



# U.S. Department of Education FY 2009 Agency Financial Report

**U.S. Department of Education**

Arne Duncan  
*Secretary*

**Office of the Chief Financial Officer**

Thomas Skelly  
*Delegated to Perform Functions of Chief Financial Officer*

November 16, 2009

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This report is available on the Department's Web site at: <http://www.ed.gov/about/overview/focus/performance.html>.

On request, this publication is available in alternative formats, such as Braille, large print or computer diskette. For more information, please contact the Department's Alternate Format Center at 202-260-0852 or 202-260-0818.

The Department's *Strategic Plan* is available on the Web at: <http://www.ed.gov/about/reports/strat/index.html>.

Department annual plans and annual reports are available on the Web at:  
<http://www.ed.gov/about/reports/annual/index.html>.

The Department welcomes all comments and suggestions on both the content and presentation of this report.  
Please forward them to: [PARcomments@ed.gov](mailto:PARcomments@ed.gov)

Office of the Chief Financial Officer  
U.S. Department of Education  
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The following companies were contracted to assist in the preparation of the  
U.S. Department of Education FY 2009 *Agency Financial Report*:

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For database design: Plexus Corporation  
For accounting services: IBM Business Consulting Services  
FMR Consulting, Inc.  
Cotton & Company, LLP

## FOREWORD

The United States Department of Education's (the Department's) *Agency Financial Report* (AFR) for fiscal year (FY) 2009 provides an overview of the Department's financial performance and results to provide Congress, the President and the American people detailed information about our stewardship over the financial resources entrusted to us. Additionally, the report provides information about our performance as an organization, our achievements and initiatives and our challenges.

The AFR is the first in a series of reports required under the Office of Management and Budget's Pilot Program for Alternative Approaches to Performance and Accountability Reporting. This is the first year that the Department has participated in this voluntary program in an effort to strengthen its annual reporting documents and to present more streamlined and timely information to clarify the relationship between performance, budgetary resources and financial reporting. The Department intends to provide a more meaningful, transparent and easily understood analysis of accountability over its resources. The report provides readers with an overview of the Department's highest priorities, as well as our strengths and challenges.

The Department's FY 2009 pilot annual reporting includes the following three components:

### **Agency Financial Report (AFR)** [available November 2009]

The AFR, the following report, is organized into three major sections:

- The Management's Discussion and Analysis section provides executive-level information on the Department's history, mission, organization, key activities, analysis of financial statements, systems, controls and legal compliance, accomplishments for the fiscal year and management and performance challenges facing the Department.
- The Financial Details section provides a Message From the Chief Financial Officer, consolidated and combined financial statements, the Department's notes to the financial statements and the Report of the Independent Auditors.
- The Other Accompanying Information section provides *Improper Payments Information Act* reporting details and other statutory reporting requirements.

### **Annual Performance Report (APR)**

[available February 2010]

The APR will be produced in conjunction with the FY 2011 President's Budget Request and will provide the detailed performance information and descriptions of results by each key performance measure.

### **FY 2009 Summary of Performance and Financial Information**

[available February 2010]

This document will provide an integrated overview of performance and financial information that integrate the AFR and the APR into a user-friendly consolidated format.

This report meets the following legislated reporting requirements:

- *Federal Managers' Financial Integrity Act of 1982 (FMFIA)* requires a report on the status of internal controls and the agency's most serious problems.
- *Government Performance and Results Act of 1993 (GPRA)* guides the agency's strategic planning and annual planning and reporting.
- *Federal Financial Management Improvement Act of 1996 (FFMIA)* requires an assessment of the agency's financial systems for adherence to governmentwide requirements.
- *Government Management Reform Act of 1994 (GMRA)* requires agency audited financial statements.
- *Reports Consolidation Act of 2000 (RCA)* requires the consolidated reporting of performance, financial and related information.
- *Improper Payments Information Act of 2002 (IPIA)* requires reporting on agency efforts to identify and reduce erroneous payments.

**All three reports will be available on the Department's Web site at**  
<http://www.ed.gov/about/overview/focus/performance.html>





“Reforming public education is not just a moral obligation. It is an . . . economic imperative. It is the foundation of a strong future and a strong society.”

—Secretary Duncan

## Message From the Secretary

November 16, 2009

This year has been the most active in the 30-year history of the U.S. Department of Education (the Department). With challenges faced by school districts, institutions of higher education and students of all ages, we have mobilized as a nation to provide stability for the present and incentives for improvement in the future.

As a Department, we have broadened and deepened our commitment to the Department's stated mission: to promote achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access, using goals and measures that reflect the importance of early childhood, K-12 and higher education.



The report focuses on achievement and access; putting performance first; ensuring responsible implementation of the *American Recovery and Reinvestment Act of 2009*, commonly known as the *Recovery Act* or *ARRA*; and bringing the government into a new time of transparency, technology and innovation. The *Recovery Act* provides \$98.2 billion in education funding and college grants and tuition tax credits.

### Achievements:

- We report weekly on *Recovery Act* spending, by state and program, and make these reports available on our Web site.
- The Department has accelerated *Recovery Act* spending by advancing its internal deadlines to award \$11.37 billion to states one month early to help save jobs and drive reform.
- President Obama joined us at the Department on July 24, 2009, to announce Race to the Top—a national competition for states to lead the way in school reforms, backed by historic levels of financial support.
- The Department continues to ensure that eligible students are able to obtain student loans despite the challenges in the credit market.
- For the eighth consecutive year, the Department has earned a clean opinion from independent auditors on its financial statements; and for the seventh consecutive year, no material weaknesses were identified.
- Since the “Listening and Learning Tour Online” went live on May 11, hundreds of comments have been made regarding the four reforms outlined in the *Recovery Act*, college graduation, teacher evaluations and early childhood. Comments are posted at: <http://www.edgovblogs.org/duncan/topic/join-the-conversation/>.

Future Initiatives:

- Simplifying the Free Application for Federal Student Aid (FAFSA).
- Working to ensure we have an efficient and effective student aid delivery process.

Challenges:

- Ongoing efforts to strengthen and improve controls over information and technology processes.
- Managing *Recovery Act* spending and continuing recipient and sub-recipient reporting.
- Addressing time lags in collection and reporting of performance data, which are mostly collected from the states.

This report includes information and assurances about the Department's financial management systems and management controls required by the *Federal Managers' Financial Integrity Act of 1982*. These systems and controls provide reasonable assurance that the objectives of this Act have been met. For further discussion, please see the Management's Assurances section of the Management's Discussion and Analysis on pages 42-43 of this report.

This year, the Department is participating in an Office of Management and Budget pilot program discussed in the Foreword of this document. Our performance data are fundamentally complete and reliable and will be reported in the *Annual Performance Report* in February.

Sincerely,

/s/

Arne Duncan

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“. . . the truest measure of a society’s worth is whether it offers all of our children the opportunity to go where they want to go, do what they want to do and fulfill their dreams. This is the promise of education . . . . This is the American promise.”

—Secretary Duncan





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# Management's Discussion and Analysis



## OUR MISSION AND HISTORY

**Mission.** The U.S. Department of Education's (the Department's) mission is *to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.*

**History.** The federal government recognized that furthering education is a national priority in 1867, creating a federal education agency to collect and report statistical data. The Department, established as a cabinet-level agency in 1979, celebrated its 30<sup>th</sup> anniversary during FY 2009. Today the federal role has grown to include federal support for education, including student financial aid, supporting education research and providing information on what works to teachers, education policymakers and parents. For a chronology of education legislation, go to: [http://nces.ed.gov/pubs2009/2009020\\_4.pdf](http://nces.ed.gov/pubs2009/2009020_4.pdf).

The Department is committed to ensuring students develop the skills they need to succeed in school, college and the workforce, while recognizing the primary role of states and school districts in providing a high-quality education, employing highly qualified teachers and administrators and establishing challenging content and achievement standards. The Department is also setting high expectations for its own employees and working to improve management practices, ensure fiscal integrity and develop a culture of high performance.

## WHO WE SERVE: OUR PUBLIC BENEFIT

Every American has a stake in the nation's educational success. The Department's Web site and print resources focus on our primary customers—

Students—See more on Departmental services to students at <http://www.ed.gov/students/landing.jhtml>.

Teachers—See more details on Departmental services for teachers at <http://www.ed.gov/teachers/landing.jhtml>.

Parents—See more details on Departmental services for parents at <http://www.ed.gov/parents/landing.jhtml>.

State and Local Educational Agencies—For a list of state agencies, see <http://www.ed.gov/about/contacts/state/index.html?src=gu>.

Administrators—Principals, superintendents and other administrators are at the center of school reform and accountability efforts. See more details at <http://www.ed.gov/admins/landing.jhtml>.

Postsecondary Students and Institutions—The Department provides assistance through programs such as the Federal Pell Grant Program, the Federal Family Education Loan (FFEL) Program, the William D. Ford Federal Direct Loan Program, the Federal Perkins Loan Program and the Federal Work-Study Program, authorized under Title IV of the *Higher Education Act of 1965*, as amended (*HEA*). See more details on student financial aid at <http://www.ed.gov/finaid/landing.jhtml?src=rt>.

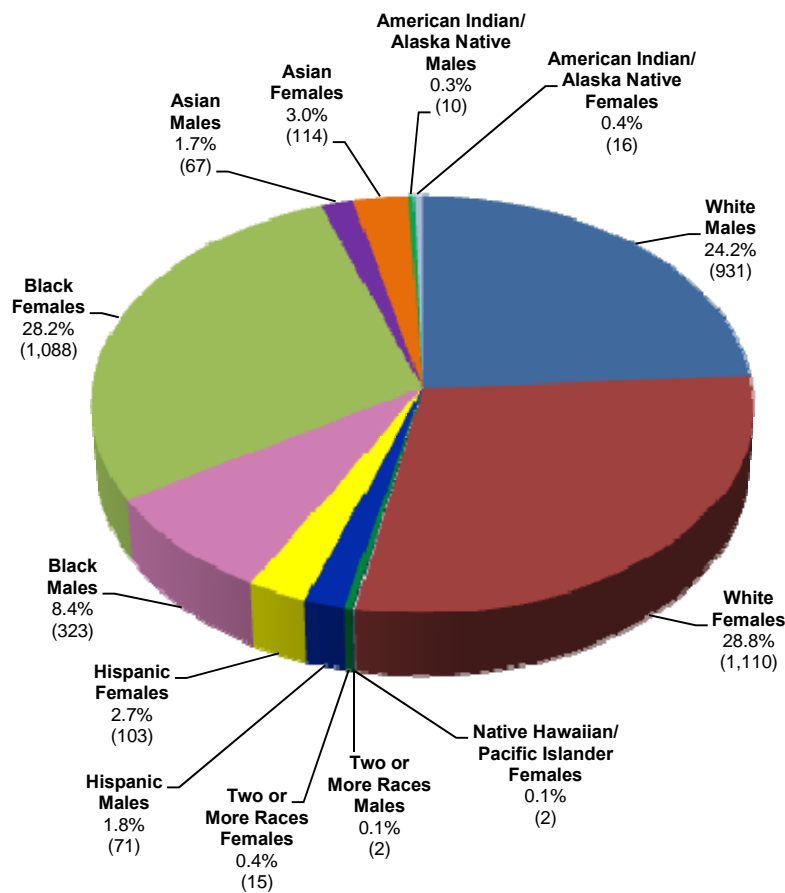
## WHO WE ARE: OUR ORGANIZATION AND WORKFORCE

### Department of Education Workforce Makeup

#### Department of Education Workforce Composition as of September 26, 2009

- Total Workforce = 4,225
- 3,852 Permanent Employees
- 373 Temporary Employees
- 62 percent (2,634) Female
- 38 percent (1,591) Male

#### Department of Education Permanent Workforce by Ethnicity and Gender as of September 26, 2009



NOTE: Numbers may not add to 100 percent due to rounding.

Source: Annual Equal Employment Opportunity Status Report: An Equal Employment Opportunity Management Directive (MD) 715 Requirement for the Period covering October 1, 2008 Through September 26, 2009.

Department of Education Coordinating Structure FY 2009



For additional information about the principal components of the Department of Education, please go to: <http://www.ed.gov/about/offices/list/index.html?src=ln>.



## LINKING TAXPAYER DOLLARS TO PERFORMANCE RESULTS: ACCOUNTABILITY THROUGH THE INTEGRATION OF RESULTS WITH INVESTMENT

Our emphasis on sound financial practices, performance results and program accountability reflects a strong desire to use taxpayers' dollars as effectively as possible. The Department strives to tie the performance of our programs with budget requests and to strengthen the link between financial investments and program quality.

In order to tie performance to budget submissions, federal agencies are required to identify a number of high-priority performance goals to further the administration's agenda for building a high-performing government and identify strategies and a means to achieve them. The draft goals are expected to be completed in FY 2010.

### Linking Program Performance With Budget Submissions

The Department participates closely with the Performance Improvement Council (PIC) to establish guidelines and metrics to more closely align program and management performance with Budget requests. The Office of Management and Budget established the PIC in FY 2007 under *Executive Order 13450: Improving Government Program Performance* as a tool to spend taxpayers' dollars more effectively and with greater accountability.

The PIC is composed of senior staff from each federal agency who are responsible for coordinating areas of performance management activities, such as ensuring that data from annual performance plans and reports are used in agency budget justifications. Collectively, the PIC is tasked with establishing program performance standards and evaluation criteria, exchanging information among agencies, coordinating and monitoring performance assessments, keeping the public informed, obtaining advice from stakeholders and making policy recommendations.

Additionally, *GPR*A requires agencies to develop annual program performance plans that include challenging performance metrics that can be used to judge the effectiveness of each program. Programs deemed ineffective or that are not delivering results based on established performance measures are reviewed for inclusion in the Department's annual budget submission to Congress.

To further our commitment to provide more effective oversight for our fiscal resources, the Department has identified a senior manager for performance management systems in the Office of the Deputy Secretary to oversee the furtherance of accountability for results for both our strategic priorities and our internal management processes. In addition, the administration has appointed a Deputy Assistant Secretary for Performance Improvement—a position housed in the Department's Office of Management.

### Performance Evaluations Improve Accountability

Each year, the Department publishes evaluations of selected programs to further demonstrate accountability for the taxpayers' investment in education spending. These evaluations serve to identify best practices as well as programs that cannot demonstrate accountability for results, as well as to inform senior management about programs in need

of additional support. The Department uses evaluations to identify programs that should be eliminated from the budget or recommended for reduced funding. The Department also uses evaluations to support budget requests for increases in program funds. Several offices in the Department have the responsibility for designing and implementing evaluations of program and management activities and operations. Those offices include the Institute of Education Sciences (IES) and the Office of Planning, Evaluation and Policy Development (OPEPD). Additionally, the Department's Office of Inspector General (OIG) and the Government Accountability Office (GAO) audits and reports provide guidance and feedback on improvements in management and program operations. Finally, the Department provides guidance to grant recipients on developing evaluations based on scientifically rigorous evidence. More detail is available at:

[http://ies.ed.gov/ncee/pubs/evidence\\_based/evidence\\_based.asp](http://ies.ed.gov/ncee/pubs/evidence_based/evidence_based.asp).

### **Ensuring Accountability and Oversight of *Recovery Act* Funds**

The Risk Management Service (RMS), in the Office of the Secretary, is responsible for Departmentwide grants policy related to identifying and working with high-risk grantees to minimize risk to federal funds that may adversely affect the advancement of the Department's priority goals.

In FY 2009 RMS took a two-phased approach to providing technical assistance to states receiving *Recovery Act* funds. The first phase targets states that received the most *Recovery Act* money and were identified as having fiscal and programmatic concerns. RMS is coordinating the provision of technical assistance to states based on basic federal grants in fiscal management requirements, such as cash management, internal controls, procurement, allowable activities, data quality and sub-recipient monitoring. In its second phase, RMS has developed a regular series of *Recovery Act* technical assistance Web conferences to enhance the ongoing provision of oversight and technical assistance to grantees receiving *Recovery Act* funds to ensure that they are held accountable to the taxpayer and that these and other Department grant funds are spent appropriately.

### **Cost Saving Measures Underway at the Department**

A major priority of the new administration is to ensure that federal agencies control costs and conduct their internal lines of business to be as effective and efficient with the use of the taxpayers' dollar as possible. The Department has undertaken measures to evaluate and implement administrative cost-saving opportunities that have already realized immediate savings and costs avoided, as well as longer-term plans that will realize additional savings in years to come. The Department has identified a number of cost saving measures that include equipment consolidation, reduction in contract and travel costs, eliminating extraneous office space and consolidating teleconferencing facilities and conference spaces. Additional cost-saving measures are under review for FY 2010.

## HOW WE VALIDATE OUR DATA

The *Government Performance and Results Act of 1993 (GPRA)* requires federal departments and agencies to clearly describe the goals and objectives of their programs, identify resources and actions needed to accomplish goals and objectives, develop a means of measuring progress made and report regularly on achievement. The goals of the act include improving program effectiveness by promoting a focus on results, service quality and customer satisfaction; improving congressional decision making by providing objective information on achieving statutory objectives; and focusing on the relative effectiveness and efficiency of federal programs and spending.

### Consolidating Data Collections Through *EDFacts*

Complete, accurate and reliable data are essential for effective decision-making. Given the requirements of the *Elementary and Secondary Education Act of 1965 (ESEA)*, as amended, accuracy of state and local educational agency performance data is crucial to funding decisions and management actions are taken on the basis of this performance information.

The mandatory regulation requires states to electronically submit data to the Education Data Exchange Network Submission System (EDENS), a centralized, Internet-based system of elementary and secondary education data (K-12) from 52 state education agencies. Data are available for state and local education agencies. School data include demographics, program participation, implementation and outcomes.

*EDFacts* became the mandatory system for states to electronically report their K–12 education data to the Department starting in school year (SY) 2008–09. The *EDFacts* system enabled the consolidation of historically separate data collection efforts, and the increased amount of data in *EDFacts* allows for even greater data collection efficiencies. The Department is using the *EDFacts* Metadata and Process System to collect each state's plan for transitioning from reporting using five racial and ethnic categories to using seven. For SY 2008–09, the collection was optional; if a state has not entered a plan, it was assumed that five categories were used for the school year.

By using the Education Data Exchange Network Submission System and *EDFacts* Metadata and Process System together, *EDFacts* is able to reduce the reporting burden for states by eliminating redundant data requests for multiple data collections. This approach also provides program offices with the ability to retire paper-based collections and improve data quality by relying solely on electronic reporting methods. In the future, the *EDFacts* initiative will employ similar strategies to increase the efficiency of data acquisition methods across the Department.

### The Validation and Verification of Performance Data

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, *GPRRA* prescribes the means to verify and validate measured values. Finally, the *Reports Consolidation Act of 2000* requires that the transmittal letter included in annual performance reports contains an assessment by the agency head of the completeness and reliability of the performance data included in its plans and reports.

In response, the Department has developed a guidance document to assist principal offices responsible for reporting data on strategic and program performance measures to address issues of data integrity and credibility. The guidance provides a framework for validating and verifying performance data before it is collected and reported and is used to evaluate data prior to publication for review by the public. Additionally, the Department has developed a worksheet for each program office to use to identify the validity of the data for their unique program performance measures.

The Department's data validation criteria require that program goals and measures are:

- appropriate to the mission of the organization and that measured performance has a direct relation to the goal;
- realistic and measurable, achievable in the time frame established and challenging in their targets;
- understandable to the lay person and terminology is adequately defined; and
- used in decision-making about the effectiveness of the program and its benefit to the public.

For more information on the guidance and its implementation and to review the worksheet, go to <http://www.ed.gov/about/reports/annual/index.html>.

### **The Institute of Education Sciences Data Quality Initiative**

The Data Quality Initiative of the Department's Institute of Education Sciences, begun in 2006, is designed to improve the Department's program performance data and reporting in support of the goals of *GPRRA*. Technical assistance is being provided to approximately 30 Department grant programs.

Activities for Department program offices include reviewing grantee evaluation plans and reports; developing annual performance reporting forms; analyzing grantee annual performance data; and developing briefings and workshops focused on evaluation strategies. In 2008 and 2009, the initiative was expanded to include programs covering a wide range of elementary and secondary education topics and populations. See [http://ies.ed.gov/ncee/projects/evaluation/assistance\\_data.asp](http://ies.ed.gov/ncee/projects/evaluation/assistance_data.asp) for more details.

### **The National Forum on Education Statistics**

The National Forum on Education Statistics, sponsored by the Department's National Center for Education Statistics, is a voluntary, participative and cooperative federal-state-local body with a mission to develop and recommend strategies for building an education data system that will support local, state and national efforts to improve public and private education throughout the United States. See more details at [http://nces.ed.gov/forum/data\\_quality.asp](http://nces.ed.gov/forum/data_quality.asp).



## OUR ACCOMPLISHMENTS AND ONGOING INITIATIVES FOR FY 2009

### *The American Recovery and Reinvestment Act of 2009*

#### Overview

The *Recovery Act* was signed into law by President Barack Obama on February 17, 2009. It is an unprecedented effort to jumpstart our economy, create or save millions of jobs and put a down payment on addressing long-neglected challenges so that our country can thrive in the 21<sup>st</sup> century. To see how *Recovery Act* funds are helping your state, visit <http://www.ed.gov/policy/gen/leg/recovery/state-fact-sheets/index.html>.

The *Recovery Act* invests heavily in education.

- The act included a total of \$98.2 billion to the Department for supplemental appropriations for reforms to strengthen elementary, secondary and higher education, including money to stabilize state education budgets and to encourage states to:
  - make improvements in teacher effectiveness and ensure that all schools have highly qualified teachers;
  - make progress toward college and career-ready standards and rigorous assessments that will improve both teaching and learning;
  - improve achievement in low-performing schools, through intensive support and effective interventions; and
  - gather information to improve student learning, teacher performance and college and career readiness through enhanced data systems.
- The act provides competitive funds to spur innovation and chart ambitious reform to close the achievement gap.
- The act addresses college affordability and improves access to higher education.
- The act includes early learning programs, including child care and programs for children with special needs.

#### *Recovery Act Successes*

##### **Orange County Public Schools, Florida**

As part of the *Recovery Act's* efforts to impact education across the country, Florida has felt the impact of more than \$3.1 billion in education funds. This includes nearly \$2 billion in State Fiscal Stabilization Funds that has kept more than 25,000 teachers and staff in Florida's classrooms and maintained other essential services, over \$335 million to provide special education and related services to children with disabilities under the *Individuals with Disabilities Act (IDEA)* and \$245 million to Title I schools.

Orange County Public Schools, the 11<sup>th</sup> largest school district in the nation and encompassing all of Orlando's public schools, says they have preserved more than 1,600 teachers, nurses, counselors, tutors and other essential staff due to \$132 million from the *Recovery Act*.

## Department Programs Receiving *Recovery Act* Funding

### Race to the Top

The \$4.35 billion Race to the Top Fund is the largest ever federal competitive investment in school reform. It will reward states for past accomplishments and create incentives for future improvements. The funding criteria that the Department proposes to use will challenge states to create comprehensive strategies for addressing the four central areas of reform that will drive school improvement:

- adopting internationally benchmarked standards and assessments that prepare students for success in college and in the workplace;
- recruiting, developing, retaining and rewarding effective teachers and principals;
- building data systems that measure student success and inform teachers and principals how best to improve their practices; and
- turning around our lowest-performing schools.

To read more about the Race to the Top Fund, visit

<http://www.ed.gov/programs/racetothetop/factsheet.html>.

### Investing in Innovation

To be eligible for this \$650 million competitive grant program, local educational agencies (LEAs), including charter school LEAs, and nonprofit organizations working in collaboration with one or more LEAs or a consortium of schools must have made progress in raising student achievement, significantly closing the achievement gap and made progress in other areas. For more information, see <http://www.ed.gov/programs/innovation/factsheet.html>.

#### *Recovery Act* Successes

##### **Richmond County School District, North Carolina**

With the decline in state revenues in North Carolina, the Richmond County School District will lose over \$3 million in support for education programs, staffing, professional development and other critical needs. The cuts threaten to diminish district efforts to pursue new academic models that have proven reform results. Even with recent state budget action, resource projections are on the decline.

**How *Recovery Act* Funds Are Being Used:** Budget reductions at the state level caused the district to face a loss of 40 positions across the system from teachers to support staff. The local educational agency's share of *Recovery Act* funds will permit the superintendent to restore a share, but not all, of these positions critical to the teaching, learning and support functions of the districts and its schools.

The one-time increase in *Individuals With Disabilities Education Act (IDEA)* funds is permitting the district to implement new teaching and learning strategies for students with special needs that will accelerate efforts to attain grade-level performance and academic achievement.

The one-time increase in Title I funds permits the district to invest in new strategies that promote a districtwide commitment to creating and sustaining professional learning communities. This long-range effort was in serious jeopardy of being curtailed with the loss of funds due to the downturn in the state economy.

*Recovery Act* funds will also be used in part to secure a state-of-the-art library facility that will be used by all district students and include access to updated technology for teaching and learning, self-directed learning and after-school programs. Without these funds, consideration of these improvements in education resources would not be possible.

## Teacher Incentive Fund

The \$200 million Teacher Incentive Fund supports state and district efforts to develop and implement performance-based teacher and principal compensation systems in high-need schools, primarily through grants to school districts and consortia of school districts. Under the compensation systems in place in virtually all school districts, teacher salaries increase based on a teacher collecting graduate credit for additional study, increasing number of years on the job or moving out of the classroom into an administrative position. These pay systems often place high-poverty schools at a disadvantage in recruiting effective teachers. The Teacher Incentive Fund supports a variety of performance-based teacher and principal compensation systems that reward teachers and principals for increases in student achievement and boost the number of effective instructors teaching in hard-to-staff subjects and in high-need schools. For more information, see <http://www.ed.gov/programs/teacherincentive/factsheet.html>.

## Teacher Quality Partnership

The \$100 million Teacher Quality Partnership program is designed to improve the quality of new teachers by creating partnerships among high-need school districts and schools or high-need early childhood education program. These partnerships create model teacher preparation programs at the pre-baccalaureate level. For more information, see <http://www.ed.gov/programs/tqpartnership/index.html>

## State Longitudinal Data Systems

This \$250 million *Recovery Act* program provides grants to states to design, develop and implement statewide longitudinal data systems to capture, analyze and use student data from preschool to high school, college and the workforce. The *Recovery Act* requires that the data systems have the capacity to link preschool, K–12 and postsecondary education as well as workforce data. To receive State Fiscal Stabilization Funds, a state must provide an assurance that it will establish a longitudinal data system that includes the 12 elements described in the *America Creating Opportunities to Meaningfully Promote Excellence in Technology, Education and Science Act* (or the *America COMPETES Act*). For more information, see <http://www.ed.gov/programs/slids/factsheet.html>.

## Title I School Improvement Grants

Title I School Improvement Grants provide states and school districts funds to leverage change and turn around Title I schools identified for improvement, corrective action or restructuring. Authorized under *ESEA* in 2002, the program did not receive funding until FY 2007. The current \$3 billion provides an unprecedented opportunity for states and school districts to implement significant reforms to transform their chronically lowest-achieving schools.

Under *ESEA*, states and school districts are required to restructure Title I schools that fail to make adequate yearly progress for five years. Reports indicate that the least rigorous interventions allowable have shown little success in turning around these chronically low-achieving schools, and that the program should be better targeted on the very lowest-performing schools. For more information, see <http://www.ed.gov/programs/sif/factsheet.html>.

## State Educational Technology Grants

The primary goal of the \$650 million Educational Technology Grants program is to improve student academic achievement through the use of technology in schools. It is also designed to help ensure that every student is technologically literate by the end of eighth grade and to encourage the effective integration of technology with teacher training and curriculum development. For more information, see <http://www.ed.gov/programs/edtech/factsheet.html>.

The *Recovery Act* programs provide an unprecedented opportunity for states, districts and schools to use innovative strategies to enhance instruction, facilitate teaching and learning and improve student achievement. They will enable districts to acquire new and emerging technologies, create state-of-the-art learning environments and offer new training and more support for teachers so that students acquire the range of skills they will need to compete in a global economy.

## State Fiscal Stabilization Fund

The State Fiscal Stabilization Fund (SFSF) provides a total of approximately \$48 billion directly to governors to help save jobs and drive education reform. The Department is awarding SFSF funds in two phases. In Phase I, states submitted applications for approximately \$35.4 billion; in Phase II, states are applying for the remainder of about \$12.6 billion.

In Phase I applications, state governors were required to assure that their states would take action and make progress in four areas of education reform:

- adopting internationally benchmarked standards and assessments that prepare students for success in college and the workplace;
- recruiting, developing, rewarding and retaining effective teachers and principals;
- building data systems that measure student success and inform teachers and principals how they can improve their practices; and
- turning around our lowest-performing schools.

In Phase II applications, governors are required to provide data in each of these four areas of reform. States would not need to demonstrate progress on the indicators in order to get funds; instead, states would ensure that the information is in place so that parents, teachers and policymakers know where our schools and students stand. If a state cannot provide the data, it would be required to submit a plan for ensuring that this information will be publicly reported as soon as possible. For more information, see <http://www.ed.gov/programs/statestabilization/applicant.html> and <http://www.ed.gov/programs/statestabilization/factsheet.html>.

## School Modernization

Funds from the SFSF under the *Recovery Act* may be used for modernization, renovation or repair of public school facilities and institutions of higher education facilities. The School Construction Tax Credits may be used for the construction, rehabilitation or repair of a public school facility or for the acquisition of land on which such a facility is to be constructed. For more details, visit <http://www.ed.gov/policy/gen/leg/recovery/modernization/index.html>.



## Title I, Part A *Recovery Act* Funds for Grants to Local Educational Agencies

The *Recovery Act* provides significant new funding for programs under Title I, Part A of *ESEA*. Specifically, the *Recovery Act* provides \$10 billion in additional FY 2009 Title I, Part A funds to LEAs for schools that have high concentrations of students from families that live in poverty to help improve teaching and learning for students most at risk of failing to meet state academic achievement standards. These funds create an unprecedented opportunity for educators to implement innovative strategies in Title I schools that improve education for at-risk students and close the achievement gaps. The additional resources will enable local educational agencies to serve more students beyond the approximately 20 million currently served and boost the quality of teaching and learning. Final allocations of Title I, Part A *Recovery Act* funds to each state and local educational agency are available at <http://www.ed.gov/about/overview/budget/statetables/index.html>

## *Individuals with Disabilities Education Act (IDEA), Parts B and C*

“We’re here today to talk about keeping teachers in the classroom—where they belong. The ultimate foundation for our nation’s future is a well-educated child. And every day, the *Recovery Act* is helping educators, parents and students work together to build the best possible foundation for the 21<sup>st</sup> century.”

—Vice President Joe Biden

The *Recovery Act* appropriates significant new funding for programs under Parts B and C of the *IDEA*. Part B of the *IDEA* provides funds to state and local educational agencies to help them ensure that children with disabilities—including children aged 3 through 5—have access to a free, appropriate public education to meet each child’s unique needs and prepare him or her for further education, employment and independent living.

Part C of the *IDEA* provides funds to each state lead agency designated by the state’s governor to implement statewide systems of coordinated, comprehensive, multidisciplinary interagency programs and make early intervention services available to infants and toddlers with disabilities and their families.

The *IDEA* funds under the *Recovery Act* will provide an unprecedented opportunity for states, local educational agencies and early intervention service providers to implement innovative strategies to improve outcomes for infants, toddlers, children and youths with disabilities. Under the *Recovery Act*, the *IDEA* funds are provided under three authorities: \$11.3 billion is available under Part B Grants to States, \$400 million under Part B Preschool Grants and \$500 million under Part C Grants for Infants and Families. Information about each state’s allocation is available at <http://www.ed.gov/about/overview/budget/statetables/index.html>.

