

Notes to Principal Financial Statements

Note 1. Summary of Significant Accounting Policies

Reporting Entity

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

The Department administers the Federal Direct Student Loan Program, the Federal Family Education Loan (FFEL) Program, Pell Grants, and Campus-Based Student Aid Programs. The Federal Direct Student Loan Program, authorized by the Student Loan Reform Act of 1993, enables the Department to make loans directly to eligible undergraduate and graduate students and their parents through participating schools. The Federal Family Education Loan (FFEL) Program, authorized by the Higher Education Act of 1965, as amended (HEA), cooperates with state and private nonprofit Guaranty Agencies to provide loan guarantees and interest subsidies on loans made by private lenders to eligible students. The Pell Grant and Campus-Based Programs provide educational grants and other financial assistance to eligible applicants.

The Department also administers numerous Grant Programs and the Facilities Loan Programs. Grant Programs include grants for elementary and secondary education, special education and rehabilitative services, and educational research and improvement, along with grants for needs of the disadvantaged. Through the Facilities Loan Programs, the Department administers low-interest loans to institutions of higher learning for the construction and renovation of facilities.

Organization and Structure at the Department of Education

The statements consolidate 225 discrete appropriations comprising 60 fund accounts within the following 10 reporting groups:

- Federal Student Aid (FSA)
- Office of Elementary and Secondary Education (OESE)
- Office of Special Education and Rehabilitative Services (OSERS)
- Office of Vocational and Adult Education (OVAE)
- Office of Postsecondary Education (OPE)
- Institute of Education Sciences (IES)
- Office of English Language Acquisition (OELA)
- Office of Safe and Drug-Free Schools (OSDFS) (Established FY 2004)
- Office of Innovation and Improvement (OII) (Established FY 2004)
- Department Management (DM)

Basis of Accounting and Presentation

These consolidated financial statements have been prepared to report the financial position, net cost of operations, changes in net position, budgetary resources, and financing of the U.S. Department of Education, as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. The financial statements were prepared from the books and records of the Department, in accordance with accounting principles generally accepted (GAAP) in the United States of America and Office of Management and Budget (OMB) Bulletin 01-09, *Form and Content of Agency Financial Statements*. GAAP for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which is the official standard setting body for the federal government. These financial statements are different from the financial reports prepared by the Department pursuant to OMB directives that are used to monitor and control the Department's use of budgetary resources.

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

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

Use of Estimates

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

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

The Department recognizes the sensitivity of the changes in assumptions and the impact that the projections can have on estimates. Management has attempted to mitigate these fluctuations by using trend analysis to project future cash flows. The assumptions used for the September 30, 2004 and 2003, financial statements are based on the best information available at the time the estimate was derived.

Changes in assumptions could significantly affect the amounts reflected in these statements. For example, a long-term change in the projected interest rate charged to borrowers could change the current subsidy re-estimate by a significant amount.

The Student Loan Model (SLM) and estimating methods used are updated periodically to reflect changing conditions. The SLM was the official estimating model of the Department as of September 30, 2004 and 2003, and was used to calculate the subsidy re-estimates recorded in these financial statements.

Budget Authority

Budget authority is the authorization provided by law for the Department to incur financial obligations that will result in outlays. The Department's budgetary resources for fiscal years 2004 and 2003 included (1) unobligated balances of resources from prior years, (2) recoveries of obligations in prior years, and (3) new resources—appropriations, authority to borrow from the U.S. Department of Treasury (Treasury), and spending authority from collections. Unobligated balances associated with resources expiring at the end of the fiscal year remain available for five years after expiration only for upward adjustments of prior-year obligations, after which they are canceled and may not be used. Unobligated balances of resources that have not expired at year-end may have new obligations placed against them, as well as net upward adjustments of prior-year obligations.

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

Fund Balance with Treasury

The Department maintains cash accounts with Treasury. The fund balance with Treasury includes appropriated, revolving, and trust funds available to pay current liabilities and finance authorized purchases, as well as funds restricted until future appropriations are received. Treasury processes the cash receipts and cash disbursements for the Department. The Department's records are reconciled with those of Treasury. (See Note 2.)

Cash and Other Monetary Assets

Cash and other monetary assets consist of Guaranty Agency reserves and deposits in transit. Guaranty Agency reserves represent the Department's interest in the net assets of the FFEL program Guaranty Agencies. Guaranty Agency reserves are classified as non-entity assets with the public (see Note 3) and are offset by a corresponding liability due to Treasury. Guaranty Agency reserves 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, administrative cost allowances, and other assets purchased out of reserve funds.

Section 422A of the HEA required FFEL Guaranty Agencies to establish a Federal Student Loan Reserve Fund (the "Federal Fund") and an Operating Fund by December 6, 1998. The Federal Fund and the non-liquid assets developed or purchased by a Guaranty Agency as a result, in whole or in part with federal funds, are the property of the United States. However, such ownership by the Department is independent of the actual control of the assets.

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

Accounts Receivable

Accounts receivable are amounts due to the Department from the public and other federal agencies. Receivables from the public typically result from such items as overpayments of educational assistance, whereas amounts due from other federal agencies result from agreements entered into by the Department with these agencies for various goods and services. Accounts receivable are recorded at cost less an allowance for uncollectible amounts. The estimate of the allowance for loss on uncollectible accounts is based on experience in the collection of receivables and an analysis of the outstanding balances. (See Note 5.)

Credit Program Receivables and Liabilities for Loan Guarantees

The financial statements at September 30, 2004 and 2003, reflect the Department's estimate of the long-term cost of direct and guaranteed loans in accordance with the Federal Credit Reform Act of 1990 (the Act). Loans and interest receivable are valued at their gross amounts less an allowance for the present value of the amounts not expected to be recovered and thus having to be subsidized—called "allowance for subsidy." The difference is the present value of the cash flows to and from the Department that are expected from the receivables over their expected lives. Similarly, liabilities for loan guarantees are valued at the present value of the cash outflows from the Department less the present value of related inflows. The estimated present value of net long-term cash outflows of the Department for subsidized costs (primarily defaults) is net of recoveries, interest supplements, and offsetting fees. The Department records all credit program loans and loan guarantees at their present values.

