ANNUAL REPORT

2008

U.S. Department of Education | Federal Student Aid

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Dear Federal Student Aid Colleagues, Partners and Customers:

James F. Manning
Acting Chief Operating Officer

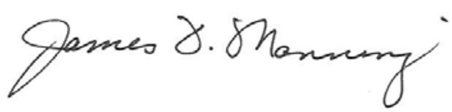
I am pleased to present the 2008 Annual Report for Federal Student Aid. This report showcases the many accomplishments realized by our organization in administering the federal student financial assistance programs authorized under Title IV of the Higher Education Act. This document also serves to highlight the many challenges we faced in achieving these successes and, frankly, those areas where we fell short.

During the year, Federal Student Aid continued to pursue systems integration efforts and cost reduction strategies in an effort to improve program integrity, efficiency and accuracy while reducing the cost to the taxpayer and improving service to college-bound students and their families. We strengthened our oversight and monitoring of program participants and increased our employee training programs to ensure the Federal Student Aid workforce is able and prepared to meet the evolving needs of our customers.

This year, Federal Student Aid also faced unanticipated challenges, most notably when the availability of federal student loans was put into question as a result of the global credit crisis. Federal Student Aid worked with colleagues from across the federal government to develop and implement programs to ensure that all eligible students would have access to federal student loans by the mid-August peak student loan period. These programs were launched on time and within budget and, to date, have funded approximately 40% of Federal Family Education Loan disbursements for the 2008–09 academic year.

While meeting these challenges, Federal Student Aid delivered more aid to more students and families in fiscal year 2008 than during any period in the history of these programs. This would not have been possible without the hard work, commitment and dedication of over 1,000 Federal Student Aid employees. Their passion to serve our customers and fulfill our mission is evident in the work they do each day. On a personal note, I would like to recognize and thank Larry Warder for his leadership and support over the last year. I am honored to present this report on behalf of Federal Student Aid.

Sincerely,



James F. Manning
Acting Chief Operating Officer

Management's Discussion and Analysis

Mission and Organizational Structure

Federal Student Aid, a principal office of the U.S. Department of Education (the Department), seeks to ensure that all eligible individuals can benefit from federally funded or federally guaranteed financial assistance for education beyond high school. We consistently champion the promise of postsecondary education to all Americans – and its value to our society. Federal Student Aid plays a central and essential role in supporting postsecondary education. We partner with postsecondary schools, financial institutions and other participants in the Title IV student financial assistance programs (Title IV programs) to deliver programs and services that help students finance their education beyond high school. Today, Federal Student Aid is responsible for a range of critical functions that include, among others:

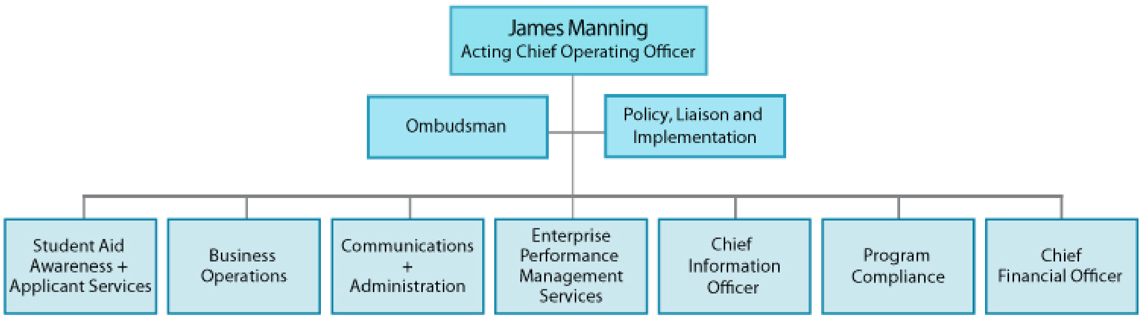
- Processing millions of student financial aid applications.
- Disbursing billions of dollars in aid funds to students through schools.
- Enforcing financial aid rules and regulations.
- Educating students and families on the process of obtaining aid.
- Servicing millions of student loan accounts.
- Securing repayment from borrowers who have defaulted on their loans.
- Operating information technology systems and tools that manage billions in student aid dollars.

This is a complex, multifaceted mission that calls on a range of staff skills and demands coordination by all levels of management. Designated a Performance-Based Organization (PBO) by Congress in 1998, Federal Student Aid emphasizes tangible results and efficient performance, as well as the continuous improvement of the processes and systems that support our mission.

Federal Student Aid Organizational Structure

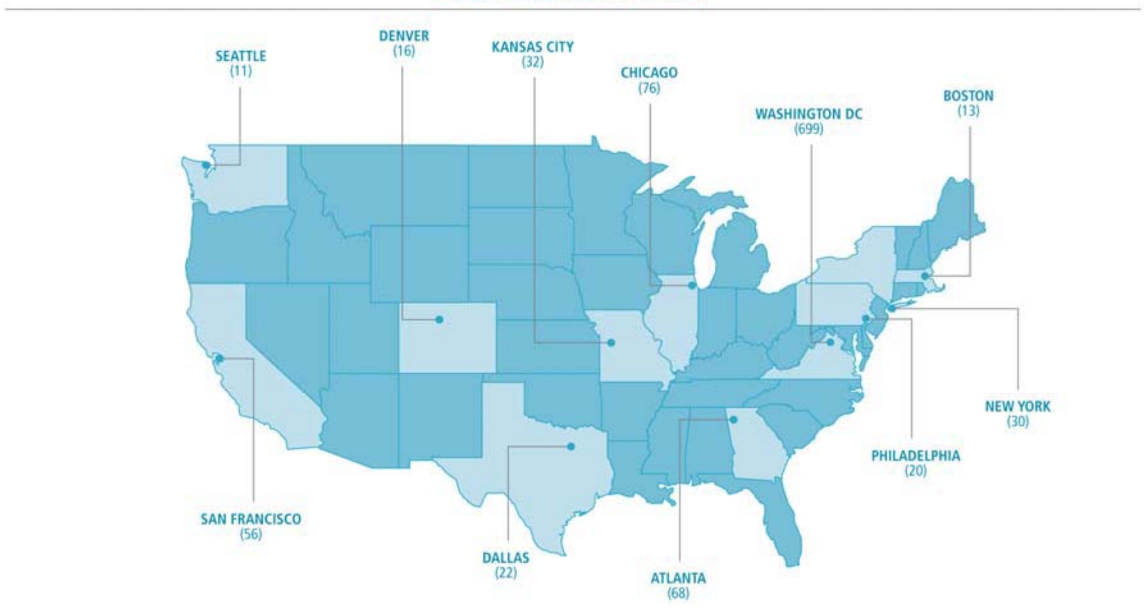
Federal Student Aid currently operates under a functional organizational structure that aligns our organization closely with our strategic drivers, business objectives and mission goals. This structure reinforces a key business goal: efficient, effective and productive interaction with our many stakeholders. This community of stakeholders includes students and parents, schools, lenders, guaranty agencies and taxpayers, as well as other federal entities and the Department itself. The following graphic illustrates the current functional organizational structure of Federal Student Aid.

Federal Student Aid Functional Organizational Structure



A Chief Operating Officer, who is appointed to a five-year term by the Secretary of Education, leads Federal Student Aid. In October 2008, the Secretary appointed James F. Manning as the Acting Chief Operating Officer. In fiscal year (FY) 2008, the organization operated on an annual administrative budget of approximately $629 million. Our staff of 1,043 is augmented by contractors who provide outsourced business operations. This workforce is based out of Washington, D.C., with ten regional offices located throughout the country.

Federal Student Aid Regional Map



As a federally designated PBO, Federal Student Aid operates under a congressional mandate to achieve concrete mission results as we improve efficiency in operations and manage and mitigate risks in Title IV portfolio performance. Federal Student Aid has focused on innovations for upgrading student aid delivery and servicing operations, vendor and contract management, budgeting and cost control as well as financial and operational management. Much of the resulting operational performance improvement stems from business process reengineering and large-scale technology integration.

Federal Student Aid is responsible for helping students manage the costs of education beyond high school. This duty includes administering the federal student financial assistance programs authorized under Title IV of the *Higher Education Act (HEA) of 1965*, *as amended*. The Title IV programs collectively represent the nation's largest source of financial aid for postsecondary students. In the paragraphs that follow, each of the major Title IV programs that deliver aid to students and their families are described.

In FY 2008, Federal Student Aid delivered or supported the delivery of approximately $96 billion in grant, work-study and loan assistance to almost 11 million postsecondary students and their families. These students attend approximately 6,200 active institutions of postsecondary education accredited by dozens of agencies. Many of these students receive loans from approximately 3,100 lenders with 35 agencies guaranteeing those loans.

The **Federal Pell Grant (Pell Grant) Program** helps ensure financial access to postsecondary education by providing grant aid to low- and middle-income undergraduate students. The most need-based awards from the Department's student aid programs, Pell Grants, vary according to the financial circumstances of students and their families. For the 2007–08 award year, the Department disbursed $14.6 billion in Pell Grants averaging approximately $2,643 to 5.5 million students. The maximum Pell Grant award was $4,310 for the 2007–08 award year. The maximum Pell Grant award increased to $4,731 for the 2008–09 award year.

The **Academic Competitiveness Grant (ACG)** and **National Science and Mathematics Access to Retain Talent (SMART) Grant Programs** were created by the Higher Education Reconciliation Act of 2005 (HERA), signed into law in 2006. The ACG is for full-time undergraduates, who are U.S. citizens and are eligible for a Pell Grant. The student must have completed a rigorous high school program, as determined by the state or local education agency and as recognized by the Secretary of Education. First-year students may receive an ACG award up to $750, whereas second-year students may receive up to $1,300 if they have maintained a cumulative grade point average of at least 3.0. The ACG award became available in the 2006–07 school year for first-year students who graduated high school after January 1, 2006, and second-year students who graduated high school after January 1, 2005. The ACG award is in addition to the student's Pell Grant award. For the 2007–08 academic year, $311 million in ACG awards were disbursed to approximately 408,000 students.

The National SMART Grant Program provides up to $4,000 to third- and fourth-year undergraduates studying full-time and majoring in physical, life or computer sciences, mathematics, technology, engineering or in a foreign language critical to national security. The student must be a U.S. citizen and meet eligibility requirements for a Pell Grant. The student must maintain a cumulative grade point average of at least a 3.0 for coursework required for the major. The grant award is in addition to the student's Pell Grant award. A student cannot receive more than one ACG or National SMART Grant award in each academic year for which they are eligible. For the 2007–08 academic year, $205 million in National SMART grants were disbursed to approximately 73,000 students.

The Teacher Education Assistance for College and Higher Education (TEACH) Grant, authorized by the *College Cost Reduction and Access Act of 2007* (CCRAA), provides up to $4,000 per year to students agreeing to teach math, science, or other specialized subjects in a high-poverty school for at least four years within eight years of their graduation. If students fail to fulfill the service requirements, grants convert to Unsubsidized Stafford Loans, with interest accrued from the time of the grant award. This grant program began in the 2008–09 school year, starting July 1, 2008. In FY 2008, the Department disbursed approximately 800 grants for almost $1.4 million under TEACH.

The **Federal Supplemental Educational Opportunity Grant (FSEOG)**, the **Federal Work-Study (FWS)** and the **Federal Perkins Loan Programs** are three campus-based programs through which the Department provides funds directly to eligible institutions, enabling them to offer grants, employment and low-interest loans to students based on need. For the 2007–08 award year, approximately $3.3 billion was disbursed through approximately 2.6 million campus-based awards.

There are two **state grant** programs. The **Leveraging Educational Assistance Partnership (LEAP) Program**, authorized by Section 415A of the HEA, makes federal funds available to assist states in providing student financial assistance programs for individuals with substantial financial need. The **Special Leveraging Educational Assistance Partnership (SLEAP) Program** was added to the LEAP Program in the 1998 Amendments to the HEA (Section 415E). SLEAP makes federal funds available to states to cover a third of the cost of supplementing their respective LEAP programs, supplementing their LEAP Community Service Work-Study programs, and/or providing Merit and Academic Achievement or Critical Careers Scholarships to students with substantial financial need. For the 2007–08 academic year, approximately $165 million in LEAP grants was disbursed to approximately 165,000 students.

In fulfilling our program responsibilities, Federal Student Aid directly manages or oversees almost $556 billion in outstanding loans—representing almost 95 million student loans to more than 30 million borrowers.

The **William D. Ford Federal Direct Loan (Direct Loan ^sm^) Program ^sm^** lends funds directly to students and parents through participating schools. This program is funded by borrowings from the U.S. Department of the Treasury (Treasury), as well as an appropriation for subsidy costs. In FY 2008, the Department made $21.8 billion[1] in net loans to 2.9 million recipients.

Under the **Federal Family Education Loan (FFEL ^sm^) Program ^sm^**, students and parents can obtain loans through private lenders. Loan guaranty agencies insure these funds, and they are, in turn, reinsured by the federal government.

During FY 2008, Federal Student Aid supported the delivery of $52.9 billion[2] in net loans to 6.0 million FFEL recipients. In addition, Federal Student Aid made gross payments of approximately $8.7 billion to lenders for interest and special allowance subsidies, and $10.6 billion to guaranty agencies for reinsurance claims and fees paid to guaranty agencies for loan processing, issuance and account maintenance.

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[1] Excludes consolidation loans of $5.8 billion.
[2] Excludes consolidation loans of $9.3 billion.

Performance Goals, Objectives and Results

Since Federal Student Aid became a PBO in 1998, we have introduced many substantial and measurable improvements in how we plan and report operational and portfolio performance in administering the federal student financial assistance programs.

Strategic Planning and Reporting

Several key strategic drivers form the scope and content of Federal Student Aid's long-term goals and objectives:

- HEA Legislation.
- Federal Financial Management Laws and Regulations.
- Customer Needs.
- PBO Legislation.
- The Department's Strategic Plan.
- The *President's Management Agenda* (PMA).
- The Department's Management Challenges.

The foundation of our long-term strategic planning is Federal Student Aid's five core strategic objectives. Taken collectively, these objectives provide the framework for continuous improvement at Federal Student Aid, guiding us in managing our programs more effectively and providing clear strategic direction to all of Federal Student Aid's internal and external constituencies.

Our core strategic objectives are to:

- Integrate Federal Student Aid systems and provide new technology solutions.
- Improve program integrity to facilitate access to postsecondary education, while reducing vulnerability of the federal student financial assistance programs to fraud, waste, abuse and mismanagement.
- Reduce program administration costs.
- Improve human capital management.
- Improve products and services to provide better customer service.

Federal Student Aid's long-term planning is outlined in its Five-Year Plan, a statement of strategic direction providing long-term guidance. Beginning with the FY 2006 – FY 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. The Five-Year Plan aligns with Federal Student Aid's annual, tactical business-level planning, tracking and implementation processes including the Annual Performance Plan.

Tactical Performance Planning and Reporting

Federal Student Aid's Annual Performance Plan establishes specific tactical initiatives to achieve organizational strategic objectives outlined in the Five-Year Plan. Timelines, milestones and status are maintained in the Annual Performance Plan and evaluated on a monthly basis to ensure their alignment with current business needs, the allocation of resources and capital, policy considerations, and statutory and regulatory requirements.

The Annual Report provides the mechanism for reporting the organization's annual performance results, including the organization's audited financial statements, a summary of the organization's progress in meeting tactical goals established in the Annual Performance Plan and detailed results of the organization's success in meeting performance standards established in the Five-Year Plan. These documents—the Five-Year Plan, the Annual Performance Plan and the Annual Report—form the foundation of Federal Student Aid's strategic planning, tactical implementation and reporting processes.

Performance Management

Federal Student Aid's performance management is a critical component in our strategic vision, as well as our day-to-day operations. Our performance management initiatives are wide-ranging and influence every aspect of our business. As a result, Federal Student Aid has developed a range of tools to monitor and report on organizational performance on a weekly, monthly and annual basis. (Refer to the "Tactical Performance Planning and Reporting" section above for discussion of annual performance planning and reporting.)

Federal Student Aid produces weekly and monthly project planning and reporting activities detailing the scope, schedule, cost, quality and overall status of key initiatives. Federal Student Aid's budget management process and our unit-cost model provide cost identification, control and management. Federal Student Aid also tracks and reports enterprise-wide operational, human capital and performance metrics through a series of dashboard tracking reports.

Program and Business Operations

In addition to annual planning and reporting, Federal Student Aid's performance management is supported by several teams throughout the enterprise that help us to meet our five core objectives. Each of the groups described below play an integral part in ensuring Federal Student Aid performs effectively and efficiently.

- **Project Management Office**

  The Project Management Office, established in FY 2003, is the central point of oversight for identified projects. Through the Project Management Office, project activities are integrated within Federal Student Aid, linking them to strategic objectives, priorities and available resources. It supports project managers by establishing enterprise project management standards of practice, advising on systems integration strategy, sharing information across projects during the full life cycle of the projects through our Enterprise Change Management Group and providing relevant reports and data to management.

- **Enterprise Risk Management Group**

In 2006, Federal Student Aid established an enterprise risk management (ERM) function to provide strategic direction for assessing, monitoring and managing risk across the organization. The Enterprise Risk Management Group (ERMG) is responsible for developing ERM strategy and implementing an ERM program at Federal Student Aid, which is among the first of its kind in the federal government. Federal Student Aid's ERM strategy is comprised of a three-phased approach for implementation of the ERM program. When fully implemented, this program will provide for a more strategic and integrated view of risk, link risks to strategic and business unit goals and objectives, and enable senior management to better anticipate, analyze and manage risks inherent in the federal student financial assistance programs and develop strategies to address these risks. As of September 30, 2008, ERMG was working to complete remaining activities in the second phase of Federal Student Aid's ERM program and beginning activities associated with the third and final phase.

The ERMG also leads or participates in special projects or strategic initiatives at the request of senior management; provides risk management guidance, training, and standards to Federal Student Aid employees; conducts internal reviews and risk assessments; and performs audit tracking and resolution services on behalf of the entire organization. In 2008, at the request of Federal Student Aid's Acting Chief Operating Officer, ERMG managed an effort to evaluate the effectiveness of the organization's regional workforce structure relating to Program Compliance and Business Operations. In addition, ERMG's Internal Review Division performed various reviews, assessments and quality control reviews within Federal Student Aid including: the testing of various financial and operational controls associated with the organization's efforts to comply with the requirements of Appendix A of the Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control,* an evaluation of Federal Student Aid's processes and efforts to comply with the Freedom of Information Act; a quality control review of the Financial Partners Program Review Standards; and a review of Federal Student Aid's Lender-Identification assignment process.

This collection of processes and programs provide management with an effective infrastructure to manage the organization's strategic and tactical planning and reporting functions. While we continually strive to improve the alignment between these planning, tracking and reporting functions, we believe they fulfill Federal Student Aid's responsibility for planning and reporting of PBO activities and comply with Title I, Part D of the HEA, as amended.

Key Performance Goals and Results

This section provides a high-level overview of Federal Student Aid's FY 2008 performance objectives and results. The information provides a summary of our achievements and our progress in meeting the organization's stated performance standards.

In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the 2006 and the 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets – while developed – were not generally published for FY 2007 or FY 2008. In this report, Federal Student Aid will report its progress primarily against FY 2008 targets that until now may not have been previously published. All targets referenced in this report – whether previously published or not – are aligned with the 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

During FY 2008, Federal Student Aid made significant progress in meeting our performance standards as outlined in the Five-Year Plan. For the most recent data available, Federal Student Aid met targets for thirteen key measures, did not meet targets for nine measures, discontinued one measure, and measured performance for one measure that did not have standards or targets established. The organization continues to analyze the impact of portfolio performance on the Cumulative Lifetime Default Rate (CLTDR) before identifying future performance targets as noted below.

The actual results for each performance standard are presented in conjunction with each objective. The respective tables present whether the actual result met or failed to meet the target. In some cases, establishing a baseline is the target and is recognized as met if the baseline was established. Note: because performance standards were established in the FY 2006 – 2010 Five-Year Plan, historical data may not be available for some of the indicated standards because the Department did not collect the data prior to FY 2006.

Please see the Annual Program Performance Report section of this report for applicable footnotes and more specific accomplishments, by objective.

Legend

Improved = Improved over prior but not met.	PM = Performance measured, standards and/or targets not established
NA = Data is not available	Met = Met or exceeded target
T = Measure replaced or discontinued	Not Met = Target not met

Performance Results Summary	FY 2006	FY 2007	FY 2008
Objective 1— Integrate Federal Student Aid Systems and provide new technology solutions.			
Integrated Partner Management	Met	Met	Not Met
Integrate Aid Delivery Systems	NA	Met	Not Met
Acquisition Strategy	NA	Met	Not Met
Infrastructure	NA	Met	Met
Objective 2— Improve program integrity to facilitate access to postsecondary education, while reducing vulnerability of the federal student financial assistance programs to fraud, waste, abuse, and mismanagement.			
President's Management Agenda Score			
A. Financial Management	Met	Met	Met
B. Improper Payments	Met	Met	Met
Cumulative Lifetime Default Rate—Title IV Student Loan Portfolio	Met	PM	PM
National Cohort Default Rate (CDR)	Met	Met	Met
Direct Loan Default Recovery Rate	Met	Met	Met
FFEL Default Recovery Rate	Met	Met	Met
Objective 3— Reduce program administration costs.			
Reduce Electronic Free Application for Federal Student Aid Direct Unit Costs	Met	Met	Met
Reduce Origination and Disbursement Direct Unit Costs	Met	Met	Met
Reduce Direct Loan Servicing Direct Unit Costs	Met	Not Met	Improved
Reduce Collections Direct Unit Costs	Met	Met	Not Met
Objective 4— Improve human capital management.			
Leadership Training	Met	Met	Met
Acquisitions Training	Met	Met	Met
Project Management Training	Met	Not Met	Not Met
Federal Student Aid Business Knowledge Training	Met	Met	Not Met
School Compliance Officials Training	Met	Met	Not Met
General Workforce Training	Met	Met	Not Met
Objective 5— Improve products and services to provide better customer service.			
Student Aid Application	Not Met	Not Met	Met
School Origination and Disbursement	Met	Met	T
Lender Payment Processing	Not Met	Met	Met
Direct Loan Borrower Servicing	Met	Met	Met

FY 2008 Accomplishments

Federal Student Aid achieved many successes and faced unprecedented challenges in FY 2008. As a result, priorities identified in the beginning of the year were reevaluated later in the year due to budgetary and human resource constraints.

Loan Purchase Programs

In early 2008, the Department began to notice the early stages of what would become a global financial crisis that could have impacted the availability of student loans. In May 2008 Congress passed and the President signed the "*Ensuring Continued Access to Student Loans Act of 2008*" (Pub. L. No. 110-227) (ECASLA). The legislation provided the Department with new authority to address concerns about capital liquidity in the student loan market.

Based on the authority granted her by the ECASLA, the Secretary announced a comprehensive plan to ensure that all eligible students (and their parents) have access to federal student loans for the upcoming academic year. That plan included four key components:

1. An offer to purchase FFEL Program loans from lenders for the 2008–09 academic year and to offer lenders access to short-term liquidity;

2. A pledge to work with the student lending community on forward-looking solutions to ensure the FFEL Program and other student lending programs serve the best interests of students and taxpayers for years to come;

3. An enhanced lender-of-last-resort program designed to provide access to FFEL Program loans for those students who face difficulty obtaining conventional loans; and

4. A more efficient Direct Loan Program with increased capacity.

This plan included the development of the Loan Purchase Programs, two new programs to purchase FFEL Program loans or interests in FFEL Program loans from lenders for the 2008–09 academic year. (This offer was made in part to ease anxieties within the credit markets by providing a federal purchase guarantee.)

