reporting group or at the consolidated level. As a result, it is still necessary for the Department to prepare its financial statements through the use of spreadsheets rather than having the system automatically generate them. The manual intervention increases the risk that errors may occur. For example, several input errors were noted on the spreadsheets that were used to prepare the financial statements. To address the weaknesses identified with FMSS, the Department is in the process of acquiring a replacement for the general ledger software package.

Financial Statement Preparation

Due to the general ledger deficiencies discussed above, the Department developed an in-house product termed the Visual Basic System to interface with FMSS and provide the Department with the capability of producing financial statement reports at both the major reporting group and consolidation levels. The financial statement balances from the Visual Basic system were then transferred to a spreadsheet, which was used to prepare all the required statements under OMB Bulletin No. 97-01. Within Visual Basic, the Department posted over 175 adjustments, most of which represent closing entries to the trial balance, in order to generate a post-close trial balance for each of the approximately 200 appropriations. The post-close trial balances were then transferred to a spreadsheet to prepare the consolidated financial statements. This process required the Department to rely heavily on contractor services to assist in the preparation of the additional reconciliations among FMSS, Visual Basic, and the financial statements.

The consolidated financial statements prepared by the Department reported a balance of approximately $7.5 billion for cumulative results of operations. The majority of this amount, which pertains to the Federal Family Education Loan (FFEL) Program, should have been reported as a payable to Treasury rather than cumulative results of operations. As a result of our audit, an adjustment was made to reclassify the account balances reported on the balance sheet. The Department needs to determine the timing for when the funds are to be returned to the U.S. Department of the Treasury. After reclassification, approximately $800 million remained in cumulative results of operation specific to the FFEL program. The Department was unable to provide supporting documentation for this amount, and this matter was considered in forming our qualified opinion in the Report of Independent Auditors on the consolidated financial statements of the Department.

In addition, the financial statements provided to us had line items with balances different from that which would normally be anticipated. For example, intragovernmental grant expenses on the statement of net cost reported a credit balance when the account normally would be expected to have a debit balance. Adjustments were made to the financial statements to correct for those line items which reflected balances different than anticipated. We also noted adjustments pertaining to prior year activity were erroneously posted in the current fiscal year financial statements. Management did not sufficiently research the cause behind those balances that were being reported differently than normally anticipated to be reported on the financial statements. Although the account balances are considered immaterial to the consolidated financial statements, as a whole, 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."

Finally, the notes to the financial statements did not include all required disclosures under OMB Bulletin No. 97-01 and applicable standards issued by the Federal Accounting Standards Advisory Board. In addition, we noted some instances where documentation was not readily available to support the information reported in the notes. The notes were revised for the areas identified as a result of the audit.

<u>**Recommendations:**</u>

We recommend that the Department of Education perform the following:

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

2. Ensure that a comprehensive review of the financial statements, including the notes thereto, is performed to verify that the financial statements are prepared in accordance with applicable accounting principles and OMB Bulletin No. 97-01.

3. Update policies and procedures to further define and document the process used to generate the post-close trial balances and financial statements using Visual Basic. These procedures should ensure to document the reconciliations needed to be performed in support of the preparation of the financial statements.

4. Update policies and procedures surrounding the preparation and review of adjustments and provide training to ensure that individuals preparing and reviewing the adjustments are provided with sufficient guidance to meet financial reporting objectives.

5. Determine the appropriate timing for when the funds payable to Treasury should be paid to the U.S. Department of the Treasury and ensure that the return of funds adhere to the requirements of the Federal Credit Reform Act of 1990 and the standards issued by the Federal Accounting Standards Advisory Board.

