U. S. Department of Education

Fiscal Year 2006 Performance and Accountability Report

U.S. Department of Education
Margaret Spellings
Secretary

Office of the Chief Financial Officer
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November 15, 2006

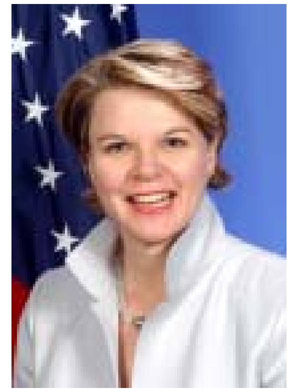
About the Department of Education's *Fiscal Year 2006 Performance and Accountability Report*

The Department of Education's publicly available *Fiscal Year 2006 Performance and Accountability Report (PAR)* will be available on the Department's Web site at http://www.ed.gov/about/reports/annual2006report/index.html. This print version, provided in limited distribution, contains the exact content provided in the online version.

Additionally, a color print highlights document containing a CD of the entire *PAR* will be available in January 2007.

To request a copy of our *Highlights Report* in print,
with CD of the full *Performance and Accountability Report,*
contact edpubs@inet.ed.gov.

To provide comments and suggestions on both the content and presentation of the report,
contact PARcomments@ed.gov.



It is my pleasure to present to you our *Fiscal Year 2006 Performance and Accountability Report*—a report card of the U.S. Department of Education's efforts and the resulting outcomes during the past fiscal year.

This year, there is a new look and feel to our *Performance and Accountability Report*. The new approach reflects our efforts to streamline the report, be more transparent, and communicate our goals, objectives and outcomes in plain language for our readers. The report provides program performance results and financial information so that all Americans can assess how we are meeting our goals and objectives. This report also emphasizes our achievements and challenges in meeting the President's and America's vision that no child will be left behind.

It has been almost five years since President Bush and the Congress led our nation in a historic commitment to a quality education for every child—regardless of race, income, or special need. We now have the data to see what's working in our schools and where we need to reconsider. Now, we must build on the successful foundation of *No Child Left Behind.* This past year, we have focused attention on accountability in our high schools, with the goal of ensuring that a high school diploma becomes a record of achievement, not just attendance.

We are heading in the right direction thanks to *No Child Left Behind*. However, we need to continue to focus on grade-level proficiency in math and reading, to increase rigor in math and science, to improve American competitiveness by increasing accountability in high schools, and to continue to ensure equal access to higher education through our student financial aid and postsecondary education programs.

Although our performance data are fundamentally complete and reliable, we continue to work to improve timeliness and accuracy as discussed in the Management's Discussion and Analysis section of this report. We have partnered with state educational agencies, colleges and universities, and financial institutions to streamline our reporting systems and to create common definitions for performance data.

Along with performance data, the report presents financial data about the Department's operations. I am pleased to announce that for the fifth year in a row, the Department has earned a "clean" opinion from independent auditors on our financial statements. The report also includes the information and assurances about the Department's financial management systems and management controls required by the *Federal Managers' Financial Integrity Act*. The Department's financial management systems and management controls, taken as a whole, provide reasonable assurance that the objectives of the act are being met, except for two material weaknesses identified by management. The two material weaknesses identified are related to Information Security and Program Management Controls. For further discussion, please see the Management's Assurances section of Management's Discussion and Analysis on pages 23-25 of this report.

We are a nation where education touches everyone. There is not one person in America who is not affected by the success of our educational systems. The Department of Education is committed to meeting the highest standards of accountability as we carry out our mission.

/s/

Margaret Spellings
November 15, 2006

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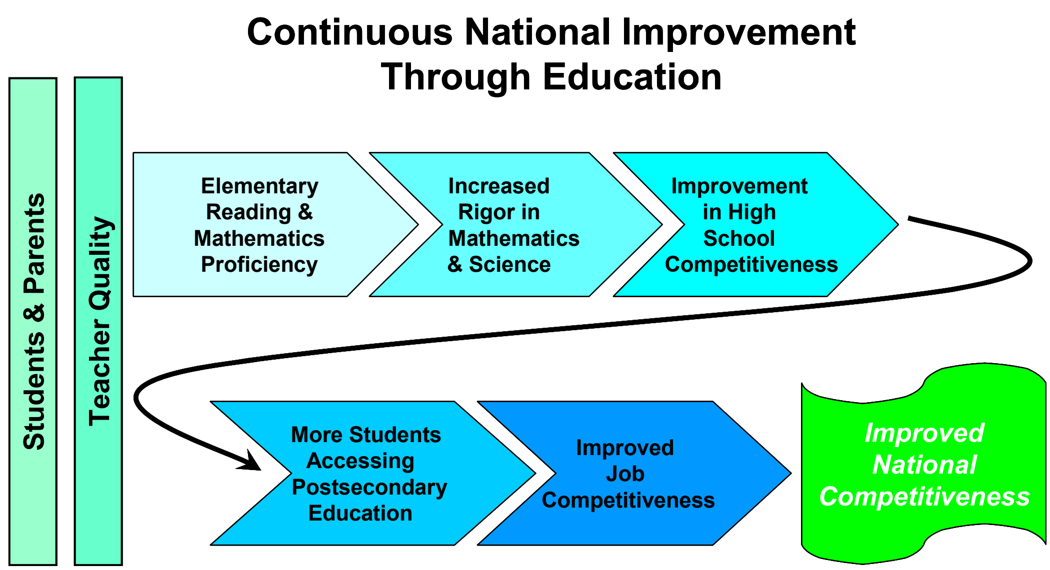
Management's Discussion and Analysis

Our Mission

Historically, the Department's mission has been "to ensure equal access to education and to promote educational excellence throughout the nation." Nearly five years after the enactment of the *No Child Left Behind Act of 2001,* this mission requires the Department to focus on achieving academic proficiency by 2014, increasing the rigor of mathematics and science curricula, improving American competitiveness, and providing access to higher education for all.

Of the many services that government provides to its citizens, few are as far-reaching as education. Every community throughout America has schools that provide instruction in reading, writing, mathematics, and science, as well as immersion in American history and culture. Most communities also have a high school where students learn science, mathematics, and other subjects that help them become informed American citizens. In addition, technical and postsecondary educational institutions are available to Americans to further improve their skills and education and enable them to become contributing members of our society.

The Department is proud to be a part of this grand enterprise.



Nationally, education expenditures are approximately $900 billion. The Department provides $99.8 billion—or 11 percent of the total—to help leverage the balance of funding and ensure that every child has the opportunity to learn and to reap the benefits of a high quality education.

Our nation's schools are the foundation for an economic engine that helps ensure we are a country with educated citizenry, full employment, and the ability to be fully competitive in the international marketplace.

To maintain our national competitiveness we must have world-class higher education and continuous learning systems. These systems derive from a secondary education system that graduates high school students with advanced mathematics and science skills. Students with these skills are the product of rigorous mathematics and science programs in elementary schools. These programs focus on inclusion of all students in challenging and comprehensive instruction using best practices and research-based techniques.

America has the world's greatest range of educational environments to meet the diverse needs of its students: public schools, public charter schools, specialized schools, and nonpublic schools. This report discusses how the Department of Education has supported and will continue to support these initiatives and activities.

History and Organization

The federal government recognized that furthering education is a national priority in 1867, when its initial role in education encompassed statistical data collection and reporting. Although the agency's form and location in the Executive Branch have changed over the years, the federal focus has remained on identifying and sharing what works in education with teachers and education policymakers. It was not until May 1980 that the Congress established the Department of Education as a Cabinet-level agency.

By that time, several major legislative actions had been taken to channel federal support to improve the quality of, and access to, education. Legislation in the late 1800s and early 1900s focused on the areas of education that would support America's overall economic progress, such as the creation of land-grant colleges and universities, and on agricultural, industrial, and home economics training for high school students. Later major legislative actions included the *Lanham Act of 1941*, Impact Aid, and the "GI Bill." These actions, a direct result of the impact of World War II on our country's families, supported school districts that were affected by the large number of military enlistments and provided opportunities for education for those men and women who served their country.

Between World War II and 1980, several landmark legislative actions shaped America's education systems. The focus during this period was equal access, and the legislation included Title VI of the *Civil Rights Act of 1964,* the *Elementary and Secondary Education Act of 1965*, the *Higher Education Act of 1965, Title IX of the Education Amendments of 1972*, Section 504 of the *Rehabilitation Act of 1973,* and the *Education of All Handicapped Children Act of 1975,* now known as the *Individuals with Disabilities Education Act*.

The *Elementary and Secondary Education Act* launched a comprehensive set of programs that are still administered by the Department today. To further enhance this legislation, President Bush recommended, and the Congress enacted, the *No Child Left Behind Act of 2001.* This recent amendment to the 1965 act established programs that account for more than 40 percent of the Department's fiscal year 2006 discretionary spending.

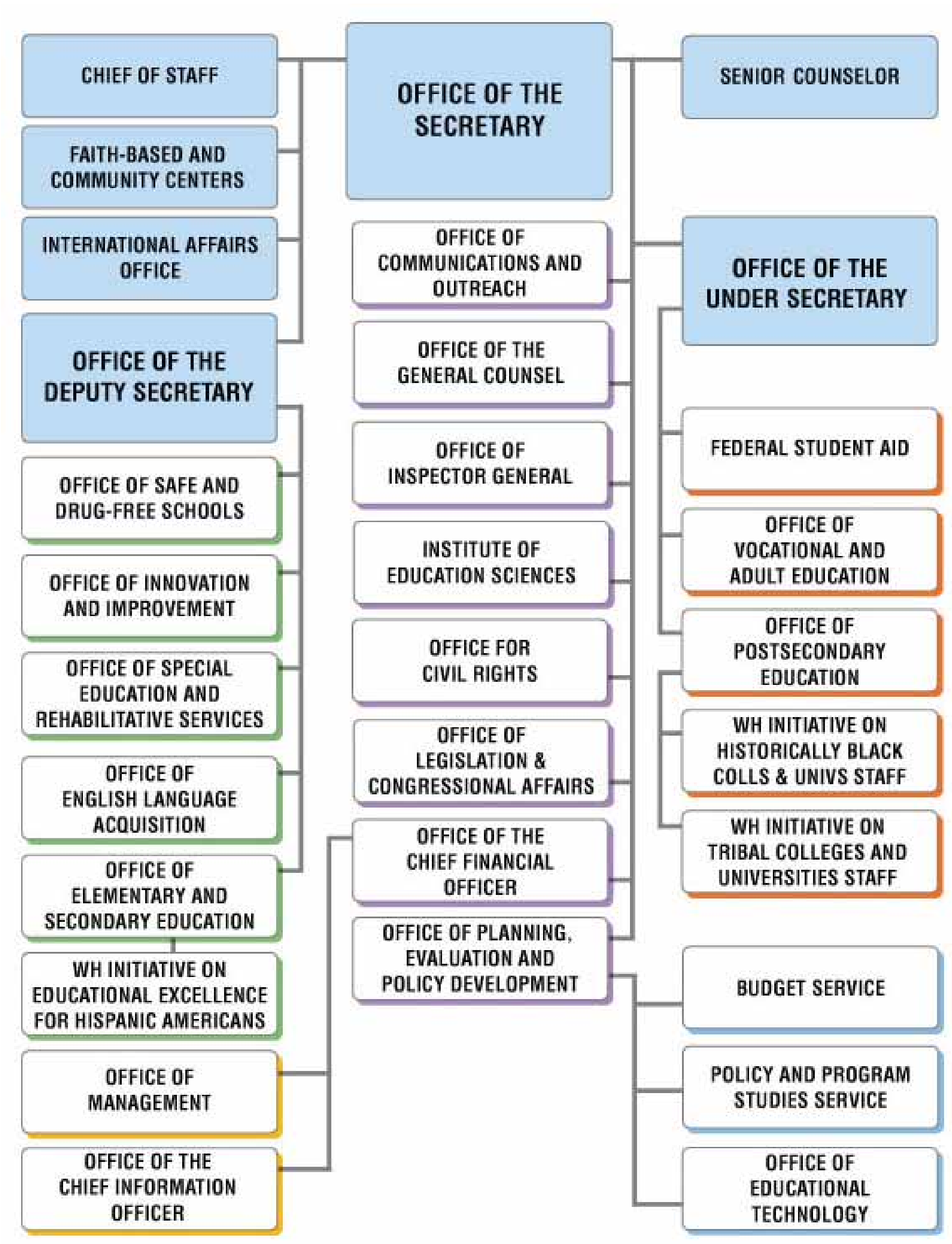
Today, the Department operates programs that touch every area and level of education. The elementary and secondary programs annually serve 15,500 school districts and approximately 50 million students. Department programs also provide grant, loan, and work-study assistance to more than 10 million postsecondary students.

The Department strives to achieve these results with the smallest workforce of the 15 Cabinet-level departments. Fewer than 4,200 full-time-equivalent staff manage approximately $58 billion in annual discretionary funds and oversee a student financial loan portfolio exceeding $400 billion.

In 2005, Secretary Spellings announced a new coordinating structure—one that better focuses resources on assisting our educational partners and emphasizes tangible results as the yardstick of our success. This structure will result in a Department that is increasingly responsive to the needs of states, districts, schools, teachers, students, institutions of higher education, and other stakeholders in fostering academic achievement. The revised coordinating structure is displayed on the next page.

The Department recognizes the primary role of states and school districts in providing a high quality education, employing highly qualified teachers and administrators, and establishing challenging content and achievement standards. The federal role is to supplement these state and local efforts with leadership, expertise, and targeted resources that optimize opportunities and improve achievements for all Americans.

Department of Education Coordinating Structure
FY 2006



Our Customers

Every American has a stake in the nation's education success.

The Department's customers include American taxpayers, students, teachers, parents, postsecondary students, institutions, and global citizens. When *No Child Left Behind* took effect, the government intensified its commitment to the students of America's elementary and secondary schools. The act benefits children, empowers parents, supports teachers, and strengthens schools.

Elementary and Secondary Students

According to the Department's report, *The Condition of Education 2006*, there are signs of improved achievement at the elementary and secondary levels. U.S. fourth-grade students had higher average scores in reading literacy than the international average as measured in the 2001 Progress in International Reading Literacy Study. Thirty-five countries participated, and the U.S. students had a higher average than 23 of the other 34 countries that participated.

In mathematics and science, the U.S. demonstrated mixed results. U.S. fourth-grade students showed no measurable change in performance in the 2003 Trends in International Mathematics and Science Study, while eighth-graders' performance improved. The standings of fourth-graders actually declined in both mathematics and science relative to students from the 14 other countries that participated in both the 1995 and 2003 assessments.

Since the inception of the *Individuals with Disabilities Education Act*, the number and percentage of youth aged 3–21 enrolled in public schools who receive special education services have steadily increased. In 2004–05, more than 6.7 million youth aged 3–21 were served under the act.

Parents

The provisions of *No Child Left Behind* have made schools more accountable to parents and provided parents with information about their children and what they should expect from their schools. *No Child Left Behind* requires that parents be informed about their child's test results and whether their child's school is making adequate yearly progress. If a school does not make progress, parents can choose to have their child transferred to another school. The following year if the school does not make progress, parents are informed and students are provided supplemental education services.

Teachers

According to the 2004 School and Staffing Survey, there were 3.3 million public school teachers and 87,621 principals working in 15,500 school districts throughout the country. *No Child Left Behind* includes provisions stating that all teachers in core academic areas must be highly qualified in the core academic subjects they teach by the end of the 2005–06 school year. In general, a highly qualified teacher must have a bachelor's degree, full state certification as defined by the state, and demonstrated competency as defined by the state in each core academic subject he or she teaches.

Postsecondary Students and Institutions

More students are enrolling in colleges and getting degrees, and the enrollment increase is projected to continue through 2015. The number of bachelor's degrees awarded increased by 33 percent between 1989–90 and 2003–04, while the number of associate's degrees increased by 46 percent. Female college enrollment passed male enrollment in 1978, and the gender gap has widened and is expected to grow.

To help students who could not otherwise afford postsecondary education, the Department provides assistance through various programs such as the Federal Family Education Loan Program, the Federal Direct Loan Program, the Pell Grant Program, the Perkins Loan Program, and the Federal Work-Study Program, authorized under Title IV of the *Higher Education Act*. In 2006, the Department's office of Federal Student Aid delivered approximately $77 billion in aid to more than 10 million students attending over 6,100 institutions.

Performance Results and Highlights

In fiscal year (FY) 2006, the Department administered and assessed 150 programs. The key measures provided in this report represent those measures that provide an overall assessment of the Department's progress in achieving improvements in the educational system.

The table below summarizes the Department's performance results for FY 2006 key measures. There are 64 key performance measures that support the Department's mission and strategic goals.

For the most recent data available, the Department met or exceeded targets for 33 key measures, did not meet 15, and is awaiting data for the remainder. This year, data are pending for 16 key measures, which is a result of the time lag of between 12 and 24 months from the end of the measurement period.

Each year, the Department assesses key measures for that year's performance plan and evaluates the utility and appropriateness of those measures. As a result, key measures are continued, replaced, or completely removed from the objective key measurement process. This assessment process provides a method for continued improvement and enhancement in Department programs.

Shown below are the actual results for each key measure. The table presents whether the actual result met, failed to meet, or exceeded the expected target. The shaded areas indicate that a measure was not in place during the time period. In some cases, establishing a baseline is the target and is recognized as met if the data are available and the baseline is established. For measures where data are not currently available, the date the data are expected is indicated.

Legend

NA = No measure for period	**√ = Met target**	**+ = Exceeded target**
T = Measure replaced or discontinued	**× = Less than target or prior year level**	

Performance Results Summary	Cohort	FY 2004	FY 2005	FY 2006
Strategic Goal 1 – Create a Culture of Achievement				
1.1 – Link federal education funding to accountability for results				
A. Number of states that have reading/language arts assessments that align with the state's academic content standards for all students in grades 3–8 and in high school. [1201]		√	×	×
B. Number of states that have mathematics assessments that align with the state's academic content standards for all students in grades 3–8 and in high school. [1202]		√	×	×
C. Number of states that have science assessments that align with the state's academic content standards for all students in grades 3–8 and in high school. [1203]		NA	NA	Dec. 2007
D. Number of states that have completed field testing of the required assessments in reading/language arts. [1204]		NA	+	√ T
E. Number of states that have completed field testing of the required assessments in mathematics. [1205]		NA	+	√ T
F. Number of states that have completed field testing of the required assessments in science. [1206]		NA	NA	+
1.2 – Increase flexibility and local control				
A. Percentage of eligible school districts utilizing the Rural Education Achievement Program flexibility authority. [1473]		×	×	Apr. 2007
B. Overall American Customer Satisfaction Index as scored by Department grantees. [2200]		NA	√	×
1.3 – Increase information and options for parents				
A. Number of charter schools in operation around the nation. [1146]		×	+	+
B. Amount of funding program grantees' leverage for the acquisition, construction or renovation of charter school facilities. [1208]		×	+	Feb. 2007

Performance Results Summary	Cohort	FY 2004	FY 2005	FY 2006
1.4 – Encourage the use of scientifically based methods within federal education programs				
A. Proportion of school-adopted approaches that have strong evidence of effectiveness compared to programs and interventions without such evidence. [2201]		NA	NA	Dec. 2007
Strategic Goal 2 – Improve Student Achievement				
2.1 – Ensure that all students read on grade level by the third grade				
A. Number of states reporting an increase in the percentage of fourth-grade low-income students meeting state performance standards by scoring at or above proficient in reading/language arts on state assessments. [1066]		NA	×	Aug. 2007
B. Number of states reporting an increase in the percentage of fourth-grade students with disabilities meeting state performance standards by scoring at or above proficient on state assessments in reading. [1519]		NA	×	Aug. 2007
C. Number of states that met the state target for attainment of English language proficiency. [1830]		NA	NA	Jan. 2007
2.2 – Improve mathematics and science achievement for all students				
A. Number of states reporting an increase in the percentage of eighth-grade low-income students meeting state performance standards by achieving proficiency or above in mathematics on state assessments. [1067]		NA	+	Aug. 2007
B. Number of states reporting an increase in the percentage of eighth-grade students with disabilities meeting state performance standards by scoring at or above proficient on state assessments in mathematics. [1520]		NA	+	Aug. 2007
2.3 – Improve the performance of all high school students				
A. Percentage of students with disabilities who graduate from high school with a regular high school diploma. [1527]		NA	√	Aug. 2007
B. Percentage of students with disabilities who drop out of school. [1528]		NA	+	Aug. 2007
C. Number of Advanced Placement tests taken by low-income public school students nationally. [1149]		NA	NA	Jan. 2007
2.4 – Improve teacher and principal quality				
A. Percentage of core academic classes in high-poverty schools taught by highly qualified teachers. [1180]		NA	√	Dec. 2007
B. Percentage of core academic classes in elementary schools taught by highly qualified teachers. [1182]		+	+	Dec. 2007
C. Percentage of core academic classes in secondary schools taught by highly qualified teachers. [1183]		+	+	Dec. 2007
Strategic Goal 3 – Develop Safe Schools and Strong Character				
3.1 – Ensure that our nation's schools are safe and drug free, and that students are free of alcohol, tobacco, and other drugs				
A. Percentage of Safe Schools/Healthy Students grant sites that experience a decrease in the number of violent incidents at schools during the three-year grant period (by cohort). [1825 & 2019]	04	NA	√	Dec. 2006
	05	NA	NA	Dec. 2006
B. Percentage of Safe Schools/Healthy Students grant sites that experience a decrease in substance abuse during the three-year grant period (by cohort). [1826 & 2020]	04	NA	√	Dec. 2006
	05	NA	NA	Dec. 2006
C. Percentage of Safe Schools/Healthy Students grant sites that improve school attendance during the three-year grant period (by cohort). [1827 & 2021]	04	NA	√	Dec. 2006
	05	NA	NA	Dec. 2006
D. Percentage of Student Drug Testing grantees that experience a 5 percent annual reduction in the incidence of past-month drug use by students in the target population (by cohort). [1828]	03	NA	NA	√
E. Percentage of Student Drug Testing grantees that experience a 5 percent annual reduction in the incidence of past-year drug use by students in the target population (by cohort). [1829]	03	NA	NA	√
3.2 – Promote strong character and citizenship among our nation's youth.				

Performance Results Summary	Cohort	FY 2004	FY 2005	FY 2006
Strategic Goal 4 – Transform Education into an Evidence-Based Field				
4.1 – Raise the quality of research funded or conducted by the Department				
A. Percentage of new research proposals funded by the Department's National Center for Education Research that receive an average score of excellent or higher from an independent review panel of qualified scientists. [1022]		NA	√	×
B. Percentage of new research proposals funded by the Department's National Center for Special Education Research that receive an average score of excellent or higher from an independent review panel of qualified scientists. [1940]		NA	NA	√
4.2 – Increase the relevance of our research in order to meet the needs of our customers				
A. Percentage of new research projects funded by the Department's National Center for Education Research and National Center for Education Evaluation and Regional Assistance that are deemed to be of high relevance to education practices as determined by an independent review panel of qualified practitioners. [1028]		√	Dec. 2006	Mar. 2007
B. Percentage of new research projects funded by the Department's National Center for Special Education Research that are deemed to be of high relevance by an independent panel of qualified practitioners. [1942]		NA	NA	√
Strategic Goal 5 – Enhance the Quality of and Access to Postsecondary and Adult Education				
5.1 – Reduce the gaps in college access and completion among student populations differing by race or ethnicity, socioeconomic status, and disability while increasing the educational attainment of all				
A. Percentage of TRIO Educational Opportunity Centers participants enrolling in college. [1612]		+	×	Dec. 2007
B. Percentage of TRIO Student Support Services participants persisting at the same institution. [1617]		+	+	Dec. 2007
C. Percentage of TRIO Student Support Services participants completing an associate's degree at the original institution or transferring to a four-year institution within three years. [1618]		NA	NA	Dec. 2007
D. Percentage of TRIO Student Support Services first-year students completing a bachelor's degree at the original institution within six years. [1619]		×	×	Dec. 2007
E. Percentage of TRIO McNair participants enrolling in graduate school. [1614]		+	+	Dec. 2007
F. Percentage of TRIO McNair participants persisting in graduate school. [1615]		+	+	Dec. 2007
5.2 – Strengthen the accountability of postsecondary institutions				
5.3 – Establish funding mechanisms for postsecondary education				
5.4 – Strengthen Historically Black Colleges and Universities, Hispanic-Serving Institutions, and Tribal Colleges and Universities				
A. Percentage of full-time undergraduate students who were in their first year of postsecondary enrollment in the previous year and are enrolled in the current year at the same Historically Black College or University. [1587]		NA	NA	×
B. Percentage of students enrolled at four-year Historically Black Colleges and Universities graduating within six years of enrollment. [1589]		NA	NA	Dec. 2007
C. Number of Ph.D., first professional, and master's degrees awarded at Historically Black Graduate Institutions. [1595]		NA	NA	Dec. 2007
D. Percentage of full-time undergraduate students who were in their first year of postsecondary enrollment in the previous year and are enrolled in the current year at the same Tribally Controlled College or University. [1569]		NA	NA	+
E. Percentage of students enrolled at four-year Tribally Controlled Colleges and Universities graduating within six years of enrollment. [1571]		NA	NA	Dec. 2007
F. Percentage of students enrolled at two-year Tribally Controlled Colleges and Universities who graduate within three years of enrollment. [1572]		NA	NA	Dec. 2007
G. Percentage of full-time undergraduate students who were in their first year of postsecondary enrollment in the previous year and are enrolled in the current year at the same Hispanic-Serving Institution.[1601]		NA	NA	Dec. 2007
H. Percentage of students enrolled at four-year Hispanic-Serving Institutions graduating within six years of enrollment. [1603]		NA	NA	Dec. 2007
I. Percentage of students enrolled at two-year Hispanic-Serving Institutions who graduate within three years of enrollment. [1604]		NA	NA	Dec. 2007
5.5 – Enhance the literacy and employment skills of American adults				
A. Percentage of general and combined state vocational rehabilitation agencies that assist at least 55.8 percent of individuals receiving services to achieve employment. [1681]		×	×	Apr. 2007

Performance Results Summary	Cohort	FY 2004	FY 2005	FY 2006
B. Percentage of adults with a high school completion goal who earn a high school diploma or recognized equivalent. [1386]		+	+	Dec. 2006
C. Percentage of adults enrolled in English literacy programs who acquire the level of English language skills needed to complete the levels of instruction in which they enrolled. [1384]		×	×	Dec. 2006
5.6 – Increase the capacity of U.S. postsecondary education institutions to teach world languages, area studies, and international issues				
A. Percentage of critical languages taught, as reflected by the list of critical languages referenced in the HEA, Title VI program statute. [1665]		NA	Dec. 2006	Dec. 2007
B. Percentage of National Resource Center Ph.D. graduates who find employment in higher education, government and national security. [1664]		+	Dec. 2006	Dec. 2007
C. Average competency score of Foreign Language and Area Studies Fellowship Program recipients at the end of one full year of instruction minus the average score at the beginning of the year. [1671]		+	√	Dec. 2006
Strategic Goal 6 – Establish Management Excellence				
6.1 – Develop and maintain financial integrity and management internal controls				
A. Achieve an unqualified opinion. [2204]		√	√	√
6.2 – Improve the strategic management of the Department's human capital				
A. Index of quality human capital performance management activities. [2205]		NA	√	×
6.3 – Manage information technology resources, using e-gov, to improve service for our customers and partners				
A. Percentage of grant programs providing online application capability. [2206]		NA	+	√
6.4 – Modernize the Federal Student Assistance programs				
A. Customer service level for Free Application for Federal Student Assistance on the Web. [2207]		NA	×	×
B. Customer service level for Direct Loan Servicing. [2208]		NA	×	+
C. Customer service level for Common Origination and Disbursement. [2209]		NA	+	+
D. Customer service level for Lender Reporting System. [2210]		NA	×	×
6.5 – Achieve budget and performance integration to link funding decisions to results				
A. Percentage of Department program dollars associated with programs reviewed under the Program Assessment Rating Tool process that demonstrate effectiveness. [2211]		NA	+	Aug. 2007
6.6 – Leverage the contributions of faith-based and community organizations to increase the effectiveness of Department programs				
A. Percentage of applications in competitions of amenable discretionary programs that are faith-based or community organizations. [2212]		NA	NA	√

Performance Achievements

Five years after the enactment of the *No Child Left Behind Act*, the revolutionary changes to our education system called for by President Bush are almost implemented. States have put in place rigorous new accountability systems and are implementing reading and math assessments covering all students in grades three through eight. Improved data collection and reporting on teacher qualifications are helping states to ensure that all teachers are highly qualified. School districts are providing new support and assistance to low-performing schools while making available public school choice and supplemental educational service options to millions of students who attend those schools.

Despite the great promise and progress of *No Child Left Behind*, gaps remain in the federal effort to improve the performance of America's public schools. These gaps are exposed by the rapid pace of technological change and increasing global economic competition.

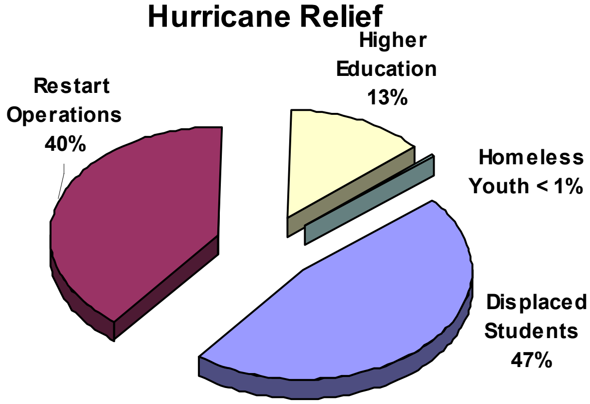
To ensure a strong and prosperous America in the 21st century, our students must possess the mathematics and science knowledge that is the foundation of our nation's long dominance in science, technology, and innovation; graduate from high school prepared to enter college or the globally competitive workforce; and master critical foreign languages needed both for success in the global business arena and to ensure our national security in the war on terrorism.

In FY 2006, the Department of Education administered over $77 billion in new grants, loans, and work-study assistance to help over 10 million students and their families pay for college. In addition to student financial assistance, the Department provides continuing support for institutional development at colleges and universities serving large percentages of minority students and funds opportunities for postsecondary students to gain international expertise and training as language and area specialists.

Hurricane Relief

On December 30, 2005, President Bush signed into law the *Hurricane Education Recovery Act*. This act provided $1.4 billion to help school districts and schools meet the educational needs of students displaced by Hurricanes Katrina and Rita. The funding provided under the act also helped schools that closed as a result of the hurricanes to reopen as quickly and effectively as possible. The act also provided funding of $200 million to help higher education institutions directly affected by the hurricanes, as well as other colleges and universities around the country that enrolled displaced students. An additional $285 million was later authorized and provided by the Congress, totaling $1.9 billion to assist the educational institutions in the immediately affected areas and those educational systems that provided assistance for displaced students. Approximately $900 million, or 47 percent of authorized funding, was provided to assist local educational agencies that accepted and assisted displaced students.

Funds Appropriated for Hurricane Relief



The *Hurricane Education Recovery Act* also authorized the Secretary, under certain circumstances, to waive or modify any statutory or regulatory provision applicable to the student financial assistance programs under Title IV of the *Higher Education Act*, as amended. The Secretary determined that institutions in the impacted areas in possession of Title IV funds awarded to students enrolled for the disrupted academic period will, generally, not be required to return funds for the students who withdrew or never began attendance. The aid related to this waiver was approximately $28 million.

As of September 30, 2006, over $230 million had been expended from the Emergency Impact Aid for Displaced Students program for restart aid. This funding was intended by the Congress for expenses related to the restart of school operations, the reopening of and the re-enrollment of students in elementary and secondary schools in Gulf Coast states.

In addition, the Department received approximately $61 million in foreign aid donations to rebuild and restore educational institutions at all levels in the affected areas. Of this amount, $35 million has been awarded.

President's Management Agenda

During FY 2006, the Department made significant improvements on the President's Management Agenda scorecard. The Office of Management and Budget recognized improved status for the Department in three areas: E-government, Budget-Performance Integration, and Eliminating Improper Payments. E-government met all milestones and continues to improve overall. Budget-Performance Integration met efficiency measures for all PART and marginal cost standards, and has assessed 99.4 percent of the budgeted dollars, excluding programs that are exempted. In addition, the Department has assessed many programs that are not required to be assessed. The Department continues to make progress in the Eliminating Improper Payments initiative by developing timelines for specific risk assessments and finalizing estimates for major programs. See p. 18 for the Scorecard Results.

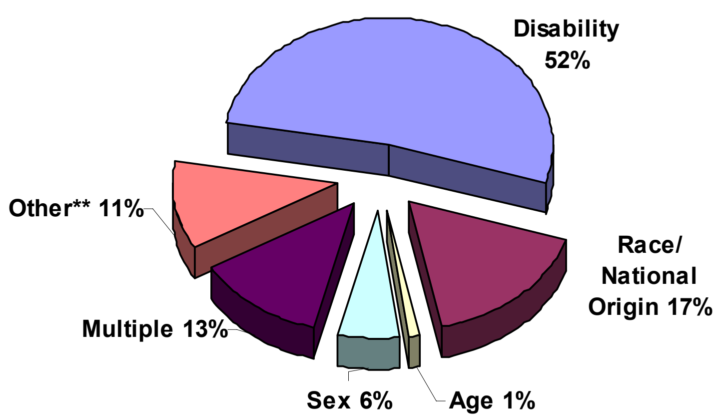
Civil Rights Enforcement

The enforcement of civil rights laws drives student outcomes by ensuring that discrimination does not deny or limit student access to education programs and activities at any educational level. The Department enforces five civil rights laws that protect students against discrimination on the basis of race, color, national origin, sex, disability, and age primarily in educational institutions that receive federal funds. In addition, the Department ensures that the Boy Scouts of America and other designated youth groups have equal access to meet in elementary and secondary schools that receive federal funds from the Department. These antidiscrimination laws protect approximately 50 million students attending elementary and secondary schools and more than 17.7 million students attending colleges and universities.

The Office for Civil Rights, a law enforcement agency within the Department, performs civil rights enforcement responsibilities in a variety of ways. Civil rights enforcement responsibilities include investigating complaints alleging discrimination, conducting compliance reviews of educational institutions, and providing technical assistance to educational institutions on compliance with the law and to parents and students on their rights under the law. The Department also issues regulations on civil rights laws, develops policy guidance interpreting the laws, and distributes the information broadly.

At the beginning of FY 2006, the Office for Civil Rights had 1,546 pending complaints of discrimination. During the year, the Department received an additional 5,805 complaints and resolved 5,893. The goal of each investigation is to address the alleged discrimination promptly and to determine if civil rights laws and regulations have been violated. As shown in the chart below, the majority of complaints received by the Department allege discrimination due to disability.

FY 2006 Discrimination Complaints



** Indicates no jurisdiction or jurisdiction not yet determined.

Data Quality

Complete, accurate, and reliable data are essential for effective decision-making. State and local educational agencies have historically provided education performance data that do not fully meet information quality standards. With the passage of the *No Child Left Behind Act,* the accuracy of state and local educational performance data is even more crucial. Funding decisions are made and management actions are taken on the basis of this performance information. Reliable information is a prerequisite for effective management. However, ensuring that data are high quality is not solely the responsibility of our grantees.

Performance Data

Collecting Data from the States Through ED*Facts*. ED*Facts* is a collaborative effort among the Department, state educational agencies, and industry partners to place the use of timely and accurate performance data at the core of decision- and policy-making in education. This initiative provides a centralized tool to collect, access, and use educational performance data in support of the requirements of *No Child Left Behind.* It also organizes collection activities in a way that minimizes the burden on the state educational agencies, which provide the Department with these data.

Data collected will be used to evaluate the effectiveness of federal education programs and monitor the status of states in meeting the requirements of *No Child Left Behind*. The data will provide the transparency required to track and improve program management, including identifying the federal education programs that provide the best outcomes for students and their families.

Confidence in the programs and their results begins with data quality. There are two major areas of focus in the ED*Facts* data quality program:

- External—Prior to submission to ED*Facts*, data collection at the school, district, and state levels will be conducted using well-organized and methodologically rigorous techniques.
- Internal—After the data files have been submitted by the state educational agencies, data will be validated through electronic and human subject matter expert review processes.

These data quality control procedures and checkpoints ensure both the quality of the data and that reports produced by ED*Facts* will be accurate and timely.

To remedy the challenges faced in the collection of data, ED*Facts* is undergoing a rigorous assessment to determine the best course of development for the further enhancement of the data quality control processes. Once this assessment is completed and the recommended options selected, the data quality program will be refined and enhanced, enabling the Department to do the following:

- Validate and improve data accuracy by identifying data collection gaps, inaccurate data, and data anomalies.
- Ensure that the data presented in reports represent valid comparisons.
- Display quality metrics on reports.
- Provide reporting tools and data access to Department leadership, federal program offices, state and local educational agencies, schools, and the public.
- Limit access to data based on security and privacy requirements.
- Provide predefined reports that display transmittal statistics on the state's submissions, and provide the Department with the same information at the national level.

The Department's future data quality improvement requirements include the following:

- An organization responsible for data quality.
- The ability for state educational agencies to view and resolve data submission errors via a user-friendly Web interface.
- A centralized data certification system and process.
- A single data repository for data usage.

- Access to financial data related to program management and monitoring.

Federal Student Aid. Federal Student Aid is improving systems to yield reliable performance data to make informed budget and policy decisions. These systems will enhance the budget process and increase the accuracy and reliability of information received from operating partners.

Department Data Quality

The Department itself also develops and uses data. One of the most visible areas in which this occurs is the annual budget development process. One goal of the budget process is to use program performance data in the formulation and execution of the Department's budget. One of the five government-wide elements of the *President's Management Agenda* is the integration of budget and performance, which focuses on making budget decisions based on results.

The Department recognizes the benefits of and need for improving the completeness, accuracy and reliability of data for *No Child Left Behind* reporting, integrated performance-based budgeting and general program management. In addition to completeness, accuracy and reliability, the Department acknowledges the need for improvements in the timeliness of data. Currently, data time lags between 12 and 24 months exist for some performance data. The Department expects that the implementation of ED*Facts* will help to reduce the reporting burden on state and local educational agencies, resulting in an improvement in the timeliness of data.

The Department also produces financial data for official submission to the Congress, the Office of Management and Budget, and other federal authorities as mandated in the *Government Performance and Results Act*. The data quality processes for financial data are reflected in our audit report and management's internal control over financial reporting assessment. The financial statements, associated notes, and auditor's reports can be found on pp. 91-155, which include the required Limitations of the Financial Statements. Management's Assurance of internal control can be found on p. 24.

Financial Highlights

In order to support state and school districts in providing quality education, the Office of the Chief Financial Officer is responsible for providing accurate, timely, and useful grant, loan, contract, and financial management information to all Department stakeholders.

The Department continues to enhance the model for what constitutes a high-quality financial reporting environment. This model will result in financial reports that reflect the underlying economics of the business in a comparable, consistent fashion. The model emphasizes transparency as the method to facilitate the free flow of information to decision-makers and stakeholders.

The Department consistently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operation. For the fifth consecutive year, we achieved an unqualified (clean) opinion from independent auditors on the annual financial statements. Since 2003, the auditors have found no material weaknesses in the Department's internal control over financial reporting. In accordance with the Office of Management and Budget's Circular No. A-123, *Management's Responsibility for Internal Control*, the Department continues to test and evaluate findings and risk determinations uncovered in management's internal control assessment.

In the first quarter of FY 2007, the Department will complete the implementation of an upgraded financial management system. This system implementation will provide the Department an enhanced financial management solution by improving reporting capabilities, data processing, and general financial management. The new system will also allow the Department to enhance the ability to link financial data to performance measures.

Sources of Funds

We managed a budget of approximately $99.8 billion in FY 2006, of which 36 percent supported elementary and secondary grant programs. Postsecondary grants and administration of student financial assistance accounted for 58 percent, including loan programs costs that helped more than 10 million students and their parents to better afford higher education during FY 2006. An additional 5 percent went toward other programs and grants encompassing research, development, and dissemination, as well as rehabilitation services. Administrative expenditures are less than 2 percent of the Department's appropriations.

Nearly all the Department's non-administrative appropriations support three primary lines of business—grants, guaranteed loans, and direct loans. The original principal balances of the Federal Family Education Loans and Federal Direct Student Loans, which compose a large share of federal student financial assistance, are funded by commercial bank guarantees and borrowings.

The Department's three largest grant programs are Title I grants for elementary and secondary education, Pell Grants for postsecondary financial aid, and Special Education Grants to States under the *Individuals with Disabilities Education Act.* Each program's FY 2006 appropriation exceeded $10 billion.

The Federal Family Education Loan Program insures the loan capital from more than 3,200 private lenders available to students and their families. Through 35 active state and private nonprofit Guaranty Agencies, the Department administers the federal loan guarantee program to protect lenders against losses related to borrower default. As of the end of September 2006, the total principal balance of outstanding guaranteed loans held by lenders was approximately $325 billion. The government's estimated maximum exposure for defaulted loans is approximately $321 billion.

The Federal Direct Student Loan Program, created by the *Student Loan Reform Act of 1993*, provides an alternative method for delivering assistance to students. This program uses Treasury funds to provide loan capital directly to postsecondary schools. The schools then disburse loan funds to students. As of September 30, 2006, the value of the Department's direct loan portfolio was $92.6 billion.

Financial Position

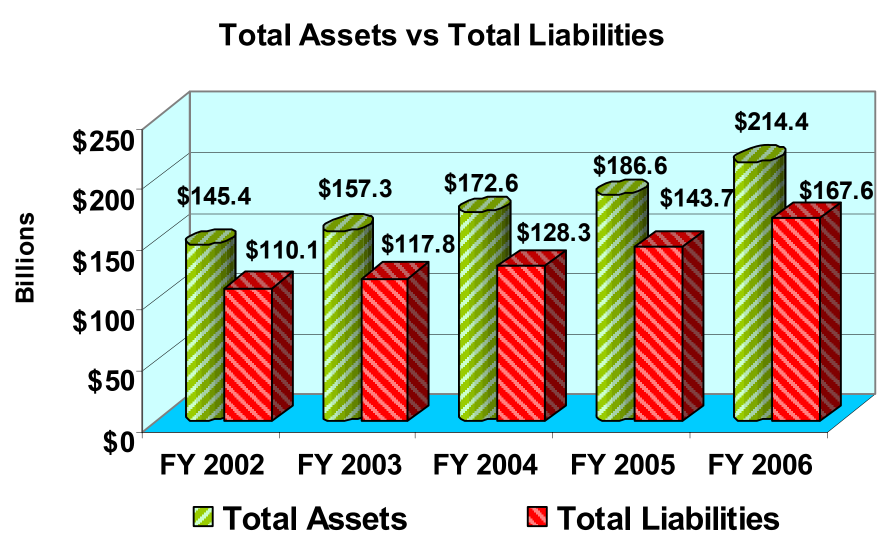
The Department's financial statements are prepared in accordance with established federal accounting standards and are audited by the independent accounting firm of Ernst & Young, LLP. FY 2006 financial statements and footnotes appear on pp. 95-127. Analyses of the principal financial statements follow.

