

# U.S. Department of Education FY 2010 Agency Financial Report

**U.S. Department of Education**

Arne Duncan

*Secretary*

**Office of the Chief Financial Officer**

Thomas Skelly

*Delegated to perform the functions and duties of Chief Financial Officer*

November 15, 2010

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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  
Washington, D.C. 20202-0600

The following companies were contracted to assist in the preparation of the  
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For general layout and Web design: ICF Macro  
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FMR Consulting, Inc.  
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## Foreword

The United States Department of Education's (the Department's) *Agency Financial Report* (AFR) for fiscal year (FY) 2010 provides to Congress, the President, and the American people an overview of the Department's financial performance and results and detailed information about our stewardship over the financial resources entrusted to us. Additionally, the report provides information about our performance as an organization, our accomplishments and initiatives, and our challenges as required by the Office of Management and Budget's Circulars A-11 and A-136.

The AFR is the first of three reports required under the Office of Management and Budget's Program for Alternative Approaches to Performance and Accountability Reporting. This is the second year that the Department has participated in this voluntary program. The Department is participating in this alternative approach in an effort to strengthen its annual reporting documents, to present more streamlined and timely information, and to clarify the relationship between performance, budgetary resources, and financial reporting. The Department's goal is 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 strengths and challenges.

The Department's FY 2010 annual reporting includes the following three documents:

### **Agency Financial Report (AFR)** [available November 15, 2010]

The AFR 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 7, 2011]

The APR is produced in conjunction with the FY 2012 President's Budget Request and provides more detailed performance information and analysis of performance results.

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

[available February 15, 2011]

This document provides an integrated overview of performance and financial information that consolidates the AFR and the APR into a user-friendly 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.
- *Government Management Reform Act of 1994 (GMRA)* requires agency audited financial statements.
- *Federal Financial Management Improvement Act of 1996 (FFMIA)* requires an assessment of the agency's financial systems for adherence to governmentwide requirements.
- *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>.**

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## Message From the Secretary



November 15, 2010

I am pleased to present the U.S. Department of Education's *Fiscal Year (FY) 2010 Agency Financial Report*. This is the first of three integrated reporting components that are included in the alternative approach to the *Performance and Accountability Report (PAR)*. The remaining two reports, the *FY 2010 Annual Performance Report* and the *FY 2010 Summary of Performance and Financial Information*, will be released in February 2011.

FY 2010 has been a transition year for the Department as we move to a new strategic plan. We are still firmly committed to our mission of promoting achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access. In

FY 2010, we faced significant challenges and achieved major milestones in promoting our education goals.

We focused our efforts on the President's goal of once again having the highest proportion of college graduates in the world—a goal that drives accountability for improvement from cradle to career. In order to achieve this goal as the end result of our education efforts, we need to continue to support students at all levels of the education continuum. We must begin with early learning, and we must do more to close the achievement gap before children enter kindergarten and ensure success in school. We must provide our students with competent and effective teachers. We must work to reduce dropout rates in our high schools, promote college readiness, and make college more accessible and affordable.

We continue to work on the reauthorization of the *Elementary and Secondary Education Act of 1965*. We need to ensure that states, districts, and schools are held accountable; provide greater flexibility to enable innovation and improvement; and focus a greater emphasis on schools and students most at risk.

We have already focused on these efforts in our current programs. *Race to the Top*, authorized under the *American Recovery and Reinvestment Act of 2009*, has prompted states and districts to remove obstacles to reform and encourage stakeholders to work together toward shared goals. I recently conducted a *Courage in the Classroom* tour to honor our nation's unsung heroes—our teachers. The major complaint I heard from teachers is that narrowly focused “bubble tests” pressure teachers to teach to the test. The *Race to the Top Assessment* program provides funding to coalitions of states to develop common assessments that measure real student knowledge and skills.

Our Investing in Innovation (i3) fund (authorized under the *American Recovery and Reinvestment Act of 2009*) provides competitive grants to districts or consortia of schools to expand innovation and evidence-based practices. Additionally, states all across America are distributing School Improvement Grant (SIG) funds to districts to provide interventions to their lowest-performing schools. And we are also distributing Teacher Incentive Fund (TIF) grants to districts to try new compensation programs that reward effective teachers or provide incentives for teachers to teach in hard-to-staff schools and subjects.



To help students struggling to enter college, the Department provides low-interest loans directly to students through the William D. Ford Federal Direct Loan Program and Pell Grants to make college more affordable and accessible. We have reformed the student loan program to save taxpayer dollars and now use private-sector companies chosen competitively based upon effective performance to service student loans.

Over the last two years, the Department has been able to support education jobs through stimulus funding provided by the *American Recovery and Reinvestment Act of 2009*. Communities across America still face serious financial challenges. Our new Education Jobs Fund is saving and creating education jobs. It requires school districts to pay the salaries and benefits of teachers, school administrators, and other essential employees.

We are continuing to monitor our progress in areas of concern that would hinder efficiency, effectiveness, and integrity in our programs and operations, and to identify actions needed to address any deficiencies. Going forward into FY 2011, our Office of Inspector General has identified four challenges that face the Department:

- implementation of new programs and statutory changes to existing programs;
- program oversight and monitoring;
- data quality and reporting; and
- information technology security.

Additionally, several new requirements related to reducing improper payments were enacted in FY 2010. The Department must be able to provide assurances that the billions of dollars entrusted to it are reaching the intended recipients.

Education is a civil right. That is why we are establishing the Equity and Excellence Commission to examine how inequities in K-12 education contribute to the achievement gap. We will ensure that all schools—traditional public schools, public charter schools, and private schools—serve the children most in need.

Also, I have recently launched the TEACH Campaign to raise awareness of teaching as a valuable profession. For more information, please visit our Web site, [www.TEACH.gov](http://www.TEACH.gov).

Finally, the financial and performance data presented in this report are complete and reliable, and provide an accurate and transparent accounting of the Department's financial situation and performance results. The report includes information and assurances about the Department's financial management systems and controls as required by the *Federal Managers' Financial Integrity Act of 1982*. I am pleased to report that for the ninth consecutive year, the Department has earned a clean opinion from independent auditors on its financial statements and that for the eighth consecutive year, no material weaknesses were identified.

Sincerely,

/s/

Arne Duncan

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# **Management's Discussion and Analysis**



## Mission and Organizational Structure

**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 was a national priority in 1867, creating a federal education agency to collect and report statistical data. The Department was established as a cabinet-level agency in 1979. For a chronology of education legislation, go to: [http://nces.ed.gov/pubs2010/2010013\\_4.pdf](http://nces.ed.gov/pubs2010/2010013_4.pdf).

**Our Public Benefit.** 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. For performance and budget overviews, go to: <http://www2.ed.gov/about/overview/focus/performance.html>.

**Our Organization.** Education is the smallest Cabinet-level federal agency. The Required Supplementary Stewardship Information section of this report contains a summary statement of offices within the Department. For an interactive organizational chart, go to: <http://www2.ed.gov/about/offices/or/index.html>.

**What We Do.** The Department engages in five major types of activities: establishing policies related to federal education funding; administering distribution of funds and monitoring their use; providing oversight on data collection and research on America's schools; identifying major issues in education and focusing national attention on them; and enforcing federal laws prohibiting discrimination in programs that receive federal funds. For details, go to: <http://www2.ed.gov/about/what-we-do.html>.

**Who We Serve.** During school year (SY) 2010–11, America's schools and colleges are serving larger numbers of students as the population increases and enrollment rates rise. As SY 2010–11 gets underway, nearly 49.4 million students attend public elementary and secondary schools. Of these, 34.7 million are in pre-kindergarten through 8th grade and 14.7 million are in grades 9 through 12. An additional 5.8 million students attend private schools.

Expenditures for public elementary and secondary schools will be about \$540 billion for SY 2010–11, excluding capital and interest. The national average current expenditure per student is projected for SY 2010-11 at \$10,792, up from \$10,297 in actual expenditures in SY 2007–08.

In fall 2010, a record 19.1 million students are expected to attend the nation's 2-year and 4-year colleges and universities, an increase of about 3.8 million since fall 2000.

For back-to-school statistics and the sources, please see <http://nces.ed.gov/fastfacts/display.asp?id=372>.

## Department of Education FY 2010 Highlights

### Civil Rights Enforcement

- Total number of complaints resolved by the Office for Civil Rights in FY 2010 was 6,830, an increase of 11% above the 6,151 complaints resolved in FY 2009.