## Vocational Rehabilitation State Grants

The *Recovery Act* appropriates significant new funding for the Vocational Rehabilitation (VR) State Grants program, authorized under Title I of the *Rehabilitation Act of 1973*, as amended (*Rehabilitation Act*). The VR State Grants program provides grants to states to help individuals with disabilities—especially those individuals with the most significant disabilities—prepare for, obtain and maintain employment.

The *Recovery Act* provides an unprecedented opportunity for states and vocational rehabilitation agencies to implement innovative strategies to improve employment

outcomes for individuals with disabilities. Under the *Recovery Act*, \$540 million is provided for the VR State Grants program. Information about each state's formula allocation is available at <http://www.ed.gov/about/overview/budget/statetables/index.html>.

### **Independent Living Services and Centers for Independent Living**

The *Recovery Act* appropriates significant new funding for the Independent Living (IL) programs authorized under Title VII, Chapter 1, Part B and Part C and Chapter 2 of the *Rehabilitation Act* and for the Centers for Independent Living Program authorized under Title VII, Chapter 1, Part C of the *Rehabilitation Act*.

The Independent Living programs support services to individuals with significant disabilities and older individuals who are blind. Under the *Recovery Act*, \$52 million is provided under separate authorities. Information about each state's formula allocation under these authorities is available at <http://www.ed.gov/about/overview/budget/statetables/index.html>.

The Centers for Independent Living Program supports nonprofit, consumer-controlled, community-based, cross-disability, nonresidential centers for independent living centers that provide an array of independent living services to individuals with significant disabilities. Under the *Recovery Act*, \$87.5 million is provided under the program authority. Information about each state's allocation under the program is available at <http://www.ed.gov/about/overview/budget/statetables/index.html>.

### **McKinney-Vento Homeless Assistance**

The *Recovery Act* provides \$70 million under the McKinney-Vento Education for Homeless Children and Youth program, which is authorized under Title VII-B of the *McKinney-Vento Homeless Assistance Act*. The *McKinney-Vento Recovery Act* funds are a one-time source of funds that supplement the McKinney-Vento funds made available under the regular FY 2009 appropriation. These additional resources will assist states and local educational agencies in addressing the educational and related needs of some of the most vulnerable members of our society—homeless children and youth—during a time of economic crisis in the United States. For more information, see <http://www.ed.gov/programs/homelessarra/index.html>.

### **Impact Aid**

The *Recovery Act* appropriated \$100 million in new funding for Impact Aid under section 8007 of Title VIII of *ESEA*. After reserving 1 percent of the appropriation for management and oversight, the Department awarded \$39.6 million to 179 local educational agencies that are eligible as a result of their enrollment of certain numbers and types of federally connected children for whom they receive funds under section 8003 of the Impact Aid Program (Basic Support Payments).

Payments are made based on the number of eligible federally connected children in average daily attendance who are dependents of members of the uniformed services and children living on Indian lands. For more information, see <http://www.ed.gov/policy/gen/leg/recovery/factsheet/impactaid.html>.

## Student Financial Assistance

The *Recovery Act* appropriated \$16.5 billion for Federal Pell Grants and Federal Work Study. These additional funds were part of the national effort to increase the affordability of postsecondary education for needy students.

### New Initiatives in Federal Student Aid

In 2008, amid unprecedented disruptions in the private credit markets, the Department developed and successfully implemented an aggressive plan to ensure uninterrupted access to federal student loans. This plan included the use of new statutory authority to purchase FFEL loans, providing lenders with the liquidity needed to make new loans, the expansion of the Department's capacity to originate and service loans under the William D. Ford Federal Direct Student Loan Program and the strengthening of the FFEL Lender of Last Resort program. As a result of these efforts, which were continued in 2009, students and families were able to obtain over \$84 billion in loans for the 2008–2009 school year smoothly and without significant disruption.

Beginning in August 2008, the Department implemented a number of programs authorized under the *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)* to ensure credit market disruptions did not deny eligible students and parents access to federal student loans for the 2008–2009 academic year. The *ECASLA* authority, which originally expired on September 30, 2009, was subsequently extended through September 30, 2010, to continue to ensure unfettered access to loans through the 2009–2010 academic year. Programs authorized under *ECASLA* are summarized below.

**Loan Participation and Loan Purchase Programs.** Under these programs, lenders may access capital to make new loans either by selling eligible FFEL loans directly to the Department or by selling the Department participation interests in eligible FFEL loans. Lenders that sell loans or participation interests in loans must represent to the Department that they will continue to participate in the FFEL Program and that when funds become reasonably available from private sources on affordable terms, they will make new loans or acquire new loans made by other lenders. Participation interests on loans made for the 2008–2009 academic year had to have been redeemed, with interest, by lenders no later than October 15, 2009, either in cash or by selling the underlying loans to the Department; for loans made for academic year 2009–2010, the deadline for redemption is September 30, 2010. Through September 2009, the Department directly purchased over 5 million loans valued at approximately \$24 billion. Through September 2009, the Department acquired more than \$41 billion in participation interests in FFEL Program loans.

**Short-Term Loan Purchase Program.** From December 2008 through March 2009, the Short-Term Loan Purchase Program purchased eligible loans made for the 2007–2008 academic year. Under this program, the Department purchased 280,000 loans worth roughly \$1 billion.

**Asset-Backed Commercial Paper Conduit Program.** The Asset-Backed Commercial Paper Conduit Program was developed to provide additional liquidity to support new lending. Under this program, which began operations mid 2009, the Department entered into forward purchase commitments with a conduit. The conduit issues commercial paper backed by qualifying student loans made between October 1, 2003 and September 30,

2009. If the conduit is unable to retire this paper as it matures, the Department commits to provide the needed funds by purchasing the underlying student loans.

**Lender of Last Resort.** The *Higher Education Act of 1965* requires guaranty agencies (GAs) to make loans as a Lender of Last Resort to those students who are unable to obtain FFEL loans from conventional FFEL lending sources. GAs may arrange for a conventional FFEL lender to make Lender of Last Resort loans or may make loans directly with their own resources. The Department may advance funds to a GA to make lender of last resort loans if that GA cannot arrange for such lending by another party and lacks other resources sufficient to make the needed loans. The Department will require that any federal advances be deposited in the GA's Federal Fund and that loans made from those funds be assigned to the Department promptly after they are disbursed. The Department has not made federal advances for Lender of Last Resort loans in FY 2009 and none are currently anticipated for FY 2010.

"Time and again, when we placed our bet for the future on education, we have prospered as a result—by tapping the incredible innovative and generative potential of a skilled American workforce . . . . That's why, at the start of my administration, I set a goal for America: by 2020, this nation will once again have the highest proportion of college graduates in the world."

—President Obama

## Making College Affordable and Accessible

Today's new initiatives complement President Obama's existing agenda for higher education. At this time of economic hardship and uncertainty, the administration's agenda will build the country's capacity, innovation and confidence to drive the nation to first place in the highly skilled workforce crucial for success in the 21<sup>st</sup> century. These initiatives include:

- **Expanding Pell Grants and College Tax Credits:** The *Recovery Act* increased Pell Grants to \$5,350 and created the \$2,500 American Opportunity Tax Credit for four years of college tuition.
- **Reforming the Student Loan Program to Save Billions:** The administration has proposed to replace guaranteed loans with Direct Loans, which are originated and serviced by private-sector companies selected through a competitive process and paid based upon performance. Direct Loans have essentially the same terms for students and are more reliable and efficient.
- **Helping Unemployed Workers Get New Skills:** President Obama has expanded opportunities for unemployed workers to go to community colleges and learn new skills. The Department has clarified that these workers should not be denied student aid based upon incomes they no longer earn, and the Department of Labor is working with states to allow workers to keep their unemployment benefits while receiving education and training.
- **Expanding the Perkins Loan Program:** The low-cost Perkins Loan Program is an important option for students who need to borrow more than what is allowed under the larger Stafford Loan Program. The administration will expand it from \$1 billion per year to \$6 billion per year.
- **Helping Families Save for College:** The President's Middle Class Task Force has directed the Department of the Treasury to investigate improvements to savings plans to help families save for college more effectively and efficiently.



**TEACH Grant Program.** Authorized by the *College Cost Reduction and Access Act of 2007 (CCRAA)*, the Teacher Education Assistance for College and Higher Education (TEACH) Grant Program offers grants of up to \$4,000 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 turn into Unsubsidized Stafford Loans, with interest accrued from the time of the grant award.

Because the grants turn into loans when the service obligations are not satisfied, budget and accounting treatment for TEACH Grants is consistent with the *Federal Credit Reform Act of 1990*. Subsidy costs reflecting the net present value of grant costs less the expected future loan payments are recorded in the TEACH Grant Program Account. In FY 2009, the Department disbursed approximately 15,000 grants for almost \$44 million under TEACH.

### Streamlining Student Financial Aid

The President has challenged the nation to once again have the highest percentage of college graduates in the world; to do that we need to send a clear message to both young people and adults that college is within their reach. More than a million students fail to apply for aid because of the application's complexity. The Department is simplifying the financial aid process by modernizing the online application, seeking legislation that will eliminate unnecessary questions and creating an easy process for students to use tax data to apply.

By developing a more user-friendly FAFSA that will make it easier to apply for college financial aid and increase postsecondary enrollment, particularly among low- and middle-income students, the Department is providing instant estimates of Pell Grant and student loan eligibility, easier navigability and seamless retrieval of tax information. See <http://www.fafsa.ed.gov/> for more information.

### Help for Those Burdened by Student Loan Debt

Through the *College Cost Reduction and Access Act of 2007*, Congress created the Public Service Loan Forgiveness Program. The program is designed to encourage young people to serve the public by working for federal, state or local governments, nonprofits or other public employers. Under this program, people with student loans can have their debts erased after 10 years of public service. Borrowers may qualify for forgiveness of the remaining balance due on their eligible federal student loans after they have made 120 payments under certain repayment plans while employed full-time by public service employers.

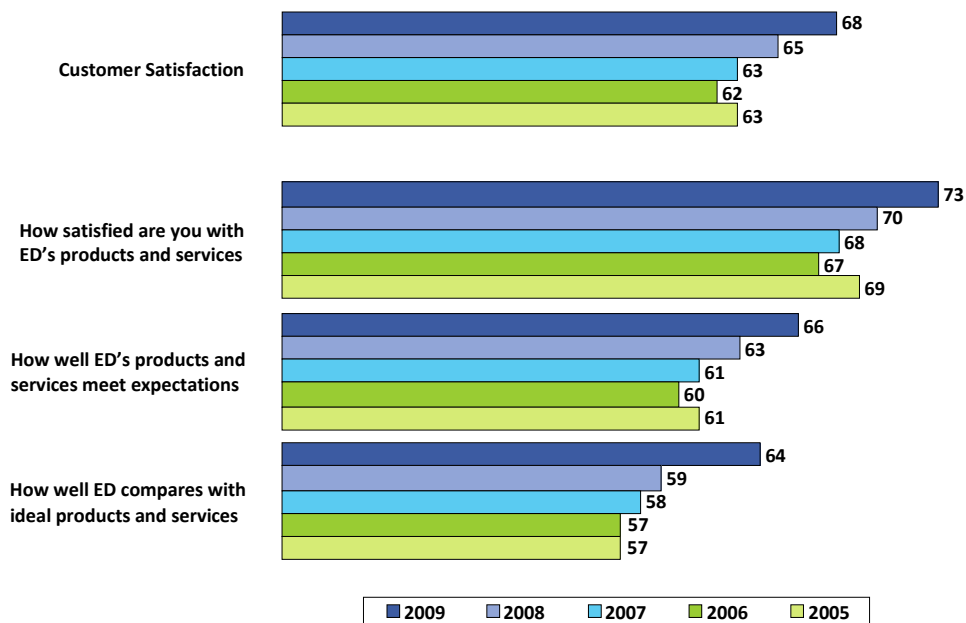
Another program that will help graduates with their student debt is the Income-Based Repayment Plan. This plan will cap the amount of the monthly federal loan payments at an amount determined by income and family size. The Department has developed an online calculator located on its student aid site to assist potential borrowers in determining their eligibility and to estimate if they would benefit from the plan. For more information, visit <http://studentaid.ed.gov/PORTALSWebApp/students/english/index.jsp>.

## Management Improvement

### Customer Satisfaction With the Department of Education

The Department strives to provide the most effective services to grantees and organizations that require support, assistance or information from the Department. Each year, the Department conducts an extensive survey of satisfaction of selected grantees and organizations. The survey is based on the American Customer Satisfaction Index, which is the national indicator of customer evaluations of the quality of goods and services and is the only uniform, cross-industry/government measure of customer satisfaction. The index is based on a scale of 100 points with a weighted average. Over a 5-year period, the Department has worked hard to provide its customers with levels of support that include quality of published guidance and documents, including online resources, effectiveness in the use of technology to deliver services, responsiveness and knowledge of Department staff and the provision of timely and quality technical assistance. In FY 2009, the Department achieved a five-point increase in customer satisfaction over the past two years. The Department saw significant increases in all drivers of customer satisfaction. For the full report, visit <http://www.ed.gov/about/reports/annual/gss/index.html>.

**Customer Satisfaction Index 2005–2009**



## The Organizational Assessment

The Department's Organizational Assessment (OA) is the Departmentwide performance management system, developed in response to the requirements of Executive Order 13450, *Improving Government Program Performance*, as well as the Office of Personnel Management's requirement that each federal agency evaluate its principal offices on an annual basis. The OA operates at the principal office level and is designed to integrate and align all of the Department's performance management elements, including the *Strategic Plan*, the Secretary's annual goals and priorities, the priorities of the principal offices and other requirements of law. The OA provides a framework for communicating goals and priorities to employees and for aligning employee performance plans with the objectives of Department and principal offices.

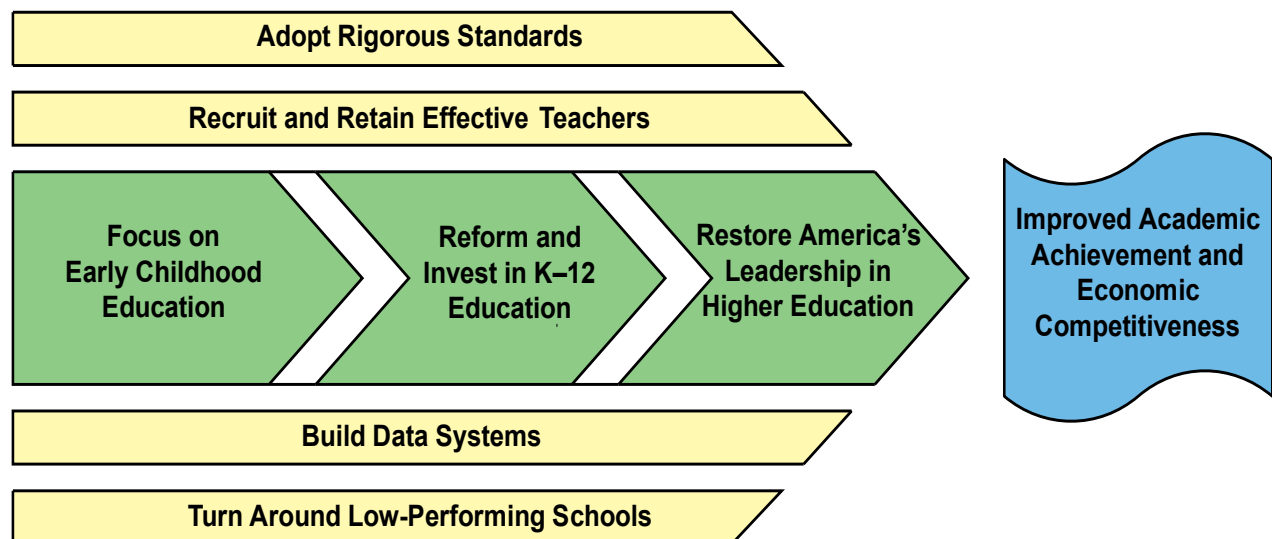
During FY 2009, the Department made significant changes to improve the transparency and accountability within its OA Initiative. These changes resulted in reducing the overall number of measures within the frameworks to better focus the Department's resources on mission-critical goals and priorities. As a result, OA leadership challenged Chief Management Officers to set ambitious goals for their Principal Operating Components. As a result, a number of steps have been implemented to ensure that the overall framework and scoring system were more rigorous in FY 2009. The goal of these changes is to improve the Department's overall performance.

## A STRATEGIC FRAMEWORK FOR EDUCATION REFORM

The administration has identified four goals for education reform. These goals are to improve standards and assessments, improve teacher and principal quality, build data systems that inform educators' decisions and turn around low-performing schools.

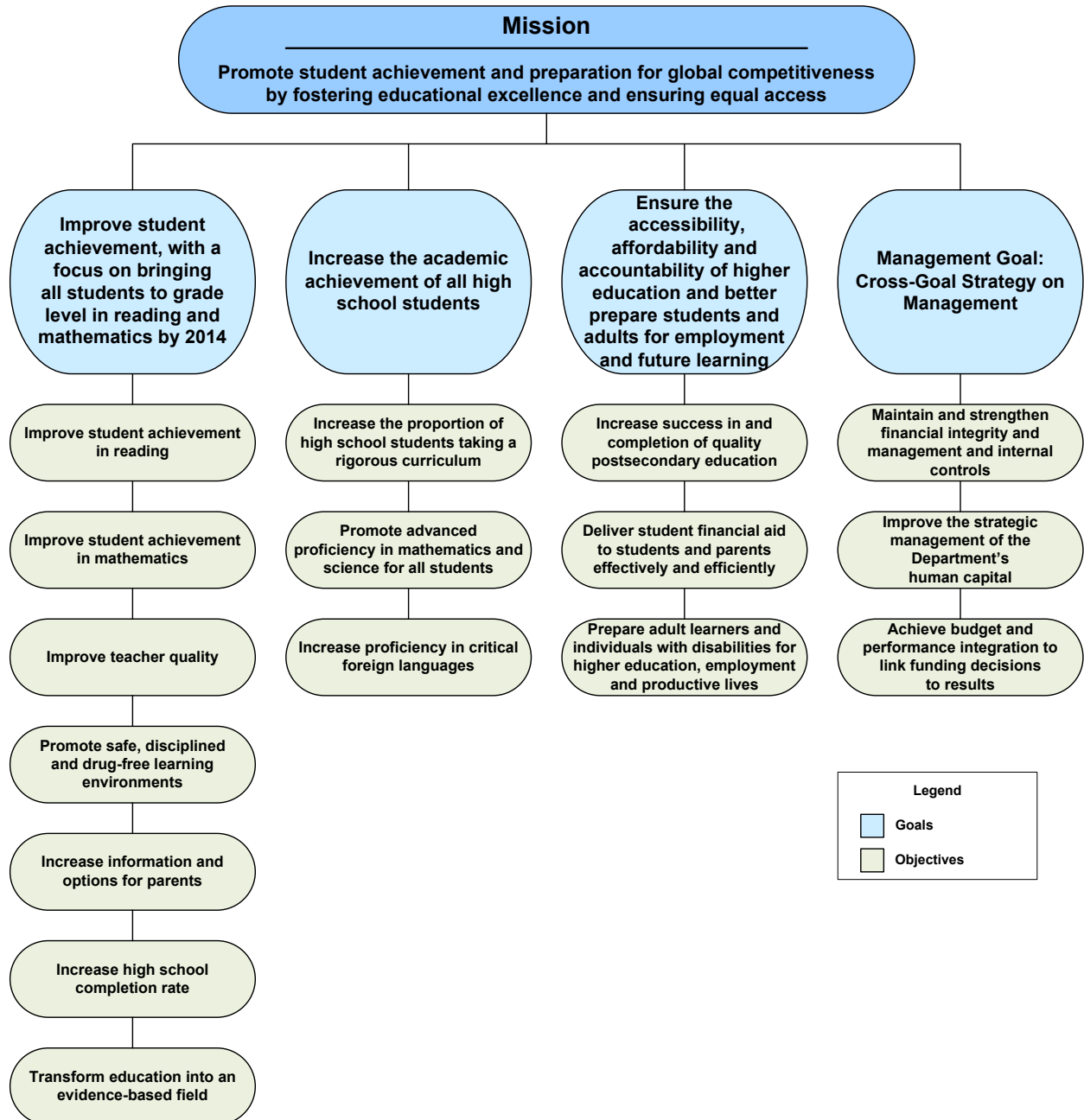
- [Adopt rigorous standards](#) and assessments that prepare students for success in college and the workforce.
- [Recruit and retain effective teachers](#), especially in classrooms where they're needed most.
- [Build data systems](#) to track student achievement and teacher effectiveness.
- [Turn around low-performing schools](#).

States must demonstrate a commitment to advancing education reform in these areas and agree to inform the Department of their progress to receive funding from the \$48.6 billion available under the *American Recovery and Reinvestment Act's (Recovery Act) State Fiscal Stabilization Fund (SFSF)*. State applications for funding are evaluated based on their assurances on these four areas of reform.



## THE DEPARTMENT'S STRATEGIC PLAN

The Department reports on measures defined by the Department's *Strategic Plan for Fiscal Years 2007–2012* under the provisions of the *Government Performance and Results Act of 1993 (GPRA)*. The Department is in the process of developing a new *Strategic Plan for Fiscal Years 2010-2015*, which will replace the current plan.

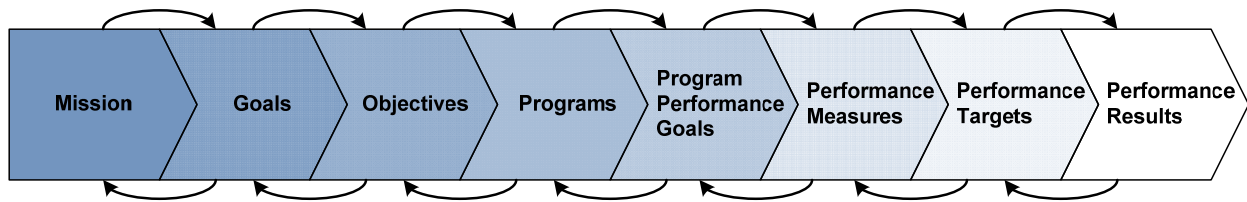




## OVERVIEW OF PERFORMANCE FOR FY 2009

### The Department's Strategic Planning Process

The Department's strategic planning process sets high expectations for America's schools, students and for the Department. It streamlines Department goals and measures while stressing continuity. This is the process by which we ensure successful performance and management outcomes.



### Challenges Linking the Program Performance to Funding Expenditures

Linking performance results, expenditures and budget for Department programs is complicated because more than 99 percent of the Department's funding is disbursed through grants and loans in which only a portion of a given fiscal year's appropriation is available to state, school, organization or student recipients during the fiscal year in which the funds are appropriated. The remainder is available at or near the end of the appropriation year or in a subsequent year.

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

Therefore, program results cannot be attributed solely to the actions taken related to FY 2009 funds but to a combination of funds from across several fiscal years. Furthermore, the results of some education programs may not be apparent for several years after the funds are expended.

There are 81 key performance measures that support the Department's mission and strategic goals under its current *Strategic Plan*. Most data for FY 2009 will be available during FY 2010. These measures will be reported on in detail in the Department's *Annual Performance Report (APR)*, which will be submitted to Congress with the President's Budget Justification for FY 2011.

## GOAL 1: Improve Student Achievement, With A Focus On Bringing All Students To Grade Level In Reading And Mathematics By 2014

### Our Public Benefit

In education, the bottom line is student learning. The *Elementary and Secondary Education Act of 1965 (ESEA)* revolutionized federal support for elementary and secondary education by establishing a national commitment to bring all children up to grade level in reading and mathematics and holding schools, districts and states accountable for making annual progress toward that goal. The *ESEA* promotes effective action to turn around schools that consistently fail to educate their students to high standards and provides students enrolled in those schools better choices and options.

Because student achievement depends on the efforts of well-prepared teachers, the Department is working with state educational agencies to devise and implement appropriate strategies for ensuring that teachers become highly qualified.

Also, teaching and learning to high standards require that our nation's schools be safe and drug free. The Department promotes practices that create safe, secure and healthy school climates.

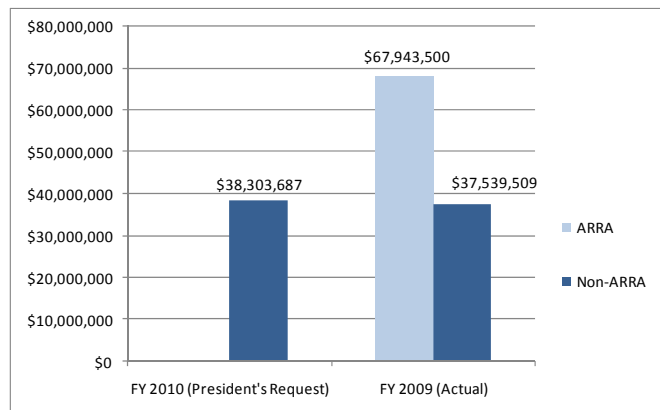
Parents are children's first and most important teachers. The Department promotes parental involvement in their children's schools, and encourages states and communities to provide information on additional options to parents.

The Department has developed the following objectives in support of Goal 1. Additionally, the Department has identified 37 key strategic performance measures for this goal.

### Strategic Objectives:

- Improve student achievement in reading
- Improve student achievement in mathematics
- Improve teacher quality
- Promote safe, disciplined and drug-free learning environments
- Increase information and options for parents
- Increase high school completion rate
- Transform education into an evidence-based field

**Goal 1 Resources  
(\$ in thousands)**



Strategies that support the Department in meeting its strategic objectives for Goal 1 include:

- assisting states and school districts in turning around low performing schools;
- collecting and disseminating student information;
- assisting states to ensure that their teachers are highly qualified;

- encouraging districts to reform teacher compensation systems to reward their most effective teachers and to create incentives to attract their best teachers;
- identifying and disseminating information about the most effective practices that create a safe, disciplined and drug free school climate;
- supporting high-quality charter schools; and
- improving the high school completion rate.

## GOAL 2: Increase the Academic Achievement of All High School Students

### Our Public Benefit

To better equip our students to compete in the global economy, the Department encourages states to adopt high school course work and programs of study that prepare all students for a postsecondary credential and facilitate a seamless transition from high school to college or the workforce. The Department will continue to enhance and promote achievement in mathematics, science and critical foreign languages through incentives for teachers to teach advanced courses, thus providing opportunities for students to be well prepared for postsecondary education or the workforce following high school. The Department encourages increased access to, and participation in, Advanced Placement (AP) or International Baccalaureate (IB) classes by low-income and other disadvantaged students. To offer challenging courses, schools must have qualified teachers to teach them. The Department promotes efforts to increase the number of teachers who have the academic content knowledge needed to teach advanced classes.

The Department will pursue the following objectives in support of Goal 2. Additionally, the Department has identified 11 key strategic performance measures for this goal.

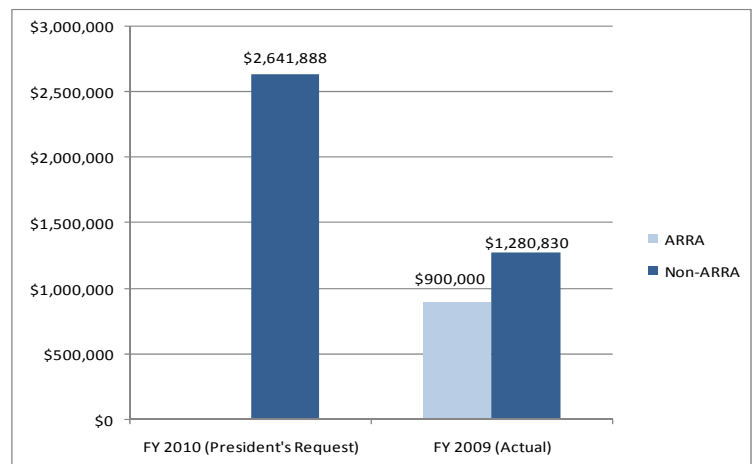
### Strategic Objectives:

- Increase the proportion of high school students taking a rigorous curriculum
- Promote advanced proficiency in mathematics and science for all students
- Increase proficiency in critical foreign languages

Strategies that support the Department in achieving its objectives for Goal 2 include:

- increasing access to AP courses nationwide;
- increasing the number of teachers qualified to teach AP and IB classes; and
- supporting projects expanding offerings and participation in advanced mathematics and science classes.

**Goal 2 Resources  
(\$ in thousands)**



### GOAL 3: Ensure the Accessibility, Affordability and Accountability of Higher Education and Better Prepare Students and Adults for Employment and Future Learning

#### Our Public Benefit

America’s institutions of higher education have long been engines of innovation, helping the nation to achieve a level of economic prosperity experienced by few other countries throughout history. The dynamics of rapid technological change over time have required greater levels of education to sustain the global competitiveness of the American economy. As a result, an increasing proportion of Americans have enrolled in and completed a program of postsecondary education in order to secure high-quality employment in competitive industries.

Financial aid must be made available to students in a more simplified manner and be more focused on students with the greatest financial need. Furthermore, adult education and vocational rehabilitation programs must provide increasingly effective services to improve the skills and employment prospects of those they serve.

The Department will pursue the following objectives in support of Goal 3. Additionally, the Department has identified 20 key strategic performance measures for this goal.

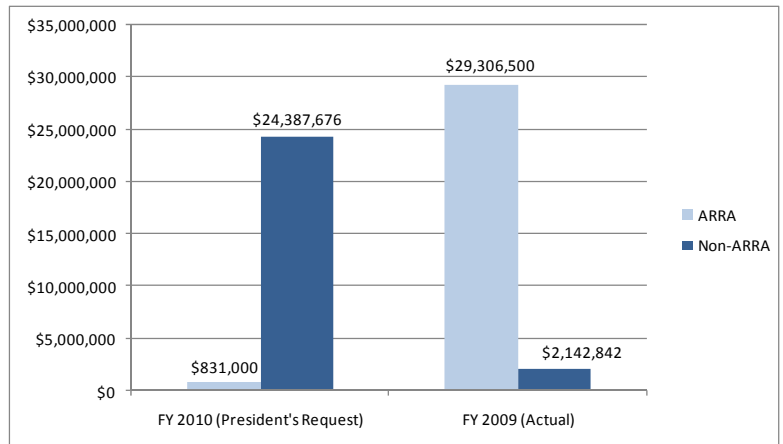
#### Strategic Objectives:

- Increase success in and completion of quality postsecondary education
- Deliver student financial aid to students and parents effectively and efficiently
- Prepare adult learners and individuals with disabilities for higher education, employment and productive lives

Strategies that support the objectives of Goal 3 include:

- maintaining high levels of college enrollment and persistence, while increasing the affordability of and accessibility to higher education through effective college preparation and grant, loan and campus-based aid programs;
- promoting and disseminating information regarding promising practices in community colleges;
- strengthening the accountability of postsecondary education institutions through accreditation, evaluation and monitoring;
- creating an efficient and integrated student financial aid delivery system;
- reducing the cost of administering federal student aid programs;

**Goal 3 Resources (\$ in thousands)**



- improving federal student aid products and services to provide better customer service; and
- strengthening technical assistance to state vocational rehabilitation agencies through improved use of data, dissemination of information and solidified partnerships.