Balance Sheet. The Balance Sheet presents, as of a specific point in time, the economic value of assets and liabilities retained or managed by the Department. The difference between assets and liabilities represents the net position of the Department. The Balance Sheet displayed on p. 95 reflects total assets of $214.4 billion, a 15 percent increase over FY 2005. Fund Balance with the Treasury increased by 38 percent over FY 2005. This increase is attributable to (1) an increase in collections from borrowers due to consolidation prepayments, and (2) an increase in the estimated long term cost of loan guarantees the Department makes to private lenders.

Liabilities for Loan Guarantees increased 71 percent or $21.8 billion. The $21.8 billion increase is primarily attributed to the marked increase in student loan consolidation activity. Student loan consolidations represent borrowers consolidating underlying variable rate loans into a new fixed rate loan.

In fiscal years 2006 and 2005, the Department experienced record highs in consolidation activity as a result of rising interest rates. As market interest rates increase, special allowance payments to lenders also increase. Special allowance payments are made to lenders when the market interest rate exceeds the borrower rate.

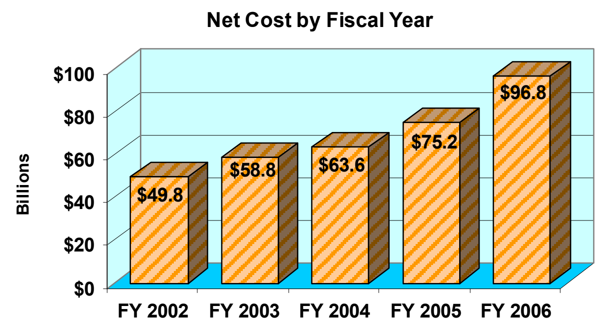
Several factors influenced the change in the Department's net position in FY 2006. The factors include the subsidy re-estimates for federal student loan programs and the increase in FY 2006 grant appropriations. Net position increased by 9 percent over FY 2005.



Statement of Net Cost. The Statement of Net Cost presents the components of the Department's net cost, which is the gross cost incurred less any revenues earned from the Department's activities. The Statement of Net Cost is presented to be consistent with the Department's strategic goals and the *President's Management Agenda*. The Department's total program net costs, as reflected on the Statement of Net Cost, p. 96, are $96.8 billion, a 29 percent increase over FY 2005. The following chart provides a detailed crosswalk of the Department's Net Cost programs linking them to *Strategic Plan* Goals 2 through 5.

Net Cost Program	Goal No.	Strategic Goal
Enhancement of Postsecondary and Adult Education	5	Enhance the Quality of and Access to Postsecondary and Adult Education
Creation of Student Achievement, Culture of Achievement and Safe Schools	2 3	Improve Student Achievement Develop Safe and Drug-Free Schools
Transformation of Education	4	Transform Education into an Evidence-Based Field
Special Education and Program Execution		Cuts across Strategic Goals 2, 3, 4 and 5

The Department considers Strategic Goal 1, Create a Culture of Achievement, a synopsis of the four pillars on which educational excellence is established. Strategic Goal 6, Establishing Management Excellence, emphasizes administrative and oversight responsibilities. These two strategic goals support the Department's programmatic mission, and as a result, we do not assign specific program costs to either of them for presentation in the Statement of Net Cost.



The Enhancement of Postsecondary and Adult Education experienced a 57 percent increase in costs over FY 2005. The increase is largely attributed to two factors associated with the Federal Family Education Loan Program, subsidy reestimate and consolidation loan volume.

Statement of Budgetary Resources. This statement provides information about the provision of budgetary resources and their status as of the end of the reporting period. The statement displayed on p. 98 shows that the Department had $210.9 billion in budgetary resources for the year ended September 30, 2006. Budgetary resources are composed of $104.3 billion in appropriated budgetary resources and $106.6 billion in non-budgetary credit reform resources, which primarily consist of borrowing authority for the loan programs. Of the $51.7 billion that remained unobligated at year-end, $47.6 billion represents funding provided in advance for activities in future periods that was not available at year end. These funds will become available during the next or future fiscal years.

Statement of Financing. This statement demonstrates the relationship between an entity's proprietary and budgetary accounting information. It links the net cost of operations (proprietary) with net obligations (budgetary) by identifying key differences between the two statements. This statement is structured to identify total resources used during the fiscal year, with adjustments based on whether the resources were used to finance the net obligations or net cost. This statement, displayed on p. 99, identifies $74.9 billion of resources used to finance activities, $19.6 billion of resources not part of the net cost of operations, and $2.3 billion of components of net cost of operations that will not require or generate resources in the current period.

President's Management Agenda Scorecard Results

Under the *President's Management Agenda*, the Executive Branch Management Scorecards track how well the departments and major agencies are executing five government-wide initiatives and other agency-specific program initiatives. The scorecard employs a simple grading system common today in well-run businesses: green for success, yellow for mixed results, and red for unsatisfactory.

Status. Scores for "status" are based on the scorecard standards for success developed by the President's Management Council and discussed with experts throughout government and academe, including the National Academy of Public Administration. The standards have subsequently been refined with continued experience implementing the *President's Management Agenda*. Under each of these standards, an agency is "green" or "yellow" if it meets all of the standards for a given level of success identified and agreed upon by the agency and the Office of Management and Budget; it is "red" if it has any one of a number of serious flaws identified for the agency.

Progress. The Office of Management and Budget assesses "progress" on a case-by-case basis against the agreed-upon deliverables and time lines established for the five initiatives as follows: green represents that implementation is proceeding according to plan; yellow indicates there is some slippage or other issues requiring adjustment by the agency in order to achieve the initiative objectives on a timely basis; and red indicates the initiative is in serious jeopardy and the agency is unlikely to realize objectives absent significant management intervention.

Department of Education Results. During FY 2006, the Department made significant improvements on the scorecard. The Office of Management and Budget recognized improvement of status for the Department in three areas: E-government, Budget-Performance Integration, and Eliminating Improper Payments.

Improved Credit Management is a new initiative developed in the fourth quarter of FY 2006 and is the primary reason we currently have a "red" status.

***President's Management Agenda* FY 2006 Scorecard**

		Q4-2005		Q4-2006	
	Target Area	**Status**	**Progress**	**Status**	**Progress**
Government-wide Initiatives	Financial Performance	G	G	G	G
	Competitive Sourcing	G	G	G	G
	Human Capital	Y	G	Y	G
	E-government	Y	G	G↑	G
	Budget-Performance Integration	Y	G	G↑	G
Program Initiatives	Faith-Based and Community Initiatives	G	G	G	G
	Eliminating Improper Payments	R	G	Y↑	G
	Improved Credit Management (New Initiative in FY 2006)	NA	NA	R	Y

G = green Y = yellow R = red NA = not applicable

Management Challenges and Future Initiatives

Management's challenges and future initiatives will involve the enhancement of the Department's governance process. This process will be based on accountability with a central focus on compliance and risk management. Numerous recent federal regulations have increased the pressure on government entities to measure and mitigate risks involving financial loss, as well as damage to their reputations.

Implementing an effective operational governance framework represents one of management's most pressing challenges moving into the future. While extremely demanding, the benefits of a well-constructed governance framework simultaneously provide increased visibility into operations leading to enhanced performance, reduced costs, and the necessary transparency to properly analyze risk. In the future, successful governance frameworks implemented by management will have to account for and integrate risk and compliance procedures into the Department's core values.

A number of the rigorous regulatory activities required to perform recently instituted compliance requirements, such as documenting processes, control assessments, and risk evaluation, are the same activities required by enterprise risk management. The convergence of these procedures permits organizations to gain efficiencies and reduce compliance costs by eliminating redundant controls and duplication of effort, effectively streamlining operations.

It is imperative that Department management begin to measure, monitor risk, and then establish acceptable levels of risk in daily operations. The advent of fully integrated Web-based systems, advancing information technology, and telecommunication systems has increased the speed of, and decreased the barriers to serving customers.

These advances of the interconnected world have correspondingly increased the risks that management must mitigate. Future governance frameworks will not only have to account for such risks, but will also have to proactively enable a continuing measurement and monitoring process. That process will allow management to either accept or mitigate the risks associated with the many benefits of the latest technological innovations.

To ensure the implementation of a governance strategy based on accountability and risk, management is implementing an executive-level process. This process will ensure that senior management's attention is focused on the most significant risk management issues facing the Department. Risk management issues include financial management, program management, human capital, security, and compliance with applicable laws and regulations.

Management has recently established a Risk Management and Compliance Committee. This committee will be an essential component of the risk management and internal control infrastructure of the Department. The committee's primary responsibilities are to ensure management is aware of the risks facing the Department and that appropriate measures are taken to mitigate those risks. Specifically, the committee will provide:

- Oversight of the *Federal Managers' Financial Integrity Act* (FMFIA) annual assessment and corrective action plan processes.
- Identification of significant risks facing the Department through the review and monitoring of significant findings from audits and investigations by the Office of Inspector General, external financial audits, reviews and audits by the Government Accountability Office, non-federal single audits, and Department monitoring reviews.
- Review of the significant risks identified in the Internal Control Evaluation Staff reviews.
- Review of the status of the Department's compliance with applicable federal laws and regulations.
- Discussion of potential risks that may result from anticipated legislative changes, environmental changes, and changes in human resources.

- Review of the annual work plans of the Office of Inspector General and the Internal Control Evaluation Staff.

The implementation of a comprehensive business governance strategy will improve the Department's business processes and drive efficiencies across the enterprise.

Credit Reform Management

A significant amount of the Department's fiscal activity is related to the administration of direct and guaranteed loans. As a result, the Department has significant challenges in addressing the estimates related to credit reform.

In response to the Office of Management and Budget's recent addition of an *Improved Credit Management Scorecard*, the Department continues to improve its financial management. This fiscal year, the Department has done the following with respect to credit management:

- Defined target borrower segments.
- Improved its lending policies and procedures.
- Established cost control estimates.

Management Challenges Identified by the Inspector General

Other current and future management challenges include those identified by the Inspector General in the annual report to improve departmental efficiencies. These recommendations are provided in the Other Accompanying Information section of this report (see pp. 175-180). The recommendations include: improving oversight and management of programs by establishing and maintaining appropriate internal control accountability, identifying and correcting improper payments, improving procurement and monitoring of contracted services, human capital planning, and managing information security and technology investments.

Department Response

The Department continues to address the challenges associated with management's oversight of internal controls related to programs, improper payments and procurement.

Accountability. Progress has been made in the oversight of certain programs through monitoring plans that include technical support provided by the staff of the Office of the Chief Financial Officer. The Department has also implemented a Grant High Risk Module within the Grant Administration Payment System to alert program offices of existing high risk conditions such that awards can be made with appropriate restrictions and requirements.

Improper Payments. Identifying and correcting improper payments remains a challenge for the Department. It has increased its participation in performing monthly monitoring site visits for the Titles I and III of the *Elementary and Secondary Education Act* programs at various state and local educational agencies.

The Department also enlists the assistance of outside resources to perform risk analysis of its programs. Recent analysis indicates that the Title I programs were not at risk of exceeding the 2.5 percent threshold that requires a statistical review. The student financial assistance program initiatives are continuing and the Deparment is working with other government agencies to conduct studies and utilize statistical sampling.

Procurement. The Department's procurement and contract management processes continues to face challenges. However, in FY 2006, the Department issued new procedures that required that contract monitoring plans be developed for all new and existing contracts.

Information Security. Information security continues to be a concern throughout the government and in the Department. The Department works to improve security controls to protect the confidentiality, integrity and availability of its data and systems as noted in the Management Assurance section of this report (see p. 24). The Department has continued efforts to strengthen individual business cases and to map proposed investments to the Department's enterprise architecture strategy. In addition, the Department recently established plans to improve controls relating to the protection of personally identifiable information.

Human Capital. Human capital planning remains a significant challenge facing the Department as well as other agencies throughout the government. The Department will see a significant percentage of its workforce eligible for retirement in 2007. In addition, the advent of technology has changed critical skill requirements for staff. As a result, staff are being challenged outside their current position requirements.

Managers must develop succession plans and identify training needs for their staff to mitigate these challenges. The Department requires managers to attend training that is designed to improve their understanding of and assist in the development of staff performance standards. In addition, communication and project management training is also offered to employees to help address essential management skill gaps required to carry out their mission.

Summary

Ensuring equal access to education and promoting educational excellence throughout the nation is our mission. Achieving management excellence is the foundation on which we are able to accomplish this mission. Department management made great strides in improving the nation's educational opportunities through data collection and reporting strategies. Producing accurate, timely, and reliable financial reports and taking steps to minimize the risk of making improper payments enables the Department to execute its mission effectively.

The Department acknowledges the challenges it faces, but only by focusing on human capital management and further integrating our performance and financial information will we continue to ensure access to, and excellence in, the nation's educational system.

Integration of Performance and Financial Information

Focusing on results and accountability through performance monitoring and financial reporting is a sound practice for increasing the Department's productivity. One gauge of how effectively taxpayer dollars are being used is for an agency to link the performance of its programs to subsequent budget determinations.

The Department constantly seeks to strengthen the linkage between financial investments and program quality. The Department enhances this linkage by developing and using program measures, reporting mechanisms, and effective budget management. This report is one example of how we provide comprehensive, accurate information to the American public in a timely manner.

Program Assessment Rating Tool. Since 2002, the Office of Management and Budget has required federal agencies to systematically assess the quality of government programs using a diagnostic tool called the Program Assessment Rating Tool (PART). The Office of Management and Budget uses this mechanism consistently across government and works with federal agencies to judge the effectiveness of programs with regard to their stated purpose, strategic planning, internal management, and results and accountability. PART reviews provide critical information that is used to establish funding priorities for budget planning and development. Once a program has been through the PART process, the Department implements follow-up actions based on PART recommendations.

By September 2006, the Department had completed PART reviews on 74 programs. This report includes information from PART reviews performed in preparation for the Department's FY 2007 budget submission.

Integrating Performance Plan Into Budget. Since FY 2005, the Department has combined the annual performance plan and annual budget to create an annual performance budget, consistent with the Office of Management and Budget's guidance. Additionally, the Department shifted from the use of strategic measures that reported the national status of education to focus on program-related measures that more accurately reflect Department objectives.

The entire program performance report required under the *Government Performance and Results Act* is available at http://www.ed.gov/about/reports/annual/2006report/program.html.

Challenges Linking Performance to Funding. The Department's challenge of linking performance results, expenditures, and budget is complicated by the fact that we accomplish objectives indirectly. More than 98 percent of the Department's funding is disbursed through grants and loans. The challenge of linking performance to expenditures is further complicated by the funding schedule for these programs.

In the Department, only a portion of a given fiscal year's appropriation is available to state, school, organization, and student recipients during the fiscal year in which the funds are appropriated. The remainder is available at or near the end of the appropriation year or in the subsequent year. The funds remain available to recipients for varying lengths of time.

Funds for competitive grant programs are generally available when appropriations are passed by the Congress. However, the processes required for conducting the grant competitions often result in the award of grants near the end of the fiscal year with funding available to grantees for additional fiscal years.

Thus, the results presented in this report cannot be attributed solely to the actions taken related to FY 2006 funds but to a combination of funds from fiscal years 2004 through 2006. Furthermore, the results of education programs may not be apparent for many years after the funds are expended.

Although we cannot isolate program results and directly link them to a fiscal year's funding, performance results during a specific single fiscal year serve as a proxy. Most Department programs are continuous and funded each year through the appropriation process.

Management's Assurances

Federal Managers' Financial Integrity Act

As required under the *Federal Managers' Financial Integrity Act*, the Department reviewed its management control system. The objectives of the management control system are to provide reasonable assurance that the following occur:

- Obligations and costs are in compliance with applicable laws.
- Assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
- The revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports, and maintain accountability over assets.
- Programs are efficiently and effectively carried out in accordance with applicable laws and management policy.

Managers throughout the Department are responsible for ensuring that effective controls are implemented in their areas of responsibility. Individual assurance statements from senior management serve as a primary basis for the Department's assurance that management controls are adequate. The assurance statement provided on p. 24 is the result of our annual assessment and is based upon each senior officer's evaluation of controls.

Department organizations that identify material deficiencies are required to submit plans for correcting the cited weaknesses. The plans must include a risk assessment, cost of correction, and estimated date of completion. These corrective action plans, combined with the individual assurance statements, provide the framework for continual monitoring and improving of the Department's management controls.

Inherent Limitations on the Effectiveness of Controls. Department management does not expect that our disclosure on controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints. The benefits of the controls must be considered relative to their associated cost. Because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

Federal Financial Management Improvement Act

The Secretary has determined that the Department is in compliance with the Federal Financial Management Improvement Act (FFMIA), although our auditor has identified instances of which the Department's financial management systems did not substantially comply with the act.

We are cognizant of our auditor's concerns relating to instances of non-compliance with FFMIA as noted in the Compliance with Laws and Regulations Report located on pp. 152-154 of this report. We continue to strengthen and improve our financial management systems.

However, since our last FFMIA report, the Department has continued to invest a considerable amount of time, effort and resources in assessing the security controls protecting its information and information resources. As a result of these assessments, the Department has learned that certain vulnerabilities identified by the Inspector General and our auditors in this year's reports were previously accepted on an enterprise-wide basis by the Department's Designated Approving Authorities, Certifier and Government Technical Expert.

To this end, the Department has made a well-informed and documented risk-based business decision to operate its networks, systems and applications in the presence of certain vulnerabilities and security exposures. This acceptance of risk is in keeping with the rules and principles governing a risk management program.

Furthermore, the Department fully understands the risks inherent in operating information resources in the presence of common vulnerabilities and security exposures. To assist in the management of the potential risks, the Department has implemented proactive processes to identify, research, manage, remediate and monitor for vulnerabilities and security exposures. This remediation cycle can be an extended process for any particular vulnerability and as a result, at any given time as they await remediation, vulnerabilities may be present in any networked environment, including the Department's.

Federal Managers' Financial Integrity Act

Management for the Department of Education is responsible for establishing and maintaining effective internal control and financial management systems that meet the intent and objectives of the *Federal Managers' Financial Integrity Act* (FMFIA). I am able to provide a qualified statement of assurance that the Department's internal control structure and financial management systems meet the objectives of FMFIA, with the exception of two material weaknesses. The details of these exceptions are provided in Exhibit 1.

The Department conducted its assessment of internal control in compliance with applicable laws and regulations, and in accordance with the Office of Management and Budget's Circular No. A-123, *Management's Responsibility for Internal Control*. Based upon the results of this evaluation, the Department identified two material weaknesses in its internal control over the effectiveness and efficiency of operations, and compliance with applicable laws and regulations, as of September 30, 2006. Other than the exceptions noted in Exhibit 1, the internal controls were operating effectively, and no material weaknesses were found in the design or operation of the internal controls.

In addition, the Department conducted an assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of the Office of Management and Budget's Circular No. A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, the Department of Education can provide reasonable assurance that its internal control over financial reporting as of June 30, 2006, was operating effectively and that no material weaknesses were found in the design or operation of the internal control over financial reporting.

/ s /

November 15, 2006

Exhibit 1 – *FMFIA* Material Weaknesses

ID	Material Weakness	Description	Corrective Action	Anticipated Correction Date
1	Information Technology Security (*FISMA*)	Instances of inadequate security controls, including password protection, encryption, and intrusion detection.	The Office of the Chief Information Officer (OCIO) is implementing a number of mitigating actions to correct information technology security deficiencies found in management, operational and technical control controls. Some of the mitigating actions include procuring a world class managed security service provider who would have independent verification & validation responsibilities in the areas of operational intrusion detection monitoring and incident escalation, situational awareness, vulnerability and configuration management, software assurance, and security operations center management. OCIO plans to mitigate weaknesses in password protection by implementing a two-factor authentication solution derived from Homeland Security Presidential Directive 12 (Hspd-12). OCIO also plans to correct deficiencies found in protecting personally identifiable information (PII) by encrypting backup tapes, laptop computers and other mobile media instruments containing PII such as thumb drives, CDs and DVDs.	Corrective actions are currently being implemented, and are expected to be completed by September 30, 2007.
2	Program Management Control	In two programs, the Reading First and the Migrant Education programs, the Department identified possible instances of lack of proper controls and management oversight in several past years in the implementation of the programs.	The Office of Elementary and Secondary Education is implementing compensating controls to correct or mitigate weaknesses in both programs. With regard to the Migrant Education program, the Office of Migrant Education is implementing compensating controls to correct or mitigate weaknesses. States are submitting new information related to eligibility based on appropriate controls. Corrective actions, including the repayment of funds, including the return of $13.6 million from Puerto Rico, are currently being implemented. With regard to the Reading First program, the Department is implementing corrective actions to address all of the recommendations made by the Office of Inspector General in an inspection report, and is also making additional improvements.	Corrective actions are currently being implemented, and most actions will be completed by December 31, 2007. Some of the corrective actions have been completed, including the return of $13.6 million from Puerto Rico; further repayments from other states may take one year or more to complete. Many corrective actions are being implemented currently, and will be completed by December 31, 2006; all corrective actions are expected to be completed by December 31, 2007.

Improper Payments Overview

The *Improper Payments Information Act of 2002 (IPIA)* requires agencies to annually review and assess all programs and activities to identify those susceptible to significant improper payments. The guidance provided by the Office of Management and Budget defines significant improper payments as those annual erroneous payments that exceed both $10 million and 2.5 percent of the program payments. For each program identified, agencies are required to report the annual estimated amount of improper payments and the steps taken to reduce or eliminate them.

The Department has undertaken the following initiatives relating to the implementation of the *Improper Payments Information Act of 2002*.

Student Financial Assistance Programs

Federal Student Aid operates and administers the majority of the *Higher Education Act of 1965*, as amended, Title IV Student Assistance (Title IV) programs for the Department. In FY 2006, nearly $77 billion was provided to students and families to help them overcome the financial barriers that make it difficult to attend and complete postsecondary education. Federal Student Aid administers a variety of grants, loans, and loan guarantees through its financial assistance programs. The processes developed to administer the programs are responsive to changes in statutes, the reauthorization of existing statutes, and the changing needs of educational institutions and their students.

Title IV student assistance programs are large and complex. Federal Student Aid relies on over 6,100 eligible postsecondary institutions, 3,200 lenders, 35 loan Guaranty Agencies, and a number of private loan servicers to administer its programs. Except for funds received as an administrative cost allowance, Federal Student Aid program funds received by a school are held in trust by the school for the students, the Department, and, in some cases, for private lenders and Guaranty Agencies.

As required by the *IPIA*, Federal Student Aid inventoried its programs during FY 2006, and reviewed program payments made during FY 2005 (the most recent complete fiscal year for which data are available), to assess the risk that a significant amount of improper payments were made. The review identified and then focused on five key programs (Federal Family Education Loan Program, Federal Pell Grant Program, Federal Supplemental Educational Opportunity Grant, Federal Work-Study Programs and Direct Loan Program), representing 98.7 percent of Federal Student Aid's FY 2005 outlays.

The following Title IV programs were identified as potentially susceptible to risk: Federal Family Education Loan Program, Federal Pell Grant Program, Campus-based programs, the William D. Ford Federal Direct Loan Program, Loan Consolidations, and the Academic Competitiveness and SMART Grant program. A detailed discussion of each of these programs can be found in the Improper Payments Details section of this *Performance and Accountability Report* on pp. 158-171.

The following table provides the outlook for three of the primary Federal Student Aid program estimates.

Federal Student Aid Improper Payment Reduction Outlook Fiscal Years 2005 – 2009
($ in millions)

	Actual						Estimated								
	2005			2006			2007			2008			2009		
Program	**Outlays**	**IP %**	**IP $**	**Outlays**	**IP %**	**IP $**	**Outlays**	**IP %**	**IP $**	**Outlays**	**IP %**	**IP $**	**Outlays**	**IP %**	**IP $**
Direct Loan Program	$12,231	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
FFEL Program	$8,626	2.2%	$190	$18,245	2.2%	$401	$5,340	2.2%	$117	$5,340	2.2%	$117	$5,340	2.2%	$117
Pell Grant Program	$12,749	3.48%	$444	$12,117	3.48%	$422	$12,825	3.48%	$446	$12,825	3.48%	$446	$12,825	3.48%	$446

Federal Student Aid Manager Accountability. Federal Student Aid program managers are responsible for making recommended improvements and achieving quantifiable savings. The Federal Student Aid Executive Management Team monitors these efforts. The Executive Management Team is composed of key managers and is the executive decision-making body within Federal Student Aid. Further, the Office of Inspector General conducts periodic audits of student aid programs and makes appropriate recommendations to management and the Congress.

Title I Programs

The Department performed a risk assessment of the *Elementary and Secondary Education Act* Title I Program, parts A, B, and D, during FY 2006. The *Erroneous Payments Risk Assessment Project Report* documented that the risk of improper payments under the current statutory requirements is very low. In order to validate the assessment data, the Department initiated a three-year review cycle in FY 2006. The review encompasses all states and territories receiving Title I funds. The Office of the Chief Financial Officer participated with the Office of Elementary and Secondary Education in the monitoring process, beginning March 2005, to provide technical support regarding fiduciary compliance. There were no findings in the monitoring reviews with questioned costs that contradicted the data in the risk assessment.

Manager Accountability. In FY 2006, the Department used a database of the Office of Management and Budget Circular A-133 single audit findings to provide feedback to program managers regarding the frequency and distribution of findings within their programs. This will assist the managers in tailoring their program monitoring efforts to the type of findings that most frequently occur. Additionally, a new grants monitoring training course is now offered and a post-audit follow-up overview course is currently being developed to improve the usefulness of the Office of Management and Budget Circular A-133 single audits to the Department.

The Department also plans to develop internal control training for managers that will focus on controls to eliminate improper payments. The mandatory one-day seminar for all Department managers will provide a framework for administering the improper payment controls program utilizing applicable regulations, guidelines, and best practices. Part of this one-day training will focus on the utilization of the risk assessment criteria to properly assess the risk of improper payments in the Department's programs.

Grant Program
Improper Payment Estimates

Functional Program	%			
	2001	**2002**	**2003**	**2004**
Education Research, Statistics & Assessment	0.00	0.02	0.36	0.0
Elementary & Secondary Education	0.13	0.12	0.13	0.6
English Language Acquisition	0.00	0.02	0.10	0.1
Higher Education	2.72	0.29	0.21	0.4
Impact Aid	0.00	0.55	0.04	0.4
Innovation and Improvement	0.28	0.21	0.23	0.1
Rehabilitation Services & Disability Research	0.07	0.12	0.32	2.1
Safe & Drug-Free Schools	0.37	0.33	0.13	1.2
Special Education	0.09	0.06	0.83	0.1
Title I	0.04	0.16	1.19	0.2
Vocational & Adult Education	0.20	0.25	0.12	0.2
Total	**0.06**	**0.04**	**0.16**	**0.4**

Remaining Grant Programs

During FY 2006, the Department instituted a more detailed risk assessment of all its other grant programs. The Department continued to work with the Department of Energy's Oak Ridge National Laboratory to perform data-mining on information available in the Federal Audit Clearinghouse's Single Audit Database, the Department's Grant Administration and Payment System, and the Department's Audit Accountability and Resolution Tracking System. The Department is leveraging the results of the thousands of single audits already being performed by independent auditors on grant recipients.

The Department sought to develop a methodology to produce statistically valid improper payment estimates that could be applied uniformly across non-Federal Student Aid grant programs. This approach establishes a level of quality control for all programs while simultaneously producing a cost-effective measure.

In FY 2006, the risk assessments were performed at the program level to ensure that improper payment error rates are not masked by large groupings or scope. The details of this analysis are available from the Office of the Chief Financial Officer upon request.

Recovery Auditing Progress

To effectively address the risk of improper administrative payments, the Department continued a recovery auditing initiative to review contract payments. All vendor payment transactions made from FY 1998 through FY 2005 were reviewed. Potential recoveries are minimal. Fiscal year 2006 payments will be reviewed during FY 2007. Our purchase and travel card programs remain subject to monthly reviews and reconciliations to identify potential misuse or abuse.

Other Matters

During the fiscal year, the Inspector General issued an audit report that questioned payments made to an entity that participates in the Federal Family Education Loan Program. The findings cited in this report are under consideration by the Department. Until the matter is resolved, the potential impact, if any, on the Department's financial position is not possible to estimate.

In addition, the Office of Inspector General has identified potential improper payments related to Migrant Education. The Migrant Education program is currently implementing compensating controls to correct or mitigate control weaknesses. These compensating controls are expected to be in place by December 31, 2007. In addition, the states are submitting new information related to eligibility based on appropriate controls. The Department has also received repayment from Puerto Rico in the amount of $13.6 million, with further repayments from other states anticipated over the next year.

With respect to the Reading First program, the Department is implementing corrective actions to address recommendations contained in the inspection report released September 29, 2006 by the Inspector General titled "*The Reading First Program's Grant Application Process*."

Summary

The Department of Education continues its efforts to comply with the *Improper Payments Information Act*. While there are still challenges to overcome, the Department has demonstrated in FY 2006 that it is committed to ensuring the integrity of its programs. The Office of Management and Budget recognized our progress in managing improper payments when it raised the Department's implementation progress score to green on the PMA initiative for Eliminating Improper Payments.

The Department is focused on identifying and managing the risk of improper payment problems and mitigating the risk with adequate control activities. In FY 2007, we will continue to work with the Office of Management and Budget and the Inspector General to explore additional methods for identifying and reducing potential improper payment activity in our programs, and to ensure continued compliance with the *IPIA*.

Performance Details

Performance Details Overview

The Department presents the key measures for each of the strategic goals, results, and Program Assessment Rating Tool reviews, where applicable. The Performance Details section provides an overview of the results for the key measures for each strategic goal.

Key Measures

For each strategic goal, the Department has selected key program measures that center around the desired outcomes. Each goal chapter provides specific details about the performance progress for each key measure.

How to Read This Report

Each chapter presents a description of the goal and objectives. Within the objective discussion is a table that describes the key measures, indicates the actual performance, and summarizes the results. The insert below describes the information that is presented for each key measure.

Explanation of Documentation for Key Measures

Table. Provides trend data including the latest reported data. Boldface entries represent data not previously reported in an annual performance report. Status row shows relationship between new actual values and targets as follows:

- *Exceeded* if the measure performance was better than the target.
- *Met* if the measure performance reached the target without exceeding it.
- *Made progress* if the measure performance was better than the prior reported data but fell short of the target.
- *Did not meet* if the measure performance fell short of the target and did not show progress.
- *Set baseline* if the Department collected data on the measure for the first time.

Source. Provides bibliographic information.

Analysis of Progress. Provides insights into the Department's progress, including explanations for unmet targets and actions being taken or planned.

Data Quality. Incorporates information such as the universe included in the measure; definitions; the way data were collected, calculated, and reviewed; data strengths and limitations; and plans for data quality improvement.

Target Context. Explains the rationale for targets, especially where anomalies exist.

Additional Information. Provides relevant background or other pertinent information about a measure.

Not all measures will have all data fields described above.

Program Assessment Rating Tool Analysis

The Program Assessment Rating Tool (PART) was developed and implemented by the Office of Management and Budget as a standardized process for determining program effectiveness in a consistent way across government agencies. Programs are assessed and receive scores on a scale of 0 to 100 in each of four weighted sections: program purpose and design (weighted 20 percent), strategic planning (10 percent), program management (20 percent), and program results and accountability (50 percent). Weighted scores are combined and translated into one of four ratings (effective, moderately effective, adequate, and ineffective); a rating of results not demonstrated is given if the program does not have agreed-upon performance measures or lacks baseline performance data. The Department has conducted 74 program reviews using the Program Assessment Rating Tool.

Programs

The Department administers 150 programs. Each program supports one of our strategic goals. In applicable goal chapters, a table provides a summary of each program's performance results for four years, its FY 2006 budget, and FY 2006 expenditures.

Methodology for Program Performance Summary

In keeping with the *Government Performance and Results Act*, the Department has established program-specific annual plans with measures and targets for the majority of the grant and loan programs and has provided the corresponding program performance reports in conjunction with the publication of the annual *Performance and Accountability Report*. Since 2002, these program performance plans and reports have been published on the Department's Web site at http://www.ed.gov/about/reports/annual/index.html?src=pn.

In the Program Performance Summary tables that are part of each goal chapter of this *FY 2006 Performance and Accountability Report*, we provide an overview of the performance results on the program measures for each of the past four years, from FY 2003 through FY 2006. For each year, we assess performance on the measures that were established for that year in the program's published plan and provide the percentage of measures whose targets were met (including exceeded), the percentage whose targets were not met, and the percentage for which we have no data.

The percentage with no data may include measures for which we were unable to collect data and measures with pending data. In some cases, the target was defined as the establishment of a baseline; this was necessary when *No Child Left Behind* created a new program environment and trend data were not available for many important concepts. In the case of these measures, if data were collected and a baseline established, then that measure was considered "met"; if we were unable to collect the data to establish the baseline, we counted that measure as "no data."

The tables also identify, by shading, those programs that did not have a performance plan for a particular year from FY 2003 through FY 2006.

The table includes the PART assessment rating for each program.

The full individual program performance reports for FY 2006 are available at http://www.ed.gov/about/reports/annual/2006report/program.html. The FY 2006 program performance reports also show the targets and actual values for prior years (except for measures that were discontinued prior to FY 2006).

Goal 1: Create a Culture of Achievement

Key Measures

The Department's first strategic goal is to create a culture of achievement in education. Achievement can only be determined if measures are identified and tracked, and accountability for results is required. Accountability for results is the foundation for the other five goals. We have not specified programs or funding streams directly supporting Goal 1—this goal is the foundation for all Department programs and activities. We have, however, identified 11 key measures that indicate our progress in meeting the objectives of Goal 1.

State Accountability Systems in Compliance

The *No Child Left Behind Act of 2001* placed specific requirements on state accountability systems, requirements designed to improve student achievement. The basic components of a state accountability system, as outlined in the law, are standards and assessments, goals of adequate yearly progress for schools and districts to have all students meet state standards, public school choice, supplemental services, and teacher quality.

The Department measured states' progress on implementing state accountability systems by calculating the number of states with approved assessment systems in reading and mathematics and the number of states that are field testing reading and mathematics assessments. In FY 2006, the Department added measures 1.1.C and 1.1.F, which address the number of states that have completed field testing for science and developed science assessments as required by *No Child Left Behind* by SY 2007–08.

1.1.A State Assessments. The number of states that have reading/language arts assessments that align with the state's academic content standards for all students in grades three through eight and in high school. [1201]

Fiscal Year	Actual
2004	0
2005	**0**
2006	**51**

Made progress in 2006
Target of 52 not met

1.1.B State Assessments. The number of states that have mathematics assessments that align with the state's academic content standards for all students in grades three through eight and in high school. [1202]

Fiscal Year	Actual
2004	0
2005	**0**
2006	**51**

Made progress in 2006
Target of 52 not met

1.1.C State Assessments. The number of states that have science assessments that align with the state's academic content standards for all students in grades three through eight and in high school. [1203]

Fiscal Year	Actual
2004	NA
2005	NA
2006	**0**

New measure in 2006
2006 data expected Dec. 2007

NA = Not applicable; measure is new.

Note. These measures refer to states with assessment systems that have been approved by the Department as meeting the requirements of *No Child Left Behind*.

U.S. Department of Education, Standards and Assessment External Peer Review Process, Title I review processes, staff recommendations, and decisions by the Secretary of Education.

Analysis of Progress. The Department did not meet established targets for the numbers of states that have approved reading/language arts and mathematics assessments at the requisite grade levels.

However, measures 1.1.A and 1.1.B showed significant improvement over FY 2005. Fifty-one states have been designated either fully approved, approved with recommendations, approval expected, or approval pending. One state is not approved.

States were required to have their reading/language arts and mathematics assessments in place by SY 2005–06. The state assessments for science are not required to be completed until the end of SY 2007–08 and no state has submitted a science assessment implementation plan at this time.

Data Quality. The universe for this measure is the 52 entities (50 states, the District of Columbia and Puerto Rico) that are required by *No Child Left Behind* to administer reading/language arts and mathematics assessments in grades three through eight and high school by SY 2005–06 and science assessments for grades three through eight and high school by SY 2007–08.

Target Context. The targets for these measures represent the 52 entities that are required to have their standards and assessments peer reviewed and approved. The 52 entities are required to have a science assessment plan in place by the end of SY 2007–08, and the target represents, for measure 1.1.C, the number of states that will have plans submitted and approved for FY 2006.

Additional Information. *No Child Left Behind* required state assessments for reading/language arts and mathematics to be implemented by SY 2005–06.

1.1.D State Assessments. The number of states that have completed field testing of the required assessments in reading/language arts. [1204]	
Fiscal Year	**Actual**
2003	16
2004	20
2005	47
2006	**52**
2006 target of 52 met	

1.1.E State Assessments. The number of states that have completed field testing of the required assessments in mathematics. [1205]	
Fiscal Year	**Actual**
2003	16
2004	20
2005	47
2006	**52**
2006 target of 52 met	

1.1.F State Assessments. The number of states that have completed field testing of the required assessments in science. [1206]	
Fiscal Year	**Actual**
2003	NA
2004	NA
2005	NA
2006	**26**
2006 target of 20 exceeded	

NA = Not applicable; measure not in place.

U.S. Department of Education, Consolidated State Performance Report, grantee submissions; state Web sites.

Analysis of Progress. The Department met the established targets for the numbers of states completing the field testing of reading/language arts and mathematics assessments. These measures were required for the completion of objectives 1.1.A and 1.1.B. This is the last year that measures 1.1.D and 1.1.E will be presented for reading/language arts and mathematics.

Measure 1.1.F requires that states complete field testing of the required assessments for science prior to the submission and approval of the state assessment plan. The target of 20 states completing field testing was exceeded in FY 2006. This measure will continue through FY 2008.

Data Quality. Fifty-two entities (50 states, the District of Columbia and Puerto Rico) are required by *No Child Left Behind* to have reading/language arts and mathematics assessments in grades three through eight and in high school by SY 2005–06. Each state developed a schedule by which its reading/language arts, mathematics and science assessments will be developed, field tested, and submitted to the Department for review and approval prior to implementation.

Target Context. The target of 52 was set for measures 1.1.D and 1.1.E with the knowledge that states were required by law to have standards and assessments for grades three through eight and high school by the end of SY 2005–06. The target of 20 states completing field testing for science was set based upon state schedules by which science assessments will be developed, field tested, and submitted to the Department for review and approval prior to implementation.

Additional Information. Field testing is one of the initial phases of establishing statewide reading/language arts, mathematics, and science assessments prior to the actual administration of the assessment. Field testing helps ensure the validity and reliability of test items and permits states to omit those test items that are deemed biased, too difficult, or too easy, thus affecting the rigor of the test.

Local Flexibility for Targeting Federal Funds

A collection of federal provisions gives states, school districts, and schools the authority to target identified federal program funds toward unique local education needs. These provisions include the following:

- Funding Transferability for State and Local Educational Agencies.
- State-Flexibility Demonstration Program.
- Local-Flexibility Demonstration Program.
- Rural Education Achievement Program.

States reported that in FY 2005 (the most recent year for which the Department has data), 4,780 local educational agencies were eligible to utilize the Rural Education Achievement Program flexibility authority, and 2,694 local educational agencies took advantage of the authority.

The Alternative Uses of Funds Authority under the Rural Education Achievement Program allows eligible local educational agencies the authority to combine funding under certain federal programs to carry out activities under other specified federal programs. Eligible districts are those that serve relatively small numbers of students and are located in rural areas (ESEA Section 6221(b)(1)).

The Department measured the use of flexibility authorities by collecting data on the percentage of eligible local educational agencies that used the Rural Education Achievement Program flexibility authority.

1.2.A Rural Education Program. The percentage of eligible school districts utilizing the Rural Education Achievement Program flexibility authority. [1473]

Fiscal Year	Actual
2003	61
2004	59
2005	**56**
2006	Target is 65
2005 target of 65 not met 2006 data expected Apr. 2007	

U.S. Department of Education, Consolidated State Performance Report, grantee submissions.

Analysis of Progress. The flexibility authority offered in the Rural Education Achievement Program has been available for five years. Approximately 60 percent of the 4,700 districts eligible to use this authority have done so according to the latest reports from the states. The Department has provided extensive information about the availability of this authority over the past five years and considers that 60 percent is close to the percentage of districts that need this authority to allocate resources effectively.

Data Quality. Department staff reviewed Consolidated State Performance Reports submitted by state educational agencies in spring 2006 for SY 2004–05.

Target Context. The expectation is that less than 100 percent of eligible districts would use the authority. This is a desired outcome because it reflects that the normal allocation of federal resources, without the Rural Education Achievement Program, meets districts' needs. Despite outreach, the Department has not seen an increase in the percentage of eligible school districts using the Rural Education Achievement program flexibility authority, suggesting that there does not appear to be an unmet need among the non-participating districts.

Customer Satisfaction With the Department

To measure how well the Department's products and services meet the needs of the people we serve, we conduct several customer satisfaction surveys. The Grantee Satisfaction Survey queries the chief state school officers and nine groups of state-level education leaders who direct federal programs in their states. The questionnaire includes general questions about the Department's performance in five areas: use of technology, online resources, documents, technical assistance provided by Department-funded providers, and technical assistance provided by Department staff. The questionnaire also includes custom questions for each grantee group. In the final section of the survey, respondents are asked to answer three culminating questions that provide the American Customer Satisfaction Index score. The index score allows the Department to benchmark customer satisfaction against that of businesses and other federal agencies.

Other major Department surveys include a biennial customer survey conducted by the National Center for Education Statistics and an annual survey conducted by Federal Student Aid. The results from the Federal Student Aid survey are reported in Goal 6, pp. 82-83, under Student Financial Assistance programs.

1.2.B The overall American Customer Satisfaction Index (ACSI) as scored by Department grantees. [2200]

Fiscal Year	Actual
2005	63
2006	**62**
2006 target of 64 not met	

U.S. Department of Education, Grantee Satisfaction Survey.

Analysis of Progress. For perspective on how to interpret the Department's American Customer Satisfaction Index score of 62, it is notable that the most recent average score for federal agencies was 71. It is important to note that federal agencies that serve grantees or interact in a regulatory role typically score in the low 60s. A score of 62, while below the federal agency average, is on a par with the typical scores of comparable grant-making agencies. The scores of grant-making agencies range from the high 50s to the low 60s. In response to survey results, Department program offices that participated in the survey identified areas of greatest impact, which will guide their direction for making improvements.