### Freedom of Information Act of 1966 Requests

- Received 2,230
- Processed 1,921

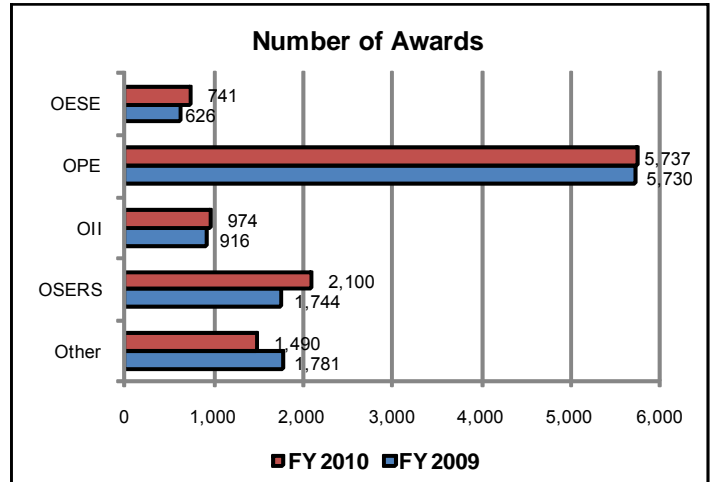
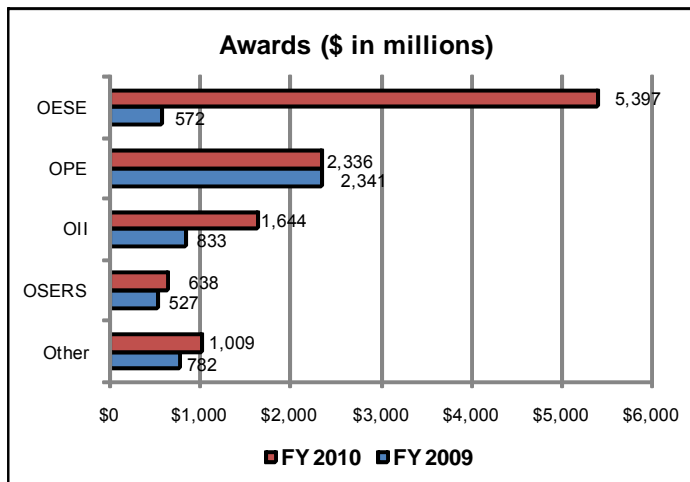
### P-12 Reform

- Early learning outreach to 18 states (including DC) and 87 speaking engagements
- 36 states (including DC) have adopted the Common Core State Standards
- 41 states and the District of Columbia are creating comprehensive, statewide longitudinal data systems

### Communications

- Responded to 62,015 calls
- Regional staff spoke at more than 150 different events (over 36,400 stakeholders)
- 263,333 Information Resource Center contacts received

## Discretionary Grants



**OESE** = Office of Elementary and Secondary Education.

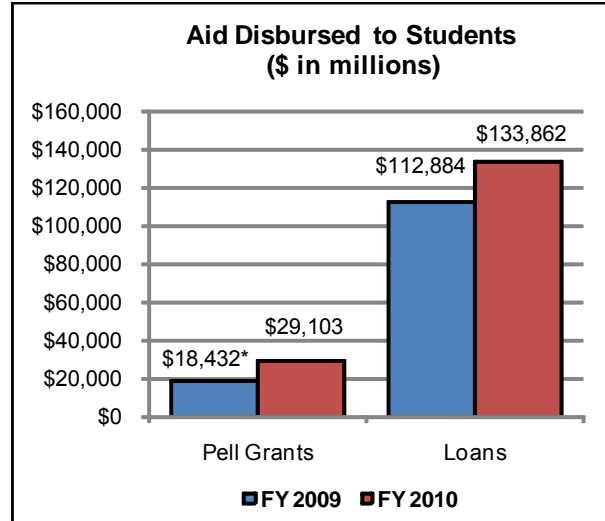
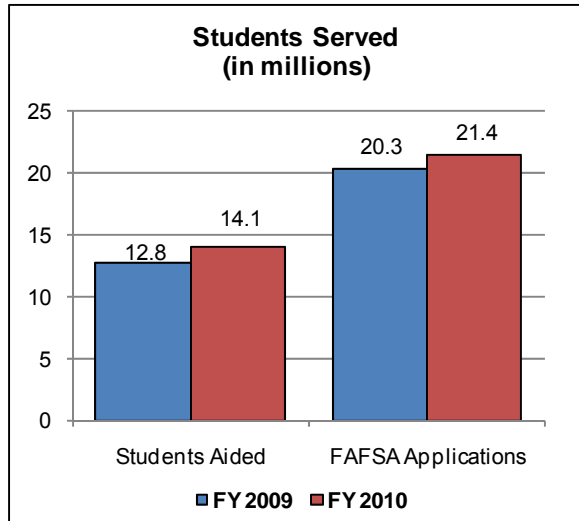
**OPE** = Office of Postsecondary Education.

**OII** = Office of Innovation and Improvement.

**OSERS** = Office of Special Education and Rehabilitative Services.

**Other** = Institute of Education Sciences (IES), Office of English Language Acquisition (OELA), Office of Safe and Drug-Free Schools (OSDFS), and Office of Vocational and Adult Education (OVAE).

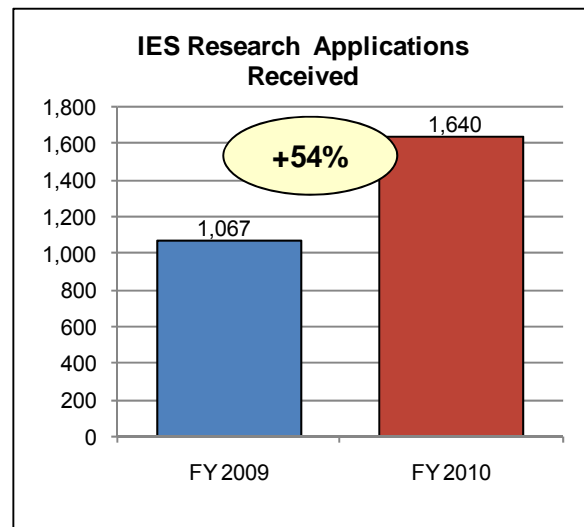
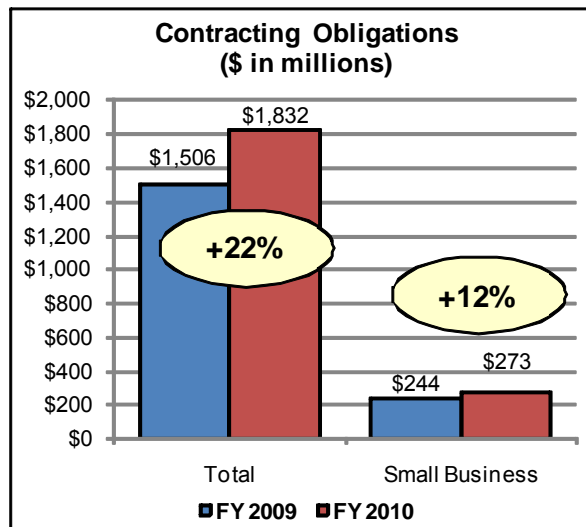
### Federal Student Aid (FSA)



\* Reflects reported FY 2009 estimate of Pell disbursements; in an FY 2010 update, these disbursements are now estimated at \$18,282.

### FY 2010 Hiring Plan

Principal Office	Workforce Planned	Recruitments Submitted	# of Recruitments Pending	Hires on Board	% Hires on Board vs. Workforce Planned	Attrition Rate FY10
All POCs (Excluding FSA)	566	469	93	342	60%	5.68%
FSA	507	489	18	304	60%	5.80%
Grand Total - End of FY10	1073	958	111	646	60%	5.68%





## Performance Highlights

### National Measures of Success in Education

President Obama, in his first address to Congress, challenged America to meet an ambitious goal for education: by 2020, we will once again have the highest proportion of college graduates in the world. In order to achieve that goal, we must ensure that all children in America receive a world-class education to prepare them to succeed in college and careers. Reaching the President's goal will require comprehensive education reforms beginning early in a child's life and supporting that child through postsecondary education, ensuring each child becomes a lifelong learner who can adapt to changes in the technology-driven workforce of the global economy.

Unfortunately, progress in improving student achievement in reading appears to be stalled. In 2009, for reading, gains in overall average scores seen in earlier years did not continue at grade 4 but did continue at grade 8. The results of the nation's report card, the National Assessment of Educational Progress (NAEP), indicate that while grade 4 performance was higher in 2009 than in 1998, it was not higher than in 2007. Grade 8 performance was the same in 2009 as in 1998.