2. Reconciliations Need to be Improved (Repeat Condition)

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

Weaknesses in the Department's internal control over the reconciliation process prevented timely detection and correction of errors in its underlying accounting records. In general, we noted that the Department did not perform proper or timely reconciliations of its financial accounting records throughout fiscal year 1999. In addition, evidence of supervisory review was not always documented on the reconciliations that were performed. In some instances, we noted that the Department adjusted its general ledger to reflect the balance per the subsidiary records, without sufficiently researching the cause of the differences. The following provides examples in which reconciliations were not performed properly or on a timely basis:

- The Department has had difficulty identifying and resolving differences between its accounting records and cash transactions reported by the U.S. Department of the Treasury for several years. There are many underlying reasons for the Department's difficulties, including formal reconciliation procedures not being performed in an adequate manner or on a timely basis throughout fiscal year 1999. For example, the Department's reconciliation procedures indicate that for those appropriations that reflect a difference between the amount reported in its general ledger and the amount reported by the U.S. Department of the Treasury, the general ledger is adjusted to equal the balance reported by the U.S. Department of the Treasury. For fiscal year 1999, the Department adjusted its Fund Balance with Treasury, due to a difference between its general ledger and the U.S. Department of the Treasury, by a net amount of approximately $244.5 million.

  As reported in the prior year, and noted in this fiscal year, the Department cannot readily determine to which appropriations the excess funds in the Grantback account belong. The general ledger reports approximately $314 million in Fund Balance with Treasury with a corresponding liability for the Grantback account (X6191) as of September 30, 1999. Subsequent to September 30, 1999, the Department returned approximately $146 million from the Grantback fund to the U.S. Department of the Treasury for amounts associated with canceled appropriations. Furthermore, the Department established a Memorandum of Understanding with the U.S. Department of the Treasury, Center for Applied Financial Management to provide assistance to the Department in performing further analysis of the Grantback account to determine the appropriate accounting for the remaining funds. In addition, the General Accounting Office (GAO) is performing a review of this account.

Also, the Budget Clearing account (F3875), which reflects a credit balance of approximately $68.3 million as of September 30, 1999, has not been fully reconciled as of the date of this report. Although the Department indicates that the activity in the Budget Clearing account relates to reclassifications of amounts between appropriations, sufficient documentation was not provided.

Although this issue remained a material weakness for fiscal year 1999, the Department has made progress in its reconciliation efforts. For example, the Department developed a reconciliation tool which facilitated an automated data match between the U.S. Department of the Treasury and FMSS; thereby assisting in the overall fiscal year-end reconciliation efforts of Fund Balance with Treasury. Specifically, this tool enabled the Department to perform reconciliations consistently for the September 30, 1999 Fund Balance with Treasury. In addition, the Department was able to provide the year-end reconciliation in a more timely manner than the prior year.

- The Grant Administration and Payment System (GAPS) is used by grantees to submit drawdown requests, via the Internet, to the Department. The transactions are electronically accumulated and transmitted to FMSS, the Department's general ledger system. Accordingly, the expenditure and drawdown data reported in GAPS should be equal to the expenditures and drawdown amounts reflected in FMSS. However, during our testing of grant expenditures, we noted that the Department did not perform routine reconciliations of its grants subsidiary ledger, GAPS, with the FMSS general ledger during fiscal year 1999. For the financial statement preparation, the Department did compare total grant expenditures in GAPS to the total grant expenditures recorded in FMSS. As of the date of this report, an unreconciled net difference for grant expenditures of approximately $97 million, which was less than one percent of the total grant expenditures, existed between FMSS and GAPS as of September 30, 1999.

  Although the Department has procedures in place that should detect duplicate payments from GAPS and correct them within a reasonable timeframe, we were informed by management that the Department processed duplicate transactions, causing payments to be issued twice for the same funding request. Management indicated that the duplicate payments occurred three times over the past two fiscal years with respect to grants, with two known immaterial occurrences in fiscal year 1999. The funds have been accounted for in those instances and appropriately reflected in the financial statements. In addition, subsequent to fiscal year 1999, management indicated that two additional instances of duplicate payments for grants occurred.

The Department has not yet developed formal policies and procedures to reconcile the expenditure data between GAPS and FMSS. Given the high volume of grant transactions that flow through GAPS (over $30 billion per year), the lack of formal policies and procedures specific to the reconciliation of grant expenditures increases the risk that material errors or irregularities could occur and not be detected on a timely basis.

- The Facilities Loan Program provides low-interest loans to assist in the construction, reconstruction or renovation of housing, academic facilities, and other educational facilities for students and faculty at institutions of higher education. The Federal Financing Bank (FFB) and the Federal Reserve Bank (FRB) service these loans on behalf of the Department. During our review of this program, which reflects a net receivable balance of approximately $424 million, we noted that the Department does not reconcile its records with the information provided by the FFB or FRB on a regular basis. In addition, policies and procedures do not exist for calculating and reconciling the allowance associated with the account balances. We also noted that a supervisory review was not performed for the calculations of the allowance for the Facilities Loan Program balance. As a result of the audit testing, the financial statements were adjusted to reflect the proper balance.