Data Quality. The CFI Group, under contract to the Department, conducted the 2006 survey using the methodology of the American Customer Satisfaction Index. The index was developed by the University of Michigan Business School, the CFI Group, and the American Society for Quality and meets their standards for data quality. The CFI Group reports business and federal agency customer satisfaction indices quarterly in major news outlets, which allows for standardization of customer satisfaction information.

Grantee Satisfaction Survey respondents included the chief state school officers and the state-level directors and coordinators of the Early Intervention, Special Education, Education Data Exchange Network, Career and Technical Education, Adult Education and Literacy, English Language Acquisition (Title III), Improving the Academic Achievement for Disadvantaged Students Grants to Local Educational Agencies (Title I), and Educational Technology programs. The survey was e-mailed to 571 potential respondents; the response rate was 70 percent.

Target Context. The FY 2006 actual value of 62 is the American Customer Satisfaction Index score reported by our revised customer survey. It is not a percentage; rather, the score is best thought of as a weighted scale based on multiple responses to questions in the survey. Survey scores are indexed on a 100-point scale. Agencies that score in the 80s are ranked as world class.

Expansion of Choice Options for Parents

Parents of public school children who attend a Title I school that has been designated by the state to be in need of improvement have choices under the provisions of *No Child Left Behind*. They may send their child to another public school in the district, and, if the school's status remains "in need of improvement" for more than one year, families whose children stay in the home school may enroll their children in supplemental educational services (tutoring). Parents' options within the public school system have also increased with the growing numbers of public charter schools that create alternatives to the traditional public school.

Department data collected from the Center for Education Reform indicate that the number of charter schools in operation around the nation has increased 8 percent, from 3,344 in September 2005 to 3,997 in 2006. To help inform parents, the Department created a listserv whereby interested parents can automatically receive periodic notification of relevant charter school information posted on the Department's Web site, www.ed.gov.

As of May 2006, state lists posted online include 3,168 approved supplemental service providers, compared to 2,734 in May 2005. The number of students nationwide receiving services under the Supplemental Educational Services program grew from 245,267 in SY 2003–04 to 430,044 in SY 2004–05. In a May 15, 2006, letter to all chief state school officers, the Secretary directed states to help their districts become fully compliant with supplemental educational services in SY 2006–07 through monitoring and the provision of technical assistance.

Additionally, the Department has assigned to the Comprehensive Center on Innovation and Improvement the task of developing a technical assistance effort to respond to the needs of states, districts, and community-based organizations on supplemental education services issues. The center will be implementing this effort in sites around the country during SY 2006–07. During its meeting with state supplemental educational services directors in October 2006, the Department disseminated promising practices including information on successful state actions that ensure a diversity of providers and successful partnerships between districts, schools, and providers.

1.3.A Charter Schools Grants. The number of charter schools in operation. [1146]

Fiscal Year	Actual
1996	255
1997	428
1998	790
1999	1,100
2000	1,700
2001	2,110
2002	2,431
2003	2,700
2004	2,996
2005	3,344
2006	**3,997**
2006 target of 3,600 exceeded	

Center for Education Reform, Annual Survey of America's Charter Schools.

Analysis of Progress. The number of charter schools increased at a rate of approximately 20 percent, surpassing Department expectations. The Department's Charter Schools Grants program will continue to increase national awareness of the charter schools model by funding national leadership activities that result in the dissemination of successful charter schools practices and policies.

Data Quality. Data are verified by Department program staff through on-site monitoring, data from the Center for Education Reform, technical assistance activities, and reviews of the Government Accountability Office and Office of Inspector General reports.

There are substantial differences in the definition of charter schools among states. Some states count a single charter with multiple sites as a single charter school, while other states count a single charter with multiple sites as multiple charter schools, causing variability in the counts reported by state educational agencies. Reported data are based on each state's definition of charter schools.

Target Context. Targets are set based on previous growth trends, which have averaged 10 percent per year over the last five years. The Education Commission of the States compiles statistics, policy reviews, and case studies on charter schools as part of its public education issues data collection.

Additional Information. Growth in the number of charter schools is largely under the control of state legislatures, which maintain the authority to pass laws authorizing the creation and regulation of charter schools. While some states have reached capacity in terms of the number of charter schools allowed by their laws, other states have amended their statutes to allow for multiple authorizers and, therefore, greater flexibility. In addition, some states have used *No Child Left Behind* provisions that allow local educational agencies to convert low-performing Title I schools into charter schools.

1.3.B Credit Enhancement for Charter School Facilities. The amount of funding grantees leverage for the acquisition, construction, or renovation of charter school facilities. [1208]

Fiscal Year	Actual
2003	$66 million
2004	$74 million
2005	**$109 million**
2006	**Target is $100 million**
2005 target of $100 million exceeded Data for 2006 are expected Feb. 2007	

U.S. Department of Education, Credit Enhancement for Charter School Facilities Program Performance Reports.

Analysis of Progress. The Credit Enhancement for Charter School Facilities program helps charter schools with their facility needs typically by guaranteeing debt and some leases used to obtain their facilities. The program, which first issued grants in 2002, reported leveraging $140 million in debt and leases as of the end of FY 2004. The total amount leveraged will be much greater over the 5- to 20-year lifespan of the grants.

Data Quality. Data are self-reported annually by grantees. Department program staff verifies these data during site visits to grantees and to the schools that grantees serve. The number of dollars leveraged consists of the dollar amount raised as a direct result of the guarantee.

Some grantees under the Credit Enhancement program have loan pools through which they work with a number of lenders to raise a given amount of funds for charter school facility loans. If the grantee received a non-Department of Education grant (such as a New Markets Tax Credit allocation[1]) and is using it to provide additional leveraging for a school served by the federal grant, such leveraging may also be counted as funds leveraged by the federal grant. A grantee may count senior debt toward the total amount of funds leveraged if it uses grant funds to guarantee or insure subordinate debt. Likewise, grantees may count subordinate debt toward the total amount of funds leveraged if they only use grant funds to credit-enhance senior debt.

The Department originally computed the dollars pledged by lenders as the amount of dollars leveraged in the year the loan pool closed. After learning that these pledges have contingencies, the Department revised the methodology to reflect only the funds in loans that have closed. Trend data shown in the table reflect this revised approach.

Target Context. The Department modified the FY 2005 target to be more realistic based on the updated methodology.

Additional Information. Grantees for this program receive multiyear funding at the beginning of the first project period. The federal funds and earnings on those funds remain available until they have been expended for the grant's purposes or until financing facilitated by the grant has been retired, whichever is later. Most of the Department's grantees are required to report midyear performance data to qualify for continuation awards, but, because there are no continuation awards for this program, we allow these grantees to report after the end of each fiscal year to give them a full year of performance before reporting data.

Evidence-Based Approaches to Instruction

The *No Child Left Behind* goal—all students proficient in reading and mathematics by SY 2013–14—has the best chance of being met if classroom instruction is built around what works. The What Works Clearinghouse (WWC) was established in 2002 by the Department's Institute of Education Sciences to provide educators, policymakers, researchers, and the public with a central and trusted source of scientific evidence of what works in education. The WWC can be found at http://www.whatworks.ed.gov.

The WWC provides education consumers with high-quality reviews of the effectiveness of educational interventions (programs, products, practices, and policies) that are designed to improve student outcomes. The WWC promotes informed education decision-making through a set of easily accessible databases and user-friendly reports that provide education consumers with high-quality reviews of the effectiveness of replicable educational interventions. To do this, the WWC uses standards for reviewing and synthesizing research. The WWC is currently conducting systematic reviews of existing research, and producing intervention and topic reports. Topics being explored include character education, dropout prevention, early childhood education, English language learning, and mathematics and reading interventions.

[1] The U.S. Treasury Department provides New Markets Tax Credits on a competitive basis. These tax credits are used to attract development in low-income communities. The credit provided to the investor totals 39 percent of the cost of the investment and is claimed over a seven-year credit allowance period. In each of the first three years, the investor receives a credit equal to 5 percent of the total amount paid for the stock or capital interest at the time of purchase. For the final four years, the value of the credit is 6 percent annually. Investors may not redeem their investments prior to the conclusion of the seven-year period.

1.4.A The proportion of school-adopted approaches that have strong evidence of effectiveness compared to programs and interventions without such evidence. [2201]	
Fiscal Year	**Actual**
2006	**Establish Baseline**
2006 data expected Dec. 2007	

U.S. Department of Education, Institute of Education Sciences, National Center for Education Research survey.

Analysis of Progress. Data on the use of evidence-based interventions cannot be collected until the clearinghouse has released more information on such interventions. To date, information is available only on middle school mathematics programs. The Department intends to retain this measure and will collect data when more information is available to schools about a range of evidence-based approaches.

Discontinued Strategic Measures

The following measure was discontinued after FY 2004, but was reported as pending in the *FY 2005 Performance and Accountability Report*. The latest data are reported below.

Measure		Fiscal Year	Target	Actual	Status
1.3.3	Of eligible children, the percentage using supplemental educational services under the provisions of *ESEA* Title I	2003	Set baseline	7%	Target met Baseline set
		2004	Baseline + 5 PP	19%	Exceeded target

PP = percentage point

Sources

1.3.3 U.S. Department of Education, *Evaluation of Title I Accountability and School Improvement Efforts (TASSIE): Findings From 2002–2003 and 2003–2004.*

Goal 2: Improve Student Achievement

Key Measures

Improving student proficiency and closing the achievement gap are the cornerstones of the Department's work. In FY 2006, the Department administered 74 distinct programs that supported Goal 2, Improve Student Achievement. From the universe of measures that help determine these programs' effectiveness, the Department identified 11 key measures to report our progress. Results on these key measures are shown below.

See p. 30 for an explanation of the documentation fields for the key measures.

Reading Achievement

Research shows that students who fail to read well by the fourth grade have a greater likelihood of dropping out of school and diminished life opportunities. Providing consistent support for reading success from the earliest age has critically important benefits. As of FY 2006, $5.3 billion has been expended on national reading initiatives. These funds provide assistance to support local efforts through competitive grants that enhance the school readiness of young children. Additional federal support for reading instruction goes to states through the large formula grants for disadvantaged students (Title I Grants to Local Educational Agencies), for special education (Special Education Grants to States), and for vocational education (Vocational Education State Grants).

2.1.A Title I Grants to Local Educational Agencies. The number of states reporting an increase in the percentage of fourth-grade low-income students meeting state performance standards by scoring at or above proficient on state assessments in reading/language arts. [1066]

Fiscal Year	Actual
2004	25
2005	**22**
2006	**Target is 25**

2005 target of 25 not met
2006 data expected Aug. 2007

U.S. Department of Education, Consolidated State Performance Report.

2.1.B Special Education Grants to States. The number of states reporting an increase in the percentage of fourth-grade students with disabilities meeting state performance standards by scoring at or above proficient on state assessments in reading. [1519]

Fiscal Year	Actual
2004	24
2005	**13**
2006	**Target is 25**

2005 target of 25 not met
2006 data expected Aug. 2007

U.S. Department of Education, Consolidated State Performance Report.

Analysis of Progress. For measure 2.1.A, 22 out of the 34 states that tested fourth-grade students in reading/language arts in both 2004 and 2005 reported an increase in the percentage of these students scoring proficient or above on state assessments in reading/language arts. Although the target of 25 was just missed, the difference between the target and the actual is in part a reflection of the fact that only 34 states tested fourth-graders in this subject both years. A solid majority of the 34 states that did test both years showed increases.

Measure 2.1.B shows that there was a significant decrease in the number of states reporting an increase in the percentage of fourth-grade students with disabilities scoring at or above proficient on state assessments in reading/language arts. Although the target of 25 was not met, the difference between the target and the actual is in part a reflection of the fact that only 34 states tested fourth-graders in this subject both years. A solid majority of the 34 states that did test both years showed increases.

This measure parallels the measure for Title I Grants to Local Educational Agencies program (2.1.A) under the *Elementary and Secondary Education Act*. The Department has proposed regulations to provide flexibility to states to include in the calculations of the "proficient" scores of students with the most significant cognitive disabilities those who take assessments based on alternate achievement standards. Additional regulations have been proposed that would allow some children with disabilities to be proficient based on modified achievement standards.

Beginning in FY 2007 the reading/language arts measures will change from single state level indicators to student level indicators for each measure.

Data Quality. Data are self-reported by grantees.

Target Context. The FY 2006 targets were set prior to the receipt of data. The universe for these measures is 52 entities (50 states, the District of Columbia, and Puerto Rico) that are required by *No Child Left Behind* to administer reading/language arts assessments in grades 3 through 8.

Additional information. Prior to the 2005-2006 school year, states only had to test one time during grades three through five and one time during grades six through nine, which is why there is not consistently two years of data across all states for these indicators.

2.1.C English Language Acquisition. The number of states that met the target for attainment of English language proficiency. [1830]

Fiscal Year	Actual
2005	**23**
2006	**Target is 29**
New measure in 2006 2006 data expected Jan. 2007	

U.S. Department of Education, Consolidated State Performance Report and Office of English Language Acquisition Title III Biennial Evaluation Reports.

Analysis of Progress. New key measure for FY 2006.

Data Quality. Data are self-reported by grantees.

Additional Information. Baseline data reflect partial state data from the 2005 Consolidated State Performance Report. Beginning in FY 2007, data will be available through ED*Facts*.

Mathematics Achievement

American students' performance on international mathematics assessments provides a compelling rationale for intensive, targeted initiatives designed to strengthen the mathematics skills of our students. Results from the 2003 Program for International Student Assessment suggest that American high school students continue to lag behind students in other countries in mathematics, and the gap in mathematics learning between American students and students in other countries is widening.

On the Program for International Student Assessment, the United States 15-year-old students scored lower than 20 other countries belonging to the Organization for Economic Cooperation and Development.

To raise the number of highly qualified teachers in mathematics and science, and to increase the number of students reaching proficiency in these subjects, school districts use federal resources from the Mathematics and Science Partnership program. The program connects university professors, business leaders, and staff from nonprofit or for-profit organizations with educators from high-need school districts to improve science and mathematics learning. The results from a descriptive analysis of successful applications to the program indicate that this partnership program is on track in meeting its goals.

Highlights of the descriptive analysis show 90 percent of the partnership projects link content to state mathematics and science standards. Ninety-two percent offer teachers summer institutes with an average of 64 hours of instruction and 48 hours of follow-up instruction. Two-thirds administer content knowledge tests to teachers, conduct observations, and make pretest and posttest comparisons, and 92.2 percent include partnerships with professors from mathematics or science departments in key planning or oversight roles. The preliminary evaluation pointed to one potential problem area for many of the projects: the quality of project evaluation plans. In response to this finding, the Department enlisted the Coalition for Evidence-Based Policy to produce “How to Solicit Rigorous Evaluations of Mathematics and Science Partnerships Projects” for state coordinators of the programs.

2.2.A Title I Grants to Local Education Agencies. The number of states reporting an increase in the percentage of eighth-grade low-income students meeting state performance standards by scoring proficient or above on state assessments in mathematics. [1067]

Fiscal Year	Actual
2004	30
2005	**30**
2006	**Target is 25**

2005 target of 25 exceeded
2006 data expected Aug. 2007

U.S. Department of Education, Consolidated State Performance Report.

2.2.B Special Education Grants to States. The number of states reporting an increase in the percentage of eighth-grade students with disabilities meeting state performance standards by scoring at or above proficient on state assessments in mathematics. [1520]

Fiscal Year	Actual
2004	26
2005	**32**
2006	**Target is 25**

2005 target of 25 exceeded
2006 data expected Aug. 2007

U.S. Department of Education, Consolidated State Performance Report.

Analysis of Progress. For measure 2.2.A, 30 out of the 42 states that tested eighth-grade students in mathematics in both 2004 and 2005 reported an increase in the percentage of these students scoring proficient or above on state assessments in mathematics. The target of 25 was exceeded, despite the fact that only 42 States tested 8th graders in this subject both years.

The target for measure 2.2.B was exceeded. The number of states reporting increases in proficiency shows positive movement. More states reported that students with disabilities were achieving at or above proficient than had reported the previous year. This measure parallels a measure for the Title I Grants to Local Educational Agencies program (2.2.B) under the *Elementary and Secondary Education Act*. The Department has provided flexibility to states to include in the calculations of the "proficient" scores of students with the most significant cognitive disabilities those who take assessments based on alternate achievement standards.

Also, beginning next year the mathematics measures will change from single state level indicators to student level indicators for each measurement.

Data Quality. Data are self-reported by grantees.

Target Context. The FY 2006 targets were set prior to the receipt of data. The universe for these measures is 52 entities (50 states, the District of Columbia, and Puerto Rico) that are required by *No Child Left Behind* to administer mathematics assessments in grades 3 through 8.

Additional information. Prior to the 2005-2006 school year, states only had to test one time during grades three through five and one time during grades six through nine, which is why there is not consistently two years of data across all States for these indicators. The number of states reporting an increase is continuing to slowly increase.

High School Completion

There is a consensus for high school reform among governors, business leaders, for-profit and nonprofit leaders, and the Department. This reform must start with an honest calculation of graduation rates.

Accurate graduation rates are crucial to meeting the requirements of *No Child Left Behind*. States are required to set high school graduation rate targets as one indicator for measuring a high school's progress.

One of the major complications for states in accurately calculating high school graduation rates is the lack of a comprehensive data collection system that tracks students over time. Until states have the capacity to collect these data, the Department has committed to publishing two sets of state graduation rates: state-reported rates and standardized rates prepared by the Department. According to a Government Accountability Office report, as of July 2005, 12 states used a graduation rate definition referred to as the cohort definition, which tracks students from when they enter high school to when they leave. Thirty-two states used a definition based primarily on the number of dropouts over a four-year period and the number of graduates. For its calculation, the Department uses enrollment and other data found in the Common Core of Data at the National Center for Education Statistics.

Additional effort to reform our nation's high schools is evident in the Department's initiative to support formula grants to state educational agencies that reserve a portion of the funds to support the development of additional reading/language arts and mathematics assessments as part of their state assessment systems. States award the remaining funds competitively to local educational agencies to implement targeted interventions in high-need secondary schools to increase student achievement and narrow achievement gaps.

2.3.A Special Education Grants to States. The percentage of students with disabilities that graduate from high school with a regular high school diploma. [1527]	
Fiscal Year	**Actual**
1996	42
1997	43
1998	45
1999	47
2000	46
2001	48
2002	51
2003	52
2004	54
2005	**54**
2006	**Target is 56**
2005 target of 54 met 2006 data expected Aug. 2007	

U.S. Department of Education, Office of Special Education and Rehabilitative Services, Office of Special Education Programs, section 618 state-reported data.

Analysis of Progress. The nation is continuing to make steady progress ensuring that students with disabilities graduate from high school at increasing rates within the mainstream curriculum.

Data Quality. Data are self-reported by grantees.

Target Context. The graduation rate is calculated by dividing the number of students aged 14 and older with disabilities who graduated with a regular diploma by the total number of students with disabilities in the same age group who graduate with a regular diploma, receive a certificate of completion, reach the maximum age for services, die, drop out, or move and are not known to have continued in education.

Additional Information. This includes calculations for 57 entities (50 states, the District of Columbia, Puerto Rico, Guam, American Samoa, the Virgin Islands, Northern Marianas and the Bureau of Indian Affairs).

2.3.B Special Education Grants to States. The percentage of students with disabilities who drop out of school. [1528]	
Fiscal Year	**Actual**
1996	47
1997	46
1998	44
1999	42
2000	42
2001	41
2002	38
2003	34
2004	31
2005	**28**
2006	**Target is 29**
2005 target of 34 exceeded 2006 data expected Aug. 2007	

U.S. Department of Education, Office of Special Education and Rehabilitative Services, Office of Special Education Programs, section 618 state-reported data.

Analysis of Progress. The FY 2005 target of 34 was exceeded. Dropout rates for students with disabilities continue to decline proportionally with the increase in graduation rates.

Data Quality. Data are self-reported by grantees.

Target Context. The dropout rate is calculated by dividing the number of students aged 14 and older with disabilities who dropped out or moved and are not known to have continued in education by the total number of students with disabilities in the same age group who graduate with a regular diploma, receive a certificate of completion, reach the maximum age for services, die, drop out, or move and are not known to have continued in education.

Additional Information. This includes calculations for 57 entities (50 states, the District of Columbia, Puerto Rico, Guam, American Samoa, Virgin Islands, Northern Marianas and the Bureau of Indian Affairs).

Advanced Placement Participation

Enrollment in Advanced Placement courses has nearly tripled over the past decade. Participation by minority and low-income students has increased, but an access gap continues. According to the College Board, the number of students from low-income families who took the Board's Advanced Placement exams increased more than 13 percent between 2004 and 2005. However, participation in advanced placement programs is still highly correlated with family income. In 2005, only 12 percent of all students who took Advanced Placement exams were from low-income families.

Some minority groups continue to be underrepresented among students who take Advanced Placement exams. According to the College Board, African American students make up 13.4 percent of the nation's student population but only 6.4 percent take Advanced Placement exams. Hispanic students represent 13.4 percent of the nation's student population and 13.6 percent of the students who take Advanced Placement exams. However, Hispanic students take approximately 53 percent of Advanced Placement Spanish Language exams and 77 percent of the Advanced Placement Spanish Literature exams.

Participation in advanced placement programs for low-income and minority students is associated with higher levels of postsecondary enrollment and completion. In his 2006 study, *The Toolbox Revisited*, Clifford Adelman found that participation in a challenging curriculum is related to students' completion of a college degree. Advanced Placement courses strengthen the high school curriculum and hold students to high standards of achievement.

The focus on the learning of foreign languages is in line with the National Security Language Initiative, and efforts to increase challenging coursework in mathematics and science are critical to increased national security and America's success in the global economy.

2.3.C Advanced Placement. The number of Advanced Placement tests taken by low-income public school students nationally. [1149]

Fiscal Year	Actual
1999	87,149
2000	92,083
2001	105,138
2002	132,459
2003	157,334
2004	187,691
2005	**223,263**
2006	**Target is 209,411**
New measure for 2006 2006 data expected Jan. 2007	

Fee Reduction Summary Report.

Analysis of Progress. New key measure for FY 2006. This measure was adjusted to focus on public school students. Prior year data included data for public and non-public school students. The measure now aligns with the population served by the program. Prior year data are provided for historical purposes.

Data Quality. The Fee Reduction Summary Report is a year-end accounting file that provides a final count of Advanced Placement test fee reductions granted. Test fee reductions are provided to students with acute need.

Target Context. The FY 2006 target was established based on public and non-public school data. Targets for FY 2007 and forward are calculated based on the previous year's target plus ten percent.

Teacher Quality

The Department continues to work with states and school districts to ensure that all teachers are highly qualified, especially in core academic subjects. Monitoring visits to states indicate that states have made changes to their certification requirements. These changes include requiring more content knowledge, having teacher candidates pass written examinations, encouraging alternative certification programs, requiring teacher preparation institutions to improve their programs, requiring secondary school teachers to have a major in the subjects they teach, and implementing incentive systems to attract and retain highly qualified teachers.

Many local educational agencies had difficulty ensuring their special education and secondary mathematics and science teachers were highly qualified. In spring 2006, the Department reviewed states' progress in meeting the highly qualified teacher requirement and requested states to submit revised plans for reaching the requirement of having all teachers highly qualified by the end of SY 2006–07. *No Child Left Behind* requires that all public school teachers of core academic subjects meet the qualifications outlined in the definition by the end of SY 2005–06.

For the first time, the Congress legislated the goal that teachers in every core academic class have a bachelor's degree, have a state license or a certificate, and be competent in the subjects they teach. In addition, the recently reauthorized *Individuals with Disabilities Education Act* addresses teacher qualification and requires all special educators who teach core academic subjects to be highly qualified. Resources provided states to meet the goal of a "highly qualified teacher" in every core academic class include major funding from the $3 billion Improving Teacher Quality State Grants and the $68 million Teacher Quality Enhancement programs.

2.4.A Improving Teacher Quality State Grants. The percentage of core academic classes in high-poverty schools taught by highly qualified teachers. [1180]

Fiscal Year	Actual
2003	74
2004	**86**
2005	**90**
2006	**Target is 95**

2004 actual updated
2005 target of 90 met
2006 data expected Dec. 2007

2.4.B Improving Teacher Quality State Grants. The percentage of core academic classes in elementary schools taught by highly qualified teachers. [1182]

Fiscal Year	Actual
2003	85
2004	**91**
2005	**93**
2006	**Target is 95**

2004 actual updated
2005 target of 90 exceeded
2006 data expected Dec. 2007

2.4.C Improving Teacher Quality State Grants. The percentage of core academic classes in secondary schools taught by highly qualified teachers. [1183]

Fiscal Year	Actual
2003	80
2004	**88**
2005	**89**
2006	**Target is 92**

2004 actual updated
2005 target of 85 exceeded
2006 data expected Dec. 2007

U.S. Department of Education, Consolidated State Performance Report, grantee submissions.

Analysis of Progress. The data reported through the *Consolidated State Performance Report* show that states are about 90 percent of the way toward having all classes taught by highly qualified teachers.

Data Quality. During monitoring visits to states over the past three years, the Department found that many states were confused about the definition of "highly qualified teacher", particularly for special education teachers; therefore, previous years' data may not have been entirely accurate. Most states are now using the correct definition, and data are now considered to be generally accurate.

Discontinued Strategic Measures

The following measures were discontinued after FY 2005 but were reported as pending in the *FY 2005 Performance and Accountability Report*. The latest data are reported below.

Measure			Fiscal Year Discontinued	Target	Actual	Status
2.3.20–2.3.22	The percentage of 18- to 24-year-olds who have completed high school.	All Students	**2004**	87.5	87.5	Target met
		African American Students	**2004**	85.5	83	Target not met
		Hispanic American Students	**2004**	69.0	70	Target met
2.14	Vocational Education State Grants. The percentage of vocational concentrators meeting state-established academic standards.		**2005**	77	78	Exceeded target
2.19	The percentage of program completers who are highly qualified teachers.		**2005**	80	95	Exceeded target

Sources and Notes

2.3.20–2.3.22 Federal Interagency Forum on Child and Family Statistics, *America's Children: Key National Indicators of Well-Being, 2005.*

Previously reported FY 2002 data were estimated and preliminary. Final data were 87.3 percent (all students), 84.8 percent (African Americans), and 67.9 percent (Hispanic Americans)**.**

2.14 U.S. Department of Education, Office of Vocational and Adult Education, Vocational Technical Education Annual Performance and Financial Report.

2.19 U.S. Department of Education, Office of Postsecondary Education, Teacher Quality Enhancement Program Performance Report.

Goal 2: Improve Student Achievement
Program Performance Summary

Seventy-four of our grant programs most directly support Goal 2. These programs are listed below. In the table, an overview is provided for the results of each program on its program performance measures. (See p. 31 for the methodology of calculating the percentage of targets met, not met, and without data.) Individual program performance reports are available at http://www.ed.gov/about/reports/annual/2006report/program.html. Appropriation and expenditure data for FY 2006 are included for each of these programs.

Program Name	PART Rating	Appro-pria-tions†	Expen-ditures ‡	Program Performance Results Percent of Targets Met, Not Met, Without Data											
				FY 2006			FY 2005			FY 2004			FY 2003		
		FY 2006 $ in millions	FY 2006 $ in millions	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data
APEB: American Printing House for the Blind	RND	18	19	38	54	8	60	40	0	100	0	0	100	0	0
CFAA: Supplemental Education Grants	NA	18	16							/// (not funded)			/// (not funded)		
CRA: Training and Advisory Services	RND	7	7	100	0	0	0	100	0	0	0	100	0	0	100
ESEA: 21st Century Community Learning Centers	A	981	838	0	0	100	0	100	0	45	55	0	38	62	0
ESEA: Advanced Credentialing	NA	17	0	100	0	0	100	0	0	100	0	0			
ESEA: Advanced Placement	ME	32	29	40	20	40	0	0	100	100	0	0	100	0	0
ESEA: Alaska Native Education Equity	NA	34	33	33	67	0	100	0	0	0	100	0			
ESEA: Arts In Education	NA	35	38	0	0	100	0	0	100						
ESEA: Charter Schools Grants	A	215	187	25	13	62	50	50	0	0	100	0	0	100	0
ESEA: Civic Education: Cooperative Education Exchange	NA	12	13				100	0	0						
ESEA: Comprehensive School Reform	A	8	238	0	0	100	0	0	100	0	0	100	0	0	100
ESEA: Credit Enhancement for Charter School Facilities	NA	37	33	0	0	100	100	0	0	50	50	0	///		
ESEA: Dropout Prevention Programs	NA	5	3												
ESEA: Early Childhood Educator Professional Development	NA	15	12	0	0	100	0	67	33	67	33	0			

Program Name	PART Rating	Appro-pria-tions† FY 2006 $ in millions	Expen-ditures ‡ FY 2006 $ in millions	Program Performance Results Percent of Targets Met, Not Met, Without Data: FY 2006 % Met	FY 2006 % Not Met	FY 2006 % No Data	FY 2005 % Met	FY 2005 % Not Met	FY 2005 % No Data	FY 2004 % Met	FY 2004 % Not Met	FY 2004 % No Data	FY 2003 % Met	FY 2003 % Not Met	FY 2003 % No Data
ESEA: Early Reading First	NA	103	89	0	0	100	100	0	0	100	0	0	///		
ESEA: Education for Native Hawaiians	NA	34	34	0	0	100	100	0	0	0	100	0			
ESEA: Educational Technology State Grants	RND	272	552	0	0	100	0	0	100	0	0	100	0	100	0
ESEA: English Language Acquisition	NA	669	647	0	0	100	60	0	40	20	0	80	30	0	70
ESEA: Even Start	I	99	226	0	0	100	20	80	0	50	50	0	50	0	50
ESEA: Excellence in Economic Education	NA	2	1	0	0	100	0	0	100				/// (not funded)		
ESEA: Foreign Language Assistance	NA	22	16	0	0	100	100	0	0						
ESEA: Fund for the Improvement of Education Programs of National Significance	NA	12	228												
ESEA: Impact Aid Basic Support Payments	RND	1,092	989	50	50	0	100	0	0	100	0	0	100	0	0
ESEA: Impact Aid Payments for Children with Disabilities	RND	49	42	0	50	50									
ESEA: Impact Aid Construction	A	18	40	0	0	100	0	100	0	0	100	0	0	100	0
ESEA: Impact Aid Facilities Maintenance	NA	5	4												
ESEA: Impact Aid Payments for Federal Property	RND	64	70	0	50	50									
ESEA: Improving Teacher Quality State Grants	ME	2,887	2,711	0	0	100	80	20	0	100	0	0	100	0	0
ESEA: Indian Education Grants to Local Educational Agencies	NA	95	82				25	75	0	0	0	100	0	67	33
ESEA: Javits Gifted and Talented Education	NA	10	12	0	0	100	100	0	0						
ESEA: Literacy Through School Libraries	NA	19	20	0	0	100	0	50	50	50	50	0			
ESEA: Magnet Schools Assistance	A	107	108	0	0	100	0	0	100	0	0	100	0	0	100
ESEA: Mathematics and Science Partnerships	NA	182	142	0	0	100	0	0	100	50	50	0	/// (program reconfigured)		
ESEA: Migrant State Agency Program	NA	387	406	0	0	100	0	0	100	17	33	50	88	13	0
ESEA: National Writing Project	RND	22	20	0	0	100	0	0	100	0	100	0			

Program Name	PART Rating	Appro-pria-tions†	Expen-ditures ‡	Program Performance Results Percent of Targets Met, Not Met, Without Data											
				FY 2006			FY 2005			FY 2004			FY 2003		
		FY 2006 $ in millions	FY 2006 $ in millions	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data
ESEA: Neglected and Delinquent State Agency Program	RND	50	73	0	0	100	100	0	0	0	100	0	75	0	25
ESEA: Parental Information and Resource Centers	RND	40	40	0	0	100	100	0	0	100	0	0	0	0	100
ESEA: Reading First State Grants	NA	1,029	1,057	0	0	100	0	0	0				11	11	78
ESEA: Reading Is Fundamental/ Inexpensive Book Distribution	NA	25	24	0	0	100	0	100	0	0	100	0	100	0	0
ESEA: Ready to Teach	NA	11	9	0	0	100	0	0	100	0	0	100			
ESEA: Ready-to-Learn Television	RND	24	23	0	0	100	50	25	25	0	0	100	0	0	100
ESEA: Rural Education	NA	169	170	0	0	100	67	33	0	0	100	0	100	0	0
ESEA: School Leadership	NA	15	14	0	0	100	0	0	100	100	0	0			
ESEA: Smaller Learning Communities	RND	94	120	0	0	100	0	0	100	33	67	0	0	100	0
ESEA: Special Programs for Indian Children	NA	19	21	0	0	100	0	0	100	0	0	100			
ESEA: Star Schools Program	NA	15	16	0	0	100									
ESEA: State Assessments	A	408	417	50	33	17	40	60	0	0	100	0	0	0	100
ESEA: State Grants for Innovative Programs	RND	99	229	0	0	100	75	25	0	50	50	0	100	0	0
ESEA: Striving Readers	NA	30	4				///			/// (not funded)			/// (not funded)		
ESEA: Teaching American History	RND	122	100	0	0	100	0	0	100	0	0	100	0	0	100
ESEA: Title I Grants to Local Educational Agencies	NA	12,713	12,597	0	0	100	33	67	0	25	0	75	100	0	0
ESEA: Transition to Teaching	A	44	42	0	0	100	0	100	0	0	100	0	50	0	50
ESEA: Troops-to-Teachers	A	15	16	0	0	100	100	0	0	100	0	0	100	0	0
ESEA: Voluntary Public School Choice	NA	26	29	0	0	100	100	0	0	0	0	100	100	0	0
ESEA: Women's Educational Equity	NA	3	3	0	0	100	0	0	100						
ESRA: Comprehensive Centers	RND	56	31	0	0	100	///			/// (not funded)			/// (not funded)		

Program Name	PART Rating	Appro-pria-tions† FY 2006 $ in millions	Expen-ditures ‡ FY 2006 $ in millions	Program Performance Results: Percent of Targets Met, Not Met, Without Data — FY 2006 % Met	FY 2006 % Not Met	FY 2006 % No Data	FY 2005 % Met	FY 2005 % Not Met	FY 2005 % No Data	FY 2004 % Met	FY 2004 % Not Met	FY 2004 % No Data	FY 2003 % Met	FY 2003 % Not Met	FY 2003 % No Data
ESRA: National Assessment	E	88	51	(off year for collection)			100	0	0	(off year for collection)			0	100	0
ESRA: Regional Educational Laboratories	NA	66	18	0	0	100	0	0	100	0	0	100	100	0	0
ESRA: Statewide Data Systems	NA	25	3				///			/// (not funded)			/// (not funded)		
HEA: High School Equivalency Program	RND	19	19	0	0	100	0	0	100	0	0	100	100	0	0
HEA: State Grants for Incarcerated Youth Offenders	NA	23	19	100	0	0	0	100	0	100	0	0	0	100	0
HEA: Teacher Quality Enhancement and Teacher Incentive Fund	RND	157	86	0	0	100	67	33	0	0	0	100	0	0	100
HERA: Aid for Elementary and Secondary Education (Hurricane Relief)	NA	1,635	973	NA											
IDEA: Special Education Grants for Infants and Families	RND	436	471	0	67	33	33	67	0	25	50	25	67	0	33
IDEA: Special Education Grants to States	A	10,583	10,676	13	0	87	34	33	33	0	100	0	43	43	14
IDEA: Special Education Parent Information Centers	RND	26	25	0	0	100	0	0	100	0	0	100	50	0	50
IDEA: Special Education Personnel Preparation	RND	90	84	0	0	100	25	25	50	0	0	100	0	33	67
IDEA: Special Education Preschool Grants	RND	381	390	0	67	33	0	50	50	0	100	0	0	100	0
IDEA: Special Education State Personnel Grants	NA	50	50	0	0	100	///			/// (not funded)			/// (not funded)		
IDEA: Special Education Technical Assistance and Dissemination	RND	49	57	0	0	100	0	0	100	0	0	100	0	25	75
IDEA: Special Education Technology and Media Services	NA	38	38	0	0	100	100	0	0	0	0	100	0	40	60
MVHAA: Education for Homeless Children and Youths	NA	62	81	0	0	100	100	0	0	33	33	33	67	0	33

Program Name	PART Rating	Appropriations† FY 2006 $ in millions	Expenditures ‡ FY 2006 $ in millions	FY 2006 % Met	FY 2006 % Not Met	FY 2006 % No Data	FY 2005 % Met	FY 2005 % Not Met	FY 2005 % No Data	FY 2004 % Met	FY 2004 % Not Met	FY 2004 % No Data	FY 2003 % Met	FY 2003 % Not Met	FY 2003 % No Data
VTEA: Occupational and Employment Information	RND	0	9	0	0	100	50	50	0	50	50	0			
VTEA: Tech-Prep Demonstration	NA	0	3	0	0	100	33	67	0						
VTEA: Vocational Education National Programs	NA	9	11	0	0	100	40	60	0	60	40	0			
VTEA: Tech-Prep Education State Grants	RND	105	112	27	13	60	50	50	0	27	73	0	14	86	0
VTEA: Vocational Education State Grants	I	1182	1,185												
Administrative and Support Funding for Goal 2[#]	NA	5	5	#			#			#			#		
TOTAL		**37,620**	***37,306**												

† Budget for each program represents program budget authority.

‡ Expenditures occur when recipients draw down funds to cover actual outlays. FY 2006 expenditures may include funds from prior years' appropriations.

A shaded cell denotes that the program did not have targets for the specified year.

/// Denotes programs not yet implemented. (Programs are often implemented near the end of the year they are first funded.)

The Department does not plan to develop performance measures for programs, activities, or budgetary line items that are administrative in nature or that serve to support other programs and their performance measures.

* Expenditures by program do not include outlays in the amount of $90 million for prior years' obligations for Goal 2 programs that were not funded in FY 2006 and FY 2006 estimated accruals in the amount of $304 million.

APEB: *Act to Promote the Education of the Blind*
CFAA: *Compact of Free Association Act, Amendments of 2003*
CRA: *Civil Rights Act*
ESEA: *Elementary and Secondary Education Act of 1965*
ESRA: *Education Sciences Reform Act of 2002*
HEA: *Higher Education Act of 1965*
HERA: *Hurricane Education Recovery Act*
IDEA: *Individuals with Disabilities Education Act*
MVHAA: *McKinney-Vento Homeless Assistance Act*
VTEA: *Perkins Vocational and Technical Education Act*

PART Rating

E = Effective
ME = Moderately Effective
A = Adequate
I = Ineffective
RND = Results Not Demonstrated
NA = Program has not been assessed

Goal 3: Develop Safe and Drug-Free Schools

Key Measures

In FY 2006, the Department designated eight existing key measures to track the performance of two programs: Safe Schools/Healthy Students, and Student Drug Testing. The data for these key measures track specific indicators of success related to the activities of those two programs. The Department's third strategic goal also addresses the development of strong character. We have not identified measures for this objective; however, the 12 programs identified as supporting Goal 3 include programs that support character development and safe and drug-free schools. See p. 30 for an explanation of the documentation fields for the key measures.

Drug use, violence, and crime continue to be serious problems for school-age youth. Students cannot be expected to learn to the high standards envisioned by *No Child Left Behind* in schools where they are threatened by violence, drugs or dealing with mental health issues.

In response to the recent school shootings, which heightened public concern about school safety, President Bush and Secretary Spellings convened a conference of leading experts, law enforcement officials, and stakeholders to discuss how federal, state, and local governments and communities can work together to help ensure the schools are safe places for students to learn. The conference highlighted best practices for making schools safe, shared lessons learned from prior incidents of school violence, and identified resources and experts to help make schools safer, and to assist communities and families to recover from school tragedies.

In FY 2006, the Department identified strategic measures that reflect programs that provide direct support to local educational agencies, address key national concerns, and are structured in a way to enable grantees and independent evaluators to measure progress, demonstrate accountability, and identify the most effective interventions.

Safe Schools/Healthy Students
Grants support local educational agencies in the development of community-wide approaches to creating safe and drug-free schools and promoting healthy childhood development. Programs are intended to prevent violence and the illegal use of drugs to promote safety and discipline. Coordination with other community-based organizations is required. This program is jointly funded and administered by the departments of Education, Justice, and Health and Human Services.

3.1.A Safe and Drug-Free Schools and Communities Other National Programs. The percentage of Safe Schools/ Healthy Students grant sites that experience a decrease in the number of violent incidents at schools during the three-year grant period. ***2004 cohort*** [1825]

Fiscal Year	Actual
2005	**Baseline data collected**
2006	**Dec 2006**

2005 target to set baseline met
2006 data expected Dec. 2006

3.1.B Safe and Drug-Free Schools and Communities Other National Programs. The percentage of Safe Schools/ Healthy Students grant sites that experience a decrease in substance abuse during the three-year grant period. ***2004 cohort*** [1826]

Fiscal Year	Actual
2005	**Baseline data collected**
2006	**Dec 2006**

2005 target to set baseline met
2006 data expected Dec. 2006

3.1.C Safe and Drug-Free Schools and Communities Other National Programs. The percentage of Safe Schools/ Healthy Students grant sites that improve school attendance during the three-year grant period. ***2004 cohort*** [1827]

Fiscal Year	Actual
2005	**Baseline data collected**
2006	**Dec 2006**

2005 target to set baseline met
2006 data expected Dec. 2006

3.1.A Safe and Drug-Free Schools and Communities Other National Programs. The percentage of Safe Schools/Healthy Students grant sites that experience a decrease in the number of violent incidents at schools during the three-year grant period. ***2005 cohort*** [2019]

Fiscal Year	Actual
2006	**Establish baseline**

2006 data expected Dec. 2006

3.1.B Safe and Drug-Free Schools and Communities Other National Programs. The percentage of Safe Schools/Healthy Students grant sites that experience a decrease in substance abuse during the three-year grant period. ***2005 cohort*** [2020]

Fiscal Year	Actual
2006	**Establish baseline**

2006 data expected Dec. 2006

3.1.C Safe and Drug-Free Schools and Communities Other National Programs. The percentage of Safe Schools/Healthy Students grant sites that improve school attendance during the three-year grant period. ***2005 cohort*** [2021]

Fiscal Year	Actual
2006	**Establish baseline**

2006 data expected Dec. 2006

U.S. Department of Education, Office of Safe and Drug Free Schools, Safe and Drug-Free Schools and Communities, Other National Programs Annual Grantee Performance Report.

Analysis of Progress. Data to set baseline were collected for the 2004 and 2005 cohorts.

Data Quality. There are 24 grantees in the 2004 cohort of Safe Schools/Healthy Students. All three measures established for this program require three years of data, as the performance measures look at grantee performance at the conclusion of the three-year grant period. Grantees submitted their first annual reports in 2005. Nineteen grantees provided the baseline data requested, resulting in a 79 percent response rate. These data are reported via school incident reports and self-report behavioral surveys conducted by evaluators at each site.