## Cross-Goal Strategy on Management

### Our Public Benefit

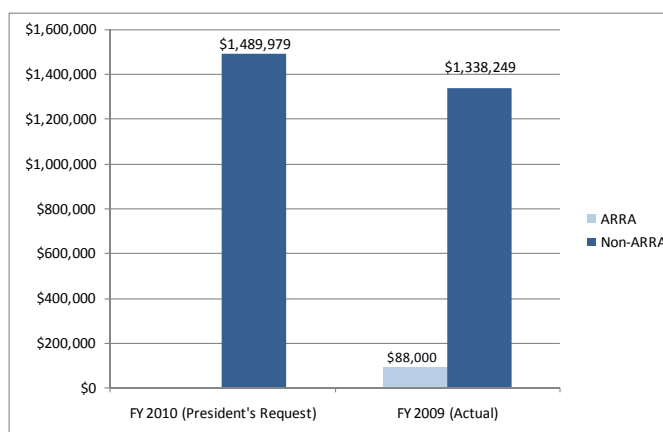
The Department carries out its mission and attains results for its goals through a commitment to excellent management practices. Through strong leadership, fiscal responsibility and strategic deployment of human capital, the Department ensures that all Americans have access to quality programs and benefit from successful outcomes.

The Department will pursue the following objectives in support of the cross-goal management strategy. Additionally, the Department has identified 13 key strategic performance measures for this goal.

### Strategic Objectives:

- Maintain and strengthen financial integrity and management and internal controls
- Improve the strategic management of the Department's human capital
- Achieve budget and performance integration to link funding decisions to results

### Cross-Goal Resources (\$ in thousands)



Strategies that support the achievement of this strategic objective include:

- implementing risk mitigation activities to strengthen internal control and the quality of information used by managers;
- improving formula and discretionary grant management processes;
- improving compliance with information security requirements;
- fostering leadership and accountability;
- improving the Department's hiring process;
- holding people and programs accountable for budget and performance integration;
- improving performance measurement and data collection; and
- using performance information to inform program management and performance.



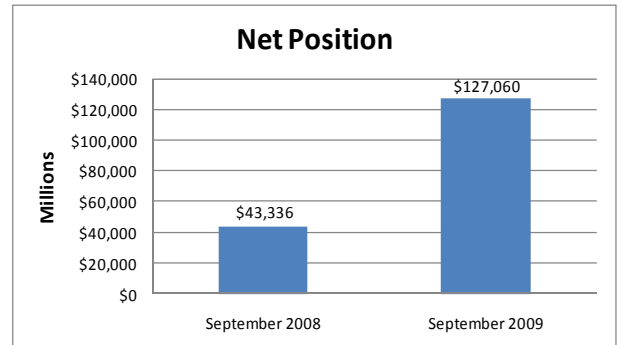
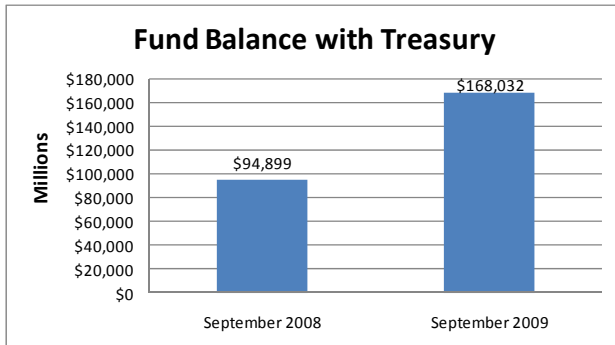
## FINANCIAL HIGHLIGHTS

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

### *American Recovery and Reinvestment Act of 2009*

The *Recovery Act* provides \$98.2 billion in additional funding to the Department. A significant portion of *Recovery Act* funding, \$53.6 billion, is for the State Fiscal Stabilization Fund whose purpose is to minimize and avoid reductions in education and other essential services and to promote reform. The remaining funds will be used for currently authorized federal education activities. These activities include Impact Aid, Higher Education, Institute of Education Sciences, Student Aid Administration, Student Financial Assistance, Innovation and Improvement, Special Education, Rehabilitative Services and Disability Research, Education for the Disadvantaged, Office of Inspector General and School Improvement Programs.

This significant increase in funding is evident from a comparison of the Department's financial statements as of September 30, 2009, and September 30, 2008. The increases in Fund Balance with Treasury and Net Position were 77 percent and 193 percent, respectively, which are due to effects of the *Recovery Act* funding.

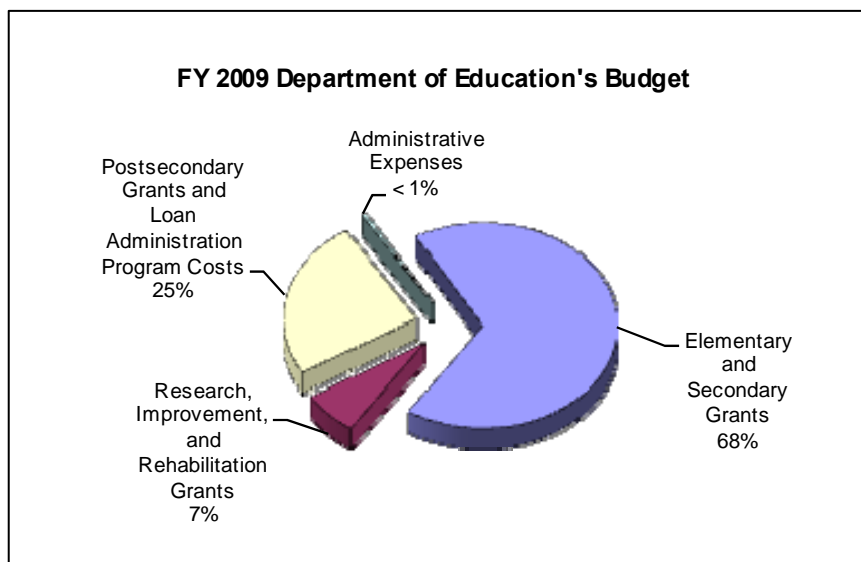


## Sources of Funds

The Department managed a budget in excess of \$140.5 billion during FY 2009, of which 68 percent supported elementary and secondary education grant programs.

Postsecondary education grants and administration of student financial assistance accounted for

25 percent, including loan programs costs that helped almost 13 million students and their parents to better afford higher education during FY 2009. An additional 7 percent went toward programs and grants encompassing research, development and dissemination, as well as vocational rehabilitation services. Administrative expenditures were less than 1 percent of the Department's appropriations.



Nearly all of the Department's non-administrative appropriations support three primary lines of business: grants, guaranteed loans and direct loans. The original principal balances of the Federal Family Education Loan (FFEL) Program and Federal Direct Student Loan Program loans, which compose a large share of federal student financial assistance, are funded by commercial banks and borrowings from the Treasury, respectively.

The Department's four largest grant programs are SFSF, Title I grants for elementary and secondary education, Pell Grants for postsecondary financial aid and Special Education Grants to States under the *Individuals with Disabilities Education Act*. In addition, this was the first full year of the Teacher Education Assistance for College and Higher Education (TEACH) Grant Program. This program awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students.

The FFEL Program ensures that the loan capital for approximately 2,900 private lenders is available to students and their families. Through loan guarantees issued by 35 active state and private nonprofit Guaranty Agencies, backed by federal reinsurance provided by the Department, the FFEL Program protects lenders against losses from borrower default. As of the end of September 2009, the total principal balance of outstanding guaranteed loans held by lenders was approximately \$457 billion. The government's estimated maximum exposure for defaulted loans was approximately \$445 billion.

The *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)* amended the FFEL Program to authorize the secretary to purchase or enter into forward commitments to purchase FFEL loans. The Department has implemented three activities under this

temporary loan purchase authority. These activities are: (1) loan purchase commitments under which the Department agrees to purchase loans directly from FFEL lenders; (2) loan participation interest purchases in which the Department purchases participation interests in FFEL loans; and (3) an Asset-Backed Commercial Paper (ABCP) Conduit program in which the Department enters into a forward commitment to purchase FFEL loans from a student loan-backed conduit, as needed, to allow the conduit to repay short-term liquidity loans used to re-finance maturing commercial paper.

The William D. Ford Federal Direct Student Loan Program, created by the *Student Loan Reform Act of 1993*, provides an alternative method for delivering assistance to students. This program uses Treasury funds to provide loan capital directly to eligible undergraduate and graduate students and their parents through participating schools. These schools then disburse loan funds to students. As of September 30, 2009, the value of the Department's direct loan portfolio was \$152.8 billion.

## Financial Position

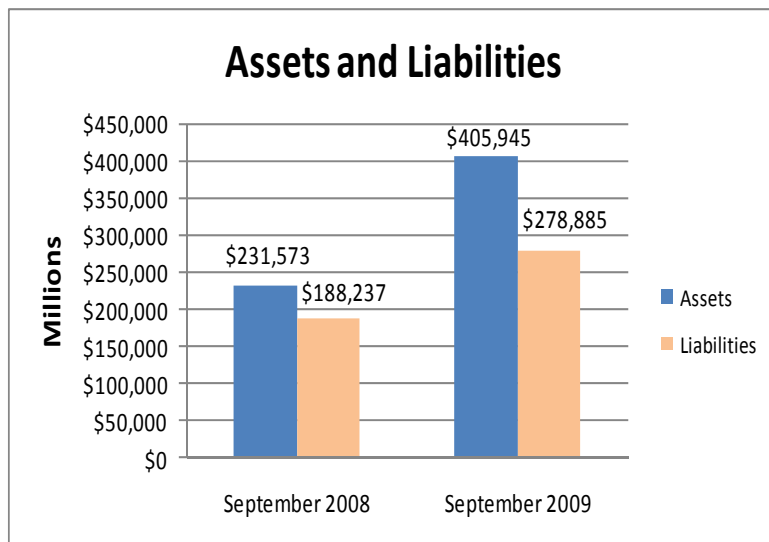
The Department's financial statements are prepared in accordance with established federal accounting standards and are audited by the independent accounting firm of Ernst & Young, LLP. Financial statements and footnotes for FY 2009 appear on pages 48-96. An analysis of the principal financial statements follows.

### Balance Sheet.

The Balance Sheet presents, as of a specific point in time, the recorded value of assets and liabilities retained or managed by the Department. The difference between assets and liabilities represents the net position of the Department. The Balance Sheet displayed on page 48 reflects total assets of \$406 billion, a 75 percent increase over FY 2008.

The majority of this increase is due to both the

*American Recovery and Reinvestment Act* and to *ECASLA*. Credit Program Receivables increased by \$99.5 billion, a 74 percent increase over FY 2008. This increase is largely due to an increase in direct loan disbursements, and activity related to loan purchase commitments and loan participation purchases under the Federal Family Education Loan (FFEL) program. The majority of this loan portfolio is principal and interest owed by students on direct loans. The remaining balance is related to defaulted guaranteed loans purchased from lenders under terms of the FFEL Program and to loan purchase commitments and loan participation purchases under the FFEL Program. The net portfolio for direct loans increased by over \$42.9 billion due to increased direct loan disbursements. FFEL Program loans increased by \$56.4 billion during FY 2009, due primarily to loan



volume and activity related to loan purchase commitments and loan participation purchases. The Fund Balance with Treasury increased by \$73.1 billion, a 77 percent increase from FY 2008. The vast majority of this increase is due to the *Recovery Act*.

Total Liabilities for the Department increased by \$90.6 billion, a 48 percent increase over FY 2008. The increase is primarily due to the fact that borrowing increased for the Direct Loan Program and to provide funds for the loan purchase commitments and loan participation purchases activities under the FFEL Program. Liabilities for Loan Guarantees for the FFEL Program decreased \$22.8 billion, a 53 percent decrease due primarily to subsidy transfers, re-estimates and modifications. These liabilities present the estimated costs, on a present-value basis, of the net long-term cash outflows due to loan defaults and interest subsidies net of offsetting fees.

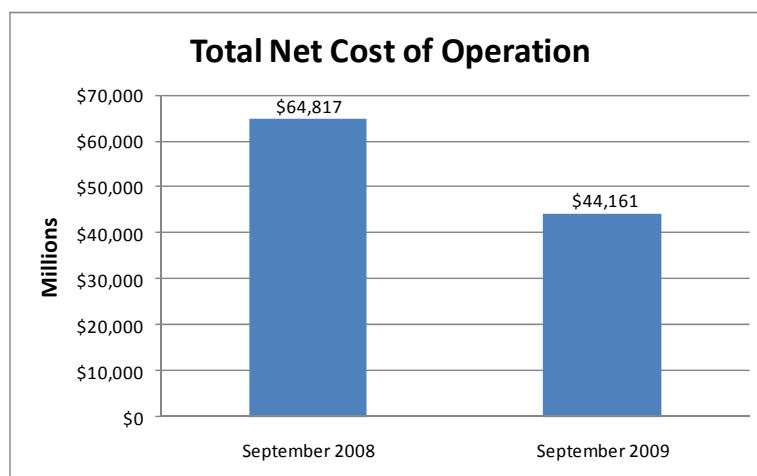
The Department's Net Position as of September 30, 2009 was \$127.1 billion, an \$83.8 billion increase over the \$43.3 billion Net Position as of September 30, 2008. This 193 percent increase was largely due to the *Recovery Act*.

### Statement of Net Cost.

The Statement of Net Cost presents the components of the Department's net cost, which is the gross cost incurred less any revenues earned from the Department's activities. The Department's total program net costs, as reflected on the Statement of Net Cost, page 49, were

\$44.2 billion, a 32 percent decrease from September 30, 2008. This change largely reflects the effects of both the \$2.6 billion downward modification and the \$21.7 billion downward re-estimate in the guarantee loan portion of the FFEL Program, and the \$5.2 billion downward re-estimate for Direct Loans.

The Statement of Net Cost is presented to be consistent with the Department's strategic goals. As required by the *Government Performance and Results Act of 1993*, each of the Department's Reporting Organizations has been aligned with the major goals presented in the Department's *Strategic Plan 2007–2012*.

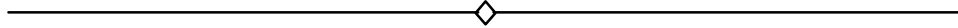


Net Cost Program	Reporting Organizations/ Groups	Strategic Goal
Ensure Accessibility, Affordability and Accountability of Higher Education and Career and Technical Advancement	<ul style="list-style-type: none"> <li>• Federal Student Aid</li> <li>• Office of Postsecondary Education</li> <li>• Office of Vocational and Adult Education</li> </ul>	3 Ensure the accessibility, affordability and accountability of higher education, and better prepare students and adults for employment and future learning
Promote Academic Achievement in Elementary and Secondary Schools	<ul style="list-style-type: none"> <li>• Office of Elementary and Secondary Education</li> <li>• Office of English Language Acquisition</li> <li>• Office of Safe and Drug-Free Schools</li> <li>• Hurricane Education Recovery</li> </ul>	<p>1 Improve student achievement, with the focus on bringing all students to grade level in reading and mathematics by 2014</p> <p>2 Increase the academic achievement of all high school students</p>
Transformation of Education	<ul style="list-style-type: none"> <li>• Institute of Education Sciences</li> <li>• Office of Innovation and Improvement</li> </ul>	1 Improve student achievement, with the focus on bringing all students to grade level in reading and mathematics by 2014
Special Education	<ul style="list-style-type: none"> <li>• Office of Special Education and Rehabilitative Services</li> </ul>	Cuts across Strategic Goals 1, 2 and 3
<i>American Recovery and Reinvestment Act</i>	<ul style="list-style-type: none"> <li>• <i>Recovery Act</i></li> </ul>	Cuts across Strategic Goals 1, 2 and 3

Strategic Goals 1, 2 and 3 are sharply defined directives that guide reporting organizations to carry out the Department's vision and programmatic mission, and the net cost programs can be specifically associated with these three strategic goals. The Department has a Cross-Goal Strategy on Management, which is considered a high-level premise on which the Department establishes its foundation for the three goals. As a result, we do not assign specific programs to the Cross-Goal Strategy for presentation in the Statement of Net Cost.



**Statement of Budgetary Resources.** This statement provides information about the provision of budgetary resources and their status as of the end of the reporting period. The statement displayed on page 51 shows that the Department had \$437.8 billion in total budgetary resources for the 12 months ended September 30, 2009. These budgetary resources were composed of \$170.1 billion in appropriated budgetary resources and \$267.7 billion in non-budgetary credit reform resources, which primarily consist of borrowing authority for the loan programs. Of the \$46.6 billion that remained unobligated at year end, \$12.1 billion represents funding provided in advance for activities in future periods that were not available at year end. These funds will become available in following fiscal years.



## Limitations of Financial Statements

Management has prepared the accompanying financial statements to report the financial position and operational results for the U.S. Department of Education for FY 2009 and FY 2008 pursuant to the requirements of Title 31 of the United States code, section 3515(b).

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

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


## MEMORANDUM FROM THE OFFICE OF INSPECTOR GENERAL



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

### MEMORANDUM

TO: Secretary Arne Duncan  
FROM: Mary Mitchelson, Acting   
RE: Management Challenges for Fiscal Year 2010  
DATE: October 30, 2009

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Pursuant to the *Reports Consolidation Act of 2000*, we provide the attached report, Management Challenges for the U.S. Department of Education for Fiscal Year 2010. We look forward to working with you to address these challenges and improve the efficiency and integrity of the Department's programs and operations.

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.*

## OFFICE OF INSPECTOR GENERAL'S MANAGEMENT CHALLENGES FOR FISCAL YEAR 2010

The Office of Inspector General (OIG) works to promote efficiency, effectiveness and integrity in the programs and operations of the U.S. Department of Education (Department). Through our audits, inspections, investigations and other reviews, we continue to identify areas of concern within the Department's programs and operations and recommend actions the Department should take to address these weaknesses.

The *Reports Consolidation Act of 2000* requires OIG annually to identify and summarize the top management challenges facing the Department and provide information on the Department's progress in addressing those challenges. In recent years, we have focused our Management Challenges reports on six operational areas that our work identified as most vulnerable to waste, fraud and abuse: (1) student financial assistance programs; (2) information technology (IT) security and management; (3) grantee monitoring and oversight; (4) grant and contract awards, performance and monitoring; (5) data reliability; and (6) human resources. While our previous Management Challenges reports have noted some progress by the Department in addressing these challenges, with passage of the *American Recovery and Reinvestment Act of 2009 (Recovery Act)* and the *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)*, there is an immediate need for the Department to increase its efforts to ensure that Federal education programs are operating effectively, efficiently and as required by statute. It is with that goal in mind that we focus this report on three overall challenges that impact virtually every operational aspect of the Department: (1) the *Recovery Act*; (2) student financial assistance programs/*ECASLA*; and (3) information security and management.

The Department has voiced its commitment to tackling these challenges and addressing the underlying problem of internal controls. "Internal controls" are plans, methods and procedures an entity employs to provide reasonable assurance that it meets its goals and achieves its objectives while minimizing operational problems and risks. By establishing effective internal controls, the Department can be an effective steward of the billions of taxpayer dollars supporting its programs and operations. America's students and taxpayers deserve nothing less.

### **Challenge: Implementing the *Recovery Act***

The *Recovery Act* was signed into law on February 17, 2009, and includes approximately \$98.2 billion in new funding for federal education programs and operations. This includes funding for programs within the *Elementary and Secondary Education Act of 1965, as amended (ESEA)*; the *Higher Education Act of 1965, as amended (HEA)*; the *Individuals with Disabilities Education Act of 2004, as amended*; and the *Rehabilitation Act of 1973*. With 55 state and territorial educational agencies, more than 16,000 school districts and thousands of schools, colleges and universities potentially eligible to receive these funds, the Department faces a formidable challenge in ensuring that *Recovery Act* funds reach the intended recipients and achieve the desired results. To do so, the Department must: (1) provide effective oversight and monitoring of its grantees and subrecipients; (2) ensure that the information reported to the Department and by the Department is accurate and reliable; and (3) make certain it has knowledgeable staff on board to successfully carry out and manage its programs and operations. While our specific *Recovery Act* work is underway,

previous OIG audits, inspections and investigations have uncovered problems in these three areas, making each a significant challenge for the Department.

## **Grantee and Subrecipient Oversight and Monitoring**

Ineffective monitoring and oversight can have a significant impact on a grantee's ability to meet statutory requirements and ensure critical education funds reach the intended recipients. Recent OIG audits, inspections and investigations have uncovered problems with program control and oversight of a number of grantees, almost all of which are eligible to receive *Recovery Act* funds. Further complicating this issue is the requirement that grantees receiving *Recovery Act* funds closely monitor subrecipients' use of and account for the funds. Our previous audit and investigation work identified a number of weaknesses in grantee oversight and monitoring of its subrecipients. For example, some state educational agencies' (SEA) subrecipient monitoring efforts lacked a fiscal oversight component, while other SEAs were found to conduct on-site program monitoring of subrecipients infrequently. Other grantees were found to rely too heavily on local educational agency single audits, which often times are too late for early detection of inappropriate use of funds. In addition, preliminary *Recovery Act* work has shown that some grantees are relying on existing monitoring procedures that do not appear adequate to ensure their subrecipients use of and accounting for *Recovery Act* funds appropriately, and do not cover new program funding, including dollars from the *Recovery Act's* State Fiscal Stabilization Fund. These factors make it a challenge for the Department to ensure that adequate and timely monitoring of *Recovery Act* funds is taking place at both the SEA and subrecipient levels.

***The Department's Progress.*** *The Department has expressed its commitment to improving oversight of its grantees and subrecipients. As an example, the Department has been working closely with the Michigan Department of Education and Detroit Public Schools to aggressively address significant financial and performance problems which left the school system on the verge of collapse. The Department's plan includes provisions for a structurally balanced budget, accountability and systemic controls and deficit elimination. With regard to the Recovery Act, the Department has issued a number of policy guidance documents and fact sheets to assist grantees in implementing Recovery Act programs. It is also developing a technical assistance plan and training curricula for grantees that will include administrative requirements for implementation of federal grants and will convey the importance of complying with those requirements. The Department also intends to conduct outreach efforts, such as conferences, workshops and Webinars, to provide additional technical assistance to Recovery Act grantees.*

## **Data Reliability**

The Department, its grantees and subrecipients must have controls in place and effectively operate to ensure that accurate, reliable data is reported. This is particularly important with regard to *Recovery Act* funds, as recipients must submit regular reports detailing the projects and activities funded with those dollars. They are also required to submit quarterly reports, which include new data elements that must be submitted within 10 days of the close of each fiscal quarter. Our preliminary *Recovery Act* work has determined that some SEAs are planning to use existing data systems to collect, compile and report *Recovery Act* data, but had not yet modified their systems to reflect new reporting requirements. Also, some SEAs expressed concern that they had not received adequate guidance, or that their

states might not have enough staff and funding resources to meet all of the new reporting requirements and timelines. In addition, the *Recovery Act* requires that all fund recipients register in the Central Contractor Registration database, which means the Department must ensure that all of these recipients are registered in time to meet reporting requirements. As previous OIG work has identified issues of noncompliance with data collection and reporting requirements, it will be a challenge for the Department to ensure that data received from *Recovery Act* fund recipients is accurate, reliable and complete.

***The Department's Progress.*** *The Department has collected data and has developed a risk-assessment model for technical assistance that will allow its staff to provide more guidance to states and other grantees that are at increased risk for problems. Department staff has also been using conference calls with states to provide targeted technical assistance to meet each state's specific needs. The Department established a Metrics and Monitoring Team that is charged with ensuring transparency, accountability and oversight of Recovery Act dollars. The team meets weekly to coordinate oversight efforts and develop new reports that are required for posting on the Recovery.gov Web site.*

## Human Resources

Like most federal agencies, the Department will see a significant percentage of its workforce eligible for retirement in 2010. Compounding the situation is the immediate demand for staff to address the requirements of the *Recovery Act*. Prior OIG work in the area of grants monitoring has shown that staff handled a large number of grants and were not able to closely monitor all necessary activities. Human resources is a challenge that the Department must immediately address, as current staff will be further stretched to monitor the unprecedented levels of new funding available to state and local governments and other entities under the *Recovery Act*.

***The Department's Progress.*** *The Department has devoted significant resources to implement requirements related to the Recovery Act. Teams have been formed to issue guidance and provide technical assistance and outreach on various topics to ensure Recovery Act fund recipients are aware of their responsibilities, all at a time when a number of critical positions have not yet been filled due to the change in administration. While efforts to date have been significant, Department staff may not be able to maintain the current pace without additional resources as its Recovery Act efforts move from implementation to monitoring.*

## Challenge: Student Financial Assistance Programs/ECASLA

The federal student financial assistance programs involve more than 6,200 postsecondary institutions, more than 2,900 lenders, 35 guaranty agencies and many third party servicers. In 1998 and in response to the growing complexity, increased demand and the likelihood for waste, fraud and abuse associated with the student financial assistance programs, Congress established a Performance Based Organization (PBO) in the Department to manage and administer the student financial assistance programs authorized under Title IV of the *HEA*. In the decade since becoming the PBO, the Federal Student Aid (FSA) office's responsibilities have increased as the programs have grown substantially. In 2009, FSA disbursed \$18.4 billion in Pell Grants averaging approximately \$2,973 to 6.2 million students. In fulfilling its program responsibilities, FSA directly manages or oversees almost \$622 billion in outstanding loans, representing over 111 million student loans to more than



32 million borrowers. Further, with the significant disruptions in the credit markets, in early 2008, lenders in the Federal Family Education Loan (FFEL) Program expressed concerns that there would be insufficient private capital to fund FFEL loans to meet the demands of Stafford and PLUS loan borrowers. To address these concerns, Congress passed the *ECASLA*, which provided the Department with the authority to purchase or enter into forward commitments to purchase student loans from lenders to ensure that loans are available for all students. Colleges and universities also expanded participation in the William D. Ford Federal Direct Loan (Direct Loan) program due to uncertainty over FFEL availability. Prior to 2008, the Direct Loan program has accounted for about 20 percent of new student loan volume. However, the Direct Loan program's new loan volume is expected to increase to about 60 percent for the 2009–2010 academic year, and the administration has proposed a transition to 100 percent direct lending for the 2010–2011 academic year.

In order to fulfill all of its responsibilities as a PBO, as well as sufficiently administer the Title IV and *ECASLA* programs, FSA must: (1) have a system of effective internal controls in place; (2) provide sufficient oversight and monitoring of Title IV program participants; (3) provide effective contract monitoring to ensure that it receives quality goods and services from its vendors; and (4) make certain it has knowledgeable staff on board to successfully carry out and manage its programs and operations. Our specific *ECASLA*-related work is ongoing, but previous OIG efforts found that FSA does not have sufficient capacity or resources necessary to provide effective oversight for all aspects of the student financial assistance programs, leaving programs vulnerable to waste, fraud and abuse.

## Internal Controls

Establishing effective internal controls has long been a challenge for Federal Student Aid, and three recent OIG reports show that problems in this area continue. First, an OIG audit that sought to determine whether FSA was meeting its responsibilities as a PBO in three key areas found that FSA had not done so, and as a result, the Congress, the Secretary and the public have not been clearly informed about FSA's progress toward achieving its purposes as a PBO or whether it has reduced its program costs since becoming a PBO more than a decade ago. Second, an OIG review of FSA's oversight of GAs, lenders and loan servicers found that improvements were needed in each of the five areas of internal control: control environment, risk assessment, information and communications, control activities and monitoring. This was a follow-up report to a 2006 audit that contained similar findings, many of which had not been fully addressed. Third, OIG performed an inspection of FSA's Enterprise Risk Management Group, an effort initiated by FSA in 2006 with the goal of developing risk assessments and providing a more strategic view of future risks. The OIG inspection found that FSA had not fully implemented enterprise risk management, leaving its programs vulnerable to waste, fraud and abuse. Based on these findings, the passage of *ECASLA* and the expansion of the Direct Loan Program, it is vital that FSA leaders take on this challenge and implement effective internal controls.

***The Department's Progress.*** FSA has agreed to improve the management of its programs. It is restructuring and improving its chief compliance officer organization for the oversight of the FFEL Program. FSA is also in the process of implementing the authorities provided by *ECASLA* for the Loan Participation/Purchase programs, and establishing internal controls to provide for accountability and monitoring and ensure compliance with the requirements of the law.

## Participant Oversight and Monitoring

FSA has always faced a significant challenge in conducting effective monitoring and oversight of the thousands of entities participating in its programs. Recent OIG efforts have revealed cases of lenders violating the inducement provision of the *HEA* or overbilling the Department for loans under the 9.5 percent special allowance payment (SAP); guaranty agencies that did not comply with *HEA* requirements regarding the Federal Fund and Operating Fund; and schools that did not comply with Title IV requirements for institutional and program eligibility, the 90-10 rule and other criteria. With *ECASLA*, the need for FSA to conduct effective oversight and monitoring has only intensified. FSA estimated that about 75 percent of FFEL new loan volume for the 2008–2009 academic year would be financed through *ECASLA* programs, and significant increases in student loan volume were expected in the Direct Loan program. FSA must make improvements in oversight and monitoring to ensure that the entities participating in the federal student financial assistance programs are adhering to statutory, regulatory and program requirements. Still another challenge facing both FSA and schools participating in the Title IV programs involves identity verification of students receiving federal student financial assistance. FSA does not yet require schools to verify the identity of students receiving aid, which leaves the programs vulnerable to identity theft and other fraudulent schemes, particularly distance education programs.

***The Department's Progress.*** *FSA has agreed to develop and implement consistent oversight procedures of the entities participating in the federal student financial assistance programs. As an example, in response to our audit work on 9.5 percent SAP, the Department has required all lenders wishing to bill at the 9.5 percent SAP rate to undergo audits to determine the eligibility of loans for payments at the 9.5 percent rate. With ECASLA, FSA has conducted outreach efforts to inform industry participants of ECASLA-related programs and operations, and developed testing and certification requirements for industry participants with the advice of OIG. Additionally, FSA has executed Lender of Last Resort Agreements with 30 guaranty agencies. To increase the capacity of the Direct Loan Program, FSA has expanded the capacity of the Common Origination and Disbursement system used to originate Direct Loans. To handle the increased need for servicing Direct Loans and loans purchased under the ECASLA-related programs, FSA contracted with four additional entities to service loans. In addition, as part of its corrective action to the recommendations made in our 2007 inspection report on guaranty agency compliance with the establishment of a Federal Fund and Operating Fund at each agency, FSA contracted for program reviews at 22 guaranty agencies. FSA hired contractors to carry out these efforts. These program reviews identified more than \$33 million in potential recoveries to the Federal Fund. Finally, FSA is aware of the issues involving identity verification of students receiving federal student financial assistance and may discuss the issue at its next negotiated rulemaking session.*

## Contract Awards, Monitoring and Performance

In 2005, the Secretary of Education delegated authority to the Chief Operating Officer in FSA to procure property and services in the performance of functions managed by FSA as a PBO. Since that time, more than 50 percent of the contracts entered into and paid by the Department are done so by and through FSA. A 2007 audit by OIG found that FSA's contract monitoring process did not always ensure contractors adhered to contract requirements and FSA received the products and services intended. We found that FSA

staff did not always ensure appropriate review and approval of invoices, appropriately communicate acceptance/rejection of deliverables, issue modifications for contract changes and appropriately issue or sign necessary appointment letters. This occurred because of resource limitations and because FSA staff was not always familiar with applicable policies and procedures. FSA must expand its oversight and monitoring to new contractors, such as the four new contractors hired to service loans.

***The Department's Progress.*** In 2008 FSA hired consultants to review its acquisition processes and make recommendations for improvement. In addition, FSA revised its Contracting Officer's Representative Training Program to incorporate more stringent certification, training and recordkeeping requirements.