Components of subsidy costs involved with loans and guarantees include defaults, net of recoveries, contractual payments to third-party private loan collectors who receive a set percentage of amounts they collect, and, as an offset, application and other fees to be collected. For direct loans, the difference between interest rates incurred by the Department on its borrowings from Treasury and

interest rates charged to target groups is also subsidized (or may provide an offset to subsidy if the Department's rate is less). The corresponding interest subsidy in loan guarantee programs is the payment of interest supplements to third-party lenders in order to buy down the interest rates on loans made by those lenders. Subsidy costs are recognized when direct loans or guaranteed loans are disbursed to borrowers and are re-estimated each year. (See Note 4.)

General Property, Plant and Equipment

The Department capitalizes single items of property and equipment with a cost of \$50,000 or more that have an estimated useful life greater than two years. Additionally, the Department capitalizes bulk purchases of property and equipment with an aggregate cost of \$500,000 or more. A bulk purchase is defined as the purchase of like items related to a specific project or the purchase of like items occurring within the same fiscal year that have an estimated useful life greater than two years. Property and Equipment are depreciated over their estimated useful lives using the straight-line method of depreciation. (See Note 6.) Internal Use Software (IUS) meeting the above cost and useful life criteria is also capitalized. IUS is software purchased off the shelf, internally developed, or contractor developed solely to meet the agency's internal needs.

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

Major Classes of Depreciable Property and Equipment	Years
Information Technology (IT), Internal Use Software (IUS) and Telecommunications equipment	3
Furniture and Fixtures	5

Liabilities

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

Treasury Debt

The amount shown for the liability to Treasury from borrowings represents unpaid principal owing on the loans at year-end associated with the Department's loan activities. The Department repays the loan principal based on available fund balances. Interest on the debt is calculated at fiscal year-end using rates set by Treasury, with such rates generally fixed based on the rate for 10-year securities. As discussed in Note 4, the interest received by the Department from borrowers will vary from the rate paid to the Treasury. Principal and interest payments are made annually. (See Note 7.)

Accrued Grant Liability

Disbursements of grant funds are recognized as expenses at the time of disbursement. However, some grant recipients incur expenditures prior to initiating a request for disbursement based on the nature of the expenditures. A liability is accrued by the Department for expenditures incurred by grantees prior to receiving grant funds for the expenditures. The amount is estimated using statistical sampling techniques. (See Note 11.)

Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include undelivered orders and unobligated balances of appropriations, except those for federal credit financing and liquidating funds, and trust funds. Cumulative results of operations represent the net difference since inception between (1) expenses and (2) revenues and financing sources. (See Note 12.)

Personnel Compensation and Other Employee Benefits

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

Retirement Plans and Other Employee Benefits. Employees participate either in the Civil Service Retirement System (CSRS), a defined benefit plan, or in the Federal Employees Retirement System (FERS), a defined benefit and contribution plan. For CSRS employees, the Department contributes a fixed percentage of pay. For FERS employees, the Department contributes fixed percentages to both a defined benefits plan and a defined contributions plan (Thrift Savings Plan). For FERS employees, the Department also contributes the employer's share for Social Security (FICA) and Medicare.

The FERS program is fully funded by agency and worker contributions. Such contributions for other retirement plans and benefits are insufficient to fully fund the programs, which are subsidized by the Office of Personnel Management (OPM). The Department imputes its share of the OPM subsidy, using cost factors OPM provides, and reports the full cost of the programs related to its employees.

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

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

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

Labor evaluates the estimated projections to ensure that the resulting projections were reliable. The analysis includes two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection.

Intragovernmental Transactions

The Department's financial activities interact and are dependent upon the financial activity of the centralized management functions of the federal government. The Department is subject to financial regulation and management control by the Office of Management and Budget and Treasury. As a result of this relationship, operations may not be conducted and financial positions may not be reported as they would if the Department were a separate, unrelated entity. Transactions and balances among the Department's entities have been eliminated from the Consolidated Balance Sheet.

Other Intragovernmental Assets

Other intragovernmental assets represent interagency agreements between the Department and the National Science Foundation (NSF). As of September 30, 2004 and 2003, other intragovernmental assets totaled \$17 million and \$27 million, respectively. These agreements were entered into prior to FY 2003 and were appropriately treated as an expense by the Department. During FY 2003, NSF informed the Department that \$27 million was recorded on NSF's books as an "advance from others." This amount represents unexpended balances for interagency agreements with the Department. The Department began recording "advances to others" in order to facilitate the United States Financial Statement Consolidated Eliminations (for federal governmentwide financial statements) in FY 2003. Accordingly, the previous expense of \$27 million associated with the NSF interagency agreements was reversed in FY 2003 as a prior period adjustment and recorded as an "advance to others."

Note 2. Fund Balance with Treasury

Fund balance with Treasury at September 30, 2004 and 2003, consisted of the following:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Appropriated Funds	\$ 49,353	\$ 46,637
Revolving Funds	17,010	11,190
Other Funds	8	81
Total Fund Balance with Treasury	\$ 66,371	\$ 57,908

Status of Fund Balance with Treasury

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Unobligated Balance		
- Available	\$ 1,603	\$ 3,377
- Unavailable	14,738	10,609
Obligated Balance, Not Yet Disbursed	50,022	43,841
Other Funds	8	81
Total Status of Fund Balance with Treasury	\$ 66,371	\$ 57,908

Fund Balance with Treasury is an entity asset maintained with Treasury. The monies are available to pay current liabilities and finance loan programs. The Department has the authority to disburse funds to agencies and institutions participating in its programs through the Treasury, which processes cash receipts and disbursements on its behalf.