Grantees are anticipated to submit their three-year performance reports in November 2007. The data will be compared to year-one data to determine the percentage of grantees that experienced improvement in each measure's data over the three-year grant period. Baseline data were collected in 2005. They will be compared with 2007 data to determine if the target was met over the three-year period.

Similarly, the 40 grantees for the Safe Schools/Healthy Students 2005 cohort submitted baseline data in 2006, and are expected to submit their three-year performance reports in November 2008.

Student Drug Testing

This program provides funds to develop and implement, or expand, school-based mandatory random or voluntary drug-testing programs for students. Any drug-testing program awarded funds under this program must be limited to one or more of the following: students who participate in the school's athletic program, and students who are engaged in competitive, extracurricular, school-sponsored activities.

3.1.D Safe and Drug-Free Schools and Communities Other National Programs. The percentage of Student Drug Testing grantees that experience a five percent annual reduction in the incidence of past-*month* drug use by students in the target population. ***2003 cohort*** [1828]

Fiscal Year	Actual
2005	**Baseline data collected**
2006	**33**
The 2006 target to establish a baseline was met	

3.1.E Safe and Drug-Free Schools and Communities Other National Programs. The percentage of Student Drug Testing grantees that experience a five percent annual reduction in the incidence of past-*year* drug use by students in the target population. ***2003 cohort*** [1829]

Fiscal Year	Actual
2005	**Baseline data collected**
2006	**25**
The 2006 target to establish a baseline was met	

U.S. Department of Education, Office of Safe and Drug-Free Schools, Safe and Drug-Free Schools and Communities, Other National Programs Annual Grantee Performance Report.

Analysis of Progress. There were eight grantees in the 2003 cohort of Drug Testing grantees. Implementation of all grants was behind by a year due to a delay in Institutional Review Board approval. This measure requires two years of data because the measure is an assessment of the grant sites that experience decrease in student drug use. No data were available for the 2003 cohort until 2006 for setting the performance baseline because of the nature of the measure and the Institutional Review Board-related delay.

Data Quality. Cohort data for 2003 quality issues include the requirement for two years of data from self-report use surveys, which creates a potential issue if the grantee does not use identical measurements in both years. The decrease in past-month and past-year drug use must be by at least 5 percent to meet the threshold established for this measure. Of the 8 grantees, 3 provided two years of comparable data (38 percent response rate). Of those, one experienced a decrease in past-month drug use of 5 percent or more. Due to the very low response rate, caution is recommended when interpreting the data and drawing conclusions about the program's performance. For past-year drug use, of the 8 grantees, 4 provided two years of valid data (a 50 percent response rate). Of those, one experienced a decrease in past-year drug use of 5 percent or more.

Discontinued Strategic Measures

The following measures were discontinued after FY 2005 but were reported as pending in the *FY 2005 Performance and Accountability Report*. The latest data are reported below.

Measure			Fiscal Year	Target	Actual	Status
3.1	The percentage of students in grades 9 through 12 who were offered, sold, or given an illegal drug on school property during the past 12 months		2005	28	25	Target exceeded
3.2	The percentage of students in grades 9 through 12 who used marijuana one or more times during the past 30 days		2005	21	20	Target exceeded
3.3	The percentage of students in grades 9 through 12 who had five or more drinks of alcohol in a row (that is, within a couple of hours) one or more times during the past 30 days		2005	27	26	Target exceeded
3.4	The percentage of students in grades 9 through 12 who were in a physical fight on school property one or more times during the past 12 months		2005	12	14	Target not met
3.5	The percentage of students in grades 9-12 who carried a weapon such as a gun, knife, or club on school property one or more times during the past 30 days		2005	5	7	Target not met
3.1.1	The rate of violent crimes and serious violent crimes experienced at school by students aged 12 through 18		2003	24/1000	28/1000	Target not met
			2004	23/1000	Pending	Data expected 12/2006
3.1.2	The rate of violent crimes and serious violent crimes experienced at school by students aged 12 through 18		2003	4/1000	6/1000	Target not met
			2004	4/1000	Pending	Data expected 12/2006
3.1.3–3.1.5	The percentage of youth aged 12 through 17 who reported using the following substances in the past 30 days	Alcohol	2004	14	18	Target not met
		Tobacco (Cigarettes)	2004	11	12	Target not met
		Marijuana	2004	7	7	Target met
3.2.2	The percentage of students in grade 12 who think most of the students in their classes would dislike it or dislike it very much if a student intentionally did things to make his/her teachers angry		2004	36	35	Target not met
3.2.3	The percentage of students in grade 12 who think that most students in their classes would dislike it or dislike it very much if a student cheated on a test		2004	19	15	Target not met

Sources

3.1-3.5 U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, Youth Risk Behavior Surveillance System (YRBSS).

3.1.1–3.1.2 U.S. Departments of Education and Justice, *Indicators of School Crime and Safety*.

3.1.3–3.1.5 U.S. Department of Health and Human Services, Substance Abuse and Mental Health Services Administration (SAMHSA), National Survey on Drug Use and Health (formerly called the National Household Survey on Drug Abuse).

3.2.2–3.2.3 University of Michigan, Survey Research Center, Monitoring the Future.

Goal 3: Develop Safe and Drug-Free Schools

Program Performance Summary

Twelve of our grant programs most directly support Goal 3. These programs are listed below. In the table, an overview is provided for the results of each program on its program performance measures. (See p. 31 for the methodology of calculating the percentage of targets met, not met, and without data.) Individual program performance reports are available at http://www.ed.gov/about/reports/annual/2006report/program.html. Appropriation and expenditure data for FY 2006 are included for each of these programs.

Program Name	PART Rating	Appropriations†	Expenditures‡	Program Performance Results Percent of Targets Met, Not Met, Without Data											
				FY 2006			FY 2005			FY 2004			FY 2003		
		FY 2006 $ in millions	FY 2006 $ in millions	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data
ESEA: Alcohol Abuse Reduction	NA	32	35	0	0	100	0	0	100				0	0	100
ESEA: Character Education	NA	24	25	0	0	100				0	0	100	100	0	0
ESEA: Civic Education: We the People	NA	17	16				0	0	100						
ESEA: Close-Up Fellowships	NA	1	1	0	0	100	0	0	100	0	0	100			
ESEA: Elementary and Secondary School Counseling	NA	35	34	0	0	100	0	0	100				0	0	100
ESEA: Exchanges with Historic Whaling and Trading Partners	NA	9	9	0	0	100	0	0	100	60	0	40			
ESEA: Foundations for Learning	NA	1	1							/// (not funded)					
ESEA: Mental Health Integration in Schools	NA	5	2				///			/// (not funded)			/// (not funded)		
ESEA: Physical Education Program	RND	73	70	0	0	100	0	0	100				0	0	100
ESEA: Mentoring Program	NA	49	50	100	0	0	0	0	100				100	0	0
ESEA: Safe and Drug-Free Schools and Communities Other National Programs	NA	141	126	25	0	75	80	20	0						
ESEA: Safe and Drug-Free Schools and Communities State Grants	I	347	434	0	0	100	0	0	100				0	29	71
TOTAL		**734**	***803**												

† Budget for each program represents program budget authority.

‡ Expenditures occur when recipients draw down funds to cover actual outlays. FY 2006 expenditures may include funds from prior years' appropriations.

A shaded cell denotes that the program did not have targets for the specified year.

/// Programs not yet implemented. (Programs are often implemented near the end of the year they are first funded.)

* Expenditures by program do not include outlays in the amount of $10 million for prior years' obligations for Goal 3 programs that were not funded in FY 2006 or FY 2006 estimated accruals in the amount of $36 million.

ESEA: Elementary and Secondary Education Act

PART Rating I = Ineffective RND = Results not demonstrated NA = Program has not been assessed

Goal 4: Transform Education Into an Evidence-Based Field

Key Measures

No Child Left Behind grounds education improvement in the application of scientifically based research that is rigorous, systematic, and objective in order to obtain reliable and valid knowledge relevant to education activities and programs. In FY 2006, the Department administered five distinct programs supporting the objectives of Goal 4. Each program established measures and targets to assess its performance. From these measures, the Department identified four key measures that focus on the quality and relevance of its educational research.

See p. 30 for an explanation of the documentation fields for key measures.

Quality of Education Research

The Department has elevated the standards and methodologies for Department-sponsored education research. Funding of research proposals is based on clear criteria for research excellence. As in other scientifically based fields, rigorous research methods in education contribute to reliable and valid conclusions. The Department demonstrated a thorough commitment to research quality by expanding the use of scientifically based procedures for the evaluation of Department programs, training a new generation of education researchers in rigorous methodologies and improving the quality of data collections. In addition, the Department requires all research proposals to be reviewed by an independent panel of qualified scientists.

4.1.A Research, Development, and Dissemination. The percentage of new research proposals funded by the Department's National Center for Education Research that receive an average score of excellent or higher from an independent review panel of qualified scientists. [1022]

Fiscal Year	Actual
2003	88
2004	97
2005	100
2006	**94**
2006 target of 100 not met	

U.S. Department of Education, National Center for Education Research, independent external review panels.

Analysis of Progress. Data on this measure were first collected in FY 2003. Although there has been a steady increase in the percentage of proposals for newly funded education research that receive an average score of excellent or higher, the score decreased because the Department elected to fund two proposals that scored below excellent. These proposals addressed gaps in the research portfolio, and the deficiencies in the proposals noted by the review panel were problems that could be remedied prior to implementation.

Data Quality. The Department established a system of peer review that is similar in many ways to the peer review process used by the National Institutes of Health. Independent review panels of leading researchers evaluate the scientific and technical merit of research proposals.

Target Context. The measure is calculated as the average review panel score for newly funded research proposals.

4.1.B Research in Special Education. The percentage of new research proposals funded by the Department's National Center for Special Education Research that receive an average score of excellent or higher from an independent review panel of qualified scientists. [1940]

Fiscal Year	Actual
2006	**89**
2006 baseline established	

U.S. Department of Education, National Center for Education Research, independent external review panels.

Analysis of Progress. This is a new measure for FY 2006, and the target was to set a baseline.

Data Quality. The Department has established a system of peer review that is similar in many ways to the process of peer review at the National Institutes of Health. Independent panels of leading researchers evaluate the scientific and technical merit of research proposals.

Relevance of Education Research

In addition to a focus on sound methodology, education researchers need to address practical problems in powerful ways. The Department aligns its priorities with the needs of education practitioners and policymakers to ensure that we are providing information that is relevant to the improvement of education. Too few high quality evidence-based studies have been done to provide education policymakers and practitioners with the level and type of information they need for educational decision-making. The Department supports research that contributes to improved academic achievement for all students, and particularly for those whose educational prospects are hindered by conditions associated with poverty, minority status, family circumstance, and inadequate educational services. The Department supports research that identifies, develops, and validates effective educational programs and practices.

The Department ensures the production of relevant education research by having all newly funded research reviewed by an independent panel of qualified practitioners. For FY 2006, grants were awarded on such topics as high school reform, cognition and student learning, reading and writing education, mathematics and science education, teacher quality, education finance, leadership and management, post-doctoral research training, and national research and development centers.

4.2.A Research, Development, and Dissemination. The percentage of new research projects funded by the Department's National Center for Education Research and National Center for Education Evaluation and Regional Assistance that are deemed to be of high relevance to education practice as determined by an independent review panel of qualified practitioners. [1028]

Fiscal Year	Actual
2001	21
2002	25
2003	60
2004	50
2005	**Target is 65**
2006	**Target is 75**
2005 data are pending 2006 data expected Mar. 2007	

U.S. Department of Education, National Center for Education Research, independent external review panels.

Analysis of Progress. Data for FY 2005 are pending.

Data Quality. To evaluate the relevance of newly funded research projects, a panel of experienced education practitioners and administrators reviews descriptions of a randomly selected sample of newly funded projects and rates the degree to which the projects are relevant to education practice. These panels are convened after the close of the fiscal year to review the proposals of the prior year.

Target Context. The target of 75 percent recognizes that some important research may not seem immediately relevant, but will make important contributions over the long term.

4.2.B Research in Special Education. The percentage of new research projects funded by the Department's National Center for Special Education Research that are deemed to be of high relevance by an independent review panel of qualified practitioners. [1942]

Fiscal Year	Actual
2006	**Establish baseline**
2006 target to set baseline met Data are pending	

U.S. Department of Education, National Center for Education Research, independent external review panels.

Analysis of Progress. In FY 2006, the target was to set a baseline. At the time of the publication of this document, the FY 2006 data are not available.

Data Quality. To evaluate the relevance of newly funded research projects, a panel of experienced education practitioners and administrators reviews descriptions of a randomly selected sample of newly funded projects and rates the degree to which the projects are relevant to education practice. These panels are convened after the close of the fiscal year to review the proposals of the prior year.

Goal 4: Transform Education Into an Evidence-Based Field

Program Performance Summary

Five of our grant programs most directly support Goal 4. These programs are listed below. In the table, an overview is provided for the results of each program on its program performance measures. (See p. 31 for the methodology of calculating the percentage of targets met, not met, and without data.) Individual program performance reports are available at http://www.ed.gov/about/reports/annual/2006report/program.html. Appropriation and expenditure data for FY 2006 are included for each of these programs.

Program Name	PART Rating	Appropriations†	Expenditures‡	Program Performance Results Percent of Targets Met, Not Met, Without Data											
				FY 2006			FY 2005			FY 2004			FY 2003		
		FY 2006 $ in millions	FY 2006 $ in millions	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data
ESEA: Indian Education National Activities	NA	4	6	0	0	100									
ESRA: Research, Development and Dissemination	NA	163	224	40	20	40	80	0	20	67	33	0	100	0	0
ESRA: Statistics	E	90	53	14	29	57	15	85	0	43	57	0	0	0	100
ESRA: Research in Special Education	RND	72	24	33	0	67	///			/// (not funded)			/// (not funded)		
RA: National Institute on Disability and Rehabilitation Research	A	107	104	18	10	72	25	12	63	0	100	0	42	29	29
Administrative and Support Funding for Goal 4[#]		19	9				#			#			#		
TOTAL		**455**	***420**												

† Budget for each program represents program budget authority.

‡ Expenditures occur when recipients draw down funds to cover actual outlays. FY 2006 expenditures may include funds from prior years' appropriations.

A shaded cell denotes that the program did not have targets for the specified year.

/// Programs not yet implemented. (Programs are often implemented near the end of the year they are first funded.)

The Department does not plan to develop performance measures for programs, activities, or budgetary line items that are administrative in nature or that serve to support other programs and their performance measures.

* Expenditures by program do not include FY 2006 estimated accruals in the amount of $2 million.

ESEA: *Elementary and Secondary Education Act*
ESRA: *Education Sciences Reform Act*
RA: *Rehabilitation Act*

PART Rating
E = Effective
A = Adequate
RND = Results not demonstrated
NA = Program has not been assessed

Goal 5: Enhance the Quality of and Access to Postsecondary and Adult Education

Key Measures

In FY 2006, the Department administered 58 distinct programs that supported the objectives of Goal 5. The Department identified 21 key measures, drawn from the program-specific measures that focus on significant areas of performance related to Goal 5.

See p. 30 for an explanation of the documentation fields for key measures.

Growth in college tuition and fees has outpaced both inflation and median family income since the early 1990s. In the face of this fiscal reality, the federal higher education programs are critical for ensuring access to postsecondary and adult education across America and closing the gaps in enrollment and completion among student populations differing by race, ethnicity, socioeconomic status and disability.

Postsecondary Persistence and Completion

Grants and loans are the major forms of federal financial support to postsecondary students. In the 2003-04 school year, 72 percent of all low-income dependent undergraduate students received federal grants and 42 percent received federal loans. The Department delivered about $77 billion dollars in new federal aid to about 10 million postsecondary students and their families in 2005. This is a tremendous increase from the $27.0 billion delivered to 7.1 million recipients just over a decade ago.

To assess the performance of the student financial aid programs, the Department measures the percentage of high school completers immediately enrolling in college and the percentage of college enrollees who graduate from college within six years. The percentage of high school completers who enrolled in college in the fall immediately after high school rose to 67 percent in FY 2005. This reflects an increase from 64 percent in FY 2004 and 62 percent in FY 2002. The percentage of students completing a four-year degree within six years of enrollment was 57 percent in FY 2004, up from 56 percent in FY 2003.

Federal TRIO programs provide an array of programs to help disadvantaged students, who are traditionally underrepresented in higher education, prepare for and succeed in college. TRIO Educational Opportunity Centers help adults apply for college, Student Support Services provide support to increase postsecondary retention and graduation rates and McNair Postbaccalaureate Achievement prepares undergraduate students for doctoral study. The Department measured the percentage of McNair participants enrolling in graduate school and persistence and completion rates for Student Support Services and McNair participants.

5.1.A TRIO Educational Opportunity Centers. The percentage of TRIO Educational Opportunity Centers participants enrolling in college. [1612]

Fiscal Year	Actual
2000	57
2001	66
2002	66
2003	56
2004	**57.4**
2005	**56.9**
2006	**Target is 58**

2005 target of 57.5 not met
2006 data expected Dec. 2007

U.S. Department of Education, Office of Postsecondary Education, TRIO Annual Performance Report, grantee submissions.

Analysis of Progress. In FY 2005, more than half of all TRIO Educational Opportunity Centers program participants enrolled in college.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. Increasing targets reflect the aim of the TRIO Educational Opportunity Centers program to increase the percentage of adult participants enrolling in college.

5.1.B TRIO Student Support Services. The percentage of Student Support Services participants persisting at the same institution. [1617]

Fiscal Year	Actual
2000	67
2001	70
2002	72
2003	**72**
2004	**73.1**
2005	**74.1**
2006	**Target is 72**

2005 target of 69 exceeded
2006 data expected Dec. 2007

U.S. Department of Education, Office of Postsecondary Education, Student Support Services Program Annual Performance Report, grantee submissions.

Analysis of Progress. The percentage of students participating in Student Support Services who persist in college has exceeded 70 percent continuously since 2001, showing program improvement that also exceeded established performance target increases. TRIO's performance with disadvantaged students is helping to bring their persistence rate close to the overall retention rate nationwide. Persistence rates were 72 percent for fall 2004 for all two- and four-year postsecondary institutions eligible for Title IV grants or loans.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. Targets for FY 2004 and FY 2005 were set before data for FY 2001 through FY 2003 were available.

5.1.C TRIO Student Support Services. The percentage of Student Support Services participants completing an associate's degree at the original institution or transferring to a four-year institution within three years. [1618]

Fiscal Year	Actual
2001	**23.1**
2002	**26**
2003	**27.7**
2004	**25.6**
2005	**24.5**
2006	**Target is 27**

New measure in 2006
2006 data expected Dec. 2007

U.S. Department of Education, Office of Postsecondary Education, Student Support Services Program Annual Performance Report, grantee submissions.

Analysis of Progress. Between FY 2001 and 2005, approximately one quarter of Student Support Services participants completed an associate's degree at a two-year institution or transferred to a four-year institution within three years. Although performance did not increase in 2005, it did maintain the 2004 performance level. Nationally, less than one quarter of students at two-year institutions complete an associate's or bachelor's degree within five years. The Student Support Services program serves students who are most at-risk for dropping out of college.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

5.1.D TRIO Student Support Services. The percentage of Student Support Services first-year students completing a bachelor's degree at the original institution within six years. [1619]

Fiscal Year	Actual
2004	**28.1**
2005	**29.4**
2006	**Target is 28**

New measure in 2006
2005 target of 30.5 not met
2006 data expected Dec. 2007

U.S. Department of Education, Office of Postsecondary Education, Student Support Services Program Annual Performance Report, grantee submissions.

Analysis of Progress. This is a new key measure for FY 2006. It is a replacement for the previous TRIO measure for students completing a degree at the same institution. See p. 74.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

5.1.E TRIO McNair Postbaccalaureate Achievement. The percentage of McNair participants enrolling in graduate school. [1614]	
Fiscal Year	**Actual**
1999	35
2000	35
2001	40
2002	39
2003	36
2004	**45.3**
2005	**56.8**
2006	**Target is 37**
2004 target of 36 exceeded 2005 target of 36 exceeded 2006 data expected Dec. 2007	

U.S. Department of Education, Office of Postsecondary Education, TRIO Annual Performance Report, grantee submissions.

Analysis of Progress. Over the past six years, the program has met or exceeded its performance targets. The target exceeds the national average of students who enrolled in graduate school within two years of achieving a baccalaureate degree. Immediate enrollment of McNair participants has generally increased annually from more than one third of students in 1999–00 to half in 2004–05. The increase in performance is partially attributable to experienced grantees that improve their delivery of services and direct resources toward services that support enrollment and persistence in graduate school. Also, the large increase in enrollment from 2004 to 2005 reflects more complete and timely reporting.

Data Quality. Enrollment refers to immediate enrollment in graduate school of bachelor's degree recipients. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. The targets for FY 2004 through FY 2006 were established based upon FY 1999 actual performance before actual values for FY 2001 through FY 2003 were available.

5.1.F TRIO McNair Postbaccalaureate Achievement. The percentage of McNair participants persisting in graduate school. [1615]	
Fiscal Year	**Actual**
2003	78
2004	**77.7**
2005	**80**
2006	**Target is 79**
2004 target of 75 exceeded 2005 target of 70 exceeded 2006 data expected Dec. 2007	

U.S. Department of Education, Office of Postsecondary Education, TRIO Annual Performance Report, grantee submissions.

Analysis of Progress. Since 2000, McNair postbaccalaureate persistence has exceeded the target, with over three quarters of McNair participants persisting in graduate school. However, current trend data are not available because the calculation of the measure of persistence was changed in FY 2003.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. Targets for FY 2004 and FY 2005 were set before data for FY 2003 were available. Targets for FY 2006 and beyond are more ambitious.

Strengthening Institutions That Serve Underrepresented Populations

The Department's institutional aid programs strengthen and improve the quality of programs in hundreds of postsecondary education institutions that serve low-income and minority students including Historically Black Colleges and Universities, Alaska Native and Native Hawaiian-Serving Institutions, Hispanic-Serving Institutions and Tribally Controlled Colleges and Universities. By expanding and enhancing academic quality, institutional management and financial stability at these institutions, the Department reduces gaps in college access and completion among differing student populations, improves academic attainment, and strengthens accountability. The following key measures are new for fiscal year 2006. The new measures are grouped by postsecondary education institutions that serve low-income and minority students based on their continuing enrollment and graduation from two-year, four-year or graduate schools.

5.4.A AID Strengthening Historically Black Colleges and Universities. The percentage of full-time undergraduate students who were in their first year of postsecondary enrollment in the previous year and are enrolled in the current year at the same Historically Black College and University institutions. [1587]

Fiscal Year	Actual
2004	**64**
2005	**65**
2006	**64**

New measure in 2006
2006 target of 65 not met

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new key measure for FY 2006. The slight decline from 65 percent in FY 2005 to 64 percent in 2006 is in line with student persistence nationally, which dropped from 71 percent to 70 percent over the same period.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted. Institutions only report a persistence rate, not the numerator and denominator generating the rate. As a result, the persistence rate for the program must be calculated as a median rate.

Target Context. The target is derived by applying the difference between regression-based predicted values from Title IV institutions and actual grantee values for school year 2002–03, which was 3.6 percent.

5.4.B AID Strengthening Historically Black Colleges and Universities. The percentage of students enrolled at four-year Historically Black Colleges and Universities graduating within six years of enrollment. [1589]

Fiscal Year	Actual
2003	**39**
2004	**39**
2005	**38**
2006	**Target is 37**

New measure in 2006
2006 data expected Dec. 2007

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new key measure for FY 2006. Program performance remains above the target level set for 2006, even though the graduation rate declined slightly from 39 percent in FY 2004 to 38 percent in FY 2005.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. The target for the graduation rate is derived by applying the difference between regression-based predicted values from Title IV institutions and actual grantee values for school year 2002–03, which was 1.4 percent.

5.4.C AID Strengthening Historically Black Graduate Institutions. The number of Ph.D., first professional, and master's degrees awarded at Historically Black Graduate Institutions. [1595]

Fiscal Year	Actual
2003	**4,055**
2004	**4,219**
2005	**4,410**
2006	**Target is 4,178**
New measure in 2006 2006 data expected Dec. 2007	

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new key measure for FY 2006. Continued increase in number of degrees awarded places current program performance well above target set for FY 2006.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. Program experience indicates that an annual increase of 1 percent is an ambitious goal. Targets are derived by applying an estimated annual increase rate of 1 percent through FY 2009 and an increase rate of 0.5 percent beginning in FY 2010.

5.4.D AID Strengthening Tribally Controlled Colleges and Universities. The percentage of full-time undergraduate students who were in their first year of postsecondary enrollment in the previous year and are enrolled in the current year at the same Tribally Controlled Colleges and Universities institution. [1569]

Fiscal Year	Actual
2004	**41**
2005	**48**
2006	**44**
New measure in 2006 2006 target of 41 exceeded	

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new key measure for FY 2006. Program performance exceeded the target, even though persistence declined from 48 percent in FY 2005 to 44 percent in FY 2006. Persistence also declined nationally during this period.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. Institutions report a persistence rate, not the numerator and denominator. As a result, the persistence rate is calculated as a median.

5.4.E AID Strengthening Tribally Controlled Colleges and Universities. The percentage of students enrolled at four-year Tribally Controlled Colleges and Universities graduating within six years of enrollment. [1571]

Fiscal Year	Actual
2003	**23**
2004	**32**
2005	**Data expected Dec. 2006**
2006	**Target is 32**

New measure in 2006
2005 data expected Dec. 2006
2006 data expected Dec. 2007

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new key measure for FY 2006.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. Graduation rate data first became available from the Integrated Postsecondary Education Data System for FY 2003. Prior to 2003, the Department did not require graduation rate data to be provided by the institution.

5.4.F AID Strengthening Tribally Controlled Colleges and Universities. The percentage of students enrolled at two-year Tribally Controlled Colleges and Universities who graduate within three years of enrollment. [1572]

Fiscal Year	Actual
2003	**40**
2004	**34**
2005	**Data expected Dec. 2006**
2006	**Target is 29**

New measure in 2006
2005 data expected Dec. 2006
2006 data expected Dec. 2007

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new key measure for FY 2006.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. Graduation rate data first became available from the Integrated Postsecondary Education Data System for FY 2003.

5.4.G AID Developing Hispanic-Serving Institutions. The percentage of full-time undergraduate students who were in their first year of postsecondary enrollment in the previous year and are enrolled in the current year at the same Hispanic-Serving Institution. [1601]

Fiscal Year	Actual
2004	**66.5**
2005	**66**
2006	**Target is 67**

New measure in 2006
2006 data expected Dec. 2006

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new key measure for FY 2006. Institutions report a persistence rate, not the numerator and denominator.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted. Institutions only report a persistence rate, not the numerator and denominator generating the rate. As a result, the persistence rate for the program must be calculated as a median rate.

Target Context. The target is derived by applying the difference between regression-based predicted values from Title IV institutions and actual grantee values for school year 2003–04, which was 1.12 percent.

5.4.H AID Developing Hispanic-Serving Institutions. The percentage of students enrolled at four-year Hispanic-Serving Institutions graduating within six years of enrollment. [1603]	
Fiscal Year	**Actual**
2003	**35**
2004	**36**
2005	**Data expected Dec. 2006**
2006	**Target is 34**
New measure in 2006 2005 data expected Dec. 2006 2006 data expected Dec. 2007	

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new key measure for FY 2006. The most recent (FY 2004) performance is above the graduation rate target set for FY 2006. Data for FY 2003 were recalculated and now reflect a more accurate representation than previously reported.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. The target for the four-year graduation rate is derived by applying the difference between regression-based predicted values from Title IV institutions and actual grantee values for school year 2002–03, which was 3.54 percent.

5.4.I AID Developing Hispanic-Serving Institutions. The percentage of students enrolled at two-year Hispanic-Serving Institutions who graduate within three years of enrollment. [1604]	
Fiscal Year	**Actual**
2003	**21**
2004	**22**
2005	**Data expected Dec. 2006**
2006	**Target is 36**
New measure in 2006 2005 data expected Dec. 2006 2006 data expected Dec. 2007	

U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System. Web site is http://nces.ed.gov/ipedspas.

Analysis of Progress. This is a new measure for FY 2006.

Data Quality. These data are self-reported by grantees. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. Program experience was used to estimate targets. An increase of 0.5 percent was used to generate annual targets each year through FY 2009, and an increase of 0.3 percent will be used beginning in FY 2010.

Vocational Rehabilitation

The Department's vocational rehabilitation programs help individuals with physical or mental disabilities obtain employment and live more independently by providing grants that support job training and placement, medical and psychological services, and other individualized services. Annually, the Vocational Rehabilitation State Grants program helps over 200,000 individuals with disabilities obtain employment. The Department measures state vocational rehabilitation agencies' progress by monitoring the percentage of individuals receiving services that achieve employment.

5.5.A Vocational Rehabilitation State Grants. The percentage of general and combined state vocational rehabilitation agencies that assist at least 55.8 percent of individuals receiving services to achieve employment. [1681]

Fiscal Year	Actual
2001	75
2002	75
2003	66
2004	66
2005	**71**
2006	**Target is 70**

2005 target of 75 not met
2006 data expected Apr. 2007

U.S. Department of Education, Office of Special Education and Rehabilitative Services, Rehabilitation Services Administration, state agency data from performance report RSA-911.

Analysis of Progress. The established target of 75 percent was not met. After several years of declines, the percentage of individuals who received services under the program and achieved an employment income increased in FY 2005. As a result, the FY 2005 performance of general and state vocational agencies on this measure improved as compared to the past two previous years. However, performance is still below the FY 2002 level. Future performance targets assume that the decline in employment outcomes will stabilize with improving economic conditions, and states will improve their performance on this measure.

Data Quality. The accuracy and consistency of state rehabilitation staff report data cannot be guaranteed as counselors' interpretations of the data reported may vary. Timeliness is dependent upon submittal of clean data from 80 grantees, and Rehabilitation Services Administration staff have worked with grantees to improve the accuracy and timeliness of performance report data.

Target Context. This indicator is derived from state vocational rehabilitation agency performance expectations defined in the program regulations. For each vocational rehabilitation agency, the Rehabilitation Services Administration examines the percentage of individuals who achieve employment compared to all individuals whose cases were closed after receiving services. To pass this indicator, a general or combined agency must achieve a rate of 55.8 percent, while an agency for the blind must achieve a rate of 68.9 percent.

Adult Learning

In an age of rapid economic and technological change, lifelong learning can provide benefits for individuals and for society as a whole. This year, data are continuing to show steady increases in the following measures:

- The percentage of adults with a high school completion goal who earn a high school diploma or recognized equivalent.
- The percentage of adults enrolled in English literacy programs who acquire the level of English language skills needed to complete the levels of instruction in which they are enrolled.

5.5.B Adult Education State Grants. The percentage of adults with a high school completion goal who earn a high school diploma or recognized equivalent. [1386]	
Fiscal Year	**Actual**
1996	36
1997	37
1998	33
1999	34
2000	34
2001	33
2002	42
2003	44
2004	45
2005	**51**
2006	**Target is 46**
2005 target of 46 exceeded 2006 data expected Dec. 2006	

U.S. Department of Education, Office of Vocational and Adult Education, National Reporting System for Adult Education.

Analysis of Progress. The FY 2005 target was exceeded. The increase can be attributed to targeted technical assistance and use of standardized assessments to properly place students.

As of FY 2000, the performance data reflect the percentage of adult learners with a goal of completing high school in secondary-level programs of instruction who, upon exit, had earned their high school diploma or GED credential within the reporting period.

Data Quality. Program monitoring and data review and analyses are conducted by Department staff through the Data Quality Certification Process. Data are verified by electronic checks and expert staff analysis, and by requiring confirmation and attestation of data by state directors. State data are checked independently by Department staff from the Office of Vocational and Adult Education during onsite monitoring and state audit reviews.

Target Context. Increasing targets reflect the aim of the Adult Education State Grants program to increase the percentage of adults with a high school completion goal who earn a high school diploma or recognized equivalent. FY 2007 and future-year targets have been adjusted because trend data suggest that they were inappropriately projected and not ambitious enough.

5.5.C Adult Education State Grants. The percentage of adults enrolled in English literacy programs who acquire the level of English language skills needed to complete the levels of instruction in which they enrolled. [1384]	
Fiscal Year	**Actual**
1996	30
1997	28
1998	28
1999	49
2000	20
2001	31
2002	34
2003	36
2004	36
2005	**37**
2006	**Target is 38**
2005 target of 45 not met 2006 data expected Dec. 2006	

U.S. Department of Education, Office of Vocational and Adult Education, National Reporting System for Adult Education.

Analysis of Progress. Although the Department did not meet its target of 45 for FY 2005, we showed improvement.

As of 2000, data reflect the percentage of English literacy learners (adults with minimal English language skills) who demonstrated a level of English language proficiency needed to advance to the next educational functioning level. Educational functioning levels range from beginning-level English literacy through advanced-level English literacy. The target is difficult to meet because of the large number of participants who are not literate in their native language and the large number of participants who stay in the program only long enough to acquire the language skills needed to enter the workforce.

Data Quality. Program monitoring and data review and analyses are conducted by Department staff through the Data Quality Certification Process. Data are verified by electronic checks and expert staff analysis, and by requiring confirmation and attestation of data by state directors. State data are checked independently by Department staff from the Office of Vocational and Adult Education during onsite monitoring and state audit reviews.

Target Context. FY 2007 and future-year targets have been adjusted because trend data suggest that they were inappropriately projected.

Expanding Global Perspectives

The Department's international education and graduate fellowship programs have helped thousands of students, particularly at the graduate level, prepare for careers in areas of national need, including foreign languages and area studies. A long-lasting, productive partnership between the federal government and the nation's universities has created an unparalleled capacity to teach both foreign languages and area studies about societies around the world—covering all continents and more than 100 of the less-commonly taught languages. These programs also conduct outreach activities focused on improving elementary and secondary teachers' skills. The centers provide professional development workshops, enhance curricula, develop and publish lesson plans, and conduct resource awareness and language training. In 2004, the number of activities conducted increased by 51 percent over the previous year, with federal funding supporting 3,057 separate outreach activities.

The Department measures progress in International Education and Foreign Language Studies domestic programs, in part, by the expansion of critical languages taught at National Resource Centers and the employment of centers' Ph.D. graduates in targeted areas and by improved language competency in the Foreign Language and Area Studies Fellowship program.

5.6.A International Education and Foreign Language Studies Domestic Programs. The percentage of critical languages taught, as reflected by the list of critical languages referenced in the *Higher Education Act,* Title VI program statute. [1665]

Fiscal Year	Actual
2003	56
2004	56
2005	Target is 74
2006	**Target is 60**

2005 data expected Dec. 2006
2006 data expected Dec. 2007

5.6.B International Education and Foreign Language Studies Domestic Programs. The percentage of National Resource Centers Ph.D. graduates who find employment in higher education, government service, and national security. [1664]

Fiscal Year	Actual
2001	48.5
2002	53.7
2003	55
2004	**71.8**
2005	Target is 47.5
2006	**Target is 48**

2005 data expected Dec. 2006
2006 data expected Dec. 2007

5.6.C International Education and Foreign Language Studies Domestic Programs. The average competency score of Foreign Language and Area Studies Fellowship recipients at the end of one full year of instruction (post-test) minus the average competency score at the beginning of the year (pre-test). [1671]

Fiscal Year	Actual
2003	1.3
2004	1.2
2005	1.2
2006	**Target is 1.2**

2005 target of 1.2 met
2006 data expected Dec. 2006

Note: These measures report on the National Resource Centers and Foreign Language and Area Studies Fellowship program under the International Education and Foreign Language Studies Domestic Programs, authorized by Title VI of the *Higher Education Act*.

U.S. Department of Education, Office of Postsecondary Education, International Education and Foreign Language Studies Domestic Programs Annual Performance Report.

Analysis of Progress. As of the publication of this report, there are no new data for measures 5.6.A and 5.6.B. Measure 5.6.C remained steady and the target was met.

Data Quality. Data are self-reported by institutions. Program staff employ data quality checks to assess the completeness and reasonableness of the data submitted.

Target Context. The Department set targets for FY 2006 on the basis of historical trends and program experience before data for FY 2004 were available.

Discontinued Strategic Measures

The following measures were discontinued after FY 2005 but were reported as pending in the *FY 2005 Performance and Accountability Report*. The latest data are reported below.

Measure			Fiscal Year	Target	Actual	Status
5.1.2–5.1.7	The percentage of 16- to 24-year-old high school graduates enrolled in college the October following graduation	White	2002	66.9	68.9	Target met
			2003	67.0	66.2	Target not met
			2004	69.4	68.8	Target not met
		Black	2002	59.6	59.4	Target not met
			2003	60.3	57.5	Target not met
			2004	60.8	62.5	Target met
		White-Black Gap	2002	7.3	9.5	Target not met
			2003	6.7	8.7	Target not met
			2004	8.6	6.3	Target exceeded
		Hispanic	2002	50.0	53.3	Target exceeded
			2003	51.5	58.6	Target exceeded
			2004	57.5	61.8	Target exceeded
		White-Hispanic Gap	2002	16.9	15.6	Target met
			2003	15.5	7.6	Target exceeded
			2004	11.9	7.0	Target exceeded
5.1.8 – 5.1.9	The percentage of 16- to 24-year-old high school graduates enrolled in college the October following graduation	Low Income	2002	51.5	56.4	Target met
			2003	53.5	52.8	Target not met
			2004	51.0	49.6	Target not met
		High Income	2002	76.9	78.2	Target met
			2003	77.0	80.1	Target met
			2004	80.0	79.3	Did not meet
		Income Gap	2002	25.4	21.8	Target met
			2003	23.5	27.3	Target not met
			2004	29.0	29.7	Target not met
5.1.11–5.1.15	The national percentage of full-time, bachelor's degree-seeking students who graduate from four-year institutions within six years	White	2004	56.8	58.2	Target met
		Black	2004	37.4	39.7	Target met
		White-Black Gap	2004	19.4	18.5	Target exceeded
		Hispanic	2004	43.2	45.8	Target met
		White-Hispanic Gap	2004	13.6	12.4	Target met

Measure			Fiscal Year	Target	Actual	Status
5.1.16–5.1.21	The percentage of full-time, degree- or certificate-seeking students at two-year institutions who graduate, earn a certificate, or transfer from two-year institutions within three years	Overall	2004	34.0	30.0	Target not met
		White	2004	34.5	31.1	Target not met
		Black	2004	27.3	24.3	Target not met
		White-Black Gap	2004	7.2	6.8	Target met
		Hispanic	2004	31.1	30.3	Target not met
		White-Hispanic Gap	2004	3.4	0.8	Target exceeded
5.1	**Student Financial Assistance Programs.** The percentage of high school graduates aged 16 through 24 enrolling immediately in college		2004	67	66.7	Target not met
			2005	67	Pending	
5.2	**TRIO Talent Search.** The percentage of Talent Search participants enrolling in college		2004	73.5	77.6	Target exceeded
			2005	74	Dec. 2007	Pending
5.4	**TRIO Upward Bound.** The percentage of Upward Bound participants enrolling in college		2004	65	Nov. 2007	Pending
			2005	65	Nov. 2008	Pending
5.5	**TRIO Upward Bound**. The percentage of higher-risk Upward Bound participants enrolling in college		2004	35.5	Nov. 2008	Pending
			2005	36	Nov. 2009	Pending
5.6	**Student Financial Assistance Programs.** The percentage of full-time, degree-seeking students completing a four-year degree within 150 percent of the normal time required		2004	55	55.3	Target met
			2005	55	July 2007	Pending
5.8	**TRIO Support Services.** The percentage of TRIO Student Support Services participants completing a degree at the same institution		2004	30	28.1	Target not met
			2005	30.5	Dec. 2006	Pending
5.11	**Student Aid Administration.** The percentage of Pell Grant overpayments		2005	3.2	2.4	Target exceeded
5.12	**Aid for Institutional Development, Titles III and V.** The percentage of Title III and Title V project goals relating to the improvement of institutional management and fiscal stability that have been met or exceeded		2005	81	70.2	Target not met
5.13	**Aid for Institutional Development, Titles III and V.** The percentage of Title III and Title V project goals relating to the improvement of student services and student outcomes that have been met or exceeded		2005	91	78.9	Target not met
5.14	**Aid for Institutional Development, Titles III and V.** The percentage of Title III and Title V project goals relating to the improvement of academic quality that have been met or exceeded		2005	91	72.7	Target not met

Sources and Notes

5.1.2–5.1.9 U.S. Department of Education, National Center for Education Statistics (2003). *The Condition of Education 2003* (NCES 2003–067), table 18-1 and previously unpublished tabulations for 2002–03 (January 2005). U.S.

	Department of Commerce, Bureau of the Census, Current Population Survey, October Supplement, 1972–2003.
5.1.11–5.1.21	U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System, spring 2004.
5.2.1	U.S. Department of Education, Office of Postsecondary Education, Title II Data System.
5.3.1	U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System, Fall Enrollment Survey and Institutional Characteristics Survey.
5.4.1	U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System.
5.4.2	U.S. Department of Education, Institutional Development and Undergraduate Education Service, Annual Performance Report.
5.5.1	U.S. Department of Education, Office of Special Education and Rehabilitative Services, Rehabilitation Services Administration 911 Case Service Report.
5.6.1	U.S. Department of Education, Office of Postsecondary Education, Fund for the Improvement of Postsecondary Education, internal data.
5.6.3–5.6.5	U.S. Department of Education, International Education Programs Service, Evaluation of Exchange, Language, and International Area Studies, performance report program data.
5.1	U.S. Department of Education, National Center for Education Statistics, *Condition of Education 2005*, Student Effort and Educational Progress, Table 20-1.
5.2	U.S. Department of Education, Office of Postsecondary Education, TRIO Annual Performance Reports. Future targets were recalculated in FY 2006.
5.4–5.5	National Evaluation of the Upward Bound Program.
5.6	U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System, Graduation Rate Survey.
5.8	National Evaluation of Student Support Services Program.
5.11	Analysis of sampled Internal Revenue Service income data compared to data reported on the Department of Education's Free Application for Federal Student Aid reported by the Office of Federal Student Aid and the Common Origination and Disbursement System.
5.12-14	U.S. Department of Education, *Higher Education Act*, Titles III and V Annual Performance Report, grantee submissions.

Note: Titles III and V of the *Higher Education Act* include the following programs: Strengthening Institutions, American Indian Tribally Controlled Colleges and Universities, Alaska Native and Native Hawaiian-Serving Institutions, Strengthening Historically Black Colleges and Universities, Strengthening Historically Black Graduate Institutions, Minority Science and Engineering Improvement, and Developing Hispanic-Serving Institutions.

Goal 5: Enhance the Quality of and Access to Postsecondary and Adult Education

Program Performance Summary

Fifty-eight of our grant programs most directly support Goal 5. These programs are listed below. In the table, an overview is provided for the results of each program on its program performance measures. (See p. 31 for the methodology of calculating the percentage of targets met, not met, and without data.) Individual program performance reports are available at http://www.ed.gov/about/reports/annual/2006report/program.html. Appropriation and expenditure data for FY 2006 are included for each of these programs.