## Human Resources

Due to the complexities of the student financial assistance programs, FSA personnel must have the necessary skills and training for effective program monitoring and oversight. During the course of our 2007 inspection report on guaranty agency compliance with the establishment of the Federal and the Operating Funds, Department officials acknowledged that FSA did not have sufficient staff with the qualifications and knowledge needed to monitor guaranty agencies, lenders and other participants. Further, our 2009 audit of FSA's oversight of guaranty agencies, lenders and loan servicers noted that staff resources were not sufficient to adequately provide oversight of those participants, and core competencies had not been developed to ensure proper qualifications for staff conducting program reviews. We also found that FSA staff did not complete adequate training related to their duties. FSA must take the steps necessary to ensure it has knowledgeable staff so it has the capacity to successfully carry out the student financial assistance programs.

***The Department's Progress.*** To address the human resource weaknesses identified in recent OIG audit and inspection reports, FSA has contracted for services, including program reviews. In addition, FSA agreed with OIG recommendations that it ensure that its staff have the requisite knowledge to sufficiently evaluate programs; that it dedicate sufficient staff resources to provide oversight of the FFEL program; and that it develop core competencies and implement mandatory training for responsible staff.

## Challenge: Information Security and Management

The *Federal Information Security Management Act (FISMA)* requires each federal agency to develop, document and implement an agencywide program to provide information security and develop a comprehensive framework to protect the government's information, operations and assets. To ensure the adequacy and effectiveness of information security controls, Igs conduct annual independent evaluations of the agencies' information security programs and report the results to the Office of Management and Budget. OIG work conducted since 2004 has revealed numerous system security internal control weaknesses, all of which increase the risk for inappropriate disclosure or unauthorized use of sensitive and personally identifiable information (PII). The Department's challenges in the area of IT security and management involve the *Recovery Act*, oversight and monitoring of its multimillion-dollar IT contracts; addressing cybersecurity threats; and administering its IT capital investment portfolio. It is vital that the Department addresses these challenges to ensure that its IT and information security projects are appropriately managed so they meet their technical and functional goals on time and on budget.

## Recovery Act Funds

Through the *Recovery Act*, an additional \$98.2 billion will flow through the Department's systems. These systems must simultaneously administer and process transactions for the *Recovery Act* as well as existing programs. As a result, it is essential that the Department implement and maintain appropriate systems security controls over IT assets used to administer *Recovery Act* funds.

***The Department's Progress.*** *The Department has agreed to improve its managerial, operational and technical security controls to adequately protect its data. While we are currently conducting work related to the Recovery Act, previous FISMA-related reports identified critical risks and vulnerabilities in the Department's systems. Our findings have provided management with key recommendations for tightening of security awareness and incident handling, ensuring adequate maintenance of the Department's systems and damage assessment.*

## Contract Awards, Monitoring and Performance

In 2007, the Department awarded a 10-year, nearly \$500 million contract to a single vendor to acquire IT network services and improve all services provided to the Department customers and to lower costs to the Department through IT integration. While OIG is currently reviewing this contract, previous OIG work revealed that improvement was needed in the Department's IT contract management. A 2007 OIG audit of the previous IT network services contract revealed a number of weaknesses, including that the Department did not provide effective performance incentives or disincentives to allow for timely enforcement of an acceptable level of performance, and that contract modifications were not fully evaluated to consider whether a reduction in cost was appropriate for the reduced level of effort required by the contractor to meet acceptable levels of performance. We also found that the Department's controls did not ensure the contractor provided the quality and services required by the contract. As a result, the Department paid for a quality or level of services it did not receive.

***The Department's Progress.*** *The Department agreed to take action on a number of the recommendations made in our 2007 IT audit, which included: ensuring that future performance-based contracts include appropriate incentives and disincentives to motivate contractor performance; providing a correlation between performance and payments to the contractor; and assuring minimum quality levels for all critical services. It also agreed to require contractors to provide the Department with alternatives to address unsatisfactory contractor performance and allow for execution of option years for achievement of satisfactory performance levels if such continuation is in the best interest of the Department. The Department also agreed to develop and implement an internal contract-deliverables tracking system.*

## Ongoing Cybersecurity Threats

The nature of the ongoing cybersecurity threat has shifted. Historically the threat was from the outside "hacker" conducting attacks to compromise systems for bragging rights or use of resources. Now the primary threat is from criminal elements, including organized crime and even terrorist organizations. The threat vector most commonly used by these parties is to influence regular users to go to malicious Web sites or open malicious files and

compromise the computer. The consequences of security incidents from these threats can include disclosure of sensitive information and PII, lost staff hours, damaged or altered records, extensive financial damage and the loss of the public's confidence in its government.

***The Department's Progress.*** *The Department is making progress in establishing policies to protect sensitive information and PII and has implemented enhanced security monitoring to protect users' computers within the Department's network. More needs to be done, however, to reduce the threats posed by external business partners who have remote access to Department systems. For example, while the Department is working hard to implement two-factor authentication within the Department's network, little progress has been made on strengthening remote access from business partners.*

### **IT Capital Investment Portfolio**

The Department's IT capital investment portfolio for FY 2009 was \$656.9 million and for FY 2010 is expected to be \$920.8 million, with many resource-intensive projects pending. It is critical that the Department have a sound IT investment management control process that can ensure that technology investments are appropriately evaluated, selected, justified and supported. This oversight and monitoring process must address IT investments as an agency-wide portfolio.

***The Department's Progress.*** *The Department has recently strengthened the IT capital investment program by expanding membership of two of its review groups, the Investment Review Board and the Planning and Investment Review Working Group. The Department continues its efforts to strengthen individual business cases and to map proposed investments to an agencywide enterprise architecture strategy.*



## MANAGEMENT'S ASSURANCES

### *Federal Managers' Financial Integrity Act*

As required under the *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*, the Department reviewed its management-control system. The objectives of the management-control system are to provide reasonable assurance that the following occur:

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

Managers throughout the Department are responsible for ensuring that effective controls are implemented in their areas of responsibility. Individual assurance statements from senior management serve as a primary basis for the Department's assurance that management controls are adequate. The assurance statement provided on page 43 is the result of our annual assessment and is based upon each senior officer's evaluation of controls.

Department organizations that identify material deficiencies are required to submit plans for correcting the cited weaknesses. These corrective action plans, combined with the individual assurance statements, provide the framework for continual monitoring and improving of the Department's management controls.

**Material Weakness Reported in FY 2008 Resolved.** Corrective actions have been implemented to resolve the "Information Technology (IT) Security" material weakness reported in the *FY 2008 Performance and Accountability Report*. The Office of the Chief Information Officer implemented corrective actions in response to OIG audits and reviews of IT security. These actions have led to a significant improvement in IT security internal controls.

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

### *Federal Financial Management Improvement Act*

The Secretary has determined that the Department is in compliance with the *Federal Financial Management Improvement Act of 1996 (FFMIA)*, although the auditors have identified instances in which the Department's financial management systems did not substantially comply with the act.



The Department is cognizant of its auditor's concerns relating to instances of noncompliance with *FFMIA* as noted in the Compliance with Laws and Regulations Report located on pages 118-120 of this report. The Department continues to strengthen and improve its financial management systems.

The *FFMIA* requires that agencies' financial management systems provide reliable financial data in accordance with generally accepted accounting principles and standards. Under *FFMIA*, the financial management systems substantially comply with the three following requirements under *FFMIA*—federal financial management system requirements, applicable federal accounting standards and the use of the U.S. Government Standard General Ledger at the transaction level.

### ***FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT***

Management for the Department of Education is responsible for establishing and maintaining effective internal control and financial management systems that meet the intent and objectives of the *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*. The Department conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with the Office of Management and Budget Circular No. A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, the Department of Education can provide reasonable assurance that its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2009, was operating effectively and no material weaknesses were found in the design or operations of the internal controls.

In addition, the Department conducted an assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of the Office of Management and Budget's Circular No. A-123. In accordance with the results of this assessment, the Department of Education can provide reasonable assurance that its internal control over financial reporting as of June 30, 2009, was operating effectively and that no material weaknesses were found in the design or operation of the internal control over financial reporting.

/s/

Arne Duncan  
November 16, 2009



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# Financial Details



“Improving education is not just a moral obligation of society. It’s not just an economic imperative. It’s the civil rights issue of our generation—the only sure path out of poverty and the only way to achieve the vision of equality spelled out by our founders.”

—Secretary Duncan

## Message From the Chief Financial Officer

The Department of Education continued its high standard of financial management and reporting during FY 2009. The Department's excellence in financial management has been a joint effort of its managers, employees and business partners. In FY 2009, we:

- Successfully implemented financial reporting requirements for the *Recovery Act*. The Department prepares detailed *Recovery Act* related financial information that is submitted and posted to Recovery.gov on a weekly basis;
- Continued to successfully implement new loan access initiatives to ensure accessibility of federal student loans to eligible students and parents;
- Received an unqualified opinion on the principal financial statements for the eighth consecutive year, continuing a clear pattern of financial accountability;
- Continued to have no material weaknesses identified by our auditors as part of our Report on Internal Control for the seventh consecutive year; and
- Continued to provide reasonable assurance of the Department's internal controls.



In FY 2009, the Department also took steps to address two significant deficiencies identified in the FY 2008 "Report on Internal Controls," credit reform and information system controls. Regarding credit reform, the Department improved student loan reporting and analysis by amending and expanding the analytical tools used for the loan estimation process to accommodate the *ECASLA* programs. Additionally, the Department examined deferment, forbearance and default rates as part of ongoing cohort analysis, and conducted sensitivity analysis to show the impact of variations in major assumptions on the loan estimation process.

Regarding information system controls, the Department continued to address security and control weaknesses. The Department established an Enterprise Corrective Action Process (ECAP) to assess security vulnerabilities, conduct root cause analysis and establish remediation efforts. Additionally, the Department standardized vulnerability scanning, security controls, testing criteria and server configuration procedures.

During FY 2009, the Department assessed the effectiveness of its internal controls over financial reporting. This review was based on the requirements of OMB Circular A-123 (Appendix A), *Management's Responsibility for Internal Control*. We are pleased to report that the Department can give an unqualified statement of assurance on its internal control over financial reporting. This examination provided a valuable opportunity to review and improve internal controls and ensure integrity in financial management and reporting.

/s/

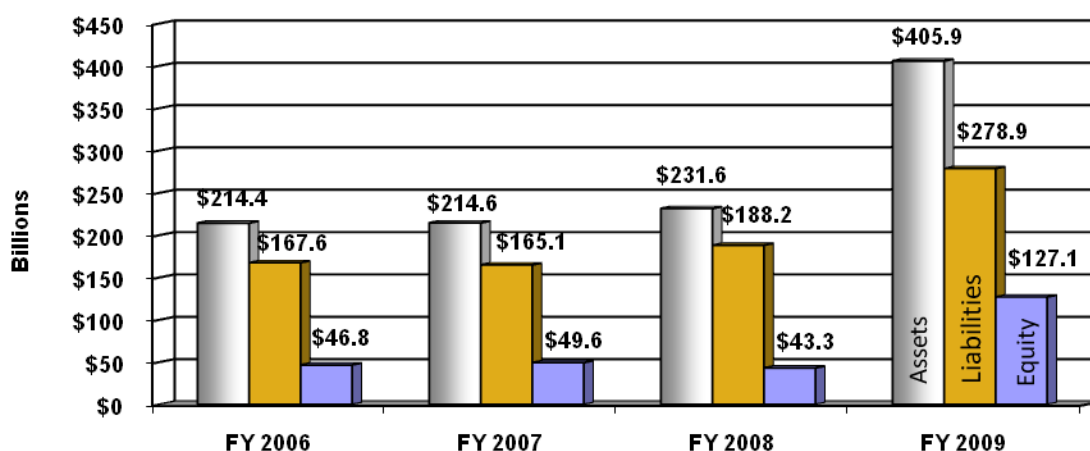
Thomas P. Skelly  
Delegated to Perform Functions of Chief Financial Officer  
November 16, 2009

## Financial Summary

Dollars in Millions

### Balance Sheet

	% Change 2009/2008	FY 2009	FY 2008	FY 2007	FY 2006
Fund Balance with Treasury	+77%	\$ 168,032	\$ 94,899	\$ 97,532	\$ 107,053
Credit Program Receivables	+74%	234,254	134,725	115,904	106,728
Other	+88%	3,659	1,949	1,202	640
<b>Total Assets</b>		<b>405,945</b>	<b>231,573</b>	<b>214,638</b>	<b>214,421</b>
Debt	+83%	235,385	128,668	104,287	105,677
Liabilities for Loan Guarantees	-53%	20,543	43,322	50,874	52,453
Other	+41%	22,957	16,247	9,896	9,481
<b>Total Liabilities</b>		<b>278,885</b>	<b>188,237</b>	<b>165,057</b>	<b>167,611</b>
Unexpended Appropriations	+157%	127,269	49,506	52,047	51,812
Cumulative Results of Operations	-97%	(209)	(6,170)	(2,466)	(5,002)
<b>Total Net Position</b>		<b>127,060</b>	<b>43,336</b>	<b>49,581</b>	<b>46,810</b>
<b>Total Liabilities and Net Position</b>		<b>\$ 405,945</b>	<b>\$ 231,573</b>	<b>\$ 214,638</b>	<b>\$ 214,421</b>



### Statement of Net Cost

	% Change 2009/2008	FY 2009	FY 2008	FY 2007	FY 2006
Gross Cost	-25%	\$ 55,412	\$ 74,034	\$ 72,316	\$ 104,699
Earned Revenue	+22%	(11,251)	(9,217)	(8,032)	(7,870)
<b>Total Net Cost of Operations</b>		<b>\$ 44,161</b>	<b>\$ 64,817</b>	<b>\$ 64,284</b>	<b>\$ 96,829</b>
<b>Net Cost Based on the Department's Strategic Plan 2007-2012</b>		<b>FY 2009</b>	<b>FY 2008</b>		
Goal 1 Improve student achievement, with a focus on bringing all students to grade level in reading and mathematics by 2014		\$ 49,357	\$ 37,045		
Goal 2 Increase the academic achievement of all high school students		2,299	2,112		
Goal 3 Ensure the accessibility, affordability, and accountability of higher education, and better prepare students and adults for employment and future learning		(8,060)	25,094		
Cross-goal Strategy on Management		565	566		
<b>Total Net Cost of Operations</b>		<b>\$ 44,161</b>	<b>\$ 64,817</b>		

**United States Department of Education**  
**Consolidated Balance Sheet**  
**As of September 30, 2009 and 2008**  
(Dollars in Millions)

	<u>FY 2009</u>	<u>FY 2008</u>
<b>Assets:</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 168,032	\$ 94,899
Accounts Receivable (Note 4)		2
Other Intragovernmental Assets (Note 8)	141	95
Total Intragovernmental	<u>168,173</u>	<u>94,996</u>
Cash and Other Monetary Assets (Note 5)	2,414	1,663
Accounts Receivable, Net (Note 4)	520	100
Credit Program Receivables, Net (Note 6)	234,254	134,725
General Property, Plant and Equipment, Net (Note 7)	38	52
Other Assets (Note 8)	<u>546</u>	<u>37</u>
<b>Total Assets (Note 2)</b>	<b><u>\$ 405,945</u></b>	<b><u>\$ 231,573</u></b>
<b>Liabilities:</b>		
Intragovernmental:		
Accounts Payable		\$ 8
Debt (Note 9)	\$ 235,385	128,668
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5)	2,414	1,663
Payable to Treasury (Note 6)	3,569	3,766
Other Intragovernmental Liabilities (Note 10)	<u>11,503</u>	<u>7,124</u>
Total Intragovernmental	252,871	141,229
Accounts Payable	1,919	1,296
Accrued Grant Liability (Note 11)	2,962	2,245
Liabilities for Loan Guarantees (Note 6)	20,543	43,322
Other Liabilities (Note 10)	<u>590</u>	<u>145</u>
<b>Total Liabilities</b>	<b><u>\$ 278,885</u></b>	<b><u>\$ 188,237</u></b>
Commitments and Contingencies (Note 20)		
<b>Net Position:</b>		
Unexpended Appropriations		
Earmarked Funds (Note 19)		
Other Funds	\$ 127,269	\$ 49,506
Cumulative Results of Operations		
Earmarked Funds (Note 19)	8	17
Other Funds	<u>(217)</u>	<u>(6,187)</u>
<b>Total Net Position (Note 12)</b>	<b><u>\$ 127,060</u></b>	<b><u>\$ 43,336</u></b>
<b>Total Liabilities and Net Position</b>	<b><u>\$ 405,945</u></b>	<b><u>\$ 231,573</u></b>

*The accompanying notes are an integral part of these statements.*



**United States Department of Education  
Consolidated Statement of Net Cost  
For the Years Ended September 30, 2009 and 2008**  
(Dollars in Millions)

<b>Program Costs</b>	<b>FY 2009</b>	<b>FY 2008</b>
<b>Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement</b>		
Gross Costs	\$ (6,344)	\$ 33,090
Less: Earned Revenue	11,107	9,082
Net Program Costs	(17,451)	24,008
<b>Total Program Costs</b>	<b>\$ (17,451)</b>	<b>\$ 24,008</b>
<b>Promote Academic Achievement in Elementary and Secondary Schools</b>		
Gross Costs	\$ 23,239	\$ 23,490
Less: Earned Revenue	89	86
Net Program Costs	23,150	23,404
<b>Total Program Costs</b>	<b>\$ 23,150</b>	<b>\$ 23,404</b>
<b>Transformation of Education</b>		
Gross Costs	\$ 1,667	\$ 1,569
Less: Earned Revenue	35	32
Net Program Costs	1,632	1,537
<b>Total Program Costs</b>	<b>\$ 1,632</b>	<b>\$ 1,537</b>
<b>Special Education</b>		
Gross Costs	\$ 15,232	\$ 15,885
Less: Earned Revenue	20	17
Net Program Costs	15,212	15,868
<b>Total Program Costs</b>	<b>\$ 15,212</b>	<b>\$ 15,868</b>
<b>American Recovery and Reinvestment Act</b>		
Gross Costs	\$ 21,618	
Less: Earned Revenue		
Net Program Costs	21,618	
<b>Total Program Costs</b>	<b>\$ 21,618</b>	<b>\$ 0</b>
<b>Net Cost of Operations (Notes 13 &amp; 16)</b>	<b>\$ 44,161</b>	<b>\$ 64,817</b>

*The accompanying notes are an integral part of these statements.*

**United States Department of Education**  
**Consolidated Statement of Changes in Net Position**  
**For the Years Ended September 30, 2009 and 2008**

(Dollars in Millions)

	FY 2009		FY 2008	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
<b>Beginning Balances</b>				
Earmarked Funds	\$ 17		\$ 39	
All Other Funds	\$ (6,187)	\$ 49,506	\$ (2,505)	\$ 52,047
<b>Budgetary Financing Sources:</b>				
Appropriations Received				
Earmarked Funds				
All Other Funds		\$ 164,927		\$ 72,991
Appropriations Transferred - in/out				
Earmarked Funds				
All Other Funds		1		
Other Adjustments (rescissions, etc)				
Earmarked Funds				
All Other Funds	\$ 2	(302)	\$ (6)	(2,202)
Appropriations Used				
Earmarked Funds				
All Other Funds	86,863	(86,863)	73,330	(73,330)
Nonexpenditure Financing Sources-Transfers-Out				
Earmarked Funds				
All Other Funds	(18)		(208)	
<b>Other Financing Sources:</b>				
Imputed Financing from Costs Absorbed by Others				
Earmarked Funds				
All Other Funds	32		29	
Others				
Earmarked Funds				
All Other Funds	(36,757)		(12,032)	
<b>Total Financing Sources</b>				
Earmarked Funds				
All Other Funds	\$ 50,122	\$ 77,763	\$ 61,113	\$ (2,541)
<b>Net Cost of Operations</b>				
Earmarked Funds	\$ (9)		\$ (22)	
All Other Funds	\$ (44,152)		\$ (64,795)	
<b>Net Change</b>				
Earmarked Funds	\$ (9)		\$ (22)	
All Other Funds	\$ 5,970	\$ 77,763	\$ (3,682)	\$ (2,541)
<b>Ending Balances (Note 12)</b>				
Earmarked Funds	\$ 8		\$ 17	
All Other Funds	\$ (217)	\$ 127,269	\$ (6,187)	\$ 49,506

*The accompanying notes are an integral part of these statements.*

**United States Department of Education  
Combined Statement of Budgetary Resources  
For the Years Ended September 30, 2009 and 2008**

(Dollars in Millions)

	FY 2009		FY 2008	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
<b>Budgetary Resources:</b>				
Unobligated balance, brought forward, October 1	\$ 4,307	\$ 26,847	\$ 5,272	\$ 37,111
Recoveries of prior year Unpaid Obligations	1,012	8,038	2,097	3,115
Budgetary Authority:				
Appropriations	164,934	132	73,002	153
Borrowing Authority (Note 15)		200,265		57,743
Spending authority from offsetting collections (gross):				
Earned				
Collected	1,701	45,536	1,751	33,570
Change in Receivables from Federal Sources	1	(3)	(1)	
Change in unfilled customer orders				
Advance Received	4		4	
Without advance from Federal Sources	1	10		
Subtotal	\$ 166,641	\$ 245,940	\$ 74,756	\$ 91,466
Temporarily not available pursuant to Public Law	(887)			
Permanently not available	(980)	(13,141)	(2,980)	(16,844)
<b>Total Budgetary Resources (Note 15)</b>	<b>\$ 170,093</b>	<b>\$ 267,684</b>	<b>\$ 79,145</b>	<b>\$ 114,848</b>
<b>Status of Budgetary Resources:</b>				
Obligations incurred: (Note 15)				
Direct	\$ 133,398	\$ 257,690	\$ 74,742	\$ 88,001
Reimbursable	94		96	
Subtotal	\$ 133,492	\$ 257,690	\$ 74,838	\$ 88,001
Unobligated Balances:				
Apportioned	\$ 33,263	\$ 474	\$ 1,540	\$ 396
Subtotal	\$ 33,263	\$ 474	\$ 1,540	\$ 396
Unobligated Balance not available	3,338	9,520	2,767	26,451
<b>Total Status of Budgetary Resources</b>	<b>\$ 170,093</b>	<b>\$ 267,684</b>	<b>\$ 79,145</b>	<b>\$ 114,848</b>
<b>Change in Obligated Balance:</b>				
Obligated balance, net:				
Unpaid obligations, brought forward, October 1	\$ 49,875	\$ 41,440	\$ 50,712	\$ 14,734
Uncollected customer payments from Federal Sources, brought forward, October 1	(2)		(3)	
Total, unpaid obligated balance, brought forward, net	\$ 49,873	\$ 41,440	\$ 50,709	\$ 14,734
Obligations Incurred, net (+/-)	133,492	257,690	74,838	88,001
Gross Outlays	(86,867)	(157,295)	(73,578)	(58,180)
Recoveries of prior year unpaid obligations, actual	(1,012)	(8,038)	(2,097)	(3,115)
Change in uncollected customer payments from Federal Sources (+/-)	(2)	(7)	1	
	<b>\$ 95,484</b>	<b>\$ 133,790</b>	<b>\$ 49,873</b>	<b>\$ 41,440</b>
Obligated Balance, net, end of period:				
Unpaid Obligations	\$ 95,488	\$ 133,797	\$ 49,875	\$ 41,440
Uncollected customer payments from Federal Sources	(4)	(7)	(2)	
<b>Total, unpaid obligated balance, net, end of period</b>	<b>\$ 95,484</b>	<b>\$ 133,790</b>	<b>\$ 49,873</b>	<b>\$ 41,440</b>
<b>Net Outlays:</b>				
Gross Outlays	\$ 86,867	\$ 157,295	\$ 73,578	\$ 58,180
Offsetting collections	(1,705)	(45,536)	(1,755)	(33,570)
Distributed Offsetting receipts	(31,763)		(103)	(5,750)
<b>Net Outlays (Note 15)</b>	<b>\$ 53,399</b>	<b>\$ 111,759</b>	<b>\$ 71,720</b>	<b>\$ 18,860</b>

*The accompanying notes are an integral part of these statements.*



## Notes to the Principal Financial Statements For the Years Ended September 30, 2009 and 2008

### Note 1. Summary of Significant Accounting Policies

#### Reporting Entity

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

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

The *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)* amended the FFEL Program to authorize the Secretary to purchase or enter into forward commitments to purchase FFEL loans. This temporary loan purchase authority was to expire on September 30, 2009; however, Public Law (P.L.) 110-350 extended the authority through September 30, 2010. The Department has implemented three activities under this temporary loan purchase authority. These activities are: (1) loan purchase commitments under which the Department purchases loans directly from FFEL lenders; (2) loan participation purchases in which the Department purchases participation interests in FFEL loans; and (3) an Asset-Backed Commercial Paper (ABCP) Conduit in which the Department enters into a forward commitment to purchase FFEL loans from a conduit, as needed, to allow the conduit to repay short-term liquidity loans used to re-finance maturing commercial paper.

The Teacher Education Assistance for College and Higher Education Grant (TEACH) Program was implemented beginning July 1, 2008. This program, added to the *HEA* by the *College Cost Reduction and Access Act (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.

The Federal Pell Grant Program provides need-based grants to low-income undergraduate and certain post-baccalaureate students to promote access to postsecondary education. Additionally, the Department administers numerous other grant programs and facilities loan programs. Grant programs include grants to state and local entities for elementary and

secondary education; special education and rehabilitative services; educational research and improvement; and grants for needs of the disadvantaged. Through the facilities loan programs, the Department administers low-interest loans to institutions of higher education for the construction and renovation of facilities.

The *American Recovery and Reinvestment Act of 2009 (Recovery Act)*, enacted on February 17, 2009 as P.L. 111-5, provides funding to the Department for improving schools, raising students' achievement, driving reform and producing better results for children and young people for the long term health of the nation. Approximately 55 percent of the Department's *Recovery Act* funding was appropriated for the creation of a new State Fiscal Stabilization Fund with the goal to stabilize state and local government budgets to avoid reductions in education and other essential public services while driving education reform. The Department was tasked with promptly disbursing these funds through a variety of existing and new grant programs, while ensuring the transparency and accountability of every dollar spent.

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

### Reporting Organizations

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

### Major Reporting Groups

- Federal Student Aid
- Office of Elementary and Secondary Education
- American Recovery and Reinvestment Act (ARRA)
- Office of Special Education and Rehabilitative Services
- Other

The FSA, IES, OESE, OII and OSERS reporting organizations are responsible for the administration of *Recovery Act* funds; however, activities for *Recovery Act* funds are reported under the "American Recovery and Reinvestment Act" major reporting group. (See Notes 11, 13 and 18) The major reporting group "Other" includes the IES, OELA, OII, OM, OPE, OSDFS and OVAE reporting organizations and Hurricane Education Recovery (HR) activities. (See Notes 11, 13 and 19)

### 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 Department, as required by the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994*. The financial statements were prepared from the books and records of the Department, in accordance with accounting principles generally accepted in the United States of America for



federal entities, issued by the Federal Accounting Standards Advisory Board (FASAB), and the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, as revised June 2009. These financial statements are different from the financial reports prepared by the Department pursuant to OMB directives that are used to monitor and control the Department's use of budgetary resources.

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

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

Intradepartmental transactions and balances have been eliminated from the consolidated financial statements.

### **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 re-estimated annually.

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 are prepared. Minor adjustments to any of these components may create significant changes to the estimate.

The Department estimates all future cash flows associated with the Direct Loan, FFEL and TEACH 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).

The Department uses a computerized cash flow projection Student Loan Model to calculate subsidy estimates for the Direct Loan, FFEL and TEACH Programs. Each year, the Department re-evaluates the estimation methods related to changing conditions. The Department uses 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 2010 Mid-Session Review, a government-wide exercise required annually by OMB. These estimates are based on the most current information available to 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. 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.

The Department recognizes 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 financial 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 to incur financial obligations that will result in outlays. The Department's budgetary resources include (1) unobligated balances of resources from prior years, (2) recoveries of prior-year obligations and (3) new resources, which include appropriations, authority to borrow from the U.S. Department of the Treasury (Treasury) and spending authority from collections.

Unobligated balances associated with resources expiring at the end of the fiscal year remain available for five years after expiration only for upward adjustments of prior year obligations, after which they are canceled and may not be used. Unobligated balances of resources that have not expired at year-end 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, the TEACH Program and activities under the temporary loan purchase authority. Subsidy and administrative costs of the programs are funded by appropriations. Budgetary resources from collections are used primarily to repay the Department's debt to Treasury. Major sources of collections include (1) principal and interest collections from borrowers, (2) related fees and (3) interest from Treasury on balances in certain credit financing accounts that make and administer loans and loan 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, the TEACH Program and activities under the temporary loan purchase authority. In addition, borrowing authority is requested in advance of expected collections to cover negative subsidy cost. Treasury prescribes the terms and conditions of borrowing authority and lends to the credit 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 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, trust, special 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 the Department. The Department's records are reconciled with those of Treasury.

A portion of the general funds 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. Trust funds generally consist of donations for the hurricane relief activities. Other funds, which are non-budgetary, primarily consist of deposit and receipt funds and clearing accounts.

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

The Fund Balance with Treasury also includes funds received for grants during FY 2009, which are statutorily not available for obligation until FY 2010. Since this is a deferral made in law, it reduces total budgetary resources during FY 2009. (See Notes 3 and 12)

### **Accounts Receivable**

Accounts Receivable are amounts due to the Department 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 federal agencies result from reimbursable agreements entered into by the Department with other agencies to provide various goods and services. Accounts receivable are reduced to net realizable value by an allowance for uncollectible amounts. The estimate of an allowance for loss on uncollectible accounts is based on the Department's experience in the collection of receivables and an analysis of the outstanding balances. (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.

The Department disburses 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 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 the Department that are expected from the receivables over their projected lives. Similarly, liabilities for loan guarantees are valued at the present value of the cash outflows from the Department less the present value of related inflows. The estimated present value of net long-term cash outflows of the Department for subsidized costs is net of recoveries, interest supplements and offsetting fees. The Department records all credit program loans and loan guarantees at their present values.

Credit program receivables for activities under the temporary loan 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 on its borrowings from Treasury and interest rates charged to target groups is also subsidized (or may provide an offset to subsidy if the Department's rate is less). The corresponding interest subsidy in loan guarantee programs is the payment of interest supplements to third-party lenders in order to 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**

The Department capitalizes single items of property and equipment with a cost of \$50,000 or more that have an estimated useful life greater than two years. Additionally, the Department capitalizes bulk purchases of property and equipment with an aggregate cost of \$500,000 or more. A bulk purchase is defined as the purchase of like items related to a specific project or the

purchase of like items occurring within the same fiscal year that have an estimated useful life greater than two years. Property and equipment are depreciated over their estimated useful lives using the straight-line method of depreciation. 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 Department's needs. (See Note 7)

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

### Other Assets

Other assets include assets not reported separately on the balance sheet. The Department's other intragovernmental assets primarily consist of advance payments to federal agencies as part of interagency agreements for various goods and services. The Department's other assets (with the public) consist of payments made to grant recipients in advance of their expenditures and in-process disbursements for the FFEL Program. (See Note 8)

### 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 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 that an 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 10)

### Debt

The Department borrows to provide funding for the Direct Loan Program, the TEACH Program and activities under the temporary loan purchase authority. The liability to Treasury from borrowings represents unpaid principal at year-end. The Department 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. In addition, the Federal Financing Bank (FFB) holds bonds issued by a designated bonding authority, on behalf of the Department, for the Historically Black Colleges and Universities Capital Financing Program. The Department reports the corresponding liability for full payment of principal and accrued interest on bonds as a payable to the FFB. (See Note 9)

### Accrued Grant Liability

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



**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, and trust funds. Cumulative results of operations represent the net difference since inception between (1) expenses and (2) revenues and financing sources. (See Note 12)

**Earmarked Funds**

Earmarked funds are recorded as specially identified resources, often supplemented by other financing sources, which remain available over time. These funds are required by statute to be used for designated recipients. The Department's earmarked funds are primarily related to the 2005 Hurricane Relief efforts. (See Note 19)

**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. (See Note 10) Sick leave and other types of non-vested leave are expensed as taken.