A portion of the appropriated funds included at September 30, 2004 and 2003, was funded in advance by multi-year appropriations for expenditures anticipated during the current and future fiscal years. Revolving funds conduct continuing cycles of business-like activity and do not require an annual appropriation. Their fund balance comes from collections (other federal entities and the public) and from borrowings. Other funds primarily consist of suspense, deposit funds and clearing accounts.

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts that are not apportioned for obligation during the current fiscal year and expired appropriations no longer available to incur new obligations. Obligated balances not yet disbursed include reimbursements and other income earned, undelivered orders and expended authority-unpaid.

Note 3. Cash and Other Monetary Assets

Cash and Other Monetary Assets consisted of Guaranty Agency reserves (non-entity assets) and deposits in transit as of September 30, 2004 and 2003.

<u>(Dollars in Millions)</u>	2004		
	Guaranty Agency Reserves	Deposits in Transit	Total
Beginning Balance, September 30	\$ 1,107	\$ 1	\$ 1,108
Current Year Activity	(67)	(1)	(68)
Ending Balance, September 30	<u>\$ 1,040</u>	<u>\$ -</u>	<u>\$ 1,040</u>

<u>(Dollars in Millions)</u>	2003		
	Guaranty Agency Reserves	Deposits in Transit	Total
Beginning Balance, September 30	\$ 1,169	\$ 36	\$ 1,205
Current Year Activity	(62)	(35)	(97)
Ending Balance, September 30	<u>\$ 1,107</u>	<u>\$ 1</u>	<u>\$ 1,108</u>

Guaranty Agency reserves are collected and held on behalf of the U.S. government, a liability due to Treasury and considered intragovernmental liabilities. These balances represent the federal government's interest in the net assets of state and nonprofit FFEL Program Guaranty Agencies. (See Note 1.)

On September 30, 2004 and 2003, Guaranty Agencies held approximately \$1,040 million and \$1,107 million in federal assets, respectively. The agencies use the funds to pay lender claims, primarily for loan defaults and discharges. Consistent with Section 422A(e) of the HEA, these funds are considered "property of the United States" and are reflected in the *Budget of the United States Government*.

Note 4. Credit Program Receivables and Liabilities for Loan Guarantees

The Department operates the William D. Ford Direct Student Loan and Federal Family Education Loan (FFEL) programs to help students finance the costs of higher education. Under the programs, the Department makes loans directly or guarantees all or a portion of loans made by participating lending institutions to individuals who meet statutorily set eligibility criteria and attend eligible institutions of higher education—public and private two- and four-year institutions, graduate schools, and vocational training schools. Students and their parents receive loans regardless of income or credit rating; student borrowers who demonstrate financial need also receive federal interest subsidies.

Under the Direct Loan program, the federal government makes loans directly to students and parents through participating schools. Loans are originated and serviced through contracts with private vendors. Under the FFEL program, more than 3,400 financial institutions make loans directly to students and parents. FFEL loans are guaranteed by the federal government against default, with 36 state or private nonprofit Guaranty Agencies acting as intermediaries in administering the guarantees. Beginning with loans first disbursed on or after October 1, 1993, financial institutions became responsible for two percent of the cost of each default. Guaranty Agencies also began paying a portion of the cost (in most cases, five percent) of each defaulted loan from federal funds they hold in trust. FFEL lender participants receive statutorily set federal interest and special allowance subsidies; Guaranty Agencies receive fee payments as set by statute. In most cases, loan terms and conditions under the two programs are identical.

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

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

The Department uses a computerized cash flow projection Student Loan Model (SLM) to calculate subsidy estimates for Direct Loans and guaranteed FFEL program loans. Cash flows are projected over the life of the loan, aggregated by loan type, cohort year, and risk category. The loan's cohort year represents the year a direct loan was obligated or a loan was guaranteed, regardless of the timing of disbursements. Risk categories include two-year colleges, freshmen and sophomores at four-year colleges, juniors and seniors at four-year colleges, graduate schools, and proprietary (for-profit) schools.

The estimates reflected in these statements were prepared using assumptions developed for the FY 2005 Mid-Session Review, a governmentwide exercise required annually by the OMB. These estimates are the most current available to the Department at the time the financial statements are prepared. Department management has a process to review these estimates in the context of subsequent changes in assumptions, and reflect the impact of these changes as appropriate.

In recent years, the consolidation of existing loans into new direct or guaranteed loans has increased significantly. Under the Act and requirements provided by OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, the retirement of loans being consolidated is considered a receipt of principal and interest; this receipt is offset by the disbursement related to the newly created

consolidation loan. The underlying direct or guaranteed loans, whether performing or non-performing, in any given cohort are paid off in their original cohort and new loans are opened in the cohort in which consolidation activity occurs. This consolidation activity is taken into consideration in establishing the subsidy rate for defaults.

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

The Department disbursed approximately \$20 billion in Direct Loans to eligible borrowers in FY 2004 and approximately \$18 billion in FY 2003. Half of all loan volume is obligated in the fourth quarter of the fiscal year. Loans typically disburse in multiple installments over an academic period; as a result, loan disbursements for an origination cohort year often cross fiscal years. Regardless of the fiscal year in which they occur, disbursements are tracked by the cohort to which they belong, which is determined by the time of obligation rather than disbursement.

As of September 30, 2004 and 2003, the total principal balances outstanding of guaranteed loans held by lenders were approximately \$245 billion and \$213 billion, respectively. As of September 30, 2004 and 2003, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately \$240 billion and \$209 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the Guaranty Agencies, based on the appropriate reinsurance rates, which range from 100 to 95 percent. Any remaining insurance not paid as reinsurance would be paid to lenders by the Guaranty Agencies from their federal funds. Payments by Guaranty Agencies do not reduce government exposure because they are made from federal funds administered by the agencies.