Program Name		PART Rating	Appro-pria-tions†	Expen-ditures‡	Program Performance Results Percent of Targets Met, Not Met, Without Data											
					FY 2006			FY 2005			FY 2004			FY 2003		
			FY 2006 $ in millions	FY 2006 $ in millions	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data
AEFLA:	Adult Education National Leadership Activities	NA	9	8	0	0	100	0	100	0	0	100	0	50	50	0
AEFLA:	Adult Education State Grants	RND	564	582	0	0	100	40	60	0	0	100	0	40	60	0
AEFLA:	National Institute for Literacy	NA	7	4	0	0	100									
ATA:	Assistive Technology Alternative Financing	RND	4	2	0	0	100					/// (not funded)				
ATA:	Assistive Technology Programs	NA	27	35	0	0	100									
EDA:	Gallaudet University	I	107	75	46	46	8	43	57	0	43	57	0	42	58	0
EDA:	National Technical Institute for the Deaf	A	56	31	67	33	0	43	57	0	29	71	0	60	40	0
HEA:	AID Developing Hispanic-Serving Institutions	RND	95	98	0	0	100	0	0	100	67	33	0	67	33	0
HEA:	AID Minority Science and Engineering Improvement	NA	9	8	0	25	75									
HEA:	AID Strengthening Alaska Native and Native Hawaiian-Serving Institutions	NA	12	10	0	0	100									
HEA:	AID Strengthening Historically Black Colleges and Universities	RND	238	222	0	0	100									
HEA:	AID Strengthening Historically Black Graduate Institutions	RND	58	56	0	0	100									
HEA:	AID Strengthening Institutions	NA	80	83	0	0	100									

Program Name	PART Rating	Appropriations†	Expenditures‡	Program Performance Results Percent of Targets Met, Not Met, Without Data											
				FY 2006			FY 2005			FY 2004			FY 2003		
		FY 2006 $ in millions	FY 2006 $ in millions	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data
HEA: AID Strengthening Tribally Controlled Colleges and Universities	NA	24	19	0	0	100									
HEA: Academic Competitiveness and SMART Grants	NA	790	47	New Program											
HEA: B.J. Stupak Olympic Scholarships	RND	1	1	0	0	100									
HEA: Byrd Honors Scholarships	RND	41	42	0	0	100	0	0	100	100	0	0	100	0	0
HEA: Child Care Access Means Parents In School	RND	16	15				0	100	0	50	50	0			
HEA: College Assistance Migrant Program	RND	15	16	0	0	100	0	0	100	0	0	100			
HEA: Demonstration Projects to Ensure Quality Higher Education for Students with Disabilities	NA	7	7	0	0	100									
HEA: Fund for the Improvement of Postsecondary Education	NA	22	136	0	0	100	50	50	0	0	100	0	50	50	0
HEA: Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)	A	303	308	60	40	0	80	20	0	100	0	0	86	14	0
HEA: Graduate Assistance in Areas of National Need (GAANN)	RND	30	28	0	0	100	85	15	0	100	0	0	100	0	0
HEA: International Education and Foreign Language Studies Domestic Programs	RND	92	93	0	0	100	33	0	67	0	0	0	60	40	0
HEA: International Education and Foreign Language Studies Institute for International Public Policy	NA	2	2	0	0	100									
MECEA: International Education and Foreign Language Studies Overseas Programs	NA	13	12	0	9	91									
HEA: Javits Fellowships	A	10	9	0	0	100	0	0	100	100	0	0	100	0	0

<table>
<tr><th rowspan="3">Program Name</th><th>PART Rating</th><th>Appro-pria-tions†</th><th>Expen-ditures‡</th><th colspan="12">Program Performance Results
Percent of Targets Met, Not Met, Without Data</th></tr>
<tr><th rowspan="2"></th><th rowspan="2">FY 2006 $ in millions</th><th rowspan="2">FY 2006 $ in millions</th><th colspan="3">FY 2006</th><th colspan="3">FY 2005</th><th colspan="3">FY 2004</th><th colspan="3">FY 2003</th></tr>
<tr><th>% Met</th><th>% Not Met</th><th>% No Data</th><th>% Met</th><th>% Not Met</th><th>% No Data</th><th>% Met</th><th>% Not Met</th><th>% No Data</th><th>% Met</th><th>% Not Met</th><th>% No Data</th></tr>
<tr><td>HEA: SFA Federal Direct Student Loans</td><td>A</td><td>6,191</td><td>6,664</td><td rowspan="7">0</td><td rowspan="7">0</td><td rowspan="7">100</td><td rowspan="7">0</td><td rowspan="7">0</td><td rowspan="7">100</td><td rowspan="7">20</td><td rowspan="7">13</td><td rowspan="7">67</td><td rowspan="7">33</td><td rowspan="7">13</td><td rowspan="7">54</td></tr>
<tr><td>HEA: SFA Federal Family Education Loan Program & Liquidating</td><td>A</td><td>27,206</td><td>27,901</td></tr>
<tr><td>HEA: SFA Federal Pell Grants</td><td>A</td><td>17,345</td><td>12,261</td></tr>
<tr><td>HEA: SFA Federal Perkins Loans</td><td>RND</td><td>65</td><td>71</td></tr>
<tr><td>HEA: SFA Federal Supplemental Educational Opportunity Grants</td><td>RND</td><td>771</td><td>784</td></tr>
<tr><td>HEA: SFA Federal Work-Study</td><td>RND</td><td>980</td><td>968</td></tr>
<tr><td>HEA: SFA Leveraging Educational Assistance Partnerships</td><td>RND</td><td>65</td><td>68</td></tr>
<tr><td>HEA: Student Aid Administration</td><td>A</td><td>719</td><td>736</td><td>0</td><td>0</td><td>100</td><td colspan="3"></td><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td>HEA: Thurgood Marshall Legal Education Opportunity</td><td>NA</td><td>3</td><td>2</td><td colspan="3"></td><td colspan="3"></td><td colspan="3">/// (not funded)</td><td colspan="3"></td></tr>
<tr><td>HEA: TRIO Educational Opportunity Centers</td><td>NA</td><td>47</td><td>61</td><td>0</td><td>0</td><td>100</td><td>0</td><td>0</td><td>100</td><td>100</td><td>0</td><td>0</td><td colspan="3"></td></tr>
<tr><td>HEA: TRIO McNair Postbaccalaureate Achievement</td><td>NA</td><td>42</td><td>52</td><td>0</td><td>0</td><td>100</td><td>100</td><td>0</td><td>0</td><td>0</td><td>0</td><td>100</td><td>100</td><td>0</td><td>0</td></tr>
<tr><td>HEA: TRIO Student Support Services</td><td>ME</td><td>273</td><td>338</td><td>0</td><td>0</td><td>100</td><td>0</td><td>0</td><td>100</td><td>50</td><td>0</td><td>50</td><td>0</td><td>0</td><td>100</td></tr>
<tr><td>HEA: TRIO Talent Search</td><td>ME</td><td>149</td><td>182</td><td>0</td><td>0</td><td>100</td><td>0</td><td>0</td><td>100</td><td>100</td><td>0</td><td>0</td><td colspan="3"></td></tr>
<tr><td>HEA: TRIO Upward Bound</td><td>I</td><td>311</td><td>216</td><td>0</td><td>0</td><td>100</td><td>0</td><td>0</td><td>100</td><td>50</td><td>0</td><td>50</td><td>0</td><td>0</td><td>100</td></tr>
<tr><td>HEA: Underground Railroad Program</td><td>NA</td><td>2</td><td>3</td><td>0</td><td>0</td><td>100</td><td>0</td><td>100</td><td>0</td><td>100</td><td>0</td><td>0</td><td colspan="3"></td></tr>
<tr><td>HERA: Aid for Institutions of Higher Education</td><td>NA</td><td>250</td><td>168</td><td colspan="3"></td><td colspan="3"></td><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td>HKNCA: Helen Keller National Center for Deaf-Blind Youths and Adults</td><td>NA</td><td>9</td><td>11</td><td>37</td><td>13</td><td>50</td><td>50</td><td>50</td><td>0</td><td>50</td><td>50</td><td>0</td><td colspan="3"></td></tr>
<tr><td>RA: Client Assistance State Grants</td><td>NA</td><td>12</td><td>12</td><td>0</td><td>0</td><td>100</td><td>50</td><td>50</td><td>0</td><td>50</td><td>50</td><td>0</td><td>100</td><td>0</td><td>0</td></tr>
<tr><td>RA: Independent Living State Grants</td><td>RND</td><td>97</td><td>97</td><td>0</td><td>0</td><td>100</td><td>0</td><td>0</td><td>100</td><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td>RA: Independent Living Services for Older Blind Individuals</td><td>NA</td><td>33</td><td>35</td><td>0</td><td>0</td><td>100</td><td>67</td><td>0</td><td>33</td><td colspan="3"></td><td colspan="3"></td></tr>
<tr><td>RA: Migrant and Seasonal Farmworkers</td><td>NA</td><td>2</td><td>2</td><td>0</td><td>0</td><td>100</td><td>100</td><td>0</td><td>0</td><td>50</td><td>50</td><td>0</td><td colspan="3"></td></tr>
<tr><td>RA: Projects with Industry</td><td>A</td><td>20</td><td>20</td><td>0</td><td>0</td><td>100</td><td>50</td><td>50</td><td>0</td><td>50</td><td>50</td><td>0</td><td>33</td><td>67</td><td>0</td></tr>
</table>

Program Name		PART Rating	Appropriations†	Expenditures‡	Program Performance Results Percent of Targets Met, Not Met, Without Data											
					FY 2006			FY 2005			FY 2004			FY 2003		
			FY 2006 $ in millions	FY 2006 $ in millions	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data	% Met	% Not Met	% No Data
RA:	Protection and Advocacy of Individual Rights	NA	16	17	0	0	100	100	0	0	100	0	0			
RA:	Supported Employment State Grants	NA	30	30	0	0	100	0	100	0	100	0	0	100	0	0
RA:	Vocational Rehabilitation Demonstration and Training Programs	RND	7	21	0	0	100	67	33	0	0	100	0	60	40	0
RA:	Vocational Rehabilitation Grants for Indians	A	33	31	0	0	100	100	0	0	33	67	0	100	0	0
RA:	Vocational Rehabilitation Recreational Programs	NA	2	2	0	100	0	100	0	0	100	0	0			
RA:	Vocational Rehabilitation State Grants	A	2,687	2,582	0	0	100	50	50	0	50	50	0	50	50	0
RA:	Vocational Rehabilitation Training	NA	38	42	0	0	100	100	0	0	75	25	0	57	43	0
USC:	Howard University	A	237	234	0	0	100	0	0	100	100	0	0	42	58	0
VTEA:	Tribally Controlled Postsecondary Vocational and Technical Institutions	RND	7	7	0	100	0	0	100	0	0	100	0	100	0	0
Administrative and Support Funding for Goal 5#			181	2	#			#			#			#		
TOTAL			**60,462**	***55,579**												

† Budget for each program represents program budget authority.

‡ Expenditures occur when recipients draw down funds to cover actual outlays. FY 2006 expenditures may include funds from prior years' appropriations.

A shaded cell denotes that the program did not have targets for the specified year.

/// Denotes programs not yet implemented. (Programs are often implemented near the end of the year they are first funded.)

\# The Department does not plan to develop performance measures for programs, activities, or budgetary line items that are administrative in nature or that serve to support other programs and their performance measures.

* Expenditures by program do not include outlays in the amount of $15 million for prior years obligations for Goal 5 programs that were not funded in FY 2006 or FY 2006 estimated accruals in the amount of $1,719 million.

AEFLA: Adult Education and Family Literacy Act
AID: Aid for Institutional Development
ATA: Assistive Technology Act
EDA: Education of the Deaf Act
ESEA: Elementary and Secondary Education Act
HEA: Higher Education Act
HERA: Hurricane Education Recovery Act

HKNCA: Helen Keller National Center Act
MECEA: Mutual Educational and Cultural Exchange Act of 1961
NLA: National Literacy Act
RA: Rehabilitation Act
SFA: Student Financial Assistance programs
USC: United States Code
VTEA: Perkins Vocational and Technical Education Act

PART Rating
E = Effective
ME = Moderately Effective
A = Adequate
I = Ineffective
RND = Results Not Demonstrated
NA = Program has not been assessed

Goal 6: Establish Management Excellence

Key Measures

The Office of Management and Budget has required all 15 Cabinet-level departments and 10 other major federal agencies to report quarterly on their progress toward demonstrating administrative excellence. The *President's Management Agenda* comprises five major initiatives designed to assure Americans of the efficient use of federal funds and the effective responsiveness of the federal government to their needs.

At the Department, we have identified within our sixth goal, Establishing Management Excellence, nine key measures aligned with the initiatives of the *President's Management Agenda*. Success in meeting challenging targets for these measures ensures management results that maximize value to taxpayers, channel available resources toward high-performing programs, and help students achieve in the classroom.

Financial Integrity and Management

One major initiative of the *President's Management Agenda* is Improved Financial Performance. The Office of Management and Budget monitors 24 departments and agencies progress in relation to Financial Management through the *President's Management Agenda Scorecard.* Each year agencies are required to step up their financial management program. The Department demonstrated its ability to improve financial management through several foundational requirements. First, the Department has maintained an unqualified opinion for 5 years, improved reporting capabilities and is working to further enhance reporting through risk adjusted performance reporting. This initiative further enhances our management and external reporting.

6.1.A The achievement of an unqualified audit opinion. [2204]

Fiscal Year	Actual
1999	Qualified
2000	Qualified
2001	Qualified
2002	Unqualified
2003	Unqualified
2004	Unqualified
2005	Unqualified
2006	Unqualified
2006 target met	

Independent Auditors' Financial Statement and Audit Reports, FY 1999 through FY 2006.

Analysis of Progress. For the fifth year, the Department has earned an unqualified or "clean" audit opinion from independent auditors.

Data Quality. Independent auditors follow professional standards and conduct the audit under the oversight of the Department's Office of Inspector General. There are no data limitations.

Strategic Human Capital Management

Human capital management is a concern throughout the federal government and is a major reason for the *President's Management Agenda* initiative, Strategic Management of Human Capital. Not only must the federal government compete with the private sector for top talent, but also it faces a potential shortage of experienced staff. At this time, it is estimated that approximately one half of the current federal employee workforce will be eligible either to retire or to seek early retirement by the year 2010. At the Department, we are approaching historic lows in total personnel, while our budget is at an all-time high. Our employees must manage increasing responsibilities while maintaining exemplary performance to guarantee the effective use of federal dollars for the benefit of America's students.

6.2.A Index of quality human capital performance management activities.[2205]	
Fiscal Year	**Actual**
2005	72
2006	**58**
2006 target of 73 not met	

U.S. Department of Education, Office of Management, via data from the Education Department Performance Appraisal System and the U.S. Department of the Interior's Federal Personnel/ Payroll System. The latter system provides personnel and payroll support to numerous federal agencies, including the Department of Education.

Analysis of Progress. This measure is a composite of three measurements: percentage of employees that have established effective performance standards prior to the beginning of the rating cycle, the percentage of employees who have documented ratings of record in the system with 30 days of the close of the rating cycle, and lastly, the percentage of awards paid out to employees with outstanding performance ratings.

The large variance from last year and the target is attributed to the fact that senior leadership extended the timelines for the completion of performance plans and ratings, and the first two components of the measure experienced material decreases. The two measures declined 14 and 31 percent respectively, while the third measure increased 14 percent.

Information Technology Management

Expanded electronic government comprises a fourth major initiative of the *President's Management Agenda*. The Department's primary task in this initiative is the migration of discretionary grant competitions from paper to electronic format.

The Department has played a leading role in the initiative to simplify federal government grant application and award processes. In FY 2006, the Department was selected as a "center of excellence" in the Grants Management Line of Business government-wide project. The Department will be a grant administration service center available to federal agencies.

6.3.A The percentage of discretionary grant programs providing online application capability. [2206]

Fiscal Year	Actual
2000	5
2001	20
2002	29
2003	57
2004	77
2005	86
2006	**84**
2006 target of 84 met	

U.S. Department of Education, Office of the Chief Financial Officer, Grant Administration and Payment System.

Analysis of Progress. This Department met its target for utilizing online facilities in the grant application process. Although the measure declined slightly, there was no material difference.

Data Quality. This statistic is a comparison between active schedules in the Grant Administration and Payment System and e-Grants participation. Grant competitions providing either e-Application or Grants.gov applications will be counted as participating in the electronic submission.

Customer Service for Student Financial Assistance

A major foundation of the *President's Management Agenda* is that government must be focused on the citizens it serves, and student financial assistance programs unquestionably comprise the busiest area of Department customer service activity. In overseeing a student loan portfolio comprising more than $400 billion and exceeding 26 million borrowers, and in managing the Federal Pell Grant program, which provided more than $12 billion in FY 2006 for low-income postsecondary students, we demonstrate the quality level of our customer service activities before a very large audience. Thus, our customer service performance measures focus on various aspects of service delivery within student financial assistance operations.

6.4.A Customer service level for Free Application for Federal Student Aid on the Web. [2207]

Fiscal Year	Actual
2003	86
2004	81
2005	81
2006	**80**
2006 Target of 83 not met	

FY 2006 American Customer Satisfaction Index Survey.

6.4.B Customer service level for Direct Loan Servicing. [2208]

Fiscal Year	Actual
2003	77
2004	78
2005	76
2006	**79**
2006 Target of 77 exceeded	

FY 2006 American Customer Satisfaction Index Survey.

6.4.C Customer service level for Common Origination and Disbursement. [2209]

Fiscal Year	Actual
2003	66
2004	72
2005	76
2006	**77**
2006 Target of 76 exceeded	

FY 2006 American Customer Satisfaction Index Survey.

6.4.D Customer service level for Lender Reporting System. [2210]

Fiscal Year	Actual
2003	71
2004	73
2005	72
2006	**71**
2006 Target of 74 not met	

FY 2006 American Customer Satisfaction Index Survey.

Analysis of Progress. The FY 2006 American Customer Satisfaction Index (ACSI) ratings for Federal Student Aid's highest volume products and services – including Direct Loan Servicing, *Free Application for Federal Student Aid* (*FAFSA)* on the Web, the Common Origination and Disbursement system and the Lender Application and Reporting System – score in the "Excellent" and "Good" range. The Common Origination and Disbursement system received an improved ACSI score.

Continuation of the multi-year enterprise communications strategy that was launched in FY 2005 to better articulate the benefits of postsecondary education, raise awareness of federal student aid programs and improve consistency across all communications to the many stakeholders, including currently underserved communities. In FY 2006, Federal Student Aid began full-scale implementation of this strategy launching a new Federal Student Aid brand and incorporating it across multiple points of presence.

Direct Loan Servicing and the Common Origination and Disbursement measures exceeded their performance targets. However, customer service for the *FAFSA* on the Web missed its target by three points and the Lender Reporting System by one point. Customer service for *FAFSA* is still the highest scoring Federal Student Aid product or service. However, its score declined by one point from last year. Direct Loan Servicing made significant progress this year increasing its score to a 79, an increase of three points. Common Origination and Disbursement servicing and the Lender Reporting system remain relatively unchanged.

Data Quality. Federal Student Aid established performance targets last year that were included in the *FY 2006 – 2010 Five Year Plan* to measure customer service were delineated in percentile rank. This was done to provide a common measure of customer satisfaction regardless of the method or company used to conduct the customer satisfaction surveys. Unfortunately, so few companies are included in the ACSI sector benchmark averages, the percentile rank does not accurately reflect true performance. For example, a single point change in the ACSI score of *FAFSA* on the Web resulted in a 21 percent change in percentile ranking.

Budget and Performance Integration

A fifth major initiative of the *President's Management Agenda* is Budget and Performance Integration. Simply put, the size of a federal education program's budget should significantly correlate with its efficacy in improving student achievement. If a program works, more funding is justified; if it doesn't, the program either should undergo corrective action or be eliminated.

The Office of Management and Budget and the Department have worked together to measure program effectiveness by means of the Program Assessment Rating Tool (PART). By analyzing a program's purpose, strategic planning functions, management capability, and demonstrated results, this tool has identified the strengths and weaknesses of both major and minor Department programs. The Department used the PART process to make significant changes to ineffective programs or, in some cases, to recommend their termination. The overriding goal is that Department-funded programs demonstrate proven effectiveness.

6.5 The percentage of Department program dollars associated with programs, reviewed under the Program Assessment Rating Tool process, which were rated effective. [2211]	
Fiscal Year	**Actual**
2002	55
2003	52
2004	47
2005	**78**
2006	**Target is 79**
2005 target of 78 met 2006 data expected Aug. 2007	

U.S. Department of Education, analysis of Program Assessment Rating Tool findings.

Analysis of Progress. In FY 2005, the Office of Management and Budget assessed 18 Department programs using the PART, bringing the total number of programs assessed to 74. These programs represent 78.3 percent of the Department's 2005 appropriation for PART-eligible programs. Because of its successful efforts to address program deficiencies identified through the PART process, the Department was able to move 5 programs that were previously rated "Results Not Demonstrated" out of this category and into the "Adequate" and "Moderately Effective" categories in FY 2005.

These reassessed programs, including the Special Education Grants to States and Improving Teacher Quality State Grants programs, represent 25 percent of the budget authority for programs subject to the PART through FY 2005. The Department also made significant strides in its efforts to measure and improve the efficiency of its programs. In July 2005, the Department submitted its first annual efficiency measures report to the Office of Management and Budget with information on the 42 programs for which the Department had established efficiency measures.

Faith-Based and Community Organization Grantees

In addition to the five major *President's Management Agenda* initiatives, the Office of Management and Budget also grades the Department on eliminating improper barriers that hinder faith-based and community organizations from participating in the provision of certain federal social services. The Department has actively encouraged faith-based and community organizations to apply for discretionary grant competitions deemed amenable to their participation. Of particular significance, we developed clear guidance for our program offices on the equal treatment of grant applicants regardless of their organizational background. This effort has had a side benefit of increasing our awareness of the efforts of novice (first-time) applicants other than faith-based and community organizations.

6.6 The percentage of applications in competitions of amenable discretionary programs that are faith-based or community organizations. [2212]	
Fiscal Year	**Actual**
2006	**Baseline established**
2006 target to establish baseline met	

U.S. Department of Education, Office of the Secretary, Center for Faith-Based and Community Initiatives.

Analysis of Progress. This is a new key measure for FY 2006. The data was collected, and a baseline was established.

Data Quality. The Department tracks the application process and analyzes the data at the end of the fiscal year.

Target Context. The measure is calculated as the number of discretionary grant competition applications from faith-based and community organizations divided by the total discretionary grant competition applications.

Goal 6: Establish Management Excellence

Performance Summary

The Department attributes the accounts below to Goal 6. These programs are listed below. In the table, an overview is provided for the results of each program on its program performance measures. (See p. 31 for the methodology of calculating the percentage of targets met, not met, and without data.) Individual program performance reports are available at http://www.ed.gov/about/reports/annual/2006report/program.html. Appropriation and expenditure data for FY 2006 are included for each of these programs.

Program Name	**Appro-pria-tions†**	**Expen-ditures‡**	**Program Performance Results Percent of Targets Met, Not Met, Without Data**											
	FY 2006 $ in millions	**FY 2006 $ in millions**	**FY 2006**			**FY 2005**			**FY 2004**			**FY 2003**		
			% Met	**% Not Met**	**% No Data**	**% Met**	**% Not Met**	**% No Data**	**% Met**	**% Not Met**	**% No Data**	**% Met**	**% Not Met**	**% No Data**
Office for Civil Rights	91	85	100	0	0	100	0	0	100	0	0	100	0	0
Office of Inspector General	49	46	100	0	0	33	67	0						
Program Administration #	411	420	#				#			#			#	
TOTAL	**551**	**555**												

† Budget for each account represents function budget authority.

‡ Expenditures occur when recipients draw down funds to cover actual outlays. FY 2006 expenditures may include funds from prior years' appropriations.

A shaded cell denotes that the program did not have targets for the specified year.

The Department does not plan to develop performance measures for programs, activities, or budgetary line items that are administrative in nature or that serve to support other programs and their performance measures.

Summary of Inspector General and Government Accountability Office Reports

The previous pages of this document have explained in detail how the Department is doing in meeting its *Strategic Plan* performance goals. The Office of Inspector General (OIG) promotes the efficiency, effectiveness and integrity of the Department's programs through independent and objective audits, among other activities. These activities, along with reports from the Government Accountability Office (GAO), allow the Department to focus its attention and resources on areas of particular importance in meeting the *Strategic Plan* performance goals.

Below is an abbreviated list of the FY 2006 Inspector General and Government Accountability Office reports presented by Strategic Plan Goal. We provide a brief synopsis of the issue and Department's response.

Goal	Report Name Organization	Issue	Department's Response
1	Gulf Coast Hurricanes: Lessons Learned for Protecting and Educating Children (GAO-06-680R) May 2006 **Department**	This report reviewed the numbers of missing children, foster children receiving welfare services, and schoolchildren displaced by the storms or damage to their schools, and the challenges for educating displaced school-aged children. Four federal agencies were referenced.	The Department granted flexibility in reporting and other requirements that allowed states and districts to focus on rebuilding. Using the *McKinney-Vento Homeless Assistance Act* to enroll displaced students in new schools ensured that the students' education continued.
1	No Child Left Behind: States Face Challenges Measuring Academic Growth That Education's Initiatives May Help Address (GAO-06-661) July 2006 **Department / Office of Elementary and Secondary Education**	The Department should provide assistance in helping states with the challenges they face in measuring academic growth and in measuring progress in achieving key No Child Left Behind goals.	The Department initiated a pilot project for selected states to use growth models that met its specific criteria to determine "adequate yearly progress." Additionally, the Department initiated a grant competition to support the design of longitudinal data systems to track individual student test scores over time.
2	No Child Left Behind: Improved Accessibility to Education's Information Could Help States Further Implement Teacher Qualification Requirements (GAO-06-25) November 2005 **Department / Office of Elementary and Secondary Education**	The Department should explore ways to make the Web-based information on teacher qualification requirements more accessible to users of its Web site.	The Department agreed with this finding and has already taken steps to address it.

Goal	Report Name Organization	Issue	Department's Response
2	Individuals with Disabilities Education Act: Education Should Provide Additional Guidance to Help States Smoothly Transition Children to Preschool (GAO-06-26) December 2005 **Office of Special Education and Rehabilitative Services**	The Department needs to provide states with additional guidance on transition planning and services for children with third birthdays during the summer, and especially in cases where children are likely to need extended school year services.	The Department disagreed that service gaps in the transition from Part C (birth to age three) to Part B (ages three through five) are specific to summer months as the report states. Preliminary data from a Department-funded study indicated that the service gap is specific to transition whenever the transition occurs, not just the summer months.
2	The U.S. Department of Education's Activities Relating to Consolidating Funds in Schoolwide Programs Provisions (ED-OIG/A07F0014) December 2005 **Office of Elementary and Secondary Education**	The Department could do more to assist state educational agencies in eliminating state fiscal and accounting barriers to consolidating funds in their schoolwide Title I programs.	The Department concurred with both findings. However, the Department did not concur with the recommendation to require reports for state educational agencies, program reviews and corrective actions to identify failures on the part of state educational agencies to fulfill their responsibilities. The disagreement is due to a contradiction in statutory requirements.
2	Final Audit Report of the Cooperative Agreement Between the State Scholars Initiative Program and the Department of Education (ED-OIG/A06F0006) January 2006 **Office of Vocational and Adult Education**	The Department did not award the State Initiative grant in accordance with applicable regulations and Department policy, and the Office of Vocational and Adult Education did not provide adequate program management and did not address financial problems expeditiously.	The Department is taking steps to improve guidance on maintaining official grant files, but staff, when alerted to irregularities, took immediate action.
2	Troops-to-Teachers Program Brings More Men and Minorities to the Teaching Workforce, but Education Could Improve Management to Enhance Results (GAO-06-265) March 2006 **Office of Innovation and Improvement**	The Department should improve program management for the Troops-to-Teachers program and better coordinate with other teacher recruitment and retention initiatives.	The Department generally concurred with GAO's findings and recommendations and is proceeding with implementation.
2	No Child Left Behind Act: Assistance From Education Could Help States Better Measure Progress of Students with Limited English Proficiency (GAO-06-815) July 2006 **Department / Office of Elementary and Secondary Education**	The Department should support additional research on accommodations, support states to ensure the validity of academic assessments, publish more detailed guidance on assessing English proficiency, and provide flexibility in measuring annual progress for students with limited English proficiency.	The Department generally agreed with GAO's recommendations. The Department has conducted research on the effectiveness of accommodations and has begun identifying additional technical assistance needs of states for academic assessments and to help states assess English language proficiency. The Department has already provided flexibility regarding the inclusion of limited English proficient students in accountability systems.

Goal	Report Name Organization	Issue	Department's Response
2	No Child Left Behind: Education Actions Needed to Improve Local Implementation and State Evaluation of Supplemental Educational Services (GAO-06-758) August 2006 **Department**	The Department should disseminate information on promising practices to improve Supplemental Educational Services implementation, provide states with technical assistance to improve evaluation of Supplemental Educational Services' effect on student achievement, and expand program flexibility.	The Department generally concurred with GAO's recommendations. The Department has provided state and local agencies with sample parent notification material in non-regulatory guidance. The Department's Comprehensive Center on Innovation and Improvement has provided additional technical assistance. The Department will be providing additional technical assistance at the Project Directors' meeting and will be disseminating promising practices.
4	Federal Autism Activities: Funding for Research Has Increased, but Agencies Need to Resolve Surveillance Challenges (GAO-06-700) July 2006 **Department**	The Department should work with the Department of Health and Human Services to identify options for overcoming challenges to the Centers for Disease Control's ability to acquire individual student records for autism surveillance.	The Department did not agree as the recommendation does not reflect the important privacy protections established by the Family Educational Rights and Privacy Act nor Congress' concern with preserving the rights of parents to be notified and refuse or consent to disclosure of their children's records.
5	Transfer Students: Postsecondary Institutions Could Promote More Consistent Consideration of Coursework by Not Basing Determinations on Accreditation (GAO-06-22) October 2005 **Office of Postsecondary Education**	The Department and Congress require postsecondary institutions eligible for Title IV funding not to deny the transfer of credit on the basis of a sending institutions' type of accreditation.	The Department found the recommendation to be useful and informative.
5	Death and Total and Permanent Disability Discharges of FFEL and Direct Loan Program Loans (ED-OIG/A04E0006) November 2005 **Federal Student Aid**	The Inspector General identified problems with policies, procedures, and internal controls over loans established for disability discharges.	The Department concurred with one finding but did not concur that, when reinstated from a conditional discharge status, borrowers should be required to pay interest.
5	Overlapping Services in the Department of Education's Office of Postsecondary Education Programs (ED-OIG/X07F0002) February 2006 **Office of Postsecondary Education**	The Office of Postsecondary Education administers at least 41 discretionary and formula grants with duplicative program objectives serving like areas and populations as 14 Vocational and Adult Education programs and 13 Elementary and Secondary Education programs.	The Department concurred with the report and has proposed elimination of many duplicative or unneeded programs. The Department continues to realign programs with similar goals and objectives.

Goal	Report Name Organization	Issue	Department's Response
5	Review of Financial Partners' Monitoring and Oversight of Guaranty Agencies, Lenders and Servicers. (ED-OIG/AO4E0009) September 2006 **Federal Student Aid**	The report identified internal control weaknesses relating to five of the internal control standards – control environment, control activities, monitoring, information and communication, and risk assessment. Based on the review, Financial Partners did not provide adequate oversight and consistently enforce FFEL program requirements.	The Department disagreed with the overall conclusion reached regarding the control environment, but acknowledged that there may be areas where improvements can be made.
5	Special Allowance Payments to Nelnet for Loans Funded by Tax-Exempt Obligations. (ED-OIG/A07F0017) September 2006 **Federal Student Aid**	The report questioned payments made to an entity that participates in the Federal Family Education Loan Program.	The Secretary is currently considering the Department's response to the findings and recommendations contained in this report.
6	Education's Data Management Initiative: Significant Progress Made, but Better Planning Needed to Accomplish Goals (GAO-06-6) October 2005 **Office of Planning, Evaluation and Policy Development**	The Department should develop a strategy to help states provide quality data and a clear plan for completing final aspects of the initiative.	The Department concurred with the recommendations and is in the process of developing a detailed project plan to complete the initiative and is devoting additional resources for its enhancement.
6	Discretionary Grants: Further Tightening of Education's Procedures for Making Awards Could Improve Transparency and Accountability (GAO-06-268) February 2006 **Department / Office of Innovation and Improvement**	The Department should develop a systematic format to select unsolicited proposals, ensure that all competition plans are finalized before competitions begin, and implement a policy to screen applicants for compliance with audit requirements before the award.	The Department agreed with three of the four recommendations, but disagreed with the recommendation that it develop a more systematic approach to select unsolicited proposals for consideration as it would not necessarily produce high-quality applications.
6	Audit of the Department of Education's Follow-up Process for Internal Audits (ED-OIG/A19E0017) February 2006 **Office of the Chief Financial Officer**	The Department's audit follow-up system was not always effective as systems were not always in place to follow up on corrective actions, monitor the Department's compliance with the Office of Management and Budget Circular A-50, and ensure the effectiveness of the audit resolution process.	The Department concurred with the report and provided a proposed corrective action plan to address recommendations.
6	The U.S. Department of Education's Monitoring of Adherence to Matching Requirements (ED-OIG/A05F0015) March 2006 **Office of the Chief Financial Officer**	The Department did not have adequate procedures in place to monitor grantees' adherence to matching requirements for the majority of its programs, and adequate guidance, training, and oversight of procedures to monitor cost-sharing were not provided to program staff.	The Department concurred and will revise its Handbook to better inform program staff about matching requirements, and will review selected programs for compliance with matching requirements. The Department will update all relevant training courses and ensure the training reflects current policy.

Goal	Report Name Organization	Issue	Department's Response
6	Faith-Based and Community Initiative: Improvements in Monitoring Grantees and Measuring Performance Could Enhance Accountability (GAO-06-616) June 2006 **Department**	Federal agencies should include information on safeguards in grants and grant monitoring, improve data on grants awarded to faith-based organizations, and develop a plan for reporting on faith-based organizations' long-term goals.	The Department disagreed with the recommendation on the basis that the safeguards are already in place for grant programs apply equally to faith-based organizations.

Financial Details

The Department of Education continued its high standard of financial management and reporting during fiscal year 2006. In this part of the *Performance and Accountability Report*, I have the pleasure of presenting to the President and the American people the financial details on the Department's stewardship and management of the public funds to which we have been entrusted.

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

- Received an unqualified opinion on the principal financial statements for the fifth consecutive year, demonstrating a clear pattern of financial accountability;
- Continued to have no material weaknesses identified as part of our Report on Internal Control for the fourth consecutive year;
- Received a "green" status in Financial Management on the *President's Management Scorecard* for the third consecutive year;
- Awarded the prestigious "Certificate of Excellence in Accountability Reporting" from the Association of Government Accountants for the third consecutive year;
- Continue to provide reasonable assurance of its internal controls over financial reporting.

In 2006, the Department furthered its efforts to correct the two reportable conditions identified by the auditors in the "Report on Internal Controls." To address the reportable condition regarding the credit reform estimation the Credit Steering committee has worked diligently to continue to improve the process. The work group is comprised of managers from the Office of the Chief Financial Officer, Budget Service and Federal Student Aid. Throughout the fiscal year the committee has reviewed and documented the analytical tools used for the loan estimation process. Currently new analytical tools are also in development to enhance the monitoring of loans at the cohort level. The Department also continued to address the other reportable condition regarding controls surrounding information systems.

During FY 2006, the Department conducted an assessment of the effectiveness of its internal control over financial reporting. This review was based upon the expanded requirements of OMB Circular A-123 (Appendix A), *Management's Responsibility for Internal Control*. We are pleased to report that the Department can give an unqualified statement of assurance on its internal control over financial reporting. This examination has presented us the opportunity to further review and improve upon our internal controls and thereby will continue to ensure the greatest integrity in our financial management and reporting.

/s/

Lawrence Warder
Chief Financial Officer
November 15, 2006

Financial Summary

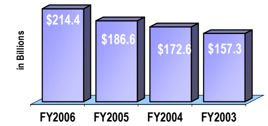
(Dollars in Millions)

At End of Year	% Change 2006 / 2005	FY2006	FY2005	FY2004	FY2003
Condensed Balance Sheet Data					
Fund Balance with Treasury	+ 38%	$ 107,053	$ 77,569	$ 66,371	$ 57,908
Credit Program Receivables	- 1%	106,728	107,937	104,966	97,965
Accounts Receivable	- 69%	44	141	155	183
Other	- 35%	596	920	1,117	1,202
Total Assets	+ 15%	$ 214,421	$ 186,567	$ 172,609	$ 157,258
Debt	+ 1%	$ 105,677	$ 104,597	$ 96,649	$ 92,018
Other Intragovernmental Liabilities	+ 1%	6,182	6,146	6,051	8,250
Liabilities for Loan Guarantees	+ 71%	52,453	30,611	23,329	15,432
Other Liabilities	+ 39%	3,299	2,371	2,246	2,124
Total Liabilities	+ 17%	167,611	143,725	128,275	117,824
Unexpended Appropriations	+ 10%	51,812	47,288	47,285	43,931
Cumulative Results of Operations	+ 13%	(5,002)	(4,446)	(2,951)	(4,497)
Total Net Position	+ 9%	46,810	42,842	44,334	39,434
Total Liabilities and Net Position	+ 15%	$ 214,421	$ 186,567	$ 172,609	$ 157,258

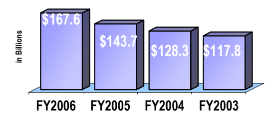
For the Year	2006 / 2005	FY2006	FY2005	FY2004	FY2003
Statement of Net Cost					
Total Cost	+ 27%	$ 104,699	$ 82,204	$ 70,187	$ 65,327
Earned Revenue	+ 13%	(7,870)	(6,965)	(6,564)	(6,523)
Total Net Cost of Operations	+ 29%	$ 96,829	$ 75,239	$ 63,623	$ 58,804
Net Cost by Strategic Goal					
Goal 2 Improve Student Achievement	+ 4%	$ 37,700	$ 36,415	$ 32,687	$ 29,679
Goal 3 Develop Safe Schools and Strong Character	- 3%	849	877	756	776
Goal 4 Transform Education into Evidenced-Based Field	- 5%	422	442	467	490
Goal 5 Enhance Quality of and Access to Postsecondary and Adult Education	+ 55%	57,303	36,940	29,713	27,859
Goal 6 Management Excellence[1]	- 2%	555	565	-	-
	+ 29%	$ 96,829	$ 75,239	$ 63,623	$ 58,804
Net Cost Percentages by Strategic Goal					
Goal 2 Improve Student Achievement	- 20%	38.90%	48.40%	51.38%	50.47%
Goal 3 Develop Safe Schools and Strong Character	- 25%	0.88%	1.17%	1.19%	1.32%
Goal 4 Transform Education into Evidenced-Based Field	- 25%	0.44%	0.59%	0.73%	0.83%
Goal 5 Enhance Quality of and Access to Postsecondary and Adult Education	+ 21%	59.18%	49.09%	46.70%	47.38%
Goal 6 Management Excellence[1]	- 20%	0.60%	0.75%	N/A	N/A

[1] *In FY03 and FY04 Goal 6 was not included in this summary*

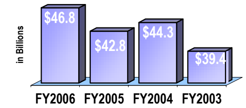
Total Assets



Total Liabilities

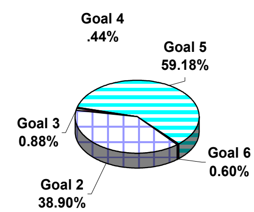


Net Position

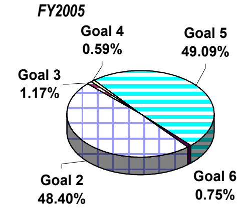


Net Cost by Strategic Goal

FY 2006



FY2005



Limitations of Financial Statements

Management has prepared the accompanying financial statements to report the financial position and operational results for the U.S. Department of Education for fiscal years 2006 and 2005 pursuant to the requirements of Title 31 of the United States Code, section 3515(b).

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

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

United States Department of Education
Consolidated Balance Sheet
As of September 30, 2006 and 2005

(Dollars in Millions)

	Fiscal Year 2006	Fiscal Year 2005
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 2)	$ 107,053	$ 77,569
Accounts Receivable (Note 3)	1	
Other Intragovernmental Assets		12
Total Intragovernmental	107,054	77,581
Cash and Other Monetary Assets (Note 4)	566	888
Accounts Receivable, Net (Note 3)	43	141
Credit Program Receivables, Net (Note 5)	106,728	107,937
General Property, Plant and Equipment, Net (Note 6)	29	19
Other Assets	1	1
Total Assets	**$ 214,421**	**$ 186,567**
Liabilities:		
Intragovernmental:		
Accounts Payable		$ 12
Debt (Note 7)	$ 105,677	104,597
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 4)	566	888
Payable to Treasury (Note 5)	5,519	5,166
Other Intragovernmental Liabilities (Note 8)	97	80
Total Intragovernmental	111,859	110,743
Accounts Payable	859	684
Accrued Grant Liability (Note 9)	2,059	1,328
Liabilities for Loan Guarantees (Note 5)	52,453	30,611
Other Liabilities (Note 8)	381	359
Total Liabilities	**$ 167,611**	**$ 143,725**
Commitments and Contingencies (Note 16)		
Net Position:		
Unexpended Appropriations - Earmarked Funds		
Unexpended Appropriations - Other Funds	$ 51,812	$ 47,288
Cumulative Results of Operations - Earmarked Funds (Note 15)	61	
Cumulative Results of Operations - Other Funds	(5,063)	(4,446)
Total Net Position (Note 10)	**$ 46,810**	**$ 42,842**
Total Liabilities and Net Position	**$ 214,421**	**$ 186,567**

The accompanying notes are an integral part of these statements.

United States Department of Education
Consolidated Statement of Net Cost
For the Years Ended September 30, 2006 and 2005
(Dollars in Millions)

	Fiscal Year 2006	Fiscal Year 2005
Program Costs		
Enhancement of Postsecondary and Adult Education		
Gross costs	$ 63,356	$ 42,351
Less: Earned Revenue	7,790	6,870
Net Program Costs	55,566	35,481
Total Program Costs	**$ 55,566**	**$ 35,481**
Creation of Student Achievement, Culture of Achievement and Safe Schools		
Gross costs	$ 24,605	$ 24,464
Less: Earned Revenue	60	76
Net Program Costs	24,545	24,388
Total Program Costs	**$ 24,545**	**$ 24,388**
Transformation of Education		
Gross costs	$ 1,363	$ 1,220
Less: Earned Revenue	18	17
Net Program Costs	1,345	1,203
Total Program Costs	**$ 1,345**	**$ 1,203**
Special Education and Program Execution		
Gross costs	$ 15,375	$ 14,169
Less: Earned Revenue	2	2
Net Program Costs	15,373	14,167
Total Program Costs	**$ 15,373**	**$ 14,167**
Grand Total Program Costs	**$ 96,829**	**$ 75,239**
Net Cost of Operations (Note 11)	**$ 96,829**	**$ 75,239**

The accompanying notes are an integral part of these statements.