- For fiscal year 1999, 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 statement of budgetary resources is one of the principal statements required by OMB Bulletin No. 97-01. During our testing of this statement, we noted that the Department did not perform routine reconciliations of its budgetary accounts. As a result, we identified differences among the balances reported on the subsidiary listings, the general ledger, and the financial statements. Although the differences were considered immaterial to the financial statements, management was unable to provide sufficient explanation for the differences.

Recommendations:

We recommend that the Department of Education perform the following:

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

2. Perform reconciliations of all significant accounts and programs, both proprietary and budgetary, on 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 should be performed of the reconciliations.

3. Review and update current policies and procedures surrounding the processing of grant and loan disbursements. These policies and procedures should be specific in order to provide sufficient guidance to the Department's personnel.

4. Resolve unreconciled differences specific to the Grantback account. In addition, non-grantback funds should be reclassified to the appropriate suspense account.

3. Improvement of Credit Reform Reporting is Needed

The loans issued under the Federal Family Education Loan (FFEL) program are to be accounted for in accordance with the requirements of the Federal Credit Reform Act of 1990 and the standards issued by the Federal Accounting Standards Advisory Board. Accordingly, the Department maintains a program account, a financing account, as well as a liquidating account. The financing account (X4251) consists of cash collected from subsidy transfers, offsetting collections, and earned interest retained for future program claims. Annually, a portion of the unobligated balance is apportioned for current year activities. The liquidating account pertains to cash flows for loans and guaranteed loans that were made prior to fiscal year 1992.

During our review of unobligated funds specific to the FFEL program, we noted that the Department maintained a balance of approximately $7.7 billion. The Department reported $1.8 billion in unobligated balance available and $3.2 billion in unobligated balances unavailable for the financing account as of the end of fiscal year 1999. The unobligated balance in the liquidating account (X0230) at the end of fiscal year 1999 was $2.7 billion.

During testing, we noted that the Department did not account for its transactions in accordance with the Federal Credit Reform Act of 1990. Specifically, the Department did not return approximately $2.7 billion of net collections specific to the liquidating account as of September 30, 1999. Based on discussions with management, funds in the liquidating account of $2.7 billion are due to the U.S. Department of the Treasury and will be returned in fiscal year 2000.

Additionally, the Department did not sufficiently analyze the balances reflected on the financial statements to ensure that the proprietary accounts were in agreement with the related budgetary accounts. For example, we noted that the Fund Balance with Treasury pertaining to the liquidating account reported a balance of approximately $3.6 billion; however, the corresponding budgetary accounts, unobligated-unavailable and undelivered orders, reported a balance of approximately $2.9 billion. Therefore, an unexplained difference of approximately $700 million exists for the liquidating account as of September 30, 1999.

Also, it was noted that Credit Reform Reporting was not identified as a material weakness in the Department's fiscal year 1999 Federal Managers' Financial Integrity Act (FMFIA) report.

Recommendation

We recommend that the Department of Education implement policies and procedures to ensure that the Department is in full compliance with the requirements of the Federal Credit Reform Act of 1990. These procedures should ensure that management adequately analyzes the proprietary and related budgetary accounts for the financing and liquidating accounts.

4. Controls Surrounding Information Systems Need Enhancement (Repeat Condition)

In connection with the annual audit of the Department's fiscal year 1999 financial statements, we conducted a controls review of the information technology processes related to the significant accounting and financial reporting systems. These systems included: EDCAPS, National Student Loan Data System (NSLDS), Loan Origination Subsystem, Direct Loan Servicing System, and the FFEL system. 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 resources 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 noting that manual procedures are generally not a viable back-up option.

As a result of procedures performed, the following deficiencies were noted:

- The development, documentation, and testing of a comprehensive disaster recovery plan for the systems and business processes has not been finalized. Without a documented and tested disaster recovery plan, the timely restoration of EDCAPS in the event of a disaster may not be possible; thereby preventing the Department from resuming business in an adequate manner.