1. Loan Participation Purchase Program*

   Under the Loan Participation Purchase Program the Department offers to purchase "participation interests" in pools of FFEL loans made for the 2008–09 academic year through September 30, 2009. By September 30, 2009, lenders must either re-purchase those loans or sell them outright to the Department.

*Refer to reference on next page.

2. Loan Purchase Commitment Program*

   Under the Loan Purchase Commitment Program the Department offers to purchase eligible FFEL loans made for the 2008–09 academic year through September 30, 2009.

   * The President recently signed H.R. 6889, the extension of the ECASLA, extending these programs through the 2009–10 award year. At the time this report was prepared, details of the extension had not been completed.

Federal Student Aid, working with colleagues from across the Department and the federal government, developed the processes and systems necessary to launch these programs by the mid-August 2008 peak loan period. These programs were launched in August 2008 and through September 30, 2008 funded approximately 40% of FFEL disbursements for the 2008–09 academic year totaling over $5 billion. In addition, as of September 30, 2008, the Department had purchased outright, through the Loan Purchase Commitment Program, over 20,000 loans valued at approximately $61 million.

In response to disruptions in the credit markets, Federal Student Aid worked with colleagues from across the Department to design, develop and implement programs to ensure access to federal student loans for the 2008-2009 academic year. In addition to the development of the Loan Purchase Programs described above, Federal Student Aid worked with guaranty agencies to ensure that the necessary Lender-of-Last-Resort (LLR) processes and plans were in place should they be needed. Federal Student Aid significantly increased capacity in its Direct Loan Program and revised procedures to expedite, if necessary, a school's Direct Loan application and eligibility determination.

Achievements in Support of Federal Student Aid Strategic Objectives

Objective 1: Integrate Federal Student Aid Systems and Provide New Technology Solutions

In FY 2008, Federal Student Aid continued to focus on revising the approach to business application integration and development and operational integration of information technology assets. With the award of contracts to pre-qualified development vendors, Federal Student Aid is positioned to implement a management and procurement approach that increases competition, improves product quality, reduces risk, and allows for continual program evaluation. With the consolidation of over 90% of our information technology (IT) assets to a single location, Federal Student Aid is integrating support processes, procedures and plans in order to maximize our assets from an enterprise perspective, thereby standardizing methods, reducing risk and reducing costs. As we pursue integration initiatives in the future, we continue to reevaluate existing strategies, as necessary, and explore new and innovative approaches and technology to help us achieve our goals.

Objective 2: Improve Program Integrity to Facilitate Access to Postsecondary Education, while Reducing the Vulnerability of the Federal Student Financial Assistance Programs to Fraud, Waste, Abuse and Mismanagement

Federal Student Aid improved its oversight of schools and lenders participating in the FFEL Program, implementing new regulations to strengthen the rules around prohibited inducements and borrower choice and conducting comprehensive reviews of program participants to ensure those rules were being followed. Working with the Office of Inspector General (OIG), Federal Student Aid required audits of those lenders requesting special allowance subsidies at the 9.5 percent floor rate in order to verify the eligibility of the underlying loans.

In response to disruptions in the credit markets, Federal Student Aid worked with colleagues from across the Department to design, develop and implement programs to ensure access to federal student loans for the 2008-2009 academic year. In addition to the development of the Loan Purchase Programs described above, Federal Student Aid worked with guaranty agencies to ensure that the necessary Lender of Last Resort processes and plans were in place should they be needed. Federal Student Aid significantly increased capacity in its Direct Loan Program and revised procedures to expedite, if necessary, a school's Direct Loan application and eligibility determination.

Objective 3: Reduce Program Administrative Costs

Federal Student Aid continues to reduce the cost of administering the Title IV programs through strong financial and operational management; the reengineering of overly complex business processes; and simplification of the business application and computing environment. In 2008, cost reduction strategies resulted in the net unit cost reduction of over $26 million from 2007 related to processing aid applications, origination and disbursement of Pell Grants and Direct Loans and the servicing of Direct Loans. Federal Student Aid continued to reduce production of the paper form of the Free Application for Federal Student Aid (FAFSA sm), increase the accuracy of submitted applications and reduced the cost to process applications through the growth of the use of the electronic FAFSA to over 95 percent of total application volume. In addition, with the completion of the transition to the Virtual Data Center, we expect significant future savings.

Objective 4: Improve Human Capital Management

In FY 2008, Federal Student Aid began to develop and implement a succession strategy to "build leaders at all levels." The organization dedicated itself to recruiting young leaders and training the workforce in the fundamentals of our business and other mission-critical areas, building a strong bench of current and future leaders, and aligning staff in organization structures designed for high performance.

Objective 5: Improve Products and Services to Provide Better Customer Service

In response to the Secretary of Education's call for accessibility, affordability and accountability in higher education, Federal Student Aid was charged with implementing key recommendations to make the financial aid process easier for students and families. In FY 2008, Federal Student Aid began to implement application enhancements to the FAFSA and Free Application for Federal Student Aid forecaster (FAFSA4caster sm) to meet the needs of America's diverse population. Additionally, Federal Student Aid played a critical role in the development and launch of http://www.college.gov, a Web site designed by and for students to motivate and inspire them to pursue a postsecondary education and equip them with the information they need to go to college. To increase greater awareness about the availability of student financial assistance, Federal Student Aid established a series of public service announcements via a nationwide campaign. Through the Federal Student Aid Ombudsman, we continued to provide a problem resolution resource for student borrowers.

The CCRAA established the TEACH Grant Program, which Federal Student Aid implemented in FY 2008, providing up to $4,000 per year to students agreeing to teach math, science, or other specialized subjects in a high-poverty school. Federal Student Aid continues to explore new ways to ensure that access, information and resources about student financial assistance meet the needs of today's students.

Performance Reporting Limitations and Difficulties

The underlying assumptions in Federal Student Aid's performance planning and reporting processes are based on current budgetary, operational, and policy considerations. External events beyond our control can impact these underlying assumptions, potentially impacting the organization's ability to plan, meet and report upon its objectives. As necessary, Federal Student Aid reevaluates and revises its performance planning and reporting processes to adapt to these external factors. This was especially evident in FY 2008 with the Credit Management initiatives that were implemented. In three months, Federal Student Aid, in collaboration with the agencies from across the government, developed and implemented two programs, the Loan Purchase Commitment Program and the Loan Participation Purchase Program, to provide financing to FFEL lenders to ensure they could meet the needs of students and families for the 2008–09 academic year. More information on the two programs can be found at http://www.federalstudentaid.ed.gov/ffelp.

Data Validation and Verification

The Federal Student Aid Annual Report is published six weeks after the end of the fiscal year. Since a wide variety of data are submitted by diverse systems and governed by agreements with state guaranty agencies, lenders, and servicers as well as grant and loan recipients, it is not possible in all cases to report complete data for the reporting period. In instances where fiscal year end data are not available, the most recently available data are presented. Effective decision making requires complete, accurate, timely and reliable data. Funding decisions are made and management actions are taken based on performance information. Reliable information is a prerequisite for effective management. In addition to performance data received from our FFEL and Direct Loan program participants, we deal with financial data. Our data-quality processes for financial data are reflected in our financial statements and accompanying notes.

Performance Data

Federal Student Aid develops and uses such data for various purposes. Facing opportunities provided by the budget and performance management processes and activity-based management, Federal Student Aid recognizes the need to improve the accuracy, reliability and completeness of our data. Although immediate connections between specific performance and funding levels are sometimes challenging to make, Federal Student Aid is improving systems to yield reliable performance data to make informed budget and policy decisions. These systems will enhance our budget process and increase the accuracy and reliability of the information we receive from our FFEL and Direct Loan program participants.

Federal Student Aid is engaged in a long-term effort to improve data quality by integrating its processes, data and systems. In 2007, Federal Student Aid formally established an Enterprise Data Management program to better support business objectives and to emphasize data as an enterprise asset. The goal of the Enterprise Data Management program is to consistently define data and make standardized data available across the enterprise by providing information services and data technology expertise to business owners, project managers and architects.

OMB Circular A-11, Part 6, section 230.5, *Assessing the Completeness and Reliability of Performance Data*, requires each agency to design a procedure for verifying and validating data that it makes public in its annual performance plans and reports. Additionally, the *Government Performance and Results Act of 1993* describes the means to be used to verify and validate measured values. Finally, the *Reports Consolidation Act of 2000* requires that the transmittal letter included in annual performance reports contain an assessment by the agency head of the completeness and reliability of the performance data included in the reports.

Federal Student Aid developed a matrix as guidance for data providers who have the responsibility for reporting data in performance measures to evaluate and provide issues of data integrity and credibility. The matrix provides a framework for validating and verifying performance data before it is collected and reported. The matrix is being used for select projects in FY 2008 and is used to evaluate data prior to publication.

The data validation criteria require that:

- The goal and measure are appropriate to the mission of the organization, and measured performance has a direct relation to the goal.

- The goal and measure are realistic and measurable, achievable in the time frame established, and challenging in their targets.

- The goal and measure are understandable to the lay person, language is unambiguous, and terminology is adequately defined.

- The goal and measure are used in decision making about the effectiveness of the program and its benefit to the public.

Federal Student Aid's objectives to integrate the aid delivery system, improve program integrity, reduce costs and improve services come directly from the PBO enabling legislation and are consistent with the core mission. In addition, these objectives balance the needs of the students who require financial assistance to continue their education and Title IV lending and educational institutions with the taxpayer who provides the resources. To effectively support the mission and achieve success, an additional objective related to human capital has been added to ensure that Federal Student Aid staff has the most up-to-date skill sets. These objectives were developed initially in 2003 and then augmented with the appropriate performance metrics and targets in 2005 for inclusion in the 2006 Five-Year Plan.

The metrics employed to measure success are directly related to each of the objectives. As an example, under the improvement of program integrity objective, metrics measure success in increasing accountability and reducing vulnerabilities related to fraud, waste, abuse and mismanagement. The metrics measure integrity from all facets of program delivery from ensuring that all the dollars awarded to students, either directly from Federal Student Aid or through participating institutions, are accounted for properly, to limiting loan defaults, to collecting a sizeable portion of loans that default despite all the best efforts to minimize them. Targets for each of the metrics have been set at challenging, but realistic levels that are achievable within the time horizon.

We believe that the goals for each objective and the associated performance metrics and targets are understandable however there are opportunities for improving the explanation of these relationships in future editions of our performance plans. A subset of the metrics and their outcomes have been used in the 2008 Program Assessment Rating Tool evaluation of the Student Aid Administration Account, the main funding source for Federal Student Aid activities.

Analysis of Federal Student Aid's Financial Statements

Federal Student Aid is committed to providing sound management, financial systems and controls to ensure that students receive aid and repay loans according to applicable laws and regulations. Federal Student Aid's financial statements are prepared in accordance with established federal accounting standards. The financial statements are subject to an annual independent audit to ensure that they are reliable and fairly present our financial position.

In FY 2008, Federal Student Aid achieved an unqualified audit opinion on its financial statements. The Independent Auditor's Report cited no material weaknesses in internal controls.

For FY 2008 and FY 2007, the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position were prepared on a consolidated basis, and the Statement of Budgetary Resources was prepared on a combined basis as required by OMB Circular A-136, *Financial Reporting Requirements*. The Report of Independent Auditors (opinion) on these statements and accompanying Reports on Internal Control and Compliance with Laws and Regulations is included in this report.

Appropriations are available to cover the subsidy cost of each loan program and administrative expenses. Subsidy expense covers the difference between the net present value of expected future cash flows and the face value of each loan portfolio. Appropriation authority is available as needed on a permanent basis to finance costs resulting from loans guaranteed in the years before FY 1992. The Pell Grant Program receives appropriations to cover actual grant disbursements.

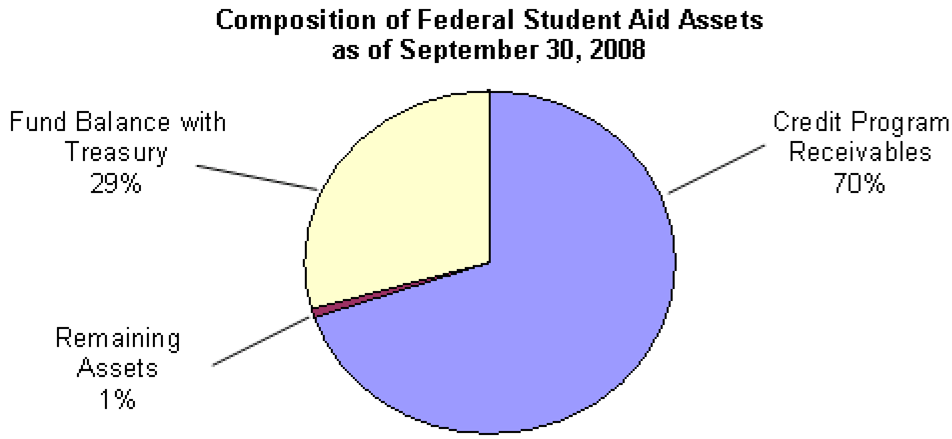
A comparison between significant line items reported in Federal Student Aid's FY 2008 and 2007 September financial statements is presented in the following table.

Summarized Financial Data as of September 30, 2008 and 2007
(Dollars in Millions)

	Percentage Change	Dollar Difference	Fiscal Year 2008	Fiscal Year 2007
Total Assets	10.4%	$18,221	$193,287	$175,066
Total Liabilities	14.0%	$22,868	$186,088	$163,220
Net Position	-39.2%	($ 4,647)	$ 7,199	$ 11,846
Net Cost of Operations	1.3%	$ 251	$ 19,759	$ 19,508

The Balance Sheet
Composition of Federal Student Aid Assets

The Consolidated Balance Sheet shows Federal Student Aid had total assets of $193.3 billion, as of September 30, 2008. This represents an increase of approximately $18.2 billion over the previous year's total assets of $175.1 billion, as of September 30, 2007. The difference resulted primarily due to an increase in Credit Program Receivables and net increases and decreases to the various programs Fund Balance with Treasury.



Fund Balance with Treasury decreased by $1.2 billion dollars from FY 2007 to FY 2008. The FFEL fund balance decreased as a result of increased payments to lenders net of cash borrowed to support the FFEL Loan Participation Purchase Program. The decrease in FFEL Fund Balance with Treasury was largely offset by increased fund balances for Direct Loans to support increased loan volume and for increased grant activity. The Treasury processes Federal Student Aid's cash receipts, such as appropriation warrants, that provide cash for operations. Treasury also processes loan payment collections received from students. The Department of the Treasury also processes loan and grant disbursements and operating expenditures on behalf of Federal Student Aid.

Credit Program Receivables, net of subsidy allowance, increased by $18.8 billion over the previous year's total as of September 30, 2008. Credit Program Receivables are comprised primarily of principal and interest amounts owed by students for Direct Loans, TEACH Grants, FFEL loans under the Loan Participation Purchase and Loan Purchase Commitment Programs and defaulted guaranteed loans under the FFEL Program. As of September 30, 2008 the balance was $134.5 billion in Credit Program Receivables – the majority of which were for Direct Loan Program receivables, the Loan Participation Program which began disbursing funds in late FY 2008, and defaulted FFEL loans.

Receivables, net of the allowance for subsidy, increased primarily due to two factors. As a result of the liquidity crisis in the financial markets, there has been a large influx of Direct Loan schools and the implementation of the Loan Participation Purchase Program – resulting in an increase of new loan originations. In addition, loan consolidation activity from the Direct Loan portfolio by the FFEL community has decreased significantly. A corresponding reduction in subsidy for the consolidated loans increased the net

Receivable balance. Subsidy allowance reduces the face value of the portfolio to the expected actual collections, at present value.

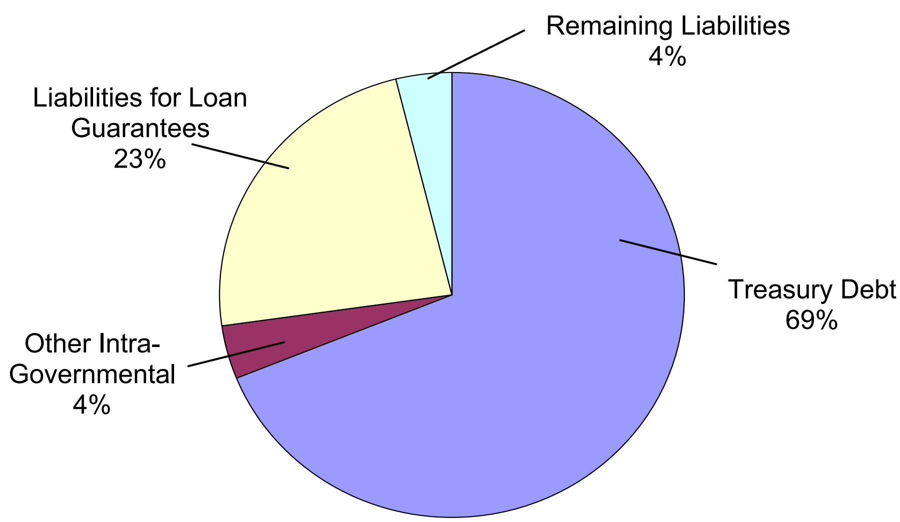
Receivables of defaulted FFEL loans, net of allowance for subsidy, increased as a result of continued growth in the average amount of loans, growth in online campus schools, economic hardship and the expiration of Exceptional Performer designation, and the expiration of Voluntary Flexible Agreements. Receivables of defaulted Direct Loans, net of allowance for subsidy, increased as a result of continued growth in the average amount of loans, growth in online campus schools, and economic hardship.

Composition of Federal Student Aid Liabilities

Federal Student Aid had total liabilities, as of September 30, 2008, of $186.1 billion, an increase of $22.9 billion over the previous year's total liabilities. The difference resulted primarily from an increase in Debt due to Treasury and Other Intragovernmental Liabilities offset by a decrease in the Liabilities for Loan Guarantees.

Debt increased as a result of increased Direct Loan Program volume and new debt for the Loan Participation Purchase Program. Other Intragovernmental Liabilities increased as a result of the downward FFEL re-estimates and modifications of subsidy. Net subsidy-related transactions resulted in a reduction of the Liability for Loan Guarantees.

Composition of Federal Student Aid Liabilities
as of September 30, 2008

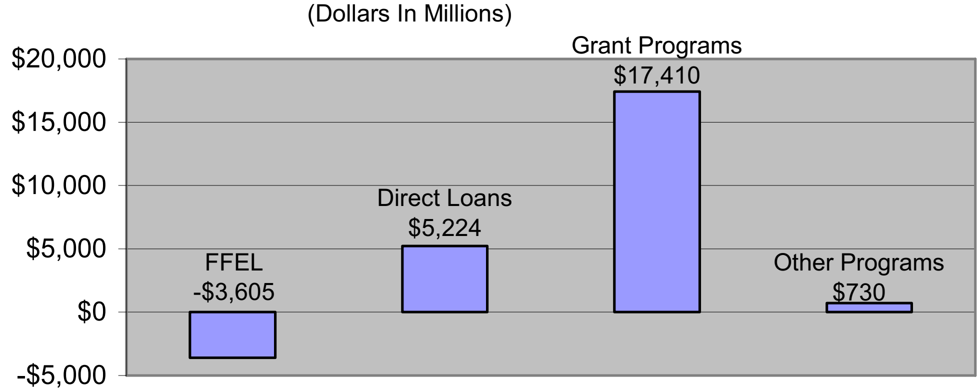


Statement of Net Cost

Federal Student Aid had total net costs of $19.8 billion for FY 2008, an increase of $0.3 billion over the previous year's total net cost of $19.5 billion. This included a significant increase in net costs for the Direct Loan and grants programs, netted against a decrease in the FFEL Programs. The gross costs are primarily composed of subsidy expenses from the re-estimates of expense, loan modifications, and increased direct loan volume in response to loan liquidity concerns, as well as the funding of grants. Subsidy expenses are the estimated costs of funding the direct loans and loan guarantees. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows.

Composition of Federal Student Aid Net Cost for the Year Ended September 30, 2008

(Dollars In Millions)



Statement of Changes in Net Position

Federal Student Aid's net position for the year ended September 30, 2008 was $7.2 billion, a decrease of $4.6 billion over the previous year's total net position of $11.8 billion. The difference is primarily due to reduced net subsidy transactions.

Statement of Budgetary Resources

The Statement of Budgetary Resources compares the budgetary resources provided with the status or execution of those resources and details the composition of the resources and the status of the resources and shows the amount of net outlays. This statement shows that Federal Student Aid had $148.5 billion in combined budgetary resources, of which $28.6 billion remained unobligated and not available.

Federal Student Aid had total net outlays for FY 2008 of $45.7 billion. There was an increase in total net outlays of $15.4 billion comparing September 2008 to September 2007. Net Outlays increased primarily due to Direct Loans, with lesser increases for FFEL and the grant programs.

Gross outlays for Federal Student Aid increased $12.9 billion comparing September 2008 to September 2007 due to increased originations in Direct and Loan Participation Purchase programs and increased grant expenditures. Offsetting receipts decreased as a result of lower collections from the consolidations of Direct Loans by FFEL loan holders and net FFEL subsidy re-estimates and modifications.

Analysis of Federal Student Aid's Systems, Controls and Legal Compliance

Internal control is a major part of managing an organization. It comprises the plans, methods and procedures used to meet missions, goals and objectives and, in doing so, supports performance-based management. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal control, which is synonymous with management control, helps government program managers achieve desired results through effective stewardship of public resources.

Internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

- Effectiveness and efficiency of operations, including the use of the entity's resources.
- Reliability of financial reporting, including reports on budget execution, financial statements, and other reports for internal and external use.
- Compliance with applicable laws and regulations.[3]

Federal Student Aid management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of *Federal Managers' Financial Integrity Act of 1982* (FMFIA). Federal Student Aid conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of its operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, Federal Student Aid reported to the Department's management that its internal controls over the effectiveness and efficiency of its operations and compliance with applicable laws and regulations, as of September 30, 2008, were operating effectively.

In addition, Federal Student Aid, working with the Department's management, conducted its current year 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 OMB Circular A-123, *Management's Responsibility for Internal Control*. The scope of Federal Student Aid's assessment included the following processes that impact the Department's financial statements:

[3] Government Accountability Office (GAO) Standards for Internal Control in the Federal Government, GAO/AIMD-00-21.3.1, November 1999, p. 4-5

- Direct Loan operations.
- Direct Loan servicing.
- Direct Loan consolidations.
- Conditional Disability Discharge.
- Debt collection.
- Grant operations (Pell, Campus-based, ACG, and SMART).
- Financial partner invoicing, services, and oversight.
- Determining student and institutional eligibility.
- Procurement management.
- Funds control management.
- Human resources management.
- Financial closing and reporting.
- General computer controls related to various agency systems.

Based on the results of this evaluation, Federal Student Aid provided reasonable assurance to the Department's management that its internal control over financial reporting as of June 30, 2008 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

In participating in the Department's successful implementation of OMB Circular A-123, Appendix A, requirements, Federal Student Aid continues to build upon its internal control framework that will be used in continuing efforts to monitor and improve internal controls.