**Retirement Plans and Other Retirement Benefits.** Employees participate in either 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 (DOL), 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 DOL 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 as determined by DOL annually. (See Note 10)



### **Intragovernmental Transactions**

The Department'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 the Department were a separate, unrelated entity.

### **Allocation Transfers**

Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. Treasury provides a separate child fund account as a subset of the parent fund account for cost accumulation and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child are charged to this allocation account as the child executes the delegated activity on behalf of the parent entity.

The Department (the child entity) was a party to allocation transfers with the Appalachian Regional Commission (the parent entity). All financial activity related to these allocation transfers was reported in the financial statements of the Appalachian Regional Commission, from which the underlying legislative authority, appropriations and budget apportionments were derived. During FY 2008, the Department returned all unused funds to the Appalachian Regional Commission.

**Note 2. Non-Entity Assets**

As of September 30, 2009 and 2008, non-entity assets consisted of the following:

**Non-Entity Assets**

(Dollars in Millions)

	<b>2009</b>	<b>2008</b>
<b>Non-Entity Assets</b>		
Intragovernmental		
Fund Balance with Treasury	\$ 45	\$ 28
<b>Total Intragovernmental</b>	<b>45</b>	<b>28</b>
With the Public		
Cash and Other Monetary Assets	2,414	1,663
Accounts Receivable, Net	16	20
Credit Program Receivables, Net	184	186
<b>Total With the Public</b>	<b>2,614</b>	<b>1,869</b>
<b>Total Non-Entity Assets</b>	<b>2,659</b>	<b>1,897</b>
Entity Assets	403,286	229,676
<b>Total Assets</b>	<b>\$ 405,945</b>	<b>\$ 231,573</b>

Non-entity intragovernmental assets primarily consist of deposit fund balances. Non-entity assets with the public primarily consist of guaranty agency reserves and 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, 2009 and 2008, consisted of the following:

**Fund Balances**

(Dollars in Millions)

	<b>2009</b>	<b>2008</b>
General Funds	\$ 130,533	\$ 52,487
Revolving Funds	37,431	42,357
Trust Funds	9	18
Special Funds	14	9
Other Funds	45	28
<b>Fund Balance with Treasury</b>	<b>\$ 168,032</b>	<b>\$ 94,899</b>

The Status of Fund Balance with Treasury, as of September 30, 2009 and 2008, consisted of the following:

<b>Status of Fund Balance with Treasury</b>		
(Dollars in Millions)		
	<b>2009</b>	<b>2008</b>
Unobligated Balance		
Available	\$ 33,737	\$ 1,936
Unavailable	10,444	27,555
Obligated Balance, Not Yet Disbursed	122,919	65,380
Authority Temporarily Precluded from Obligation	887	-
Non-Budgetary Fund Balance with Treasury	45	28
<b>Fund Balance with Treasury</b>	<b>\$ 168,032</b>	<b>\$ 94,899</b>

#### **Note 4. Accounts Receivable**

Accounts Receivable, as of September 30, 2009 and 2008, consisted of the following:

<b>Accounts Receivable</b>			
(Dollars in Millions)			
<b>2009</b>			
	<b>Gross Receivables</b>	<b>Allowance</b>	<b>Net Receivables</b>
Intragovernmental	\$ -	\$ -	\$ -
With the Public	693	(173)	520
<b>Accounts Receivable</b>	<b>\$ 693</b>	<b>\$ (173)</b>	<b>\$ 520</b>
<b>2008</b>			
	<b>Gross Receivables</b>	<b>Allowance</b>	<b>Net Receivables</b>
Intragovernmental	\$ 2	\$ -	\$ 2
With the Public	278	(178)	100
<b>Accounts Receivable</b>	<b>\$ 280</b>	<b>\$ (178)</b>	<b>\$ 102</b>

**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, 2009 and 2008.

**Cash and Other Monetary Assets**

(Dollars in Millions)

	<u>2009</u>	<u>2008</u>
<b>Beginning Balance, Cash and Other Monetary Assets</b>	<b>\$ 1,663</b>	<b>\$ 1,103</b>
Valuation Increase in Guaranty Agency Federal Funds	751	722
Less: Collections from Guaranty Agency Federal Funds		
Excess Collections	-	162
Collections Remitted to Treasury	-	162
<b>Ending Balance, Cash and Other Monetary Assets</b>	<b>\$ 2,414</b>	<b>\$ 1,663</b>

The \$751 million net increase in the Federal Fund in FY 2009 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 William D. Ford Federal Direct Loan program, referred to as the Direct Loan Program. Direct loans are originated and serviced through contracts with private vendors.

The Department disbursed approximately \$37.6 billion in Direct Loans to eligible borrowers in FY 2009 and approximately \$21.1 billion in FY 2008. 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. 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 7 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 2009 cohort, an estimated \$2.8 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. In FY 2008, the Department began administering activities under the temporary loan purchase authority by purchasing FFEL loans and participation interests in those directly from lenders. As

a result, the FFEL Program also includes approximately \$52 billion and \$5.1 billion in direct federal assets as of September 30, 2009 and 2008, respectively.

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 their Federal Fund, which consists of Federal resources held in trust by the agency. 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.

*ECASLA* gave the Department temporary authority to purchase FFEL loans and interest in those loans. This authority was to expire on September 30, 2009; however, P.L. 110-350 extended the authority through September 30, 2010. The Department has implemented three activities under this authority: loan purchase commitments; purchases of loan participation interests; and a put, or forward purchase commitment, with an ABCP Conduit. A credit program receivable is established for loans and participation interests in loans purchased through these activities.

Under the loan purchase commitment activity, lenders have the option to sell directly to the Department fully disbursed loans originated for academic years 2007-08, 2008-09 or 2009-10. As of September 30, 2009, only loans originated for the 2009-10 academic year remain eligible for future purchase.

In loan participation transactions, lenders transfer to a custodian FFEL loans originated in academic years 2008-09 or 2009-10 on which at least one disbursement has been made. The custodian issues participation certificates to the lender that convey a participation interest in the loans. The lender sells the participation interest in the loans to the Department at the par value of these loans. The Department remits the proceeds through the custodian to the lenders. Participation interests earn a yield payable from the lender to the Department at the rate of the 91-day commercial paper rate plus 50 basis points and reset quarterly. Funds to redeem these loans from the Department's participation interest may be obtained by selling the underlying loans to the Department or by other means.

The terms of these two purchase activities permit lenders to sell loans and participation interests in loans to the Department and require them to redeem the participated loans. Lenders must commit to redeem the certificates and sell loans by September 30; the Department must finalize all related transactions by October 15. As of September 30, 2009, the Department had \$26.6 billion in Notices of Intent to Sell from lenders in the purchase commitment and loan participation purchase activities.

During FY 2009, the Department, Treasury and OMB established the terms on which the Department would support an ABCP Conduit to provide liquidity to the student loan market. An ABCP Conduit under this activity issues short-term commercial paper to investors; this paper is backed by student loans pledged to the conduit. The conduit uses the proceeds of sales of its commercial paper to acquire from lenders interests in student loans. Lenders must use a portion of conduit payments to make new loans. Though the intent is for the conduit to meet demands on maturing paper by reissuing commercial paper, the Department, using its *ECASLA* authority, will purchase loans from the conduit as needed to ensure the conduit will be able to meet the demands on its paper if it is unable to refinance maturing commercial paper. The Department will purchase those pledged loans that become more than 210 days delinquent. The conduit has sold to the Department approximately \$50 million of these delinquent loans as of September 30, 2009, recorded as credit program receivables. Under the terms of the Put Agreement with the conduit, the Department may also purchase pledged loans at the date that is 45 days prior to

the Put Agreement expiration on January 19, 2014. As required by the *Credit Reform Act*, all cash flows to and from the Government resulting from its transactions with the ABCP Conduit are recorded in a non-budgetary credit financing account. Amounts in this account are a means of financing and are not included in the budget totals. Loans originated in academic years 2004-05 through 2007-08 are eligible to be purchased through the ABCP Conduit activity.

As of September 30, 2009, the Department has \$70 billion in obligations to cover any buyer-of-last-resort activities and potential purchases of the underlying student loans under the ABCP Conduit authority. These obligations are covered by available borrowing authority. In addition, the Department has estimated approximately \$4 billion in negative subsidy. The conduit, a separate legal entity, has approximately \$30 billion in commercial paper outstanding.

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.

The Department guaranteed \$80.4 billion and \$67.9 billion in gross non-consolidation loans to FFEL recipients during FY 2009 and FY 2008, respectively. In 2009, lenders disbursed \$62.7 billion in FFEL loans from the 2008 and 2009 cohorts; in 2008, \$68.8 billion were disbursed from the 2007 and 2008 cohorts. As of September 30, 2009 and 2008, total principal balances outstanding of guaranteed loans held by lenders were approximately \$457 billion and \$415 billion, respectively. As of September 30, 2009 and 2008, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately \$445 billion and \$405 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 15 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 2009 cohort, an estimated \$12.5 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 Program.** Beginning July 1, 2008, the Department 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*.

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

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

In FY 2006, Congress passed the *Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery* (P.L. 109-234). Section 2601 of this Act created a new sub-program within the HBCU Capital Financing Program under the *HEA* to provide loans on advantageous terms to HBCUs affected by Hurricanes Rita and Katrina. Under this sub-program, the interest rate charged on loans is capped at 1 percent, fees associated with the program are less than fees for the rest of the program, and institutions are not required to participate in the program's pooled escrow account. In addition, principal and interest payments on loans already made to affected HBCUs can be deferred for up to 3 years, with the Department making any payments that come due during this period. The statute gives the Department authority to make loans under the new sub-program in excess of the overall program loan caps. The Department has made four loans under the new sub-program and has assumed one default and no recoveries in making initial subsidy estimates. Based on these forecast assumptions and the expected cash flows for the new sub-program, the estimated subsidy rate for the sub-program is 76 percent. The current subsidy estimate for the sub-program is \$304 million on a loan volume of \$400 million.

### **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 new consolidated loan was obligated. 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.

Direct Loan Program consolidations increased from \$5.8 billion to \$12.5 billion reversing the previous declining consolidation trend. FFEL to FFEL Loan consolidations continue, but at a rate that did not significantly influence FFEL re-estimated subsidy cost; performing FFEL to FFEL consolidations would not affect the Department's actual costs. FFEL to Direct Loan

consolidations are part of the \$12.5 billion recorded. Direct loan consolidation activity into the FFEL Program is insignificant.

### **Modification of Subsidy Cost**

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.

**FY 2009 Modification.** *ECASLA* and its subsequent extension contained provisions authorizing the Secretary to purchase certain categories of outstanding FFEL loans. Two programs were implemented under *ECASLA* during FY 2008 and FY 2009, both for loans from academic years 2008-09 and 2009-10: 1) a standard put program in which the Department purchases loans directly from lenders, and 2) a loan participation purchase program, under which the Department purchases participation interests in loans that holders must redeem and which they may do by sale to the Department of the underlying loans. In FY 2009, the standard put program was expanded to allow the sale of loans originated for the 2007-08 academic year. In FY 2009, the Department also implemented the ABCP Conduit program under which the Department issued a five-year commitment to purchase from the conduit loans it acquires from lenders. This program allows lenders to secure private financing from the conduit at favorable rates. The Department's purchase commitment to the ABCP Conduit applies to loans acquired by the conduit and made from October 2003 through academic year 2008-09. Additionally, in response to disruptions in the commercial paper market, the Secretary used authority to approve a temporary change in the basis for calculating special allowance payments to and from loan holders for the first quarter of FY 2009.

The net effect of changes related to loan modifications executed in FY 2009 was a downward cost of \$2.6 billion in the FFEL Program with a corresponding effect on the Liability for Loan Guarantees. Of this amount, \$526 million related to the standard loan put authority for award year 2007-08, \$778 million related to the ABCP Conduit authority and \$1.3 billion related to the temporary change in the special allowance payment basis. The FFEL Program also recognized a net modification adjustment transfer loss of \$130 million.

**FY 2008 Modification.** 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 FFEL and Direct Loan borrowers, 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, 2009 and 2008, consisted of the following:

#### Credit Program Receivables

(Dollars in Millions)

	2009	2008
Direct Loan Program Loan Receivables, Net	\$ 152,771	\$ 109,850
FFEL Program		
FFEL Guaranteed Loan Program, Net (Pre-1992)	3,480	3,591
FFEL Program (Post-1991):		
FFEL Guaranteed Loan Program, Net	20,399	15,624
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	17,032	64
Loan Participation Purchase, Net	39,996	5,230
ABCP Conduit, Net	47	-
Federal Perkins Program Loan Receivables, Net	184	186
TEACH Program Receivables, Net	50	1
Facilities Loan Programs Loan Receivables, Net	295	179
<b>Credit Program Receivables, Net</b>	<b>\$ 234,254</b>	<b>\$ 134,725</b>

**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)

	2009	2008
Principal Receivable	\$ 149,437	\$ 117,610
Interest Receivable	7,370	5,983
<b>Receivables</b>	<b>156,807</b>	<b>123,593</b>
Less: Allowance for Subsidy	4,036	13,743
<b>Direct Loan Program Loan Receivables, Net</b>	<b>\$ 152,771</b>	<b>\$ 109,850</b>

Of the \$156.8 billion in receivables as of September 30, 2009, \$11.5 billion in loan principal was in default, compared to \$10.3 billion a year earlier. Defaulted Direct Loans are held in the Department's Business Operations Default Division.

**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)

	2009	2008
<b><u>FFEL Guaranteed Loan Program (Pre-1992)</u></b>		
Principal Receivable	\$ 7,100	\$ 7,587
Interest Receivable	223	182
<b>Receivables</b>	<b>7,323</b>	<b>7,769</b>
Less: Allowance for Subsidy	3,843	4,178
<b>FFEL Guaranteed Loan Program Receivables, Net (Pre-1992)</b>	<b>3,480</b>	<b>3,591</b>
<b><u>FFEL Program (Post-1991)</u></b>		
Principal Receivable		
FFEL Guaranteed Loan Program	22,403	17,641
Temporary Loan Purchase Authority:		
Loan Purchase Commitment	14,293	59
Loan Participation Purchase	37,020	5,036
ABCP Conduit	50	-
Interest Receivable		
FFEL Guaranteed Loan Program	2,305	2,143
Temporary Loan Purchase Authority:		
Loan Purchase Commitment	379	-
Loan Participation Purchase	259	11
ABCP Conduit	2	-
<b>Receivables</b>	<b>76,711</b>	<b>24,890</b>
Less: Allowance for Subsidy		
FFEL Guaranteed Loan Program	4,309	4,160
Temporary Loan Purchase Authority:		
Loan Purchase Commitment	(2,360)	(5)
Loan Participation Purchase	(2,717)	(183)
ABCP Conduit	5	-
FFEL Guaranteed Loan Program, Net	20,399	15,624
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	17,032	64
Loan Participation Purchase, Net	39,996	5,230
ABCP Conduit, Net	47	-
<b>FFEL Program Loan Receivables, Net</b>	<b>\$ 80,954</b>	<b>\$ 24,509</b>

All loans and participation interests in loans purchased by the Department under the temporary loan purchase authority are federal assets; the loan receivable represents all outstanding loans and participation interests. Loan participation interests were first purchased by the Department in August 2008. Approximately \$9 billion in participation interests were redeemed in FY 2009 by selling the underlying loans to the Department. No participation interests were redeemed in FY 2008.

**Federal Perkins Loan Program.** At September 30, 2009 and 2008, loans receivable, net of an allowance for loss, were \$184 million and \$186 million, respectively. These loans are valued at historical cost.

**TEACH Program.** At September 30, 2009 and 2008, loans receivable, net of an allowance for subsidy, were \$50 million and \$1 million, respectively.

**Facilities Loan Programs**

**Facilities Loan Programs Loan Receivables**

(Dollars in Millions)

	2009	2008
Principal Receivable	\$ 651	\$ 553
Interest Receivable	9	6
<b>Receivables</b>	<b>660</b>	<b>559</b>
Less: Allowance for Subsidy	365	380
<b>Facilities Loan Programs Loan Receivables, Net</b>	<b>\$ 295</b>	<b>\$ 179</b>

**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)

	2009	2008
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ 13,743</b>	<b>\$ 8,245</b>
<b>Components of Subsidy Transfers</b>		
Interest Rate Differential	(7,785)	(1,540)
Defaults, Net of Recoveries	1,070	454
Fees	(551)	(487)
Other	2,863	1,498
<b>Current Year Subsidy Transfers</b>	<b>(4,403)</b>	<b>(75)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates <sup>1</sup>	(322)	222
Technical and Default Re-estimates	(4,878)	946
<b>Subsidy Re-estimates</b>	<b>(5,200)</b>	<b>1,168</b>
<b>Components of Loan Modifications</b>		
Loan Modification Costs	-	4,143
Modification Adjustment Transfers	-	(9)
<b>Loan Modifications</b>	<b>-</b>	<b>4,134</b>
<b>Activity</b>		
Fee Collections	628	482
Loan Cancellations <sup>2</sup>	(432)	(240)
Subsidy Allowance Amortization	40	456
Other	(340)	(427)
<b>Total Activity</b>	<b>(104)</b>	<b>271</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ 4,036</b>	<b>\$ 13,743</b>

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

<sup>2</sup> 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)

	<u>2009</u>	<u>2008</u>
<b>Beginning Balance, FFEL Financing Accounts Liability for Loan Guarantees</b>	<b>\$ 43,185</b>	<b>\$ 50,731</b>
<b>Components of Subsidy Transfers</b>		
Interest Supplement Costs	(632)	1,212
Defaults, Net of Recoveries	494	43
Fees	(3,495)	(449)
Other <sup>1</sup>	2,108	436
<b>Current Year Subsidy Transfers</b>	<b>(1,525)</b>	<b>1,242</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	(147)	(700)
Technical and Default Re-estimates	(21,542)	(760)
<b>Subsidy Re-estimates</b>	<b>(21,689)</b>	<b>(1,460)</b>
<b>Components of Loan Modifications</b>		
Loan Modification Costs	(2,641)	(2,464)
Modification Adjustment Transfers	130	(30)
<b>Loan Modifications</b>	<b>(2,511)</b>	<b>(2,494)</b>
<b>Activity</b>		
Interest Supplement Payments	(5,389)	(8,744)
Claim Payments	(8,634)	(8,029)
Fee Collections	4,115	4,107
Interest on Liability Balance	337	1,372
Other <sup>2</sup>	12,559	6,460
<b>Total Activity</b>	<b>2,988</b>	<b>(4,834)</b>
<b>Ending Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>20,448</b>	<b>43,185</b>
FFEL Liquidating Account Liability for Loan Guarantees	95	137
<b>Liabilities for Loan Guarantees</b>	<b>\$ 20,543</b>	<b>\$ 43,322</b>

<sup>1</sup> Subsidy primarily associated with debt collections and loan cancellations due to death, disability and bankruptcy.

<sup>2</sup> Activity primarily associated with the transfer of subsidy for defaults; loan consolidation activity; negative special allowance payments; and loan cancellations due to death, disability and bankruptcy.

**Financing Account Interest Expense and Interest Revenue**

The Department borrows from Treasury to fund the unsubsidized portion of lending activities. The Department calculates and pays Treasury interest on its borrowing 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, in accordance with Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees*, as the difference between interest revenue and interest expense. For direct loans, the allowance for

subsidy is adjusted with the offset to interest revenue. For guaranteed loans, the liability for loan guarantees is adjusted with the offset to interest expense.

**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)

	2009	2008
Interest Expense on Treasury Borrowing	\$ 7,094	\$ 6,190
<b>Interest Expense</b>	<b>\$ 7,094</b>	<b>\$ 6,190</b>
Interest Revenue from the Public	\$ 5,669	\$ 5,277
Amortization of Subsidy	(40)	(456)
Interest Revenue on Uninvested Funds	1,465	1,369
<b>Interest Revenue</b>	<b>\$ 7,094</b>	<b>\$ 6,190</b>

### Payable to Treasury

Payable to Treasury for the years ended September 30, 2009 and 2008, consisted of the following:

### Payable to Treasury

(Dollars in Millions)

	2009	2008
<b>Future Liquidating Account Collections, Beginning Balance</b>	<b>\$ 3,766</b>	<b>\$ 4,108</b>
Valuation of Pre-1992 Loan Liability and Allowance	465	250
Capital Transfers to Treasury	(662)	(592)
<b>Future Liquidating Account Collections, Ending Balance</b>	<b>3,569</b>	<b>3,766</b>
<b>Payable to Treasury</b>	<b>\$ 3,569</b>	<b>\$ 3,766</b>

The liquidating account, based on available fund balance, periodically transfers Fund Balance to Treasury's account.

## Subsidy Expense

### William D. Ford Federal Direct Loan Program

#### Direct Loan Program Subsidy Expense

(Dollars in Millions)

	2009	2008
<b>Components of Current Year Subsidy Transfers</b>		
Interest Rate Differential	\$ (7,785)	\$ (1,540)
Defaults, Net of Recoveries	1,070	454
Fees	(551)	(487)
Other	2,863	1,498
<b>Current Year Subsidy Transfers</b>	<b>(4,403)</b>	<b>(75)</b>
Subsidy Re-estimates	(5,200)	1,168
Loan Modification Costs	-	4,143
<b>Direct Loan Subsidy Expense</b>	<b>\$ (9,603)</b>	<b>\$ 5,236</b>

For 2009 re-estimated subsidy cost, Direct Loan subsidy cost was decreased by \$5.2 billion. Changes in the assumption for income-based repayments decreased subsidy cost by \$3.7 billion. Rising default rates increased subsidy cost by \$374 million, interest rate changes increased costs by \$350 million, and changes in deferments and forbearance rates increased costs by \$313 million. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. 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 cost by \$455 million.

In the 2008 re-estimates, Direct Loan subsidy cost was increased by \$1.2 billion. Changes in interest rates increased subsidy cost by \$859 million, updated data on teacher loan forgiveness led to an additional increase of \$481 million, and rising default rates increased subsidy cost 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 cost by \$465 million.

## Federal Family Education Loan Program

## FFEL Program Subsidy Expense

(Dollars in Millions)

	2009	2008
<b>FFEL Guaranteed Loan Program</b>		
<b>Components of Current Year Subsidy Transfers</b>		
Interest Supplement Costs	\$ (632)	\$ 1,212
Defaults, Net of Recoveries	494	43
Fees	(3,495)	(449)
Other	2,108	436
<b>Current Year Subsidy Transfers</b>	<b>(1,525)</b>	<b>1,242</b>
Subsidy Re-estimates	(21,689)	(1,460)
Loan Modification Costs	(2,641)	(2,464)
<b>FFEL Guaranteed Loan Program Subsidy Expense</b>	<b>(25,855)</b>	<b>(2,682)</b>
<b>Temporary Loan Purchase Authority</b>		
<b>Loan Purchase Commitment</b>		
<b>Components of Current Year Subsidy Transfers</b>		
Interest Supplement Costs	(3,157)	(9)
Defaults, Net of Recoveries	102	-
Fees	268	2
Other	1,179	5
<b>Current Year Subsidy Transfers</b>	<b>(1,608)</b>	<b>(2)</b>
Subsidy Re-estimates	(245)	-
<b>Loan Purchase Commitment Subsidy Expense</b>	<b>(1,853)</b>	<b>(2)</b>
<b>Loan Participation Purchase</b>		
<b>Components of Current Year Subsidy Transfers</b>		
Interest Supplement Costs	(2,976)	(292)
Defaults, Net of Recoveries	(108)	5
Fees	(811)	(476)
Other	735	595
<b>Current Year Subsidy Transfers</b>	<b>(3,160)</b>	<b>(168)</b>
Subsidy Re-estimates	930	-
<b>Loan Participation Purchase Subsidy Expense</b>	<b>(2,230)</b>	<b>(168)</b>
<b>ABCP Conduit</b>		
<b>Components of Current Year Subsidy Transfers</b>		
Interest Supplement Costs	(6)	-
Defaults, Net of Recoveries	1	-
Fees	(3)	-
Other	6	-
<b>ABCP Conduit Subsidy Expense</b>	<b>(2)</b>	<b>-</b>
<b>FFEL Program Subsidy Expense</b>	<b>\$ (29,940)</b>	<b>\$ (2,852)</b>

For 2009 re-estimated subsidy cost, FFEL Guaranteed subsidy cost was decreased by \$21.7 billion. Interest rate changes related to updated economic assumptions accounted for approximately \$18 billion in decreased subsidy cost. A \$1.5 billion increase in subsidy cost

related to changes in deferment and forbearance rates was offset by other changes in assumptions such as \$966 million decreased cost for changes in repayment rates; loan volume changes produced a decreased subsidy cost of \$790 million. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. 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 \$16.4 billion.

In the 2008 re-estimates, FFEL subsidy cost was decreased by \$1.5 billion. Changes in interest rate forecasts decreased subsidy cost 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.

### Subsidy Rates

The subsidy rates applicable to the 2009 loan cohort year follow:

	<b>Subsidy Rates—Cohort 2009</b>				
	Interest Differential/ Supplements	Defaults	Fees	Other	Total
Direct Loan Program	(24.82%)	2.90%	(1.42%)	8.38%	(14.96%)
TEACH Program	(15.44%)	0.56%	(0.00%)	11.24%	(3.64%)
FFEL Program (Post-1991):					
Guaranteed Loan Program	(2.47%)	0.24%	(2.12%)	1.36%	(2.99%)
Temporary Loan Purchase Authority:					
Loan Purchase Commitment	(28.35%)	0.98%	2.33%	10.01%	(15.03%)
Loan Participation Purchase	(23.98%)	0.97%	0.94%	10.34%	(11.73%)
ABCP Conduit	(6.92%)	0.00%	(5.30%)	6.78%	(5.44%)

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 2009 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, 2009 and 2008, consisted of the following:

<b>Administrative Expense</b>				
(Dollars in Millions)				
	2009		2008	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	\$ 458	\$ 269	\$ 343	\$ 222
Other Expense	23	13	14	9
<b>Administrative Expenses</b>	<b>\$ 481</b>	<b>\$ 282</b>	<b>\$ 357</b>	<b>\$ 231</b>

### Note 7. General Property, Plant and Equipment

General Property, Plant and Equipment, as of September 30, 2009 and 2008, consisted of the following:

<b>General Property, Plant and Equipment</b>			
(Dollars in Millions)			
	2009		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software and Telecommunications Equipment	\$ 160	\$ (122)	\$ 38
Furniture and Fixtures	3	(3)	-
<b>General Property, Plant and Equipment</b>	<b>\$ 163</b>	<b>\$ (125)</b>	<b>\$ 38</b>
	2008		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software and Telecommunications Equipment	\$ 152	\$ (100)	\$ 52
Furniture and Fixtures	3	(3)	-
<b>General Property, Plant and Equipment</b>	<b>\$ 155</b>	<b>\$ (103)</b>	<b>\$ 52</b>

The majority of the asset costs relate to financial management systems and other information technology and communications improvements.

### Leases

The Department leases information technology and telecommunications equipment as part of a contractor-owned contractor-operated services contract. Lease payments associated with the equipment are classified as operating leases and as such are expensed as incurred. The non-cancelable lease term is one year, with the Department holding the right to extend the lease term by exercising additional one-year options.



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

<b>Leases</b>			
(Dollars in Millions)			
2009		2008	
Fiscal Year	Lease Payment	Fiscal Year	Lease Payment
2010	\$ 44	2009	\$ 47
2011	48	2010	50
2012	53	2011	54
2013	55	2012	61
2014	58	2013	70
After 2014	60	After 2013	72
<b>Total</b>	<b>\$ 318</b>	<b>Total</b>	<b>\$ 354</b>

**Note 8. Other Assets**

Other Intragovernmental Assets primarily consist of advance payments to the Department of Interior's Bureau of Indian Education under terms of an interagency agreement. Other Intragovernmental Assets were \$141 million and \$95 million as of September 30, 2009 and 2008, respectively

Other Assets With the Public consist of payments made to grant recipients in advance of their expenditures and in-process invoices for interest benefits and special allowances for the FFEL Program. Other Assets With the Public were \$546 million and \$37 million as of September 30, 2009 and 2008, respectively.

**Note 9. Debt**

Debt as of September 30, 2009 and 2008, consisted of the following:

<b>Debt</b>					
(Dollars in Millions)					
	2009				
	Beginning Balance	Accrued Interest	New Borrowing	Repayments	Ending Balance
<b>Treasury Debt</b>					
Direct Loan Program	\$ 117,419	\$ -	\$ 47,179	\$ (10,380)	\$ 154,218
FFEL Program					
Guaranteed Loan Program	-	12	1,462	-	1,474
Loan Purchase Commitment	69	-	24,811	(3)	24,877
Loan Participation Purchase	10,754	-	43,223	-	53,977
ABCP Conduit	-	-	250	(6)	244
TEACH Program	14	-	56	(2)	68
Facilities Loan Program	75	-	-	(4)	71
<b>Total Treasury Debt</b>	<b>128,331</b>	<b>12</b>	<b>116,981</b>	<b>(10,395)</b>	<b>234,929</b>
<b>Debt to the FFB</b>					
HBCU	337	4	120	(5)	456
<b>Total Debt to the FFB</b>	<b>337</b>	<b>4</b>	<b>120</b>	<b>(5)</b>	<b>456</b>
<b>Total</b>	<b>\$ 128,668</b>	<b>\$ 16</b>	<b>\$ 117,101</b>	<b>\$ (10,400)</b>	<b>\$ 235,385</b>

**Debt**

(Dollars in Millions)

	<b>Beginning Balance</b>	<b>Accrued Interest</b>	<b>2008</b>		<b>Ending Balance</b>
			<b>New Borrowing</b>	<b>Repayments</b>	
<b>Treasury Debt</b>					
Direct Loan Program	\$ 103,893	\$ -	\$ 28,172	\$ (14,646)	\$ 117,419
FFEL Program					
Guaranteed Loan Program	-	-	-	-	-
Loan Purchase Commitment	-	-	69	-	69
Loan Participation Purchase	-	-	10,754	-	10,754
ABCP Conduit	-	-	-	-	-
TEACH Program	-	-	26	(12)	14
Facilities Loan Program	81	-	-	(6)	75
<b>Total Treasury Debt</b>	<b>103,974</b>	<b>-</b>	<b>39,021</b>	<b>(14,664)</b>	<b>128,331</b>
<b>Debt to the FFB</b>					
HBCU	313	-	28	(4)	337
<b>Total Debt to the FFB</b>	<b>313</b>	<b>-</b>	<b>28</b>	<b>(4)</b>	<b>337</b>
<b>Total</b>	<b>\$ 104,287</b>	<b>\$ -</b>	<b>\$ 39,049</b>	<b>\$ (14,668)</b>	<b>\$ 128,668</b>

The amount available for 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 10. Other Liabilities**

Other liabilities include current and non-current liabilities. The non-current liabilities primarily relate to 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 negative subsidy transfers and downward subsidy re-estimates, which when executed will be paid to Treasury.