- The approach and methodology for design, selection, coordination and maintenance of information technology architecture has not been formally documented.

- The Department does not comprehensively log, monitor, review access, or issue alerts to sensitive computing resources. There is no effective process for security violation monitoring, investigation, and resolution on all critical computing platforms. In addition, critical systems settings are not effectively monitored to ensure the effectiveness of security controls.

- User account management controls, including procedures for requesting, authorizing, revalidating, and granting access to computing resources are not fully implemented.

Recommendations:

The Department of Education should perform the following:

1. Finalize development of a disaster recovery plan. Once developed, the plan should be tested and updated regularly to assess its effectiveness.

2. Develop and implement a comprehensive set of policies and procedures for system configuration and security violation monitoring for all critical computing platforms.

3. Finalize development and implementation of a formal approach and methodology for designing and maintaining its IT architecture. The plan should also clearly define related roles and responsibilities.

4. Update the security policies and procedures to reflect the changing system security needs. In addition, the Department should implement periodic reviews of the plan to ensure that changes to systems and processes are adequately addressed. Procedures should be developed and implemented to ensure that all access authorizations are documented and that access rights are revalidated on a periodic basis.

REPORTABLE CONDITIONS

5. Documentation Supporting Obligations, Undelivered Orders and Unobligated Balances Needs to be Improved (Modified Repeat Condition)

Proper reporting and accounting recognizes the significance and accountable aspects of financial transactions, events, or allocations as they occur. Proper accounting for obligations and expenditures is critical to maintaining strong internal control and providing useful financial information.

OMB Circular A-34, *Instructions on Budget Execution*, indicates that the heads of federal government agencies must establish and maintain systems of accounting and internal control that provide reliable accounting for the activities of the agencies. These systems will provide the basis for: preparing and supporting the budget requests of the agency; providing financial information the President requires in formulating the budget; and executing the budget. In addition, these systems will provide assurance that transactions, including those related to obligations and costs, are executed in compliance with laws and regulations.

- As part of our audit of the financial statements, we requested detailed listings supporting the Department's allotments, obligations incurred, undelivered orders, and the unobligated balances of funds as of September 30, 1999. Although the Department was able to generate subsidiary listings, the balances per the subsidiary listings did not agree with the financial statements. For example, we noted an unreconciled difference in undelivered orders of approximately $288 million out of approximately $35.4 billion that was reported on the statement of budgetary resources.

- We also reviewed the FMS 2108 (Year-End Closing Statement) and the SF 133 (Report on Budget Execution) to support the obligations incurred and unobligated balances of funds. The Department uses these documents to report its budget activity to the U.S. Department of the Treasury. The balances reported on these documents were inconsistent with the balances reported on the financial statements. We also noted that the Department did not submit some of the required SF 133 Reports, for September 30, 1999, by the U.S. Department of the Treasury's established deadlines.

- During our review of the statement of budgetary resources, the Department identified approximately $2.1 billion of the unobligated balances as of September 30, 1999 that were incorrectly classified as financing versus liquidating. The Department was able to identify the misclassification as a result of the implementation of a revised approach in accounting for its financing and liquidating activity. Since these funds were determined to be liquidating rather than financing, the Department established a payable to Treasury in order to adjust the financial statements for the reclassification.

Approximately $1.1 billion of the payable to Treasury, as approved by OMB, was remitted through an amended SF 133 to reduce the outstanding payable as of September 30, 1999. This adjustment properly reduced Fund Balance with Treasury, as well as the unobligated – not available balance as of September 30, 1999. The remaining $1 billion, which is recorded as a payable to Treasury on the September 30, 1999 balance sheet and as unobligated – not available balance on the statement of budgetary resources, will be returned to the U.S. Department of the Treasury in fiscal year 2000, and is a portion of the $2.7 billion noted in the prior finding on Credit Reform Reporting.

Recommendations

We recommend that the Department of Education perform the following:

1. Modify current policies and procedures and provide training to ensure that all obligations are monitored and reported on a basis consistent with management objectives, as well as applicable laws and regulations. The policies and procedures should ensure that obligations and unobligated balances are reviewed on a frequent basis, as well as at year-end, to ensure that all obligations and unobligated funds are valid and properly classified.