United States Department of Education
Consolidated Statement of Changes in Net Position
For the Years Ended September 30, 2006 and 2005

(Dollars in Millions)

	Fiscal Year 2006		Fiscal Year 2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances				
Beginning Balances - Earmarked Funds				
Beginning Balances - All Other Funds	**$ (4,446)**	**$ 47,288**	**$ (2,951)**	**$ 47,285**
Beginning Balances, as adjusted - Earmarked Funds				
Beginning Balances, as adjusted - All Other Funds	$ (4,446)	$ 47,288	$ (2,951)	$ 47,285
Budgetary Financing Sources:				
Appropriations Received				
Appropriations Received - Earmarked Funds				
Appropriations Received - All Other Funds		$ 102,139		$ 77,033
Other Adjustments (rescissions, etc)				
Other Adjustments (rescissions, etc) - Earmarked Funds				
Other Adjustments (rescissions, etc) - All Other Funds		(1,509)	$ (3)	(1,312)
Appropriations Used				
Appropriations Used - Earmarked Funds				
Appropriations Used - All Other Funds	$ 96,106	(96,106)	75,718	(75,718)
Donations and Forfeitures of Cash and Cash Equivalents				
Donations and Forfeitures of Cash and Cash Equivalents - Earmarked Funds	61			
Donations and Forfeitures of Cash and Cash Equivalents - All Other Funds				
Nonexpenditure Financing Sources - Transfers-Out				
Nonexpenditure Financing Sources - Transfers-Out - Earmarked Funds				
Nonexpenditure Financing Sources - Transfers-Out - All Other Funds	(36)		(33)	
Other Financing Sources:				
Imputed Financing from Costs Absorbed by Others				
Imputed Financing from Costs Absorbed by Others - Earmarked Funds				
Imputed Financing from Costs Absorbed by Others - All Other Funds	$ 31		$ 31	
Others				
Others - Earmarked Funds				
Others - All Other Funds	111		(1,969)	
Total Financing Sources	$ 96,273	$ 4,524	$ 73,744	$ 3
Total Financing Sources - Earmarked Funds	$ 61			
Total Financing Sources - All Other Funds	$ 96,212	$ 4,524	$ 73,744	$ 3
Net Cost of Operations				
Net Cost of Operations - Earmarked Funds				
Net Cost of Operations - All Other Funds	**$ (96,829)**		**$ (75,239)**	
Net Change				
Net Change - Earmarked Funds	$ 61			
Net Change - All Other Funds	$ (617)	$ 4,524	$ (1,495)	$ 3
Ending Balances - Earmarked Funds (Note 10)	**$ 61**	**$ (0)**	**$ (0)**	**$ (0)**
Ending Balances - All Other Funds (Note 10)	**$ (5,063)**	**$ 51,812**	**$ (4,446)**	**$ 47,288**

The accompanying notes are an integral part of these statements.

United States Department of Education
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2006 and 2005

(Dollars in Millions)

	Fiscal Year 2006 Budgetary	Fiscal Year 2006 Budgetary Credit Reform Financing Accounts	Fiscal Year 2005 Budgetary	Fiscal Year 2005 Budgetary Credit Reform Financing Accounts
Budgetary Resources:				
Unobligated balance, brought forward, October 1:	$ 2,137	$ 22,817	$ 2,245	$ 15,128
Recoveries of prior year Unpaid Obligations	1,434	3,450	1,536	1,973
Budgetary Authority:				
Appropriations	102,197	108	76,981	3
Borrowing Authority		35,089		32,209
Spending authority from offsetting collections (gross):				
Earned				
Collected	2,074	77,399	3,198	49,536
Change in Receivables from Federal Sources	1		(3)	(2)
Change in unfilled customer orders				
Advance Received	9		64	
Without advance from Federal Sources	(1)	(4)	(68)	34
Subtotal	$ 104,280	$ 112,592	$ 80,172	$ 81,780
Permanently not available	(3,537)	(32,252)	(4,047)	(24,692)
Total Budgetary Resources (Note 13)	**$ 104,314**	**$ 106,607**	**$ 79,906**	**$ 74,189**
Status of Budgetary Resources:				
Obligations incurred: (Note 13)				
Direct	$ 99,001	$ 60,117	$ 77,677	$ 51,372
Reimbursable	92		92	
Subtotal	$ 99,093	$ 60,117	$ 77,769	$ 51,372
Unobligated Balances:				
Apportioned	4,081		526	
Subtotal	$ 4,081		$ 526	
Unobligated Balance not available	1,140	46,490	1,611	22,817
Total Status of Budgetary Resources	**$ 104,314**	**$ 106,607**	**$ 79,906**	**$ 74,189**
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 48,213	$ 10,802	$ 48,221	$ 7,790
Less: Uncollected customer payments from Federal Sources, brought forward, October 1	3	34	74	2
Total, unpaid obligated balance, brought forward, net	$ 48,210	$ 10,768	$ 48,147	$ 7,788
Obligation Incurred net (+/-)	99,093	60,117	77,769	51,372
Less: Gross Outlays	95,662	54,516	76,251	46,389
Less Recoveries of prior year unpaid obligations, actual	1,434	3,450	1,536	1,973
Change in uncollected customer payments from Federal Sources (+/-)		4	72	(32)
Obligated Balance, net, end of period				
Unpaid Obligations	$ 50,210	$ 12,953	$ 48,213	$ 10,802
Less: Uncollected customer payments from Federal Sources	3	30	3	34
Total, unpaid obligated balance, net, end of period	**$ 50,207**	**$ 12,923**	**$ 48,210**	**$ 10,768**
Net Outlays				
Net Outlays:				
Gross Outlays	$ 95,662	$ 54,516	$ 76,251	$ 46,389
Less: Offsetting collections	2,083	77,399	3,264	49,536
Less: Distributed Offsetting receipts	51		32	
Net Outlays (Note 13)	**$ 93,528**	**$ (22,883)**	**$ 72,955**	**$ (3,147)**

The accompanying notes are an integral part of these statements.

United States Department of Education
Consolidated Statement of Financing
For the Years Ended September 30, 2006 and 2005

(Dollars in Millions)

	Fiscal Year 2006	Fiscal Year 2005
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred (Note 13)	$ (159,210)	$ (129,141)
Less: Spending Authority from Offsetting Collections & Recoveries	84,362	56,268
Obligations Net of Offsetting Collections and Recoveries	(74,848)	(72,873)
Less: Offsetting Receipts	(51)	(32)
Net Obligations	$ (74,899)	$ (72,905)
Other Resources		
Imputed Financing From Costs Absorbed by Others	(31)	(31)
Net Other Resources Used to Finance Activities	(31)	(31)
Total Resources Used to Finance Activities	**$ (74,930)**	**$ (72,936)**
Resources Used to Finance Items Not Part of Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not Yet Provided (+/-)	$ (2,946)	$ (3,197)
Resources that Fund Expenses Recognized in Prior Period (Note 14)	(2,840)	(1,610)
Budgetary offsetting collections and receipts that do not affect net cost of operations		2
Credit Program Collections Which Increase/Decrease Liabilities for Loan Guarantees, or Credit Program Receivables, Net including Allowances for Subsidy	73,723	46,891
Resources Used to Finance the Acquisition of Fixed Assets, or Increase/Decrease Liabilities for Loan Guarantees or Credit Program Receivables, Net in the Current or Prior Period	(48,328)	(39,977)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**$ 19,609**	**$ 2,109**
Total Resources Used to Finance the Net Cost of Operations	**$ (94,539)**	**$ (75,045)**
Components of the Net Cost of Operations that Will Not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Periods (Note 14)		
Increase in Annual Leave Liability	$ (31)	$ (28)
Upward/Downward Reestimates of Credit Subsidy Expense	(4,200)	(2,789)
Increase in Exchange Revenue Receivable from the Public	1,603	1,163
Other (+/-)	32	15
Total Components of the Net Cost of Operations that Will Require or Generate Resources in Future Periods	$ (2,596)	$ (1,639)
Components Not Requiring or Generating Resources		
Depreciation and Amortization	$ 400	$ 1,442
Other (+/-) (Note 14)	(94)	3
Total Components of the Net Cost of Operations that Will Not Require or Generate Resources	$ 306	$ 1,445
Total Components of the Net Cost of Operations that Will Not Require or Generate Resources in the Current Period	**$ (2,290)**	**$ (194)**
Net Cost of Operations (Note 11)	**$ (96,829)**	**$ (75,239)**

The accompanying notes are an integral part of these statements.

Notes to the Principal Financial Statements

Note 1. Summary of Significant Accounting Policies

Reporting Entity

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

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

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

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

Reporting Organizations

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

Major Reporting Groups

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

The Other major reporting group includes the OVAE, OPE, IES, OELA, OSDFS, OII and DM reporting organizations and Hurricane Education Recovery activities. (See Notes 9 and 11)

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 in the United States of America for federal entities issued by the Federal Accounting Standards Advisory Board (FASAB) and the Office of Management and Budget (OMB) Circular No. A-136, revised as of July 24, 2006, *Financial Reporting Requirements*. These financial statements are different from the financial reports prepared by the Department pursuant to the OMB directives that are used to monitor and control the Department's use of budgetary resources.

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

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

Use of Estimates

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

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

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

The Department estimates all future cash flows associated with the Direct Loan and FFEL programs. Projected cash flows are used to develop subsidy estimates. Subsidy cost can be positive or negative; negative subsidies occur when expected program inflows of cash (e.g., repayments and fees) exceed expected outflows. Subsidy cost is recorded as the initial amount of the loan guarantee liability when guarantees are made (the loan liability) 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 to calculate subsidy estimates for the Direct Loan and FFEL programs. In fiscal year 2006, the Department refined its approach to calculating the subsidy estimates with the input of interest rates derived from a probabilistic technique. This probabilistic technique to forecast interest rates relies on different methods to establish the relationship between an event's occurrence and the magnitude of its probability. The Department's approach estimates interest rates under numerous scenarios and then bases interest rates on the average interest rates weighted by the assumed probability of each scenario occurring. This refinement was undertaken to model certain unique characteristics of the Department's loan programs.

The estimating methods are updated periodically to reflect changing conditions. For each program, 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.

Estimates reflected in these statements were prepared using assumptions developed for the FY 2007 Mid-Session Review, a government-wide exercise required annually by the OMB. Assumptions and their impact are updated after the Mid-Session Review to account for significant subsequent changes in activity. These estimates are based on the most current information available to the Department at the time the financial statements are prepared. Department management has a process to review these estimates in the context of subsequent changes in activity and assumptions, and to reflect the impact of these changes as appropriate.

The Department recognizes that the cash flow projections and the sensitivity of the changes in assumptions can have a significant impact on the estimates. Management has attempted to mitigate fluctuations in the estimate by using trend analysis to project future cash flows. Changes in assumptions could significantly affect the amounts reflected in these statements. For example, a minimal change in the projected long-term interest rate charged to borrowers could change the current subsidy re-estimate by a significant amount. (See Note 5)

Budget Authority

Budget authority is the authorization provided by law for the Department to incur financial obligations that will result in outlays. The Department's budgetary resources include (1) unobligated balances of resources from prior years, (2) recoveries of 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.

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

Fund Balance 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.

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

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts that are not apportioned for obligation during the current fiscal year and expired appropriations no longer available to incur new obligations. Obligated balances not yet disbursed include receivables for reimbursements earned, unfilled customer orders, undelivered orders and unpaid expended authority. (See Note 2)

Accounts Receivable

Accounts receivable are amounts due to the Department from the public and other federal agencies. Receivables from the public result from recipients of grants and other financial assistance programs, and disputed costs resulting from audits of educational assistance programs. Amounts due from other federal agencies result from reimbursable 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 Department experience in the collection of receivables and an analysis of the outstanding balances. (See Note 3)

Cash and Other Monetary Assets

Cash and Other Monetary Assets consist of Guaranty Agency reserves that represent the federal government's interest in the net assets of state and nonprofit FFEL Program Guaranty Agencies. Guaranty Agency reserves are classified as non-entity assets with the public (see Note 4) and are offset by a corresponding liability due to Treasury. Guaranty Agency reserves include initial federal start-up funds, receipts of federal reinsurance payments, insurance premiums, Guaranty Agency share of collections on defaulted loans, investment income, administrative cost allowances, and other assets.

Section 422A of the HEA required FFEL Guaranty Agencies to establish a Federal Student Loan Reserve Fund (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 and reflected in the *Budget of the United States Government*. However, such ownership by the federal government is independent of the actual control of the assets. The net value of the Federal Fund will change from year to year. Recalls are payments to the Department from Guaranty Agency Federal Funds, which increase Fund Balance with Treasury, and will be remitted to Treasury by the end of the fiscal year.

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 (as authorized 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.

Credit Program Receivables and Liabilities for Loan Guarantees

The financial statements reflect the Department's estimate of the long-term cost of direct and guaranteed loans in accordance with the Credit Reform Act. Loans and interest receivable are valued at their gross amounts less an allowance for the present value of the amounts not expected to be recovered and thus having to be subsidized—called "allowance for subsidy." The difference is the present value of the cash flows to and from the Department that are expected from the receivables over their projected lives. Similarly, liabilities for loan guarantees are valued at the present value of the cash outflows from the Department less the present value of related inflows. The estimated present value of net long-term cash outflows of the Department for subsidized costs (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 for 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 5)

Other Intragovernmental Assets

Other intragovernmental assets represent advance payment for interagency agreements between the Department and the National Science Foundation. These advance payments are recognized as an asset, which is reduced when actual expenditures are recorded by the Department.

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 either 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. The government acting in its sovereign capacity can abrogate liabilities that arise from activities other than contracts. FFEL Program and Direct Loan Program liabilities are entitlements covered by permanent indefinite budget authority enacted as of year-end.

Debt

The Department borrows to provide funding for direct loans to students and facilities loans. The liability to Treasury from borrowings represents unpaid principal owing on the loans at year-end associated with the Department's student 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 5, the interest received by the Department from borrowers will vary from the rate paid to the Treasury. Principal and interest payments to the Treasury are made annually.

In addition, the Federal Financing Bank (FFB) holds bonds issued by the Department on behalf of the Historically Black Colleges and Universities Capital Financing Program. The Department reports the corresponding liability for full payment of principal and accrued interest as a payable to the FFB. (See Note 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 their receiving grant funds for the expenditures. The amount is estimated using statistical sampling techniques. (See Note 9)

Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include undelivered orders and unobligated balances of appropriations, except for federal credit financing and liquidating funds, and trust funds. Cumulative results of operations represent the net difference since inception between (1) expenses and (2) revenues and financing sources. (See Note 10)

Earmarked Funds

Earmarked funds are recorded as specially identified revenues, often supplemented by other financing sources, which remain available over time. These funds are required by statute to be used for designated activities, benefits or purposes. The Department's earmarked funds are primarily related to the 2005 Hurricane Relief efforts. (See Note 15)

Personnel Compensation and Other Employee Benefits

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

Retirement Plans and Other Retirement Benefits. Employees participate 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.

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

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

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

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

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

The estimated projections are evaluated by Labor to ensure the resulting projections are reliable. The analysis is based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in charge back year 2006 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

Intragovernmental Transactions

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

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

Note 2. Fund Balance with Treasury

(Dollars in Millions)	2006	2005
Appropriated Funds	$ 54,790	$ 49,455
Revolving Funds	52,176	28,104
Trust Funds	61	-
Other Funds	26	10
Fund Balance with Treasury	**$ 107,053**	**$ 77,569**

Status of Fund Balance with Treasury

(Dollars in Millions)	2006	2005
Unobligated Balance		
Available	$ 4,081	$ 526
Unavailable	47,063	23,540
Obligated Balance, Not Yet Disbursed	55,883	53,493
Non-Budgetary FBWT	26	10
Status of Fund Balance with Treasury	**$ 107,053**	**$ 77,569**

Note 3. Accounts Receivable

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

	2005		
(Dollars in Millions)	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ -	$ -	$ -
With the Public	318	(177)	141
Accounts Receivable	**$ 318**	**$ (177)**	**$ 141**

Note 4. Cash and Other Monetary Assets

(Dollars in Millions)	2006	2005
Beginning Balance, Cash and Other Monetary Assets	**$ 888**	**$ 1,040**
Downward Valuation of Guaranty Agency Federal Funds	(29)	(152)
Recalls from Guaranty Agency Federal Funds		
Remitted to Treasury as of September 30	(280)	-
Payable to Treasury as of September 30	(13)	-
Total Recalls	(293)	-
Ending Balance, Cash and Other Monetary Assets	**$ 566**	**$ 888**

Cash and Other Monetary Assets consist of Guaranty Agency reserves and represent non-entity assets.

Note 5. Credit Programs for Higher Education

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

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

Beginning with FFEL loans first disbursed on or after October 1, 1993, financial institutions became responsible for 2 percent of the cost of each default. Guaranty Agencies also began paying a portion of the cost (in most cases, 5 percent) of each defaulted loan from federal reserves they hold in trust. (See Note 4) FFEL lender participants receive statutorily set federal interest and special allowance subsidies. Guaranty Agencies receive fee payments as set by statute. In most cases, loan terms and conditions under the two programs are identical.

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

The Department disbursed approximately $32.3 billion in direct loans to eligible borrowers in fiscal year 2006 and approximately $27.5 billion in fiscal year 2005. Loans typically are disbursed in multiple installments over an academic period; as a result, loan disbursements for an origination cohort year often cross fiscal years. Half of all loan volume is obligated in the fourth quarter of the fiscal year. Regardless of the fiscal year in which they occur, disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

As of September 30, 2006 and 2005, total principal balances outstanding of guaranteed loans held by lenders were approximately $325 billion and $289 billion, respectively. As of September 30, 2006 and 2005, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately $321 billion and $288 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the Guaranty Agencies, based on the appropriate reinsurance rates, which range from 100 to 95 percent. Any remaining insurance not paid as reinsurance would be paid to lenders by the Guaranty Agencies from their Federal Fund. Payments by Guaranty Agencies do not reduce government exposure because they are made from the Federal Fund administered by the agencies but owned by the federal government.

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

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 7 percent of loan commitments are never disbursed. For direct loans committed in fiscal year 2006, an estimated $1.2 billion will not be disbursed; for guaranteed loans committed in fiscal year 2006, an estimated $7.6 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.

Loan Consolidations

In recent years, the consolidation of existing loans into new direct or guaranteed loans has increased significantly. The Department permits borrowers to prepay and close out existing loans without penalty from capital raised through the disbursement of a new consolidation loan.

Under the Credit Reform Act and requirements provided by OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, the retirement of loans being consolidated is considered a receipt of principal and interest; this receipt is offset by the disbursement related to the newly created consolidation loan. The underlying direct or guaranteed loans, whether performing or nonperforming, in any given cohort are paid off in their original cohort, and new loans are opened in the cohort in which consolidation activity occurs. This consolidation activity is taken into consideration in establishing the subsidy rate for defaults. The effect of new consolidations is reflected in subsidy expense for the current year cohort, while the effect on prior cohorts is reflected in the re-estimate. The loan liability and net receivables include estimates of future prepayments of existing loans through consolidations; they do not reflect costs associated with anticipated future consolidation loans.

Variable student loan interest rates were reset on July 1, 2006, increasing nearly two percentage points from 5.30 percent for academic year 2005–06 to 7.14 percent for academic year 2006–07. In fiscal year 2005, rates were reset on July 1, 2005, from 3.37 percent for academic year 2004–05 to 5.30 percent for academic year 2005–06. In anticipation of these increases in both years, private lenders, schools, and others encouraged borrowers to consolidate their existing variable rate loans into fixed rate loans. This dramatic change in interest rates resulted in surges in loan consolidations. Direct loan consolidation disbursements for fiscal year 2006 were $19.9 billion and $15.3 billion for fiscal year 2005.

Based on current estimates, the prepayment of the underlying FFEL loans produces significant savings through the elimination of future special allowance payments. New consolidations are reflected in the 2006 cohort resulting in increased prepayments of underlying loans from prior cohorts.

Credit Program Receivables, Net

(Dollars in Millions)	2006	2005
Direct Loan Program Loan Receivables, Net	$ 92,603	$ 95,696
FFEL Program Loan Receivables, Net	13,588	11,712
Perkins Program Loan Receivables, Net	192	194
Facilities and Other Loan Receivables, Net	345	335
Credit Program Receivables, Net	**$ 106,728**	**$ 107,937**

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

Direct Loan Program Receivables

(Dollars in Millions)	2006	2005
Principal Receivable	$ 97,306	$ 94,707
Interest Receivable	3,702	3,121
Receivables	**101,008**	**97,828**
Less: Allowance for Subsidy	8,405	2,132
Credit Program Receivables, Net	**$ 92,603**	**$ 95,696**

Of the $101.0 billion in Direct Loan receivables as of September 30, 2006, $8.1 billion in loan principal was in default and held at the Department's Borrowers Services Collections Group. As of September 30, 2005, $7.2 billion in loan principal was in default and held at the Department's Borrowers Services Collections Group out of a total receivable of $97.8 billion.

FFEL Program Receivables

	2006			2005		
(Dollars in Millions)	Pre-1992	Post-1991	Total	Pre-1992	Post-1991	Total
Principal Receivable	$ 8,730	$ 10,263	$ 18,993	$ 9,306	$ 8,567	$ 17,873
Interest Receivable	336	1,823	2,159	595	1,691	2,286
Receivables	**9,066**	**12,086**	**21,152**	**9,901**	**10,258**	**20,159**
Less: Allowance for Subsidy	4,717	2,847	7,564	6,736	1,711	8,447
Credit Program Receivables, Net	**$ 4,349**	**$ 9,239**	**$ 13,588**	**$ 3,165**	**$ 8,547**	**$ 11,712**

Loan Modifications

According to OMB Circular No. A-11, any government action that differs from actions assumed in the baseline estimate of cash flows and changes the estimated cost of an outstanding direct loan or loan guarantee is defined as a modification. Over the past two fiscal years, the Department has executed separate loan modifications. These modifications were the result of legislation that altered the estimated cost of outstanding direct loans or loan guarantees.

Each modification is separate and distinct. However, each is recognized under the same accounting principle for upward or downward adjustments to subsidy cost and for the recordation of modification adjustment transfer gains or losses.

Separate amounts are calculated for modification costs and modification adjustment transfers. Modification adjustment transfers are required to adjust for the difference between current discount rates used to calculate modification costs and the discount rates used to calculate cohort interest expense and revenue.

2006 Modification

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

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

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

2005 Modification

The *Taxpayer-Teacher Protection Act of 2004* (P.L. 108-409) increased the maximum amount of loan cancellation from $5,000 to $17,500 at the end of the fifth year of teaching for certain teachers who were new student loan borrowers between October 1, 1998 and October 1, 2005.

The FFEL Program recognized $148 million and the Direct Loan Program recognized $49 million in modification costs in fiscal year 2005. The FFEL Program also recognized a net modification adjustment transfer gain of $3 million, while the Direct Loan Program recognized a net gain of $1 million.

Direct Loan Program Reconciliation of Allowance for Subsidy

(Dollars in Millions)	2006	2005
Beginning Balance, Allowance for Subsidy	**$ 2,132**	**$ (1,644)**
Components of Subsidy Transfers		
Interest Rate Differential	(601)	(238)
Defaults, Net of Recoveries	1,226	355
Fees	(403)	(401)
Other	1,566	1,286
Current Year Subsidy Transfers	**1,788**	**1,002**
Components of Subsidy Re-estimates		
Interest Rate Re-estimates[1]	(339)	1,703
Technical and Default Re-estimates	5,199	2,457
Subsidy Re-estimates	**4,860**	**4,160**
Components of Loan Modifications		
Loan Modification Costs	7	49
Modification Adjustment Transfers	-	(1)
Loan Modifications	**7**	**48**
Activity		
Fee Collections	473	461
Loan Cancellations[2]	(100)	(110)
Subsidy Allowance Amortization	(406)	(1,454)
Other	(349)	(331)
Total Activity	**(382)**	**(1,434)**
Ending Balance, Allowance for Subsidy	**$ 8,405**	**$ 2,132**

[1] The interest rate re-estimate relates to subsidy associated with establishing a fixed rate for the Department's borrowing from Treasury.
[2] Loan cancellations include write-offs of loans because the primary borrower died, became disabled, or declared bankruptcy.

Direct Loan Financing Account Interest Expense and Interest Revenue

(Dollars in Millions)	2006	2005
Interest Expense on Treasury Borrowing	$ 6,505	$ 6,171
Interest Expense	**$ 6,505**	**$ 6,171**
Interest Revenue from the Public	$ 4,173	$ 3,242
Amortization of Subsidy	406	1,454
Interest Revenue on Uninvested Funds	1,926	1,475
Interest Revenue	**$ 6,505**	**$ 6,171**

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

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

Payable to Treasury

(Dollars in Millions)	2006	2005
Future Liquidating Account Collections, Beginning Balance	$ 3,411	$ 3,491
Valuation of Pre-1992 Loan Liability and Allowance	2,036	851
Capital Transfers to Treasury	(892)	(931)
Future Liquidating Account Collections, Ending Balance	**4,555**	**3,411**
Collections on Guaranty Agency Federal Funds	13	-
FFEL Downward Subsidy Re-estimate	951	1,755
Payable to Treasury	**$ 5,519**	**$ 5,166**

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

FFEL Program Reconciliation of Liabilities for Loan Guarantees

(Dollars in Millions)	2006	2005
Beginning Balance, Liability for Loan Guarantees	**$ 30,500**	**$ 23,214**
Components of Subsidy Transfers		
Interest Supplement Costs	18,268	12,562
Defaults, Net of Recoveries	1,665	865
Fees	(7,859)	(5,554)
Other[1]	4,264	2,500
Current Year Subsidy Transfers	**16,338**	**10,373**
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	90	(72)
Technical and Default Re-estimates	9,924	(586)
Subsidy Re-estimates	**10,014**	**(658)**
Components of Loan Modifications		
Loan Modification Costs	1,710	148
Modification Adjustment Transfers	94	(3)
Loan Modifications	**1,804**	**145**
Activity		
Interest Supplement Payments	(8,925)	(5,077)
Claim Payments	(4,345)	(3,716)
Fee Collections	3,799	3,060
Interest on Liability Balance	1,110	565
Other[2]	2,055	2,594
Total Activity	**(6,306)**	**(2,574)**
Ending Balance, Liability for Loan Guarantees	**52,350**	**30,500**
FFEL Liquidating Account Liability for Loan Guarantees	103	111
Liabilities for Loan Guarantees	**$ 52,453**	**$ 30,611**

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

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

Subsidy Expense

Direct Loan Program Subsidy Expense

(Dollars in Millions)	2006	2005
Components of Current Year Subsidy Transfers		
Interest Rate Differential	$ (601)	$ (238)
Defaults, Net of Recoveries	1,226	355
Fees	(403)	(401)
Other	1,566	1,286
Current Year Subsidy Transfers	**1,788**	**1,002**
Subsidy Re-estimates	4,860	4,160
Loan Modification Costs	7	49
Direct Loan Subsidy Expense	**$ 6,655**	**$ 5,211**

In the 2006 re-estimates, Direct Loan subsidy expense was increased by $4.9 billion. Several factors accounted for this increase. Changes in the assumptions for the collections of defaulted loans contributed approximately $3.3 billion to the increase in subsidy expense. Other changes in assumptions for variables (such as assumed term and maturity, loan volume, and prepayment rates) increased subsidy expense by $1.4 billion. A refinement of the Department's forecast using interest rate scenarios provided by OMB in a probabilistic approach accounted for an increase of $230 million. The subsidy rate is sensitive to interest rate fluctuations, for example a 1 percent increase in projected borrower base rates would reduce projected Direct Loan costs by $700 million. In the 2005 re-estimates, Direct Loan subsidy expense was increased by $4.2 billion. Changes in assumptions for variables (such as assumed term and maturity, loan volume, and prepayment rates) increased subsidy expense by $4.0 billion. The remaining $195 million increase was related to changes in actual and forecasted interest rates.

FFEL Program Loan Guarantee Subsidy Expense

(Dollars in Millions)	2006	2005
Components of Current Year Subsidy Transfers		
Interest Supplement Costs	$ 18,268	$ 12,562
Defaults, Net of Recoveries	1,665	865
Fees	(7,859)	(5,554)
Other	4,264	2,500
Current Year Subsidy Transfers	**16,338**	**10,373**
Subsidy Re-estimates	10,014	(658)
Loan Modification Costs	1,710	148
FFEL Loan Guarantee Subsidy Expense	**$ 28,062**	**$ 9,863**

In the 2006 re-estimates, FFEL subsidy expense was increased by $10.0 billion. Changes in interest rates account for an $8.9 billion increase in subsidy expense. Of this $8.9 billion increase, $6.2 billion is attributed to the change in interest supplement costs associated with higher than originally forecasted loan consolidations which occurred in late fiscal year 2006. In addition, the refinement of the Department's forecasting methodology, as noted above, accounted for an additional $1.8 billion to the increase in subsidy expense. Other changes in assumptions for variables (such as assumed term and maturity, loan volume, and prepayment rates) decreased subsidy expense by $700 million on a net basis. The subsidy rate is sensitive to interest rate fluctuations, for example a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by $9.5 billion. In the 2005 re-estimates, FFEL subsidy expense was decreased by $658 million. An increase of $932 million was caused by changes in actual and forecasted interest rates. Changes in assumptions for variables (such as assumed term and maturity, loan volume, and prepayment rates) decreased subsidy expense by $1.6 billion.

Subsidy Rates

The subsidy rates applicable to the 2006 loan cohort year were as follows:

Subsidy Rates—Cohort 2006

	Interest Differential	Defaults	Fees	Other	Total
Direct Loan Program	(1.73%)	3.53%	(1.17%)	4.49%	5.12%
	Interest Supplements	**Defaults**	**Fees**	**Other**	**Total**
FFEL Program	14.44%	1.28%	(6.21%)	3.47%	12.98%

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

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

Administrative Expenses

	2006		2005	
(Dollars in Millions)	**Direct Loan**	**FFEL**	**Direct Loan**	**FFEL**
Operating Expense	$ 342	$ 224	$ 401	$ 268
Other Expense	15	8	17	8
Administrative Expenses	**$ 357**	**$ 232**	**$ 418**	**$ 276**

Perkins Loan Program

The Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. In some statutorily defined cases, funds are provided to schools so that student loans may be cancelled. For certain defaulted loans, the Department reimburses the originating school and collects from the borrowers. These collections are transferred to the Treasury. At September 30, 2006 and 2005, loans receivable, net of an allowance for loss, were $192 and $194 million, respectively. These loans are valued at historical cost.

Facilities Loan Programs

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

(Dollars in Millions)	2006	2005
Principal Receivable	$ 428	$ 427
Interest Receivable	6	6
Receivables	**434**	**433**
Less: Allowance for Subsidy	89	98
Credit Program Receivables, Net	**$ 345**	**$ 335**

Note 6. General Property, Plant and Equipment

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

(Dollars in Millions)	2005 Asset Cost	2005 Accumulated Depreciation	2005 Net Asset Value
IT Equipment and Software	$ 86	$ (68)	$ 18
Furniture and Fixtures	3	(2)	1
General Property, Plant and Equipment	**$ 89**	**$ (70)**	**$ 19**

The majority of the fiscal year 2006 and 2005 costs represent the acquisition and implementation of the financial management system and additional information technology and communications improvements.

Leases

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

2006 (Dollars in Millions) Fiscal Year	2006 Lease Payment	2005 (Dollars in Millions) Fiscal Year	2005 Lease Payment
2007	$ 46	2006	$ 43
2008	47	2007	49
2009	49	2008	51
2010	53	2009	52
2011	56	2010	53
After 2011	58	After 2010	54
Total	**$ 309**	**Total**	**$ 302**

Note 7. Debt

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

	2005				
	Treasury				
(Dollars in Millions)	**Direct Loans**	**Facilities Loans**	**Total**	**FFB**	**Total**
Beginning Balance, Debt	$ 96,421	$ 110	$ 96,531	$118	$ 96,649
Accrued Interest	(2)	-	(2)	-	(2)
New Borrowing	31,299	-	31,299	10	31,309
Repayments	(23,346)	(10)	(23,356)	(3)	(23,359)
Ending Balance, Debt	**$ 104,372**	**$ 100**	**$ 104,472**	**$ 125**	**$ 104,597**

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

- Beginning-of-the-year cash balance, collections and borrowings 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. Other Liabilities

(Dollars in Millions)	2006		2005	
Other Liabilities	**Intragovern-mental**	**With the Public**	**Intragovern-mental**	**With the Public**
Liabilities Covered by Budgetary Resources				
Current				
Advances From Others	$ 95	$ -	$ 85	$ 1
Employer Contributions and Payroll Taxes	3	-	3	-
Liability for Deposit Funds	(4)	30	(11)	21
Accrued Payroll and Benefits	-	15	-	15
Deferred Credits	-	1	-	1
Contractual Services	-	83	-	70
Total Other Liabilities Covered by Budgetary Resources	**94**	**129**	**77**	**108**
Liabilities Not Covered by Budgetary Resources				
Current				
Accrued Unfunded Annual Leave	-	31	-	30
Non-current				
Accrued Unfunded FECA Liability	3	-	3	-
Custodial Liability	-	204	-	204
Accrued FECA Actuarial Liability	-	17	-	17
Total Other Liabilities Not Covered by Budgetary Resources	**3**	**252**	**3**	**251**
Other Liabilities	**$ 97**	**$ 381**	**$ 80**	**$ 359**

Other liabilities include current and non-current liabilities. The non-current custodial liability primarily consists of the student loan receivables of the Perkins Loan Program. Annually, at September 30, the collections are returned to the general fund of the U.S. Treasury.

Liabilities not covered by budgetary resources include liabilities for which congressional action is needed before budgetary resources can be provided. Although future appropriations to fund these liabilities are likely, it is not certain that appropriations will be enacted to fund these liabilities. Liabilities not covered by budgetary resources totaled $255 million and $254 million as of September 30, 2006 and 2005, respectively.

Liabilities covered by budgetary resources as of September 30, 2006 and 2005, totaled $167.4 billion and $143.5 billion, respectively.

Note 9. Accrued Grant Liability

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

(Dollars in Millions)	2006	2005
FSA	$ 1,250	$ 635
OESE	258	248
OSERS	171	90
Other	380	355
Accrued Grant Liability	**$ 2,059**	**$ 1,328**

Note 10. Net Position

Unexpended Appropriations (Dollars in Millions)	**2006**	**2005**
Unobligated Balances		
Available	$ 4,056	$ 526
Not Available	316	380
Undelivered Orders, end of period	47,440	46,382
Unexpended Appropriations	**$ 51,812**	**$ 47,288**

The Cumulative Results of Operations-Earmarked Funds as of September 30, 2006, totaled $61 million and represents donations from foreign governments, international entities and individuals to support Katrina relief and recovery efforts. (See Note 15) The Cumulative Results of Operations-Other Funds of $(5,063) million as of September 30, 2006, and $(4,446) million as of September 30, 2005, consist mostly of net investments of capitalized assets and unfunded expenses, including upward subsidy re-estimates for loan programs.

Note 11. Intragovernmental Cost and Exchange Revenue by Program Segment

As required by the *Government Performance and Results Act*, each of the Department's Reporting Organizations (see Note 1) has been aligned with the major goals presented in the Department's *Strategic Plan 2002—2007*.

Net Cost Program	Reporting Organizations	No.	Strategic Goal
Enhancement of Postsecondary and Adult Education	FSA OPE OVAE	5	Enhance the Quality of and Access to Postsecondary and Adult Education
Creation of Student Achievement, Culture of Achievement and Safe Schools	OESE OELA OSDFS	2 3	Improve Student Achievement Develop Safe and Drug-Free Schools
Transformation of Education	IES OII	4	Transform Education into an Evidence-Based Field
Special Education and Program Execution	OSERS		Cuts across Strategic Goals 2, 3, 4, and 5

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

Intragovernmental Cost and Exchange Revenue by Program Segment

2006

(Dollars in Millions)	FSA	OESE	OSERS	Other	Total
Enhancement of Postsecondary and Adult Education					
Intragovernmental Gross Cost	$ 7,857	$ -	$ -	$ 81	$ 7,938
Gross Costs with the Public	50,946	-	-	4,472	55,418
Total Program Costs	58,803	-	-	4,553	63,356
Less: Intragovernmental Earned Revenue	(3,131)	-	-	(1)	(3,132)
Earned Revenue from the Public	(4,641)	-	-	(17)	(4,658)
Total Program Revenue	(7,772)	-	-	(18)	(7,790)
Creation of Student Achievement, Culture of Achievement and Safe Schools					
Intragovernmental Gross Cost	-	172	-	20	192
Gross Costs with the Public	-	21,754	-	2,659	24,413
Total Program Costs	-	21,926	-	2,679	24,605
Less: Intragovernmental Earned Revenue	-	-	-	(60)	(60)
Earned Revenue from the Public	-	-	-	-	-
Total Program Revenue	-	-	-	(60)	(60)
Transformation of Education					
Intragovernmental Gross Cost	-	-	-	81	81
Gross Costs with the Public	-	-	-	1,282	1,282
Total Program Costs	-	-	-	1,363	1,363
Less: Intragovernmental Earned Revenue	-	-	-	(4)	(4)
Earned Revenue from the Public	-	-	-	(14)	(14)
Total Program Revenue	-	-	-	(18)	(18)
Special Education and Program Execution					
Intragovernmental Gross Cost	-	-	151	-	151
Gross Costs with the Public	-	-	15,224	-	15,224
Total Program Costs	-	-	15,375	-	15,375
Less: Intragovernmental Earned Revenue	-	-	(2)	-	(2)
Earned Revenue from the Public	-	-	-	-	-
Total Program Revenue	-	-	(2)	-	(2)
Net Cost of Operations	**$51,031**	**$21,926**	**$15,373**	**$8,499**	**$96,829**

2005

(Dollars in Millions)	FSA	OESE	OSERS	Other	Total
Enhancement of Postsecondary and Adult Education					
Intragovernmental Gross Cost	$ 7,055	$ -	$ -	$ 86	$ 7,141
Gross Costs with the Public	30,952	-	-	4,258	35,210
Total Program Costs	38,007	-	-	4,344	42,351
Less: Intragovernmental Earned Revenue	(2,140)	-	-	-	(2,140)
Earned Revenue from the Public	(4,705)	-	-	(25)	(4,730)
Total Program Revenue	(6,845)	-	-	(25)	(6,870)
Creation of Student Achievement, Culture of Achievement and Safe Schools					
Intragovernmental Gross Cost	-	166	-	20	186
Gross Costs with the Public	-	23,023	-	1,255	24,278
Total Program Costs	-	23,189	-	1,275	24,464
Less: Intragovernmental Earned Revenue	-	(17)	-	(59)	(76)
Earned Revenue from the Public	-	-	-	-	-
Total Program Revenue	-	(17)	-	(59)	(76)
Transformation of Education					
Intragovernmental Gross Cost	-	-	-	82	82
Gross Costs with the Public	-	-	-	1,138	1,138
Total Program Costs	-	-	-	1,220	1,220
Less: Intragovernmental Earned Revenue	-	-	-	(3)	(3)
Earned Revenue from the Public	-	-	-	(14)	(14)
Total Program Revenue	-	-	-	(17)	(17)
Special Education and Program Execution					
Intragovernmental Gross Cost	-	-	94	-	94
Gross Costs with the Public	-	-	14,075	-	14,075
Total Program Costs	-	-	14,169	-	14,169
Less: Intragovernmental Earned Revenue	-	-	(2)	-	(2)
Earned Revenue from the Public	-	-	-	-	-
Total Program Revenue	-	-	(2)	-	(2)
Net Cost of Operations	**$31,162**	**$23,172**	**$14,167**	**$6,738**	**$75,239**

Note 12. Interest Expense and Interest Revenue

	Direct Loan Program		FFEL Program		Other Programs		Total	
(Dollars in millions)	2006	2005	2006	2005	2006	2005	2006	2005
Federal	$ 6,505	$ 6,171	$ 1,110	$ 565	$ 15	$ 15	$ 7,630	$ 6,751
Non-federal	-	-	-	-	-	-	-	-
Interest Expense	**$ 6,505**	**$ 6,171**	**$ 1,110**	**$ 565**	**$ 15**	**$ 15**	**$ 7,630**	**$ 6,751**
Federal	$ 1,926	$ 1,475	$ 1,110	$ 565	$ -	$ -	$ 3,036	$ 2,040
Non-federal	4,579	4,696	-	-	19	26	4,598	4,722
Interest Revenue	**$ 6,505**	**$ 6,171**	**$ 1,110**	**$ 565**	**$ 19**	**$ 26**	**$ 7,634**	**$ 6,762**

For the Direct Loan Program, interest expense is recognized on the Department's borrowings from Treasury. The interest revenue is earned on the individual loans in the loan portfolio, while federal interest is earned on the uninvested fund balances with Treasury. For the FFEL Program, federal interest revenue is earned on the uninvested fund balance with Treasury in the financing fund. The Direct Loan Program and the FFEL Program are included on the Statement of Net Cost in Enhancement of Postsecondary and Adult Education.

Note 13. Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) compares budgetary resources with the status of those resources. As of September 30, 2006, budgetary resources were $210,921 million and net outlays were $70,645 million. As of September 30, 2005, budgetary resources were $154,095 million and net outlays were $69,808 million.

Permanent Indefinite Budget Authority

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

Apportionment Categories of Obligations Incurred

(Dollars in Millions)	2006	2005
Direct:		
Category A	$ 1,298	$ 1,308
Category B	157,644	127,489
Exempt from Apportionment	176	252
	159,118	129,049
Reimbursable:		
Category A	-	4
Category B	-	3
Exempt from Apportionment	92	85
	92	92
Apportionment Categories of Obligations Incurred	**$ 159,210**	**$ 129,141**

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

Unused Borrowing Authority

(Dollars in Millions)	2006	2005
Beginning Balance, Unused Borrowing Authority	$ 5,481	$ 5,952
Current Year Borrowing Authority	35,089	32,209
Funds Drawn From Treasury	(33,322)	(31,309)
Prior Year Unused Borrowing Authority Cancelled	-	(1,326)
Other	-	(45)
Ending Balance, Unused Borrowing Authority	**$ 7,248**	**$ 5,481**

The Department is given authority to draw funds from the Treasury to help finance the majority of its direct lending activity. Unused Borrowing Authority is a budgetary resource and is available to support obligations. The Department periodically reviews its borrowing authority balances in relation to its obligations and may cancel unused amounts.