Please refer to the Department's Performance and Accountability Report (PAR) for information related to the Department's compliance with the *Federal Financial Management Improvement Act of 1996*.

Possible Future Effects of Existing Events and Conditions

Federal Student Aid's ability to fully implement the initiatives described in this report is impacted by external factors, including budget and policy considerations and unanticipated events. Federal Student Aid works closely with the Department and OMB to develop our administrative budget and ensure appropriate resources are allocated to support our strategic objectives. Legislative and/or regulatory action may result in policy, resources or program changes requiring Federal Student Aid to revisit our current strategic plan. Specifically, the *Higher Education Opportunity Act of 2008* was passed in the current fiscal year. As a result, Federal Student Aid will revise both our Annual Performance Plan and the Five-Year Plan to meet the new legislative and/or regulatory requirements.

Other external factors could also affect our ability to achieve the organization's objectives. For example, in 2007, deteriorating credit markets began pressuring lender margins. As a result, in 2008, some lenders chose to scale back their participation in the FFEL Program or exit the program altogether. In May 2008 Congress passed and the President signed the ECASLA. The legislation provides the Department with new authority to address concerns about capital liquidity in the student loan market. Based on the authority granted her by the ECASLA, the Secretary announced a comprehensive plan to ensure that all eligible students and their parents have access to federal student loans for the upcoming academic year. In three months, Federal Student Aid, in collaboration with the agencies from across the government, developed and implemented two programs, the Loan Purchase Commitment Program and the Loan Participation Purchase Program, to provide financing to FFEL lenders to ensure they could meet the needs of students and families for the 2008–09 academic year. More information on the two programs can be found at http://www.federalstudentaid.ed.gov/ffelp. We are unable to anticipate the full impact of Federal Student Aid's ability to achieve its strategic objectives included in the Five-Year Plan as a result of a long-term commitment to other similar unforeseen events.

Limitations of Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of Federal Student Aid, pursuant to the requirements of 31 U.S.C. 3515(b).

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

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

Annual Program Performance Report

Annual Program Performance

During FY 2008, Federal Student Aid achieved significant accomplishments, as well as made progress in meeting our performance standards as outlined in the Five-Year Plan. The information presented herein provides details of our achievements, by objective. Under each objective below, we have identified the corresponding Performance Standard, as well as the organization's progress in meeting the stated target. A matrix providing information on the data quality and analysis of progress is also presented under each objective. Unless otherwise noted, these performance standards and their respective ratings are based on criteria established by Federal Student Aid.

Explanation of Documentation for Performance Results

Tables.
Provide trend data including the latest available reported data. The Performance Column shows the relationship between the new actual values and targets as follows:

- *Target Met* = Performance results met or exceeded the target.
- *Target Not met* = Performance results fell short of the target.
- *Improved* = Performance results improved over prior year but fell short of the target.
- *PM* = Measured performance, standards and/or targets not established.
- *T* = Measure replaced or discontinued.
- *NA* = Data is not available.

Analysis of Progress.
Provides insight into Federal Student Aid's progress.

Data Quality.
Incorporates information such as the universe included in the measure.

Target Context.
Explains the parameters or rationale for targets.

Objective 1: Integrate Federal Student Aid systems and provide new technology solutions.

Federal Student Aid will continue to improve efficiency and productivity and increase the usability of our systems. Federal Student Aid will continue to provide appropriate and integrated technology solutions that enable ongoing improvements for a more efficient and cost-effective delivery of the student financial assistance programs. The organization will take advantage of new technologies and continue to reassess existing systems to improve application processing, customer service, productivity and efficiency.

In FY 2008, Federal Student Aid continued to focus on revising its business application integration approach and development and operational integration of information technology assets. With the award of contracts to pre-qualified development vendors, Federal Student Aid is positioned to implement a management and procurement approach that increases competition, improves product quality, reduces risk, and allows for continual program evaluation. With the consolidation of over 90% of our IT assets to a single location, Federal Student Aid is integrating support processes, procedures and plans in order to maximize our assets from an enterprise perspective, thereby standardizing methods, reducing risk and reducing costs. As we pursue integration initiatives in the future, we continue to reevaluate existing strategies, as necessary, and explore new and innovative approaches and technology to help us achieve our goals.

In FY 2008, Federal Student Aid successfully:

- Completed the transition of the Virtual Data Center from two legacy contractors and physical locations to a single vendor and location.
- Established the first component of the new procurement and management approach to business application development with the award of the Enterprise Development Support Services contracts to five development providers.
- Deployed new enterprise architectural components supporting Service Oriented Architecture, including the Enterprise Service Bus and the Enterprise Portal Infrastructure.
- Implemented the "Employee View", the first application using the portal infrastructure and the Security Architecture.
- Baselined a sequencing and deployment plan for the procurement, development and deployment approach to achieve the objectives of the Target State Vision.
- Developed security functions and processes to enhance the security posture of Federal Student Aid systems and the data it houses including identification of a "Two Factor Authentication" solution, implementation of a "virtual keyboard" and identification of an "active confirmation" process for validating customer "super users" of Federal Student Aid systems.
- Launched http://www.college.gov, a Web product aimed at providing a single source of inspiration and information for students and their support network about the possibility of college.
- Integrated four new applications with the Security Architecture infrastructure.
- Developed a data integration service for use across the enterprise to increase data quality and standardization.
- Integrated an additional application into the e-authentication infrastructure.

Performance Standards and Results

The following performance standards were established to measure Federal Student Aid's success in achieving our key integration initiatives. Success is predicated on the timely completion of all scheduled project deliverables in the design, development and implementation phases of the four main systems integration initiatives as described below.

Objective 1 Performance Metrics and Results

Metric	FY 2005	FY 2006	FY 2007	FY 2008 (Target)	FY 2008 (Actual)	Performance
Integrated Partner Management	*	Design	In Development	In Development	Development Terminated. New Approach and Timeline Being Developed.	Target Not Met
Integrate Aid Delivery Systems	*	*	Strategies Completed	Award Component of Person Data Management Solution Complete High-Level Transition and Integration Plan	Issued Request for Information with a Draft Statement of Work for Person Data Management. High Level Planning Completed.	Target Not Met
Acquisition Strategy	*	*	Approach and Timeline Completed	Award IT Developer Pool; Finalize Approach and Timeline for Customer Care Pool	Developer Pool Established. Customer Care Not Complete.	Target Not Met
Infrastructure	*	*	Phase 1 Completed	Deploy Enterprise Portal Infastructure and Enterprise Services BUS	Deployed Enterprise Portal Infastructure Enterprise Services BUS	Target Met

Objective 1 Performance Metrics and Results
Data Quality: Data was achieved upon the completion of the prescribed phases of the corresponding projects.
Analysis of Progress: As we reported in the FY 2007 Annual Report, while the objectives of several of Federal Student Aid's integration projects will remain the same, the development and procurement strategies for them will change. Federal Student Aid discovered that large contracts requiring multiple business capabilities, and supporting a complex and multi-faceted business process, do not provide Federal Student Aid the best solution providers from the marketplace. In addition, the lack of post-award competition led to price, quality and innovation issues preventing Federal Student Aid from being able to quickly transition services, potentially putting our business at risk. It is important to reiterate that while Federal Student Aid has reevaluated components of its strategy to achieve its integration efforts, its Target State Vision remains the same and progress continues on our multi-year sequencing plan by focusing on major initiatives and activities that bring us closer to that vision.
Target Context: In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the 2006 and the 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets – while developed – were not generally published for FY 2007 or FY 2008. In this report, Federal Student Aid will report its progress primarily against FY 2008 targets that until now may not have been previously published. All targets referenced in this report – whether previously published or not – are aligned with the 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

* Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established.

Objective 2: Improve program integrity to facilitate access to postsecondary education, while reducing vulnerability of the federal student financial assistance programs to fraud, waste, abuse and mismanagement.

Federal Student Aid continues to ensure that student aid under the Title IV programs is delivered directly by Federal Student Aid and through school, lender and guarantor participants in a manner that reduces the vulnerability of these programs to fraud, waste, abuse and mismanagement. Federal Student Aid is continually working to improve program integrity and is committed to continued success in the management of the Title IV programs.

In FY 2008, Federal Student Aid improved its oversight of schools and lenders participating in the Federal Family Education Loan Program, implementing new regulations to strengthen the rules around prohibited inducements and borrower choice and conducting comprehensive reviews of program participants to ensure those rules were being followed. Working with the OIG, Federal Student Aid required audits of those lenders requesting special allowance subsidies at the 9.5 percent floor rate in order to verify the eligibility of the underlying loans.

In response to disruptions in the credit markets, Federal Student Aid worked with colleagues from across the Department to design, develop and implement programs to ensure access to federal student loans for the 2008-2009 academic year. In addition to the development of the Loan Purchase Programs described above, Federal Student Aid worked with guaranty agencies to ensure that the necessary Lender of Last Resort processes and plans were in place should they be needed. Federal Student Aid significantly increased capacity in its Direct Loan Program and revised procedures to expedite, if necessary, a school's Direct Loan application and eligibility determination.

In FY 2008, Federal Student Aid successfully:

- Processed 99% of school compliance audits, 99% of school financial statements, and 95% of financial institution audits on time.
- Expanded monitoring of the financial performance of publicly-traded schools and large school groups under common ownership.
- Conducted targeted oversight of schools and lenders related to lender inducements and borrower choice.
- Completed Phase II of the school Program Review Standards as well as the Program Review Standards for financial institutions.
- Signed interagency agreement with the Federal Bureau of Investigation to conduct joint campus security site visits to increase monitoring of this area.
- Completed risk assessments of both school and financial institutions.
- Reduced the FY 2007 FMFIA Financial Partner oversight material weakness to a significant deficiency in FY 2008.
- Implemented provisions of the ECASLA in FY 2008 to ensure liquidity in financial markets so that eligible students and parents have access to federal student loans for the 2008–09 academic year.
- Achieved a "*Green*" progress and status score on the September 30, 2008 PMA scorecards for Financial Performance, and a "*Yellow*" progress and status score for Eliminating Improper Payments and a "*Green*" progress and "*Yellow*" status score for Improved Credit Management. For more detailed information on Eliminating Improper Payments, please refer to "Other Accompanying Information" in the Department's PAR.
- Developed and published the CLDTR for the federal student loan portfolio for FY 2002–2006.
- Achieved a continued low rate of 5.2 percent for the FY 2006 CDR.
- Achieved Direct Loan and FFEL default recovery goals for FY 2008.
- Achieved unqualified financial statement audit opinion for FY 2008.

- Continued to conform to OMB Circular A-123, Appendix A, to demonstrate sound financial management controls. In addition to complying with OMB requirements, Federal Student Aid has established an internal control framework to be leveraged for continuous internal control improvement.

Performance Standards and Results

The following performance standards were established to gauge Federal Student Aid's success in improving program integrity, while reducing the vulnerability of the Title IV programs to fraud, waste and abuse. Our success relies on maintaining "green" status on the PMA, continuing to achieve low default rates and increasing the recovery rate.

Objective 2 Performance Metrics and Results

Metric	FY 2005**	FY 2006**	FY 2007**	FY 2008 (Target)	FY 2008** (Actual)	Performance
PMA Status Score for Financial Management***	Green	Green	Green	Green	Green	Target Met
PMA Score for Improper Payments	Red	Yellow	Yellow	Yellow	Yellow	Target Met
Cumulative Lifetime Default Rate: Title IV Student Loan Portfolio	FY 2003 5.48% FY 2002 7.82% FY 2001 9.93% FY 2000 11.82% FY 1999 12.24%	FY 2004 5.9% FY 2003 7.3% FY2002 9.2% FY2001 10.9% FY 2000 12.7%	FY 2005 5.5% FY 2004 8.0% FY 2003 8.8% FY 2002 10.3% FY 2001 11.9%	****	FY 2006 5.8% FY 2005 7.4% FY 2004 9.5% FY 2003 10.0% FY 2002 11.3%	PM
CDR	FY 2003 4.50%	FY 2004 5.10%	FY 2005 4.60%	<6%	FY 2006 5.20%	Target Met
Direct Loan Default Recovery Rate	*	19.0%	20.08%	19.75%	21%	Target Met
FFEL Default Recovery Rate	*	19.4%	19.61%	19.5%	23.61%	Target Met

Data Quality: Indicates what year the data was reported. For example, during FY 2007, Federal Student Aid calculated the FY 2005 CDR.
Analysis of Progress: Federal Student Aid continues to make progress in improving program integrity as defined by the identified performance standards above. In FY 2008, the organization met each target. In FY 2009, we anticipate reviewing the stated performance standards when we draft the next Five-Year Plan to better align identified performance standards and organizational achievements
Target Context: In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the 2006 and the 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets – while developed – were not generally published for FY 2007 or FY 2008. In this report, Federal Student Aid will report its progress primarily against FY 2008 targets that until now may not have been previously published. All targets referenced in this report – whether previously published or not – are aligned with the 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

Refer to next page for notations "*", "**", "***", and "****".

* Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established.
**Indicates what year the data was reported. For example, during FY 2007, Federal Student Aid calculated the FY 2005 CDR.
***See http://www.results.gov for definitions, trend and PMA scorecard support for both financial management and improper payments. Results reflect OMB Scorecard as of September 30, 2008.
****The CLTDR was first published in FY 2006. Since that time, Federal Student Aid has produced and published the FY 2005, FY 2006 and FY 2007 calculations for the relevant preceding five-year periods, respectively. Federal Student Aid will continue to analyze the impact of portfolio performance on the CLTDR before identifying future performance targets.

Objective 3: Reduce program administration costs.

Federal Student Aid continued to focus on reducing costs through efficiency and productivity gains that can be achieved throughout the organization. Business process reengineering has resulted in an acquisition strategy that better aligns business objectives with procurement and we will continue to use activity-based costing to better manage costs and formulate budgets. Migrating more of our customers from paper to electronic processes also results in additional savings.

In FY 2008, cost reduction strategies resulted in the net unit cost reduction of over $26 million, when compared to FY 2007, related to the processing of aid applications, the origination and disbursement of Pell Grants and Direct Loans and the servicing of Direct Loans. Federal Student Aid continued to reduce production of paper FAFSAs, increase the accuracy of submitted applications and reduce the cost to process applications as adoption of the electronic FAFSA grew to over 95 percent of total application volume. In addition, with the completion of the transition to the Virtual Data Center, we expect significant future savings.

In FY 2008, Federal Student Aid successfully:

- Continued to expand the Activity Based Costing Model to facilitate reduction of administrative costs, identify process improvement opportunities and assist in budget formulation.
- Improved financial management of Federal Student Aid contracts through more precise analysis of contract costs, leading to more accurate tracking and allocation of budgets.
- Implemented strategic changes in how we procure services through award of multiple vendor developmental contracts and increased small-business participation in Federal Student Aid procurement.
- Populated the Federal Student Aid cost library and used data in the library to improve cost estimation, budget planning, fiscal management, and contract negotiations.
- Reduced bulk distribution of paper FAFSAs by providing paper FAFSAs to high schools and colleges only upon request.

Performance Standards and Results

Performance standards were established to measure Federal Student Aid's ability to control costs in an environment of increasing workloads. Success relies on achieving economies of scale in our application, delivery, servicing and collection activities.

Objective 3 Performance Metrics and Results

Metric	FY 2005	FY 2006*	FY 2007*	FY 2008 (Target)	FY 2008* (Actual)	Performance
Reduce the Unit Cost to Process an Electronic FAFSA	**	$ 5.04	$ 4.34	$ 4.03	$ 3.91	Target Met
Reduce the Unit Cost of Originating and Disbursing Direct Loans and Pell Grants	**	$ 4.42	$ 4.03	$ 3.98	$ 3.65	Target Met
Reduce the Unit Cost of Servicing a Direct Loan Borrower	**	$ 20.95	$ 21.45	$ 18.44	$ 19.59	Improved
Reduce the Unit Cost of Collecting One Dollar in Default Status	**	$ 0.14	$ 0.13	$ 0.12	$ 0.14	Target Not Met

Data Quality: Unit costs are based on prior year data. For example, in FY 2008, the unit costs were based on data from FY 2007.

Analysis of Progress: Federal Student Aid has made significant progress in its efforts to reduce the administrative unit costs. All measures are equal to or below the baseline amounts from FY 2006. Due to the nature of the cost calculation for Default Collections, it will be difficult to meet the target of $.12. This is due to the fact that this measure includes the costs for Private Collection Agency contracts, which increase in cost as the amount collected increases. While the unit cost of collecting one dollar in default is relatively steady, the actual amount collected has increased since the FY 2006 baseline. We plan to reevaluate this standard when we produce the next Five-Year Plan.

Target Context: In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the 2006 and the 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets – while developed – were not generally published for FY 2007 or FY 2008. In this report, Federal Student Aid will report its progress primarily against FY 2008 targets that until now may not have been previously published. All targets referenced in this report – whether previously published or not – are aligned with the 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives. Targets were set in the FY 2006 – 2010 Five-Year Plan. The targets are based on reductions from the baseline set in FY 2006.

*Indicates year data was reported.
** Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established.

Objective 4: Improve human capital management.

Human capital management is a critical component of Federal Student Aid's current business operations and future initiatives. Federal Student Aid continues to grow as an organization that empowers individuals to perform at a high level of effectiveness and efficiency. Federal Student Aid is utilizing innovative hiring and employee development techniques aimed at attracting and retaining highly qualified individuals to create a more productive, results-oriented workforce. Additionally, the organization is committed to workforce development and training to ensure a skilled and highly qualified professional workforce.

In FY 2008, Federal Student Aid began to develop and implement a succession strategy to "build leaders at all levels." The organization dedicated itself to recruiting young leaders and training the workforce in the fundamentals of our business and other mission-critical areas, building a strong bench of current and future leaders, and aligning staff in organization structures designed for high performance.

In FY 2008, Federal Student Aid successfully:

- Developed a framework that defines leadership competencies needed for non-supervisors, first-line supervisors, managers, and executives.
- Continued to build leadership knowledge and skills at all levels of the organization, training nearly all (96%) of our new supervisors in our "home grown" Cornerstones of Supervision Program and nearly all (96%) of our experienced managers in a range of leadership development programs, classes or workshops.
- Developed workshops, delivered by subject matter experts in the agency, to provide employees a working knowledge of the awareness and application phases of the Federal Student Aid process.
- Examined and evaluated current organization structures to maximize mission accomplishment and accountability in three major business units of Federal Student Aid.
- Developed and launched a study examining position classification in Federal Student Aid, particularly in the Management Analyst series.
- Developed and delivered training to Federal Student Aid supervisors to help them manage and motivate employees and ensure accountability. Topics included overviews of labor relations, and equal employment opportunity functions, development of meaningful performance standards, delivery of meaningful performance feedback and execution of time and attendance responsibilities.
- Facilitated focus group meetings with employees within the business unit responsible for program compliance to identify ways to improve the conduct of performance management activities and to develop business-specific performance benchmarks.
- Launched the development of an automated Web-based system for processing employee applications to participate in teleworking activities that help balance work/life challenges and improve the agency's ability to manage and report on the program effectively.

Performance Standards and Results

The performance standard for improving human capital management measures Federal Student Aid's ability to maintain a skilled and knowledgeable workforce. Specifically, the performance measures will identify our mission-critical competencies, identify where current or potential weaknesses exist and identify training plans for individuals to further develop competency/skills/knowledge.

Objective 4 Performance Metrics and Results

Metric	FY 2005	FY 2006	FY 2007	FY 2008 (Target)	FY 2008 (Actual)	Performance
Use Training Resources to Develop a Highly Skilled Workforce to Ensure Competency in Mission Critical Skills/Knowledge	*	Leadership: Trained 100% of New Supervisors and 52% of Current Supervisors	Leadership: Trained 95% of New Supervisors and 60% of Current Supervisors	Leadership: Train 95% of New and 65% of Current Supervisors	Leadership: Trained 96% of New and 96% of Current Supervisors	Target Met
	*	Acquisitions: Trained 100% of Contracting Officials	Acquisitions: Trained 100% of Contracting Officials	Acquisitions: Train 100% of New & Current Contracting Officials	Trained 100% of Contracting Officials	Target Met
	*	Project Management: Trained 100% of Key IT Project Managers	Project Management: Trained 75% of Key IT Project Managers	Project Management: Train 75% of Key IT Project Managers	Trained 67% of Key IT Managers	Target Not Met
	*	Federal Student Aid Business Knowledge: Trained 90% of New Employees	Federal Student Aid Business Knowledge: Trained 100% of New Employees	Federal Student Aid Business Knowledge: Train 90% of New Employees	Trained 89% of New Employees	Target Not Met
		Trained 100% of School Compliance Officials	Trained 100% of School Compliance Officials	Trained 80% of School Compliance Officials	Trained 76% of School Compliance Officials	
		Trained 40% of General Workforce	Trained 100% of General Workforce	Trained 50% of General Workforce	Trained 34% of General Workforce	

Refer to next page for notation "*".

Data Quality: Data was obtained from training class rosters and attendance records.
Analysis of Progress: Leadership training of new supervisors was successfully completed, in part, because of communications/marketing with both prospective participants and their supervisors; the program is on-site and discussions focus on real-time issues in the organization. Targets for training current supervisors were met/exceeded in part because off-site programs are supported by a central fund, certain business units arranged for training of intact management teams, and, in 2008, supervisors were required to attend customized training on internal controls. Training and certification requirements for acquisitions and project managers have recently been formalized – and increased – throughout the government community. Targets for acquisitions were met. Targets for project management were not met as project managers struggled to meet the new training requirements while at the same time carried the day-to-day project management workload that competes for their time and attention. Targets were not met for training in the business of Federal Student Aid; money was not available for some new regional employees to travel to headquarters for orientation; school officials had competing workload/ priorities that prevented them from attending training; and given the current workload, and the over-estimate of employees who would complete the on-line Federal Student Aid business overview course, the target of 50% for the general workforce was too high.
Target Context: In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the 2006 and the 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets – while developed – were not generally published for FY 2007 or FY 2008. In this report, Federal Student Aid will report its progress primarily against FY 2008 targets that until now may not have been previously published. All targets referenced in this report – whether previously published or not – are aligned with the 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

* Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established.

Objective 5: Improve products and services to provide better customer service.

Federal Student Aid is dedicated to improving products and services for students and their families and program participants such as schools, lenders and guaranty agencies. Being aware of the customer concerns is a critical component of our efforts to improve federal student aid products and services. Federal Student Aid is committed to reducing the complexity of our products and services ensuring compliance is maintained and promoting increased self-service opportunities for customers. In addition, Federal Student Aid will continue to develop strategies to provide integrated solutions for customers.

In response to the Secretary of Education's call for accessibility, affordability and accountability in higher education, Federal Student Aid has been charged with implementing key recommendations to make the financial aid process easier for students and families. In FY 2008, Federal Student Aid began to implement application enhancements to the FAFSA and FAFSA4caster to meet the needs of America's diverse population. Additionally, Federal Student Aid played a critical role in the development and launch of http://www.college.gov, a Web site designed by and for students to motivate and inspire them to pursue a postsecondary education and equip them with the planning and payment information they needed to get to college. To increase greater awareness about the availability of student financial assistance, Federal Student Aid also established a series of public service announcements via a nationwide campaign and continued to provide a problem resolution resource via our Federal Student Aid Ombudsman.

The CCRAA established the TEACH Grant Program, which Federal Student Aid implemented in FY 2008, providing up to $4,000 per year to students agreeing to teach math, science, or other specialized subjects in a high-poverty school. Federal Student Aid continues to explore new ways to ensure that access, information and resources about student financial assistance meet the needs of today's students.