2. Modify current detailed reports to ensure that they accurately reflect all transactions. The Department should periodically review the reports and investigate any discrepancies with the general ledger account details.

6. Communication and Coordination Efforts Need to be Improved for Financial Management

The Department needs to improve its communication and coordination efforts among offices that are responsible for providing information in support of financial reporting. Although the Office of Chief Financial Officer (OCFO) has the ultimate responsibility for compiling the financial statements, OCFO relies on many offices within the Department, as well as outside entities, to provide key data for inclusion in the financial statements. Based on our audit, it appears that the financial roles and responsibilities of managers and employees should be more clearly defined to provide for ownership of financial management and reporting as related to specific areas.

OMB Circular A-123, *Management Accountability and Control*, defines accountability as "the expectation that managers are responsible for the quality and timeliness of program performance, increasing productivity, controlling costs and mitigating adverse aspects of agency operations, and assuring that programs are managed with integrity and in compliance with applicable law."

The following provides instances we noted where communication and coordination could be improved:

- OCFO obtains data from the Budget Service specific to the Loan Liability, Obligations, Unobligated Funds, Budget Authority, and other financial statement line items. In addition, throughout the course of the year, Budget Service provides the OCFO with documentation to process budgetary transactions. During our testing of the statement of budgetary resources, we noted apportionments were incorrectly adjusted by OCFO. A contributing factor to the occurrence of this error is a result of OCFO and Budget Service not effectively communicating. We also noted that detailed listings maintained by the program offices did not always agree to the subsidiary listings generated by the OCFO.

- Throughout our testing, it was necessary for us to obtain the detail listings of transactions recorded in FMSS from OCFO while obtaining the related supporting documentation from the Contracts and Purchasing Operations. Since roles and responsibilities for financial statement reporting have not been clearly defined throughout the Department, including those offices that maintain the detailed support, we encountered some difficulties in obtaining appropriate documentation for audit purposes. However, the documentation was ultimately received.

- Under the Higher Education Act of 1965, as amended, the Department is authorized to enter into agreements with guaranty agencies under which the guaranty agencies perform certain roles in the FFEL Program. As a result of this program, the Department recognizes loans as either unassigned or assigned. Unassigned loans represent those loans receivable that have defaulted and are held at the guaranty agencies for further collection efforts. Assigned loans represent those loans receivable that have defaulted but the Department is responsible for the collection effort.

  During our review of this program, we noted several issues. First, with the recent passage of the amendments to the Higher Education Act of 1965, we noted that the Department has not provided sufficient instructions on the accounting for the reserve funds. The amendments require the guaranty agencies to establish a Federal Student Loan Reserve (FSLR) Fund and an Operating Fund. The guaranty agencies are to set aside funds from the FSLR Fund for return to the Federal government. These funds are referred to as the "recall funds." As part of our testing procedures, we requested confirmations from the guaranty agencies of the balances of these funds. We then compared the confirmation responses to the ED Form 1130 and noted inconsistencies in the reporting of these funds to the Department. The ED Form 1130 is a quarterly report that summarizes the loans maintained by a guaranty agency, as well as documents those loans that are assigned to the Department. The Operating Fund is the property of the guaranty agencies, while the FSLR Fund is the property of the

Department. Therefore, if the information is reported to the Department in an inconsistent manner, then the Department may be misstating the guaranty agency FSLR Fund balance.

Additionally, we noted that the Department's instructions for completing the ED Form 1130 are not being consistently interpreted by the guaranty agencies. Since the Department performs analysis of the unassigned loans, assigned loans, and the FSLR Fund accounts based on activity reported by the guaranty agencies, it is important that the information being utilized from the 36 guaranty agencies is consistently captured to prevent misinterpretation of the results of the analysis by the Department.

In addition, the guaranty agencies participating in the Federal Family Education Loan Program report assigned loans to the Department via magnetic tape or hardcopy and also submit the ED Form 1130 that summarizes the loans assigned to SFA. During our testing, we noted that the Department does not sufficiently analyze the loans the guaranty agencies reported as assigned to the Department on the ED Form 1130 to the loans that are transmitted to the Debt Collection Management System (DCMS). In addition, we noted discrepancies between the guaranty agencies confirmations and DCMS records for loans assigned during the year.