Undelivered Orders at the End of the Period

	2006		2005	
(Dollars in Millions)	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
Undelivered Orders at the end of the period	**$ 47,630**	**$ 12,472**	**$ 46,493**	**$ 10,472**

Undelivered orders at the end of the year, as presented above, will differ from the undelivered orders included in the Net Position, Unexpended Appropriations. Undelivered orders for trust funds and federal credit financing and liquidating funds are not funded through appropriations and are not included in Net Position. (See Note 10)

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

The *FY 2008 Budget of the United States Government* (President's Budget) presenting the actual amounts for the year ended September 30, 2006 has not been published as of the issue date of these financial statements. The FY 2008 President's Budget is scheduled for publication in February 2007. A reconciliation of the FY 2005 column on the SBR to the actual amounts for FY 2005 in the FY 2007 President's Budget for budgetary resources, obligations incurred, distributed offsetting receipts and net outlays is presented below.

(Dollars in Millions)	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Combined Statement of Budgetary Resources	$ 154,095	$ 129,141	$ 32	$ 69,808
Less: Expired Funds	(882)	(527)	-	-
Add: Amounts included in the President's Budget	5,325	5,325	-	-
Less: Funds excluded from President's Budget and Rounding	4	6	-	(4)
Plus: Distributed Offsetting Receipts				32
Budget of the United States Government	**$ 158,542**	**$ 133,945**	**$ 32**	**$ 69,836**

Budgetary accounting as shown in the President's Budget includes a public enterprise fund that reflects the net obligations by the FFEL Program for the estimated activity of the consolidated Federal Funds of the Guaranty Agencies. The consolidated balance of the Federal Fund accounts reflected in the financial statements represents actual cash activity, resulting in timing difference as shown on the Statement of Budgetary Resources. In 2005, obligations of $4,977 million were recorded and $4,725 million in offsetting collections transferred to Guaranty Agency Federal Fund accounts from the Department. Collections from non-federal sources of $100 million were deposited in 2005.

Note 14. 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 difference between the amounts reported as liabilities not covered by budgetary resources on the Balance Sheet and amounts reported as Other Components Requiring or Generating Resources in Future Periods on the Statement of Financing represents an increase in custodial liability activities.

Components Not Requiring or Generating Resources primarily result from the subsidy expense recognized for financial statement re-estimate purposes as required by the Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees*. Re-estimates published in the President's Budget generate or require resources.

Note 15. 2005 Hurricane Relief

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

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

Funds Appropriated for Hurricane Relief

The *Hurricane Education Recovery Act* (PL 109-148) was enacted on December 30, 2005. The act appropriated $1.6 billion to the Department. This funding provides needed assistance to reopen schools and helps educate the 370,000 students affected by hurricanes Katrina and Rita. In June 2006, an additional $285 million was transferred to the Department to assist with the relief efforts. As of September 30, 2006, $1.9 billion in aid has been obligated to assist local educational agencies and non-public schools and approximately $1.1 billion has been expended. The remaining funds will be released following review of applications from the educational agencies and non-public schools.

(Dollars in Millions)	Appropriated	Obligated	Expended
Emergency Impact Aid for Displaced Students (Impact Aid) Program	$ 880	$ 878	$ 739
Immediate Aid to Restart School Operations (Restart Aid) Program	750	750	233
Higher Education Relief	250	250	168
Assistance for Homeless Youth (Homeless Aid) Program	5	5	-
2005 Hurricane Disaster Relief	**$ 1,885**	**$ 1,883**	**$ 1,140**

Earmarked Funds Donated for Hurricane Relief

In the aftermath of hurricane Katrina, a number of foreign governments, international entities and individuals made donations of financial assistance to the U.S. Government to support Katrina relief and recovery efforts. These donations were received by the U.S. Department of State as an intermediary. Subsequently, $60.5 million was transferred to the Department to finance educational initiatives in Louisiana and Mississippi under a Memorandum of Understanding issued in March 2006. Applications are being received from the affected areas and are being reviewed. As of September 30, 2006, $35.2 million has been obligated from the earmarked funds to assist in the relief and recovery efforts.

Note 16. Contingencies

Guaranty Agencies

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

Perkins Loan Reserve Funds

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

In fiscal year 2005, the Department provided funding of 84.6 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 15.4 percent of program funding. For the academic year ended June 30, 2005, approximately 779,129 loans were made, totaling $1.6 billion at 1,653 institutions, averaging $2,069 per loan. The Department's share of the Perkins Loan Program was approximately $6.4 billion as of June 30, 2005.

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

Litigation and Other Claims

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

Other Matters

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

During the fiscal year, the Inspector General issued an audit report that questioned payments made to an entity that participates in the Federal Family Education Loan Program. The findings cited in this report are under consideration by the Department. Until the matter is resolved, the potential impact, if any, on the Department's financial position is not possible to estimate.

Required Supplementary Information

United States Department of Education
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2006
(Dollars in Millions)

	Combined		Federal Student Aid		Office of Elementary & Secondary Education		Office of Special Education & Rehabilitative Services		OTHER	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:										
Unobligated balance, brought forward, October 1:	$ 2,137	$ 22,817	$ 1,429	$ 22,817	$ 314		$ 80		$ 314	
Recoveries of prior year Unpaid Obligations	1,434	3,450	1,005	3,450	340		34		55	
Budgetary Authority:										
Appropriations	102,197	108	56,221	105	21,297		15,072		9,607	$ 3
Borrowing Authority		35,089		35,073						16
Spending authority from offsetting collections (gross):										
Earned										
Collected	2,074	77,399	1,967	77,367			1		106	32
Change in Receivables from Federal Sources	1						1			
Change in unfilled customer orders										
Advance Received	9						(1)		10	
Without advance from Federal Sources	(1)	(4)		(4)			1		(2)	
Subtotal	$ 104,280	$ 112,592	$ 58,188	$ 112,541	$ 21,297		$ 15,074		$ 9,721	$ 51
Permanently not available	(3,537)	(32,252)	(2,861)	(32,230)	(334)		(153)		(189)	(22)
Total Budgetary Resources	**$ 104,314**	**$ 106,607**	**$ 57,761**	**$ 106,578**	**$ 21,617**	**$ (0)**	**$ 15,035**	**$ (0)**	**$ 9,901**	**$ 29**
Status of Budgetary Resources:										
Obligations incurred:										
Direct	$ 99,001	$ 60,117	$ 53,374	$ 60,088	$ 21,334		$ 14,848		$ 9,445	$ 29
Reimbursable	92						4		88	
Subtotal	$ 99,093	$ 60,117	$ 53,374	$ 60,088	$ 21,334		$ 14,852		$ 9,533	$ 29
Unobligated Balances:										
Apportioned	4,081		3,437		181		171		292	
Subtotal	$ 4,081		$ 3,437		$ 181		$ 171		$ 292	
Unobligated Balance not available	1,140	46,490	950	46,490	102		12		76	
Total Status of Budgetary Resources	**$ 104,314**	**$ 106,607**	**$ 57,761**	**$ 106,578**	**$ 21,617**	**$ (0)**	**$ 15,035**	**$ (0)**	**$ 9,901**	**$ 29**
Change in Obligated Balance:										
Obligated balance, net										
Unpaid obligations, brought forward, October 1	$ 48,213	$ 10,802	$ 9,225	$ 10,763	$ 18,823		$ 10,936		$ 9,229	$ 39
Less: Uncollected customer payments from Federal Sources, brought forward, October 1	3	34		34			2		1	
Total, unpaid obligated balance, brought forward, net	$ 48,210	$ 10,768	$ 9,225	$ 10,729	$ 18,823		$ 10,934		$ 9,228	$ 39
Obligation Incurred net (+/-)	99,093	60,117	53,374	60,088	21,334		14,852		9,533	29
Less: Gross Outlays	95,662	54,516	50,010	54,460	21,773		15,137		8,742	56
Less Recoveries of prior year unpaid obligations, actual	1,434	3,450	1,005	3,450	340		34		55	
Change in uncollected customer payments from Federal Sources (+/-)		4		4			(2)		2	
Obligated Balance, net, end of period										
Unpaid Obligations	$ 50,210	$ 12,953	$ 11,584	$ 12,941	$ 18,044		$ 10,617		$ 9,965	$ 12
Less: Uncollected customer payments from Federal Sources	3	30		30			4		(1)	
Total, unpaid obligated balance, net, end of period	$ 50,207	$ 12,923	$ 11,584	$ 12,911	$ 18,044		$ 10,613		$ 9,966	$ 12
Net Outlays										
Net Outlays:										
Gross Outlays	$ 95,662	$ 54,516	$ 50,010	$ 54,460	$ 21,773		$ 15,137		$ 8,742	$ 56
Less: Offsetting collections	2,083	77,399	1,967	77,367					116	32
Less: Distributed Offsetting receipts	51		51							
Net Outlays	**$ 93,528**	**$ (22,883)**	**$ 47,992**	**$ (22,907)**	**$ 21,773**	**$ (0)**	**$ 15,137**	**$ (0)**	**$ 8,626**	**$ 24**

Required Supplementary Stewardship Information

Stewardship Expenses

In the Department of Education, discretionary spending constitutes approximately 58 percent of the budget and includes nearly all programs, the major exceptions being student loans and rehabilitative services. While spending for entitlement programs is usually a function of the authorizing statutes creating the programs and is not generally affected by appropriations laws, spending for discretionary programs is decided in the annual appropriations process. Most Department programs are discretionary.

Education in the United States is primarily a state and local responsibility. States, communities, and public and private organizations establish schools and colleges, develop curricula, and determine requirements for enrollment and graduation. The structure of education finance in America reflects this predominantly state and local role. Of the estimated $909 billion being spent nationwide on education at all levels for school year 2005–2006, about 90 percent comes from state, local, and private sources. The federal contribution to national education expenditures is about $90.9 billion. The federal contribution includes education expenditures not only from the Department of Education, but also from other federal agencies such as the Department of Health and Human Services' Head Start Program and the Department of Agriculture's School Lunch Program.

The Department's $99.8 billion appropriation is 11.0 percent of total education expenditures in the United States and 3.7 percent of the federal government's $2.7 trillion budget in fiscal year 2006.

Investment in Human Capital

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

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

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

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

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

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

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

Office of Vocational and Adult Education. The Office of Vocational and Adult Education funds academic, vocational, and technical education for youth and adults in high schools, community colleges, and regional technical centers. Educational opportunities are provided for adults over the age of 16, not currently enrolled in school, who lack high school diplomas or the basic skills to function effectively as parents, workers, and citizens.

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

Program Inputs

The Department currently administers programs affecting every area and level of education. The Department's elementary and secondary programs annually serve 15,500 school districts and more than 52 million students attending over 88,000 public schools and more than 28,000 private schools. Department programs also provide grant, loan, and work-study assistance to more than 10 million postsecondary students.

While the Department's programs and responsibilities have grown substantially over the years, the Department itself has not. Since *No Child Left Behind* was enacted in 2001, the Department's staff of approximately 4,111 is 10 percent below the 4,566 employees who administered federal education programs in 2001. At the same time, the Department manages 40 percent more in funds in 2006 than it did in 2001 when its human capital investment was only $38.7 billion. These staff reductions, along with a wide range of management improvements, have helped limit administrative costs to less than 2 percent of the Department's budget, ensuring that the Department delivers about 98 cents on the dollar in education assistance to states, school districts, postsecondary institutions, and students.

Summary of Human Capital Expenses

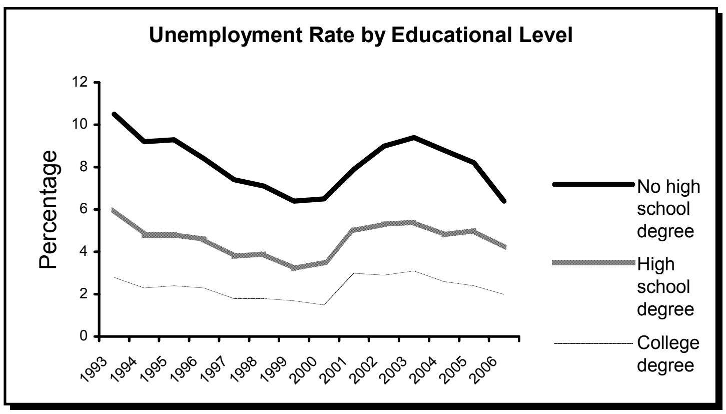
(Dollars in Millions)	2006	2005	2004	2003	2002
Federal Student Aid Expense					
Direct Loan Subsidy	$ 6,655	$ 5,211	$ (543)	$ 4,716	$ 877
Guaranteed Loan Subsidy	28,062	9,863	8,516	2,509	3,988
Grant Programs	15,447	15,070	14,943	13,836	12,256
Salaries & Administrative	172	164	186	179	207
Subtotal	**50,336**	**30,308**	**23,102**	**21,240**	**17,328**
Other Departmental					
Elementary and Secondary Education	21,710	22,940	21,188	19,493	16,127
Special Education & Rehabilitative Services	15,215	13,995	12,687	11,529	9,906
Other Departmental Programs	5,353	6,067	5,160	4,828	4,531
Salaries & Administrative	467	486	448	395	472
Subtotal	**42,745**	**43,488**	**39,483**	**36,245**	**31,036**
Grand Total	**$93,081**	**$73,796**	**$62,585**	**$57,485**	**$48,364**

During the early fall of 2005, just as schools were opening, hurricanes Katrina and Rita devastated the Gulf Coast. The Department's investment in the rebuilding of the educational systems of this region and the support provided to the districts affected across the country are reflected in the numbers above, representing almost 2 percent of the Department's 2006 budget. As a result, the Department has directly affected the lives of schoolchildren, their teachers, their schools, and the local economies of hundreds of communities throughout the United States. This investment, along with the investments made by other federal programs, represents one of the greatest educational efforts in the history of our country.

Program Outcomes

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

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



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

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

Unemployment rate. Persons with lower levels of educational attainment were more likely to be unemployed than those who had higher levels of educational attainment. The September 2006 unemployment rate for adults (25 years old and over) who had not completed high school was 6.4 percent compared with 4.2 percent of those with four years of high school and 2.0 percent for those with a bachelor's degree or higher. Younger people with only high school diplomas tended to have higher unemployment rates than persons 25 and over with similar levels of education.

Annual Income. As of September 2006, the annualized median income for adults (25 years and over) varied considerably by education level. Men with a high school diploma earned $36,088, compared with $61,932 for men with a college degree. Women with a high school diploma earned $26,052, compared with $47,840 for women with a college degree. Men and women with college degrees earned 73.8 percent more than men and women with high school diplomas. Earnings for workers with college degrees have increased in the past year by 10.5 percent for women and 6.6 percent for men. These returns of investing in education directly translate into the advancement of the American economy as a whole.

Report of the Independent Auditors

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

NOV 15 2006

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

Dear Madam Secretary:

The enclosed reports present the results of the annual audits of the U.S. Department of Education's financial statements for fiscal years 2006 and 2005, to comply with the Government Management Reform Act of 1994 (GMRA). The reports should be read in conjunction with the Department's financial statements and notes to fully understand the context of the information contained therein.

We contracted with the independent certified public accounting firm of Ernst & Young, LLP (Ernst & Young) to audit the financial statements of the Department as of September 30, 2006 and 2005, and for the years then ended. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards; OMB's bulletin, *Audit Requirements for Federal Financial Statements*; and the GAO/PCIE *Financial Audit Manual*.

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

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

Sincerely,

John P. Higgins, Jr.

Enclosures

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

ERNST & YOUNG

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Report of Independent Auditors

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheets of the U.S. Department of Education (the Department) as of September 30, 2006 and 2005, and the related consolidated statements of net cost, changes in net position, and financing and the combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements.* Those standards and bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Department's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of September 30, 2006 and 2005, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information presented in the Management's Discussion and Analysis, required supplementary stewardship information, required supplementary information, and other accompanying information is not a required part of the basic financial statements but is supplementary information required by OMB Circular No. A-136, *Financial Reporting Requirements.* The other accompanying information has not been subjected to the auditing procedures applied in our audits of the basic financial statements and, accordingly, we express no

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Report of Independent Auditors
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opinion on it. For the remaining information, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 7, 2006, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Ernst + Young LLP

November 7, 2006

ERNST & YOUNG

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Report on Internal Control

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2006, and the related consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 06-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

In addition, we considered the Department's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the agency's internal control, determined whether internal control had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 06-03 and not to provide assurance on internal control. Accordingly, we do not provide an opinion on such controls.

With respect to internal controls related to performance measures reported in the Management's Discussion and Analysis of the Department's consolidated and combined financial statements, we obtained an understanding of the design of significant internal control relating to the existence and completeness assertions, as required by OMB Bulletin No. 06-03. 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.

However, as a result of the procedures we did perform, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described below.

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Report on Internal Control
Page 2

A material weakness, based on auditing standards generally accepted in the United States as established by the American Institute of Certified Public Accountants, 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 caused by errors or fraud 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 that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described below is a material weakness.

REPORTABLE CONDITIONS

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

The Federal Credit Reform Act of 1990, as amended, was enacted to require agencies to more accurately measure and budget for the cost of federal loan programs. In implementing the requirements of the Credit Reform Act, and in complying with Federal accounting standards, agencies are required to estimate the net cost of extending credit over the life of a direct loan or guaranteed loan based on the present value of estimated net cash flows, excluding certain administrative costs. Such costs are also re-estimated on a periodic basis. While improvements have been made over the last several years, particularly during fiscal year (FY) 2006, we noted that internal controls and processes surrounding the calculation and reporting of the loan liability activity and subsidy estimates should be further refined to ensure that appropriate estimates are prepared.

During FY 2006, we noted that the Department made significant progress on certain aspects of this reportable condition. For example, the Department has developed a methodology to analyze student loan activity at the origination cohort level. In developing this cohort analysis system, a review of all transactions since 1992 was undertaken to allocate activity to the appropriate cohort. Together with this cohort analysis effort, the Department has also developed a set of credit program analytical reports. These reports have been developed to analyze the accounting activity and fluctuation analysis of the credit reform transactions. This process, which was put in place in FY 2006, has already been helpful to the Department in analyzing the potential sources of anomalous balances for further research. The newly instituted cohort level analytic tools and comparison of general ledger activity to model cash flows are significant steps in enhancing the Department's knowledge.

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Report on Internal Control
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In addition, the Credit Reform Workgroup (CRW), which was created in FY 2004 and consists of managers from the Office of the Chief Financial Officer (OCFO), Federal Student Aid (FSA), and Budget Service, met on a consistent basis and were heavily involved throughout the credit reform process in FY 2006. The primary purpose of the CRW was to inform the appropriate parties of key internal issues related to credit reform, and to manage the development of improved processes, procedures, and sources of information to enhance the credit reform estimation process.

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

- The long-term cost for the credit programs is reflected in the financial statements through periodic charges for subsidy costs, adjustments or re-estimates to those subsidy costs, and loan activity, which is all recognized in the allowance for the direct loan (DL) receivable and liability for the guaranteed loan (FFEL) program. The Department uses a computer-based cash flow projection model (i.e., Student Loan Model, or SLM) and OMB calculator to calculate subsidy estimates related to the loan programs that are then recorded in the allowance for subsidy or liability account. The model uses multiple sources of loan data and hundreds of assumptions. In order to perform a check of estimates resulting from the SLM and OMB calculator, the Department prepares a backcast, which compares the model's estimates to actual activity for the current and prior fiscal years. The SLM for the prior year also produces a forecast of the expected cash flows in the current year for the outstanding loans. The new data analysis tools prepared by the Department support more disaggregated reviews of data by cohort. The Department's efforts in this regard are evolving, particularly in capturing the value of the new data analysis tool. These efforts have highlighted differences between recorded activity by cohort in the Department's records as compared to expected cash flows or cash flows derived from credit systems which merit further investigation.

- The early phase of the loan estimation process includes the development of the assumptions which are used to populate the SLM with data that, in turn, feeds into the OMB calculator, which arrives at the actual cost re-estimates. In order to develop a majority of the assumptions, the Department utilizes the National Student Loan Database System (NSLDS) to extract a sample of loan data, which is known as the Statistical Abstract (STAB). The Department then executes internally developed computer programs to arrive at the assumption data that is entered into the SLM. While we understand some improvements have been made, we were informed that the programming language was not fully documented to explain the procedures executed by the programs. As a result, a review of the logic of these programs cannot be performed by someone unfamiliar with the code, which could have the potential of allowing undetected errors to exist in the development of the assumption data. We continue to advocate completion of this process.

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- Particularly in areas that have relatively less predictive capability in the existing model, management should consider the use of reasonable simplified assumptions in estimate development, which can result in simpler programs, thus establishing transparency and limiting the potential for errors. The pattern of large re-estimates in the Department's programs, which reflect difficulties projecting future cash flows, can lead to a call for model enhancements which generate successively more complex and theoretically precise estimates. On balance, however, such refinement may do little to counteract the volatility of the estimates which are highly sensitive to changes in the underlying data. Introducing further complexity may create the appearance of further precision which is largely unwarranted due to the underlying volatility. Such changes, by further complicating the model and the process to develop the estimate, can also significantly increase the risk of errors in updating and running the model.

- FFEL program receivables are classified as pre-1992 loans (liquidating account loans) and post-1991 loans (financing account loans). The Department records certain collections on each of these loan categories using an estimation process (splitter process), as this information cannot be obtained directly from cash collections. The allocation of collections between liquidating and financing loans ultimately affects the liability account for loan guarantees and accounts payable to Treasury. Currently, the Department relies primarily on the output of the credit reform model to record the net value of the pre-1992 loans. The Department's financial systems are not configured to account for cash flows on a rigorous cohort level. As noted earlier, some improvements have been achieved with the development of certain aspects of cohort level analysis. Accurate cohort-level data is increasingly important to ensure that estimates in the subsidy models are appropriately adjusted as cohorts from the early 1990s wind down, and cash flows from default activities create temporary demands for cash that are currently funded on an aggregate basis across cohorts. The process may ultimately help resolve the splitter issues discussed above.

- The Department continues to be challenged in estimating lender and borrower behavior, and relies significantly on prior patterns to estimate future activity. There may be situations, however, in which a refinement of such estimates should be made if circumstances suggest that the pattern will not repeat. Due to lags in the receipt of information on consolidation loans, the Department did not accurately estimate the split between in-school and out-of-school borrowers who consolidated in developing FY 2005 subsidy rates. When actual figures were known, it was determined that the Department had underestimated in-school consolidations, resulting in a re-estimate during FY 2006. Interest rates for in-school borrowers were much lower than for borrowers who were out of school, resulting in an increased subsidy for FY 2006.

  While patterns in the SLM reflect historical data, it seems possible that the level of consolidations will decrease significantly in the future, since many of the incentives for borrowers to consolidate, such as locking in lower interest rates in a rising interest rate environment, are no longer available. High consolidation volume has potentially

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artificially masked long term loan defaults and potential write-offs, since the consolidation process pays off the old loan and establishes a new loan. While the Department's approach is data based, users of the estimates should be made aware of the significant volatility of the estimates and potential for significant future re-estimates as the program changes take effect, the interest rate environment changes and actual default losses become more readily determined.

Recommendations:

We recommend that the Department of Education perform the following:

1. Continue to improve the analytical tools used for the loan estimation process. Ensure that all analytical tools reconcile with one another to allow for their use as detect controls for loan program cost estimates.

2. Document, in detail, the programs written to develop the assumptions for the SLM and document scenarios under which deviation from patterns of prior cash flows are appropriate.

3. The Department should continue to develop detailed operating procedures for the loan estimation process, which would include the step-by-step procedures that take place during the various phases of the process.

4. Efforts to more fully implement cohort reporting should continue, with specific research on whether balances in the Department's financial records are supported by estimates, by cohort, from the SLM and the newly developed cohort analysis tool. Analytical tools should be developed to assure that the splitter process is operating as intended and that remaining credit reform estimates for each cohort are appropriate in relation to the remaining outstanding loans for such cohorts.

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

In connection with the annual audit of the Department's FY 2006 financial statements, we conducted a controls review of the information technology processes related to the significant accounting and financial reporting systems. OMB Circular A-130, *Management of Federal Information Resources*, requires: (1) standard documentation and procedures for certification and accreditation of systems; (2) records management programs that provide adequate and proper documentation of agency activities; (3) agencies to develop internal information policies and procedures and oversee, evaluate, and otherwise periodically review agency information resource management activities; and (4) agency plans to assure that there is an ability to recover and provide service sufficient to meet the minimal needs of users of the system.

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

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

While the Department has made progress in strengthening controls over information technology processes and has continued making improvements in the areas of configuration management, virus protection, and security patch management during FY 2006, our audit work and audit reports prepared by the Office of Inspector General (OIG) identify certain control weaknesses, including several that were repeat conditions, within information technology security and systems that need to be addressed.

More specifically the Department should: (1) strengthen access controls to protect mission critical systems (e.g. user provisioning process, periodic access revalidation, timely removal of user access, physical data center access controls); (2) improve the configuration management process to ensure consistent security configuration of servers and mainframe security packages across the organization and improve configuration settings to comply with best practices; (3) enforce the use of complex passwords in all systems across the organization; (4) comprehensively review technical security weaknesses identified in prior audits in order to determine whether security controls have been fully implemented or adequately address the security weaknesses across the organization; (5) implement consistent tape back up controls; (6) strengthen security incident handling procedures and intrusion detection systems; (7) consistently perform risk assessments and Certification and Accreditation on its new systems and new environments, especially after migrating to a new location or a new system; (8) improve private data protection controls (e.g. proper disclosure of the use of 'cookies' on Department websites and polices and procedures on dial up access and encryption of back up data); (9) enhance its security training and awareness program and the monitoring of this program, specifically in accounting for completion of such training by all employees and contractors; (10) improve protection of sensitive information, including read-only access to personally identifiable information on Department systems; and (11) the Office of Management should continue its efforts to reconstruct its inventory database or otherwise reconcile its physical inventory of computing and other equipment to ensure that all Department computing resources and the data residing in them are secured and safeguarded.

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The OIG has identified significant deficiencies for the Department in its 2006 Federal Information Security Management Act (FISMA) report in the areas of (1) the Department's management control structure in incident handling and intrusion detection systems which restrict its ability to reasonably identify and report suspicious activity; and (2) the Department's configuration management program that restricts its ability to reasonably maintain security over its systems in a consistent manner. In addition, a number of repeat conditions were noted in our work and in the OIG's audit reports, an indication that the control environment and monitoring components of internal controls at the Department require additional focus.

Recommendation:

1. Audit resolution activities have traditionally been focused around addressing the immediate security and control weaknesses identified by audit reports rather than a detailed evaluation of the root cause for the identified weaknesses, which is indicated by the number of repeat findings. We recommend that the Department continue its efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness, which should decrease the likelihood of a similar weaknesses being identified in future audit assessments and internal self-assessments. Examples of addressing root causes may include, but are not limited to, additional training for the information technology professionals within the organization, updates to procedures to ensure proper configuration of servers against documented hardening standards at the time of deployment, and auditing performance-based contracts of vendors providing system support services to the Department.

STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the FY 2005 audit of the Department of Education's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

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Summary of FY 2005 Reportable Conditions

Issue Area	Summary Control Issue	FY 2006 Status
Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Reportable Condition)	Management controls and analysis need to be strengthened over credit reform estimation and financial reporting processes.	Improvements noted – Modified Repeat Condition Reportable Condition
Controls Surrounding Information Systems Need Enhancement (Reportable Condition)	Improvements are needed in overall information technology security management.	Improvements noted – Modified Repeat Condition Reportable Condition

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

In addition to the reportable conditions described above, we noted certain other matters involving internal control and its operations that were reported to management in a separate letter dated November 7, 2006.

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

Ernst + Young LLP

November 7, 2006

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Report on Compliance with Laws and Regulations

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2006, and the related consolidated statements of net cost, changes in net position, and financing and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

The management of the Department is responsible for complying with laws and regulations applicable to the Department. As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 06-03, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03. We noted certain other matters involving compliance with laws and regulations that were reported to management in a separate letter dated November 7, 2006.

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

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

While the Department has made progress in strengthening controls over information technology processes and has continued making improvements in the areas of configuration management, virus protection, and security patch management during FY 2006, our audit work and audit reports prepared by the Office of Inspector General (OIG) identify certain control weaknesses, including several that were repeat conditions, within information technology security and systems that need to be addressed. More specifically, the Department should: (1) strengthen access controls to protect mission critical systems (e.g. user provisioning process, periodic access revalidation, timely removal of user access, physical data center access controls); (2) improve the configuration management process to ensure consistent security configuration of servers and mainframe security packages across the organization and improve configuration settings to comply with best practices; (3) enforce the use of complex passwords in all systems across the organization; (4) comprehensively review technical security weaknesses identified in prior audits in order to determine whether security controls have been fully implemented or adequately address the security weaknesses across the organization; (5) implement consistent tape back up controls; (6) strengthen security incident handling procedures and intrusion detection systems; (7) consistently perform risk assessments and Certification and Accreditation on its new systems and new environments, especially after migrating to a new location or a new system; (8) improve private data protection controls (e.g. proper disclosure of the use of 'cookies' on Department websites and polices and procedures on dial up access and encryption of back up data); (9) enhance its security training and awareness program and the monitoring of this program, specifically in accounting for completion of such training by all employees and contractors; (10) improve protection of sensitive information, including read-only access to personally identifiable information on Department systems; and (11) the Office of Management should continue its efforts to reconstruct its inventory database or otherwise reconcile its physical inventory of computing and other equipment to ensure that all Department computing resources and the data residing in them are secured and safeguarded.

The Report on Internal Control includes additional information related to the financial management systems that were found not to comply with the requirements of FFMIA relating to information technology security and controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMIA, and our recommendations related to the specific issues. We have reviewed our findings and recommendations with management of the Department. Management concurs with our recommendations and, to the extent findings and recommendations were noted in prior years, has provided a proposed action plan to the OIG in accordance with applicable Department directives.

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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

November 7, 2006

UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, D.C. 20202-________

NOV - 8 2006

MEMORANDUM

TO: John P. Higgins, Jr.
Inspector General

FROM: Lawrence A. Warder
Chief Financial Officer

Bill Vajda
Chief Information Officer

SUBJECT: DRAFT AUDIT REPORTS
Fiscal Years 2006 and 2005 Financial Statement Audit
U.S. Department of Education
ED-OIG/A17G0003

Please convey our sincere thanks and appreciation to everyone on your staff who worked diligently on this financial statement audit. The Department has reviewed the draft Fiscal Years 2006 and 2005 Financial Statement Audit Reports. Without exception, we concur and agree with the Internal Control Report and the Auditor's Opinion. We also concur and agree with the report on Compliance with Laws and Regulation.

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

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

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

Other Accompanying Information

Improper Payments Information Act Reporting Details

The *Improper Payments Information Act of 2002* (IPIA) and the Office of Management and Budget's (OMB) Circular No. A-123, Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments*, require agencies to annually review and assess all programs and activities to identify those susceptible to significant improper payments. The guidance in OMB Circular No. A-123, Appendix C, defines significant improper payments as those in any particular program that exceed both 2.5 percent of program payments and $10 million annually. For each program identified as susceptible, agencies are required to report to the President and the Congress the annual amount of estimated improper payments, along with steps taken and actions planned to reduce them.

To facilitate agency efforts to meet the reporting requirements of the IPIA, the OMB announced a new *President's Management Agenda* program initiative beginning in the first quarter of FY 2005 entitled Eliminating Improper Payments. Previously, the OMB tracked the Department's IPIA activities with other financial management activities through the Improving Financial Performance initiative. The establishment of a dedicated *President's Management Agenda* initiative focused the Department's improper payments efforts. Under the new initiative, the Department's status and progress are tracked and reported to the OMB in quarterly scorecards.

The Department has divided its improper payment activities into the following segments: Student Financial Assistance Programs, Title I Program, Other Grant Programs, and Recovery Auditing.

Student Financial Assistance Programs

Federal Student Aid operates and administers the majority of the *Higher Education Act of 1965*, as amended (HEA), Title IV[1] Student Assistance (Title IV) programs for the Department. In FY 2006, nearly $77 billion was provided to students and families to help them overcome the financial barriers that make it difficult to attend and complete postsecondary education. Federal Student Aid administers a variety of grants, loans, and loan guarantees through its financial assistance programs. The processes developed to administer the programs are responsive to changes in statutes, the reauthorization of existing statutes, and the changing needs of educational institutions and their students.

Title IV student assistance programs are large and complex. Federal Student Aid relies on over 6,100 eligible postsecondary institutions, 3,200 lenders, 35 loan Guaranty Agencies, and a number of private loan servicers to administer its programs. Except for funds received as an administrative cost allowance, Federal Student Aid program funds received by a school are held in trust by the school for the students, the Department, and, in some cases, for private lenders and Guaranty Agencies.

The HEA and subsequent Department regulations to implement the law comprise a succession of eligibility definitions, standards, requirements, tests, and other internal controls designed to minimize the risk that improper payments will be made either to students or to postsecondary or financial institutions. The law provides criteria for an institution to be eligible to participate in student financial assistance programs and mandates the joint responsibility of a program integrity triad made up of state educational agencies, accrediting agencies, and the Department. This structure, while empowering educational institutions to operate programs based on area needs, can increase the

[1] Title IV is the portion of the Higher Education Act that authorizes and regulates various student financial aid programs.

risk of improper payments and pose oversight and monitoring challenges for the federal government.

Federal Student Aid engages in a continual process of actively identifying new risks in the programs it administers. Noncompliance with statutes, regulations and policies, whether by students, schools, lenders, Guaranty Agencies, or loan servicers, not only places Title IV funds at risk, but also erodes public trust in the programs. To address these concerns, Federal Student Aid has several initiatives underway to identify real or potential risks for fraud, waste, abuse, mismanagement, and inadvertent errors in the delivery of student financial assistance programs and funds.

Controls Over Financial Aid Applications

Over 13 million postsecondary school students apply for federal student aid each year by completing the required *Free Application for Federal Student Aid* (*FAFSA*). Information provided on the *FAFSA* is used to (1) calculate the expected family contribution (EFC), an amount applicants and their families are expected to contribute to the cost of their postsecondary education expenses for a given award year, and (2) confirm eligibility through computer matches with other agencies. Unless the application is rejected due to inconsistencies or inadequate information, the Department's central processing system will automatically calculate the EFC. The HEA establishes the formula for the EFC calculation. The result is a measure of the applicant's financial strength, and is significant in the determination of the amount and type of aid a student can receive.

The Department processes the *FAFSA* data it receives each year, using a sophisticated set of database matches and computerized editing techniques to confirm student eligibility for the Title IV programs and to target error-prone applications for a verification process. All applicants are subjected to one or more of the student eligibility database matches and approximately 30 percent (approximately 3.9 million) are selected for verification.

Those applicants selected for verification are required to submit documentation to their school in order to verify their reported household size, number of family members attending college, adjusted gross income (AGI), U.S. income taxes paid, and certain untaxed income and benefits reported on the *FAFSA*. Schools are required to collect copies of income tax returns from applicants who file returns (and their parents, if the applicant is a dependent student) to determine that AGI, income taxes paid, and certain untaxed income and benefits amounts were correctly reported on the *FAFSA*. Any discrepancies detected during the verification process must be corrected.

Risk Assessment

As required by the IPIA, Federal Student Aid inventoried its programs during FY 2006, and reviewed program payments made during FY 2005 (the most recent complete fiscal year available), to assess the risk that a significant amount of improper payments were made. The review identified and then focused on five key programs (Federal Family Education Loan Program, Federal Pell Grant Program, Federal Supplemental Educational Opportunity Grant and Federal Work-Study Programs, and Direct Loan Program), representing 98.7 percent of Federal Student Aid's FY 2005 outlays. (Outlays in this context represent the amount of money actually spent during a fiscal year.)

The criteria for determining susceptible risk within the programs were defined as follows:

- For those programs with annual outlays that did not exceed the OMB susceptibility threshold of $10 million, a comprehensive program risk assessment was not prepared and the programs were determined to be unsusceptible to the risk of significant improper payments.
- For programs with outlays greater than $10 million, but less than $200 million, estimates of improper payments were prepared using the susceptible threshold error rate of 2.5 percent. Programs with improper payment estimates of less than $5 million were deemed unlikely to be susceptible to the risk of significant improper payments.
- Programs were selected for further determination of susceptibility to significant

improper payments if annual outlays exceeded $200 million.

- Finally, programs were automatically deemed susceptible if previously required to report improper payment information under OMB Circular A-11, *Budget Submission*, former Section 57.[2]

Risk Susceptible Programs

The following five Title IV programs were deemed to be potentially susceptible to the risk of significant improper payments based on the OMB threshold of potential annual improper payment amounts exceeding both 2.5 percent of program payments and $10 million.

Federal Family Education Loan Program. The Federal Family Education Loan (FFEL) Program is a guaranteed loan program established by the HEA. Under the FFEL Program, eligible students apply to lenders such as banks, credit unions, and savings and loan associations for loans to vocational, undergraduate, and graduate schools to help pay for educational expenses. If the lender agrees to make the loan, a state or private nonprofit loan Guaranty Agency insures the loan against default. The federal government subsequently reinsures this loan. FFEL Programs offer various repayment options and provide four types of loans to qualified applicants.

- Subsidized Stafford Loans—Need-based loans in which the government pays interest when the student is in school and during qualified periods of grace and deferment.
- Unsubsidized Stafford Loans—Loans in which the government does NOT pay interest.
- PLUS Loans—Loans to parents of dependent undergraduate students in which the government does not pay interest. As a result of the *Higher Education Reconciliation Act of 2005,* graduate or professional students are now eligible to borrow under this loan program, subject to eligibility.
- Consolidated Loans—Loans that allow borrowers to combine multiple outstanding federal student assistance loans.

During FY 2006, net loans of $46.2 billion were provided to 6.2 million FFEL recipients. In addition, Federal Student Aid paid an estimated $7.5 billion to lenders for interest and special allowance subsidies, and an estimated $4.6 billion to Guaranty Agencies to reimburse them for defaulted FFEL loans, loan processing fees, issuance fees, and account maintenance fees required by the HEA. The interest payments and special allowance subsidies, combined with the default, loan processing, issuance, and account maintenance fees comprise the program outlays at risk.

Federal Pell Grant Program. The Federal Pell Grant (Pell Grant) Program provides need-based grants to low-income undergraduate and certain postbaccalaureate students to promote access to postsecondary education. Students may use their grants at any one of approximately 6,100 eligible postsecondary institutions. Grant amounts are dependent on the student's EFC, the cost of attending the institution, whether the student attends full-time or part-time, and whether the student attends the institution throughout the entire academic year. The statutory maximum award remained at $4,050 for the 2005-2006 award year.

Under the terms of the HEA, eligibility for Pell Grant awards is determined exclusively through applicant self-reported income, family size, number of dependents in college, and assets. These data are key drivers in the determination of program eligibility and eligible amounts. However, historical analysis indicates that the accuracy of self-reported data is prone to error, and that these errors subsequently increase the risk of improper payments within the Pell Grant program.

While limited matching of some self-reported income data is currently conducted with data

[2] The four original programs identified in OMB Circular A-11, Section 57 were Student Financial Assistance (now Federal Student Aid), Title I, Special Education Grants to States, and Vocational Rehabilitation Grants to States. Subsequently, after further review of the program risk, the OMB removed Special Education Grants to States and Vocational Rehabilitation Grants to States from the list. The OMB considers Section 57 programs susceptible to significant improper payments regardless of the established thresholds.

from the Department of the Treasury, Internal Revenue Service (IRS) annual income tax filings, Federal Student Aid is pursing additional authority to allow greater access to IRS data. Specifically, Federal Student Aid has requested authorization to verify 100 percent of the annual student financial aid applications with the financial data reported to the IRS in annual income tax returns. The ability to verify self-reported financial data could result in a significant reduction of the risk of improper payments in the Pell Grant program. Legislation to amend the Internal Revenue Code to permit a 100 percent data match has not yet been enacted, and at this time appears unlikely to be enacted. In the interim, Federal Student Aid is working with the OMB to develop alternative methods.

Federal Supplemental Educational Opportunity Grant and Federal Work-Study Programs. The Federal Supplemental Educational Opportunity Grant program is one of three campus-based[3] formula grant programs allocated to eligible institutions for the purpose of providing grants to needy undergraduate students attending the institution. During FY 2005, the Department allocated $1 billion through the Federal Supplemental Educational Opportunity Grant program to institutions who awarded grants to about 1.3 million low-income students.

The Federal Work-Study program is another of the three campus-based formula grant programs, providing part-time employment to needy undergraduate and graduate students. In FY 2006, the Department allocated $1.2 billion to schools.

The Federal Supplemental Educational Opportunity Grant and Federal Work-Study programs were surveyed and determined not to be of significant risk of improper payments. Combined, the two programs constituted $2.3 billion, or just 2.6 percent of the Department's total payments in FY 2005. Each year, participating institutions complete the *Fiscal Operations Report and Application to Participate*. The *Fiscal Operations Report and Application to Participate* serves as a mechanism to report prior year funds usage and current year need. Each year, the aggregated amount of need (for all participating institutions) far exceeds the appropriated amounts for both Federal Supplemental Educational Opportunity Grant and Federal Work-Study programs. Therefore, by design, the risk of over-awarding funds is inherently minimized since award distribution is prioritized by order of need, and not all students with demonstrated need actually receive awards. Moreover, continuing oversight activities, including audits and program reviews, have not revealed significant risk in either of these programs.

William D. Ford Federal Direct Loan Program. Similar to the FFEL Program, the William D. Ford Federal Direct Loan (Direct Loan) Program provides the following four types of loans to qualified individuals to assist with the cost of postsecondary education: (1) Stafford Subsidized; (2) Stafford Unsubsidized; (3) PLUS; and (4) Consolidation.

Under the Direct Loan Program, the Department uses Department of Treasury funds to provide loan capital directly to schools, which then disburse loan funds to students. During FY 2005, the Department disbursed $13.9 billion in Direct Loans (net of loan consolidations) through participating institutions to 1.8 million applicants with financial need who met the program criteria.

Similar to the Pell Grant Program, improper payments in the Direct Loan Program are generally the result of errors in the self-reported eligibility data provided on the *FAFSA*. However, since the aid is provided as a loan rather than a gift, and is subject to full repayment (some loans including interest), eligibility errors alone do not necessarily result in a significant loss to the government.

Moreover, the authority of the Department to successfully pursue the collection of defaulted loans (properly or improperly made) through tax refund offsets, wage garnishment offsets, and other legal actions further reduces the government's risk. The principal risk to the government lies in the cost of administering the loans and the subsidy—the net present value of cash flows to and from the government that result from providing these loans to borrowers.

[3] Campus-based financial aid programs are administered to students by participating postsecondary institutions and not by the Department of Education.