In FY 2008, Federal Student Aid successfully:

- Developed a Web site to provide guidance to participants in the Loan Purchase Programs to ensure students and families can continue to access federal student loans.
- Implemented the TEACH Grant Program, providing up to $4,000 per year to students agreeing to teach math, science, or other specialized subjects in a high-poverty school for at least four years within eight years of their graduation.
- Developed and launched http://www.college.gov, a unique student-focused Web site that inspires and motivates high school students to go to college and provides practical advice on planning and paying for college.
- Implemented several enhancements to the FAFSA application to make it easier for students and families, including a real-time Personal Identification Number, a simplified Student Aid Report, a PDF FAFSA and Spanish versions of all FAFSA materials.
- Piloted the FAFSA on the Phone application for applicants with limited Internet access.
- Enhanced the FAFSA4caster to allow the applicant to transfer data from the FAFSA4caster to the FAFSA for the students' 2008–09 school year.
- Launched a real-time American Customer Satisfaction Index (ACSI) survey from *FAFSA on the Web* sm to provide real-time feedback to enhance the customer's application experience.
- Developed a Natural Disaster Web site providing guidance to students and schools in hurricane and other natural disaster-impacted areas.
- Continued the multi-year enterprise communications strategy that was launched in FY 2005 to better articulate the benefits of postsecondary education, raise awareness of federal student financial assistance programs and improve consistency across all communications to its many stakeholders, including currently underserved communities.
- Launched the "My Story" public service campaign in January 2008, resulting in approximately 75,000 television airings generating nearly 890 million impressions worth an estimated $32.2 million and over 90,000 radio airings generating over 250 million impressions worth almost $11.2 million.
- Resolved 19,000 disputes through the Ombudsman's office in FY 2008.
- Scored in the "excellent" or "good" range in the FY 2008 ACSI ratings for Federal Student Aid's highest volume products and services – including Direct Loan Servicing, FAFSA on the Web and the Lender Reporting System.

Performance Standards and Results

The following performance standards were established to measure Federal Student Aid's success in meeting and exceeding customer service goals. Specifically, success is realized with continuous improvement in customer satisfaction scores for the four main systems.

Objective 5 Performance Metrics and Results

Metric	FY 2005	FY 2006	FY 2007	FY 2008 (Target)	FY 2008 (Actual)	Performance
Student Aid Application	81	80	80	83	83	Target Met
School Origination and Disbursement	76	77	81	81	NA*	T
Lender Payment Processing	72	71	75	75	77	Target Met
Direct Loan Borrower Servicing	76	79	80	80	80	Target Met

Data Quality: The ACSI survey is conducted annually on Federal Student Aid's major programs. The index provides a national, cross-industry, cross-public-and-private sector economic indicator, using widely accepted methodologies to obtain standardized customer satisfaction information. Survey scores are indexed on a 100-point scale. This index has been tracked annually since 1999, with the exception of FY 2002.

Analysis of Progress: The FY 2008 ACSI ratings for Federal Student's highest volume products and services – including Direct Loan Servicing, FAFSA on the Web, and the Lender Reporting System – score in the "Excellent" or "Good" range in comparison to other entities that appear in the ACSI index. According to Claes Fornell International Group who partners with National Quality Research Center and the American Society for Quality in conducting the survey, companies with "business to business" customers scoring between 75 and 84 points on the index and businesses with "business to consumer" customers scoring between 80 and 90 are considered "Excellent". These categories include such companies as UPS, Amazon and Mercedes.

Target Context: In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the 2006 and the 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets – while developed – were not generally published for FY 2007 or FY 2008. In this report, Federal Student Aid will report its progress primarily against FY 2008 targets that until now may not have been previously published. All targets referenced in this report – whether previously published or not – are aligned with the 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

*Since significant progress has been made in the School Origination and Disbursement metric, rising from an ACSI of 66 in 2003 to an 81 in 2007, the ACSI tracking of School Origination and Disbursement was discontinued. As a result, we will not report on this metric in future performance reports.

Major Obstacles

During FY 2008, Federal Student Aid was faced with many challenges as the organization worked to fulfill its mission and meet its strategic objectives. Most notably was the disruption to the credit markets and its impact on FFEL Program lenders. However, there were several other planned and unplanned obstacles that diverted much-needed human and capital resources from our central mission. In addition to the Federal Student Aid related challenges outlined in the Inspector General's Discussion of Management Challenges included in the Department's PAR, the following is a brief summary of the major obstacles faced by Federal Student Aid in FY 2008.

Disruption in Credit Markets

In early 2008, the Department began to notice the early stages of what would become a global financial crisis that could have impacted the availability of student loans. In May 2008 Congress passed and the President signed the ECASLA. The legislation provides the Department with new authority to address concerns about capital liquidity in the student loan market.

Based on the authority granted her by the ECASLA, the Secretary of Education announced a comprehensive plan to ensure that all eligible students would have access to federal student loans for the upcoming academic year. That plan includes the development of the Loan Purchase Programs, two new programs to purchase FFEL Program loans or interests in FFEL Program loans from lenders for the 2008–09 academic year. The President recently signed H.R. 6889, the extension of the ECASLA, extending these programs through the 2009–10 award year. At the time this report was prepared, details of the extension had not been completed.

Federal Student Aid, working with colleagues from across the Department and the federal government, developed the processes and systems necessary to launch these programs by the mid-August peak loan period. These programs were launched in August and, to date, have funded approximately 40% of FFEL disbursements for the 2008–09 academic year totaling over $5 billion through the end of the federal fiscal year.

Another component of the Secretary's plan was an enhanced LLR program. Statutory and regulatory authority in the FFEL Program provides for loan access in extraordinary circumstances through a LLR Program. Under LLR, FFEL loans are made by existing FFEL lenders or by FFEL guaranty agencies using their own funds. In certain circumstances, there is authority to advance guaranty agencies federal funds from which they can make LLR loans. Federal Student Aid worked with guaranty agencies to ensure that the necessary processes and plans are in place. No LLR advances were made in FY 2008 and no advances are anticipated in FY 2009.

9.5 Percent Special Allowance Payment

Section 438 of the HEA authorizes a quarterly payment by the government to eligible FFEL Program lenders of a subsidy, called a special allowance payment (SAP), on certain FFEL loans. The HEA provides a separate SAP rate for certain loans that were "made or purchased with funds obtained by the holder from the issuance of obligations, the income from which is exempt from taxation under the *Internal Revenue Code of 1986* or with specific sources derived from those funds." In general, the SAP rate for such loans is one-half the rate that would be paid on other loans. However, such loans are subject to a minimum SAP rate of 9.5 percent from which the applicable interest is subtracted.

As interest rates began to fall, ultimately reaching historic lows in 2004, 9.5 percent SAP loans were earning returns in excess of other federal student loans. Because lenders generate earnings from the spread between the yield they receive on their student loan portfolio and the cost of funding these loans, when interest rates are low, 9.5 percent SAP loans provided greater returns than similar loans paid under the usual SAP rates. As a result, some lenders began to look for ways to expand their portfolio of loans eligible for this subsidy.

In January 2007, the Department issued a Dear Colleague Letter (DCL) FP-07-01 immediately suspending, effective October 1, 2006, any future 9.5 percent SAP payments until the Department could verify the first-generation and second-generation eligibility of loans for which participating lenders were billing the Department for 9.5 percent SAP subsidies. To identify those loans that met this eligibility criteria, the Department's Offices of the General Counsel, Postsecondary Education and Federal Student Aid working with the OIG devised a way to identify which loans currently billed for SAP at the 9.5 percent rate could be considered eligible for SAP at that rate. In April 2007, the Department issued DCL FP-07-06 outlining the OIG audit requirements a lender must follow in order to determine which loans were first-generation and second-generation loans and therefore eligible for 9.5 percent SAP for the quarter ending December 31, 2006 and subsequent quarters. The Department's OIG drafted the *Auditor's Guide* to implement the established methodology to identify first-generation and second-generation loans. As a result, 15 lenders submitted to an audit of their loan portfolio to determine which loans were first-generation and second-generation loans and therefore eligible for 9.5 percent subsidies for the quarter ending December 31, 2006 and subsequent quarters. The OIG and Federal Student Aid worked with the auditors to provide technical and programmatic guidance, and have conducted oversight of the audit process by reviewing the audit reports and conducting quality control reviews of the auditors' work. As a result, both the OIG and Federal Student Aid have expended considerable resources in FY 2008 providing oversight to ensure SAP was paid at the appropriate rate.

Inducements and Borrower Choice

Under the HEA a borrower attending a school that participates in the FFEL Program must be allowed to choose their FFEL lender. A school may not refuse to certify a FFEL loan based upon the borrower's choice of lender or guaranty agency. A school may not coerce a borrower, directly or indirectly, to choose a particular lender. A FFEL lender may not have any agreements, or engage in activities, with a school in the FFEL Program that prevents or impedes a borrower from exercising the right to choose a FFEL lender. Also, under the HEA an eligible lender may not offer, directly or indirectly, points, premiums, payments, or other inducements to secure applicants for loans made under the FFEL Program.

In October 2006, Federal Student Aid supported colleagues from the Office of Postsecondary Education in negotiating with representatives of the lending and higher education communities new rules that strengthened and created new regulations on prohibited inducements and ensuring a borrower's choice of lender. In addition to the committee deliberations, Secretary of Education Margaret Spellings formed a Task Force in April 2007 that made specific recommendations to eliminate unethical practices and further safeguard the integrity of our student aid system. These recommendations led to strengthened regulations around "preferred lender lists" by requiring a minimum of three lenders and providing full disclosure of the method and criteria used to select lenders. These regulations were issued in November 2007 and became effective July 1, 2008.

In April 2007, Federal Student Aid began performing on-site reviews of 44 schools and 26 lender/eligible lender trustee relationships for which inappropriate practices had been recently alleged to determine if there had, in fact, been violations of the anti-inducement provisions of the HEA.

In June 2007, Federal Student Aid sent letters to 921 schools where 80 percent or more of their FFEL loans were issued from one lender. This letter reminded the schools that the statutory and regulatory provisions governing the FFEL Program allow a borrower to choose their FFEL lender and prohibit a school from refusing to certify a FFEL loan based upon the borrower's choice of lender or guaranty agency or from coercing, directly or indirectly, a borrower to choose a specific lender.

In October 2007, Federal Student Aid mailed letters to 55 schools (from the list of 921 schools) that had significant annual loan volume and a large percentage of the school's loan volume with a single lender. Letters were also mailed to 23 FFEL lenders affiliated with those schools. In the letters to the schools and the lenders, we requested that they provide the Department with information about:

- Agreements between the schools and other FFEL participants (lenders, guaranty agencies or their subsidiaries or partners).
- Remuneration paid to school officials by FFEL participants.
- Financial transactions between schools and FFEL participants.
- Program compliance policies and procedures.
- Program decision making policies regarding preferred lender lists and school incentives.

These letters were sent to request information to help determine if there had been any violations of the prohibition against improper inducements or improper restrictions on the choice of lender by borrowers. Upon receipt and review of the information provided, we requested additional information. In most cases, we have determined that there had not been a violation of the statute or regulations that existed at the time. We continue to monitor lender and school relationships under the new regulations.

Natural Disasters

In August and September 2008, Hurricanes Gustav and Ike struck the Gulf Coast impacting students and schools in those regions. In preparation for these storms, Federal Student Aid published an electronic announcement on the Information for Financial Aid Professionals Web site http://www.ifap.ed.gov alerting schools that we were monitoring situations in the Gulf Coast region. We provided schools with contact information at the Department should they be impacted by the storm. We also announced the establishment of a Web site http://ww.ifap.ed.gov/disaster.html which schools could use to report alternate contact information as well as access updates on Departmental support and policy changes should they be necessary.

In addition, for those counties in hurricane-affected areas designated for assistance by Federal Emergency Management Agency, Federal Student Aid automatically implemented requirements of DCL Gen-04-04 for any school that requested it. This included providing administrative relief in the form of an extension of September 30 deadlines to close out Pell, ACG and SMART grant programs for the year as well as an extension to file their Fiscal Operations Report and Application to Participate. In addition, for any school that contacted the Department, we were authorized to provide an automatic loan deferment for students attending those schools.

In FY 2009, Federal Student Aid will develop a comprehensive strategy to better assist schools, students and borrowers impacted by eligible natural disasters.

Budgetary Impact

Funding for student aid administration totaled $696 million for FY 2008. Ensuring the uninterrupted availability of student loans through both increased Direct Loan volume and the creation of emergency loan purchase and participation initiatives resulted in substantial unanticipated administrative costs. To fund these unexpected activities, the Department reduced FY 2008 expenditures in other areas by deferring planned projects, enacting a hiring freeze, and eliminating discretionary initiatives. In addition, in July 2008 the Administration submitted a budget amendment to Congress requesting an additional $50 million above the FY 2009 President's Budget level to support student aid administrative activities. Under current estimates these additional funds would be more than offset by savings generated by the loan purchase and participation initiatives.

Performance Plan Items Reported as Incomplete or Cancelled

Following is a summary of the items on the FY 2008 Performance Plan reported as incomplete or cancelled as of September 30, 2008.

FY 2008 Performance Plan **Projects Incomplete or Cancelled as of September 30, 2008**	
Project Name and Number	Reason for “Red” Rating
Assist in testing and implementing PM portion of IPM *(Project 4.6)*	Federal Student Aid terminated the Integrated Partner Management development contract with Perot Systems in late September, as the contractor was unable to meet the implementation schedule.
Update Federal Student Aid’s Five-Year Performance Plan for FY 2008 – 2012 and plan for the following year update, if appropriate *(Project 9.5)*	An FY 2008 update was not released as the strategy was under review. However in FY 2009, Federal Student Aid will issue a Five-Year Plan for FY 2009 – FY 2013.
Provide high-quality, timely human resources operations support service *(Project 9.17)*	The Mission Critical Occupation hiring proficiency is reported at 88%, the minimally successful range for the Principal Operating Component Assessment Organizational scoring. Due to budget constraints, a hiring freeze has been in effect since early July. Since that time, all pending recruitment actions have been cancelled.
Provide Project Management Educational Opportunities *(Project 10.6)*	Decision was made not to proceed with requirements training until a requirements management process was in place. Funds were added to the training development task order to have the vendor write a requirements management process. Once approved, work on the training material will resume.
Implement the Integrated Partner Management Solution *(Project 20.9)*	Federal Student Aid terminated the Integrated Partner Management development contract with Perot Systems in late September, as the contractor was unable to meet the implementation schedule.
Implement the Master Person Record Management Service (PRMS) *(Project 20.18)*	Although the high-level integration strategy and transition plan was completed in FY 2008, the awarding of the initial component to build the detailed requirements and design documents was not completed in FY 2008 due to a lack of resources and support.
Implement EDSS Model *(Project 20.28)*	Protests on the procurements delayed the process significantly.
Develop and implement Cyber Security Program *(Project 20.27)*	Approval of cancellation request pending.
Establish a new Business Liaison function within CIO *(Project 20.25)*	Project was cancelled due to competing priorities and lack of available resources.
Procure the Portfolio/Program/Project Management Support Vendor Pool (component of Enterprise Development Support Services) *(Project 20.31)*	Protests on the procurements delayed the process significantly.

Legislative and Regulatory Recommendations

Key among Federal Student Aid's mission responsibilities is the task of developing legislative recommendations. These recommendations customarily center on improving and simplifying the Title IV programs, minimizing administrative costs and improving program integrity. Our recommendations inform the Department's policymaking process, including its activities and decisions related to the reauthorization of the HEA and its reaction to the financing difficulties for the FFEL student lending programs. These activities are usually accomplished by direct contact with colleagues in the Department's Office of Postsecondary Education and the Office of the Under Secretary at both the senior policy level and at a staff level. These efforts, while primarily carried out by Federal Student Aid's Policy Liaison and Implementation Staff, also involve other Federal Student Aid offices and senior managers. While a portion of this policy advising is accomplished on an ongoing, informal daily basis, Federal Student Aid staff contributed to policy decision-making in a more formalized way related to among other things legislation to address student loan financing issues and development of a simplified federal student aid process as requested by the Secretary.

Annual Bonus Awards

As of the end of FY2008, there were 49 Federal Student Aid senior managers. In addition, there were 12 Senior Executive Service staff. Three of the 49 senior managers and three of the 12 Senior Executive Service staff served on the Federal Student Aid Executive Leadership Team and reported directly to the Chief Operating Officer. The remaining 46 senior managers and nine Senior Executive Service staff served in a variety of senior positions and capacities within Federal Student Aid.

In FY 2008, the Acting Chief Operating Officer achieved a performance rating of Outstanding. While the Acting COO received a salary for his role as the Department's Chief Financial Officer, he did not receive any additional compensation for the responsibilities he assumed as Federal Student Aid's Acting COO, and he did not receive a bonus for his work at Federal Student Aid.

FY2008 performance ratings and awards for Federal Student Aid senior managers and Senior Executive Service staff were not finalized at the time this report was prepared.

At the end of FY2007, there were 57 Federal Student Aid senior managers. In addition, there are 12 Senior Executive Service staff. Six of the 57 senior managers and two of the 12 Senior Executive Service staff served on the Federal Student Aid Executive Leadership Team and reported directly to the Chief Operating Officer. The remaining 51 senior managers and 10 Senior Executive Service staff served in a variety of senior positions and capacities within Federal Student Aid.

For FY2007, ratings and awards for 48 of the 51 senior managers who did not serve on the Executive Leadership Team last year were as follows: 17 achieved a performance rating of Outstanding, 20 achieved a performance rating of Highly Successful, 11 achieved a performance rating of Fully Successful. Three senior managers were not eligible for a rating.

Award amounts for those achieving an Outstanding rating ranged from a low of $5,791 to a high of $15,245, with a median award of $9,892. Award amounts for those achieving a Highly Successful rating ranged from a low of $2,830 to a high of $10,000, with a median award of $6,844. Those receiving a rating of Fully Successful were not eligible for an award.

FY 2007 approved ratings and awards for the eight members of the Executive Leadership Team and the remaining 10 Senior Executive Service staff were as follows: four achieved a performance rating of Outstanding, 11 achieved a performance rating of Highly Successful, and three received a performance rating of Fully Successful.

Award amounts for those achieving an Outstanding rating ranged from a low of $13,743 to a high of $31,542, with a median award of $14,171. Award amounts for those achieving a Highly Successful rating ranged from a low of $7,187 to a high of $25,852, with a median award of $14,815. Those receiving a rating of Fully Successful were not eligible for an award.

For additional information, please refer to:

http://www.ed.gov/policy/highered/leg/hea98/sec101D.html.

Report of the Federal Student Aid Ombudsman

The Office of the Ombudsman in Federal Student Aid completed its ninth year of operation in FY 2008. Established by the HEA, the office uses informal dispute resolution processes to address complaints about Title IV financial aid programs. To effectively resolve problems identified by individual federal student aid recipients, the office applies a collaborative approach in working with institutions of higher education, lenders, guaranty agencies, loan servicers and other participants in student aid programs. Individual complaint data is compiled into the Ombudsman Case Tracking System. Information is summarized for internal and external reports for Federal Student Aid and the industry in general, and to identify systemic issues affecting Title IV programs. Implementation of systemic solutions can at times prevent problems, an approach preferable to resolving individual problems as they occur.

Information on the existence and role of the Office of the Ombudsman is disseminated to the industry and borrowers throughout the student aid life cycle. A plain language approach to the office's Web site, http://www.ombudsman.ed.gov, helps individuals resolve loan problems independently, learn about student aid information and resources, and submit issues or complaints electronically. The Office of the Ombudsman brochure is available electronically or in print, and is used by colleges and universities in helping students recognize the office as a resource after other service avenues are unsuccessful. The monthly Ombudsman Newsletter focuses on Ombudsman case activity and industry news.

Coordination with guaranty agencies and others is a crucial element in the effective resolution of complaints. Establishment of the Student Loan Ombudsman Caucus in 2007 provided an additional foundation for bringing interested parties together to discuss emerging industry trends, provide training, and develop aggregated information on systemic issues in 2008. In addition to meeting with Student Loan Ombudsman Caucus member agencies and others to identify and address issues common to the industry, the Office prepares tailored reports for individual agency use.

Since its inception, the Office of the Ombudsman has handled more than 138,500 complaints, including 19,006 in FY 2008, a 9% increase over FY 2007 and the highest number of new cases received in a fiscal year. The Office resolved more than 74% of FY 2008 issues within three days of the initial receipt, and took an average of approximately 120 days to resolve about 5,000 issues requiring additional research. Of the cases requiring additional effort, individual borrowers had an average of 12 loans. About 20% of those borrowers' loans are in default, 35% of the loans have been in repayment less than five years, and 78% of those loans are FFEL. As of September 30, 2008, the office has 1,610 open research cases, all of which are expected to be resolved in FY 2009.

In FY 2008, Loan Cancellation/Discharge issues represented the top problem area, and increased 20% over the previous fiscal year. Case analysis shows that more customers escalate Loan Cancellation/Discharge issues to Executive or Legislative offices than any other type of Ombudsman issue, demonstrating that more emphasis is needed on early resolution of these cases. The most common problem within the Loan Cancellation/ Discharge category relates to Total and Permanent Disability (TPD) with more than 600 individuals objecting to the handling of their disability discharge requests. Review of TPD cases reveals that undue process complexity, lack of transparency and applicant burden are significant problems. In FY 2008, Ombudsman representatives participated in a task force to evaluate and improve disability discharge procedures. The Conditional Disability Discharge Task Force used analyses of Ombudsman TPD cases to inform decisions on procedural changes. Ombudsman and Borrower Services staff met with the Social Security Administration to develop a better understanding of the disability benefits program and to explore ways in which elements of their process could be used in streamlining Federal Student Aid's program. Significant increases in Federal Student Aid Ombudsman cases in three other issue areas suggest that current economic conditions may be adversely affecting student loan borrowers. When compared to last year, FY 2008 saw noticeable increases in cases relating to Default (+50%), Repayment Plans/Amounts (+28%), and Account Balance (+21%).

Recent Congressional action appears to have contributed to a significant reduction in Ombudsman cases in the Loan Consolidation issue area. Loan Consolidation cases, the most common borrower issue in FY 2007, declined 62% in FY 2008. The number of customers who complained about deceptive business practices by consolidation loan marketers declined as did the number who wanted to reverse their consolidation loans.

A key Ombudsman emphasis in FY 2008 was on producing periodic, in-depth analyses of specific issues such as *General Assistance* inquiries and *Total and Permanent Disability* cases to determine the issues' root causes and to identify potential process improvements. In addition, the Ombudsman participated in ongoing communication with the Federal Trade Commission regarding deceptive student loan practices and collaborated with the Federal Trade Commission and other Federal Student Aid offices in developing the fact sheet "Student Loans: Avoiding Deceptive Offers". This fact sheet can be found at http://www.ombudsman.ed.gov/CRE43-studentloans3.pdf.

The Ombudsman also coordinated with other agencies in emphasizing comprehensive service as appropriate for specific needs. Specialized projects included finalizing student loan discharges for more than 100 Hurricane Katrina victims whose loans were overlooked in initial discharge efforts. Another emphasis was on enhancing the sensitivity and efficiency of all Federal Student Aid offices in working with military service members and their families.

Throughout FY 2008, the Ombudsman responded to numerous inquiries received from Executive (i.e., White House, Secretary, Chief Operating Officer, etc.) and Legislative offices. New cases referred through Congressional offices increased by 40% from the previous year.