<u>**Recommendations**</u>

We recommend that the Department of Education perform the following:

1. Review the current organizational structure and update and clearly define roles and responsibilities for the Department's personnel to ensure that defined roles and the related responsibilities will achieve the financial reporting objectives established by management.

2. Enhance the interaction and communication with the guaranty agencies, thereby facilitating the accounting and reporting aspects of the Federal Family Education Loan Program. This process should also include clarifying the instructions of the ED Form 1130. For example, the instructions should include a more detailed explanation of how to account and report for the Operating and Federal Student Loan Reserve Funds.

7. Documentation Supporting Accounts Payable, Accrued Liabilities and Expenditures Needs to be Improved (Modified Repeat Condition)

Proper reporting and accounting recognizes the significance and accountable aspects of financial transactions, events, or allocations as they occur. OMB Circular A-123 states that documentation for transactions, management controls, and other significant events must be clear and readily available for examination. Accordingly, proper accounting for accounts payable and expenditures is critical to maintaining a strong internal control and providing useful financial information.

- The Department's accounting system, FMSS, does not automatically generate a subsidiary ledger for its accounts payable and accrued liabilities. Therefore, in order to test the accounts payable balance, it was necessary to query the system (via COGNOS – a query software package) to obtain a listing of accounts payable as of September 30, 1999.

  During our testing of accounts payable, we noted that the Department's classification of accounts payable on the Department's financial statements did not agree with the system's classification. For example, the financial statements reflected certain amounts as either Intragovernmental (Gv) or Governmental (Co) but the transactions were coded the opposite way per the COGNOS query. In order to validate the presentation for financial statement purposes, we requested an additional listing of the accounts payable to include vendor names. Based on a review of the listings provided, we noted several instances where the vendor name or sector codes (Gv or Co) were incomplete. A contributing factor to this issue pertains to weaknesses related to the FMSS Document Type System Account Event (SAE), which is a set of accounting code combinations used to facilitate correct posting. Therefore, we were unable to determine the appropriate classification of the transactions. Although these amounts were not considered material to the financial statements, the Department was not able to fully comply with reporting requirements of OMB Bulletin No. 97-01.

- During our testing of accounts payable and expenditures, we noted that the documentation maintained by the Department to support transactions needs improvement. For example, in several instances, we noted that invoices submitted by contractors for payment did not include sufficient detail to adequately support the amount invoiced. In addition, journal vouchers for adjustments to expenditures did not contain sufficient explanation as to why the transaction was needed nor was management able to provide sufficient detail regarding batched items. We also noted some transactions that did not pertain to the current fiscal year were processed as if they were a result of current year activity.

- During our testing of the estimated grant liability, we noted that the estimate has not been calculated consistently for the past three years. In the prior fiscal year, it was noted that the Department did not have an appropriate methodology for calculating its grant expenditures incurred but not yet reported to the Department as of year end. Prior to fiscal year 1998, the Department requested the grantees to submit a form (SF 272) with information that could be used to determine the liability for financial reporting purposes. For fiscal year 1999, the Department confirmed, with approximately 550 recipients, the grant expenditures incurred but not drawn down as of September 30, 1999. These recipients received approximately 75 percent of the

Department's grant funding. The results of the confirmations were projected to the entire population of grantees to calculate an estimated liability. Although the Department was able to determine an estimated liability for fiscal year 1999, the Department has not developed a formal methodology for estimating its grant liability to ensure that the estimated liability will be calculated on a consistent basis in the future.

- At the end of each fiscal year, the Department needs to calculate interest payable/expense on its borrowings from the U.S. Department of the Treasury. This calculation is complex and involves numerous manual inputs. During our testing of the interest payable/expense, we noted several inaccuracies in the calculations. We also noted that the calculations were not sufficiently reviewed by a supervisor. The financial statements were adjusted for the differences identified.

- During testing of grant expenditures for the Impact Aid Grant Program, which incurred approximately $1 billion of expenditures during fiscal year 1999, we noted that two individuals were able to process drawdown requests for funds and then subsequently approve their own processing of the drawdown request. Furthermore, we noted that several other individuals performed incompatible functions in the processing of Impact Aid payments. For example, certain individuals have the authority to initiate payment requests, approve payment requests, and subsequently batch the requests and authorize payment by the finance department. Inadequate segregation of duties in sensitive areas, such as payment processing, can greatly increase the risk of errors or irregularities, result in noncompliance with the requirements of the Impact Aid Act or result in noncompliance with the Department's policies and procedures, as well as Federal regulations.