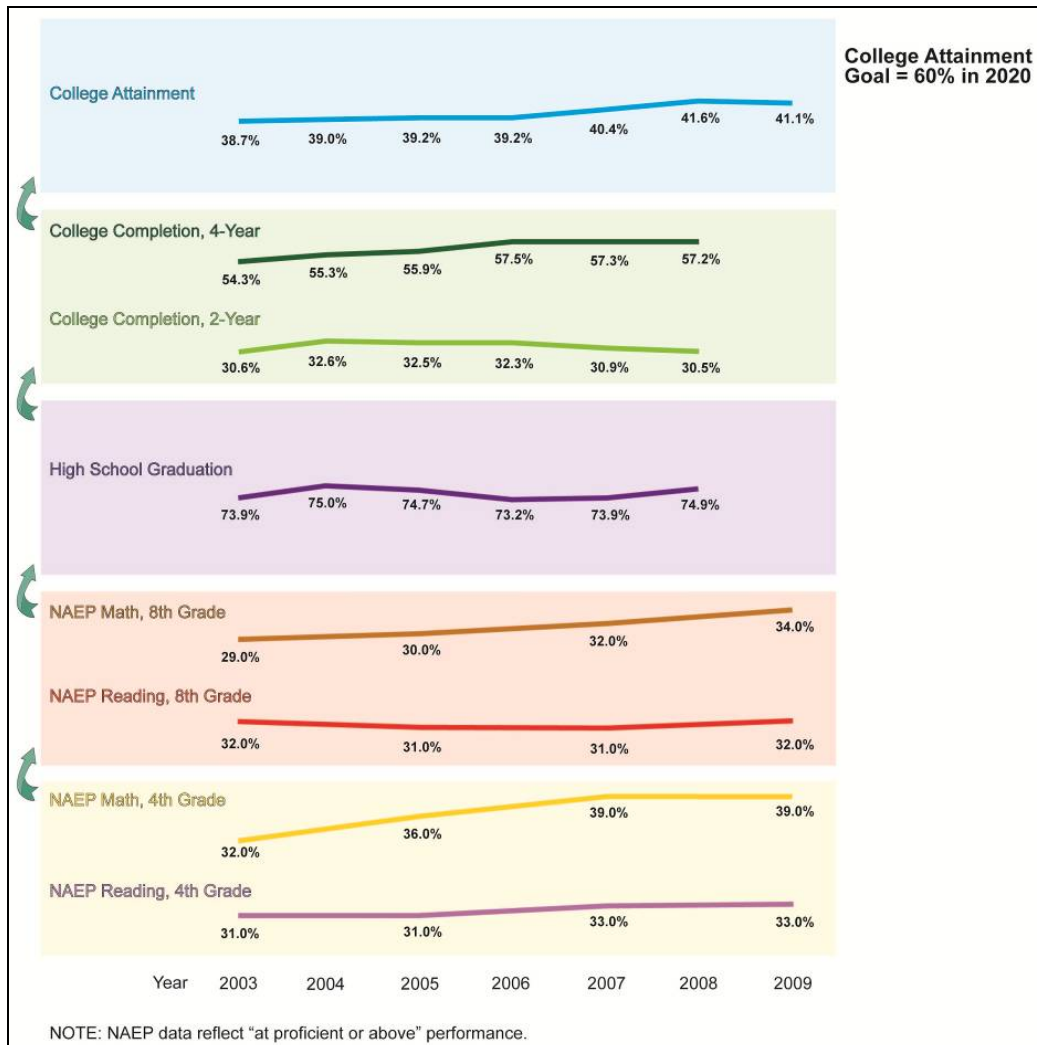
For mathematics, gains in overall average scores also did not continue at grade 4 but did continue at grade 8. While still higher than the scores in the assessment years from 1990 to 2005, the overall average score for fourth-graders in 2009 was unchanged from the score in 2007. The upward trend seen in earlier assessments for eighth-graders continued with a 2-point increase from 2007 to 2009.

We must ensure that students graduate from high school and are ready to succeed in college and careers. Today, our high schools do not adequately prepare students for success in college. As shown in the graphic on the next page, while improving somewhat in 2004, the averaged freshman high school graduation rate has declined moderately in more recent years and continues to remain only in the mid-70 percent range for those students who graduate 4 years after starting the 9th grade.

College completion rates remain unacceptably low. In 2008, for those students who completed a certificate or bachelor's degree at a 4-year institution, only 57.2 percent had graduated within 6 years, up only about 3 percentage points from 2003. For those students who completed their program at a 2-year institution, only 30.5 percent had finished within 3 years in 2008, representing a small decline from 2003, and a more significant decline after an initial increase in the years in between.

In 2009, the percentage of adults 25 to 34 who held an associate degree or higher was only 41.1 percent, a modest increase from 38.7 percent in 2003.

## College Attainment, College Completion, High School Graduation, and NAEP Math and Reading Rates, FY 2003–FY 2009



**Sources:**

**College Attainment:** U.S. Census Bureau, Current Population Survey (<http://www.census.gov/hhes/socdemo/education/data/cps/index.html>).

**College Completion:** U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS) Graduation Rate Survey. (<http://nces.ed.gov/ipeds/>). 2003 Data: "Enrollment in Postsecondary Institutions, Fall 2003; Graduation Rates, 1997 and 2000 Cohorts; and Financial Statistics, Fiscal Year 2003," Table 7 (<http://nces.ed.gov/pubs2005/2005177.pdf>) and "Enrollment in Postsecondary Institutions, Fall 2003; Graduation Rates, 1997 and 2000 Cohorts; and Financial Statistics, Fiscal Year 2003," Table 8 (<http://nces.ed.gov/pubs2005/2005177.pdf>). 2004 Data: "Enrollment in Postsecondary Institutions, Fall 2004; Graduation Rates, 1998 and 2001 Cohorts; and Financial Statistics, Fiscal Year 2004," Table 5 (<http://nces.ed.gov/pubs2006/2006155.pdf>). 2005 Data: "Enrollment in Postsecondary Institutions, Fall 2005; Graduation Rates, 1999 and 2002 Cohorts; and Financial Statistics, Fiscal Year 2005," Table 5 (<http://nces.ed.gov/pubs2007/2007154.pdf>). 2006 Data: "Enrollment in Postsecondary Institutions, Fall 2006; Graduation Rates, 2000 and 2003 Cohorts; and Financial Statistics, Fiscal Year 2006," Table 5 (<http://nces.ed.gov/pubs2008/2008173.pdf>). 2007 Data: "Enrollment in Postsecondary Institutions, Fall 2007; Graduation Rates, 2001 and 2004 Cohorts; and Financial Statistics, Fiscal Year 2007," Table 5 (<http://nces.ed.gov/pubs2009/2009155.pdf>). 2008 Data: "Enrollment in Postsecondary Institutions, Fall 2008; Graduation Rates, 2002 and 2005 Cohorts; and Financial Statistics, Fiscal Year 2008," Table 5 (<http://nces.ed.gov/pubs2010/2010152rev.pdf>).

**High School Graduation:** U.S. Department of Education, National Center for Education Statistics, Common Core of Data (<http://nces.ed.gov/ccd/pdf/Insdr07gen1a.pdf>, <http://nces.ed.gov/ccd/pdf/Insdr06gen1a.pdf>, <http://nces.ed.gov/ccd/pdf/sdr051bqen.pdf>, [http://nces.ed.gov/pubs2009/dropout07/tables/table\\_13.asp](http://nces.ed.gov/pubs2009/dropout07/tables/table_13.asp), and <http://nces.ed.gov/pubs2006/2006606rev.pdf>). Data are collected annually. Averaged freshman graduation rate is a Common Core of Data measure that provides an estimate of the percentage of high school students who graduate on time by dividing the number of graduates with regular diplomas by the size of the incoming class four years earlier.

**NAEP Math and Reading:** National Assessment of Educational Progress ([http://nationsreportcard.gov/reading\\_2009/nat\\_g4.asp?tab\\_id=tab2&subtab\\_id=Tab\\_1#tabsContainer](http://nationsreportcard.gov/reading_2009/nat_g4.asp?tab_id=tab2&subtab_id=Tab_1#tabsContainer) and [http://nationsreportcard.gov/reading\\_2009/nat\\_g8.asp?tab\\_id=tab2&subtab\\_id=Tab\\_1#tabsContainer](http://nationsreportcard.gov/reading_2009/nat_g8.asp?tab_id=tab2&subtab_id=Tab_1#tabsContainer)).

## The Department's Priority Performance Goals

As part of the fiscal year (FY) 2011 budget development process, senior management of all cabinet-level federal agencies identified a small number of near-term, ambitious, outcome-focused priority performance goals that have high direct value to the public.

