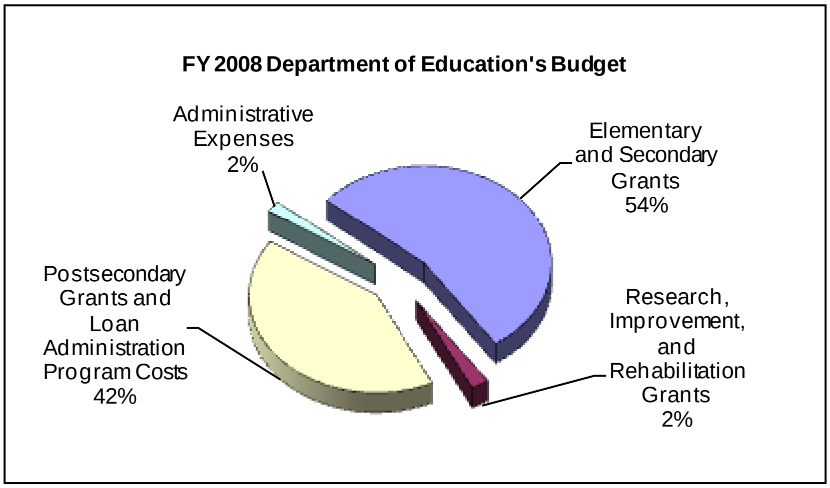
Financial Highlights

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 seventh consecutive year, we achieved an unqualified (clean) opinion from independent auditors on the annual financial statements. Since FY 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 from management's internal control assessment.

Sources of Funds



The Department managed a budget in excess of $68 billion during FY 2008, of which 54 percent supported elementary and secondary education grant programs.

Postsecondary education grants and administration of student financial assistance accounted for 42 percent, including loan program costs that helped more than 11 million students and their parents to better afford higher education during FY 2008. An additional 2 percent went to programs and grants encompassing research and improvement, as well as vocational rehabilitation services. Administrative expenditures were 2 percent of the Department's appropriations.

Nearly all of 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 Loan (FFEL) Program and the William D. Ford Federal Direct Loan Program loans, which comprise a large share of federal student financial assistance, are funded by commercial bank guarantees and borrowings from the Treasury, respectively.

The Department's three largest grant programs are ESEA 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 of these program's FY 2008 appropriations exceeded $10 billion. In addition, the TEACH Grant Program was implemented this year. This program awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students.

The FFEL Program helps ensure that the loan capital for approximately 3,100 private lenders is available to students and their families. Through 35 active state and private nonprofit guaranty agencies, lenders and schools, the Department administers the FFEL

Program to help students and families pay for postsecondary education by providing grants and low-rate loans. The Department is active in all phases of the loan life-cycle from determining borrower eligibility during the Free Application for Federal Student Aid process to processing guarantor claims for reinsurance. As of the end of September 2008, the total principal balance of outstanding guaranteed loans held by lenders was approximately $415 billion. The government's estimated maximum exposure for defaulted loans was approximately $405 billion.

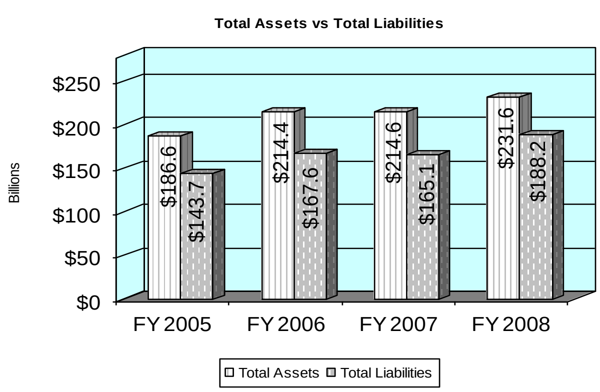
The *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) amended the FFEL Program to authorize the Secretary to buy FFEL loans for the 2008-2009 academic year. Within the existing FFEL Program, the Department has implemented two activities under this temporary loan purchase authority to purchase FFEL loans generally originated between July 1, 2008 and June 30, 2009. These two activities include: loan purchase commitments where the Department purchases loans directly from FFEL lenders, and loan participation purchases where the Department purchases participation interests in FFEL loans.

On October 7, 2008, President Bush signed P.L. 110-350, which extended the Secretary of Education's authority to purchase FFEL loans. This authority, originally enacted in the ECASLA, would have otherwise expired on September 30, 2009; P.L. 110-350 extended the authority through September 30, 2010. The Administration recently announced plans to replicate the 2008-2009 loan purchase and participation options for the 2009-2010 award year. Other approaches to purchase outstanding FFEL loans are also under consideration, but specific terms and conditions have yet to be determined.