The Department accrues interest receivable and records interest revenue on its performing direct loans. Given the Department's substantial collection rates, interest receivable is also accrued and interest revenue recognized on defaulted direct loans. Guaranteed loans that default are initially turned over to Guaranty Agencies for collection, and interest receivable is accrued and recorded on the loans as the collection rate is substantial. After approximately four years, defaulted guaranteed loans not in repayment are turned over to the Department for collection; accrued interest is calculated but only realized upon collection. Interest income is recognized for performing and defaulted direct loans. The Department does not record interest income on defaulted guaranteed loans; all borrower interest actually or expected to be accrued or received is used in estimating the FFEL liability for loss and allowance for subsidy.

As previously noted, borrowers may prepay and close out existing loans without penalty from capital raised through the disbursement of a new consolidation loan. The loan liability and net receivables include estimates of future prepayments of existing loans; they do not reflect costs associated with anticipated future consolidation loans.

Due to the nature of the loan commitment process in which schools establish a loan commitment with the filing of an aid application, which may occur before a student has been accepted by the school or begins classes, approximately seven percent of loan commitments are never disbursed. For Direct Loans committed in FY 2004, an estimated \$1.3 billion will not be disbursed; for guaranteed loans committed in FY 2004, an estimated \$6.3 billion will not be disbursed. Direct Loan schools may originate loans through a cash advance from the Department, establishing a loan receivable, or by advancing their own funds in anticipation of reimbursement from the Department.

Credit Program Receivables, Net

The Credit Program Receivables, Net consisted of the following program loans:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Direct Loan Program Loan Receivables, Net	\$ 93,747	\$ 86,634
FFEL Program Loan Receivables, Net	10,671	10,786
Perkins Program Loan Receivables, Net	194	195
Facilities and Other Loan Receivables, Net	354	350
Credit Program Receivables, Net	\$ 104,966	\$ 97,965

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

Direct Loan Program Receivables

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Principal Receivable	\$ 89,245	\$ 84,520
Interest Receivable	2,858	2,771
Receivables	92,103	87,291
Less: Allowance for Subsidy	(1,644)	657
Credit Program Receivables, Net	\$ 93,747	\$ 86,634

Of the \$92.1 billion in Direct Loan receivables as of September 30, 2004, \$6.3 billion are currently in default and held at the Department's Borrowers Services Collections Group. As of September 30, 2003, \$5.6 billion were in default and held at the Department's Borrowers Services Collections Group out of a total receivable of \$87.3 billion.

FFEL Program Receivables

<u>(Dollars in Millions)</u>	<u>2004</u>			<u>2003</u>		
	<u>Pre-1992</u>	<u>Post-1991</u>	<u>Total</u>	<u>Pre-1992</u>	<u>Post-1991</u>	<u>Total</u>
Principal Receivable	\$ 10,324	\$ 7,247	\$ 17,571	\$ 10,555	\$ 7,119	\$ 17,674
Interest Receivable	857	1,580	2,437	1,144	1,553	2,697
Receivables	11,181	8,827	20,008	11,699	8,672	20,371
Less: Allowance for Subsidy	7,921	1,416	9,337	8,273	1,312	9,585
FFEL Program Receivables, Net	\$ 3,260	\$ 7,411	\$ 10,671	\$ 3,426	\$ 7,360	\$ 10,786

Direct Loan Program Reconciliation of Allowance for Subsidy

The reconciliation of allowance for subsidy for the Direct Loan Program follows:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Beginning Balance, Allowance for Subsidy	\$ 657	\$ (2,115)
Components of Subsidy Transfers		
Interest Rate Differential	(1,276)	(1,724)
Defaults, Net of Recoveries	390	613
Fees	(401)	(377)
Other	1,117	1,122
Current Year Subsidy Transfers	(170)	(366)
Components of Subsidy Re-estimates		
Interest Rate Re-estimates ¹	(1,526)	388
Technical and Default Re-estimates	1,153	4,694
Total Subsidy Re-estimates	(373)	5,082
Activity		
Fee Collections	450	408
Loan Cancellations ²	(92)	(104)
Subsidy Allowance Amortization	(1,815)	(1,953)
Other	(301)	(295)
Total Activity	(1,758)	(1,944)
Ending Balance, Allowance for Subsidy	\$ (1,644)	\$ 657

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

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

FFEL Program Reconciliation of Liabilities for Loan Guarantees

Liabilities for Loan Guarantees represent the present value of future projected cash outflows from the Department, net of inflows, such as fees, and collection of principal and interest on defaulted guaranteed loans assumed for direct collection.

The FFEL Program Liability for Loan Guarantees reconciliation is associated with the FFEL Program loans guaranteed in the financing account. The FFEL liquidating account liability for loan guarantees is included in the total Liabilities for Loan Guarantees.

(Dollars in Millions)	2004	2003
Beginning Balance, Liability for Loan Guarantees	\$ 15,310	\$ 11,571
Components of Subsidy Transfers		
Interest Supplement Costs ¹	10,087	5,569
Defaults, Net of Recoveries	888	1,398
Fees	(4,230)	(3,181)
Other ²	2,151	2,087
Current Year Subsidy Transfers	8,896	5,873
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	70	4
Technical and Default Re-estimates	(1,449)	(2,534)
Subsidy Re-estimates in Liability	(1,379)	(2,530)
Activity		
Interest Supplement Payments	(2,345)	(2,088)
Claim Payments	(2,803)	(2,834)
Fee Collections	2,588	2,025
Interest on Liability Balance	436	458
Other ³	2,511	2,835
Total Activity	387	396
Ending Balance, Liability for Loan Guarantees	23,214	15,310
FFEL Liquidating Account Liability for Loan Guarantees	115	122
Total Liabilities for Loan Guarantees	\$ 23,329	\$ 15,432

¹ Increase in 2004 primarily results from costs associated with increased consolidation loan volume.