The Federal Student Aid Ombudsman Office measures customer satisfaction, in part, through independently conducted telephone surveys following case closure. Closed cases are chosen at random, and customers are asked to rate service accessibility, Ombudsman representatives' knowledge, timeliness of case resolution, level of satisfaction with the resolution, and overall service. On a scale of 1 - 5, with 5 the highest rating, survey results are calculated weekly and cumulatively for the fiscal year. Only ratings of 4.0 or higher meet the Ombudsman customer satisfaction performance goal. The average FY 2008 customer satisfaction rating was 4.46. Customers also write or call independently to express appreciation for assistance from the Office.

Financial Section

Message from the Chief Financial Officer

John W. Hurt, III
Chief Financial Officer

During fiscal year 2008, Federal Student Aid continued efforts to maintain its high standards of financial management and fiscal reporting related to the postsecondary education programs. These efforts were made not only by our staff, but also by our schools, lenders, and guaranty agencies. All of us take great pride in helping so many people further their education, especially during the recent challenging economic times. Highlights of these successful efforts over the last year included:

- An unqualified opinion was received on the principal financial statements for the seventh consecutive year, demonstrating a clear pattern of financial accountability.
- No material weaknesses were identified as part of our Report on Internal Control for the sixth consecutive year.
- Reasonable assurance was provided of our internal controls over financial reporting.
- New loan access initiatives were and continue to be successfully implemented.

The new loan access initiatives are being implemented in accordance with the *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA). ECASLA* was enacted in response to student lending issues that arose and has resulted in a significant cash infusion to the student loan marketplace. These initiatives include the following:

- FFEL Loan Participation Purchase Program.
- FFEL Loan Purchase Commitment Program.

These major loan access initiatives are being implemented thus far without an increase to our Student Aid Administration budget or staff levels. These same staff also supported the delivery of approximately $96 billion in grant, work-study, and loan assistance to almost 11 million postsecondary students and their families in FY 2008, an increase of over $13 billion in aid from last fiscal year.

Through cooperative efforts among the Department's Office of the Chief Financial Officer, Budget Service, and Federal Student Aid, the Department continued to correct the three significant deficiencies in credit reform estimation, program monitoring, and information systems controls that were identified by auditors in the FY 2007 "Report on Internal Controls". As a result of these concerted efforts, in the FY 2008 Internal Control Report the auditors recognized improvements in all three areas and removed the program monitoring deficiency as a significant deficiency.

During FY 2008, Federal Student Aid continued to support the process to provide a Department-wide assurance statement on the effectiveness of internal control over financial reporting. This integrated process was based upon the requirements of OMB

Circular A-123, Appendix A, and required Federal Student Aid to perform the following tasks:

- Conduct internal risk assessments.
- Update its documentation of organizational and process hierarchies.
- Update its entity and process level control libraries.
- Reassess the effectiveness of its controls over financial reporting.
- Coordinate remediation activities and retesting.
- Report on status and results to the Department.

The successful results of this assessment effort are described further in the "Analysis of Federal Student Aid's Systems, Controls and Legal Compliance" section. We are pleased to report that, as a part of this integrated process, Federal Student Aid provided to the Department an unqualified statement of assurance on its internal control over postsecondary education financial reporting, and we will continue to strive to improve and strengthen the integrity of our financial management and reporting procedures.

John W. Hurt, III
Chief Financial Officer
November 17, 2008

Principal Financial Statements and Notes to Principal Financial Statements

...Consolidated Balance Sheet

United States Department of Education
Federal Student Aid
Consolidated Balance Sheet
As of September 30, 2008 and 2007

(Dollars in Millions)

	Fiscal Year 2008	Fiscal Year 2007
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 56,915	$ 58,141
Total Intragovernmental	56,915	58,141
Cash and Other Monetary Assets (Note 5)	1,663	1,103
Accounts Receivable, Net (Note 4)	83	36
Credit Program Receivables, Net (Note 6)	134,546	115,752
General Property, Plant and Equipment, Net	43	34
Other Assets	37	-
Total Assets (Note 2)	**$ 193,287**	**$ 175,066**
Liabilities:		
Intragovernmental:		
Accounts Payable	$ 2	$ -
Debt (Note 7)	128,256	103,893
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5)	1,663	1,103
Payable to Treasury (Note 6)	3,766	5,351
Other Intragovernmental Liabilities (Note 8)	7,022	190
Total Intragovernmental	140,709	110,537
Accounts Payable	1,128	756
Accrued Grant Liability (Note 9)	862	1,030
Liabilities for Loan Guarantees (Note 6)	43,322	50,874
Other Liabilities (Note 8)	67	23
Total Liabilities	**$ 186,088**	**$ 163,220**
Commitments and Contingencies (Note 15)		
Net Position:		
Unexpended Appropriations	$ 13,472	$ 14,420
Cumulative Results of Operations	(6,273)	(2,574)
Total Net Position (Note 10)	**$ 7,199**	**$ 11,846**
Total Liabilities and Net Position	**$ 193,287**	**$ 175,066**

The accompanying notes are an integral part of these statements.

...Consolidated Statement of Net Cost

United States Department of Education
Federal Student Aid
Consolidated Statement of Net Cost
For the Years Ended September 30, 2008 and 2007

(Dollars in Millions)

	Fiscal Year 2008	Fiscal Year 2007
Program Costs		
Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement		
Gross Costs	$ 28,788	$ 27,419
Less: Earned Revenue	9,029	7,911
Net Program Costs	19,759	19,508
Total Program Costs	**$ 19,759**	**$ 19,508**
Net Cost of Operations (Notes 11 & 14)	**$ 19,759**	**$ 19,508**

The accompanying notes are an integral part of these statements.

United States Department of Education
Federal Student Aid
Consolidated Statement of Changes in Net Position
For the Years Ended September 30, 2008 and 2007
(Dollars in Millions)

	Fiscal Year 2008		Fiscal Year 2007	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	**$ (2,574)**	**$ 14,420**	**$ (5,152)**	**$ 13,639**
Budgetary Financing Sources:				
Appropriations Received	$ -	$ 28,549	$ -	$ 29,484
Appropriations Transferred - in/out	-	-	-	(1)
Other Adjustments (rescissions, etc)	(3)	(1,300)	-	(844)
Appropriations Used	28,197	(28,197)	27,858	(27,858)
Donations and Forfeitures of Cash and Cash Equivalents	-	-	-	-
Nonexpenditure Financing Sources - Transfers-Out	(190)	-	-	-
Other Financing Sources:				
Imputed Financing from Costs Absorbed by Others	$ 8	-	$ 9	$ -
Others	(11,952)	$ -	(5,781)	-
Total Financing Sources	**$ 16,060**	**$ (948)**	**$ 22,086**	**$ 781**
Net Cost of Operations	**$ (19,759)**	**-**	**$ (19,508)**	**$ -**
Net Change	**$ (3,699)**	**$ (948)**	**$ 2,578**	**$ 781**
Ending Balances (Note 10)	**$ (6,273)**	**$ 13,472**	**$ (2,574)**	**$ 14,420**

The accompanying notes are an integral part of these statements.

United States Department of Education
Federal Student Aid
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2008 and 2007
(Dollars in Millions)

	Fiscal Year 2008		Fiscal Year 2007	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
Budgetary Resources:				
Unobligated balance, brought forward, October 1:	$ 4,449	$ 36,792	$ 4,387	$ 46,490
Recoveries of prior year Unpaid Obligations	1,447	3,115	1,356	3,043
Budgetary Authority:				
Appropriations	28,562	151	29,484	
Borrowing Authority (Note 13)		57,743		19,570
Spending authority from offsetting collections (gross):				
Earned				
Collected	1,638	33,510	1,691	37,019
Change in unfilled customer orders				
Without advance from Federal Sources				(30)
Subtotal	$ 30,200	$ 91,404	$ 31,175	$ 56,559
Nonexpenditure transfers, net, anticipated and actual			(1)	
Permanently not available	(2,058)	(16,835)	(1,845)	(19,429)
Total Budgetary Resources (Note 13)	**$ 34,038**	**$ 114,476**	**$ 35,072**	**$ 86,663**
Status of Budgetary Resources:				
Obligations incurred: (Note 13)				
Direct	$ 30,418	$ 87,959	$ 30,623	$ 49,871
Subtotal	$ 30,418	$ 87,959	$ 30,623	$ 49,871
Unobligated Balances:				
Apportioned	$ 1,166	$ 396	$ 2,504	$ 321
Subtotal	$ 1,166	$ 396	$ 2,504	$ 321
Unobligated Balance not available	2,454	26,121	1,945	36,471
Total Status of Budgetary Resources	**$ 34,038**	**$ 114,476**	**$ 35,072**	**$ 86,663**
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 12,485	$ 14,425	$ 11,584	$ 12,941
Uncollected customer payments from Federal Sources, brought forward, October 1				(30)
Total, unpaid obligated balance, brought forward, net	$ 12,485	$ 14,425	$ 11,584	$ 12,911
Obligation Incurred net (+/-)	30,418	87,959	30,623	49,871
Gross Outlays	(28,529)	(58,112)	(28,366)	(45,344)
Recoveries of prior year unpaid obligations, actual	(1,447)	(3,115)	(1,356)	(3,043)
Change in uncollected customer payments from Federal Sources (+/-)				30
Obligated Balance, net, end of period				
Unpaid Obligations	$ 12,927	$ 41,157	$ 12,485	$ 14,425
Uncollected customer payments from Federal Sources				
Total, unpaid obligated balance, net, end of period	**$ 12,927**	**$ 41,157**	**$ 12,485**	**$ 14,425**
Net Outlays				
Net Outlays:				
Gross Outlays	$ 28,529	$ 58,112	$ 28,366	$ 45,344
Offsetting collections	(1,638)	(33,510)	(1,691)	(37,019)
Distributed Offsetting receipts	(28)	(5,750)	(35)	(4,700)
Net Outlays (Note 13)	**$ 26,863**	**$ 18,852**	**$ 26,640**	**$ 3,625**

The accompanying notes are an integral part of these statements.

Notes to Principal Financial Statements
For the Years Ended September 30, 2008 and 2007

Note 1. Summary of Significant Accounting Policies

Reporting Entity

Federal Student Aid was created as a PBO within the Department under the HEA from previously existing Department student financial assistance programs. Federal Student Aid operates under the PBO mandate to develop a management structure driven by strong incentives to manage for results. Federal Student Aid's primary goal is to assist lower-income and middle-income students in overcoming the financial barriers that make it difficult to attend and complete postsecondary education. Federal Student Aid is responsible for administering direct loans, guaranteed loans, and grant programs.

The Direct Loan Program, added to the HEA by the *Student Loan Reform Act of 1993*, enables Federal Student Aid to make loans directly to eligible undergraduate and graduate students and their parents through participating schools. Federal Student Aid borrows money from the Treasury to fund the loans. The program provides interest subsidies for eligible borrowers.

The FFEL Program, initially authorized by the HEA, operates through state and private nonprofit guaranty agency agencies to provide loan guarantees and interest subsidies on loans made by lenders to eligible students.

Under the Direct Loan and FFEL Programs, loans are made to individuals who meet statutorily set eligibility criteria and attend eligible institutions of higher education—public or private two- and four-year institutions, graduate schools, and vocational training schools. Students and their parents, based on eligibility criteria, receive loans regardless of income or credit rating. Student borrowers who demonstrate financial need also receive federal interest subsidies.

The ECASLA amended the FFEL Program to authorize the Secretary to buy FFEL loans for the 2008–09 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 in which the Department purchases participation interests in FFEL loans.

The TEACH Grant Program was implemented beginning July 1, 2008. This program, added to the HEA by the CCRAA, 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.

Grant appropriations funding the Pell Grant Program and campus-based student aid programs enable Federal Student Aid to provide educational grants and other financial assistance to eligible applicants. Grants are not repaid to the federal government. The Pell Grant Program provides grant aid to low-income and middle-income undergraduate students. Awards vary in proportion to the financial circumstances of students and their families. The campus-based student aid programs provide educational grants and other financial assistance to eligible applicants. These programs include the Supplemental Educational Opportunity Grant, FWS, and Federal Perkins Loan Programs. Campus-based programs are not material to these statements and have been included with other programs reported under grant programs.

Basis of Accounting and Presentation

These financial statements have been prepared to report the financial position, net cost of operations, changes in net position and budgetary resources of the Federal Student Aid reporting group, as required by the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994*. The financial statements were prepared from the books and records of Federal Student Aid, in accordance with accounting principles generally accepted in the United States of America for federal entities, issued by the Federal Accounting Standards Advisory Board, and OMB Circular No. A-136 *Financial Reporting Requirements*, as revised June 2008. These financial statements are different from the financial reports prepared by the Department pursuant to OMB directives that are used to monitor and control Federal Student Aid's use of budgetary resources.

Federal Student Aid's financial statements represent the reporting group, Federal Student Aid, within the Department of Education, which is itself a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation providing resources and legal authority to do so.

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

Transactions and balances among Federal Student Aid funds have been eliminated from the Consolidated Balance Sheet.

Use of Estimates

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

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

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

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

Federal Student Aid and the Department use a computerized cash flow projection Student Loan Model to calculate subsidy estimates for the Direct Loan, FFEL, and TEACH Grant Programs. Each year, the Department re-evaluates the estimation methods related to changing conditions. Federal Student Aid and the Department use a probabilistic technique to forecast interest rates based on different methods to establish the relationship between an event's occurrence and the magnitude of its probability. The Department's approach estimates interest rates under numerous scenarios and then bases interest rates on the average interest rates weighted by the assumed probability of each scenario occurring. Probabilistic methodology facilitates the modeling of the Department's unique loan programs.

For each program, cash flows are projected over the life of the loans, aggregated by loan type, cohort year, and risk category. The loan's cohort year represents the year a direct loan was obligated or a loan was guaranteed, regardless of the timing of disbursements. Risk categories include two-year colleges, freshmen and sophomores at four-year colleges, juniors and seniors at four-year colleges, graduate schools, and proprietary (for-profit) schools.

Estimates reflected in these statements were prepared using assumptions developed for the FY 2009 Mid-Session Review, a government-wide exercise required annually by OMB. These estimates are based on the most current information available to Federal Student Aid and the Department at the time the financial statements were prepared. Assumptions and their impact are updated after the Mid-Session Review to account for significant subsequent changes in activity. Department management has a process to review these estimates in the context of subsequent changes in activity and assumptions, and to reflect the impact of changes, as appropriate.

Federal Student Aid and the Department recognize that cash flow projections and the sensitivity of changes in assumptions can have a significant impact on estimates. Management has attempted to mitigate fluctuations in the estimates by using trend analysis to project future cash flows. Changes in assumptions could significantly affect the amounts reflected in these statements. For example, a minimal change in the projected long-term interest rate charged to borrowers could change the current subsidy re-estimate by a significant amount. (See Note 6)

Budget Authority

Budget authority is the authorization provided by law for the Department and Federal Student Aid to incur financial obligations that will result in outlays. Federal Student Aid's budgetary resources include (1) unobligated balances of resources from prior years, (2) recoveries of prior-year obligations, and (3) new resources, which include appropriations, authority to borrow from Treasury, and spending authority from collections.

Unobligated balances associated with resources expiring at the end of the fiscal year remain available for five years after expiration only for upward adjustments of prior year obligations, after which they are canceled and may not be used. Unobligated balances of resources that have not expired at year-end are available for new obligations placed against them, as well as upward adjustments of prior year obligations.

Authority to borrow from Treasury provides most of the funding for disbursements made under the Direct Loan Program, Loan Purchase Commitment Authority, Loan Participation Purchase Authority, and TEACH Grant Program. Subsidy and administrative costs of the programs are funded by appropriations. Budgetary resources from collections are used primarily to repay Federal Student Aid's debt to Treasury. Major sources of collections include (1) principal and interest collections from borrowers, (2) related fees, and (3) interest from Treasury on balances in certain credit financing accounts that make and administer loans and guarantees.

Borrowing authority is an indefinite budgetary resource authorized under the Credit Reform Act. This resource, when realized, finances the unsubsidized portion of the

Direct Loan Program, Loan Purchase Commitment Authority, Loan Participation Purchase Authority, and TEACH Grant Program. In addition, borrowing authority is requested in advance of expected collections to cover negative subsidy. Treasury prescribes the terms and conditions of borrowing authority and lends to the financing account amounts as appropriate. Amounts borrowed, but not yet disbursed, are included in uninvested funds and earn interest. Treasury uses the same weighted average interest rates for both the interest charged on borrowed funds and the interest earned on uninvested funds. The Department may carry forward borrowing authority to future fiscal years provided that cohorts are disbursing loans. All borrowings from Treasury are effective on October 1 of the current fiscal year, regardless of when the Department borrowed the funds, except for amounts borrowed to make annual interest payments.

Assets

Assets are classified as either entity or non-entity assets. Entity assets are those that the Department has authority to use for its operations. Non-entity assets are those held by the Department but not available for use in its operations. The Department combines its entity and non-entity assets on the face of the balance sheet and discloses its non-entity assets in the notes. (See Note 2)

Fund Balance with Treasury

The Fund Balance with Treasury includes general, revolving, and other funds available to pay current liabilities and finance authorized purchases, as well as funds restricted until future appropriations are received. Treasury processes cash receipts and cash disbursements for Federal Student Aid. Federal Student Aid's records are reconciled with those of Treasury.

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

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts that are not apportioned for obligation during the current fiscal year and expired appropriations no longer available to incur new obligations. Obligated balances not yet disbursed include receivables for undelivered orders and unpaid expended authority. (See Note 3)

Accounts Receivable

Accounts Receivable are amounts due to Federal Student Aid from the public and other federal agencies. Receivables from the public result from overpayments to recipients of grants and other financial assistance programs, and disputed costs resulting from audits of educational assistance programs. Amounts due from other federal agencies result from reimbursable agreements entered into by Federal Student Aid with these agencies for various goods and services. Accounts receivable are reduced to net realizable value by an allowance for uncollectible amounts. Estimates for the allowance for loss on uncollectible accounts are based on historical data. (See Note 4)

Cash and Other Monetary Assets

Cash and Other Monetary Assets consist of guaranty agency reserves that represent the federal government's interest in the net assets of state and nonprofit FFEL Program guaranty agencies. Guaranty agency reserves are classified as non-entity assets with the public (See Notes 2 and 5) and are offset by a corresponding liability due to Treasury. Guaranty agency reserves include initial federal start-up funds, receipts of federal reinsurance payments, insurance premiums, guaranty agency share of collections on defaulted loans, investment income, administrative cost allowances, and other assets.

Section 422A of the HEA required FFEL guaranty agencies to establish a Federal Student Loan Reserve Fund (Federal Fund) and an Operating Fund by December 6, 1998. The Federal Fund and the non-liquid assets developed or purchased by a guaranty agency, in whole or in part with federal funds, are the property of the United States and reflected in the *Budget of the United States Government*. However, such ownership by the federal government is independent of the actual control of the assets. Payments to the Department from guaranty agency Federal Funds, which increase Fund Balance with Treasury, are remitted to Treasury at fiscal year-end.

Federal Student Aid and the Department disburse funds to a guaranty agency. A guaranty agency, through its Federal Fund, pays lender claims and default aversion fees. The Operating Fund is the property of the guaranty agency except for amounts an agency borrows from the Federal Fund (as authorized under Section 422A of the HEA). The Operating Fund is used by the guaranty agency to fulfill responsibilities that include repaying money borrowed from the Federal Fund, and performing default aversion and collection activities.

Credit Program Receivables, Net and Liabilities for Loan Guarantees

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

Credit program receivables for the Loan Purchase Commitment Authority and Loan Participation Purchase Authority include the present value of future cash flows related to the participation agreements or purchased loans. Subsidy is transferred, which may be prior to purchasing loans, and is recognized as subsidy expense in the Statement of Net Cost. The cash flows of these authorities also include inflows and outflows associated with the underlying or purchased loans and other related activities including any positive or negative subsidy transfers.

Components of subsidy costs for loans and guarantees include defaults (net of recoveries), contractual payments to third-party private loan collectors who receive a set percentage of amounts collected, and, as an offset, origination and other fees collected. For direct loans, the difference between interest rates incurred by the Department and Federal Student Aid on its borrowings from Treasury and interest rates charged to target groups is also subsidized (or may provide an offset to subsidy if the Department's rate is less). The corresponding interest subsidy in loan guarantee programs is the payment of interest payment of interest supplements to third-party lenders in order to pay down the interest rates on loans made by those lenders. Subsidy costs are recognized when direct loans or guaranteed loans are disbursed to borrowers and re-estimated each year. (See Note 6)

General Property, Plant and Equipment

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

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

Depreciable Property and Equipment
(In Years)

Major Class	Useful Life
Information Technology, Internal Use Software and Telecommunications Equipment	3
Furniture and Fixtures	5

Liabilities

Liabilities represent actual and estimated amounts to be paid as a result of transactions or events that have already occurred. However, no liabilities can be paid by Federal Student Aid or the Department without budget authority. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources, and there is no certainty the appropriation will be enacted. The government acting in its sovereign capacity can abrogate liabilities that arise from activities other than contracts. FFEL Program and Direct Loan Program liabilities are entitlements covered by permanent indefinite budget authority. (See Note 8)

Debt

The Department borrows to provide funding for the Direct Loan Program, Loan Purchase Commitment Authority, Loan Participation Purchase Authority, and TEACH Grant Program. The liability to Treasury from borrowings represents unpaid principal at year-end. Federal Student Aid repays the principal based on available fund balances. Interest on the debt is calculated at fiscal year-end using rates set by Treasury, with such rates generally fixed based on the rate for 10-year Treasury securities. As discussed in Note 6, the interest received by Federal Student Aid from borrowers will vary from the rate paid to Treasury. Principal and interest payments to Treasury are made annually. (See Note 7)

Accrued Grant Liability

Disbursements of grant funds are recognized as expenses at the time of disbursement. However, some grant recipients incur expenditures prior to initiating a request for disbursement based on the nature of the expenditures. A liability is accrued by Federal Student Aid for expenditures incurred by grantees prior to their receiving grant funds to cover the expenditures. The amount is estimated using statistical sampling techniques. (See Note 9)

Net Position

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

Personnel Compensation and Other Employee Benefits

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

Retirement Plans and Other Retirement Benefits. Employees participate either in the Civil Service Retirement System (CSRS), a defined benefit plan, or in the Federal Employees Retirement System (FERS), a defined benefit and contribution plan. For CSRS employees, the Department contributes a fixed percentage of pay.

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

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

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

The FECA liability consists of two components. The first component is based on actual claims paid and recognized by the Department as a liability. Generally the Department reimburses Labor within two to three years once funds are appropriated. The second component is the estimated liability for future benefit payments based on unforeseen events such as death, disability, medical and miscellaneous costs. Labor determines this component annually, as of September 30, using a method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value using OMB economic assumptions for 10-year Treasury notes and bonds. To provide for the effects of inflation on the liability, wage inflation factors (i.e., cost-of-living adjustments) and medical inflation factors (i.e., consumer price index medical adjustments) are applied to the calculation of projected future benefit payments. These factors are also used to adjust historical benefit payments and to adjust future benefit payments to current-year constant dollars. A discounting formula is also used to recognize the timing of benefit payments as 13 payments per year instead of one lump sum payment per year.