Each of the Department's priority goals focuses on a clear, measurable result that it is working to achieve in a 12–24 month time period. The Department's senior management has designated a goal leader and a goal lieutenant to lead progress toward each goal's stated result.

Each goal leader has developed an action plan that charts the path to achieving the goal, along with defined targets for each goal measure, quarterly milestones, and contextual measures to provide insight into causal factors affecting the goal. Quarterly data-driven reviews will enable goal leaders to analyze performance data to guide agency action. Agencies will provide quarterly progress updates to the Office of Management and Budget (OMB).

The priority goals will contribute to accomplishment of long-term strategic goals and the agency's mission. The goals are included in the agency's strategic planning process.

The Department's priority goals are:

- **College- and Career-Ready Standards: World Class College- and Career-Ready Standards** in which all states collaborate to develop, and adopt internationally benchmarked college- and career-ready standards.
- **Evidence-Based Policy: Measuring Effectiveness and Investing in What Works** to implement a comprehensive approach in using evidence to inform the Department's policies and major initiatives to further decision-making and program improvement.
- **Effective Teaching: World-Class Teaching and Learning** to increase the number of highly effective teachers of low income and minority students by 200,000 to teach in hard-to-staff subjects and ensure that all states have in place comprehensive teacher evaluation systems.
- **Struggling Schools Reform: to identify 500 of the persistently lowest achieving schools as national models** that are initiating high-quality intensive reforms to improve student achievement.
- **Data-Driven Decisions: Improved Achievement and Decision-Making through Statewide Data Systems** to have all states implement comprehensive statewide longitudinal data systems linking student achievement data, teacher performance data, higher education data, and workforce data.
- **Simplified Student Aid: Efficient and Effective Delivery of Student Loans** to enable all participating higher education institutions and loan servicers ready to deliver federal student loans efficiently and effectively through simplified applications.

For more information on our priority goals, please go to <http://www.whitehouse.gov/omb/budget/fy2011/assets/management.pdf>.



## Challenges Linking Program Performance to Funding

Linking performance results, expenditures, and budget for Department programs is complicated. Most of the Department's funding is disbursed through grants and loans. 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 2010 funds but to a combination of funds from across several fiscal years, as well as state and local investments, and many external factors, including economic conditions. Furthermore, the results of some education programs may not be apparent for several years after the funds are expended. In addition, results may be due to the effects of multiple programs.

## Summary of Performance Results

During FY 2010, the Department drafted a new strategic plan and has subjected it to an extensive review process, which was ongoing at the end of FY 2010. As of September 30, the Department's performance continued to be measured by the *2007–2012 Strategic Plan*.

There are 81 performance measures in the *2007-2012 Strategic Plan* measuring student achievement, teacher quality, school environment, preparation for college, and college access and attainment, as well as selected measures of the Department's operations.

Because most of our grantees are unable to report in the same fiscal year in which they were funded and because compilation adds time as well, most FY 2010 data will not be available until later during FY 2011. In FY 2010, the Department met or exceeded targets for 2 measures (2.5 percent), did not meet but showed improvement for 0 (0 percent) measures, did not meet 7 (8.6 percent), and is awaiting data for 59 measures (72.8 percent). The remaining 13 measures (16.1 percent) have no targets or data for FY 2010.

In FY 2009, the year with the most available data, the Department met or exceeded targets for 25 measures (31 percent), did not meet but showed improvement for 26 (32.1 percent), did not meet 14 (17.2 percent), and is awaiting data for 10 measures (12.3 percent). The remaining 6 measures (7.4 percent) have no targets or data for FY 2009.

As reported in the [FY 2009 Annual Performance Report](#), in FY 2008, the Department met or exceeded targets for 31 measures (38.3 percent), did not meet but showed improvement for 26 measures (32.1 percent), did not meet 11 measures (13.6 percent), and was awaiting data for 7 measures (8.6 percent). The remaining 6 measures (7.4 percent) had no targets or data for FY 2008.

## Accomplishments for FY 2010

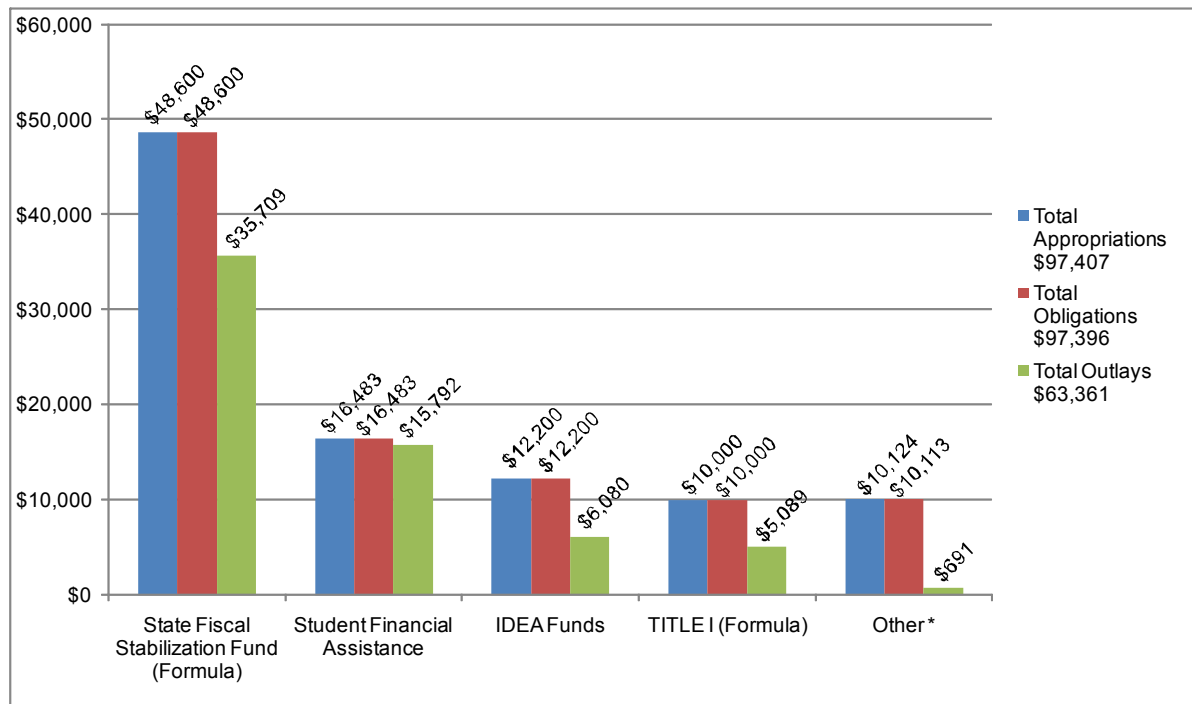
### *The American Recovery and Reinvestment Act of 2009*

#### Overview

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

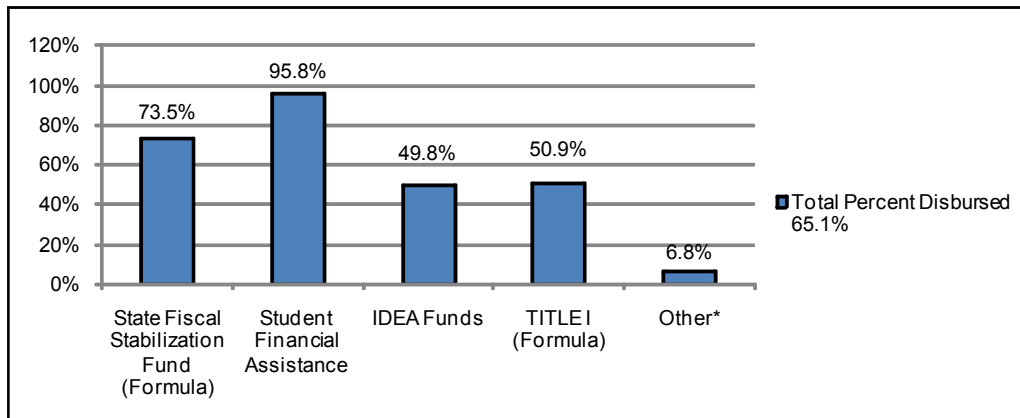
To learn more about the programs the Department administers under the *Recovery Act*, visit <http://www.ed.gov/recovery>.

**Recovery Act Funding Summary  
As of 09/30/10  
(Dollars in Millions)**



\* The Other category includes funds for Impact Aid, Rehabilitative Services and Disability Research, School Improvement Programs, Higher Education, Investing in Innovation, Race to the Top, Institute of Education Sciences, Innovation and Improvement, Student Aid Administration, School Improvement Grants, and Office of Inspector General.