² Subsidy primarily associated with debt collections and loan cancellations due to death, disability, and bankruptcy.

³ Activity primarily associated with the transfer of subsidy for defaults; loan consolidation activity; and loan cancellations due to death, disability, and bankruptcy.

Subsidy Expense

Direct Loan and FFEL program subsidy expenses were as follows:

Direct Loan Program Subsidy Expense		
<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Components of Current-Year Subsidy Transfers		
Interest Rate Differential	\$ (1,276)	\$ (1,724)
Defaults, Net of Recoveries	390	613
Fees	(401)	(377)
Other	1,117	1,122
Current Year Subsidy Transfers	(170)	(366)
Re-estimates	(373)	5,082
Direct Loan Subsidy Expense	\$ (543)	\$ 4,716

Direct Loan subsidy expense was reduced by \$373 million by the 2004 re-estimates. The re-estimate related to changes in actual and forecasted interest rates reduced subsidy expense by \$847 million. The re-estimate related to changes in assumptions for other variables, such as assumed term and maturity, loan volume, and prepayment rates increased subsidy expense by \$474 million. A one percent increase in projected borrower base rates would reduce projected Direct Loan costs by \$775 million.

FFEL Program Loan Guarantee Subsidy Expense		
<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Components of Current-Year Subsidy Transfers		
Interest Supplement Costs	\$ 10,087	\$ 5,569
Defaults, Net of Recoveries	888	1,398
Fees	(4,230)	(3,181)
Other	2,151	2,087
Current Year Subsidy Transfers	8,896	5,873
Re-estimates	(380)	(3,365)
FFEL Loan Guarantee Subsidy Expense	\$ 8,516	\$ 2,508

FFEL subsidy expense was reduced by \$380 million by the 2004 re-estimates. The re-estimate related to changes in actual and forecasted interest rates reduced subsidy expense by \$352 million. The re-estimate related to changes in assumptions for other variables, such as assumed term and maturity, loan volume, and prepayment rates reduced subsidy expense by \$28 million. A one percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by \$4.2 billion.

Subsidy Rates

The subsidy rates applicable to the 2004 loan cohort year were as follows:

Subsidy Rates - Cohort 2004					
	Interest Differential	Defaults	Fees	Other	Total
Direct Loan Program	(5.65%)	1.74%	(1.97%)	5.26%	(0.62%)
	Interest Supplements	Defaults	Fees	Other	Total
FFEL Program	13.33%	1.06%	(5.56%)	2.78%	11.61%

The subsidy rates disclosed pertain only to the cohort listed. These rates cannot be applied to direct or guaranteed loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new direct or guaranteed loans reported in the current year relate to disbursements of loans from both current and prior years' cohorts. Subsidy expense is recognized when direct loans are disbursed by the Department or third-party lenders disburse guaranteed loans. The costs of the Department's student loan programs, and especially the Direct Loan program, are highly sensitive to changes in actual and forecasted interest rates. Rates are established in statute; the existing loan portfolio has a mixture of borrower and lender rate formulae. Governmentwide interest rate projections are developed by the President's Office of Management and Budget.

New student and parent loans have variable interest rates, reset annually. The federal capital for Direct Loans is provided annually by the Treasury at a fixed interest rate. Borrowers may consolidate outstanding loans into a single loan with a fixed interest rate based on the interest rates of the original loans. Borrower interest rates differ from the rate at which the Department borrows from Treasury. When developing subsidy cost estimates, the Department considers the impact of future interest rate changes on program costs and as part of the re-estimate process, annually adjusts subsidy costs. Changes in interest rate assumptions decreased the re-estimate for Direct Loans by \$847 million in 2004 and increased the re-estimate by \$1.3 billion in 2003. For FFEL, interest rates assumption changes reduced the re-estimate by \$352 million and \$768 million in 2004 and 2003, respectively.

Administrative Expenses

The administrative expenses for Direct Loan and FFEL Programs were as follows:

(Dollars in Millions)	2004		2003	
	Direct Loan	FFEL	Direct Loan	FFEL
Operating Expense	\$ 409	\$ 281	\$ 358	\$ 271
Other Expense	10	-	10	2
Total Administrative Expenses	\$ 419	\$ 281	\$ 368	\$ 273

Perkins Loan Program

The Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. For each fiscal year 2004 and 2003, the Department provided capital contributions of \$99 million used to make loans to eligible students through participating schools at five percent interest. For certain defaulted loans, the Department reimburses the originating school and collects from the borrowers. At September 30, 2004 and 2003, loans receivable, net of an allowance for loss, was \$194 million and \$195 million, respectively. These loans, originally disbursed as grants, are valued at historical cost.

Facilities Loan Programs

The Department administers the College Housing and Academic Facilities Loans (CHAFL), College Housing Loans (CHL), and Higher Education Facilities Loans (HEFL) Programs. From 1952 to 1993, these programs provided low-interest financing to institutions of higher education for the construction, reconstruction, and renovation of housing, academic, and other educational facilities. Since 1998, no new loans have been authorized.