Other Liabilities as of September 30, 2009 and 2008 consisted of the following:

<b>Other Liabilities</b>				
(Dollars in Millions)				
	<b>2009</b>		<b>2008</b>	
	<b>Intragovern- mental</b>	<b>With the Public</b>	<b>Intragovern- mental</b>	<b>With the Public</b>
<b>Liabilities Covered by Budgetary Resources</b>				
<b>Current</b>				
Advances From Others	\$ 96	\$ -	\$ 91	\$ -
Employer Contributions and Payroll Taxes	4	-	4	-
Liability for Deposit Funds	(5)	52	(7)	35
Accrued Payroll and Benefits	-	21	-	19
Deferred Revenue	-	467	-	42
Liabilities in Miscellaneous Receipt Accounts	11,221	-	6,847	-
<b>Total Other Liabilities Covered by Budgetary Resources</b>	<b>11,316</b>	<b>540</b>	<b>6,935</b>	<b>96</b>
<b>Liabilities Not Covered by Budgetary Resources</b>				
<b>Current</b>				
Accrued Unfunded Annual Leave	-	34	\$ -	\$ 33
<b>Non-current</b>				
Accrued Unfunded FECA Liability	3	-	3	-
Liabilities in Miscellaneous Receipt Accounts	184	-	186	-
Accrued FECA Actuarial Liability	-	16	-	16
<b>Total Other Liabilities Not Covered by Budgetary Resources</b>	<b>187</b>	<b>50</b>	<b>189</b>	<b>49</b>
<b>Other Liabilities</b>	<b>\$ 11,503</b>	<b>\$ 590</b>	<b>\$ 7,124</b>	<b>\$ 145</b>

**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 \$237 million and \$238 million as of September 30, 2009 and 2008, respectively.

As of September 30, 2009 and 2008, liabilities on the Balance Sheet totaled \$278.9 billion and \$188.2 billion respectively. Of this amount, liabilities covered by budgetary resources totaled \$278.7 billion as of September 30, 2009, and \$188.0 billion as of September 30, 2008.

**Note 11. Accrued Grant Liability**

The accrued grant liability by major reporting groups as of September 30, 2009 and 2008 consisted of the following:

<b>Accrued Grant Liability</b>		
(Dollars in Millions)		
	<u>2009</u>	<u>2008</u>
FSA	\$ 1,295	\$ 862
OESE	265	557
OSERS	263	512
ARRA	860	-
Other	279	314
<b>Accrued Grant Liability</b>	<b>\$ 2,962</b>	<b>\$ 2,245</b>

**Note 12. Net Position**

Unexpended appropriations as of September 30, 2009 and 2008, consisted of the following:

<b>Unexpended Appropriations</b>		
(Dollars in Millions)		
	<u>2009</u>	<u>2008</u>
Unobligated Balances		
Available	\$ 33,243	\$ 1,526
Not Available	770	815
Undelivered Orders, end of period	92,369	47,165
Authority Temporarily Precluded from Obligation	887	-
<b>Unexpended Appropriations</b>	<b>\$ 127,269</b>	<b>\$ 49,506</b>

The Cumulative Results of Operations - Earmarked Funds of \$8 million as of September 30, 2009, and \$17 million as of September 30, 2008, represent donations from foreign governments, international entities and individuals to support Hurricane Katrina relief and recovery efforts that have not yet been used. (See Note 19)

The Cumulative Results of Operations - Other Funds of \$(217) million as of September 30, 2009, and \$(6,187) million as of September 30, 2008, consists mostly of unfunded upward subsidy re-estimates, other unfunded expenses, and net investments of capitalized assets.

**Note 13. Intragovernmental Cost and Exchange Revenue by Program**

As required by the *Government Performance and Results Act of 1993*, each of the Department's Reporting Organizations has been aligned with the major goals presented in the Department's *Strategic Plan 2007—2012*.

Net Cost Program	Reporting Organizations/ Groups	Strategic Goal
Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement	FSA OPE OVAE	3. Ensure the accessibility, affordability, and accountability of higher education, and better prepare students and adults for employment and future learning
Promote Academic Achievement in Elementary and Secondary Schools	OESE OELA OSDFS HR	1. Improve student achievement, with the focus on bringing all students to grade level in reading and mathematics by 2014  2. Increase the academic achievement of all high school students
Transformation of Education	IES OII	1. Improve student achievement, with the focus on bringing all students to grade level in reading and mathematics by 2014
Special Education	OSERS	Cuts across Strategic Goals 1, 2 and 3
American Recovery and Reinvestment Act	ARRA	Cuts across Strategic Goals 1, 2 and 3

Strategic Goals 1, 2 and 3 are sharply defined directives that guide the Department's reporting organizations to carry out the vision and programmatic mission, and the net cost programs can be specifically associated with these three strategic goals. The Department has a Cross-Goal Strategy on Management, which is considered a high-level premise on which the Department establishes its foundation for the three goals. As a result, we do not assign specific programs to the Cross-Goal Strategy for presentation in the Statement of Net Cost.

The goals of the *Recovery Act* are consistent with the Department's current Strategic Goals and programs. For reporting purposes, a new American Recovery and Reinvestment Act net cost program has been created.

The following table presents the gross cost and exchange revenue by program for the Department for September 30, 2009 and 2008. Gross costs and earned revenue are classified as intragovernmental (exchange transactions between the Department and other entities within the federal government) or with the public (exchange transactions between the Department and non-federal entities).

**Gross Cost and Exchange Revenue by Program**

Gross Cost and Exchange Revenue by Program, as of September 30, 2009 and 2008, consisted of the following:

**Gross Cost and Exchange Revenue by Program**

(Dollars in Millions)

	2009					
	<u>FSA</u>	<u>OESE</u>	<u>OSERS</u>	<u>ARRA</u>	<u>Other</u>	<u>Total</u>
<b><i>Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement</i></b>						
Intragovernmental Gross Cost	\$10,079	\$ -	\$ -	\$ -	\$ 80	\$10,159
Public Gross Cost	(21,141)	-	-	-	4,638	(16,503)
Total Gross Program Costs	(11,062)	-	-	-	4,718	(6,344)
Intragovernmental Earned Revenue	4,644	-	-	-	3	4,647
Public Earned Revenue	6,435	-	-	-	25	6,460
Total Program Earned Revenue	11,079	-	-	-	28	11,107
<b>Total Program Cost</b>	<b>(22,141)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>4,690</b>	<b>(17,451)</b>
<b><i>Promote Academic Achievement in Elementary and Secondary Schools</i></b>						
Intragovernmental Gross Cost	-	180	-	-	16	196
Public Gross Cost	-	21,472	-	-	1,571	23,043
Total Gross Program Costs	-	21,652	-	-	1,587	23,239
Intragovernmental Earned Revenue	-	-	-	-	70	70
Public Earned Revenue	-	15	-	-	4	19
Total Program Earned Revenue	-	15	-	-	74	89
<b>Total Program Cost</b>	<b>-</b>	<b>21,637</b>	<b>-</b>	<b>-</b>	<b>1,513</b>	<b>23,150</b>
<b><i>Transformation of Education</i></b>						
Intragovernmental Gross Cost	-	-	-	-	88	88
Public Gross Cost	-	-	-	-	1,579	1,579
Total Gross Program Costs	-	-	-	-	1,667	1,667
Intragovernmental Earned Revenue	-	-	-	-	1	1
Public Earned Revenue	-	-	-	-	34	34
Total Program Earned Revenue	-	-	-	-	35	35
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,632</b>	<b>1,632</b>
<b><i>Special Education</i></b>						
Intragovernmental Gross Cost	-	-	44	-	-	44
Public Gross Cost	-	-	15,188	-	-	15,188
Total Gross Program Costs	-	-	15,232	-	-	15,232
Intragovernmental Earned Revenue	-	-	2	-	-	2
Public Earned Revenue	-	-	18	-	-	18
Total Program Earned Revenue	-	-	20	-	-	20
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>15,212</b>	<b>-</b>	<b>-</b>	<b>15,212</b>
<b><i>American Recovery and Reinvestment Act</i></b>						
Intragovernmental Gross Cost	-	-	-	-	-	-
Public Gross Cost	-	-	-	21,618	-	21,618
Total Gross Program Costs	-	-	-	21,618	-	21,618
Intragovernmental Earned Revenue	-	-	-	-	-	-
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	-	-	-	-	-
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>21,618</b>	<b>-</b>	<b>21,618</b>
<b>Net Cost of Operations</b>	<b>\$(22,141)</b>	<b>\$ 21,637</b>	<b>\$ 15,212</b>	<b>\$21,618</b>	<b>\$7,835</b>	<b>\$ 44,161</b>



### Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

	2008					<u>Total</u>
	<u>FSA</u>	<u>OESE</u>	<u>OSERS</u>	<u>ARRA</u>	<u>Other</u>	
<b><i>Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement</i></b>						
Intragovernmental Gross Cost	\$ 6,903	\$ -	\$ -	\$ -	\$ 82	\$ 6,985
Public Gross Cost	<u>21,885</u>	-	-	-	<u>4,220</u>	<u>26,105</u>
Total Gross Program Costs	28,788	-	-	-	4,302	33,090
Intragovernmental Earned Revenue	4,128	-	-	-	19	4,147
Public Earned Revenue	<u>4,901</u>	-	-	-	<u>34</u>	<u>4,935</u>
Total Program Earned Revenue	<u>9,029</u>	-	-	-	<u>53</u>	<u>9,082</u>
<b>Total Program Cost</b>	<b><u>19,759</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>4,249</u></b>	<b><u>24,008</u></b>
<b><i>Promote Academic Achievement in Elementary and Secondary Schools</i></b>						
Intragovernmental Gross Cost	-	135	-	-	16	151
Public Gross Cost	-	<u>21,659</u>	-	-	<u>1,680</u>	<u>23,339</u>
Total Gross Program Costs	-	21,794	-	-	1,696	23,490
Intragovernmental Earned Revenue	-	-	-	-	70	70
Public Earned Revenue	-	<u>12</u>	-	-	<u>4</u>	<u>16</u>
Total Program Earned Revenue	-	<u>12</u>	-	-	<u>74</u>	<u>86</u>
<b>Total Program Cost</b>	<b><u>-</u></b>	<b><u>21,782</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>1,622</u></b>	<b><u>23,404</u></b>
<b><i>Transformation of Education</i></b>						
Intragovernmental Gross Cost	-	-	-	-	80	80
Public Gross Cost	-	-	-	-	<u>1,489</u>	<u>1,489</u>
Total Gross Program Costs	-	-	-	-	1,569	1,569
Intragovernmental Earned Revenue	-	-	-	-	2	2
Public Earned Revenue	-	-	-	-	<u>30</u>	<u>30</u>
Total Program Earned Revenue	-	-	-	-	<u>32</u>	<u>32</u>
<b>Total Program Cost</b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>1,537</u></b>	<b><u>1,537</u></b>
<b><i>Special Education</i></b>						
Intragovernmental Gross Cost	-	-	42	-	-	42
Public Gross Cost	-	-	<u>15,843</u>	-	-	<u>15,843</u>
Total Gross Program Costs	-	-	15,885	-	-	15,885
Intragovernmental Earned Revenue	-	-	2	-	-	2
Public Earned Revenue	-	-	<u>15</u>	-	-	<u>15</u>
Total Program Earned Revenue	-	-	<u>17</u>	-	-	<u>17</u>
<b>Total Program Cost</b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>15,868</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>15,868</u></b>
<b><i>American Recovery and Reinvestment Act</i></b>						
Intragovernmental Gross Cost	-	-	-	-	-	-
Public Gross Cost	-	-	-	-	-	-
Total Gross Program Costs	-	-	-	-	-	-
Intragovernmental Earned Revenue	-	-	-	-	-	-
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	-	-	-	-	-
<b>Total Program Cost</b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>
<b>Net Cost of Operations</b>	<b><u>\$ 19,759</u></b>	<b><u>\$ 21,782</u></b>	<b><u>\$15,868</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 7,408</u></b>	<b><u>\$ 64,817</u></b>

**Note 14. Interest Expense and Interest Revenue**

As of September 30, 2009 and 2008, interest expense and interest revenue by program consisted of the following:

**Interest Expense and Interest Revenue**

(Dollars in Millions)

	2009					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	\$ 7,094	\$ -	\$ 7,094	\$ 1,465	\$ 5,629	\$ 7,094
FFEL Program						
Guaranteed Loan Program	32	337	369	369	-	369
Loan Purchase Commitment	861	-	861	563	298	861
Loan Participation Purchase	1,876	-	1,876	1,410	466	1,876
ABCP Conduit	6	-	6	5	1	6
TEACH Program	2	-	2	1	1	2
Other Programs	17	-	17	2	36	38
<b>Total</b>	<b>\$ 9,888</b>	<b>\$ 337</b>	<b>\$ 10,225</b>	<b>\$ 3,815</b>	<b>\$ 6,431</b>	<b>\$ 10,246</b>

	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						
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
ABCP Conduit	-	-	-	-	-	-
TEACH Program	1	-	1	1	-	1
Other Programs	23	-	23	17	57	74
<b>Total</b>	<b>\$ 6,709</b>	<b>\$ 1,372</b>	<b>\$ 8,081</b>	<b>\$ 3,227</b>	<b>\$ 4,905</b>	<b>\$ 8,132</b>

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

**Note 15. Statement of Budgetary Resources**

The Statement of Budgetary Resources (SBR) compares budgetary resources with the status of those resources. As of September 30, 2009, budgetary resources were \$437,777 million and net outlays were \$165,158 million. As of September 30, 2008, budgetary resources were \$193,993 million and net outlays were \$90,580 million.

**Permanent Indefinite Budget Authority**

The Direct Loan, FFEL and TEACH Programs have permanent indefinite budget authority through legislation. Part D of the William D. Ford Federal Direct Loan Program and Part B of the

Federal Family Education Loan Program, pursuant to the *HEA*, 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 Type and Category

Obligations incurred by apportionment type and category, as of September 30, 2009 and 2008, consisted of the following:

<b>Obligations Incurred by Apportionment Type and Category</b>		
(Dollars in Millions)		
	<b>2009</b>	<b>2008</b>
Direct:		
Category A	\$ 1,385	\$ 1,285
Category B	389,623	161,452
Exempt from Apportionment	80	6
	391,088	162,743
Reimbursable:		
Category A	-	-
Category B	-	-
Exempt from Apportionment	94	96
	94	96
<b>Obligations Incurred</b>	<b>\$ 391,182</b>	<b>\$ 162,839</b>

Obligations incurred can be either direct or reimbursable. Reimbursable obligations are those financed by offsetting collections received in return for goods and services provided, while all other obligations are direct. 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, 2009 and 2008, consisted of the following:

**Unused Borrowing Authority**

(Dollars in Millions)

	2009	2008
<b>Beginning Balance, Unused Borrowing Authority</b>	<b>\$ 25,930</b>	<b>\$ 9,223</b>
Current Year Borrowing Authority	200,265	57,743
Funds Drawn From Treasury	(117,101)	(39,049)
Borrowing Authority Withdrawn	(2,739)	(1,987)
<b>Ending Balance, Unused Borrowing Authority</b>	<b>\$ 106,355</b>	<b>\$ 25,930</b>

The Department is given authority to draw funds from Treasury to finance the Direct Loan Program, the TEACH Program and activities under the temporary loan purchase authority. Unused Borrowing Authority is a budgetary resource and is available to support obligations. The Department periodically reviews its borrowing authority balances in relation to its obligations and may cancel unused amounts.

**Undelivered Orders at the End of the Period**

Undelivered orders, as of September 30, 2009 and 2008, consisted of the following:

**Undelivered Orders**

(Dollars in Millions)

	2009	2008
Budgetary	\$ 92,035	\$ 47,211
Non-Budgetary	132,500	40,621
<b>Undelivered Orders (Unpaid)</b>	<b>\$ 224,535</b>	<b>\$ 87,832</b>

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 trust funds, reimbursable agreements and federal credit financing and liquidating funds are not funded through appropriations and are not included in Net Position. (See Note 12)

**Distributed Offsetting Receipts**

The majority of the Distributed Offsetting Receipts line item on the SBR represents amounts paid from the Direct Loan Program and FFEL Program financing accounts to general fund receipt accounts for downward re-estimates and negative subsidies. In FY 2008 and prior, the Department reported these collections as non-budgetary on the SBR. Beginning FY 2009, the Department reclassified these collections as budgetary on the SBR. Although practice varies, this change was made to better align the Department's presentation of its credit activities with guidance provided by OMB and Treasury.

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

The FY 2011 *Budget of the United States Government* (President's Budget) presenting the actual amounts for the year ended September 30, 2009, has not been published as of the issue date of these financial statements. The FY 2011 President's Budget is scheduled for release in February 2010. A reconciliation of the FY 2008 SBR to FY 2010 President's Budget (FY 2008 actual amounts) for budgetary resources, obligations incurred, distributed offsetting receipts and net outlays is presented below.

**SBR to Budget of the United States Government**

(Dollars in Millions)

	<b>Budgetary Resources</b>	<b>Obligations Incurred</b>	<b>Distributed Offsetting Receipts</b>	<b>Net Outlays</b>
<b>Combined Statement of Budgetary Resources</b>	\$ 193,993	\$ 162,839	\$ 5,853	\$ 90,580
Expired Funds	(1,737)	(951)	-	-
Amounts included in the President's Budget	9,947	9,947	-	-
Funds excluded from President's Budget and Rounding	(2)	-	-	5
Distributed Offsetting Receipts	-	-	-	5,853
<b><i>Budget of the United States Government</i></b>	<b>\$ 202,201</b>	<b>\$ 171,835</b>	<b>\$ 5,853</b>	<b>\$ 96,438</b>

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 2008 SBR for the Federal Fund are compiled through combining all guaranty agencies' annual reports to determine a net valuation amount for the Federal Fund.

**Note 16. 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 note 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, 2009 and 2008, are presented below:

**Reconciliation of Net Cost of Operations to Budget**

(Dollars in Millions)

	<b>2009</b>	<b>2008</b>
<b>Resources Used to Finance Activities</b>		
Obligations Incurred	\$ (391,182)	\$ (162,839)
Spending Authority from Offsetting Collections and Recoveries	56,300	40,536
Offsetting Receipts	31,763	5,853
Imputed Financing from Costs Absorbed by Others	(32)	(29)
<b>Total Resources Used to Finance Activities</b>	<b>(303,151)</b>	<b>(116,479)</b>
<b>Resources Used to Finance Items Not Part of Net Cost of Operations</b>		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but Not Yet Provided (+/-)	(137,170)	(25,553)
Resources that Fund Expenses Recognized in Prior Period	1,091	(1,111)
Credit Program Collections which Increase/Decrease Liabilities for Loan Guarantees, or Credit Program Receivables, Net including Allowances for Subsidy	39,495	29,763
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	(147,800)	(51,742)
<b>Total Resources Used to Finance Items Not Part of the Net Cost of Operations</b>	<b>(244,384)</b>	<b>(48,643)</b>
<b>Components Not Requiring or Generating Resources</b>		
Depreciation and Amortization	325	(456)
Other (+/-)	448	290
<b>Total Components of the Net Cost of Operations that Will Not Require or Generate Resources</b>	<b>773</b>	<b>(166)</b>
<b>Components Requiring or Generating Resources in Future Periods</b>		
Increase in Annual Leave Liability	-	(6)
Upward/Downward Re-estimates of Credit Subsidy Expense	10,883	513
Increase in Exchange Revenue Receivable from the Public	2,957	2,607
Other (+/-)	(7)	71
<b>Total Components of the Net Cost of Operations that Will Require or Generate Resources in Future Periods</b>	<b>13,833</b>	<b>3,185</b>
<b>Net Cost of Operations</b>	<b>\$ (44,161)</b>	<b>\$ (64,817)</b>



**Note 17. Incidental Custodial Collections**

The Department administers certain activities associated with the collection of non-exchange revenues. The Department collects these amounts in a custodial capacity and transfers the amounts collected to the General Fund of the Treasury at the end of each fiscal year. These collections primarily consist of penalties on accounts receivable and are considered incidental to the primary mission of the Department. During FY 2009 and FY 2008, the Department collected \$1.0 million and \$1.4 million, respectively, in custodial revenues.

**Note 18. American Recovery and Reinvestment Act of 2009**

The *Recovery Act* included total funding of \$98,238 million to the Department. For FY 2009, \$97,407 million was provided in supplemental appropriations for job preservation and state and local fiscal stabilization. An additional \$831 million will be made available in FY 2010. This one-time investment was made available for use in saving jobs, supporting states and local school districts, and advancing reforms and improvements in the education of our nation's early learning, K-12 and postsecondary students. As of September 30, 2009, there were \$67,635 million in obligations and \$21,003 million in outlays.

**American Recovery and Reinvestment Act of 2009**

(Dollars in Millions)

	<u>Appropriations</u>	<u>Obligations</u>	<u>Outlays</u>
State Fiscal Stabilization Fund	\$ 53,600	\$ 35,429	\$ 12,433
Student Financial Assistance*	16,483	8,697	6,904
Education for the Disadvantaged	13,000	9,936	804
Special Education	12,200	12,200	791
School Improvement Programs	720	711	7
Rehabilitation Services and Disability Research	680	591	22
Institute of Education Sciences	250	-	-
Innovation & Improvement	200	1	-
Impact Aid	100	40	40
Higher Education	100	-	-
Student Aid Administration	60	29	1
Office of Inspector General	14	1	1
<b>Total</b>	<u><u>\$ 97,407</u></u>	<u><u>\$ 67,635</u></u>	<u><u>\$ 21,003</u></u>

\*\$831 million will be made available in FY 2010, resulting in total *Recovery Act* funding of \$98,238 million.

**State Fiscal Stabilization Fund.** The State Fiscal Stabilization Fund (SFSF) program is a new one-time appropriation of \$53,600 million. Of this amount, the Department may award governors approximately \$48,600 million by formula in exchange for a commitment to advance essential education reforms to benefit students from early learning through postsecondary education, increasing teacher effectiveness and ensuring an equitable distribution of qualified teachers, and turning around the lowest-performing schools. The Department may award the remaining \$5,000 million competitively under the Race to the Top and Investing in Innovation programs. As of September 30, 2009, the SFSF consisted of the following:

**State Fiscal Stabilization Fund**

(Dollars in Millions)

	<u>Appropriations</u>	<u>Obligations</u>	<u>Outlays</u>
SFSF Formula Grants:	\$ 48,600		
Education State Grants		\$ 26,979	\$ 9,961
Government Services Grants		8,447	2,469
Administration and Oversight		3	3
Total SFSF Formula Grants	<u>48,600</u>	<u>35,429</u>	<u>12,433</u>
Investing in Innovation and Race to the Top:	5,000		
Investing in Innovation Fund		-	-
Race to the Top Incentive Grants		-	-
Total Investing in Innovation and Race to the Top	<u>5,000</u>	<u>-</u>	<u>-</u>
<b>Total</b>	<b><u>\$ 53,600</u></b>	<b><u>\$ 35,429</u></b>	<b><u>\$ 12,433</u></b>

**Student Financial Assistance.** The *Recovery Act* continues the Department's goal of making college affordable by providing \$16,483 million for student financial assistance programs. This funding included \$15,640 million in additional Pell Grant authority for low and middle-income undergraduate students and an additional \$643 million to increase the per grant amount by \$490 to \$5,350 per year. Also, \$200 million was made available in the federal work study program for grants to eligible students to help finance their education through part-time employment. As of September 30, 2009, *Recovery Act* funding for student financial assistance consisted of the following:

**Student Financial Assistance**

(Dollars in Millions)

	<u>Appropriations</u>	<u>Obligations</u>	<u>Outlays</u>
Federal Pell Grants	\$ 15,640	\$ 7,854	\$ 6,300
Mandatory Add-on to Pell Grant	643	643	549
Federal Work Study Grants	200	200	55
<b>Total</b>	<b><u>\$ 16,483</u></b>	<b><u>\$ 8,697</u></b>	<b><u>\$ 6,904</u></b>

**Education for the Disadvantaged.** The *Recovery Act* provided \$10,000 million in additional funding for Title I, Part A of the *Elementary and Secondary Education Act of 1965* (Title I). This funding provides grants to local educational agencies for schools that have high concentrations of students from families that live in poverty in order to help improve teaching and learning. The *Recovery Act* also provided \$3,000 million for Title I school improvement grants. As of September 30, 2009, *Recovery Act* funding for education for the disadvantaged consisted of the following:

**Education for the Disadvantaged**

(Dollars in Millions)

	<u>Appropriations</u>	<u>Obligations</u>	<u>Outlays</u>
Title I Targeted/ Finance Incentive Grants	\$ 10,000	\$ 9,936	\$ 804
School Improvement Grants	3,000	-	-
<b>Total</b>	<b><u>\$ 13,000</u></b>	<b><u>\$ 9,936</u></b>	<b><u>\$ 804</u></b>

**Special Education.** The *Recovery Act* appropriated additional funding for programs under Parts B and C of the *Individuals with Disabilities Education Act (IDEA)*. This funding was provided under three authorities: \$11,300 million for Part B grants to states; \$400 million for Part B preschool grants; and \$500 million for Part C grants for infants and families. This funding provides opportunities for states, local educational agencies and early intervention service providers to implement innovative strategies to improve outcomes for infants, toddlers, children and youths with disabilities while stimulating the economy. As of September 30, 2009, *Recovery Act* funding for special education consisted of the following:

### Special Education

(Dollars in Millions)

	<u>Appropriations</u>	<u>Obligations</u>	<u>Outlays</u>
IDEA Part B Grants to States	\$ 11,300	\$ 11,300	\$ 729
IDEA Part B Preschool Grants	400	400	18
IDEA Part C Grants for Infants and Families	500	500	44
<b>Total</b>	<b>\$ 12,200</b>	<b>\$ 12,200</b>	<b>\$ 791</b>

**School Improvement Programs.** The *Recovery Act* provided additional funding for school improvement programs. The \$650 million in Enhancing Education through Technology funding can be used for a range of technology-related activities, including hardware purchases and professional development for teachers. An additional \$70 million was provided through the Education for Homeless Children and Youths program for services that help homeless children to enroll in, attend, and succeed in school. As of September 30, 2009, *Recovery Act* funding for school improvement programs consisted of the following:

### School Improvement Programs

(Dollars in Millions)

	<u>Appropriations</u>	<u>Obligations</u>	<u>Outlays</u>
Enhancing Education through Technology	\$ 650	\$ 641	\$ 1
Education for Homeless Children and Youths	70	70	6
<b>Total</b>	<b>\$ 720</b>	<b>\$ 711</b>	<b>\$ 7</b>

**Rehabilitation Services and Disability Research.** The *Recovery Act* appropriated \$680 million for the support of rehabilitation services and disability research. Of this amount, \$540 million in funding was made available to assist states in operating comprehensive, coordinated, effective and efficient programs of vocational rehabilitation. The remaining amount provides support to states to improve and expand independent living services to individuals with significant disabilities, including \$88 million for independent living centers, \$34 million for services for older blind individuals, and \$18 million for state grants. As of September 30, 2009, *Recovery Act* funding for rehabilitation services and disability research consisted of the following:

**Rehabilitation Services and Disability Research**

(Dollars in Millions)

	<b>Appropriations</b>	<b>Obligations</b>	<b>Outlays</b>
Vocational Rehabilitation	\$ 540	\$ 539	\$ 21
Independent Living Centers	88	-	-
Services for Older Blind Individuals	34	34	-
State Grants	18	18	1
<b>Total</b>	<b>\$ 680</b>	<b>\$ 591</b>	<b>\$ 22</b>

**Institute of Education Sciences.** The *Recovery Act* provided \$250 million in funding to enable state educational agencies to design, develop and implement statewide, longitudinal data systems. Of this amount, up to \$5 million may be used for state data coordinators and awards to public or private organizations to improve data coordination. As of September 30, 2009, there were \$0 in obligations and outlays.

**Innovation and Improvement.** The *Recovery Act* provided \$200 million in additional funding to innovation and improvement programs for competitive grants to develop and implement performance-based teacher and principal compensation systems in high-need schools. As of September 30, 2009, there were \$1 million in obligations and \$0 in outlays.

**Impact Aid.** The *Recovery Act* provided new funding for impact aid under section 8007 of Title VIII of the *Elementary and Secondary Education Act of 1965*. As of September 30, 2009, *Recovery Act* funding for impact aid consisted of the following:

**Impact Aid**

(Dollars in Millions)

	<b>Appropriations</b>	<b>Obligations</b>	<b>Outlays</b>
Section 8007(a) Formula Grants	\$ 40	\$ 40	\$ 40
Section 8007(b) Competitive Grants	60	-	-
<b>Total</b>	<b>\$ 100</b>	<b>\$ 40</b>	<b>\$ 40</b>

**Higher Education.** The *Recovery Act* appropriated \$100 million to the Teacher Quality Partnership program. This program aims to improve student achievement and teacher quality in high-need schools and early childhood education programs by improving teacher preparation and professional development activities, holding teacher preparation programs accountable for preparing effective teachers, and recruiting highly qualified individuals into the teaching workforce. As of September 30, 2009, there were \$0 in obligations and outlays.

**Student Aid Administration.** The *Recovery Act* funding provided \$60 million towards increasing the number of Title IV student loan servicing vehicles and improving operational performance to collect and deliver loan and grant data between program participants and the system. As of September 30, 2009, there were \$29 million in obligations and \$1 million in outlays.

**Office of Inspector General.** The *Recovery Act* appropriated \$14 million for salaries and expenses necessary for Office of Inspector General oversight and audit of *Recovery Act* programs, grants and projects. As of September 30, 2009, there were \$1 million in obligations and \$1 million in outlays.

## **Note 19. 2005 Hurricane Relief**

The *Hurricane Education Recovery Act* (P.L. 109-148, Division B, Title IV), enacted on December 30, 2005, and the *U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007*, appropriated funds to the Department to provide needed assistance to reopen schools and help educate the 370,000 students affected by Hurricanes Katrina and Rita. As of September 30, 2009, \$1,945 million has been appropriated to the Department, of which \$1,941 million has been obligated to assist local educational agencies and non-public schools, and \$1,818 million has been expended. As of September 30, 2008, \$1,945 million has been appropriated to the Department, of which \$1,942 million has been obligated to assist local educational agencies and non-public schools, and \$1,748 million has been expended.

### **Earmarked Funds Donated for Hurricane Relief**

In the aftermath of Hurricane Katrina, a number of foreign governments, international entities and individuals made donations of financial assistance to the U.S. Government to support Katrina relief and recovery efforts. These donations were received by the U.S. Department of State as an intermediary. Subsequently, \$61 million was transferred to the Department to finance educational initiatives in Louisiana and Mississippi under a Memorandum of Understanding issued in March 2006. As of September 30, 2009, \$61 million has been obligated from the earmarked funds to assist in the relief and recovery efforts and \$53 million has been expended. As of September 30, 2008, \$61 million has been obligated from the earmarked funds to assist in the relief and recovery efforts and \$44 million has been expended.

## **Note 20. Contingencies**

### **Guaranty Agencies**

The Department 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 fiscal year 2009, the Department provided funding of 82.4 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 17.6 percent of program funding. For the latest academic year ended June 30, 2009, approximately 494 thousand loans were made, totaling approximately \$954.8 million at 1,607 institutions, averaging \$1,934 per loan. The Department's share of the Federal Perkins Loan Program was approximately \$6.5 billion as of June 30, 2009.

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 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.

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. The Department may be required to compensate Federal Perkins Loan Program institutions for the cost of the partial loan forgiveness.

**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 the Department'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 Department's financial position.