  Finally, as noted in the prior year, the Office of Vocational and Adult Education (OVAE) does not have a systematic method for monitoring compliance with the Carl D. Perkins Vocational and Technical Education Act (hereafter referred to as the Perkins Act). The Perkins Act is the legislation under which OVAE operates and delivers Basic Grants to states totaling approximately $1 billion. OVAE plans to develop monitoring procedures and begin piloting them for the end of fiscal year 2000. By fiscal year 2001, all procedures should be in place.

<u>**Recommendations:**</u>

We recommend that the Department of Education perform the following:

1. Develop a formal policy to further refine the methodology for estimating the year-end grant liability accrual and ensure that this methodology is completed promptly in order to facilitate the fiscal year 2000 financial statement audit. Implementation of a

policy should facilitate consistency with reporting of financial information, as well as review by management for adherence to Department's policy.

2. Review and update its system requirements so that the Department can produce subsidiary ledgers in a timely manner, as well as substantiate all accounts payable transactions and obligations. The subsidiary ledger should also identify payables as governmental, intragovernmental, covered by budgetary resources or not covered by budgetary resources, as appropriate.

3. Establish formal procedures surrounding the calculation of the interest payable/expense on borrowings. These procedures should ensure that as many aspects of the calculation be automated and linked. In addition, a reasonableness test and supervisory review should be performed of the calculation prior to posting the amounts to the financial records.

4. Update current policies and procedures to ensure that all transactions are properly processed and supported with documentation, an adequate segregation of duties exists, and a supervisory review is performed.

8. Reporting and Monitoring of Property and Equipment Needs to be Improved

During our review of the financial statements, we noted that the Department does not capitalize purchases of property and equipment and software. As in the prior year, we were informed that the Department has not established a capitalization policy for property and equipment due to the immateriality of the transactions. During our testing, we noted that expenditures, classified as "equipment not capitalized," incurred by the Department for the purchase of property and equipment was approximately $11 million. Based on our review of the supporting documentation for these expenditures, we noted that several purchases exceeded $1 million. These purchases were for furniture and equipment. It appears that the purchases are "bulk purchases" and should have been captured as capitalized equipment.

A bulk purchase policy would enable the Department to capitalize significant acquisitions of property and equipment items that otherwise would be immaterial on an individual item by item basis. By utilizing an established set threshold, the Department would be able to capitalize significant purchases of fixed assets and allocate the costs for the use of these purchases to future periods through depreciation.

In addition to the lack of a capitalization policy, we noted several internal control issues surrounding the Department's efforts in safeguarding and reporting of property and equipment. Specifically, the Department has not established a baseline for inventory because the Department has not taken a complete, comprehensive physical inventory of property and equipment for at least the past two years. In addition, the inventory of property and equipment has been reported as a weakness in the Department's annual FMFIA report for the past several years. Conducting annual inventories will allow the Department to establish a baseline for its property and equipment in order to better account for property and equipment.

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

Recommendations:

We recommend that the Department of Education perform the following:

1. Implement a capitalization policy, which should also include a threshold for bulk purchases, and costs associated with the development of software.

2. Conduct a complete and comprehensive physical inventory of all property and equipment. Ensure to update the Asset Management Information System (AMIS) for the results of the physical inventory.

STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the fiscal year 1998 audit of the Department of Education's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