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

The credit program receivables were as follows:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Principal Receivable	\$ 452	\$ 449
Interest Receivable	6	8
Receivables	458	457
Less: Allowance for Subsidy	104	107
Credit Program Receivables, Net	\$ 354	\$ 350

Note 5. Accounts Receivable

Accounts receivable consisted of the following at September 30, 2004 and 2003:

<u>(Dollars in Millions)</u>	2004		
	<u>Gross Receivables</u>	<u>Allowance</u>	<u>Net Receivables</u>
Intragovernmental	\$ 3	\$ -	\$ 3
With the Public	377	(225)	152
Total Accounts Receivable	\$ 380	\$ (225)	\$ 155

<u>(Dollars in Millions)</u>	2003		
	<u>Gross Receivables</u>	<u>Allowance</u>	<u>Net Receivables</u>
Intragovernmental	\$ 4	\$ -	\$ 4
With the Public	460	(281)	179
Total Accounts Receivable	\$ 464	\$ (281)	\$ 183

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

Note 6. General Property, Plant and Equipment

General property, plant and equipment consisted of the following at September 30, 2004 and 2003:

(Dollars in Millions)	2004		
	Asset Cost	Accumulated Depreciation	Net Asset Value
IT Equipment and Software	\$ 76	\$ (57)	\$ 19
Furniture and Fixtures	3	(1)	2
Total General Property, Plant and Equipment	\$ 79	\$ (58)	\$ 21

(Dollars in Millions)	2003		
	Asset Cost	Accumulated Depreciation	Net Asset Value
IT Equipment and Software	\$ 65	\$ (38)	\$ 27
Furniture and Fixtures	2	(1)	1
Total General Property, Plant and Equipment	\$ 67	\$ (39)	\$ 28

Information Technology (IT) Equipment consists of computer hardware and related software. The majority of these costs represent the continuing acquisition and implementation of the financial accounting system and includes Potomac Center Plaza (PCP) phone system. Furniture and fixtures and building improvements are related to renovating and furnishing new quarters for FSA and PCP.

Leases

The Department leases office space from the General Services Administration (GSA). The lease contracts with GSA for privately and publicly owned buildings are operating leases. Future lease payments are not accrued as liabilities, but rather expensed as incurred. Estimated future minimum lease payments for privately owned buildings as of September 30, 2004 and 2003, were as follows:

2004		2003	
(Dollars in Millions)		(Dollars in Millions)	
Fiscal Year	Lease Payment	Fiscal Year	Lease Payment
2005	\$ 46	2004	\$ 32
2006	55	2005	47
2007	61	2006	51
2008	63	2007	55
2009	64	2008	56
After 2009	66	After 2008	51
Total	\$ 355	Total	\$ 292

Note 7. Treasury Debt

At September 30, 2004, the Department's Debt to the Treasury and the Federal Financing Bank (FFB) was \$96,531 million and \$118 million, respectively. The table below depicts the change in debt from October 1, 2003 to September 30, 2004:

(Dollars in Millions)	2004				
	Treasury			FFB	Total
	Direct Student Loans	Facilities Loans	Total		
Beginning Balance	\$ 91,787	\$ 151	\$ 91,938	\$ 80	\$ 92,018
Accrued Interest	1	-	1	2	3
New Borrowing	21,191	-	21,191	53	21,244
Repayments	(16,558)	(41)	(16,599)	(17)	(16,616)
Ending Balance	<u>\$ 96,421</u>	<u>\$ 110</u>	<u>\$ 96,531</u>	<u>\$ 118</u>	<u>\$ 96,649</u>

At September 30, 2003, the Department's Debt to the Treasury and FFB was \$91,938 million and \$80 million, respectively. The table below depicts the change in debt from October 1, 2002 to September 30, 2003:

(Dollars in Millions)	2003				
	Treasury			FFB	Total
	Direct Student Loans	Facilities Loans	Total		
Beginning Balance	\$ 89,498	\$ 215	\$ 89,713	\$ 69	\$ 89,782
Accrued Interest	-	-	-	1	1
New Borrowing	19,637	-	19,637	11	19,648
Repayments	(17,348)	(64)	(17,412)	(1)	(17,413)
Ending Balance	<u>\$ 91,787</u>	<u>\$ 151</u>	<u>\$ 91,938</u>	<u>\$ 80</u>	<u>\$ 92,018</u>

Funds were borrowed to provide funding for direct loans to students and facilities loan programs. In addition, the FFB holds bonds issued by the Department on behalf of the HBCU Capital Financing Program. The Department reports the corresponding liability for full payment of principal and accrued interest as a payable to the FFB under rules established by the Credit Reform Act of 1990.

The level of repayments on borrowings to Treasury is derived from many factors:

- Beginning-of-the-year cash balance, collections, borrowings, interest revenue, disbursements, and interest expense have an impact on the available cash to repay Treasury.
- Cash is held to cover future liabilities, such as contract collection costs and disbursements in transit.

Note 8. Payable to Treasury

At September 30, 2004 and 2003, Payable to the Treasury for estimated liquidating fund future cash inflows in excess of outflows and for downward re-estimates of subsidy is shown in the table below:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Future Liquidating Account Collections, Beginning Balance	\$ 3,761	\$ 2,007
Valuation of Pre-92 Loan Liability and Allowance	847	3,542
Capital Transfers to Treasury	(1,117)	(1,788)
Future Liquidating Account Collections, Ending Balance	3,491	3,761
FFEL Downward Subsidy Re-estimate	1,502	3,262
Total Payable to Treasury	\$ 4,993	\$ 7,023

In accordance with the Credit Reform Act, the liquidating fund pays monies to Treasury each year based on available fund balances, and the FFEL financing fund pays the liability related to downward subsidy re-estimates, upon budget execution.