## United States Department of Education Combining Statement of Budgetary Resources For the Year Ended September 30, 2009

*Dollars in Millions*

	Combined		Federal Student Aid		Office of Elementary and Secondary Education		Office of Special Education & Rehabilitative Services		American Recovery and Reinvestment Act		Other	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
<b>Budgetary Resources:</b>												
Unobligated balance, brought forward, October 1	\$ 4,307	\$ 26,847	\$ 3,620	\$ 26,517	\$ 366		\$ 56			\$ 265	\$ 330	
Recoveries of prior year Unpaid Obligations	1,012	8,038	398	8,035	455		28			131	3	
Budgetary Authority:												
Appropriations	164,934	132	25,417	130	19,357		14,442		\$ 97,407	8,311	2	
Borrowing Authority (Note 15)		200,265		200,214							51	
Spending authority from offsetting collections (gross):												
Earned												
Collected	1,701	45,536	1,569	45,512	9		2			121	24	
Change in Receivables from Federal Sources	1	(3)		(3)						1		
Change in unfilled customer orders												
Advance Received	4									4		
Without advance from Federal Sources	1	10								1	10	
Subtotal	\$ 166,641	\$ 245,940	\$ 26,986	\$ 245,853	\$ 19,366		\$ 14,444		\$ 97,407	\$ 8,438	\$ 87	
Temporarily not available pursuant to Public Law	(887)		(887)									
Permanently not available	(980)	(13,141)	(688)	(13,130)	(160)		(22)			(110)	(11)	
<b>Total Budgetary Resources (Note 15)</b>	<b>\$ 170,093</b>	<b>\$ 267,684</b>	<b>\$ 29,429</b>	<b>\$ 267,275</b>	<b>\$ 20,027</b>	<b>\$ 0</b>	<b>\$ 14,506</b>	<b>\$ 0</b>	<b>\$ 97,407</b>	<b>\$ 0</b>	<b>\$ 8,724</b>	<b>\$ 409</b>
<b>Status of Budgetary Resources:</b>												
Obligations incurred: (Note 15)												
Direct	\$ 133,398	\$ 257,690	\$ 23,770	\$ 257,585	\$ 19,237		\$ 14,444		\$ 67,635	\$ 8,312	\$ 105	
Reimbursable	94						2			92		
Subtotal	\$ 133,492	\$ 257,690	\$ 23,770	\$ 257,585	\$ 19,237		\$ 14,446		\$ 67,635	\$ 8,404	\$ 105	
Unobligated Balances:												
Apportioned	\$ 33,263	\$ 474	\$ 2,559	\$ 474	\$ 736		\$ 14		\$ 29,759	\$ 195		
Subtotal	\$ 33,263	\$ 474	\$ 2,559	\$ 474	\$ 736		\$ 14		\$ 29,759	\$ 195		
Unobligated Balance not available	3,338	9,520	3,100	9,216	54		46		13	125	304	
<b>Total Status of Budgetary Resources</b>	<b>\$ 170,093</b>	<b>\$ 267,684</b>	<b>\$ 29,429</b>	<b>\$ 267,275</b>	<b>\$ 20,027</b>	<b>\$ (0)</b>	<b>\$ 14,506</b>	<b>\$ (0)</b>	<b>\$ 97,407</b>	<b>\$ (0)</b>	<b>\$ 8,724</b>	<b>\$ 409</b>
<b>Change in Obligated Balance:</b>												
Obligated balance, net:												
Unpaid obligations, brought forward, October 1	\$ 49,875	\$ 41,440	\$ 12,927	\$ 41,157	\$ 17,779		\$ 9,095			\$ 10,074	\$ 283	
Uncollected customer payments from Federal Sources, brought forward, October 1	(2)						(1)			(1)		
Total, unpaid obligated balance, brought forward, net	\$ 49,873	\$ 41,440	\$ 12,927	\$ 41,157	\$ 17,779		\$ 9,094			\$ 10,073	\$ 283	
Obligation Incurred, net (+/-)	133,492	257,690	23,770	257,585	19,237		14,446		\$ 67,635	8,404	105	
Gross Outlays	(86,867)	(157,295)	(20,390)	(157,132)	(21,856)		(15,345)		(21,003)	(8,273)	(163)	
Recoveries of prior year unpaid obligations, actual	(1,012)	(8,038)	(398)	(8,035)	(455)		(28)			(131)	(3)	
Change in uncollected customer payments from Federal Sources (+/-)	(2)	(7)	3	3						(2)	(10)	
<b>\$ 95,484</b>	<b>\$ 133,790</b>	<b>\$ 15,909</b>	<b>\$ 133,578</b>	<b>\$ 14,705</b>	<b>\$ (0)</b>	<b>\$ 8,167</b>	<b>\$ (0)</b>	<b>\$ 46,632</b>	<b>\$ (0)</b>	<b>\$ 10,071</b>	<b>\$ 212</b>	
Obligated Balance, net, end of period:												
Unpaid Obligations	\$ 95,488	\$ 133,797	\$ 15,909	\$ 133,575	\$ 14,705		\$ 8,168		\$ 46,632	\$ 10,074	\$ 222	
Uncollected customer payments from Federal Sources	(4)	(7)		3			(1)			(3)	(10)	
<b>Total, unpaid obligated balance, net, end of period</b>	<b>\$ 95,484</b>	<b>\$ 133,790</b>	<b>\$ 15,909</b>	<b>\$ 133,578</b>	<b>\$ 14,705</b>	<b>\$ (0)</b>	<b>\$ 8,167</b>	<b>\$ (0)</b>	<b>\$ 46,632</b>	<b>\$ (0)</b>	<b>\$ 10,071</b>	<b>\$ 212</b>
<b>Net Outlays:</b>												
Gross Outlays	\$ 86,867	\$ 157,295	\$ 20,390	\$ 157,132	\$ 21,856		\$ 15,345		\$ 21,003	\$ 8,273	\$ 163	
Offsetting collections	(1,705)	(45,536)	(1,569)	(45,512)	(9)		(2)			(125)	(24)	
Distributed Offsetting receipts	(31,763)		(31,646)							(117)		
<b>Net Outlays (Note 15)</b>	<b>\$ 53,399</b>	<b>\$ 111,759</b>	<b>\$ (12,825)</b>	<b>\$ 111,620</b>	<b>\$ 21,847</b>	<b>\$ (0)</b>	<b>\$ 15,343</b>	<b>\$ (0)</b>	<b>\$ 21,003</b>	<b>\$ (0)</b>	<b>\$ 8,031</b>	<b>\$ 139</b>

## REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

### Stewardship Expenses

In the Department of Education, discretionary spending constitutes the majority of the budget and includes nearly all programs, the notable exceptions being student loans and rehabilitative services. Although spending for entitlement programs is usually a function of the authorizing statutes creating the programs and is not generally affected by appropriations laws, spending for discretionary programs is decided in the annual appropriations process.

Education in the United States is primarily a state and local responsibility. States, communities and public and private organizations establish schools and colleges, develop curricula and determine requirements for enrollment and graduation. The structure of education finance in America reflects this. It is estimated that roughly \$1.125 trillion will be spent nationwide on education at all levels for the school year 2009-2010, with Department of Education expenditures, as well as loans and other aid made available as a result of the Department's student financial aid programs. The Department's FY 2009 appropriations of more than \$140.5 billion represent about 4 percent of the federal government's \$4.0 trillion FY 2009 budget. The significant increase over the Department's FY 2008 appropriations reported last year is due to the *American Recovery and Reinvestment Act of 2009* (*Recovery Act*).

### *The American Recovery and Reinvestment Act of 2009*

The *Recovery Act*, enacted on February 17, 2009, provided \$98.2 billion to the Department for improving schools, raising students' achievement, driving reform and producing better results for children and young people for the long term health of the nation. Approximately 55 percent of the Department's *Recovery Act* funding was appropriated for the creation of a new State Fiscal Stabilization Fund with the goal to stabilize state and local government budgets to avoid reductions in education and other essential public services while driving education reform. The Department was tasked with promptly disbursing these funds through a variety of existing and new grant programs, while ensuring the transparency and accountability of every dollar spent.

### Investment in Human Capital

**Office of Federal Student Aid.** The Office of Federal Student Aid administers need-based financial assistance programs for students pursuing postsecondary education and makes available federal grants, direct loans, guaranteed loans and work-study funding to eligible undergraduate and graduate students. See more detail at:

<http://www.ed.gov/about/offices/list/fsa/index.html?src=oc>

**Office of Elementary and Secondary Education.** The Office of Elementary and Secondary Education provides leadership, technical assistance and financial support to state and local educational agencies for the reform, strategic investment and innovation in preschool, elementary and secondary education. Financial assistance programs support services for children in high-poverty schools, institutions for neglected and delinquent children, homeless children, certain Native American children, children of migrant families and children who live on or whose parents work on federal property. Funding is also provided to increase the academic achievement of students by ensuring that all teachers are highly qualified. See more detail at:

<http://www.ed.gov/about/offices/list/oese/index.html?src=oc>

**Office of Special Education and Rehabilitative Services.** The Office of Special Education and Rehabilitative Services supports state and local programs that assist in educating children, youth and adults with special needs to increase their level of employment, productivity, independence and integration into the community. Funding is also provided for research to improve the quality of their lives. See more detail at:

<http://www.ed.gov/about/offices/list/osers/index.html?src=oc>

**Office of Safe and Drug-Free Schools.** The Office of Safe and Drug-Free Schools supports efforts to create safe and violence-free schools, respond to crises, prevent drug and alcohol abuse, ensure the health and well-being of students and teach students good citizenship and character. Grants emphasize coordinated, collaborative responses to develop and maintain safe, disciplined and drug-free learning environments. See more detail at:

<http://www.ed.gov/about/offices/list/osdfs/index.html?src=oc>

**Office of Innovation and Improvement.** The Office of Innovation and Improvement makes strategic investments in educational practices through grants to states, schools and community and nonprofit organizations. The office leads the movement for greater parental options such as charter schools. The office also supports special grants designed to raise student achievement by improving teachers' knowledge and understanding of and appreciation for traditional U.S. history. See more detail at:

<http://www.ed.gov/about/offices/list/oii/index.html?src=oc>

**Institute of Education Sciences.** Established by the *Education Sciences Reform Act of 2002*, the Institute of Education Sciences is the research arm of the Department of Education. Its mission is to expand knowledge and provide information on the condition of education, practices that improve academic achievement and the effectiveness of federal and other education programs. Its goal is the transformation of education into an evidence-based field in which decision makers routinely seek out the best available research and data before adopting programs or practices that will affect significant numbers of students. See more detail at:

<http://www.ed.gov/about/offices/list/ies/index.html?src=oc>

**Office of English Language Acquisition.** The Office of English Language Acquisition directs programs designed to enable students with limited English proficiency to become proficient in English and meet state academic content and student achievement standards. Enhanced instructional opportunities are provided to children and youths of Native American, Alaska Native, Native Hawaiian, Pacific Islander and immigrant backgrounds who are limited English proficient. Grants pay the federal share of the cost of model programs for the establishment, improvement or expansion of foreign language study in elementary and secondary schools. See more detail at:

<http://www.ed.gov/about/offices/list/oela/index.html?src=oc>

**Office of Vocational and Adult Education.** The Office of Vocational and Adult Education provides leadership, technical assistance and funding for adult education and career and technical education to state and local agencies to help students improve their literacy skills and prepare them for postsecondary education and careers through strong high school programs and career and technical education. The office ensures the equal access of minorities, women, individuals with disabilities and disadvantaged persons to career and technical education and adult education and ensures that career and technical education students are held to the same challenging academic content and academic achievement standards established by the state under the *Elementary and Secondary Education Act of 1965*. Funding is also provided to promote identification and dissemination of effective practices in raising student achievement in high schools, community colleges and adult education programs and support targeted research investments. See more detail at: <http://www.ed.gov/about/offices/list/ovae/index.html?src=oc>

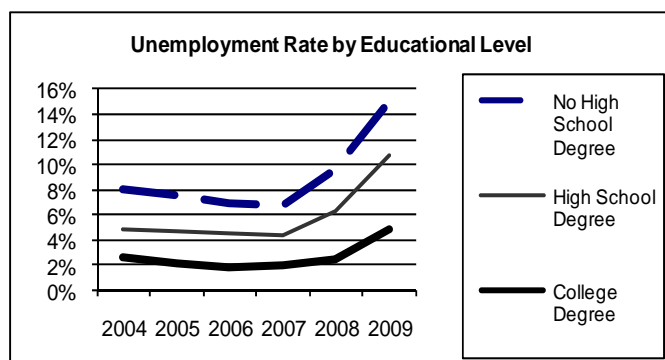
**Office of Postsecondary Education.** The Office of Postsecondary Education provides grants to colleges and universities, as well as to non-profit organizations to: promote reform, innovation and improvement in postsecondary education; increase access to and completion of postsecondary education by disadvantaged students; strengthen the capacity of colleges and universities that serve a high percentage of minority and disadvantaged students; and improve teacher and student development resources. The international programs promote international education and foreign language studies and research. The office administers the accrediting agency recognition process and coordinates activities with states that affect institutional participation in federal financial assistance programs. See more detail at: <http://www.ed.gov/about/offices/list/ope/index.html?src=oc>

Summary of Human Capital Expenses					
(Dollars in Millions)	2009	2008	2007	2006	2005
<b>Federal Student Aid Expense</b>					
Direct Loan Subsidy <sup>1</sup>	\$ (9,603)	\$ 5,236	\$ (499)	\$ 6,655	\$ 5,211
FFEL Program Subsidy <sup>1</sup>	(29,940)	(2,852)	4,884	28,062	9,863
Grant Programs	17,302	17,464	15,092	15,447	15,070
Salaries and Administrative	186	189	173	172	164
<b>Subtotal</b>	<b>(22,055)</b>	<b>20,037</b>	<b>19,650</b>	<b>50,336</b>	<b>30,308</b>
<b>Other Departmental</b>					
Elementary and Secondary Education	21,443	21,583	21,199	21,710	22,940
Special Education and Rehabilitative Services	15,075	15,730	15,402	15,215	13,995
American Recovery and Reinvestment	21,616				
Other Departmental Programs	7,150	4,911	5,109	5,353	6,067
Salaries and Administrative	472	491	467	467	486
<b>Subtotal</b>	<b>65,756</b>	<b>42,715</b>	<b>42,177</b>	<b>42,745</b>	<b>43,488</b>
<b>Grand Total</b>	<b>\$ 43,701</b>	<b>\$ 62,752</b>	<b>\$ 61,827</b>	<b>\$ 93,081</b>	<b>\$ 73,796</b>

<sup>1</sup> A reduction of 30 percent in human capital costs from FY 2008 to FY 2009 is due to downward re-estimates and negative subsidies in the Direct Loan and FFEL programs.

## Program Outcomes

Education is the stepping stone to higher living standards for American citizens, and it is vital to national economic growth. However, education's contribution is more than increased productivity and incomes. Education improves health, promotes social change and opens doors to a better future for children and adults.



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

Returns, or benefits, of investing in education come in many forms. While some returns accrue for the individual, others benefit society and the nation in general. Returns related to

the individual include higher earnings, better job opportunities and jobs that are less sensitive to general economic conditions. Returns related to the economy and society include reduced reliance on welfare subsidies, increased participation in civic activities and greater productivity. Over time, the returns of developing skills through education have become evident. Statistics illustrate the rewards of completing high school and investing in postsecondary education.

**Unemployment Rate.** Individuals with lower levels of educational attainment are more likely to be unemployed than those who had higher levels of educational attainment. The August 2009 unemployment rate for adults (25 years old and over) who had not completed high school was 15.0 percent, compared with 10.8 percent for those with four years of high school and 4.9 percent for those with a bachelor's degree or higher. Younger people with only high school diplomas tended to have higher unemployment rates than adults 25 and over with similar levels of education.

**Annual Income.** As of July 2009, the annualized median income for adults (25 years old and over) varied considerably by education level. Men with a high school diploma earned \$37,128, compared with \$69,524 for men with a college degree. Women with a high school diploma earned \$28,600, compared with \$50,596 for women with a college degree. Men and women with college degrees earned 81 percent more than men and women with high school diplomas. These returns of investing in education directly translate into the advancement of the American economy as a whole.



# Report of the Independent Auditors





**UNITED STATES DEPARTMENT OF EDUCATION**  
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 16, 2009

Honorable Arne Duncan  
Secretary of Education  
Washington, D.C. 20202

Dear Secretary Duncan:

The enclosed reports present the results of the annual audits of the U.S. Department of Education's financial statements for fiscal years 2009 and 2008, to comply with the Government Management Reform Act of 1994 (GMRA). The reports should be read in conjunction with the Department's financial statements and notes to fully understand the context of the information contained therein.

We contracted with the independent certified public accounting firm of Ernst & Young, LLP (Ernst & Young) to audit the financial statements of the Department as of September 30, 2009 and 2008, 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 the Department's financial statements, or conclusions about the effectiveness of internal control, whether the Department's financial management systems substantially complied with the Federal Financial Management Improvement Act of 1996, or on compliance with laws and regulations.

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

Sincerely,

/s/

Mary Mitchelson (Acting)

Enclosures

The Department of Education's mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.



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### Report of Independent Auditors

To the Inspector General  
U.S. Department of Education

We have audited the accompanying consolidated balance sheets of the U.S. Department of Education (the Department) as of September 30, 2009 and 2008, 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 the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 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 the Department's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of September 30, 2009 and 2008, and its net costs, changes in net position, and budgetary resources, for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 13, 2009, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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Report of Independent Auditors  
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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 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.

*Ernst & Young LLP*

November 13, 2009

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## Report on Internal Control

To the Inspector General  
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2009, 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, 2009. 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 the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department'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 purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined below. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies in internal control over financial reporting.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below to be significant deficiencies in internal control over financial reporting.

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## 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 maintained and further refined to ensure that appropriate estimates are prepared.

During FY 2008, the *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) legislation was enacted, which amended the FFEL program and provided the Secretary of Education with the authority to purchase student loans from private lenders and enter into forward commitments to purchase FFEL loans. In October 2008, the enactment of Public Law (P.L.) 110-350 extended this temporary loan purchase authority through September 30, 2010. The Department assembled a team with representatives from throughout the organization to develop, document, and implement the necessary processes surrounding the activities of the temporary loan purchase authority. Representatives included individuals from the Office of the Under Secretary, Office of the Chief Financial Officer (OCFO), Federal Student Aid (FSA), Budget Service, and Office of the General Counsel (OGC). We noted that the Department implemented, accounted for, and maintained these challenging activities throughout FY 2009, with significant activity under the programs occurring in the last quarter of the fiscal year.

Management informed us that team representatives maintained communication throughout FY 2009 on both the activities related to the temporary loan purchase authority and the development of loan volume estimates and the subsidy re-estimates for all loan programs. Discussions relating to the temporary loan purchase authority activities also played an important role in developing the re-estimates for the existing direct loan and FFEL guaranteed loan programs, since all the programs are interrelated. In contrast to efforts documented from prior monthly integrated loan program meetings or subgroups or full workgroup sessions of the prior Credit Reform Workgroup, these meetings occurred on an informal basis, and limited documentation of their activities was developed. To the extent such groups execute critical review activities, they constitute a key control for the Department, and further structure around their activities can enhance confidence in the Department's estimation processes.

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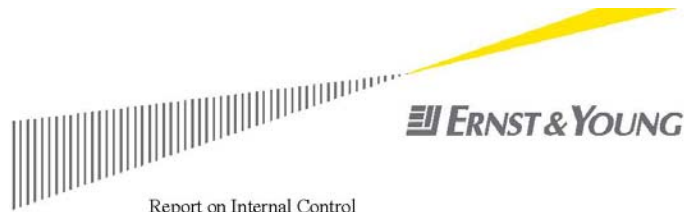
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Page 3

After identifying the challenges faced by the Department and improvements in communication made or currently being made by the Department, 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 receivables related to the direct loan (DL) program and the temporary loan purchase authority, and in the 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, other data analysis tools prepared by the Department, such as the cohort analysis, 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 cohort analysis 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 key detect controls for potential undetected errors that may exist in the development of the assumption data and credit reform estimates. In some instances, we noted calculation errors in certain of the analytical tools used by the Department, including the cohort analysis, back of the envelope, and fluctuation analysis. While these errors did not impact amounts in the financial statements, the analytical tools should contain accurate information if they are to serve their purpose as a detect control. In addition, we noted no formal detail review process surrounding these tools. Implementing such a process may reduce the potential for errors occurring in the analytical tools, lead to further refinement of the tools, and facilitate their use in a reinvigorated and more formalized cross-functional review of the 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 conditions 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 recessionary conditions, including

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increases in unemployment, reductions in credit availability for borrowers, and declines in home prices 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 economic 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 assuming the current economic recession lasts for varying lengths of time. This could be achieved by, for example:

- *Cohort Analysis.* Since differences may exist in how the events in the credit crisis and broader economic recession 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, and attempting to project changes in deterioration into default status by examining the behavior of loans that experienced an early default, deferment, or forbearance during prior downturns in the economy. 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 economic 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 or corroborating the default projections through alternative analysis could also aid the Department.
- *Unemployment Rate Forecast.* We noted that the Department's unemployment rate forecast appears to be somewhat lower than current unemployment rates. For example, the rate for FY 2009 is set to 6.77%, while monthly figures from the Bureau of Labor Statistics indicate that the unemployment rate reached 7.2% in December 2008 and has continued to climb throughout FY 2009. Considering alternative

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unemployment scenarios would allow the Department to test the sensitivity of the default estimates to the unemployment assumption. Such analysis may also provide useful information for stress-testing the Department's deferment and forbearance estimates, and, as warranted, aid in policy making to mitigate the impact of the current economic conditions on participants in the Department's programs and/or the costs of the programs.

**Recommendations:**

We recommend that the Department of Education perform the following:

1. Continue to improve the analytical tools used for the loan estimation process, working to develop formats and content that synthesize and capture loan level data available in the Department's systems. Specifically:
  - Critically assess default rates by cohort in light of recent changes in initial defaults, and increases in deferment and forbearance activity 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 unemployment, interest rate, GDP growth, and inflation scenarios.
  - Perform reviews of source data included in the Department's analytical tools to avoid errors and ensure that all analytical tools reconcile with one another to allow for their use as detect controls for loan program cost estimates.
2. Continue efforts to more fully implement cohort reporting with specific research on whether balances in the Department'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. Beginning initially with direct loans, utilize detail loan level data in NSLDS to develop summary cohort level data for each year of outstanding balances for comparison to projected future cash flows from liquidation of the loans as reflected in the SLM and cohort analysis tool.
3. Document in detail the consideration and ultimate resolution of scenarios under which early warnings from patterns in Department 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. Similarly, capture the value of financial-related data for the programs to provide information for decision-makers regarding possible prospective changes in the programs based upon

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indications of program participant performance, stress, and anticipated changes in behavior in response to changing market and economic conditions.

4. Reinforce the role of cross-functional teams, including members from OCFO, FSA, Budget Service, Office of Postsecondary Education (OPE), and OMB, in conducting integrated loan program meetings to review reports developed as part of the cohort analysis, critical assumptions in the models, and to discuss key internal issues and trends related to the portfolios. Document these activities and decisions reached in meeting minutes with copies of the distributed materials.

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

In connection with the annual audit of the Department's FY 2009 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 has worked towards strengthening and improving controls over information technology processes during FY 2009, 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 information technology general controls at the Department and FSA, we identified the following deficiencies: (1) lack of monitoring of the activities of administrator

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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) password configurations for applications, operating systems, and/or databases did not comply with the relevant Department or FSA policy; (5) documentation and related approvals required to provision user access are not consistently maintained; (6) administrator level access was assigned to individuals not requiring elevated privileges; and (7) documentation related to interfaces, including but not limited to Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding, were not up to date.

The OIG has identified information technology related deficiencies for the Department and FSA in reports issued during FY 2009. The OIG noted that the Department and FSA should improve security controls over the certification and accreditation (C&A) process for information systems to adequately protect the confidentiality, integrity, and availability of Department systems and the data residing in the system. In addition, OIG noted that the Department needs to improve security controls over its incident response and handling program and accelerate two-factor authentication for protecting Privacy Act information to adequately protect the confidentiality, integrity, and availability of the personally identifiable information (PII) data residing on public web sites. During the audit, OIG also identified significant conditions related to the work performed regarding Intrusion Detection System (IDS) configuration and public domain web site establishment and maintenance.

In addition, several of the above deficiencies are repeat conditions (although 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 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 continue to be implemented in a disparate manner across these groups. In addition, audit resolution activities have traditionally been performed 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 continue its efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness uniformly across the

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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, allocating appropriate resources and subject matter resources to the information technology process area, maintaining updated procedures to ensure proper configuration of servers against documented standards at the time of changes in the environment, and monitoring of contract performance of vendors providing system support services to the Department. As appropriate, the specific security and government standards that are to be applied, and approaches to achieving and monitoring such compliance, continue to merit additional focus in contracts the Department executes with service providers.

More specifically, the Department 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, enforcement of changes in access due to changes in roles and responsibilities); (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 Department and FSA policy; (4) strengthen incident handling and response procedures; (5) enhance its security training and awareness program, specifically around actions to be taken in the event an employee encounters suspicious activity; (6) document and update, as required, information pertaining to system interfaces, including Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding; (7) update system security plans and other documentation related to the C&A of existing systems, including documentation to support the authorization to operate (ATO); and (8) perform Privacy Impact Assessments (PIA) for systems containing PII and improve security controls over the protection of PII.

### **3. Additional Focus on Controls and Financial Reporting Processes Related to the American Recovery and Reinvestment Act is Needed**

The *American Recovery and Reinvestment Act of 2009* (ARRA) was enacted in February 2009 in response to the current recession in an effort to increase economic activity, create or save jobs, and improve accountability and transparency in government spending. The Department received approximately \$98 billion in ARRA funding for job preservation, state and local fiscal stabilization, and advancing education reforms and improvements. Approximately 55% of the Department's ARRA funding was appropriated for the creation of a new State Fiscal Stabilization Fund with the goal of stabilizing state and local government budgets to avoid reductions in education and other essential public services while driving education reform. The Department was tasked with promptly disbursing these funds through a variety of existing and new grant programs, while ensuring transparency and accountability. The Department has

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implemented new internal controls and utilized a variety of existing controls in an effort to mitigate the risks surrounding the disbursement and monitoring of this funding.

The Department has taken steps to address cash management issues under ARRA. In particular, similar to other federal grant programs, funds should not be distributed to grantees until the funds are needed to pay for authorized program expenses. The time between a grantee receiving funds and disbursing them to pay approved program expenses should be minimized. As part of its disbursement process for ongoing grant programs, the Department has controls in place to identify and monitor unusual patterns of drawdowns by grantees, including system-generated reports of drawdown requests that will require approval by the appropriate program office before being paid. Management informed us that program office personnel did follow up with grantees if unusual amounts or patterns of ARRA funds were requested to be drawn in a short period of time. The Department's program offices, Risk Management Service (RMS) and OCFO, in consultation with the OIG and the OGC, have worked to provide technical assistance to state and local agencies regarding cash management.

For financial reporting purposes, the Department recognizes disbursements of grant funds as expenses at the time the funds are disbursed. Some grant recipients incur expenditures prior to requesting grant funds. The Department records an accrued grant liability estimate for expenses incurred by grantees prior to their receiving grant funds. Conversely, the Department should record an advance for funds disbursed to grant recipients where the grantee has not spent the funds for immediate cash needs.

While the Department has worked to quickly implement the requirements of ARRA, strengthen controls over the significant amount of ARRA funds it received, and address the financial reporting issues surrounding ARRA, we noted the following matters for improvement:

- The Department's OIG recently identified several areas of concern surrounding state educational agencies' (SEA) implementation of federal cash management requirements under ARRA (ED-OIG/L09J0007). The OIG noted instances where SEA cash management systems (1) disburse ARRA funds without adequate information on whether local educational agencies (LEAs) are ready to spend the funds and (2) do not ensure LEAs remit interest earned on ARRA funds received in advance of LEA needs.
- The Department has procedures in place to identify, calculate, and record liabilities that may arise from grant disbursing activities, through the use of an estimated grant liability accrual which is reported on the financial statements. The Department estimated a grant liability related to the ARRA. We inquired whether the Department had addressed in its financial statements potential advances that may have occurred when grantees received ARRA funding but did not spend them for immediate cash needs. The Department subsequently reviewed recipient reporting data provided by ARRA grant recipients and compared recipient-reported expenses to available funds received. The Department did

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not have the final recipient-reported data as of September 30, 2009 available until October 30, 2009 to identify and record any advances that may have occurred related to ARRA grant funding. During its review, if funds received exceeded expenditures, the Department classified the amount as an advance, while conversely classifying as a liability amounts where expenditures exceeded funds received. This additional analysis performed as of September 30, 2009 resulted in a reduction of the initial year-end accrued grant liability of approximately \$550 million, and the establishment of a grant advance of nearly \$350 million. While the circumstances surrounding ARRA disbursements and reporting are somewhat unique, the potential for cash advances in other programs exists.

**Recommendations:**

We recommend that the Department of Education perform the following:

1. Reinforce existing cash management policies to grantees to emphasize that funds should not be drawn down substantially in advance of expenses.
2. Proactively monitor procedures related to the Department's non-routine grant accrual process to identify whether refinements to the process are needed, including procedures to identify, calculate, and record potential advances arising from grant disbursing activities.

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#### STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the FY 2008 audit of the U.S. Department of Education's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

##### Summary of FY 2008 Significant Deficiencies

Issue Area	Summary Control Issue	FY 2009 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.	Modified Repeat Condition classified as a Significant Deficiency
Controls Surrounding Information Systems Need Enhancement (Significant Deficiency)	Improvements are needed in overall information technology security and systems.	Modified Repeat Condition classified as a Significant Deficiency

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

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

*Ernst & Young LLP*

November 13, 2009

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### Report on Compliance with Laws and Regulations

To the Inspector General  
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2009, 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, 2009. 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 the Department is responsible for complying with laws and regulations applicable to the Department. As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 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 the Department. 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.

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

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Report on Compliance with Laws and Regulations  
Page 2

The results of our tests disclosed instances in which the Department's financial management systems did not substantially comply with certain requirements discussed in the preceding paragraph. We have identified the following instance of noncompliance:

While the Department has worked towards strengthening and improving controls over information technology processes during FY 2009, 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 information technology general controls at the Department and Federal Student Aid (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) password configurations for applications, operating systems, and/or databases did not comply with the relevant Department or FSA policy; (5) documentation and related approvals required to provision user access are not consistently maintained; (6) administrator level access was assigned to individuals not requiring elevated privileges; and (7) documentation related to interfaces, including but not limited to Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding, were not up to date. The OIG has identified information technology related deficiencies for the Department and FSA in reports issued during FY 2009. The OIG noted that the Department and FSA should improve security controls over the certification and accreditation (C&A) process for information systems to adequately protect the confidentiality, integrity, and availability of Department systems and the data residing in the system. In addition, OIG noted that the Department needs to improve security controls over its incident response and handling program and accelerate two-factor authentication for protecting Privacy Act information to adequately protect the confidentiality, integrity, and availability of the personally identifiable information (PII) data residing on public web sites. During the audit, OIG also identified significant conditions related to the work performed regarding Intrusion Detection System (IDS) configuration and public domain web site establishment and maintenance.