**Percentage of Recovery Act Funding Disbursed As of 09/30/10  
(Cumulative Outlays as a Percent of Cumulative Obligations)**

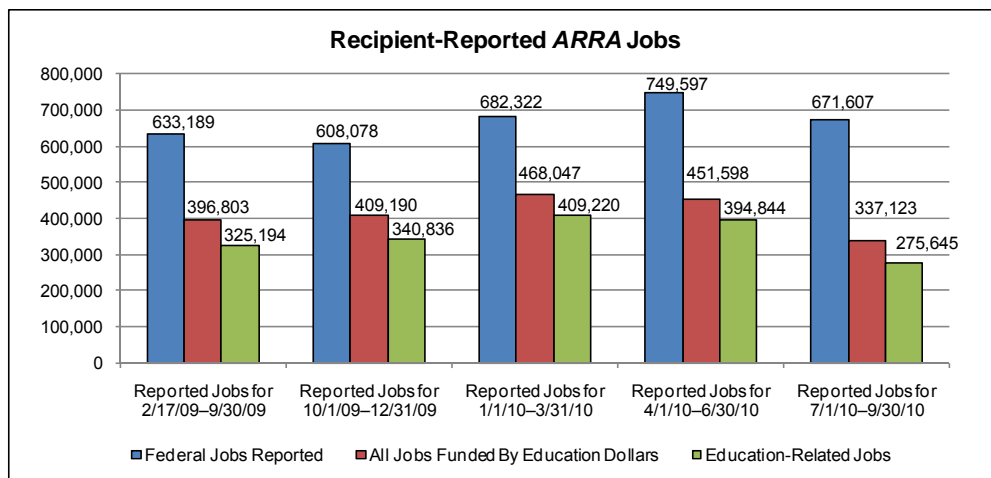


\* The Other category includes funds for Impact Aid, Rehabilitative Services and Disability Research, School Improvement Programs, Higher Education, Investing in Innovation, Race to the Top, Institute of Education Sciences, Innovation and Improvement, Student Aid Administration, School Improvement Grants, and Office of Inspector General.

**Recovery Act Recipient Reporting**

Through a nationwide data collection process the *Recovery Act* requires recipients to submit reports on the use of the funding, and estimates on the number of jobs created and retained. The Department is firmly committed to the success of the reporting process and has devoted considerable resources to this effort.

For the quarter ending September 30, 2010, grant recipients again reported that over 275,000 education jobs, such as teachers, principals, librarians, and counselors, were saved or created with *Recovery Act* funding. In total, the Department funding supported over 300,000 positions, including corrections officers, public health personnel, and construction workers.

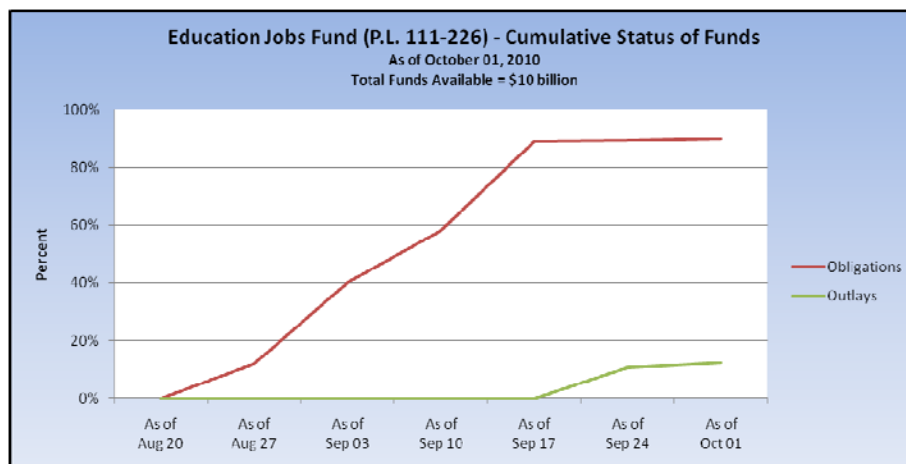


For more information on governmentwide recipient reporting, visit:  
<http://www.recovery.gov/Transparency/RecipientReportedData/Pages/RecipientLanding.aspx>.



## Education Jobs Fund

The Education Jobs Fund (Ed Jobs) program is a new federal program that provides \$10 billion in assistance to states to save or create education jobs for the 2010–11 school year. Jobs funded under this program include those that provide educational and related services for early childhood, elementary, and secondary education.



## Ongoing Initiatives in Federal Student Aid

### *The Student Aid and Fiscal Responsibility Act*

On March 30, 2010, the President signed the Health Care and Education Reconciliation Act, which included the Student Aid and Fiscal Responsibility Act (SAFRA Act), requiring that all new Federal Stafford, PLUS, and Consolidation loans be made through the William D. Ford Federal Direct Loan Program beginning July 1, 2010.

FSA successfully supported the transition of approximately 2,500 schools to the Direct Loan Program, almost doubling the number of participating schools; provided Direct Loan Program training to almost 5,200 financial aid professionals at the annual Fall Conference; processed over 10 million promissory notes, a 300 percent increase over the previous year; and supported the origination of over 19 million Direct Loans, a 176 percent increase in originations compared to the 2009–10 award year. As of September 30, 2010, 98 percent of domestic schools that had participated in the federal student loan programs in the previous two years had successfully originated a Direct Loan, and no school wishing to participate has been unable to do so.

For more information on the Federal Student Aid office, go to:  
<http://www2.ed.gov/about/offices/list/fsa/index.html?src=oc>

### **Free Application for Federal Student Aid Simplification**

In FY 2009, the President called for all Americans to seek at least one year of postsecondary education.<sup>1</sup> FSA's response to this charge was to improve access to a

<sup>1</sup> <http://www.whitehouse.gov/issues/education/>

college education by making the Free Application for Federal Student Aid (FAFSA) easier to complete. FSA continued these efforts during FY 2010. Specifically, FSA implemented an improved 2010–11 FAFSA that utilizes enhanced skip logic and the expanded use of data provided early in the application. Applicants are now presented with fewer questions and a more customized application process. This improved version resulted in a simpler experience for applicants. FSA began to coordinate with the Internal Revenue Service (IRS) to allow some applicants to import their tax form data directly into the FAFSA. Of the almost 900,000 applicants and their parents eligible to transfer data from the IRS, over 30 percent used this new functionality.

### ***Ensuring Continued Access to Student Loans Act of 2008***

Beginning in August 2008, the Department implemented a number of programs authorized under the *ECASLA* to ensure credit market disruptions did not deny eligible students and parents access to federal student loans for the 2008–09 academic year. The *ECASLA* authority, which originally expired on September 30, 2009, was subsequently extended through September 30, 2010, to administer the Loan Participation Purchase Program and Loan Purchase Commitment Program. The Asset-Backed Commercial Paper (ABCP) Conduit Program purchase option remains active until January 2014.

As of September 30, 2010, the Department has supplied approximately \$107 billion to the lending market, students, and families through the various *ECASLA* programs. Programs authorized under *ECASLA* are summarized below:

#### **Loan Participation Purchase Program**

Under this program, lenders accessed capital to make new loans by selling the Department participation interests in eligible FFEL loans. Participation interests on loans made for the 2008–09 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 2009–10, the deadline for redemption is October 15, 2010. For the 2008–09 loan period, the Department purchased over \$33 billion in participation interests. As part of the process of redeeming the participation interests, \$31 billion of those underlying loans were later sold to the Department. As of September 30, 2010, the Department had purchased over \$38 billion in participation interests for the 2009–10 loan period. When the 2009–10 loan period ended October 15, 2010, participating lenders had sold over \$37 billion of those underlying loans to the Department as part of the process of redeeming the participation interests.

#### **Loan Purchase Commitment Program**

Under this program, lenders accessed capital to make new loans by directly selling the Department eligible FFEL loans. For the 2008–09 loan period, a total of over \$48 billion in loans was sold to the Department, \$31 billion from the Loan Participation Purchase Program and \$17 billion directly. As of September 30, 2010, for the 2009–10 loan period, over \$33 billion in loans had been sold to the Department, with nearly \$12 billion from the Loan Participation Purchase Program and \$21 billion directly. When the 2009–10 program ended October 15, 2010, participating lenders sold approximately \$60 billion of FFEL loans to the Department, including approximately \$37 billion from the Loan Participation Purchase

Program, and approximately \$23 billion directly. It is estimated that the 2009–10 volume accounts for approximately 95 percent of the total FFEL Program loans made for the period.