Note 9. Other Liabilities

Other liabilities include current liabilities for contractual services, administrative services, deferred credits, liability for deposit funds, contingent liabilities, custodial liabilities, and the liability for unfunded accrued annual leave. Additionally, the non-current liabilities include accrued unfunded FECA. Other liabilities consisted of the following at September 30, 2004 and 2003:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Intragovernmental		
Accrued Unfunded FECA Liability	\$ 3	\$ 3
Liability for Deposit Funds	(21)	46
Advance From Others	22	56
Total Intragovernmental	4	105
With the Public		
Accrued Payroll and Benefits	15	12
Accrued Unfunded Annual Leave	30	29
Custodial Liability	206	220
Deferred Credits	1	7
Liability for Deposit Funds	30	36
Other	99	146
Total With the Public	381	450
Total Other Liabilities	\$ 385	\$ 555

Note 10. Liabilities Not Covered by Budgetary Resources

Liabilities on the Department's Balance Sheet as of September 30, 2004 and 2003, include liabilities for which congressional action is needed before budgetary resources can be provided. Although future appropriations to fund these liabilities are likely and anticipated, it is not certain that appropriations will be enacted to fund these liabilities. Liabilities not covered by budgetary resources consisted of the following at September 30, 2004 and 2003:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Intragovernmental		
Accrued Unfunded FECA Liability	\$ 3	\$ 3
Total Intragovernmental	3	3
With the Public		
Custodial Liability	206	220
Accrued Unfunded Annual Leave	30	29
Federal Employee and Veterans' Benefits	19	22
Total With the Public	255	271
Liabilities Not Covered by Budgetary Resources	258	274
Liabilities Covered by Budgetary Resources	128,017	117,549
Total Liabilities	<u>\$ 128,275</u>	<u>\$ 117,823</u>

Note 11. Accrued Grant Liability

The accrued grant liability by reporting groups are shown in the table below. (See Note 1.)

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
FSA	\$ 637	\$ 551
OESE	207	256
OSERS	158	250
OVAE	39	57
OPE	242	169
IES	10	52
OELA	30	31
OSDFS	3	-
OII	35	-
Total Accrued Grant Liability	<u>\$ 1,361</u>	<u>\$ 1,366</u>

Note 12. Net Position

The nature of the Department's net position was discussed in Note 1, and the components are set forth in the Statement of Changes in Net Position. The table below reports the composition of appropriations that have not been used to fund goods and services received or benefits provided as of September 30, 2004 and 2003:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Unobligated Balances		
Available	\$ 619	\$ 2,979
Not Available	280	357
Undelivered Orders	46,386	40,595
Total Unexpended Appropriations	\$ 47,285	\$ 43,931

Undelivered orders and unobligated balances for federal credit financing and liquidating funds, and trust funds are not included in the chart above because they are not funded through appropriations. As a result, unobligated and undelivered order balances in the chart above will differ from these balances in the Combined Statement of Budgetary Resources.

The Department had Cumulative Results of Operations of (\$2,951) million as of September 30, 2004, and (\$4,496) million as of September 30, 2003. Cumulative Results of Operations arise from unfunded expenses and capital purchases.

Note 13. Interest Revenue and Expense

For the Direct Loan Program, non-federal interest revenue is earned on the individual non-defaulted loans in the loan portfolio while federal interest is earned on the uninvested fund balances with Treasury. For the Direct Loan Program, interest expense is incurred on the Department's borrowings from Treasury. For the FFEL program, federal interest revenue is earned on the uninvested fund balance with Treasury in the financing fund. Program A, Enhancement of Postsecondary and Adult Education includes the Direct Loan Program and the FFEL Program.

The interest revenues and expenses directly attributable to the Direct Loan Program, the FFEL Program, and other remaining programs are summarized below as of September 30, 2004 and 2003:

(Dollars in Millions)	Direct Student Loans		FFEL Program		Other Programs		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
Interest Revenue:								
Federal	\$ 1,000	\$ 1,076	\$ 436	\$ 458	\$ -	\$ -	\$ 1,436	\$ 1,534
Non-federal	4,761	4,954	-	-	50	30	4,811	4,984
Total Interest Revenue	\$ 5,761	\$ 6,030	\$ 436	\$ 458	\$ 50	\$ 30	\$ 6,247	\$ 6,518
Interest Expense:								
Federal	\$ 5,761	\$ 6,030	\$ 436	\$ 458	\$ 16	\$ 16	\$ 6,213	\$ 6,504
Non-federal	-	-	-	-	(3)	-	(3)	-
Total Interest Expense	\$ 5,761	\$ 6,030	\$ 436	\$ 458	\$ 13	\$ 16	\$ 6,210	\$ 6,504

Note 14. Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) compares budgetary resources with the status of those resources. As of September 30, 2004, budgetary resources were \$131,766 million and net outlays were \$61,660 million. As of September 30, 2003, budgetary resources were \$118,321 million and net outlays were \$58,166 million.

Apportionment Categories of Obligations Incurred

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

The apportionment categories of obligations incurred as of September 30, 2004 and 2003, are summarized below:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Direct:		
Category A	\$ 1,279	\$ 1,244
Category B	112,970	101,840
Exempt from Apportionment	53	62
	<u>114,302</u>	<u>103,146</u>
Reimbursable:		
Category A	1	8
Category B	4	71
Exempt from Apportionment	86	3
	<u>91</u>	<u>82</u>
 Total Apportionment Categories of Obligations Incurred	 <u><u>\$ 114,393</u></u>	 <u><u>\$ 103,228</u></u>

Permanent Indefinite Budget Authority

The Federal Direct Loan and the Federal Family Education Loan Programs were granted permanent indefinite budget authority through legislation. Part D of the William D. Ford Federal Direct Loan Program and part B of the Federal Family Education Loan Program, pursuant to the HEA, pertains to the existence, purpose, and availability of this permanent indefinite budget authority.