The William D. Ford Direct Loan Program, added to the Higher Education Act of 1965 (HEA) in 1993 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. As of September 30, 2008, the value of the Department's direct loan portfolio was $109.9 billion.

Financial Position

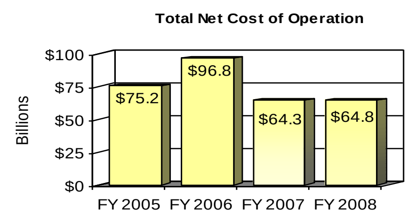
The Department's financial statements are prepared in accordance with established federal accounting standards and are audited by the independent accounting firm of Ernst & Young, LLP. Financial statements and accompanying notes for FY 2008 appear on pages 128-169. An analysis of the principal financial statements follows.



Balance Sheet. The Balance Sheet presents, as of a specific point in time, the recorded 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 page 128 reflects total assets of $231.6 billion, an 8 percent increase over FY 2007. The change is primarily due to the increase in Credit Program Receivables. Credit Program Receivables increased by $18.8 billion, a 16 percent increase over FY 2007. The majority of this loan portfolio is principal and interest owed by students on direct loans. The remaining balance is related to defaulted guaranteed loans purchased from lenders under terms of the FFEL Program and to loan purchase commitments and loan participation purchases under the FFEL Program. The net portfolio for direct loans increased by over $10.8 billion due to increased direct loan disbursements and borrower interest collections. FFEL Program loans increased by $7.9 billion during FY 2008, due primarily to loan volume and activity related to loan purchase commitments and loan participation purchases. Fund Balance with the Treasury decreased by 3 percent from FY 2007.

Total Liabilities for the Department increased by 14 percent. This change is primarily due to an increase in borrowing during FY 2008. Borrowing increased for the Direct Loan Program and to provide funds for the loan purchase commitments and loan participation purchases activity under the FFEL Program. Liabilities for Loan Guarantees for the FFEL Program decreased $7.6 billion due primarily to FFEL defaulted claims payments and the subsidy re-estimate. These liabilities present the estimated costs, on a present-value basis, of the net long-term cash outflows due to loan defaults net of offsetting fees.

The Department's Net Position as of September 30, 2008 was $43.3 billion, a $6.3 billion decrease versus the $49.6 billion Net Position as of September 30, 2007.



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 Department's total program net costs, as reflected on the Statement of Net Cost, page 129, were $64.8 billion, a 1 percent increase from FY 2007. The increase largely occurred for programs in support of the Promote Academic Achievement in Elementary and Secondary Schools goal, the Special Education goal, and the Transformation of Education goal.

The Statement of Net Cost is presented to be consistent with the Department's strategic goals and the *President's Management Agenda*. As required by the *Government Performance and Results Act of 1993*, each of the Department's reporting organizations has been aligned with the major goals presented in the Department's *Strategic Plan for Fiscal Years 2007–12*.

Net Cost Program	Goal No.	Strategic Goal
Ensure Accessibility, Affordability and Accountability of Higher Education and Career and Technical Advancement	3	Ensure the accessibility, affordability and accountability of higher education and better prepare students and adults for employment and future learning
Promote Academic Achievement in Elementary and Secondary Schools	1 2	Improve student achievement, with a focus on bringing all students to grade level in reading and mathematics by 2014 Increase the academic achievement of all high school students
Transformation of Education	1	Improve student achievement, with a focus on bringing all students to grade level in reading and mathematics by 2014
Special Education		Cuts across Strategic Goals 1, 2 and 3

In FY 2007, the Department streamlined its strategic goals to better serve its mission to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access to education. Strategic Goals 1, 2 and 3 are sharply defined directives that guide the Department's reporting organizations to carry out the vision and programmatic mission, and the Net Cost programs can be specifically associated with these three strategic goals. The Department has a Cross-Goal Strategy on Management, which is considered a high-level premise on which the Department bases its foundation for the other three goals. As a result, we do not assign specific programs to this goal for presentation in the Statement of Net Cost.

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 page 131 shows that the Department had $193.9 billion in total budgetary resources for the year ended September 30, 2008. These budgetary resources were composed of $79.1 billion in appropriated budgetary resources and $114.8 billion in non-budgetary credit reform resources, which primarily consist of borrowing authority for the loan programs. Of the $31.2 billion that remained unobligated at year end, $29.2 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 fiscal year or future fiscal years.

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 FY 2008 and FY 2007 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.