### **ABCP Conduit Program**

The ABCP Conduit Program was developed to provide additional liquidity to support new lending. Under this program, which began operations in 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 no other financing is available to retire this paper as it matures, the Department commits to provide the needed funds by purchasing the underlying student loans. Lenders were able to place loans into the conduit until June 30, 2010. By that time, a total of 25 lenders had participated, and backed by their loans, the conduit issued a total of \$41 billion in commercial paper. Under the Put Agreement with the conduit, the Department purchases loans subject to the occurrence of certain events. As of September 30, 2010, the Department had purchased about \$0.5 billion in delinquent loans from the conduit. The conduit has not yet put any other loans to the Department. The option to sell loans to the Department ends January 2014. The ABCP Conduit Program is the single remaining active *ECASLA* program.

## **Innovation**

### **Race to the Top**

During FY 2010, the Department awarded 12 Race to the Top grants, expected to directly affect 13.6 million students and 980,000 teachers in 25,000 schools in Delaware, Florida, Georgia, Hawaii, Maryland, Massachusetts, New York, North Carolina, Ohio, Rhode Island, Tennessee, and the District of Columbia. These grants reward states that are leading the way in comprehensive, coherent, statewide education reform in key areas:

- adopting standards and assessments that prepare students to succeed in college and the workplace;
- building data systems that measure student growth and success, and inform teachers and principals how to improve instruction; and
- recruiting, developing, rewarding, and retaining effective teachers and principals, especially where they are needed most.

<http://www2.ed.gov/programs/racetothetop/index.html>

To provide ongoing feedback to teachers during the course of the school year, measure annual student growth, and move beyond narrowly-focused bubble tests, the Department awarded two groups of states grants to develop a new generation of tests. The tests will assess students' knowledge of mathematics and English language arts from third grade through high school.

<http://www2.ed.gov/programs/racetothetop-assessment/index.html>

### **Investing in Innovation Fund**

The Department made grant awards to 49 applicants from a pool of nearly 1,700. The Investing in Innovation Fund, established under the *Recovery Act*, provides funding to support local educational agencies (LEAs) and nonprofit organizations in partnership with

one or more LEAs or a consortium of schools. The purpose of this program is to provide competitive grants to applicants with a record of improving student achievement and attainment in order to expand the implementation of, and investment in, innovative practices that are demonstrated to have an impact on improving student achievement or student growth, closing achievement gaps, decreasing dropout rates, increasing high school graduation rates, or increasing college enrollment and completion rates.

<http://www2.ed.gov/programs/innovation/index.html>.

### **Teacher Incentive Fund**

In FY 2010, the Department awarded in Teacher Incentive Fund (TIF) grants to states, school districts, nonprofit organizations, and institutions of higher education to develop and implement performance-based teacher and principal compensation systems in high-need schools. The winning applicants represent rural and urban school districts, as well as nonprofit groups and state education organizations from 27 states.

The TIF program seeks to strengthen the education profession by rewarding excellence, attracting teachers and principals to high-need schools, and providing all teachers and principals with the feedback and support they need to succeed.

<http://www2.ed.gov/programs/teacherincentive/index.html>.

### **State Fiscal Stabilization Fund**

The State Fiscal Stabilization Fund (SFSF) provides resources for states to advance student-focused education reforms from early learning through postsecondary education, including: college- and career- ready standards and high-quality, valid, and reliable assessments for all students; development and use of pre-K through post-secondary and career data systems; increasing teacher effectiveness and ensuring an equitable distribution of qualified teachers; and turning around the lowest-performing schools.

State Fiscal Stabilization Fund Phase II awards continued through FY 2010, with the states and the District of Columbia receiving a portion of stabilization funds totaling \$11.5 billion.

<http://www2.ed.gov/policy/gen/leg/recovery/factsheet/stabilization-fund.html>.

### **High School Graduation Initiative**

The U.S. Department of Education's High School Graduation Initiative supports activities such as early warning systems designed to identify students at risk of dropping out, rigorous academic programs and support services to engage students and implement dropout prevention, credit recovery programs, and targeted re-engagement programs that identify out-of-school youth and encourage them to reenter school. The Initiative targets high schools with high dropout rates and middle schools that feed into schools with high dropout rates. In FY 2010, 29 states and districts were awarded \$46.6 million under the High School Graduation Initiative.

<http://www2.ed.gov/programs/dropout/index.html>.



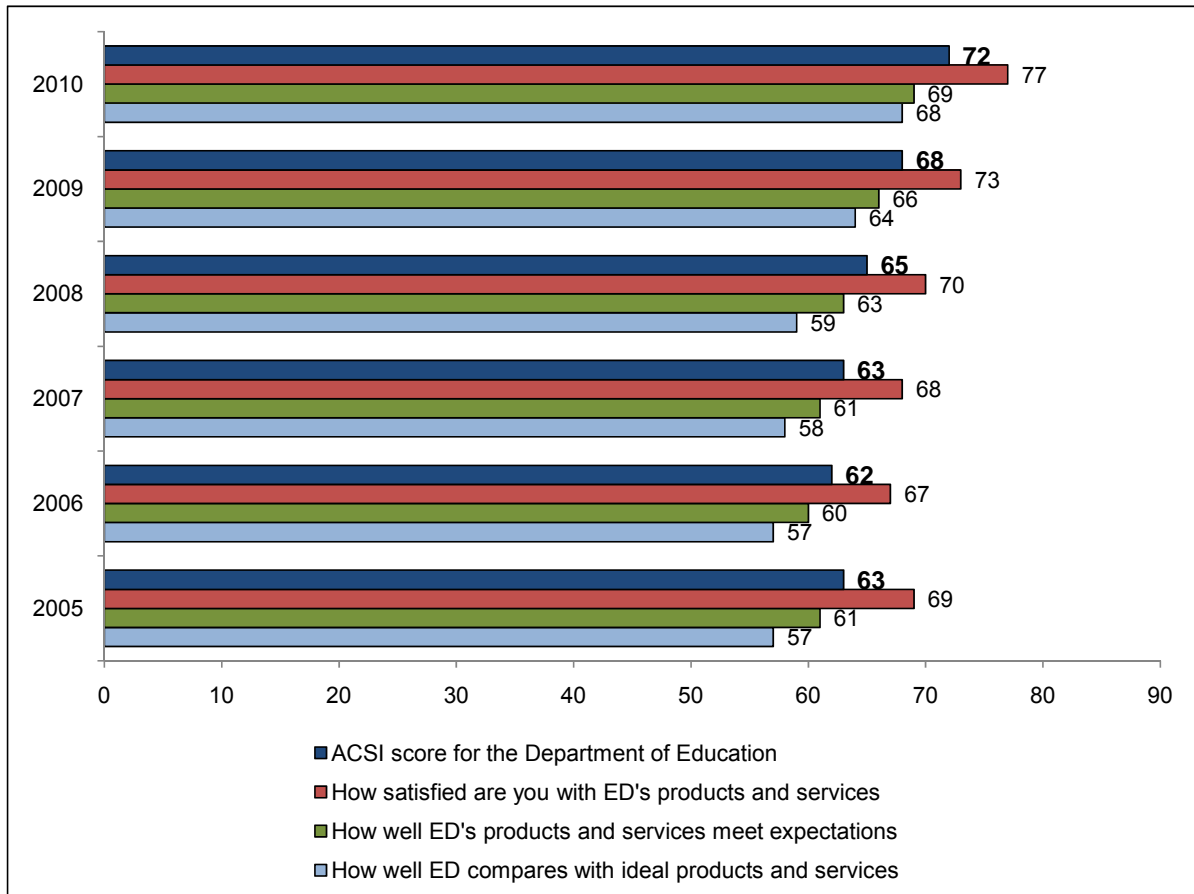
## Customer Satisfaction With the Department of Education

The American Customer Satisfaction Index (ACSI) is the national indicator of customer evaluations of the quality of goods and services, and is the only uniform benchmarking measure of customer satisfaction across government agencies and private industry. The customer satisfaction index is a weighted average of three questions that measure overall satisfaction, satisfaction compared to expectations, and satisfaction compared to an “ideal” organization.

In FY 2010, the Department transitioned to a survey that focused exclusively on metrics of satisfaction among its grantees in order to evaluate program performance and to align with metrics of customer satisfaction in its Organizational Assessment. A total of 15 Department programs participated in the FY 2010 Grantee Satisfaction Survey. This year, the Department received its biggest gain in satisfaction with a score of 72, placing it 3 points above the current federal government average of 69. Grantee satisfaction with the Department’s services continues its upward trend with a 2-point improvement in 2008, a 3-point improvement in 2009, and a 4-point improvement in 2010 over the previous year. For complete information, see the full report at

<http://www2.ed.gov/about/reports/annual/gss/index.html>.