The Department contracts with multiple educational and financial institutions to originate, disburse, service, and collect Direct Loans, while the HEA and subsequent reauthorization actions determine the allowable interest rates and fees. Eligibility requirements are determined through the analysis of factors such as income and assets, and the schools make the final award decisions. Because of this multifaceted structure that encompasses multiple entity involvement and variable annual eligibility requirements, a full and rigorous assessment of the rate of improper payments in the Direct Loan Program is extremely complex. Despite this challenge, the Department is analyzing the eligibility data used to determine the Pell Grant improper payment rate as part of its comprehensive effort to lower the risk of improper payments in all financial aid programs that are reliant on applicants' self-reported eligibility information.

Academic Competitiveness/SMART Grants. In FY 2006, Federal Student Aid program managers discussed the potential risks and controls for avoiding improper payments in the recently authorized Academic Competitiveness /SMART Grant program. Payment processes and risk categories have been identified. In addition, a risk control matrix has been developed for these new programs.

Federal Student Aid Administrative Payments. As part of our annual assessment of risk for the susceptibility of significant improper payments, we reviewed other types of payments made by Federal Student Aid. An initial review of the administrative payments such as payroll disbursements, vendor payments, and travel expenses determined that those payments were not susceptible to the risk of significant improper payments, as defined by IPIA and the related OMB implementation guidance.

Statistical Sampling

The size and complexity of the student aid programs make it difficult to consistently define "improper" payments. The legislation and the OMB guidance use the broad definition, "Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirement." Federal Student Aid has a wide array of programs, each with unique objectives, eligibility requirements, and payment methods. Consequently, each program has its own universe (or multiple universes) of payments that must be identified, assessed for risk, and, if appropriate, statistically sampled to determine the extent of improper payments.

Federal Family Education Loan Program. The Department and Federal Student Aid have been working with the OMB on the implementation of the *President's Management Agenda* initiative, Eliminating Improper Payments. The initiative involves a range of quarterly activities designed to ensure that the Department is prepared to meet the annual reporting requirements of the IPIA. Through meetings and discussions with the OMB and other Department offices, Federal Student Aid finalized its sampling methodology for estimating improper FFEL program payments in compliance with the requirements of the IPIA and implementation guidance.

In FY 2006, Federal Student Aid identified and performed an internal review of all invoices included in the statistically valid sample. All of the Guaranty Agencies and lenders associated with each of the invoices in the selected samples were identified. Twenty-one Guaranty Agencies and 47 lenders have been identified for on-site reviews, which will be conducted in FY 2007. Program review staff from Federal Student Aid's Program Compliance business unit have been identified to perform the on-site reviews.

For FY 2005, Federal Student Aid established a baseline of estimated improper payments in the FFEL Program by evaluating the following information:

- Overpayments identified during Financial Partners Service program reviews of Guaranty Agencies, lenders and loan servicers during FY 2005.
- Overpayments identified by independent public accountants and third-party audit

firms in Single Audit[4] reports for Guaranty Agencies and lenders.

- Overpayments reported by the Department's Inspector General in audits and reviews of Guaranty Agencies, lenders, and loan servicers during FY 2005.
- Outstanding loan balance amounts at Guaranty Agencies, lenders, and servicers selected for review.

The preliminary estimated rate for the FFEL Program is 2.2 percent. This estimate was derived based on an evaluation of the criteria aforementioned.

The information was compiled by entity and compared to the total payments made to those entities in fiscal year 2005 to determine if there exists a susceptibility to significant improper payments. The focus of this analysis was to (1) determine a baseline error rate for FFEL payments, (2) establish an action plan for improving the accuracy of future measurements, and (3) ensure that the planned methodology and approach for measuring improper payments meets the requirements of the IPIA.

During the fiscal year, the Inspector General issued an audit report that questioned payments made to an entity that participates in the Federal Family Education Loan Program. The findings cited in this report are under consideration by the Department. Until the matter is resolved, the potential impact, if any, on the Department's financial position is not possible to estimate.

Federal Pell Grant Program. Section 484(q) of the HEA authorizes the Department to confirm directly with the IRS the AGI, taxes paid, filing status, and number of exemptions reported by students and parents on the *FAFSA*. Under the IRS Code, Federal Student Aid is not authorized to view the complete data, but is provided with summary data by the IRS.

The Department began routinely conducting studies with the IRS using *FAFSA* data for the 2000-2001 award year. Data provided by the IRS study were used to estimate improper payments for the Pell Grant Program for the 2004-2005 award year. Federal Student Aid is currently working with the IRS on the fifth annual study, using *FAFSA* data collected for the 2005-2006 award year, which will be matched with IRS data for the 2004 income tax year. (Applicants for the 2005-2006 award year reported income information based on their actual or estimated 2004 income tax year.)

In the latest completed study, which compared 2004-2005 *FAFSA* data with 2003 IRS data, a sample file of 155,000 *FAFSA* applicant records was provided to the IRS along with a sampling program designed to allow the IRS to select the desired analysis sample from the larger file. This was done to preserve IRS confidentiality requirements. The final sample, generated by the IRS, contained 50,000 independent undergraduates and 50,000 dependent undergraduates (for whom parental data was matched).

The IRS matched the final sample to its main database, and when a match occurred, it extracted the fields for AGI, taxes paid, type of return filed and earned income tax credit information for the tax filer and compared this information to similar information reported to the Department on the *FAFSA*. Using a computer program supplied by Federal Student Aid, the IRS calculated revised EFC and Pell Grant awards for matching records by substituting the IRS income information for the *FAFSA* income information. The IRS provided aggregated statistical tables to the Department that presented the results of these comparisons. The results allowed the Department to estimate the following Pell Grant improper payment information:

- Improper payment rate and amount—The average amount of over- and under-reporting of *FAFSA* income data—as compared to the IRS income data—and the potential dollar amount of improper Pell Grant awards;
- Assessment of measurement accuracy—The volume of applicants for whom a mismatch between *FAFSA* and IRS data may be legitimate;

[4] "Single audit" means an audit, which includes both the entity's financial statements and the federal awards pursuant to the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156. The provisions of the statute are set forth in OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

- Identification of further potential risks—Types of applicants who are more likely to misreport income on the *FAFSA*;
- Analysis of existing edits—Validity of the current verification selection edits, and information to further refine them.

The table below presents a historical analysis of the results of the IRS Statistical Study of Pell Grants.

Pell Grant Improper Payment Estimates
($ in millions)

Fiscal Year	Disbursements	Underpayments	Overpayments	Total Improper Payments*	Percent Underpayments*	Percent Overpayments*	Percent Total Improper Payments*
2001	$ 9,851	$ 64	$272	$336	.8%	3.4%	4.2%
2002	$11,619	$ 49	$328	$378	.5%	3.3%	3.8%
2003	$12,680	$205	$365	$569	1.8%	3.1%	4.9%
2004	$13,042	$221	$349	$571	1.8%	2.8%	4.5%
2005	$12,749	$140	$303	$444	1.1%	2.38%	3.48%

*Amounts are rounded

William D. Ford Federal Direct Loan Program. The analysis and corrective actions developed for the Pell Grant Program, relative to application accuracy, will also improve the accuracy of Direct Loan program applications, because (1) the same application is used for both programs, and (2) eligibility for subsidized direct loans are founded on the same need-based analysis formula and institutional cost of attendance. Federal Student Aid, in coordination with the OMB, performed an assessment of the risk of improper payments based upon the comparison of school cash draws with loan disbursements for FY 2005. This assessment showed that the risk of improper payments in this function has decreased from 2003-2004 to 2004-2005 and is minimal at this time. However, we recognize the importance of being vigilant in analyzing data reported to the Department. The strengthening of verification to improve the accuracy of applicant reported data will have an effect on reducing improper payments in all Title IV programs, including the Federal Direct Loan Program.

Corrective Actions

Federal Family Education Loan Program. Federal Student Aid is working closely with the OMB and other Department offices in the development of an action plan designed to (1) improve the accuracy of the FFEL improper payment estimate, and (2) reduce the level of risk and the amount of known improper payments in the FFEL Program. Understanding and developing systems of internal controls over program payments is crucial to these goals.

Federal Student Aid has a number of existing internal controls integrated into its systems and activities. Program reviews, independent audits and Inspector General audits of Guaranty Agencies, lenders, and servicers are some of its key management oversight controls. Other control mechanisms in place are described below.

- System Edits—the systems used by the Guaranty Agencies, lenders, and servicers to submit fee bills for payment include "hard" and "soft" edits to prevent erroneous information from being entered into the system and translated into erroneous payments. The hard edits prevent fee bills with certain errors from being approved, and these errors must be corrected before proceeding with payment processing. The soft edits alert the user and Federal Student Aid to potential errors. Federal Student Aid reviews these warnings prior to approval of payment.
- Reasonability Analysis—data stored in the National Student Loan Data System are used as a tool to assess the reasonability of fee billing, and to determine payment amounts

for account maintenance and loan issuance processing fees paid to Guaranty Agencies. Federal Student Aid also performs trending analysis of previous payments to Guaranty Agencies, lenders and servicers, as a means of evaluating reasonableness of changes in payment activity and payment levels.

- Focused Monitoring and Analysis—Federal Student Aid targets specific areas of FFEL payment processing that are at an increased risk for improper payments as areas of focus for increased monitoring and oversight.

These existing controls are re-evaluated on a regular basis to determine their effectiveness and to allow Federal Student Aid to make necessary corrections. Further, Federal Student Aid's action plan incorporates the development of additional internal controls designed to improve the accuracy of future FFEL payments to lenders, servicers, and Guaranty Agencies.

- Special Allowance Payments – increased focus and review of payments of fees to lenders and servicers associated with loans eligible for tax-exempt special allowance payments.
- Guaranty Agencies – enhanced review of the Guaranty Agency Financial Report (Form 2000) to report collection activities, claims reimbursement, and loan portfolio status; and under- and over-billings for account maintenance, loan issuance, and processing fees associated with incorrect National Student Loan Data System reporting.

Additional controls are being considered for both cost efficiency and effectiveness in reducing FFEL payment errors. Updates to the corrective action plan will be reported to the OMB in the quarterly scorecard for *Eliminating Improper Payments*.

Federal Pell Grant Program. Federal Student Aid has several initiatives underway designed to improve its ability to detect and reduce improper payments made in the Pell Grant Program. Working with the OMB on quarterly action plan objectives designed to facilitate full implementation of the IPIA, it has identified additional methods to determine the error rate and to estimate the annual amount of improper payments.

Preliminary Analysis. Eligibility for Title IV student aid is determined through applicant self-reported income, family size, number of dependents in college, and assets. These data are reported through the *FAFSA*, which applicants typically complete prior to the April 15 IRS tax filing deadline. The *FAFSA* data are key drivers in the determination of student aid program eligibility and eligible amounts. Federal Student Aid performs regular analysis on the accuracy of income and other financial data submitted via the *FAFSA*. These routine analyses include a variety of methods and techniques designed to ensure payment accuracy.

- Annual Analysis of System Data - Analysis of central processing system data for anomalies.
- Focus Groups - Meetings with educational institutions to discuss improving the integrity of FSA programs.
- Quality Assurance - Enhanced program integrity processes.
- Verification - A process by which institutions compare applicant data to IRS data for the same period.

Federal Student Aid is also using the IRS statistical study in which financial data from a random sample of *FAFSA* submissions is compared to financial data reported to the IRS in annual income tax filings to identify new solutions for preventing improper payments.

The analysis of the IRS statistical study indicates that failure to accurately report income, family size, number of dependents in college, and assets may be the primary cause of improper payments within the Pell Grant Program. It is expected that a decrease in financial reporting errors would have the greatest impact on the reduction of estimated improper payments. In an effort to achieve this reduction, Federal Student Aid has requested authorization to perform a 100 percent match of the financial data reported on the *FAFSA* to the financial data reported to the IRS on applicant income tax returns. However, current law does not permit Federal Student Aid to verify income data with the IRS. Although

Federal Student Aid plans to pursue this option, it must continue to meet the reporting requirements of the IPIA. Federal Student Aid is pursuing alternatives that will accomplish the same result: reduced improper payments in the Pell Grant Program.

Alternatives to Verifying Self Reported AGI. Federal Student Aid, working with officials from the OMB and the Department, has been exploring alternatives to the 100 percent IRS match for verifying self-reported financial information reported on the *FAFSA*, and assessing the strengths and weaknesses of those alternatives. Listed below are some of the alternatives that are being considered:

- Private database matches (data aggregators).
- Require actual tax returns for *FAFSA* filing.
- Require update to income data at tax filing deadline.
- Expand verification beyond 30 percent.

The ongoing action plan details the steps necessary to (1) perform statistical analysis, (2) complete the review of the alternative, (3) incorporate current IRS statistical analysis, and (4) submit the recommended alternative or combination of alternatives. Progress in completing actions will continue to be reported to the OMB in the quarterly scorecard for *Eliminating Improper Payments*.

Federal Student Aid's ability to project improper payment reductions is wholly dependent upon the completion of the corrective action plan and the selection of an alternative approach to a 100 percent IRS income match for every application. This will not be a quick or easy process. It is important to note that the system development life cycle for the pertinent Federal Student Aid systems requires significant lead time for requirements, testing, coding and implementation of changes required to deploy the changes necessary to reduce improper payments.

William D. Ford Federal Direct Loan Program. While the risk of significant improper payments in the Direct Loan Program has been considered minimal, Federal Student Aid developed a separate action plan to achieve IPIA reporting elements for this program during FY 2006. Assessment of the risk of improper payments in the Direct Loan Program was based upon an evaluation of the annual audits required of the schools participating in the programs. Information on all audits was queried from Postsecondary Education Participants Systems, our management information system of all schools participating in the student aid programs. Audit deficiencies resulting in liabilities due to a specific Direct Loan Program violation or due to a violation of regulations applicable to all programs were isolated. The liability amount for each deficiency applicable to the Direct Loan Program was calculated and compared with total funding.

The contractor's correction plan verified that incorrect payments were identified by completing two separate reviews of all National Student Loan Data System sourced certifications. This review verified that incorrectly disbursed funds were recovered, or are in the process of being recovered. In addition, the contractor reviewed the loan servicing accounts of both the underlying loans that were Direct Loans and the resulting consolidation loans to ensure that correcting transactions being passed from loan consolidation resulted in complete correction of the borrowers' accounts, and no adverse impact was imposed on the borrower. This review included ensuring that borrowers' progress toward and eligibility for on-time payment incentives was not affected, and that payments were correctly reapplied following receipt of the correcting transaction.

Federal Student Aid Summary

The following table presents the improper payments outlook for the primary Federal Student Aid Programs.

Federal Student Aid Improper Payment Reduction Outlook Fiscal Years 2005 – 2009 ($ in millions)															
	Actual						Estimated								
	2005			2006			2007			2008			2009		
Program	Outlays[1]	IP %	IP $	Outlays	IP %	IP $	Outlays	IP %	IP $	Outlays	IP %	IP $	Outlays	IP %	IP $
Direct Loan Program	$12,231	NA[2]	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
FFEL Program[4]	$8,626	2.2%	$190	$18,245	2.2%	$401	$5,340	2.2%	$117	$5,340	2.2%	$117	$5,340	2.2%	$117
Pell Grant Program	$12,749	3.48%[3]	$444	$12,117	3.48%	$422	$12,825	3.48%	$446	$12,825	3.48%	$446	$12,825	3.48%	$446

1 Outlays reported in the table have been adjusted to reflect actual disbursements of funds, net of internal and intra-governmental adjustments or transfers.

2 Federal Student Aid is working with the OMB and other Department offices to determine whether a statistically valid estimate of improper payments is necessary for the Direct Loan Program.

3 Combined over- and under-payment error rate is 3.48 percent. A separate analysis of the overpayments and underpayments was previously presented in the Pell Grant table.

4 Federal Student Aid is working to update future year improper payment estimates as the methodology is further developed.

Manager Accountability

Federal Student Aid program managers are responsible for making recommended improvements and achieving quantifiable savings. The Federal Student Aid Executive Management Team monitors these efforts. The Executive Management Team is composed of key managers and is the executive decision-making body within Federal Student Aid. Further, the Office of Inspector General conducts periodic audits of student aid programs and makes appropriate recommendations to management and the Congress.

Reducing improper payments in the Pell Grant Program has been a performance measure in the Department's Strategic Plan since 2002. The IRS statistical study has also been included in Federal Student Aid's Annual Plans. In addition, projects have been included in the Federal Student Aid Annual Plan to improve the verification process results.

Beginning in 2005, a control group of *FAFSA* applicants who had estimated their 2004 income when completing the application were advised after April 15 to revise the application with the correct and known information filed on their 2004 income tax return.

Statutory or Regulatory Barriers

As stated previously, a database match with the IRS would likely improve the accuracy of Pell Grant awards. In addition, it would eliminate the need for schools to rely on paper copies of tax returns submitted by the applicant (and the applicant's parent, if the applicant is dependent) to verify AGI and taxes paid amounts. However, legislation to amend the Internal Revenue Code to permit the database match has not yet been enacted and at this time appears unlikely to be enacted.

Title I

The Department performed a risk assessment of the *Elementary and Secondary Education Act* Title I Program, parts A, B, and D, during FY 2006. The *Erroneous Payments Risk Assessment Project Report* documented that the risk of improper payments under the current statutory requirements is very low. In order to validate the assessment data, the Department conducted an on-site monitoring review in FY 2006 that encompassed all states and territories receiving Title I funds with a three-year review cycle. The Office of the Chief Financial Officer participated with the Office of Elementary and Secondary Education in the monitoring process, beginning March 2005, to provide technical support regarding fiduciary compliance. There were no findings in the monitoring reviews with questioned costs that contradicted the data in the risk assessment.

The Department is continuing to review and monitor for data quality. A key element of the monitoring process involves the wide use of the number of children who qualify for free and reduced price meals to determine an individual school's Title I eligibility and allocation by local educational agencies. The Title I statute authorizes local educational agencies to use these data, provided under U.S. Department of Agriculture's National School Lunch Program, for this purpose. In many districts these data are the only indicator of poverty available at the individual school level.

Currently, the U.S. Department of Agriculture is working with states and localities to improve program integrity, within the existing statutory and regulatory framework, through enhanced monitoring and auditing to improve program integrity. The U.S. Department of Agriculture is also working with the Department and other federal agencies that have programs that make use of these data to explore long term policy options.

Manager Accountability

In fiscal year 2006, the Department used a database of the OMB Circular A-133 single audit findings to provide feedback to program managers regarding the frequency and distribution of findings within their programs. This will assist the managers in tailoring their program monitoring efforts to the type of findings that most frequently occur. Additionally, a new grants monitoring training course is now offered and a post-audit follow-up overview course is currently being developed to improve the usefulness of OMB Circular A-133 single audits to the Department.

The Department also plans to develop manager's internal control training that will focus on controls to eliminate improper payments. The mandatory one-day seminar for all Department managers will provide a framework for administering the improper payment controls program utilizing applicable regulations, guidelines, and best practices. Part of this one-day training will focus on the utilization of the risk assessment criteria to properly assess the risk of improper payments in the Department's programs.

Planned Corrective Actions

In addition to the actions previously outlined under the Federal Student Aid Programs and Title I sections, the Department will configure our corrective action plans based on the results of the initiatives outlined above. The Department will record and maintain corrective action plans as required. These records will include due dates, process owners, and task completion dates.

Information Systems and Infrastructure

The Department has requested $450,000 for FY 2007 and $450,000 for FY 2008 in our budget submission for information system infrastructure improvements. A portion of the funds will be used to continue the refinement of the Oak Ridge National Laboratory data mining effort. It is also anticipated that the Department will incur costs related to mitigation activities.

Remaining Grant Programs

During FY 2006, the Department expanded and strengthened its approach to evaluating the risk of improper payments associated with its remaining grant programs. The Department continued to work with the Department of Energy's Oak Ridge National Laboratory to perform data-mining on information available in the Federal Audit Clearinghouse's Single Audit Database, the Department's Grant Administration and Payment System, and the Department's Audit Accountability and Resolution Tracking System.

The Department's approach to the risk assessment process for non-Federal Student Aid grant programs was to develop a methodology to produce statistically valid measures that could be applied uniformly across the Department's programs. The intent is to use the same methodology across all non-Federal Student Aid grant programs to establish a level of quality control for all programs and at the same time produce a cost effective measure. The Department deemed it cost effective to utilize the results of the thousands of single audits already being performed by independent auditors on grant recipients.

FY 2006 Improvement to Risk Assessment

One of the concerns that resulted from the FY 2005 Oak Ridge National Laboratory study is the definition of what constitutes a "program." The Department's original definition was at a high level in order to effectively match anticipated outlays as defined in our budget submissions and consequently grouped many Catalogue of Federal Domestic Assistance (CFDA) numbers into a single "functional program." The concern with this definition was that calculating estimated improper error rates at that high of a level can effectively mask the potentially higher rates that might exist if a "program" is defined to mean the CFDA level. To further refine the Department's methodology, Oak Ridge National Laboratory was tasked to perform the FY 2006 risk assessment at the CFDA level in addition to the functional program level. The details of this analysis are available from the Office of the Chief Financial Officer upon request.

Another change implemented for the FY 2006 review was to count all costs identified as questioned costs in single audits as improper payments. The FY 2005 assessment reduced the questioned costs by one half to account for the questioned costs that are not sustained during the audit resolution process. Although it was reasonable to adjust the questioned costs downward to account for the low percentage of sustained questioned costs, the Department determined a more conservative approach better serves the intent of the IPIA. In addition, the risk assessment is designed to establish the upper bound of improper payments for the programs.

Risk Assessment

To conduct the risk screening, Oak Ridge National Laboratory augmented the *Audit Accountability and Resolution Tracking System* database with imputed values for the "likely questioned costs" for grants that were not audited. The imputed and real questioned costs could then be tabulated to provide a reasonable upper bound estimate of the rate of erroneous payments for each of the functional programs of interest. If the computed upper bound percentage is below 2.5 percent, then the actual value will be lower than 2.5 percent. If the computed upper bound percentage is greater than 2.5 percent, then the actual value may be greater or less than 2.5 percent but the Department will need additional information to determine the appropriate estimate.

The key results of the analysis are presented in the chart. It contains the estimates of the average functional program rates of questioned costs for recent years. The most striking point about the table is the generally low rate of questioned costs. With only one exception, the rates are below 2.5 percent. The key finding of this analysis is that for the most recent year for which data are available (FY 2004), none of the functional programs exceeds the threshold value of 2.5 percent. The assessment at the CFDA level revealed similar results. Consequently, none of the programs should be labeled as a high-risk program.

Managing Risk in Discretionary Grants

In FY 2006, the Department managed more than 10,000 discretionary grant awards. Due to the vast legislative differentiation and the complexity of the Department's grant award programs, ensuring that our program staff are fully aware of potentially detrimental issues relating to individual grantees is a significant challenge. Program offices must occasionally designate specific grants as high-risk, following collaboration with the respective program legal counsel and the Department's Grants Policy and Oversight Staff.

In an effort to ensure efficiency and reduce risk, the Department has established the Grants High-Risk Module. This module is housed within the Department's Grant Administration and Payment System, such that program office staff are required to review and certify their awareness of the high-risk status of applicable grantees before making awards.

Policies and procedures were developed to support implementation of the high-risk module. System input to the module's database is limited to specific grants policy staff who are fully trained in policy and system use. In addition to the module's certification requirement, various reports are provided such that continual monitoring of grantee risk is made available to Department program administrators.

Grant Program
Improper Payment Estimates

Functional Program	%			
	2001	2002	2003	2004
Education Research, Statistics & Assessment	0.00	0.02	0.36	0.0
Elementary & Secondary Education	0.13	0.12	0.13	0.6
English Language Acquisition	0.00	0.02	0.10	0.1
Higher Education	2.72	0.29	0.21	0.4
Impact Aid	0.00	0.55	0.04	0.4
Innovation and Improvement	0.28	0.21	0.23	0.1
Rehabilitation Services & Disability Research	0.07	0.12	0.32	2.1
Safe & Drug-Free Schools	0.37	0.33	0.13	1.2
Special Education	0.09	0.06	0.83	0.1
Title I	0.04	0.16	1.19	0.2
Vocational & Adult Education	0.20	0.25	0.12	0.2
Total	**0.06**	**0.04**	**0.16**	**0.4**

Implementation of the module provides greater accountability and significantly reduces risk within the Department's grant award process by ensuring program office awareness of potentially detrimental grantee issues prior to award determination. We anticipate that increased accessibility of information and communication across our program offices will promote further monitoring of high-risk grantees, such that the number of grantees so designated will decline.

Recovery Auditing Progress

To effectively address the risk of improper administrative payments, the Department continued a recovery auditing initiative to review contract payments. All vendor payment transactions made from FY 1998 through FY 2005 were reviewed. Potential recoveries are minimal. Fiscal year 2006 payments will be reviewed during FY 2007. Our purchase and travel card programs remain subject to monthly reviews and reconciliations to identify potential misuse or abuse.

Summary

The Department of Education is continuing its efforts to comply with the *Improper Payments Information Act*. While there are still challenges to overcome, the Department has demonstrated in FY 2006 that it is committed to ensuring the integrity of its programs. The Office of Management and Budget recognized our progress in managing improper payments when the Department's implementation progress scorecard was raised to green on the *President's Management Agenda* initiative for Eliminating Improper Payments.

The Department is focused on identifying and managing the risk of improper payment problems and mitigating the risk with adequate control activities. In FY 2007, we will continue to work with the OMB and the Inspector General to explore additional methods for identifying and reducing potential improper payment activity in our programs, and to ensure compliance with the IPIA.

Report to Congress on Audit Follow-up

The *Inspector General Act,* as amended, requires that the Secretary report to the Congress on the final action taken for the Inspector General audits. With this *Performance and Accountability Report*, the Department of Education is reporting on audit follow-up activities for the period October 1, 2005, through September 30, 2006.

The *Audit Accountability and Resolution Tracking System* is the Department's single database system used for tracking, monitoring, and reporting on the audit follow-up status of the Government Accountability Office audits; the Office of Inspector General issued internal audits, external audits, and alternative products; and Single Audits of funds held by non-federal entities. The Department's audit follow-up system functionalities allow the following:

- Tracking of internal, external, sensitive, and alternative product types from inception to final disposition.
- Evaluation and escalation points for audit reports and recommendations at appropriate levels in the user hierarchy.
- Notifying users of audit decisions and approaching or expiring events and transactions.
- Downloading report and query results into electronic file formats.
- Attaching files to the audit record.
- Providing a personal portal (Digital Dashboard) for user-assigned transactions.
- Providing a search function to query application (Audit Report) data.
- Providing for both a defined and an ad hoc report generation environment.

Number of Audit Reports and Dollar Value of Disallowed Cost

At the start of this reporting period, the balance for audit reports with disallowed costs totaled 59, representing $34.3 million. At the end of the reporting period, the outstanding balance was 72 audits, representing $42.9 million. The information in the table below represents audit reports for which receivables were established.

Final Actions on Audits with Disallowed Costs
Fiscal Year Ended September 30, 2006

	Number of Reports	Disallowed Costs
Beginning Balance as of 10/1/2005	59	$ 34,285,141
+ Management Decision	192	28,670,284
Pending Final Action	251	$ 62,955,425
- Final Action	179	20,078,463
Ending Balance as of 9/30/2006	72	$ 42,876,962

Number of Audit Reports and Dollar Value of Recommendations That Funds Be Put to Better Use

The Department has a total of 9 audit reports of which one is under review. The remaining 8 audit reports totaling $254 million with recommendations that funds be put to better use. Only 4 of these, totaling $12.5 million, have been resolved. Resolution occurs when there is agreement between the program office and the Department's Office of Inspector General on the corrective actions that will be taken to address all of the recommendations in the audit.

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

As of September 30, 2006, the Department has a total of eight Office of Inspector General internal and nationwide audit reports on which final action was not taken within a year after the issuance of a management decision; 62 percent were less than two years old. Many corrective actions are dependent upon major system changes that are currently being implemented. For detailed information on these audits, refer to the Department's *Semiannual Report to Congress on Audit Follow-up Number 35.*

Credit Management and Debt Collection Improvement Act

The Department of Education has designed and implemented a comprehensive credit management and debt collection program that enables us to effectively administer our multi-billion-dollar student loan and other programs. The credit management and debt collection program covers each phase of the credit cycle—including prescreening of loan applicants, account servicing, collection, and close-out—and it conforms to the government-wide policies in the Federal Claims Collection Standards, the Office of Management and Budget Circular No. A-129, "*Managing Federal Credit Programs*," and the *Debt Collection Improvement Act*. As a result, the Department has made significant strides in student loan default management and prevention.

The Department has been working diligently with schools and partners in the student loan industry to reduce the cohort default rate. The fiscal year 2004 cohort default rate is 5.1 percent. The low default rate is a function of the Department's improved borrower counseling and the steps we have taken in gate keeping to remove schools with high rates from participating in the federal student loan programs.

Borrowers who default on student loans face serious repercussions, such as the withholding of federal income tax refunds and other federal payments, wage garnishment, adverse credit bureau reports, denial of further student aid, and prosecution. To avoid these sanctions, defaulters have the option to consolidate their loans and establish an income-based repayment plan that more realistically matches their ability to pay.

The Department also continues to conduct computer matches with other federal agencies as part of our effort to strengthen the management and oversight of student financial assistance programs. The computer matches are designed to ensure that students meet various eligibility criteria and to increase the collections from students who have defaulted on their loans.

The Department categorizes debt into two basic categories: student loan debt, which accounts for approximately 99 percent of all of the Department's outstanding debts, and institutional and other administrative debt. The Department of Treasury granted the Department a permanent exemption from the cross-servicing requirements of the *Debt Collection Improvement Act* for defaulted student loans and approval to continue to service our own internal student loan debts because of our successful track record. However, we have been referring eligible student loan debts—those we previously tried to collect using all other available tools—to the Department of Treasury for tax refund offset since 1986.

The Department handles our institutional and administrative debts outside of the systems established for student loans. The Department was one of the first to participate in the Treasury Cross Servicing Program and has been referring delinquent debts since October 1996. As of September 30, 2006, we have forwarded approximately 95 percent of all institutional and administrative debts eligible for cross servicing to Treasury.

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

TO: Secretary Margaret Spellings

FROM: John P. Higgins, Jr.

RE: Management Challenges for Fiscal Year 2007

DATE: October 25, 2006

Pursuant to the *Reports Consolidation Act of 2000*, we provide the attached report, Management Challenges for the U.S. Department of Education for Fiscal Year 2007. We look forward to working with you to address these challenges and improve the efficiency and integrity of the Department's programs and operations.

Attachment
Cc: Senior Officers

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510

MANAGEMENT CHALLENGES FOR FISCAL YEAR 2007

The Office of Inspector General (OIG) works to promote efficiency, effectiveness, and integrity in the programs and operations of the U.S. Department of Education (Department). Through our audits, inspections, investigations, and other reviews, we have identified areas of concern within the Department's programs and operations and have recommended actions the Department should take to address these weaknesses. The Department generally implements our recommendations and takes action to recover funds from grantees, contractors, and other recipients we identify as wrongly paid. While our work is a valuable tool for the Department, it is not a substitute for good management and organizational accountability.

The *Reports Consolidation Act of 2000* requires OIG annually to identify and summarize the top management and performance challenges facing the Department, as well as to provide information on the Department's progress in addressing those challenges. Based on our recent work and knowledge of the Department's programs and operations, we have identified three specific challenge areas for the Department for FY 2007: (1) accountability; (2) information technology; and (3) human resources (HR). While this report discusses the progress the Department is making in addressing these challenges, it is evident that additional focus, attention, and emphasis are needed.

1. ACCOUNTABILITY

Challenge: Internal Control and Oversight

The success of an organization's mission and the achievement of its goals depend on how well it manages its programs. It cannot effectively manage its programs without establishing and maintaining appropriate internal accountability. In 1999, the Government Accountability Office released *"Standards for Internal Control for the Federal Government,"* a document that provides federal agencies with an overall framework for establishing and maintaining internal controls, *i.e*., the plans, methods, and procedures that will help the organization meet its goals and achieve its objectives.

Our recent audits, inspections, and investigations continue to uncover problems with program control and oversight of program participants, placing billions of taxpayer dollars at risk of waste, fraud, abuse and non-compliance. The Department must ensure that all entities involved in its programs are adhering to statutory and regulatory requirements, and that the offices responsible for administering these programs are providing adequate oversight of program participants. Only by improving effective oversight of its operations and demanding accountability by its managers, staff, contractors, and grantees can the Department be an effective steward of the billions of taxpayer dollars supporting its programs and operations.

The Department's Progress: The Department has made some progress toward improving oversight and monitoring of non-student financial assistance programs. For the *Elementary and Secondary Education Act (ESEA)* Title I program, the Department's monitoring plan now includes participation by staff from the Office of the Chief Financial Officer to provide technical support in the fiduciary area of the reviews. In a review of audited questioned costs and analysis of improper payments, the Department is no longer reducing questioned costs by 50 percent to establish an estimated amount of sustained costs, but is correctly using the full amount to better establish an upper bound of improper payments. The Department also has implemented a Grants High-Risk Module within the Grant Administration and Payment System to better alert program offices of potentially detrimental grantee issues prior to award determination.

To address internal control issues identified by our work, Federal Student Aid (FSA), the office that administers the student financial assistance programs, made changes to the organizational structure of one of its internal offices, Financial Partners, and transferred the regional offices out of Financial Partners to a new Program Compliance organization. The functional statements for the new organizations, however, indicate overlapping jurisdiction and do not clearly delineate responsibility for resolving compliance violations.

Challenge: Improper Payments

Improper payments include those made in the wrong amount, payments made to an ineligible recipient, or payments improperly used by the recipient. The need for agencies to take action to eliminate overpayments is recognized by the President's Management Agenda, as well as the *Improper Payments Information Act of 2002.* Identifying and correcting improper payments remains a challenge for the Department, which is a result of ineffective oversight and monitoring of its policies, programs and program participants.

The Department's Progress: To address the requirements of the *Improper Payments Information Act*, the Department continued to participate in presentations or perform monthly monitoring site visits for its *ESEA* Title I program at various state and local educational agencies. It also continued to enlist the help of the Oak Ridge National Laboratory to perform its risk analysis of its non-student financial assistance programs. The 2006 Oak Ridge National Laboratory Report indicated that the Title I program was not at risk of exceeding the 2.5 percent *Improper Payments Information Act* threshold that would require further statistical review. The Department is also performing on-site monitoring reviews for its *ESEA* Title III program.

With regard to the student financial assistance programs, FSA has undertaken several initiatives to help address and reduce improper payments. Some of these efforts have included a continued focus on controls over financial aid applications; performing risk assessments; working with the Office of Management and Budget (OMB) and the Department on a quarterly basis to address various *Improper Payment Information Act* implementation issues, such as the sampling methodology for estimating improper payments; conducting studies with the Internal Revenue Service; focused monitoring activities; and performing various analyses of certain data in the FSA programs. For the most recent year, 2004-05, FSA reported an improper payment rate for the Pell Grant program of 3.48 percent, down from 4.5 percent for the prior year. FSA also is taking steps to identify risks and establish controls to avoid improper payments in a new program – the Academic Competitiveness/SMART Grant program.

Challenge: Procurement

The Department contracts for many services that are critical to its operations, at a value of close to $1 billion a year. The Department must improve its procurement and contract management processes to ensure that it is receiving quality goods and services in accordance with the contract terms. Our audit work continues to find weaknesses in the Department's processes for monitoring contractor performance, such as not effectively tracking and inspecting deliverables, paying for deliverables that were not provided, not adequately reviewing invoices, improperly providing incentive payments, giving unauthorized instructions to the contractor, not informing the contracting officer of changes in key personnel, and not documenting evaluations of contractor reports.

The Department's Progress. In response to OIG's continuing audits of the contracting monitoring processes, the Department issued a new procedure requiring that contract monitoring plans be developed for all new contracts. This procedure was issued in December 2005, and also required that contract monitoring plans be developed for all existing contracts by January 31, 2006. In March 2006, the Department updated its policy, *Contract Monitoring for Program Officials*, to correct issues noted in prior OIG reviews.

2. INFORMATION TECHNOLOGY

Challenge: Information Security

The *Federal Information Security Management Act (FISMA)* requires each federal agency to develop, document, and implement an agency-wide program to provide information security for the information and information systems that support the operations and assets of the agency, including those provided or managed by another agency, contractor, or other source. It also requires the Inspectors General to perform an annual, independent evaluation of its agency's information security program and practices.

We have conducted *FISMA* compliance audits for the last four years. In each case, we identified security weaknesses that the Department must address to maintain the security certification and accreditation of its systems. We determined that certain management, operational, and technical security controls need improvement to adequately protect the confidentiality, integrity, and availability of its systems. We have identified weaknesses in the Department's incident handling process and procedures, intrusion detection system deployments, and enterprise-wide technical configuration standards for all systems. In addition, we found that its outsourced data centers do not have adequate security controls and safeguards in place to protect personally identifiable information (PII) and other sensitive information that is stored on its system tape backups. During a related audit, we also found that the office in the Department that had the highest number of contractors in FY 2005 had not ensured that all contractor staff met screening requirements before giving them access to the Department data and facilities. These deficiencies must be addressed in order to maintain the security certification and accreditation of its systems, as well as to protect PII and other sensitive information.

The Department's Progress: The Department continues to struggle to establish a mature computer security program in the areas of developing technical configuration standards for all its systems, managing its outsourced contractors who operate its critical information systems, and ensuring the identification and response to its incident handling program and intrusion detection systems.

The Department recently established plans to improve its controls relating to the protection of PII in order to meet the standards and good practice requirements established by OMB. Budget and contracting constraints have negatively impacted the Department in moving forward with improving these controls.

Challenge: Information Technology Capital Investment and Project Management

The Department's anticipated FY 2007 Information Technology (IT) capital investment portfolio is over $90 million, and many critical IT projects are pending, including investments in the Office of the Chief Financial Officer, the Office of the Chief Information Officer, and FSA. It is critical that the Department have a sound IT investment management control process that can ensure that technology investments are appropriately evaluated, selected, justified, and supported. This oversight and monitoring process must address IT investments as an agency-wide portfolio. It must also ensure that individual projects are appropriately managed so as to meet their technical and functional goals on time and on budget. As part of this process, the Department must identify a means of conducting independent evaluations of significant IT projects. Independent Verification and Validation (IV&V) could be a viable approach, if the IV&V results are shared with the Investment Review Board for its consideration. Poor management of individual IT investments leads to wasted resources and/or unreliable or inadequate systems.

The Department's Progress: While the critical issue of independent assessment remains unaddressed, the Department has recently strengthened the IT capital investment program by expanding the Investment Review Board and Planning and Investment Review Group memberships. The Department has also made continued efforts to strengthen individual business cases, and to map proposed investments to an agency-wide enterprise architecture strategy. These efforts are important and should continue.

3. HUMAN RESOURCES

Challenge: Human Capital Management and Human Resources Services

Our last several Management Challenges reports have included human capital planning as one of the significant challenges facing the Department. Like most federal agencies, the Department will see a significant percentage of its workforce eligible for retirement in 2007. The Department is also continuing to see a significant change in critical skill requirements for many of its staff. Identification of needed action steps and prompt implementation of action items to adequately address these workforce and succession planning issues, including recruitment, hiring and retention, is critically important.

The Department has already committed considerable time and resources to prior HR initiatives -- One-ED and the HR most efficient organization -- that were minimally beneficial, if at all. In order to address the HR issues facing it, the Department must be willing to commit adequate resources.

The Department's Progress: In January 2006, the Secretary approved a request from FSA to set up an independent HR function on a pilot basis. Also this year, the Department focused on performance management and worked with all Department managers to improve their understanding of performance agreements and ratings. It hired a Deputy Human Capital Officer who is focused on improving HR issues throughout the Department. We understand that it will soon release a new strategy for improving HR.

Glossary of Acronyms and Abbreviations

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ACSI	American Customer Satisfaction Index
AEFLA	*Adult Education and Family Literacy Act*
AGI	Adjusted Gross Income
APEB	*Act to Promote the Education of the Blind*
ATA	*Assistive Technology Act of 2004*
CFAA	*Compact of Free Association Amendments Act of 2003*
CFDA	Catalogue of Federal Domestic Assistance
CRA	*Civil Rights Act of 1964*
CSRS	Civil Service Retirement System
DM	Department Management
EDA	*Education of the Deaf Act of 1986*
EFC	Expected Family Contribution
ESEA	*Elementary and Secondary Education Act of 1965*
ESRA	*Education Sciences Reform Act of 2002*
FAFSA	Free Application for Federal Student Aid
FASAB	Federal Accounting Standards Advisory Board
FECA	*Federal Employees' Compensation Act*
FERS	Federal Employees Retirement System
FFB	Federal Financing Bank
FFEL	Federal Family Education Loan
FFMIA	*Federal Financial Management Improvement Act of 1996*
FISMA	*Federal Information Security Management Act of 1982*
FMFIA	*Federal Managers' Financial Integrity Act*
FSA	Federal Student Aid
FY	Fiscal Year
GEAR UP	Gaining Early Awareness and Readiness for Undergraduate Programs
GSA	General Services Administration
HBCUs	Historically Black Colleges and Universities
HEA	*Higher Education Act of 1965*
HKNCA	*Helen Keller National Center Act*
HR	Human Resources
IDEA	*Individuals with Disabilities Education Act*
IES	Institute for Education Sciences
IP	Improper Payments
IPIA	*Improper Payments Information Act of 2002*

IRS	Internal Revenue Service
IT	Information Technology
IUS	Internal Use Software
IV&V	Independent Verification and Validation
MECEA	*Mutual Educational and Cultural Exchange Act of 1961*
MVHAA	*McKinney-Vento Homeless Assistance Act*
NLA	*National Literacy Act of 1991*
OCR	Office for Civil Rights
OELA	Office of English Language Acquisition
OESE	Office of Elementary and Secondary Education
OIG	Office of Inspector General
OII	Office of Innovation and Improvement
OMB	Office of Management and Budget
OPE	Office of Postsecondary Education
OPM	Office of Personnel Management
OSDFS	Office of Safe and Drug-Free Schools
OSERS	Office of Special Education and Rehabilitative Services
OVAE	Office of Vocational and Adult Education
PAR	Performance and Accountability Report
PART	Program Assessment Rating Tool
PII	Personally Identifiable Information
PMA	*President's Management Agenda*
RA	*Rehabilitation Act of 1973*
SOF	Statement of Financing
SY	School Year
TASSIE	Title I Accountability Systems and School Improvement Efforts
TRIO	A group of grant programs under the HEA, originally three programs; not an acronym
USC	United States Code
VTEA	*Carl Perkins Vocational and Technical Education Act of 1998*
WWC	What Works Clearinghouse
YRBSS	Youth Risk Behavior Surveillance System

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The Department's Strategic Plan is available on the Web at:
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The Department welcomes all comments and suggestions on both the content and presentation of this report. Please forward them to:

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