The estimated projections are evaluated by Labor to ensure that the resulting projections are reliable. The analysis is based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in charge back year 2008 to the average pattern observed during the most recent three charge back years, and (4) a comparison of the estimated liability per case in the 2008 projection to the average pattern for the projections of the most recent three years.

A portion of the estimated liability for disability benefits assigned to the Department under the FECA Program is accrued by Federal Student Aid. The accrual is based on the present value of estimated net future payments by Labor.

Intragovernmental Transactions

Federal Student Aid's financial activities interact with and are dependent upon the financial activities of the centralized management functions of the federal government. Due to financial regulation and management control by OMB and Treasury, operations may not be conducted and financial positions may not be reported as they would if Federal Student Aid were a separate, unrelated entity.

Note 2. Non-Entity Assets

As of September 30, 2008 and 2007, non-entity assets consisted of the following:

Non-Entity Assets

(Dollars in Millions)

	2008	2007
Non-Entity Assets		
Intragovernmental		
Fund Balance with Treasury	$ 8	$ 9
Total Intragovernmental	8	9
With the Public		
Cash and Other Monetary Assets	1,663	1,103
Accounts Receivable, Net	4	-
Credit Program Receivables, Net	186	188
Total With the Public	1,853	1,291
Total Non-Entity Assets	**1,861**	**1,300**
Entity Assets	191,426	173,766
Total Assets	$ 193,287	$ 175,066

Non-entity intragovernmental assets primarily consist of deposit fund balances. Non-entity assets with the public primarily consist of guaranty agency reserves and Federal Perkins Program Loan Receivables. (See Notes 5 and 6)

Note 3. Fund Balance with Treasury

The Fund Balance with Treasury, by fund type, as of September 30, 2008 and 2007, consisted of the following:

Fund Balances

(Dollars in Millions)

	2008	2007
General Funds	$ 14,874	$ 15,829
Revolving Funds	42,024	42,305
Special Funds	9	-
Other Funds	8	7
Fund Balance with Treasury	**$ 56,915**	**$ 58,141**

The Status of Fund Balance with Treasury, as of September 30, 2008 and 2007, consisted of the following:

Status of Fund Balance with Treasury

(Dollars in Millions)

	2008	2007
Unobligated Balance		
Available	$ 1,562	$ 2,825
Unavailable	26,912	37,313
Obligated Balance, Not Yet Disbursed	28,433	17,996
Non-Budgetary Fund Balance with Treasury	8	7
Fund Balance with Treasury	**$ 56,915**	**$ 58,141**

Note 4. Accounts Receivable

Accounts Receivable, as of September 30, 2008 and 2007, consisted of the following:

Accounts Receivable

(Dollars in Millions)

	2008		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ -	$ -	$ -
With the Public	118	(35)	83
Accounts Receivable	**$ 118**	**$ (35)**	**$ 83**

	2007		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ -	$ -	$ -
With the Public	53	(17)	36
Accounts Receivable	**$ 53**	**$ (17)**	**$ 36**

Note 5. Cash and Other Monetary Assets

Cash and Other Monetary Assets consist of reserves held in the FFEL Guaranty Agency Federal Funds. Changes in the valuation of the Federal Fund increase or decrease the Department's Cash and Other Monetary Assets with a corresponding change in the Payable to Treasury. The table below presents Cash and Other Monetary Assets for the years ended September 30, 2008 and 2007.

Cash and Other Monetary Assets
(Dollars in Millions)

	2008	2007
Beginning Balance, Cash and Other Monetary Assets	**$ 1,103**	**$ 566**
Valuation Increase in Guaranty Agency Federal Funds	722	793
Less: Collections from Guaranty Agency Federal Funds		
Statutory Recall Amounts Collected from GAs	-	82
Excess Collections	162	174
Collections Remitted to Treasury	162	256
Ending Balance, Cash and Other Monetary Assets	**$ 1,663**	**$ 1,103**

The $560 million net increase in the Federal Fund from FY 2007 to FY 2008 reflects the impact of guaranty agencies' ongoing operations. During FY 2008, $162 million was remitted to the Department by a guaranty agency whose agreement with the Department requires the agency to remit funds in excess of agreed-upon working capital levels. Remitted funds were returned to Treasury.

Note 6. Credit Programs for Higher Education

William D. Ford Federal Direct Loan Program. The federal government makes loans directly to students and parents through participating institutions of higher education under the Direct Loan Program. Direct Loans are originated and serviced through contracts with private vendors.

The Department disbursed approximately $21.1 billion in Direct Loans to eligible borrowers in FY 2008 and approximately $15.7 billion in FY 2007. Loans typically are disbursed in multiple installments over an academic period; as a result, loan disbursements for an origination cohort year often cross fiscal years. Half of all loan volume is obligated in the fourth quarter of a fiscal year. Loan cohorts disburse over two years. Regardless of the fiscal year in which they occur, disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

Approximately 10 percent of Direct Loan obligations made in an individual fiscal year are never disbursed. Loan obligations are established at a summary level based on estimates of schools' receipt of aid applications. The loan obligation may occur before a student has been accepted by a school or begins classes. For Direct Loans obligated in the 2008 cohort, an estimated $3.2 billion will never be disbursed. Eligible schools may originate direct loans through a cash advance from the Department or by advancing their own funds in anticipation of reimbursement from the Department.

The Department accrues interest receivable and records interest revenue on performing Direct Loans and, given the Department's substantial collection rates, on defaulted Direct Loans.

Federal Family Education Loan Program. Prior to FY 2008, the FFEL Program included only private lender loans to students and parents insured against default by the federal government. Nonprofit guaranty agencies act as intermediaries in administering the guarantees. In FY 2008, the FFEL Program also includes approximately $5.1 billion in direct federal assets.

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

The temporary loan purchase authority was added to the FFEL Program by ECASLA, effective July 1, 2008 through September 30, 2009. The Department has implemented two activities under this authority for loans originated in academic year 2008–09: loan purchase commitments where the Department purchases loans directly from FFEL lenders and loan participations where the Department purchases participation interests in FFEL loans. A credit program receivable is established for loans purchased directly or through a participation interest.

In loan participation transactions, lenders transfer to a custodian title of FFEL loans on which at least one disbursement has been made. The custodian sells financial certificates to the Department at the par value of these loans and remits the proceeds to lenders. Certificates bear an interest rate of the 91-day commercial paper rate plus 50 basis points, reset quarterly, and must be redeemed by September 30, 2009. Funds to redeem certificates may be obtained by selling the underlying loans to the Department.

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

As of September 30, 2008 and 2007, total principal balances outstanding of guaranteed loans held by lenders were approximately $415 billion and $363 billion, respectively. As of September 30, 2008 and 2007, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately $405 billion and $359 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the guaranty agencies, based on the appropriate reinsurance rates, which range from 100 to 95 percent. Any remaining insurance not paid as reinsurance would be paid to lenders by the guaranty agencies from their Federal Fund. Payments by guaranty agencies do not reduce government exposure because they are made from the Federal Fund administered by the agencies but owned by the federal government.

Approximately 13 percent of guaranteed loan commitments made in an individual fiscal year are never disbursed due to the nature of the loan commitment process. For guaranteed loans committed in the 2008 cohort, an estimated $9.5 billion will never be disbursed.

Guaranteed loans that default are initially turned over to guaranty agencies for collection, and interest receivable is accrued and recorded on the loans as the collection rate is substantial. After approximately four years, defaulted guaranteed loans not in repayment are turned over to the Department for collection. Accrued interest on the subrogated loan is calculated, but only realized upon collection.

Federal Perkins Loan Program. The Federal Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. In some statutorily defined cases, funds are provided to reimburse schools for loan cancellations. For defaulted loans assigned to the Department, collections of principal, interest and fees, net of amounts paid by the Department to cover contract collection costs, are transferred to Treasury annually.

TEACH Grant Program. Beginning July 1, 2008, the TEACH Grant Program awards annual grants up to $4,000 to eligible undergraduate and graduate students agreeing to serve as full-time mathematics, science, foreign language, bilingual education, special education, or reading teachers at high-need schools for four years within eight years of graduation. For students failing to fulfill the service requirement, grants are converted to Direct Unsubsidized Stafford Loans. Because grants could be converted to loans, for budget and accounting purposes the program is operated under the requirements of the Credit Reform Act.

Loan Consolidations

Borrowers may prepay existing loans without penalty through a new consolidation loan. Under the Credit Reform Act and requirements provided by OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, the retirement of Direct Loans being consolidated is considered a receipt of principal and interest. This receipt is offset by the disbursement related to the newly created consolidation loan. Underlying direct or guaranteed loans, performing or nonperforming, are paid off in their original cohort; new consolidation loans are originated in the cohort in which the activity occurs. Consolidation activity is taken into consideration in establishing subsidy rates for defaults and other cash flows. The cost of new consolidations is included in subsidy expense for the current-year cohort; the effect of prepayments on existing loans could contribute to re-estimates of prior cohort costs. The loan liability and net receivables include estimates of future prepayments of existing loans through consolidations; they do not reflect costs associated with anticipated future consolidation loans.

Student loan consolidation disbursements for FY 2008 were $15 billion ($9 billion in FFEL and $6 billion in Direct Loans), a 70% reduction from FY 2007. This lower rate of consolidations is a continuation of the trend identified in FY 2007, which was 45% lower than FY 2006. This trend exists due to a number of technical, legislative and economic factors. In the student loan programs a borrower is generally limited to a one-time consolidation; the high level of consolidations between FY 2002 and FY 2006, $280 billion, significantly reduced the existing pool of loans eligible for consolidation to generally those students currently in school. Recent legislative changes, particularly the establishment of fixed interest rates on new loans and the reduction of guaranteed lender returns, have significantly reduced both borrowers' financial benefits from consolidations and lenders' willingness to market consolidations through lower interest rates or other financial incentives. In FY 2008, economic conditions restricted the availability of capital, further reducing consolidation activity.

FY 2008 Modification

The recorded subsidy cost of a loan is based on a set of assumed future cash flows. Government actions that change these assumed future cash flows change subsidy cost and are recorded as loan modifications. Loan modifications are recognized under the same accounting principle as subsidy re-estimates. Modification adjustment transfers are required to adjust for the difference between current discount rates used to calculate modification costs and the discount rates used to calculate cohort interest expense and revenue. Separate amounts are calculated for modification costs and modification adjustment transfers.

The CCRAA included a number of provisions affecting the cost of existing loans. New income-based repayment and public service loan forgiveness programs were created; income-based repayment is available to existing borrowers in both FFEL and Direct Loans, while public service loan forgiveness is available to existing Direct Loan borrowers. (Existing FFEL borrowers may consolidate into Direct Loans to obtain the benefit.) The Act also made retroactive changes to loan deferment provisions for certain military personnel.

The Act also eliminated the provision under which FFEL lenders designated as “exceptional performers” received a higher insurance rate on defaulted loans, reduced FFEL guaranty agencies’ account maintenance fees, and lowered the percentage guaranty agencies may retain on collections of certain defaulted loans.

Loan modification savings of $2.5 billion were recorded in the FFEL Program and $4.1 billion in modification costs were recorded in the Direct Loan Program. The FFEL Program also recognized a net modification adjustment transfer saving of $30 million and the Direct Loan Program recognized a net savings of $9 million.

Credit Program Receivables

Credit Program Receivables as of September 30, 2008 and 2007, consisted of the following:

Credit Program Receivables
(Dollars in Millions)

	2008	2007
Direct Loan Program Loan Receivables, Net	$ 109,850	$ 99,002
FFEL Program		
FFEL Guaranteed Loan Program, Net (Pre-1992)	3,591	4,036
FFEL Program (Post-1991):		
FFEL Guaranteed Loan Program, Net	15,624	12,526
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	64	-
Loan Participation Purchase, Net	5,230	-
Federal Perkins Program Loan Receivables, Net	186	188
TEACH Grant Program Receivables, Net	1	-
Credit Program Receivables, Net	**$ 134,546**	**$ 115,752**

William D. Ford Federal Direct Loan Program. The following schedule summarizes the principal and related interest receivables, net of the allowance for subsidy.

Direct Loan Program Loan Receivables, Net
(Dollars in Millions)

	2008	2007
Principal Receivable	$ 117,610	$ 102,440
Interest Receivable	5,983	4,807
Receivables	**123,593**	**107,247**
Less: Allowance for Subsidy	13,743	8,245
Direct Loan Program Loan Receivables, Net	**$ 109,850**	**$ 99,002**

Of the $123.6 billion in receivables as of September 30, 2008, $10.3 billion in loan principal were in default, compared to $9.3 billion a year earlier. Defaulted Direct Loans are held in the Department's Borrower Services Collections Group.

Federal Family Education Loan Program. The following schedule summarizes the principal and related interest receivables, net of the allowance for subsidy.

FFEL Program Loan Receivables, Net

(Dollars in Millions)

	2008	2007
FFEL Guaranteed Loan Program (Pre-1992)		
Principal Receivable	$ 7,587	$ 8,208
Interest Receivable	182	224
Receivables	**7,769**	**8,432**
Less: Allowance for Subsidy	4,178	4,396
FFEL Guaranteed Loan Program Receivables, Net (Pre-1992)	**3,591**	**4,036**
FFEL Program (Post-1991)		
Principal Receivable		
FFEL Guaranteed Loan Program	17,641	13,324
Temporary Loan Purchase Authority:		
Loan Purchase Commitment	59	-
Loan Participation Purchase	5,036	-
Interest Receivable		
FFEL Guaranteed Loan Program	2,143	1,957
Temporary Loan Purchase Authority:		
Loan Purchase Commitment	-	-
Loan Participation Purchase	11	-
Receivables	**24,890**	**15,281**
Less: Allowance for Subsidy		
FFEL Guaranteed Loan Program	4,160	2,755
Temporary Loan Purchase Authority:		
Loan Purchase Commitment	(5)	-
Loan Participation Purchase	(183)	-
FFEL Guaranteed Loan Program, Net	15,624	12,526
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	64	-
Loan Participation Purchase, Net	5,230	-
FFEL Program Loan Receivables, Net	**$ 24,509**	**$ 16,562**

All loans under the temporary loan purchase authority are federal assets; the loan receivable represents all outstanding loans. Loan participation interests were first purchased by the Department in August 2008. No participation interests were redeemed in FY 2008.

Federal Perkins Loan Program. At September 30, 2008 and 2007, loans receivable, net of an allowance for loss, were $186 million and $188 million, respectively. These loans are valued at historical cost.

TEACH Grant Program. At September 30, 2008, loans receivable, net of an allowance for loss, was $1 million. The TEACH Grant Program was established in FY 2008.

Reconciliation of Allowance for Subsidy and Liability for Loan Guarantees

William D. Ford Federal Direct Loan Program. The following schedule provides a reconciliation between the beginning and ending balances of the allowance for subsidy for the Direct Loan Program:

Direct Loan Program Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2008	2007
Beginning Balance, Allowance for Subsidy	**$ 8,245**	**$ 8,405**
Components of Subsidy Transfers		
Interest Rate Differential	(1,540)	(846)
Defaults, Net of Recoveries	454	422
Fees	(487)	(398)
Other	1,498	1,117
Current Year Subsidy Transfers	**(75)**	**295**
Components of Subsidy Re-estimates		
Interest Rate Re-estimates[1]	222	(311)
Technical and Default Re-estimates	946	(483)
Subsidy Re-estimates	**1,168**	**(794)**
Components of Loan Modifications		
Loan Modification Costs	4,143	-
Modification Adjustment Transfers	(9)	-
Loan Modifications	**4,134**	**-**
Activity		
Fee Collections	482	448
Loan Cancellations[2]	(240)	(154)
Subsidy Allowance Amortization	456	435
Other	(427)	(390)
Total Activity	**271**	**339**
Ending Balance, Allowance for Subsidy	**$ 13,743**	**$ 8,245**

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

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

Federal Family Education Loan Program. The following schedule provides a reconciliation between the beginning and ending balances of the liability for loan guarantee for the insurance portion of the FFEL Program:

FFEL Program Reconciliation of Liabilities for Loan Guarantees

(Dollars in Millions)

	2008	2007
Beginning Balance, FFEL Financing Accounts Liability for Loan Guarantees	**$ 50,731**	**$ 52,350**
Components of Subsidy Transfers		
Interest Supplement Costs	1,212	7,580
Defaults, Net of Recoveries	43	885
Fees	(449)	(5,052)
Other[1]	436	2,967
Current Year Subsidy Transfers	**1,242**	**6,380**
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	(700)	1,286
Technical and Default Re-estimates	(760)	(2,782)
Subsidy Re-estimates	**(1,460)**	**(1,496)**
Components of Loan Modifications		
Loan Modification Costs	(2,464)	-
Modification Adjustment Transfers	(30)	-
Loan Modifications	**(2,494)**	**-**
Activity		
Interest Supplement Payments	(8,744)	(10,991)
Claim Payments	(8,029)	(5,924)
Fee Collections	4,107	4,036
Interest on Liability Balance	1,372	1,616
Other[2]	6,460	4,760
Total Activity	**(4,834)**	**(6,503)**
Ending Balance, FFEL Financing Account Liability for Loan Guarantees	**$ 43,185**	**$ 50,731**
FFEL Liquidating Account Liability for Loan Guarantees	137	143
Liabilities for Loan Guarantees	**$ 43,322**	**$ 50,874**

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

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

Financing Account Interest Expense and Interest Revenue

Financing accounts borrow from Treasury to fund the unsubsidized portion of lending activities. The Department calculates and pays Treasury interest at the end of each year. During the year, interest is earned on outstanding direct loans, outstanding FFEL loans purchased by the Department, participation interests, and the Fund Balance with Treasury.

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

William D. Ford Federal Direct Loan Program. The following schedule summarizes the Direct Loan financing account interest expense and interest revenue:

Direct Loan Program
(Dollars in Millions)

	2008	2007
Interest Expense on Treasury Borrowing	$ 6,190	$ 5,675
Interest Expense	**$ 6,190**	**$ 5,675**
Interest Revenue from the Public	$ 5,277	$ 4,859
Amortization of Subsidy	(456)	(435)
Interest Revenue on Uninvested Funds	1,369	1,251
Interest Revenue	**$ 6,190**	**$ 5,675**

Payable to Treasury

Payable to Treasury for the years ended September 30, 2008 and 2007 consisted of the following:

Payable to Treasury
(Dollars in Millions)

	2008	2007
Future Liquidating Account Collections, Beginning Balance	**$ 4,108**	**$ 4,555**
Valuation of Pre-1992 Loan Liability and Allowance	250	288
Capital Transfers to Treasury	(592)	(735)
Future Liquidating Account Collections, Ending Balance	**$ 3,766**	**$ 4,108**
Collections on Guaranty Agency Federal Funds	-	2
Direct Loan Program Downward Subsidy Re-estimate	-	498
FFEL Program Downward Subsidy Re-estimate	-	743
Payable to Treasury	**$ 3,766**	**$ 5,351**

The liquidating account, based on available fund balance, periodically transfers Fund Balance to Treasury's account. The FFEL and Direct Loan financing accounts pay the liability related to downward subsidy re-estimates upon budget execution. Effective FY 2008, Treasury guidance requires that the liability resulting from downward subsidy re-estimates be included in Other Intragovernmental Liabilities on the Balance Sheet (see Note 8).

Subsidy Expense

William D. Ford Federal Direct Loan Program

Direct Loan Program Subsidy Expense

(Dollars in Millions)

	2008	2007
Components of Current Year Subsidy Transfers		
Interest Rate Differential	$ (1,540)	$ (846)
Defaults, Net of Recoveries	454	422
Fees	(487)	(398)
Other	1,498	1,117
Current Year Subsidy Transfers	**(75)**	**295**
Subsidy Re-estimates	1,168	(794)
Loan Modification Costs	4,143	-
Direct Loan Subsidy Expense	**$ 5,236**	**$ (499)**

In the 2008 re-estimates, Direct Loan subsidy expense was increased by $1.2 billion. Changes in interest rates increased subsidy expense by $859 million, updated data on teacher loan forgiveness led to an additional increase of $481 million, and rising default rates increased subsidy expense by $194 million. These increases were partially offset by decreases due to reduced prepayments of $(606) million and changes in the rate at which loans enter repayment of $(261) million. The subsidy rate is sensitive to interest rate fluctuations. For example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan subsidy expense by $465 million.

In the 2007 re-estimates, Direct Loan subsidy expense was decreased by $794 million. Changes in the income-contingent repayment assumption increased subsidy expense by $1 billion. This increase was more than offset by decreases in subsidy cost related to loan volume of $(924) million, statutory loan discharges of $(544) million, interest rates of $(348) million and other factors. The subsidy rate is sensitive to interest rate fluctuations. For example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan costs by $955 million.

Federal Family Education Loan Program

FFEL Program Subsidy Expense

(Dollars in Millions)

	2008	2007
FFEL Guaranteed Loan Program		
Components of Current Year Subsidy Transfers		
Interest Supplement Costs	$ 1,212	$ 7,580
Defaults, Net of Recoveries	43	885
Fees	(449)	(5,052)
Other	436	2,967
Current Year Subsidy Transfers	**1,242**	**6,380**
Subsidy Re-estimates	(1,460)	(1,496)
Loan Modification Costs	(2,464)	-
FFEL Guaranteed Loan Program Subsidy Expense	**$ (2,682)**	**$ 4,884**
Temporary Loan Purchase Authority		
Loan Purchase Commitment		
Components of Current Year Subsidy Transfers		
Interest Supplement Costs	$ (9)	$ -
Defaults, Net of Recoveries	-	-
Fees	2	-
Other	5	-
Loan Purchase Commitment Subsidy Expense	**$ (2)**	**$ -**
Loan Participation Purchase		
Components of Current Year Subsidy Transfers		
Interest Supplement Costs	$ (292)	$ -
Defaults, Net of Recoveries	5	-
Fees	(476)	-
Other	595	-
Loan Participation Purchase Subsidy Expense	**$ (168)**	**$ -**
FFEL Program Subsidy Expense	**$ (2,852)**	**$ 4,884**

In the 2008 re-estimates, FFEL subsidy expense was decreased by $1.5 billion. Changes in interest rate forecasts decreased subsidy expense by $8.7 billion. This decrease was partially offset by increases of $4.4 billion due to reduced prepayments, $2.5 billion due to changes in projected guaranty agency retention of collections on defaulted loans, and $1.3 billion due to greater use of teacher loan forgiveness benefits. The subsidy rate is sensitive to interest rate fluctuations. For example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by $16.3 billion.

In the 2007 re-estimates, FFEL subsidy expense was decreased by $1.5 billion. Changes in the federal cost of loan deferments and forbearance increased subsidy expense by $2.3 billion. This increase was more than offset by changes in subsidy cost related to statutory loan discharges of $(1.4) billion, loan maturity and repayment rates of $(1.5) billion, loan volume of $890 million and other factors. The subsidy rate is sensitive to interest rate fluctuations. For example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by $11.1 billion.

In FY 2007 the Department restated the eligibility requirements specified by the HEA for lenders to receive SAP at the 9.5 percent minimum return rate on loans made or purchased with funds derived from tax-exempt obligations issued before October 1993, and implemented certain processes to validate eligibility. As a result of lenders' business decisions and audits performed in FYs 2007 and 2008, nearly two-thirds of lenders previously requesting this SAP have ceased requesting the payment in 2008. The Department decreased the FFEL subsidy by $269 million as a result.

