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.

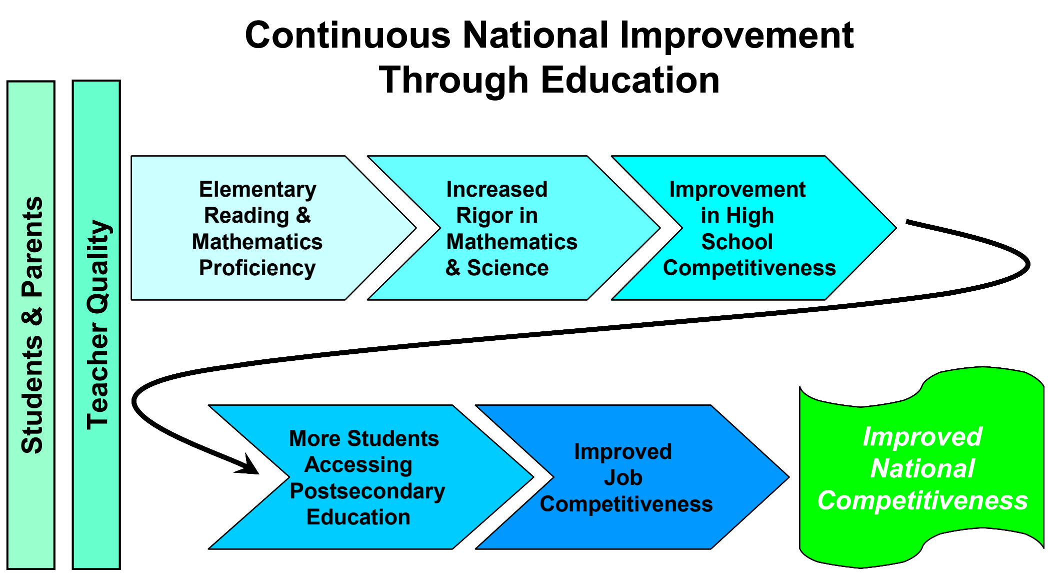
Of the many services that government provides to its citizens, few are as far-reaching as education. Every community throughout America has schools that provide instruction in reading, writing, mathematics, and science, as well as immersion in American history and culture. Most communities also have 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.

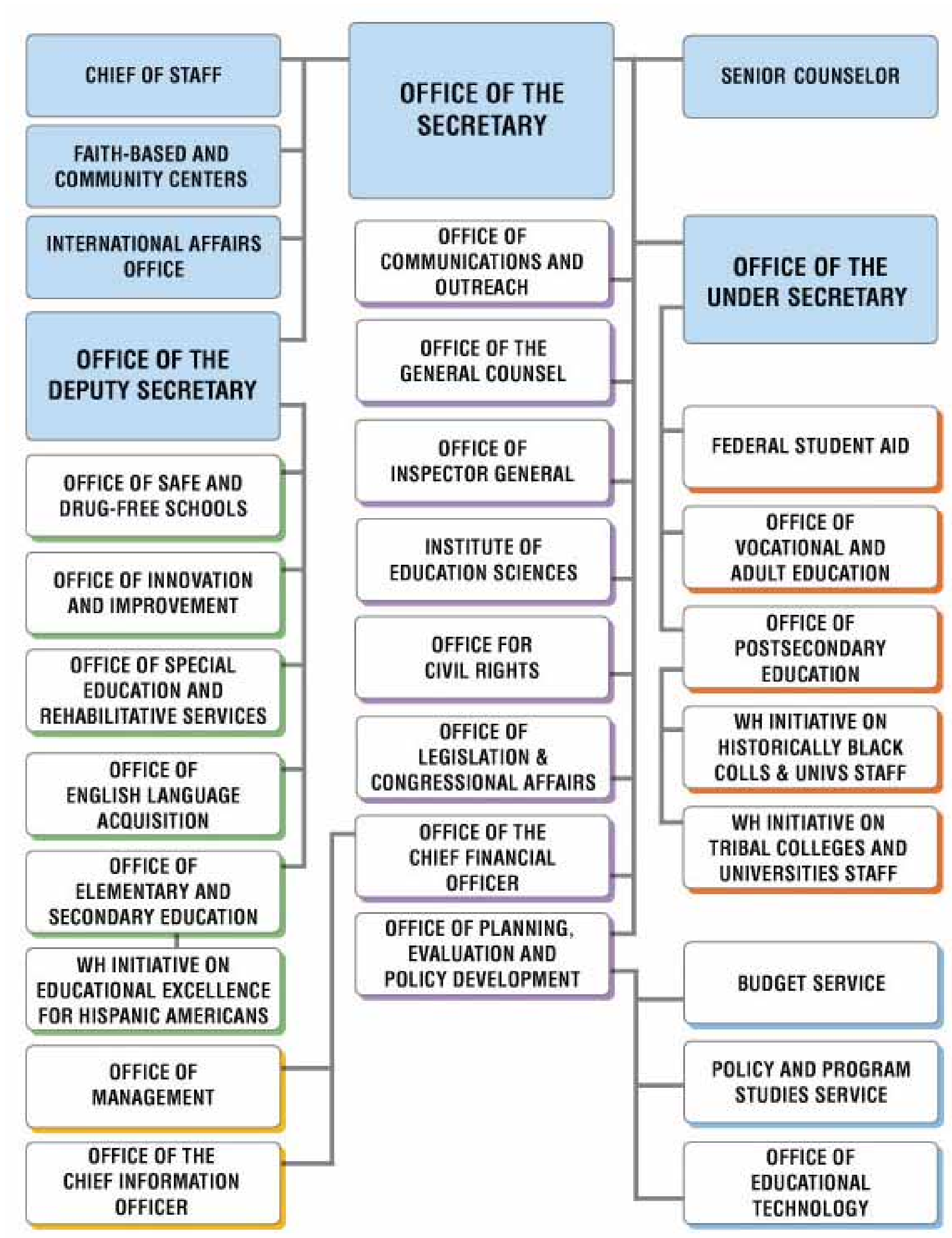
Today, the Department operates programs that touch every area and level of education. The elementary and secondary programs annually serve 15,500 school districts and approximately 50 million students. Department programs also provide grant, loan, and work-study assistance to more than 10 million postsecondary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

Management's Discussion and Analysis

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.