Our Report on Internal Control dated November 13, 2009, includes additional information related to the financial management systems that were found not to comply with the requirements of FFMIA relating to information technology security and controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMIA, and our recommendations related to the specific issues. We have reviewed our findings and recommendations with management of the Department. Management concurs with our recommendations and, to the extent findings and recommendations were noted in prior years, has provided a proposed action plan to the OIG in accordance with applicable Department directives. We did not audit management's proposed action plan and, accordingly, we express no opinion on it.

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Report on Compliance with Laws and Regulations  
Page 3

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

*Ernst & Young LLP*

November 13, 2009

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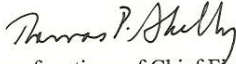
UNITED STATES DEPARTMENT OF EDUCATION


WASHINGTON, D.C. 20202-\_\_\_\_\_

November 10, 2009

MEMORANDUM

TO: Mary Mitchelson  
Acting Inspector General

FROM: Thomas P. Skelly   
Delegated to perform functions of Chief Financial Officer

Danny Harris   
Chief Information Officer

SUBJECT: DRAFT AUDIT REPORTS  
Fiscal Years 2009 and 2008 Financial Statement Audit  
U.S. Department of Education  
ED-OIG/A17J0001

Please convey our sincere thanks and appreciation to everyone on your staff who worked diligently on this financial statement audit. The Department has reviewed the draft Fiscal Years 2009 and 2008 Financial Statement Audit Reports. Without exception, we concur and agree with the Report of Independent Auditors and the Report on Internal Control. We also concur and agree with the Report on Compliance with Laws and Regulations.

We will share the final audit results with responsible senior officials, other interested program managers, and staff. At that time we will also request that they prepare corrective action plans to be used in the resolution process.

Again, please convey my appreciation to everyone on your staff whose efforts permitted the Department to complete the audit within the established timeframe. Please contact Gary Wood at (202) 401-0862 with questions or comments.



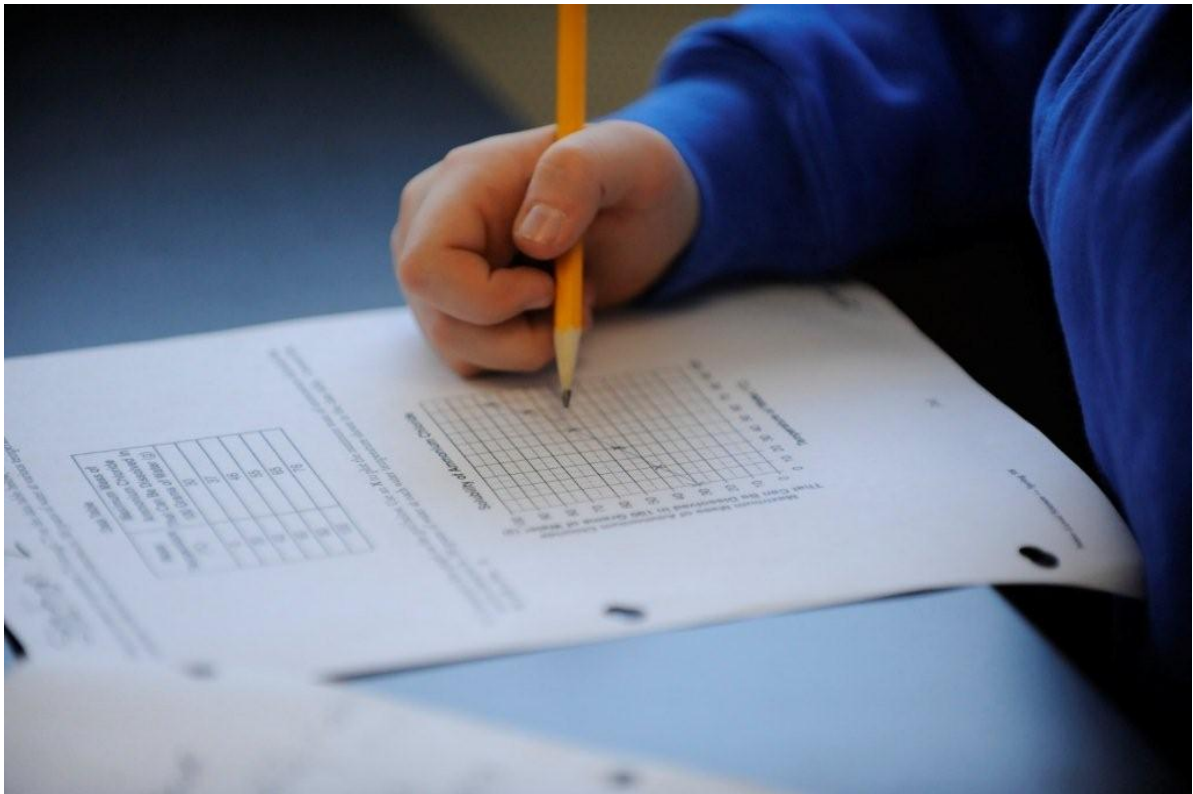
*Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.*





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# OTHER ACCOMPANYING INFORMATION



## IMPROPER PAYMENTS INFORMATION ACT REPORTING DETAILS

The *Improper Payments Information Act of 2002 (IPIA)* (Public Law 107-300) and the Office of Management and Budget's (OMB) Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments, define requirements to reduce improper/erroneous payments made by the federal government. OMB also has established specific reporting requirements for agencies with programs that possess a significant risk of erroneous payments and for reporting on the results of recovery auditing activities. Agencies are required to annually review and assess all programs and activities to identify those susceptible to significant improper payments. The guidance in OMB Circular A-123, Appendix C, defines a significant improper payment 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 and determined to be at risk, agencies are required to report to the President and the Congress the annual amount of estimated improper payments, along with steps taken and actions planned to reduce them.

The Department has divided its improper payment activities into the following segments: Student Financial Assistance Programs, *ESEA*, Title I Program, Other Grant Programs, and Recovery Auditing.

### Student Financial Assistance Programs

#### Risk Assessment

As required by the *IPIA*, The Department inventoried its programs during FY 2009 and reviewed program payments made during FY 2008 (the most recent complete fiscal year available) to assess the risk of improper payments. The review identified and then focused on the following key programs: Academic Competitiveness Grant (ACG) Program, William D. Ford Federal Direct Loan (Direct Loan) Program, Federal Family Education Loan (FFEL) Program, Federal Pell Grant (Pell Grant) Program, and the National Science and Mathematics Access to Retain Talent (SMART) Grant Program.

In addition to the A-123 guidance, the criteria for determining susceptible risk within the programs were defined as follows:

Programs with annual outlays that exceed \$200 million or programs that were previously required to report improper payment information under OMB Circular A-11, *Budget Submission*, former Section 57.2<sup>1</sup>.

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<sup>1</sup> The four original programs identified in OMB Circular A-11, Section 57, were Student Financial Assistance (now Federal Student Aid), *ESEA*, Title I, Special Education Grants to States, and Vocational Rehabilitation Grants to States. Subsequently, after further review of the program risk, OMB removed Special Education Grants to States and Vocational Rehabilitation Grants to States from the list. OMB considers Section 57 programs susceptible to significant improper payments regardless of the established thresholds. OMB Circular A-136 also applies.

## Risk-Susceptible Programs

The Title IV programs that were deemed to be potentially susceptible to the risk of significant improper payments based on OMB criteria described above include ACG, Direct Loan, FFEL, Pell Grant and SMART. We have reassessed the Federal Supplemental Educational Opportunity Grant and Federal Work-Study Programs and have determined that, due to low volume and relatively low eligibility requirements, they are not risk susceptible.

As data becomes available, the Teacher Education Assistance for College and Higher Education (TEACH) Grant Program will be assessed. It is anticipated that the first assessment will take place in FY 2011.

In FY 2008, the lack of liquidity in financial markets impacted the ability of FFEL lenders and secondary markets to find cost-effective financing. As a result, Congress passed the *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)*, which was signed by the President on May 8, 2008. This gave the Department authority to purchase FFEL loans from lenders to ensure liquidity in the FFEL. The following three programs were developed under the *ECASLA* mandate:

- Loan Purchase Commitment Program.
- Loan Participation Purchase Program.
- Asset-Backed Commercial Paper (ABCP) Conduit Program.

Federal Student Aid has determined that each of these is potentially a risk-susceptible program. A risk assessment for each of these programs will be completed during FY 2010.

**ACG Program.** A risk assessment was completed for the ACG Program in FY 2009. Assessment of the risk of improper payments in the ACG based upon audit findings was accomplished by evaluating the results of annual audits required of schools participating in the Federal Student Aid Programs. Information on all audits was queried from the Postsecondary Education Participants System (PEPS), the management information system for all schools participating in the Federal Student Aid Programs. Audit deficiencies resulting in liabilities due to a specific ACG Program violation or due to a violation of regulations applicable to all programs were isolated. The liability amount for each deficiency applicable to the ACG was calculated and totaled and then compared with total funding. The overall improper payment rate, based on this risk analysis, was .0045 percent. Since this rate is below the threshold for reporting on improper payments, no further information on the ACG Program is included herein.

**Direct Loan Program.** A risk assessment was completed for the Direct Loan Program in FY 2009. There were no changes to the sampling process from prior years. The overall improper payment rate, based on this risk analysis, was 0.38 percent. Since this rate is below the threshold for reporting on improper payments, no further information on the Direct Loan Program is included herein.

**FFEL Program.** An ongoing risk assessment is in process for FFEL. See Footnote <sup>(1)</sup> under Federal Student Aid Improper Payment Reporting Summary.

**Pell Grant Program.** A risk assessment was completed for Pell Grant Program in FY 2009. There were no changes to the sampling process from prior years. The overall improper payment rate, based on this risk analysis, was 3.5 percent.

**SMART Program.** Assessment of the risk of improper payments in the SMART Program based upon audit findings was accomplished by evaluating the results of annual audits required of schools participating in the Federal Student Aid Programs. Information on all audits was queried from the PEPS, the management information system for all schools participating in the Federal Student Aid Programs. Audit deficiencies resulting in liabilities due to a specific SMART Program violation or due to a violation of regulations applicable to all programs were isolated. The liability amount for each deficiency applicable to the SMART Program was calculated and totaled and then compared with total funding. The overall improper payment rate, based on this risk analysis, was .00001 percent. Since this rate is below the threshold for reporting on improper payments, no further information on the SMART Program is included herein.

## Statistical Sampling

The size and complexity of the student aid programs make it difficult to consistently define “improper” payments. The legislation and OMB guidance use the broad definition: “Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirement.” Federal Student Aid has a wide array of programs, each with unique objectives, eligibility requirements, and payment methods. Consequently, each program has its own universe (or multiple universes) of payments that must be identified, assessed for risk, and, if appropriate, statistically sampled to determine the extent of improper payments.

**FFEL Program.** In FY 2009, the Department worked with OMB to target their improper payment risk analysis using data mining techniques to identify potential improper payments, with particular focus on special allowance payments (SAP) to lenders. In recent years, SAP has been among the largest categories of payments to lenders or guarantors. However, the *College Cost Reduction Act of 2007* reduced SAP rates and, combined with a historically low interest rate environment, has resulted in SAP amounts due to the Department beginning in FY 2007. This substantial decline, coupled with a significant increase in the Direct Loan Program versus FFEL and the proposed move to 100 percent Direct Loans at the end of FY 2010, have resulted in an improving risk profile related to the potential for FFEL improper payments. The agreed-upon *IPIA* targeted SAP analysis discussed above began in the fourth quarter of FY 2009 and is expected to be completed by the end of the second quarter of FY 2010. In addition to the substantial SAP decline, there is a major impact from the new *ECASLA* loan participation and loan purchase processes that needs to be evaluated with regard to the effect on payments to lenders.

Because the Department conducted a risk analysis in FY 2009 focused on identifying sources of potential improper payments, the Department will not be reporting an error rate for the FFEL program in the 2009 AFR. Rather, the Department plans to use information gained from its analysis to establish a new error measurement methodology in FY 2010 that could be used for future reporting purposes.

**Pell Grant Program.** The Department conducts studies with the IRS using FAFSA data. Data provided by the IRS study are used to estimate improper payments for the Pell Grant Program. The methodology for the Pell Grant Program did not change in FY 2009, and

additional details about the study can be found in the 2008 PAR under the [statistical sampling section](#).

## Corrective Actions

**FFEL Program.** In addition to the payment data analyses mentioned above, Federal Student Aid has a number of existing internal controls integrated into its systems and activities. Program reviews, independent audits and Inspector General audits of guaranty agencies, lenders, and servicers are some of its key management oversight controls. Other control mechanisms include the following:

- **System Edits**—the system used by guaranty agencies, lenders, and servicers to submit bills and remit payments includes “hard” and “soft” edits to prevent erroneous information from being entered into the system and prevent potential erroneous payments. The edits look at a variety of factors (e.g., code combinations, reported amounts etc.) to determine either reasonableness or validity of the data. The hard edits require correction before proceeding with payment processing. The soft edits alert the user and Federal Student Aid to potential errors.
- **Reasonability Analysis**—Data reported by guaranty agencies to the National Student Loan Data System are used to determine payment amounts for account maintenance and loan issuance processing fees. Federal Student Aid also performs trend analysis of previous payments to guaranty agencies and lenders as a means of evaluating reasonableness of changes in payment activity and payment levels.
- **Focused Monitoring and Analysis**—Federal Student Aid targets specific areas of FFEL payment processing that are at an increased risk for improper payments as areas of focus for increased monitoring and oversight. In FY 2009, Federal Student Aid completed a series of audits of guaranty agencies’ establishment of the federal and operating funds in 1998 in response to an OIG recommendation. Those audits are in the resolution process.

**Pell Grant Program.** A new IRS data retrieval process is scheduled to be implemented as a pilot on January 24, 2010. The new process will be added to the 2009-2010 FAFSA on the Web (FOTW) application. Eligible FOTW applicants and their parents will be presented a link in the financial section of the online application giving them the option to go to an IRS site, review their 2008 income information, and automatically transfer income information into the appropriate fields on the FAFSA. This process, for those who elect to use it, has the potential to significantly reduce errors on the FAFSA and thus reduce improper payments in all Federal Student Aid Programs. If successful, this data retrieval and transfer process will be implemented for the 2010–11 application year, once IRS data becomes available sometime in the summer of 2010. Federal Student Aid is also using the IRS statistical study in which financial data from a random sample of FAFSA submissions are compared with financial data reported to the IRS in annual income tax filings to identify new solutions for preventing improper payments.



## Federal Student Aid Improper Payment Reporting Summary

The following table presents the improper payments outlook for the primary Federal Student Aid programs.

(\$ in millions)

Program	FY 2009 Actual			FY 2010 Estimated			FY 2011 Estimated			FY 2012 Estimated			FY 2013 Estimated		
	Outlays	IP %	IP \$	Outlays	IP %	IP \$	Outlays	IP %	IP \$	Outlays	IP %	IP \$	Outlays	IP %	IP \$
FFEL <sup>(1)</sup>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Pell Grant <sup>(2)</sup>	16,281	3.5	570	28,820	3.5	1,009	32,301	3.5	1,131	34,236	3.5	1,198	35,422	3.5	1,240

<sup>(1)</sup> Since the Department is completing the ongoing risk assessment for FFEL in lieu of a measurement, no error rate will be presented for FFEL in this year's *Agency Financial Report*. This work will include an examination of the error rate methodology followed by development of a new plan and measurement. In addition, the methodology will need to be expanded in the future to reflect the *ECASLA* initiatives.

<sup>(2)</sup> The source of FY 2009 Pell outlays reflects total expenditures from FMSS. The 3.5 IP percent used for 2010-2013 is based on discussions held with OMB during FY 2007 and FY 2008. The 3.5 percent rate is being used since it is a more current target than the targets previously identified in the Federal Student Aid 2006 – 2010 Five-Year Plan.

Note: The final Pell error rate for FY 2008 was 3.69 percent. This 3.69 percent rate was reported as "preliminary" in the *FY 2008 Performance and Accountability Report*, however, it did not change.

### Recovery Efforts

For Pell, recovery is achieved through assessments made during program reviews and compliance reviews. Pell also makes recoveries when overpayments to students are assigned to Federal Student Aid for collection. Pell recoveries for the period 2004 through September 30, 2009 are presented in the following table.

<b>Pell Recoveries</b> (Dollars in Millions)					
<b>FY 2004 \$</b>	<b>FY 2005 \$</b>	<b>FY 2006 \$</b>	<b>FY 2007 \$</b>	<b>FY 2008 \$</b>	<b>FY 2009 \$</b>
10.2	11.2	13.6	14.2	10.8	6.6

### **Statutory and Regulatory Barriers**

There are currently no identified barriers which may limit Federal Student Aid's corrective actions in reducing improper payments and actions taken by the agency to mitigate the barriers' effects. The Department previously reported in its PAR that provisions in the Internal Revenue Code precluded it from data-matching with regard to grants made by the Department. Legislation to amend the Internal Revenue Code to allow data-matching capabilities has not been enacted, but through administrative changes, the Department and the U.S. Department of the Treasury implemented a process to verify students' (and their parents') income, tax and certain household information appearing on their tax return that they provide as part of the application for federal student aid. This initiative was cited in the "Journal of Government Financial Management" and recognized as the type of proactive approach that is vital to addressing the root causes of improper payments.

### **ESEA, Title I Program**

The Department performed a risk assessment of the *Elementary and Secondary Education Act of 1965* Title I Program, Grants to Local Educational and Agencies, during FY 2009. The assessment, based on FY 2007 single audit data (the most recent available), yielded an estimated improper payment rate of 0.23 percent or \$29 million. This confirms previously reported data indicating that the risk of improper payments under current statutory requirements is very low. To validate the assessment data, the Department conducts on-site monitoring reviews on a three-year review cycle that encompass all states and territories receiving Title I funds. There were no findings in the monitoring reviews with questioned costs that contradicted the data in the risk assessment.

The Department is continuing to review and monitor for data quality. A key element of the monitoring process involves the wide use of the number of children who qualify for free and reduced-price meals to determine an individual school's Title I eligibility and allocation by local educational agencies. The Title I statute authorizes local educational agencies to use these data, provided under the U.S. Department of Agriculture's national School Lunch Program, for this purpose. In many districts these data are the only indicator of poverty available at the individual school level.

The U.S. Department of Agriculture is working with states and localities to improve program integrity, within the existing statutory and regulatory framework, through enhanced monitoring and auditing. The U.S. Department of Agriculture is also working with the Department and other federal agencies that have programs that make use of these data to explore long-term policy options.

### **Risk Assessment for Other Grant Programs**

The Department's approach to the risk assessment process for non-Federal Student Aid grant programs was to develop a methodology to produce statistically valid measures that

could be applied uniformly across the Department's programs. The intent was to use the same methodology across all non-Federal Student Aid grant programs to establish a level of quality control for all programs and, at the same time, produce a cost-effective measure. The Department deemed it cost effective to utilize the results of the thousands of single audits already being conducted by independent auditors on grant recipients.

In FY 2007, the Department worked with the Department of Energy's Oak Ridge National Laboratory to perform data mining on information available in the Federal Audit Clearinghouse's Single Audit Database, the Department's Grant Administration and Payment System, and the Department's Audit Accountability and Resolution Tracking System to assess the risk of improper payments in its remaining grant programs. To conduct the risk assessment screening, Oak Ridge National Laboratory augmented the Audit Accountability and Resolution Tracking System database with imputed values for the likely questioned costs for grants that were not audited. The imputed and real questioned costs could then be tabulated to provide a reasonable upper-bound estimate of the rate of erroneous payments for each of the functional programs of interest.

If the computed upper-bound percentage was below 2.5 percent, then the actual value would be lower than 2.5 percent. If the computed upper-bound percentage was greater than 2.5 percent, then the actual value may be greater or less than 2.5 percent, but the Department would need additional information to determine the appropriate estimate.

The most striking result of the analysis was the generally low rate of questioned costs. The key finding of this analysis was that for the most recent year for which data were available (FY 2005), none of the functional programs exceeded the threshold value of 2.5 percent. Consequently, none of the programs would be labeled as susceptible to significant erroneous payments.

In accordance with OMB Circular A-123, Appendix C, programs deemed low risk only require a risk assessment every three years unless a program experiences a significant change in legislation and/or a significant increase in funding level. Since the Oak Ridge National Laboratory risk assessments have not indicated any significant risk of improper payments, the Department did not task Oak Ridge National Laboratory to perform the risk assessment for FY 2009. However, the Department is taking the following actions to further improve its monitoring efforts.

**Migrant Education Grants to States.** The Review of the Migrant Education Program (MEP) focused on the Office of Migrant Education's (OME's) monitoring of child eligibility under Title I, Part C, of the *ESEA*. On December 4, 2007, the Office of Inspector General (OIG) sent an audit closeout memorandum to the Assistant Secretary for Elementary and Secondary Education (OESE), informing her that OIG terminated its audit of the MEP at OME. OIG decided to terminate its audit based on ". . . ongoing changes to Department monitoring, and proposed changes to the migrant law. . ." The memorandum points out, however, that the termination of OIG's review ". . . does not preclude the Department of Education from taking action concerning any aspect of the entities reviewed." Five external audit reports had relevancy to the MEP eligibility issue. Four of the reports have been either resolved or closed.

In June 2009, staff from the Internal Controls Evaluation Group (ICEG) met with personnel from OME to discuss the ramifications of discontinuing tracking the Federal Managers' Financial Integrity Act (FMFIA) deficiencies in relation to OIG's internal audit of the MEP.

Due to the termination of the audit, and after conferring with OME personnel, ICEG concluded there would be no justification for continuing to track the FMFIA deficiencies in this audit. Therefore, OESE need not report these internal control deficiencies in its FY 2009 FMFIA annual certification.

**Risk Management Service.** The goal of the Risk Management Service in the Office of the Secretary is to identify and take effective action to manage and mitigate risks in the area of grants management that may adversely affect the advancement of the Department's mission. To achieve this objective, the Risk Management Service develops and coordinates a Departmentwide risk management strategy and coordinates and supports consistent, high-quality management of formula and discretionary grants Departmentwide.

The office focuses on identifying potential high-risk grantees before problems begin to occur. Program office and Risk Management Service staff members provide assistance to those grantees regarding their grants and financial management practices to help strengthen the grantees' management of federal funds. In the case of grantees identified as high risk, resources are directed toward solving and managing issues of misuse, abuse, or waste of federal funds. The Risk Management Service has developed a Decision Support System that analyzes available information on grants and grantees, and makes this information available to support decisions on where the Department should deploy resources for oversight and technical assistance. The Decision Support System will continue to develop and expand over the next few years. This year, in response to the risk associated with the large amount of grant funding made available by the *American Recovery and Reinvestment Act of 2009*, the Risk Management Service is also leading Departmentwide technical assistance to the recipients of the largest amount of funds under the Act. Finally, the office also provides customer service in the form of training and responses to inquiries on policy interpretations to grantees, grant applicants, and program offices awarding and monitoring grants.

**Managing Risk in Discretionary Grants.** In FY 2009, the Department managed more than 10,000 discretionary grant awards. Due to the vast legislative differentiation and the complexity of the Department's grant award programs, ensuring that program staff are fully aware of potentially detrimental issues relating to individual grantees is a significant challenge. Program offices designate specific grants as high risk in accordance with Departmental regulations. The Department uses the Grants High-Risk Module housed within the Department's Grant Administration and Payment System, to track grants and grantees that are designated high risk. Program office staff are required to review and certify their awareness of the high-risk status of applicable grantees before making awards.

**Manager Accountability.** The Department categorized OMB Circular A-133 single audit findings to provide feedback to program managers regarding the frequency and type of findings within their programs. This assists managers in tailoring their program monitoring efforts to the type of findings that most frequently occur. Additionally, post-audit follow-up courses have been developed to associate audit corrective actions with monitoring to minimize future risk and audit findings. Managerial compliance with monitoring procedures is reviewed and tested during the assurance process under OMB Circular A-123, *Management's Responsibility for Internal Control*.

**Planned Corrective Actions.** In addition to the actions previously outlined under the Student Financial Assistance Programs and *ESEA*, Title I Program sections, the Department will periodically update any corrective action plans based on the results of the

initiatives outlined above. The Department will record and maintain corrective action plans as required, which will include due dates, process owners and task completion dates.

**Information Systems and Infrastructure.** The Department has submitted budget requests of \$250,000 for FY 2010 and FY 2011 for information system infrastructure improvements. A portion of the funds will be used to continue the refinement of the Oak Ridge National Laboratory data mining effort. It is also anticipated that the Department will incur costs related to mitigation activities.

**American Recovery and Reinvestment Act (Recovery Act) Programs.** For FY 2009 and FY 2010, the *Recovery Act* supplemented the Department of Education's appropriations by \$98.2 billion. The law created the new \$48.6 billion State Fiscal Stabilization Fund grant program. The *Recovery Act* also supplemented existing programs, including *ESEA* Title I and *IDEA* Part B and Part C, nearly doubling the funds available for some major grant programs at the Department. Immediately following the enactment of *Recovery Act*, the Department conducted a systematic assessment of the risks presented by the law and concluded that recipient expenditures under all *Recovery Act* grants should be monitored because of the high level of funding. Further, the Department concluded that the State Fiscal Stabilization Fund program should receive a particularly high level of oversight because the program is both new and funded at an extremely high level.

The Department has established an elevated level of oversight for *Recovery Act* grants in order to avoid improper payments. Monitoring for potential excessive draws against these grants began immediately after the Department made the funds available to grantees. The Department quickly automated this process so that the finance system automatically notifies the Federal program officer any time a grantee requests payment of a large sum or a large proportion of a grant. The program officer then contacts the grantee to ensure the payment is in compliance with program rules and federal financial assistance management requirements. The program officer approves the large payment requests before they are processed.

The Department has also automated the review of the expenditure and activities data that recipients are reporting into [FederalReporting.gov](http://FederalReporting.gov) under the requirements of *Recovery Act* Section 1512. The staff across the Department is reviewing exception reports for inconsistencies between expenditures reported by recipients and the information in the Department's finance system. The staff is also reviewing the reports to gauge the reasonableness of reported expenditures and the relationship of prime recipient draws on their grants to the amount expended by their subrecipients, to monitor for cash management issues.

## Recovery Auditing Progress

To effectively address the risk of improper administrative payments, the Department continued a recovery auditing initiative to review contract payments. The Department performed a review of payments based on a statistical sample of FY 2008 payment transactions. No improper payments were indicated in the review. The Department's purchase and travel card programs remain subject to monthly reviews and reconciliations to identify potential misuse or abuse.

Recovery Auditing Summary (in millions)								
Agency Component	Amount Subject to Review for CY Reporting	Actual Amount Reviewed and Reported CY	Amounts Identified for Recovery CY	Amounts Recovered CY	Amounts Identified for Recovery PYs	Amounts Recovered PYs	Cumulative Amounts Identified for Recovery (CY + PYs)	Cumulative Amounts Recovered (CY + PYs)
All	\$1,569	\$29.3	\$0	N/A	\$0.3	\$0.1	\$0.3	\$0.1

## Summary

The Department is continuing its efforts to comply with the *IPIA*. Although there are still challenges to overcome, the Department is committed to ensuring the integrity of its programs.

The Department is focused on identifying and managing the risk of improper payments and mitigating the risk with adequate control activities. In FY 2010, we will continue to work with OMB and the Inspector General to explore additional opportunities for identifying and reducing potential improper payments and to ensure compliance with the *IPIA*.



## SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

The following tables provide a summarized report on the Department's financial statement audit and its management assurances. For more details the auditor's report can be found on pages 103–122 and the Department's Management assurances on pages 42–43.

Summary of Financial Statement Audit					
Audit Opinion	Unqualified				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
<b>Total Material Weaknesses</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Summary of Management Assurances					
Effectiveness of Internal Control over Financial Reporting - <i>Federal Managers' Financial Integrity Act (FMFIA) 2</i>					
Statement of Assurance	Unqualified				
Material Weaknesses	Beginning Balance	New	Resolved	Reassessed	Ending Balance
<b>Total Material Weaknesses</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
The Department had no material weaknesses in the design or operation of the internal control over financial reporting.					
Effectiveness of Internal Control over Operations - <i>FMFIA 2</i>					
Statement of Assurance	Unqualified				
Material Weaknesses	Beginning Balance	New	Resolved	Reassessed	Ending Balance
Information Technology Security	1		1		0
<b>Total Material Weaknesses</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>
Conformance with Financial Management System Requirements - <i>FMFIA 4</i>					
Statement of Assurance	The Department systems conform to financial management system requirements.				
<b>Non-Conformance</b>	Beginning Balance	New	Resolved	Reassessed	Ending Balance
<b>Total Non-Conformance</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Compliance with <i>Federal Financial Management Improvement Act</i>					
	Agency		Auditor		
<b>Overall Substantial Compliance</b>	Yes		No		
1. System Requirements	Yes		No		
2. Federal Accounting Standards	Yes		Yes		
3. United States Standard General Ledger at Transaction Level	Yes		Yes		

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# APPENDIX

## APPENDIX: SELECTED DEPARTMENT WEB LINKS

### The American Recovery and Reinvestment Act

- **Important Recovery Act Reference Sites**

- [Recovery.Gov](#)
- [Department Updates](#)
- [Department Weekly and Communication Reports](#)
- [Department Recovery Act Program Plans](#)
- [Department FY 2010 Detailed Budget and Budget Requests](#)
- [American Recovery and Reinvestment Act of 2009: Frequently Asked Questions](#)

### Department Evaluation Studies

The Department designs evaluation studies to produce rigorous scientific evidence on the effectiveness of education programs and practices.

<http://ies.ed.gov/ncee/projects/evaluation/index.asp>

<http://www.ed.gov/about/offices/list/oepd/ppss/reports.html>

### Performance Data

EDFacts is a Department initiative to put performance data at the center of policy, management and budget decisions for all K-12 educational programs.

<http://www.ed.gov/about/inits/ed/edfacts/index.html>

### Projections of Education Statistics to 2018

For the 50 states and the District of Columbia, the tables, figures and text contain data on projections of public elementary and secondary enrollment and public high school graduates to the year 2018. The report includes a methodology section describing models and assumptions used to develop national and state-level projections.

<http://nces.ed.gov/pubsearch/pubsinfo.asp?pubid=2009062>

### Discretionary Grant Programs for FY 2009–2010

This site lists Department grant competitions previously announced, as well as those planned for later announcement, for new awards organized according to the Department's principal program offices.

<http://www.ed.gov/fund/grant/find/edlite-forecast.html>

## Information Policy, E-Gov and Information Technology

The Office of Management and Budget (OMB) ensures that agency reports, rules, testimony, procurement, financial management, information, regulatory policies and proposed legislation are consistent with the President's Budget and with Administration policies.

<http://www.whitehouse.gov/omb/inforeg/infopoltech.html>

## Research and Statistics

The *Education Sciences Reform Act of 2002* established the Institute of Education Sciences (IES) within the Department to provide research, evaluation and statistics to our nation's education system.

<http://ies.ed.gov/>

## National Assessment of Educational Progress

The National Assessment of Educational Progress assesses samples of students in grades 4, 8 and 12 in various academic subjects. Results of the assessments are reported for the nation and states in terms of achievement levels—basic, proficient and advanced.

<http://nationsreportcard.gov/>

## Government Accountability Office

The GAO supports Congress in meeting its constitutional responsibilities and helps improve the performance and accountability of the federal government for the benefit of the American people.

<http://www.gao.gov/docsearch/agency.php>

## Office of Inspector General

The OIG has four primary business functions: audit, investigation, cyber security and evaluation and inspection.

<http://www.ed.gov/about/offices/list/oig/index.html>

For a list of recent reports, go to:

<http://www.ed.gov/about/offices/list/oig/areports.html>



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