Reauthorization of Legislation

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

Unused Borrowing Authority

The Department is given authority to draw funds from the Treasury to help finance the majority of its direct lending activity in accordance with its needs. Unliquidated Borrowing Authority is considered a budgetary resource and is available to support obligations. The Department periodically reviews its borrowing authority balances and may cancel unused amounts. Unused Borrowing Authority as of September 30, 2004 and 2003, was determined as follows:

<u>(Dollars in Millions)</u>	<u>2004</u>	<u>2003</u>
Beginning Balance, Unused Borrowing Authority	\$ 6,978	\$ 4,953
Current Year Borrowing Authority	22,483	21,766
Funds Drawn From Treasury	(21,244)	(19,648)
Prior Year Unused Borrowing Authority Cancelled	(2,265)	(93)
Ending Balance, Unused Borrowing Authority	<u>\$ 5,952</u>	<u>\$ 6,978</u>

Comparison to the Budget of the United States Government

Statement of Federal Financial Accounting Standards No. 7 (SFFAS No. 7), *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires an explanation of material differences between budgetary resources available, the status of those resources and outlays as presented in the Statement of Budgetary Resources to the related actual balances published in the *Budget of the United States Government (Budget)*. However, the *Budget* has not yet been published. The *Budget* is scheduled for publication in February 2005 and will be available through OMB. Accordingly, information required for such disclosure is not available at the time of publication of these financial statements. There were no material differences between the FY 2003 column on the Statement of Budgetary Resources and the FY 2003 actual amounts reported in the *Budget*.

Note 15. Statement of Financing

The Statement of Financing (SOF) provides information on the total resources used by an agency, both those received through budgetary resources and those received through other means during the reporting period. The statement reconciles these resources with the net cost of operations by (1) removing resources that do not fund net cost of operations and (2) including components of net cost of operations that did not generate or use resources during the year.

The SOF is presented as a consolidated statement for the Department and its major programs. Net interagency eliminations are presented for proprietary amounts. The budgetary amounts are reported on a combined basis as presented in the Statement of Budgetary Resources. Accordingly, net interagency eliminations for budget amounts are not presented.

The relationship between the amounts reported as liabilities not covered by budgetary resources on the Balance Sheet and amounts reported as components requiring or generating resources in future periods on the Statement of Financing were analyzed. The differences are primarily due to the increase in custodial liability, which does not generate net cost of operations or require the use of budgetary resources.

Other, in the components not requiring or generating resources for FY 2004, is primarily comprised of the subsidy expense recognized in FY 2003 that was not funded in FY 2004 for the Direct Loan Program.

Note 16. Cost and Earned Revenue by Budget Function

The Department's gross costs and revenue, by budget function for September 30, 2004 and 2003, are presented below:

(Dollars in Millions)	2004			2003		
	Gross Costs	Earned Revenue	Net Costs	Gross Costs	Earned Revenue	Net Costs
Education, Training Employment and Social Services	\$70,062	\$(6,564)	\$63,498	\$65,208	\$(6,523)	\$58,685
Administration of Justice	125	-	125	119	-	119
Total	\$70,187	\$(6,564)	\$63,623	\$65,327	\$(6,523)	\$58,804

The Department's intragovernmental gross costs and revenue, by budget function for September 30, 2004 and 2003, are presented below:

(Dollars in Millions)	2004			2003		
	Gross Costs	Earned Revenue	Net Costs	Gross Costs	Earned Revenue	Net Costs
Education, Training Employment and Social Services	\$ 6,536	\$(1,738)	\$ 4,798	\$ 6,709	\$(1,551)	\$ 5,158
Administration of Justice	125	-	125	119	-	119
Total	\$ 6,661	\$(1,738)	\$ 4,923	\$ 6,828	\$(1,551)	\$ 5,277

Note 17. Program Costs by Segment

The format of the Statement of Net Cost is in compliance with OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*. Specifically, responsibility segments were aligned with the major goals of the Department of Education's *Strategic Plan 2002–2007*, as required by the Government Performance and Results Act (GPRA).

Reporting groups were aligned with the following Strategic Goals:

- Enhance the quality and access to postsecondary and adult education,
- Create a culture of achievement,
- Improve student achievement,
- Develop safe schools and strong character, and
- Transform education into an evidence-based field.

The importance of special education was highlighted by maintaining a separate responsibility segment on the Statement of Net Cost.

Program A on the Statement of Net Cost relates directly to Strategic Goal 5: Enhance the quality of and access to postsecondary and adult education. It combines the reporting groups of Federal Student Aid, the Office of Vocational and Adult Education, and the Office of Postsecondary Education. Program B relates directly to Strategic Goals 1, 2, and 3: Create a culture of achievement, Improve student achievement, and Develop safe schools and strong character. Program B combines the Office of Elementary and Secondary Education, the Office of English Language Acquisition and the Office of Safe and Drug-free Schools. Program C relates to Strategic Goal 4: Transform education into an evidenced-based field, and includes the Institute of Education Sciences and Office of Innovation and Improvement. Finally, Program D relates to "special education and program execution" and includes the Office of Special Education and Rehabilitative Services.

Note 18. Contingencies

Guaranty Agencies

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

Perkins Loans Reserve Funds

The Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. In FY 2004, the Department provided funding of 84.8 percent of the capital used to make loans to eligible students through participating schools at five percent interest. The school provided the remaining 15.2 percent of program funding. For the latest academic year ended June 30, 2004, approximately 750,420 loans were made, totaling \$1.6 billion at 1,700 institutions, averaging \$2,161 per loan. The Department's share of the Perkins Loan Program was approximately \$6.5 billion as of June 30, 2004.

In FY 2003, the Department provided funding of 85.2 percent of the capital used to make loans to eligible students through participating schools at five percent interest. The school provided the remaining 14.8 percent of program funding. For the academic year ended June 30, 2003, approximately 763,890 loans were made, totaling \$1.5 billion at 1,742 institutions, averaging \$1,919 per loan. The Department's share of the Perkins Loan Program was approximately \$6.5 billion as of June 30, 2003.

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

Litigation and Other Claims

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

Other Matters

Some portion of the current year financial assistance expenses (grants) may include funded recipient expenditures that 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.