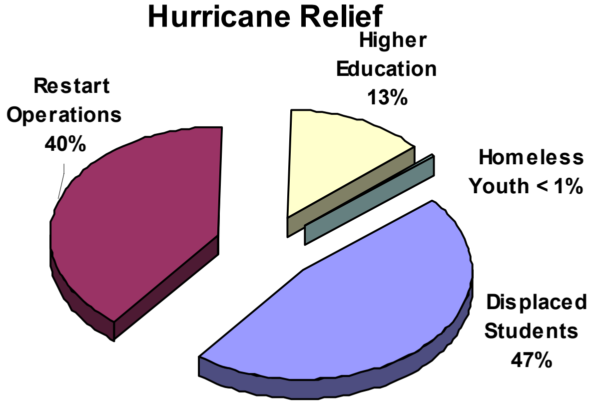
To ensure a strong and prosperous America in the 21st century, our students must possess the mathematics and science knowledge that is the foundation of our nation's long dominance in science, technology, and innovation; graduate from high school prepared to enter college or the globally competitive 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.

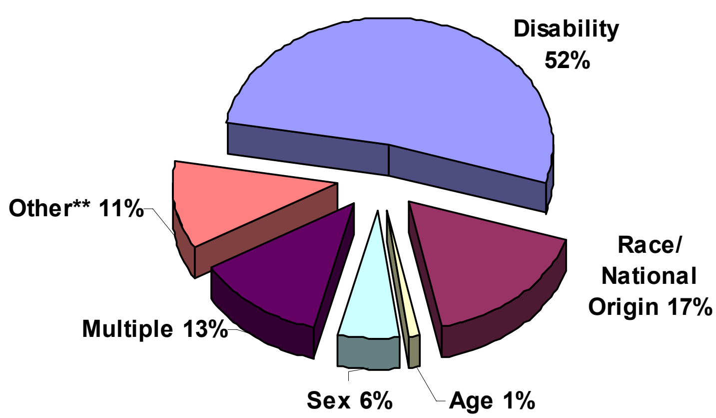
Civil Rights Enforcement

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

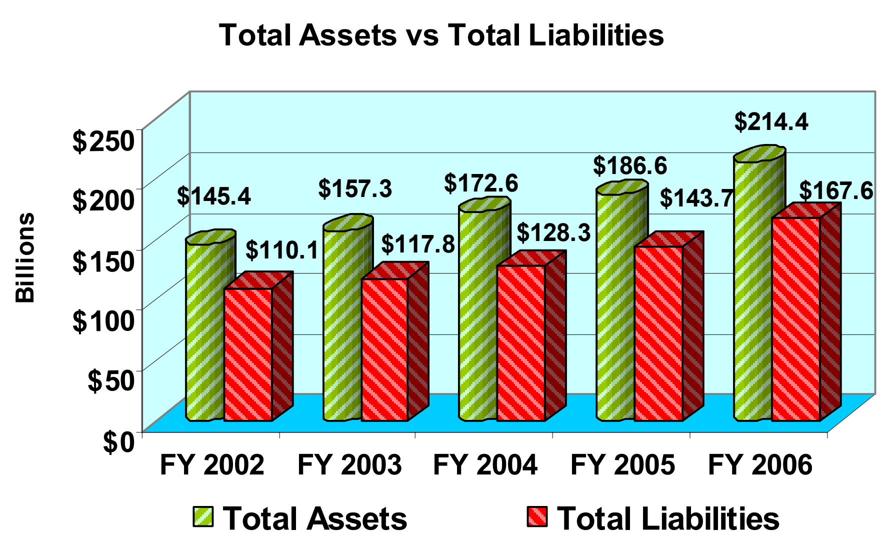
The Department's financial statements are prepared in accordance with established federal accounting standards and are audited by the independent accounting firm of Ernst & Young, LLP. FY 2006 financial statements and footnotes appear on pp. 95-127. Analyses of the principal financial statements follow.

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.

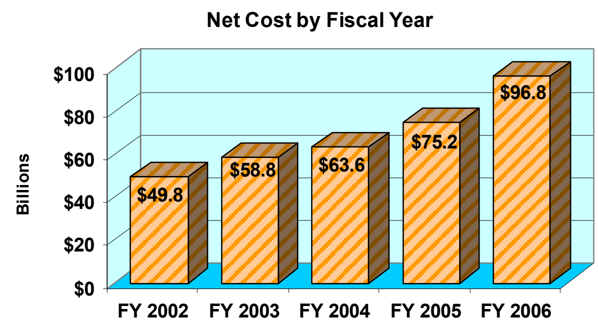
Several factors influenced the change in the Department's net position in FY 2006. The factors include the subsidy re-estimates for federal student loan programs and the increase in FY 2006 grant appropriations. Net position increased by 9 percent over FY 2005.



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*.