Subsidy Rates

The subsidy rates applicable to the 2008 loan cohort year follow:

Subsidy Rates—Cohort 2008

	Interest Differential/ Supplements	Defaults	Fees	Other	Total
Direct Loan Program	(7.28%)	1.58%	(1.95%)	5.68%	(1.97%)
FFEL Program (Post-1991):					
FFEL Guaranteed Loan Program	0.88%	0.53%	(3.57%)	2.15%	(0.01%)
Temporary Loan Purchase Authority:					
Loan Purchase Commitment	(14.78%)	0.07%	2.66%	8.19%	(3.86%)
Loan Participation Purchase	(3.53%)	0.06%	(5.80%)	7.26%	(2.01%)

The subsidy rate represents the subsidy expense of the program in relation to the obligations or commitments made during the fiscal year. The subsidy expense for new direct or guaranteed loans reported in the current year relate to disbursements of loans from both current and prior years' cohorts. Subsidy expense is recognized when the Department disburses direct loans or third-party lenders disburse guaranteed loans. The subsidy expense reported in the current year also includes modifications and re-estimates. The subsidy rates shown above, which reflect aggregate negative subsidy in the FY 2008 cohort, cannot be applied to direct or guaranteed loans disbursed during the current reporting year to yield the subsidy expense, nor are these rates applicable to the portfolio as a whole.

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

Administrative Expenses

Administrative Expense for the years ended September 30, 2008 and 2007, consisted of the following:

Administrative Expense
(Dollars in Millions)

	2008		2007	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	$ 343	$ 222	$ 397	$ 232
Other Expense	14	9	16	9
Administrative Expenses	**$ 357**	**$ 231**	**$ 413**	**$ 241**

Note 7. Debt

Debt to Treasury as of September 30, 2008 and 2007 consisted of the following:

Debt
(Dollars in Millions)

	2008			
	Beginning Balance	New Borrowing	Repayments	Ending Balance
Treasury Debt				
Direct Loan Program	$ 103,893	$ 28,172	$ (14,646)	$ 117,419
FFEL Program				
Loan Purchase Commitment	-	69	-	69
Loan Participation Purchase	-	10,754	-	10,754
TEACH Grant Program	-	26	(12)	14
Total Treasury Debt	**$ 103,893**	**$ 39,021**	**$ (14,658)**	**$ 128,256**

	2007			
	Beginning Balance	New Borrowing	Repayments	Ending Balance
Treasury Debt				
Direct Loan Program	$ 105,430	$ 17,892	$ (19,429)	$ 103,893
FFEL Program				
Loan Purchase Commitment	-	-	-	-
Loan Participation Purchase	-	-	-	-
TEACH Grant Program	-	-	-	-
Total Treasury Debt	**$ 105,430**	**$ 17,892**	**$ (19,429)**	**$ 103,893**

The level of repayments on borrowings to Treasury is derived from many factors. For instance, beginning of the year cash balances, collections, and new borrowings have an impact on the cash available to repay Treasury. Cash is also held to cover future liabilities, such as contract collection costs and disbursements in transit.

Note 8. Other Liabilities

Other liabilities include current and non-current liabilities. The non-current liabilities primarily relate of the student loan receivables of the Federal Perkins Loan Program, which when collected, will be returned to the General Fund of Treasury.

The current liabilities covered by budgetary resources primarily consist of downward subsidy re-estimates, which when executed will be paid to Treasury. Effective FY 2008, Treasury guidance requires that the liability resulting from downward subsidy re-estimates be included in Other Intragovernmental Liabilities. In FY 2007 and prior, these amounts were included in Payable to Treasury. (See Note 6)

Other Liabilities as of September 30, 2008 and 2007 consisted of the following:

Other Liabilities

(Dollars in Millions)

	2008		2007	
	Intragovern-mental	**With the Public**	**Intragovern-mental**	**With the Public**
Liabilities Covered by Budgetary Resources				
Current				
Employer Contributions and Payroll Taxes	$ 1	$ -	$ 1	$ -
Liability for Deposit Funds	-	8	-	8
Accrued Payroll and Benefits	-	5	-	4
Deferred Revenue	-	42	-	-
Liabilities in Miscellaneous Receipt Accounts	6,834	-	-	-
Total Other Liabilities Covered by Budgetary Resources	**$ 6,835**	**$ 55**	**$ 1**	**$ 12**
Liabilities Not Covered by Budgetary Resources				
Current				
Accrued Unfunded Annual Leave	$ -	$ 8	$ -	$ 7
Non-current				
Accrued Unfunded FECA Liability	1	-	1	-
Liabilities in Miscellaneous Receipt Accounts	186	-	188	-
Accrued FECA Actuarial Liability	-	4	-	4
Total Other Liabilities Not Covered by Budgetary Resources	**$ 187**	**$ 12**	**$ 189**	**$ 11**
Other Liabilities	**$ 7,022**	**$ 67**	**$ 190**	**$ 23**

Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary resources include liabilities for which congressional action is needed before budgetary resources can be provided. Although future appropriations to fund these liabilities are likely, it is not certain that appropriations will be enacted to fund these liabilities. Liabilities not covered by budgetary resources totaled $199 million and $200 million as of September 30, 2008 and 2007, respectively.

As of September 30, 2008 and 2007, liabilities on the Balance Sheet totaled $186.1 billion and $163.2 billion respectively. Of this amount, liabilities covered by budgetary resources totaled $185.9 billion as of September 30, 2008, and $163.0 billion as of September 30, 2007.

Note 9. Accrued Grant Liability

Federal Student Aid's accrued grant liability was $862 million and $1,030 million as of September 30, 2008 and 2007, respectively.

Note 10. Net Position

Unexpended appropriations as of September 30, 2008 and 2007 consisted of the following:

Unexpended Appropriations

(Dollars in Millions)

	2008	2007
Unobligated Balances		
Available	$ 1,153	$ 2,496
Not Available	505	659
Undelivered Orders	11,814	11,265
Unexpended Appropriations	**$ 13,472**	**$ 14,420**

Federal Student Aid had Cumulative Results of Operations of $(6,273) million as of September 30, 2008, and $(2,574) million as of September 30, 2007. Cumulative Results of Operations consists mostly of unfunded upward subsidy re-estimates, other unfunded expenses, and net investments of capitalized assets.

Note 11. Intragovernmental Cost and Exchange Revenue by Program

As required by the *Government Performance and Results Act of 1993*, Federal Student Aid's reporting organization has been aligned with Strategic Goal 3 presented in the U.S. Department of Education's *Strategic Plan 2007—2012*. Strategic Goal 3, Ensure the Accessibility, Affordability, and Accountability of Higher Education, and Better Prepare Students and Adults for Employment and Future Learning, is a sharply defined directive that guides divisions to carry out the vision and programmatic mission of Federal Student Aid.

The following table presents Federal Student Aid's gross cost and exchange revenue by program for FY 2008 and FY 2007. Gross costs and earned revenue are classified as intragovernmental (exchange transactions between Federal Student Aid and other entities within the federal government) or with the public (exchange transactions between Federal Student Aid and non-federal entities).

Gross Cost and Exchange Revenue by Program
(Dollars in Millions)

	2008	2007
Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement		
Intragovernmental Gross Cost	$ 6,903	$ 5,561
Gross Costs with the Public	21,885	21,858
Total Program Costs	**28,788**	**27,419**
Less: Intragovernmental Earned Revenue	4,128	3,452
Earned Revenue from the Public	4,901	4,459
Total Program Revenue	**9,029**	**7,911**
Net Cost of Operations	**$ 19,759**	**$ 19,508**

Note 12. Interest Expense and Interest Revenue

For FY 2008 and FY 2007, interest expense and interest revenue by program consisted of the following:

Interest Expense and Interest Revenue
(Dollars in Million)

	2008					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	$ 6,190	$ -	$ 6,190	$ 1,369	$ 4,821	$ 6,190
FFEL Program						
FFEL Guaranteed Loan Program	-	1,372	1,372	1,372	-	1,372
Loan Purchase Commitment	3	-	3	3	-	3
Loan Participation Purchase	492	-	492	465	27	492
TEACH Grant Program	1	-	1	1	-	1
Total	**$ 6,686**	**$ 1,372**	**$ 8,058**	**$ 3,210**	**$ 4,848**	**$ 8,058**

	2007					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	$ 5,675	$ -	$ 5,675	$ 1,251	$ 4,424	$ 5,675
FFEL Program						
FFEL Guaranteed Loan Program	-	1,616	1,616	1,616	-	1,616
Loan Purchase Commitment	-	-	-	-	-	-
Loan Participation Purchase	-	-	-	-	-	-
TEACH Grant Program	-	-	-	-	-	-
Total	**$ 5,675**	**$ 1,616**	**$ 7,291**	**$ 2,867**	**$ 4,424**	**$ 7,291**

Federal interest expense is recognized on the Department's outstanding debt. Non-federal interest revenue is earned on the individual loans and participation interest in FFEL loans. Federal interest revenue is earned on the uninvested fund balance with Treasury.

Note 13. Statement of Budgetary Resources

The Statement of Budgetary Resources compares budgetary resources with the status of those resources. As of September 30, 2008, budgetary resources were $148,514 million and net outlays were $45,715 million. As of September 30, 2007, budgetary resources were $121,735 million and net outlays were $30,265 million.

Permanent Indefinite Budget Authority

The Direct Loan, FFEL, and TEACH Grant Programs have permanent indefinite budget authority through legislation. Part D of the Direct Loan Program and Part B of the FFEL Program, pursuant to the HEA pertain to the existence, purpose, and availability of this permanent indefinite budget authority.

Reauthorization of Legislation

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

Obligations Incurred by Apportionment Category

Obligations incurred by apportionment category, as of September 30, 2008 and 2007, consisted of the following:

Obligations Incurred by Apportionment Category
(Dollars in Millions)

	2008	2007
Direct and Reimbursable:		
Category A	$ 707	$ 722
Category B	117,665	79,760
Exempt from Apportionment	5	12
Obligations Incurred	**$ 118,377**	**$ 80,494**

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

Unused Borrowing Authority

Unused borrowing authority, as of September 30, 2008 and 2007, consisted of the following:

Unused Borrowing Authority
(Dollars in Millions)

	2008	2007
Beginning Balance, Unused Borrowing Authority	**$ 8,915**	**$ 7,237**
Current Year Borrowing Authority	57,743	19,570
Funds Drawn From Treasury	(39,021)	(17,892)
Borrowing Authority Withdrawn	(1,987)	-
Ending Balance, Unused Borrowing Authority	**$ 25,650**	**$ 8,915**

Federal Student Aid is given authority to draw funds from Treasury to finance the Direct Loan, Loan Purchase Commitment Authority, Loan Participation Purchase Authority, and TEACH Grant Program. Unused Borrowing Authority is a budgetary resource and is available to support obligations. Federal Student Aid periodically reviews its borrowing authority balances in relation to its obligations and may cancel unused amounts.

Undelivered Orders at the End of the Period

Undelivered orders, as of September 30, 2008 and 2007, consisted of the following:

Undelivered Orders
(Dollars in Millions)

	2008	2007
Budgetary	$ 11,839	$ 11,290
Non-Budgetary	40,338	13,908
Undelivered Orders (Unpaid)	**$ 52,177**	**$ 25,198**

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

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

Budgetary accounting as shown in the President's Budget includes a public enterprise fund that reflects the gross obligations by the FFEL Program for the estimated activity of the consolidated Federal Funds of the guaranty agencies. Ownership by the federal government is independent of the actual control of the assets. Since the actual operation of the Federal Fund is independent from the Department's direct control, budgetary resources and obligations are estimated and disclosed in the President's Budget to approximate the gross activities of the combined Federal Funds. Amounts reported on the FY 2007 Statement of Budgetary Resources for the Federal Fund are compiled through combining all guaranty agencies' Annual Reports to determine a net valuation amount for the Federal Fund.

Note 14. Reconciliation of Net Cost of Operations to Budget

The Reconciliation of Net Cost of Operations (proprietary) to Budget provides information on how budgetary resources obligated during the period relate to the net cost of operations. The schedule presented in this footnote reconciles budgetary resources with the net cost of operations by (1) removing resources that do not fund net cost of operations and (2) including components of net cost of operations that did not generate or use resources during the year.

Components Requiring or Generating Resources in Future Periods primarily result from subsidy re-estimates that will be executed in future periods. The Reconciliation of Net Cost of Operations to Budget as of September 30, 2008 and 2007, are presented below:

Reconciliation of Net Cost of Operations to Budget

(Dollars in Millions)

	2008	2007
Resources Used to Finance Activities		
Obligations Incurred	$ (118,377)	$ (80,494)
Spending Authority from Offsetting Collections and Recoveries	39,710	43,079
Offsetting Receipts	5,778	4,735
Imputed Financing from Costs Absorbed by Others	(8)	(9)
Total Resources Used to Finance Activities	**(72,897)**	**(32,689)**
Resources Used to Finance Items Not Part of Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but Not Yet Provided (+/-)	(27,062)	(2,602)
Resources that Fund Expenses Recognized in Prior Period	(1,104)	(3,306)
Credit Program Collections which Increase/Decrease Liabilities for Loan Guarantees, or Credit Program Receivables, Net including Allowances for Subsidy	29,692	33,894
Resources Used to Finance the Acquisition of Fixed Assets, or Increase/Decrease Liabilities for Loan Guarantees or Credit Program Receivables, Net in the Current or Prior Period	(51,678)	(39,799)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**(50,152)**	**(11,813)**
Components Not Requiring or Generating Resources		
Depreciation and Amortization	(451)	(441)
Other (+/-)	290	907
Total Components of the Net Cost of Operations that Will Not Require or Generate Resources	**(161)**	**466**
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	-	(7)
Upward/Downward Re-estimates of Credit Subsidy Expense	513	(1,354)
Increase in Exchange Revenue Receivable from the Public	2,607	2,302
Other (+/-)	27	(39)
Total Components of the Net Cost of Operations that Will Require or Generate Resources in Future Periods	**3,147**	**902**
Net Cost of Operations	**$ (19,759)**	**$ (19,508)**

Note 15. Contingencies

Guaranty Agencies

Federal Student Aid can assist guaranty agencies experiencing financial difficulties by various means. No provision has been made in the principal statements for potential liabilities related to financial difficulties of guaranty agencies because the likelihood of such occurrences cannot be estimated with sufficient reliability.

Federal Perkins Loan Program Reserve Funds

The Federal Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. In FY 2008, the Department provided funding of 83.01 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 16.99 percent of program funding. For the latest academic year ended June 30, 2008, approximately 648 thousand loans were made, totaling approximately $1.4 billion at 1,625 institutions, averaging $2,121 per loan. The Department's share of the Federal Perkins Loan Program was approximately $6.5 billion as of June 30, 2008.

In FY 2007, the Department provided funding of 84.3 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 15.7 percent of program funding. For the academic year ended June 30, 2007, approximately 722 thousand loans were made, totaling approximately $1.6 billion at 1,636 institutions, averaging $2,230 per loan. The Department's share of the Federal Perkins Loan Program was approximately $6.5 billion as of June 30, 2007.

Federal Perkins Loan Program borrowers who meet statutory eligibility requirements—such as service as a teacher in low-income areas, as a Peace Corps or VISTA volunteer, in the military or in law enforcement, in nursing, or in family services—may receive partial loan forgiveness for each year of qualifying service. In these circumstances, a contingency is deemed to exist. Federal Student Aid may be required to compensate Federal Perkins Loan Program institutions for the cost of the partial loan forgiveness. Payments required under the Federal Perkins Loan partial forgiveness statutes do not have a material effect on Federal Student Aid's financial statements.

Litigation and Other Claims

The Department is involved in various lawsuits incidental to its operations. In the opinion of management, the ultimate resolution of pending litigation will not have a material effect on Federal Student Aid's financial position.

Other Matters

Some portion of the current-year financial assistance expenses (grants) may include funded recipient expenditures that are subsequently disallowed through program review or audit processes. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Federal Student Aid's financial position.

Note 16. Subsequent Events

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.

Required Supplementary Information

United States Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2008
(Dollars in Millions)

		Combined		Direct Student Loan Program		Administrative Funds
		Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary
Budgetary Resources:						
Unobligated balance, brought forward, October 1:	$	4,449	36,792	36	3,563	27
Recoveries of prior year Unpaid Obligations		1,447	3,115	-	2,870	12
Budgetary Authority:						
Appropriations		28,562	151	5,302	123	708
Borrowing Authority		-	57,743	-	34,616	-
Spending authority from offsetting collections (gross):						
Earned						
Collected		1,638	33,510	-	17,353	-
Subtotal	$	30,200	91,404	5,302	52,092	708
Nonexpenditure transfers, net, anticipated and actual		-	-	-	-	-
Permanently not available		(2,058)	(16,835)	-	(16,765)	(37)
Total Budgetary Resources	$	**34,038**	**114,476**	**5,338**	**41,760**	**710**
Status of Budgetary Resources:						
Obligations incurred:						
Direct	$	30,418	87,959	5,302	41,088	707
Subtotal	$	30,418	87,959	5,302	41,088	707
Unobligated Balances:						
Apportioned	$	1,166	396	-	-	2
Subtotal	$	1,166	396	-	-	2
Unobligated Balance not available		2,454	26,121	36	672	1
Total Status of Budgetary Resources	$	**34,038**	**114,476**	**5,338**	**41,760**	**710**
Change in Obligated Balance:						
Obligated balance, net						
Unpaid obligations, brought forward, October 1	$	12,485	14,425	-	10,716	402
Total, unpaid obligated balance, brought forward, net	$	12,485	14,425	-	10,716	402
Obligation Incurred net (+/-)		30,418	87,959	5,302	41,088	707
Gross Outlays		(28,529)	(58,112)	(5,302)	(28,501)	(701)
Recoveries of prior year unpaid obligations, actual		(1,447)	(3,115)	-	(2,870)	(12)
Obligated Balance, net, end of period						
Unpaid Obligations		12,927	41,157	-	20,433	396
Total, unpaid obligated balance, net, end of period	$	**12,927**	**41,157**	-	**20,433**	**396**
Net Outlays						
Net Outlays:						
Gross Outlays	$	28,529	58,112	5,302	28,501	701
Offsetting collections		(1,638)	(33,510)		(17,353)	
Distributed Offsetting receipts		(28)	(5,750)		(649)	
Net Outlays	$	**26,863**	**18,852**	**5,302**	**10,499**	**701**

United States Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2008

(Dollars in Millions)

		Teach Grant Program		Federal Family Education Loan Program		Grant Programs
		Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary
Budgetary Resources:						
Unobligated balance, brought forward, October 1:	$	-	-	1,296	33,229	3,090
Recoveries of prior year Unpaid Obligations		-	-	682	245	753
Budgetary Authority:						
Appropriations		7	-	3,457	28	19,088
Borrowing Authority		-	26	-	23,101	-
Spending authority from offsetting collections (gross):						
Earned						
Collected		-	2	1,638	16,155	-
Subtotal	$	7	28	5,095	39,284	19,088
Nonexpenditure transfers, net, anticipated and actual		-	-	-	-	-
Permanently not available		-	(12)	(1,431)	(58)	(590)
Total Budgetary Resources	$	**7**	**16**	**5,642**	**72,700**	**22,341**
Status of Budgetary Resources:						
Obligations incurred:						
Direct	$	7	14	3,687	46,857	20,715
Subtotal	$	7	14	3,687	46,857	20,715
Unobligated Balances:						
Apportioned	$	-	-	10	396	1,154
Subtotal	$	-	-	10	396	1,154
Unobligated Balance not available		-	2	1,945	25,447	472
Total Status of Budgetary Resources	$	**7**	**16**	**5,642**	**72,700**	**22,341**
Change in Obligated Balance:						
Obligated balance, net						
Unpaid obligations, brought forward, October 1	$	-	-	1,946	3,709	10,137
Total, unpaid obligated balance, brought forward, net	$	-	-	1,946	3,709	10,137
Obligation Incurred net (+/-)		7	14	3,687	46,857	20,715
Gross Outlays		-	(1)	(4,927)	(29,610)	(17,599)
Recoveries of prior year unpaid obligations, actual		-	-	(682)	(245)	(753)
Obligated Balance, net, end of period						
Unpaid Obligations		7	13	24	20,711	12,500
Total, unpaid obligated balance, net, end of period	$	**7**	**13**	**24**	**20,711**	**12,500**
Net Outlays						
Net Outlays:						
Gross Outlays	$	-	1	4,927	29,610	17,599
Offsetting collections		-	(2)	(1,638)	(16,155)	-
Distributed Offsetting receipts		-	-	-	(5,101)	(28)
Net Outlays	$	**-**	**(1)**	**3,289**	**8,354**	**17,571**

Required Supplementary Stewardship Information

Investment in Human Capital

Human Capital investments are those expenses included in net cost for general public education and training programs that are intended to increase or maintain national economic productive capacity.

Expenses incurred for human capital investments consisted of the following for FY 2008 and the preceding four years:

Summary of Human Capital Expenses
(Dollars in Millions)

	2008	2007	2006	2005	2004
Federal Student Aid Expense					
Direct Loan Subsidy	$ 5,236	$ (499)	$ 6,655	$ 5,211	$ (543)
FFEL Program Subsidy	(2,852)	4,884	28,062	9,863	8,516
Grant Programs	17,464	15,092	15,447	15,070	14,943
Salaries & Administrative	189	173	172	164	186
Total	**$ 20,037**	**$ 19,650**	**$ 50,336**	**$ 30,308**	**$ 23,102**

The Direct Loan Program is a direct-lending program in which loan capital is provided to students by the federal government through borrowings from the U.S. Treasury.

The FFEL Loan Program operates with state and private nonprofit guaranty agencies to provide loan guarantees and interest supplements through permanent budget authority on loans by private lenders to eligible students. The FFEL Loan Program expenses include the Loan Participation Purchase and Loan Purchase Commitment Programs expenses of ($168) million and ($2) million respectively. In FY 2008, the Department directly purchased over 20,000 loans valued at more than $61 million and acquired over $5.1 billion participation interest in FFEL loans.

The TEACH Grant program, authorized by the CCRAA, 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. If the students do not satisfy their agreement to serve, the grants are converted to Direct Unsubsidized Loans (TEACH).

The ECASLA authorized the Secretary to buy guaranteed student loans for the 2008–09 award year. Within the existing FFEL Program, the Department is using this authority to purchase fully disbursed Stafford, Unsubsidized Stafford, and Parent Loans for Undergraduate Students generally originated between July 1, 2008 and June 30, 2009, referred to as the Loan Purchase Commitment Program. In addition to buying fully disbursed loans, the Department has established agreements with FFEL lenders to buy participation interests in fully or partially disbursed loans, referred to as the Loan Participation Purchase Program. A lender, through an approved sponsor, transfers the title of an eligible loan to a custodian who issues a participation certificate. The

Department purchases a participation interest issued by the custodian, who in turns remits funds to the lender. The participation interests must be redeemed and amounts provided under these agreements remitted to the Department. Lenders can obtain outside funding or opt to have the Department purchase fully disbursed loans that were part of the participation agreement. Loans purchased by the Department under the Loan Purchase Commitment Program and Loan Participation Purchase Program are loans owned directly by the federal government and serviced under the FFEL Program. The participation agreements and the Department's commitment to purchase guaranteed loans will terminate September 30, 2009.

Grant programs include the Pell Grant Program that awards direct grants through participating institutions to undergraduate students with financial need. Participating institutions either credit the appropriated funds to the student's school account or pay the student directly once per term. Signed into law in 2006, the ACG and the SMART Programs are available to encourage eligible students to take more challenging courses in high school and to pursue college majors in high demand in the global economy.