**Customer Satisfaction Index  
2005–2010**



## Forward Looking Initiatives

### Implementation of Changes in Federal Student Aid

The *SAFRA Act*, which was enacted as part of the *Health Care and Education Reconciliation Act of 2010*, ended the origination of new FFEL loans after June 30, 2010. This means that students previously served by the FFEL Program now receive loans under the Direct Loan Program. The Department's challenge has been to expand its capacity to originate and service the increased Direct Loan volume; train and monitor schools new to the program; and continue oversight of FFEL lenders and guaranty agencies that service the outstanding portfolios. The Department has taken actions to ensure a smooth transition, including providing outreach and technical support to schools, enhancing the key information systems, contracting with additional loan servicers, hiring additional staff, and developing contingency plans.

Over the longer term, there are opportunities for FSA to improve its rapid-response capabilities. First, FSA will further develop its ability to anticipate changes by having an ear to the ground in the marketplace, at schools, and in policy discussions. Second, FSA will improve its resourcing model to ensure that it has highly capable personnel and vendors who are available to respond to unforeseen events.

The growth in the government held Direct Lending portfolio will require FSA to procure broader support from private and nonprofit entities to service outstanding Direct Loans. In addition to Direct Loan origination and servicing, FSA will need help reaching out to customers and promoting financial literacy.

The Department has taken contractual actions to expand the Direct Loan Program's capacity to both originate and service the increased loan volume, including contract monitoring practices and appropriate system testing to ensure that systems perform adequately under increased processing requirements.

### Data Quality and Reporting

The Department, its grantees, and subrecipients must have controls in place to ensure that accurate, reliable data are reported. Data are used by the Department to make funding decisions, evaluate program performance, and support management decisions. Reported data provides transparency and allows the public to see how funds are being spent.

State educational agencies (SEAs) collect data annually from local educational agencies (LEAs). The Department has identified a number of weaknesses in the quality of its reported data and is recommending improvements at the SEA and LEA levels to establish adequate controls over data accuracy and reliability and to develop consistent data definitions and terminology. The Department continues to provide guidance and clarify requirements through the development of consistent definitions for data terms to enhance reporting accuracy. The Department recommends that the *General Education Provisions Act*, which applies to data reporting requirements for grant applicants, be amended to require management certifications of the validity and reliability of submitted data, along with assurances that the systems maintaining the data have adequate controls in place to ensure accuracy and comparability of data that are reported to the public, Congress, and the American people.

## Oversight and Monitoring

The Department is committed to effective oversight and monitoring of programs and operations to ensure that funds are used for the purposes intended, that programs are achieving goals and objectives, and that the Department is obtaining the products and level of services for which it has contracted. The complexity of factors for this initiative include the numbers of different entities and programs requiring monitoring and oversight, the amount of funding that flows through the Department, and the impact that ineffective monitoring could have on the students and taxpayers.

Four areas are highlighted for action:

For FSA program participants, the Department will improve oversight and monitoring, risk assessment, and control activities including audits of loan eligibility, program reviews at guaranty agencies, and identification of improper payments for recovery.

For distance education, the Department has initiated program reviews at high-risk schools based on risk indicators and schools identified as participating in federal aid programs that may not be complying with program requirements, including schools offering distance education, which have had recent, significant increases in enrollment numbers and funding.

For grantees, the Department is developing financial monitoring training for program staff, exploring the establishment of a dedicated group of financial monitoring experts, evaluating alternatives for improving information sharing about monitoring, and developing a technical assistance plan and training curricula to provide enhanced guidance and training to state and local officials.

For contractors, the Department is implementing a procedure to monitor all new and existing contracts and to develop a training program reinforcing the Department's contracting processes, applicable laws, and regulations. Program offices were directed to implement immediate steps and take personal responsibility for ensuring that contracts are awarded properly and effectively monitored.

## Information Technology Security

The Department will continue to address security and control weaknesses disclosed in audit reports or identified in internal assessments. The Department is working internally and partnering with other government agencies to address identified security challenges.

The Department has:

- revised its Incident Handling Procedures Handbook and its online security awareness training to address actions employees should take regarding a variety of incident scenarios;
- developed and published a Plan of Action and Milestones Guide to set forth the process for handling system vulnerabilities; and
- adopted Federal Student Aid's Operational Vulnerability Management System as the departmental standard for collection of information on all systems in the Department's

FISMA reportable inventory, including a central repository for all reported incidents, as well as tracking and auditing functions.

The Department has entered into an interagency agreement for certification and accreditation support services with the Federal Aviation Administration's Enterprise Services Center, which has begun re-certifying existing systems and certifying new systems in the Department's inventory in accordance with federal standards, including Privacy Impact Assessments for any system that stores, processes, or transmits personally identifiable information.

The Department has participated in Einstein, an intrusion detection system developed by the Department of Homeland Security that monitors government network gateways, as well as in a shared services agreement with the Federal Aviation Administration's Cyber Security Management Center; and is using National Institute Standards and Technology guidelines and recommendations for server baseline security configurations.

Implementation of these actions going forward will support governmentwide security and enhance awareness within the Department.

### **Data Privacy Safeguards**

The Department will continue to build a robust privacy safeguards program with a culture of responsibility, accountability, and transparency in protecting personal data of the millions of individuals, including students and their parents. The Department is working internally and partnering with other government agencies to adopt governmentwide best practices and to implement policies and procedures that strengthen the public's trust.

The Department has:

- prepared revisions to its privacy data external notification policies and procedures that will simplify and expedite its analysis of potential risk of harm to affected individuals, enabling more efficient and accurate notification, as appropriate, to affected individuals, including the media and Members of Congress.
- launched two major initiatives to heighten the visibility of privacy protection requirements and to strengthen employee and contractor awareness and knowledge: 1) an aggressive communications and outreach program; and 2) an expanded training program of mandatory and position-specific training.

## Management Challenges

The Office of Inspector General (OIG) works to promote efficiency, effectiveness, and integrity in the programs and operations of the Department. Through its audits, inspections, investigations, and other reviews, OIG continues 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 to identify and summarize the most significant management challenges facing the Department each year.

Last year, OIG reported three management challenges: the *Recovery Act*, student financial assistance (SFA) programs, with a focus on the *ECASLA*; and information security and management. All three have been updated as challenges for FY 2011, and Data Quality and Reporting, previously a subarea, is presented as a separate challenge. The FY 2011 management challenges are:

- Implementation of New Programs/Statutory Changes, including the *Recovery Act* and changes to the SFA loan programs;
- Oversight and Monitoring, including SFA program participants, distance education, grantees, and contractors;
- Data Quality and Reporting, including program data and *Recovery Act* reporting requirements; and
- Information Technology Security.

The Executive Summary of Management Challenges for FY 2011 is included in the Other Accompanying Information section of this report and the full report is published by the Department's Office of Inspector General. To view the full report, go to: <http://www2.ed.gov/about/offices/list/oig/managementchallenges.html>.

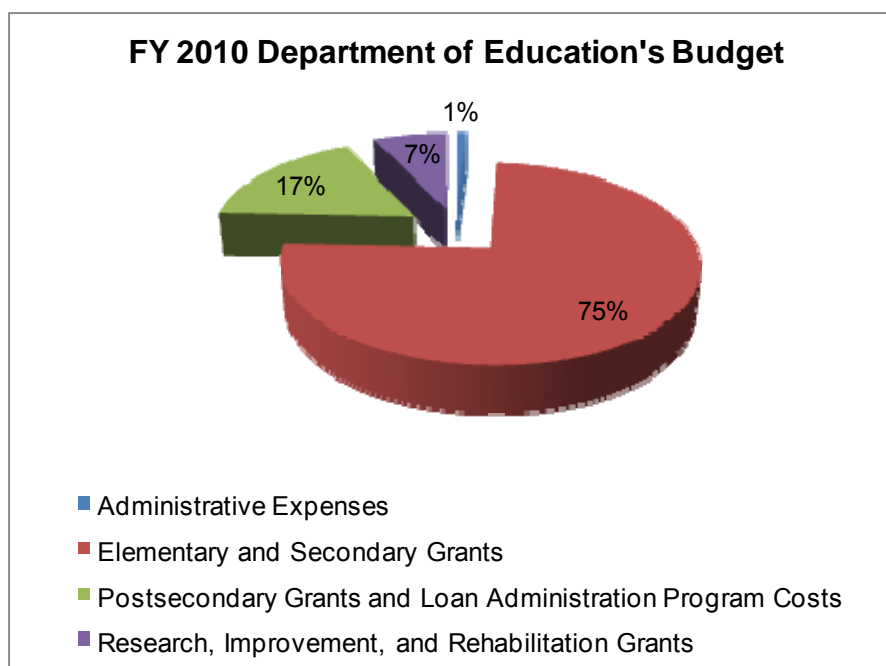


## Financial Highlights

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 ninth consecutive year, the Department 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 OMB's Circular No. A-123, *Management's Responsibility for Internal Control*, the Department continues to test and evaluate findings and risk determinations uncovered in management's internal control assessment.