Figure 1: Summary of FY 1998 Material Weaknesses and Reportable Conditions

Issue Area	Summary Control Issues	FY 1999 Status
Financial Reporting Needs to Be Strengthened (Material Weakness)	Significant weaknesses in the Department's financial reporting processes existed as a result of the EDCAPS general ledger software package, Financial Management System Software (FMSS).	Partially Resolved – Repeat Condition
Reconciliations Need to Be Improved (Material Weakness)	The Department did not perform proper or timely reconciliations of its financial accounting records.	Repeat Condition
Controls Surrounding Information Systems Need Enhancement (Material Weakness)	Improvements are required in security over financial systems and in disaster recovery capabilities.	Partially Resolved – Repeat Condition
Documentation Supporting Liabilities/Obligations was Insufficient (Reportable Condition)	The Department was unable to readily provide listings of outstanding accounts payable and accrued liabilities, as well as sufficient supporting documentation.	Repeat Condition
Controls Surrounding the Monitoring of the Department's Programs Need to be Strengthened (Reportable Condition)	Given the significant level of funding associated with these programs which flows through the outside entities, the Department should strengthen oversight of its programs.	Not Considered Reportable Condition – Issues Reported in the Management Letter
Insufficient Controls Surrounding Accounts Receivable/Cash Receipts (Reportable Condition)	The Department was unable to provide sufficient supporting documentation and a subsidiary ledger.	Not Considered Reportable Condition – Issues Reported in the Management Letter
The Department Needs to Establish Controls Over the Analysis and Reporting of Performance Measures (Reportable Condition)	The Department had not developed a process for assembling and analyzing data in accordance with OMB Bulletin No. 97-01 and GPRA for financial reporting purposes.	Not Considered Reportable Condition – Issues Reported in the Management Letter

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

In addition to the reportable conditions described above, we noted certain other matters involving internal control and its operations that were reported to management in a separate letter dated February 2, 2000.

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

Ernst + Young LLP

February 2, 2000
Washington, D.C.

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Report on Compliance with Laws and Regulations

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 1999, 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 February 2, 2000. The report states that because of the matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the combined statement of financing for the year ended September 30, 1999. The report further 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 statement of budgetary resources.

Except for the matters discussed in the third through fifth paragraphs of the Report of Independent Auditors, we conducted our audit in accordance with generally accepted auditing standards; 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. 98-08, *Audit Requirements for Federal Financial Statements*, as amended.

The management of the Department is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency'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. 98-08, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed the following instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards and OMB Bulletin No. 98-08, as amended.

The Department was not in full compliance with the Information Technology Management Reform Act (ITMRA – Clinger-Cohen Act). Specifically, the Department has not fully implemented a capital planning and investment process, as well as performed an assessment of the information resource management knowledge and skills of agency personnel and development of a plan to correct identified deficiencies. As of

September 1999, the Office of Inspector General (OIG) and the Office of Chief Information Officer agreed to a corrective action plan to address the Department's noncompliance.

The Department did not fully comply with the requirements of the Federal Credit Reform Act of 1990. The Federal Credit Reform Act of 1990 (P.L. 101-508) requires that unobligated balances of the liquidating accounts that are in excess of current needs shall be transferred to the general fund of the Treasury. Such transfers shall be made from time to time but, at least once each year. Specifically, the Department did not transfer its excess funds as required by the Federal Credit Reform Act.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this reporting requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin No. 98-08.

The results of our tests disclosed instances where the Department's financial management systems did not substantially comply with the requirements discussed in the preceding paragraph. 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, and presents relevant facts pertaining to the noncompliance and our recommendations related to the specific issues. Specifically, it was noted that the Department lacked adequate, integrated financial management systems, reports and oversight to prepare accurate financial statements. In addition, the Department did not fully comply with the requirements of OMB Circular A-130, *Management of Federal Information Resources*. Specifically, we noted deficiencies in the areas of disaster recovery planning and information systems security management.

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

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

Ernst + Young LLP

February 2, 2000
Washington, D.C.

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

February 29, 2000

To: Lorraine Lewis

From: Thomas P. Skelly Thomas P. Skelly

Subject: **Fiscal Year 1999 Annual Financial Statements Audit**

Thank you for working closely with us during the process of reviewing the Department's FY 1999 financial statements. We are in general agreement with the issues raised in the auditor's reports. We will be developing a comprehensive corrective action plan over the next thirty days as we analyze the specific report finding and recommendations. In the event we come up with alternative solutions to achieve the intent of the more complex recommendations, we will discuss them with the Office of Inspector General.

The Department recognizes the importance of public disclosure and accountability. We are committed to correcting the problems detailed in the audit report. These actions will help us to achieve our desired result, a clean opinion on future financial statement audits. This will ultimately assist us in improving the management of Departmental programs to better serve program participants and taxpayers.