Federal Student Aid's programs link with the overall initiatives of the Department in enhancing education – a fundamental stepping-stone to higher living standards for American citizens. While education is vital to national economic growth, education's contribution is more than increased productivity and incomes. Education improves health, promotes social change, and opens doors to a better future for children and adults.

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

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

Over time, the returns of developing skills through education have become evident. Statistics illustrate the rewards of investing in postsecondary education.

Other Accompanying Information

Improper Payment Information Act Reporting Details

The Improper Payment Information Act of 2002 (IPIA) requires agencies to annually review all programs and activities to identify those susceptible to significant improper payments. The guidance defines significant improper payments as those in any particular program that exceed both 2.5 percent of program payments and $10 million annually. For each program identified as susceptible, agencies are required to report the annual amount of estimated improper payments, along with steps taken and actions planned to reduce them. OMB uses quarterly color-coded scorecards to monitor agencies' status and progress toward attaining the PMA program initiative goals. In conjunction with the requirements of the IPIA, a relatively new key initiative, entitled "Eliminating Improper Payments", summarizes the results of quarterly actions to ensure compliance with the IPIA. Federal Student Aid achieved a "*Yellow*" progress score and "*Yellow*" status score on the September 30, 2008, PMA scorecard for Eliminating Improper Payments.

Federal Student Aid measures and reports annual improper payment estimates for the Pell Grant and FFEL Programs. OMB automatically considers programs previously required to report under OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, Section 57, Information on Erroneous Payments, as susceptible to significant improper payments, regardless of the established thresholds. Risk assessments conducted in FY 2008 indicated that other programs administered by Federal Student Aid are not at significant risk of improper payments.

On September 25, 2008, the OIG issued a final audit report that can be found at http://oigmis3.ed.gov/auditreports/a09h0015.pdf on Federal Student Aid's estimation of improper payments in the FFEL Program. In response to several recommendations in the audit report, where applicable, corrective actions were included in the PAR. For more detail, please refer to the Department's PAR.

Office of Inspector General Transmittal Letter

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 17, 2008

James Manning
Acting Chief Operating Officer
Federal Student Aid
Washington, D.C. 20202

Dear Mr. Manning:

The enclosed reports present the results of the annual audits of Federal Student Aid's (FSA) financial statements for fiscal years 2008 and 2007, to comply with the Higher Education Act Amendments of 1998. The reports should be read in conjunction with FSA's financial statements and notes to fully understand the context of the information contained therein.

We contracted with the independent certified public accounting firm of Ernst & Young, LLP (Ernst & Young) to audit the financial statements of FSA as of September 30, 2008 and 2007, and for the years then ended. The contract required that the audits be performed in accordance with U.S. generally accepted government auditing standards and OMB's bulletin, *Audit Requirements for Federal Financial Statements.*

In connection with the contract, we monitored the performance of the audits, reviewed Ernst & Young's reports and related documentation, and inquired of its representatives. Our review was not intended to enable us to express, and we do not express, an opinion on FSA's financial statements, or conclusions about the effectiveness of internal control, whether FSA's financial management systems substantially complied with the Federal Financial Management Improvement Act of 1996, or on compliance with laws and regulations.

Ernst & Young is responsible for the attached auditor's report and the conclusions expressed in the related reports on internal control and compliance with laws and regulations. Our review disclosed no instances where Ernst & Young did not comply, in all material respects, with U.S. generally accepted government auditing standards.

Sincerely,

/s/

Jerry G. Bridges (Acting)

Enclosures

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.

Report of Independent Auditors

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Tel: 703 747–1000
www.ey.com

Report of Independent Auditors

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheets of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2008 and 2007, and the related consolidated statements of net cost, and changes in net position, and the combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of FSA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04*, Audit Requirements for Federal Financial Statements*, as amended. Those standards and bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of FSA's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of FSA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FSA as of September 30, 2008 and 2007, and its net costs, changes in net position, and budgetary resources, for the years then ended, in conformity with accounting principles generally accepted in the United States.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information presented in the Management's Discussion and Analysis, required supplementary stewardship information, required supplementary information, and other accompanying information is not a required part of the basic financial statements but is supplementary information required by OMB Circular No. A-136, *Financial Reporting Requirements*. The other accompanying information has not been subjected to the auditing procedures applied in our audits of the basic financial statements and, accordingly, we express no

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opinion on it. For the remaining information, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 13, 2008, on our consideration of FSA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Ernst + Young LLP

November 13, 2008

Report on Internal Control

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Tel: 703 747–1000
www.ey.com

Report on Internal Control

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2008, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 13, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered FSA's internal control over financial reporting by obtaining an understanding of the design effectiveness of the entity's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of the entity's controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not to express an opinion on the effectiveness of FSA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of FSA's internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04, as amended. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

Our consideration of internal control over financial reporting was for the limited purposes described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described below to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described above and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe none of the significant deficiencies described below is a material weakness.

FSA relies on the Department's Office of Chief Financial Officer (OCFO) to provide support for FSA's financial reporting needs. Specifically, FSA has a memorandum of understanding (MOU) with OCFO that indicates that OCFO is responsible for the following: (1) preparing FSA's financial statements; (2) performing the daily operations of processing transactions in the general ledger; (3) preparing the required financial reporting to the Office of Management and Budget and the U.S. Department of the Treasury, such as the SF-133 and the SF-224; and (4) developing and distributing accounting policies and procedures.

In addition, under the MOU, FSA is responsible for: (1) implementing accounting policies and procedures; (2) coordinating with OCFO and Budget Service on all financial reporting issues; and (3) reconciling subsidiary ledgers to supporting documentation and ledgers.

SIGNIFICANT DEFICIENCIES

1. Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Modified Repeat Condition)

The Federal Credit Reform Act of 1990, as amended, was enacted to require agencies to more accurately measure and budget for the cost of federal loan programs. In implementing the requirements of the Credit Reform Act, and in complying with Federal accounting standards, agencies are required to estimate the net cost of extending credit over the life of a direct loan or guaranteed loan based on the present value of estimated net cash flows, excluding certain administrative costs. Such costs are also re-estimated on a periodic basis. While improvements have been made over the last several years, we noted that internal controls and processes surrounding the calculation and reporting of the loan liability activity and subsidy estimates should be further refined to ensure that appropriate estimates are prepared.

During FY 2008, the Department continued the monthly integrated loans program meetings that were initiated in FY 2007. These meetings, which consolidated and streamlined activities previously performed by subgroups of the Credit Reform Workgroup (CRW), include representatives from OCFO, FSA, Budget Service, Office of Postsecondary Education (OPE), and OMB. During these meetings, representatives actively reviewed reports developed to enhance credit reform discussions and to discuss key internal issues and trends related to the portfolios.

During FY 2008, new legislation, the *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA), was enacted, which provided the Secretary of Education with the authority to purchase student loans from private lenders. The Department assembled a team with representatives from throughout the organization to develop, document, and implement the necessary processes. Representatives included individuals from the Office of the Under Secretary, OCFO, Office of General Counsel, Budget Service, and FSA. We noted that the Department and FSA implemented and accounted for these challenging programs, which became effective during the last quarter of the year.

However, after identifying the challenges, considerable expertise and key improvements in communication made or currently being made by the Department and FSA, we noted the following items that indicate management controls and analysis can be strengthened:

- The long-term cost for the credit programs is reflected in the financial statements through periodic charges for subsidy costs, adjustments or re-estimates to those subsidy costs, and loan activity, which is all recognized in the allowance for the direct loan (DL) receivable and liability for the guaranteed loan (FFEL) program. The Department uses a computer-based cash flow projection model (i.e., Student Loan Model, or SLM) and OMB calculator to calculate subsidy estimates related to the loan programs that are then recorded in the allowance for subsidy or liability account. The model uses multiple sources of loan data and hundreds of complex assumptions. In order to perform a check of estimates resulting from the SLM and OMB calculator, the Department prepares a backcast, which compares the model's estimates to actual activity for the current and prior fiscal years. The SLM also produces a forecast of the expected cash flows in the current year for the outstanding loans which, when discounted, can be used to compare to the recorded activity in the general ledger. Additionally, the new data analysis tools prepared by the Department support more disaggregated reviews of data by cohort. The Department's financial systems are not configured to account for cash flows on a precise cohort level. Rigorous examinations using the new cohort data as well as comparisons using the backcast and forecast tools, and to the extent practical, recomputation of expected amounts based on loan volumes, interest rates and simplified cash flow assumptions, can serve as a key detection control for potential undetected errors that may exist in the development of the assumption data and credit reform estimates.

- Consistent with credit reform implementation guidance, the Department relies significantly on prior patterns to estimate future cash flow activity. However, the Department should be more proactive in identifying situations in which a refinement of such estimates should be made when circumstances suggest that fundamental patterns will change. For example, to the extent that lender or borrower behavior appears likely to have changed, or be changing, deviations from the use of historical data, or consideration of additional information to capture the impact of such changes, may be warranted in developing credit reform estimates. The current overall reductions in credit availability for lenders and borrowers, declines in home prices, increases in unemployment and deterioration in economic conditions may have a significant impact on student loan borrowers and consequently on the Department's credit reform results. Many of these impacts have not been explicitly reflected in the Department's estimates.

  Since the Department's approach to estimating deferment, forbearance, and default rates includes unemployment and inflation rates for selected loan products, and since forecasts of these external factors are used in arriving at the projected deferment, forbearance, and default amounts, the Department's estimates would be expected to capture some of the indirect impact of the credit environment. However, since the models are estimated using data that largely do not reflect recessionary conditions and for a significant period reflect what in hindsight has been assessed to be a credit bubble, the Department could gain additional insights by performing stress-testing around its estimates and, as necessary, postulating borrower and lender behavior that may occur under the current credit conditions and/or if recessions of varying severity unfold. This could be achieved by, for example:

  - *Cohort Analysis.* Since differences may exist in how the events in the credit crisis and broader economy impact borrowers at various points in their career, examining deferment, forbearance, and default rates by cohort may be beneficial. This could be achieved by comparing the rates at the same point in repayment for newer loans to those of older loans. This exercise would provide information regarding the extent to which there may be differences in performance across cohorts. Obtaining credit rating data for a subset of borrowers may also be useful in furthering analysis and tracking borrowers' ability to pay over time.

  - *Refinement of Tools to Reveal Trends in the Department's Loan Level Data.* We noted that the Department had made efforts to develop additional analytical tools utilizing the considerable data available to it, and is continuing the process to refine these tools and reports to aid in detecting trends. We also noted that the Department has made efforts to capture the impact of current credit conditions through the inclusion of an ad hoc variable in its model, which allows defaults for certain years to be at a different level than what would otherwise be predicted. Considering additional forms of stress-testing estimates, such as alternative unemployment and inflation scenarios, could also aid the Department in its analysis.

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- *Examining Behavior During Previous Periods of Economic Stress.* Though the data used in the Department's estimation generally reflects good economic conditions, they also cover at least two periods of economic changes from which information may be gathered to assess the potential impact of the current situation. For example, examining data and performing simulation exercises using recession-era unemployment rate paths from the early 1980s could provide additional information regarding default projections should the current economic environment result in similar increases in unemployment over the next few years. Such analysis may provide useful information for stress-testing the Department's deferment, forbearance, and default estimates, and aid in policy making to mitigate the impact of the current credit conditions on participants in the Department's programs and/or the costs of the programs.

Recommendations:

We recommend that Federal Student Aid perform the following:

1. Continue to improve the analytical tools used for the loan estimation process, working to develop formats and content that synthesizes and captures loan level data available in the Department's and FSA's systems. Specifically:
   - Examine deferment, forbearance, and default rates by cohort to determine the extent to which there may be differences in performance across cohorts.
   - For a subset of borrowers, obtain credit rating data and track the borrower's ability to pay over time. Utilize the results to further analysis.
   - Perform additional forms of stress-testing estimates, such as alternative employment and inflation scenarios.
2. Ensure that all analytical tools reconcile with one another to allow for their use as detect controls for loan program cost estimates.
3. Continue efforts to more fully implement cohort reporting with specific research on whether balances in the Department's and FSA's financial records are supported by estimates, by cohort, from the SLM and the cohort analysis tool and that remaining credit reform estimates for each cohort are appropriate in relation to the remaining outstanding loans for such cohorts.
4. Document the consideration and ultimate resolution, in detail, of scenarios under which early warnings from patterns in Department and FSA data and other indicators of stress on program participants would be expected to lead to model adjustments in anticipation of likely changes in cash flows and result in changes in credit reform estimates.

2. Controls Surrounding Information Systems Need Enhancement (Modified Repeat Condition)

In connection with the annual audit of FSA's FY 2008 financial statements, we conducted a controls review of the information technology processes related to the significant accounting and financial reporting systems. OMB Circular A-130, *Management of Federal Information Resources*, requires: (1) standard documentation and procedures for certification and accreditation of systems; (2) records management programs that provide adequate and proper documentation of agency activities; (3) agencies to develop internal information policies and procedures and oversee, evaluate, and otherwise periodically review agency information resource management activities; and (4) agency plans to assure that there is an ability to recover and provide service sufficient to meet the minimal needs of users of the system.

The Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* identifies five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communications, and Monitoring. With respect to the Control Environment and Monitoring components, the GAO publication states that:

- "management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control and conscientious management," and
- "internal control monitoring should assess the quality of performance over time and ensure that the findings of audit and other reviews are promptly resolved."

While the Department and FSA have worked towards strengthening and improving controls over information technology processes during FY 2008, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of IT general controls at the Department and FSA, we identified the following deficiencies: (1) lack of monitoring of the activities of administrator accounts at the application, operating system and/or database layers; (2) access for terminated users was not removed in a timely manner or not removed at all; (3) revalidation of users' rights is not consistently performed for all applications and users and for those revalidations that are performed, we noted instances in which there was no validation of the appropriateness of user access; (4) configurations for operating systems, databases and related security software did not conform to leading practices and, in some instances, to the relevant Department or FSA policy; and (5) separation of duties was not consistently enforced through systems access.

The OIG has identified deficiencies for the Department in its 2008 Federal Information Security Management Act (FISMA) reports related to the Debt Management and Collection System (DMCS). Areas of concern noted in the FISMA reports include: (1) lack of comprehensive incident response and handling capabilities; (2) lack of a configuration management program to reasonably maintain security over FSA systems in a consistent manner; (3) limited oversight of contractors supporting certain systems; and (4) incomplete certification and accreditation procedures.

In addition, several of the above deficiencies are repeat conditions (albeit for different platforms or systems) that were noted in our work and in the OIG's audit reports, an indication that the control environment and monitoring components of internal controls at the Department and FSA require additional focus.

Recommendation:

Applications and related infrastructure are supported by a number of separate groups within the Department and FSA. While these groups have attempted to implement controls promulgated by Department, FSA, OMB, and NIST guidelines, control processes and practices have been implemented in a disparate manner across these groups. In addition, audit resolution activities have traditionally been handled by each separate group and have largely focused around addressing the immediate security and control weaknesses identified by audit reports.

We recommend that the Department and FSA continue their efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness uniformly across the organization, which should decrease the likelihood of a similar weaknesses being identified in future audit assessments and internal self-assessments. Examples of addressing root causes may include, but are not limited to, additional training for the information technology professionals within the organization, updates to procedures to ensure proper configuration of servers against documented hardening standards at the time of deployment, and reviewing performance-based contracts of vendors providing system support services to the Department and FSA. As appropriate, the specific security setting and government standards that are to be applied, and approaches to achieving and monitoring such compliance, may merit additional focus in contracts the Department and FSA execute with service providers.

More specifically the Department and FSA should: (1) implement standards around the logging of privileged user access and activities and establish controls over the monitoring of that access; (2) strengthen access controls to protect mission critical systems (e.g., periodic access revalidation, timely removal of user access, physical data center access controls); (3) improve the configuration management process to ensure consistent security configuration of servers and mainframe security packages across the organization and improve configuration settings to comply with best practices; (4) improve governance over the changes to technical security configurations; (5) strengthen incident handling and response procedures; (6) comprehensively review technical security weaknesses identified in prior audits in order to determine whether security controls have been fully implemented or adequately address the security weaknesses across the organization; (7) enhance monitoring of its security training and awareness program, specifically around completion of such training by all employees and contractors, including the sharing of sensitive information; (8) consistently perform risk assessments and Certification and Accreditation to include new systems and new environments; (9) improve controls over the protection of personally identifiable information (PII); and (10) update its contingency planning and disaster recovery planning documentation.

STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the FY 2007 audit of Federal Student Aid's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

Summary of FY 2007 Significant Deficiencies

Issue Area	Summary Control Issue	FY 2008 Status
Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Significant Deficiency)	Management controls and analysis need to be strengthened over credit reform estimation and financial reporting processes.	Improvements noted – Modified Repeat Condition classified as a Significant Deficiency
Additional Focus on Program Monitoring Activities is Needed (Significant Deficiency)	Renewed focus is warranted regarding monitoring activities for various Departmental and FSA loan and grant programs.	Improvements noted in updating policies and risk assessment processes. Continued focus on implementation and resources is warranted – Not classified as a Significant Deficiency at September 30, 2008
Controls Surrounding Information Systems Need Enhancement (Significant Deficiency)	Improvements are needed in overall information technology security management.	Improvements noted – Modified Repeat Condition classified as a Significant Deficiency

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

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

Ernst + Young LLP

November 13, 2008

Report on Compliance with Laws and Regulations

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Tel: 703 747–1000
www.ey.com

Report on Compliance with Laws and Regulations

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2008, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 13, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The management of FSA is responsible for complying with laws and regulations applicable to the entity. As part of obtaining reasonable assurance about whether the entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to FSA.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended.

Under FFMIA, we are required to report whether FSA's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this reporting requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed instances in which the Department's financial management systems did not substantially comply with certain requirements discussed in the preceding paragraph. FSA relies on the Department's systems to provide support for FSA's financial reporting needs, including utilizing the Department's general ledger to process transactions. We have identified the following instance of noncompliance:

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Report on Compliance with Laws and Regulations
Page 2

While the Department and FSA have worked towards strengthening and improving controls over information technology processes during FY 2008, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems that need to be addressed. During our review of IT general controls at the Department and FSA, we identified the following deficiencies: (1) lack of monitoring over the activities of administrator accounts at the application, operating system and/or database layers; (2) access for terminated users was not removed timely or not removed at all; (3) revalidation of users' rights is not consistently performed for all applications and users and for those revalidations that are performed, there is no validation of the appropriateness of user access; (4) configurations for operating systems, databases and related security software did not conform to leading practices and, in some instances, to the relevant Department or FSA policy; and (5) separation of duties was not consistently enforced through systems access. The OIG has identified deficiencies for the Department and FSA in its 2008 Federal Information Security Management Act (FISMA) reports related to the Debt Management and Collection System (DMCS). Areas of concern noted in the FISMA reports include: (1) lack of comprehensive incident response and handling capabilities, (2) lack of a configuration management program to reasonably maintain security over FSA systems in a consistent manner, (3) limited oversight of contractors supporting certain systems, and (4) incomplete certification and accreditation procedures.

Our Report on Internal Control dated November 13, 2008 includes additional information related to the financial management systems that were found not to comply with the requirements of FFMIA relating to information technology security and controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMIA, and our recommendations related to the specific issues. We have reviewed our findings and recommendations with management of the Department and FSA. Management concurs with our recommendations and, to the extent findings and recommendations were noted in prior years, has provided a proposed action plan to the OIG in accordance with applicable Department directives. We did not audit management's proposed action plan and accordingly, we express no opinion on it.

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

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

Ernst + Young LLP

November 13, 2008

Management's Response

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FEDERAL STUDENT AID

November 10, 2008

MEMORANDUM

TO: Jerry G. Bridges
Acting Inspector General

FROM: John W. Hurt, III
Chief Financial Officer
Federal Student Aid

SUBJECT: DRAFT AUDIT REPORTS
Fiscal Years 2008 and 2007 Financial Statement Audit
U.S. Department of Education
ED-OIG/A17I0002

Federal Student Aid wishes to express our appreciation for the efforts and professionalism of the Office of Inspector General and our auditors, Ernst & Young, LLP, in their audit of our fiscal year 2008 financial statements. We concur with the findings and recommendations as identified in the reports of November 1, 2008.

Federal Student Aid continues to support the Department of Education's efforts to address the significant deficiencies related to the credit reform estimation and financial reporting processes. We recognize that significant additional work remains to be accomplished in order for the Department to have a fully institutionalized practice.

We are committed to maintaining an unqualified opinion in future fiscal years and we will continue to prioritize corrective actions to eliminate significant deficiencies and other matters as noted in the reports. In addition, working with the Department, we will continue to implement additional improvements on controls over information systems.

Once again, we thank the Office of Inspector General and Ernst &Young for their efforts to complete a successful audit of Federal Student Aid's financial statements.

Glossary of Acronyms and Terms

Acronym	Description
ACG	Academic Competitiveness Grant
ACSI	American Customer Satisfaction Index
CCRAA	*College Cost Reduction and Access Act of 2007*
CDR	National Cohort Default Rate
CLTDR	Cumulative Lifetime Default Rate
Credit Reform Act	*Federal Credit Reform Act of 1990*
CSRS	Civil Service Retirement System
DCL	Dear Colleague Letter
Department	U.S. Department of Education
Direct Loan	William D. Ford Federal Direct Loan Program
ECASLA	*Ensuring Continued Access to Student Loans Act of 2008*
ERM	Enterprise Risk Management
ERMG	Enterprise Risk Management Group
FAFSA	Free Application for Federal Student Aid
FAFSA4caster	Free Application for Federal Student Aid forecaster
FECA	Federal Employees' Compensation Act
Federal Fund	Federal Student Loan Reserve Fund
FERS	Federal Employees Retirement System
FFEL	Federal Family Education Loan Program
FMFIA	Federal Managers' Financial Integrity Act
FSEOG	Federal Supplemental Educational Opportunity Grant
FWS	Federal Work-Study Program
FY	Fiscal Year
GAO	Government Accountability Office
HEA	*Higher Education Act of 1965, as amended*
HERA	*Higher Education Reconciliation Act of 2005*
IPIA	*Improper Payments Information Act of 2002*
IT	Information Technology
Labor	U.S. Department of Labor
LEAP	Leveraging Educational Assistance Partnership Program
LLR	Lender-of-Last-Resort
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
Opinion	Report of Independent Auditors
PAR	*Performance and Accountability Report*
Pell Grant	Federal Pell Grant Program
PBO	Performance-Based Organization
PMA	*President's Management Agenda*
SLEAP	Special Leveraging Educational Assistance Partnership Program
SMART	National Science and Mathematics Access to Retain Talent Grant Program
SAP	Special Allowance Payment
TEACH	Teacher Education Assistance for College and Higher Education Grant Program
Title IV programs	Title IV Student Financial Assistance Programs
TPD	Total and Permanent Disability
Treasury	U.S. Department of the Treasury

Availability of Federal Student Aid's Annual Report

Availability of Federal Student Aid's Annual Report

Federal Student Aid's publicly available *FY 2008 Annual Report* is accessible on Federal Student Aid's and the Department's Web sites at:

http://www.federalstudentaid.ed.gov

http://www.ed.gov/about/reports/annual/index.html

Federal Student Aid, an office of the U.S. Department of Education, ensures that all eligible individuals benefit from federal financial assistance — grants, loans and work-study programs — for education beyond high school.

FederalStudentAid.ed.gov

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