### Sources of Funds

The Department managed a budget in excess of \$63 billion during FY 2010, of which 75 percent supported elementary and secondary education grant programs. Postsecondary education grants and administration of student financial assistance accounted for 17 percent, including loan program costs that helped almost 14 million students and their parents to better afford higher education during FY 2010. 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 guaranteed loans and William D. Ford Federal Direct Loan (Direct Loan) Program loans, which compose a large share of federal student financial assistance, are funded by commercial banks and borrowings from the Treasury, respectively. Effective July 1, 2010, no new student loans will be made under the FFEL Program. However, if the first disbursement of a FFEL loan was made by a FFEL lender on or before June 30, 2010, that lender is obligated to make subsequent disbursements after June 30, 2010. As of the end of September 2010, the total principal balance of outstanding guaranteed loans held by lenders was approximately \$390 billion. The government's estimated maximum exposure for defaulted FFEL guaranteed loans was approximately \$382 billion.

The Department's four largest grant programs are SFSF (a one-time appropriation under the *Recovery Act*), 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*.

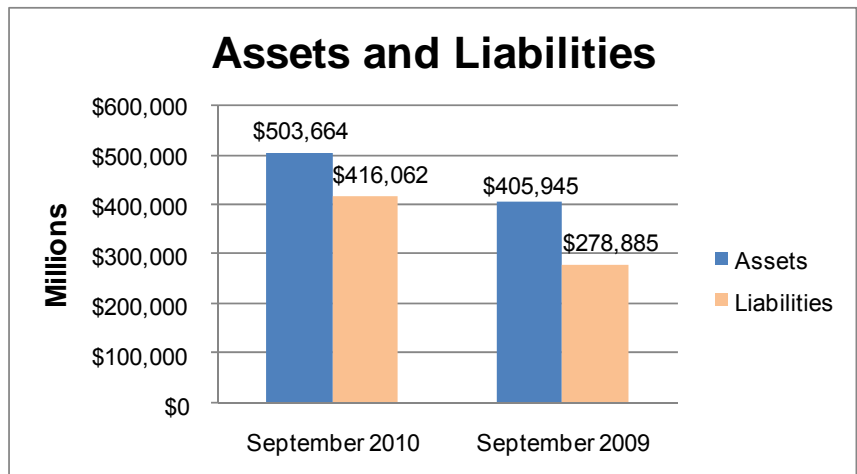
The *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)* authorized the Secretary to purchase or enter into forward commitments to purchase FFEL loans. The Department has implemented three activities under this temporary loan purchase authority. These activities are: (1) loan purchase commitments 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 refinance maturing commercial paper.

The Direct Loan Program, created by the *Student Loan Reform Act of 1993*, provides Federal loans directly 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, 2010, the value of the Department's Direct Loan portfolio was \$228.2 billion.

### Financial Position

The Department's financial statements are prepared in accordance with established federal accounting standards, as promulgated by the Federal Accounting Standards Advisory Board (FASAB), and are audited by the independent accounting firm of Ernst & Young, LLP. The audit is overseen by the OIG. Financial statements and footnotes for FY 2010 appear on pages 31–77. 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 31 reflects total assets of \$503.7 billion, a 24 percent increase over FY 2009. The vast majority of this



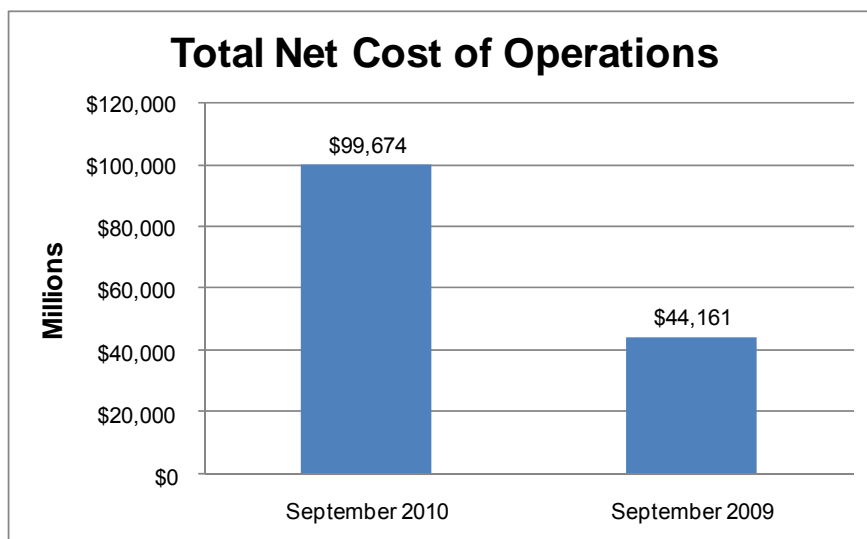
increase is due to Credit Program Receivables. Credit Program Receivables increased by \$133.7 billion, a 57 percent increase over FY 2009. This increase is largely due to Direct Loan disbursements, as well as activity related to loan purchase commitments and loan participation purchases under the FFEL program. Much of this loan portfolio is principal and

interest owed by students on Direct Loans. The remaining balance is related to defaulted guaranteed loans on which the Department paid reinsurance and which are now held by the Department and to loan purchase commitments and loan participation purchases under the FFEL Program as authorized by *ECASLA*. The net portfolio for Direct Loans increased \$75.4 billion due to Direct Loan disbursements net of borrower principal and interest collections. FFEL Program loans increased by \$57.9 billion during FY 2010, due primarily to loan volume and activity related to loan purchase commitments and loan participation purchases. The Fund Balance with Treasury decreased by \$35.8 billion, a 21 percent decrease from FY 2009. This decrease is largely due to *Recovery Act* disbursements during FY 2010.

Total Liabilities for the Department increased by \$137.2 billion, a 49 percent increase over FY 2009. The increase is the result of increased borrowing 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 by \$6 billion, a 30 percent decrease that is primarily due to FFEL defaulted claims payments and the subsidy re-estimate. These liabilities present the estimated costs, on a present-value basis, of the net long-term cash outflows due to loan defaults net of offsetting fees.

The Department's Net Position as of September 30, 2010, was \$87.6 billion, a \$39.5 billion decrease from the \$127.1 billion Net Position as of September 30, 2009. This decrease is largely due to *Recovery Act* disbursements during FY 2010.

**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 32, were \$99.7 billion, a 126 percent increase from September 30, 2009. This change largely reflects the \$44 billion *Recovery Act* and Education Jobs Fund



disbursements and the \$23.6 billion reduction in negative subsidy related costs. These costs include downward modifications, downward re-estimates, and negative subsidy transfers. For FY 2010 re-estimated subsidy cost, Direct Loan subsidy cost was increased by \$4.7 billion and FFEL Guaranteed subsidy cost was reduced by \$12.7 billion. For 2009 re-estimated subsidy cost, Direct Loan subsidy cost was decreased by \$5.2 billion and FFEL Guaranteed subsidy cost was reduced by \$21.7 billion. The \$6 billion increase in earned revenue is primarily the result of interest revenue associated with a loan portfolio that was larger than in FY 2009.

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.

<b>Net Cost Program</b>	<b>Reporting Organizations/Groups</b>	<b>Strategic Goal</b>
Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement	Office of Federal Student Aid Office of Postsecondary Education Office of Vocational and Adult Education	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	Office of Elementary and Secondary Education Office of English Language Acquisition Office of Safe and Drug-Free Schools Hurricane Relief	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	Institute of Education Sciences Office of Innovation and Improvement	1. Improve student achievement, with the focus on bringing all students to grade level in reading and mathematics by 2014
Special Education	Office of Special Education and Rehabilitative Services	Cuts across Strategic Goals 1, 2, and 3
<i>American Recovery and Reinvestment Act</i> and Education Jobs Fund	<i>American Recovery and Reinvestment Act</i> Education Jobs Fund	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.

**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 34 shows that the Department had \$362.5 billion in total budgetary resources for the 12 months ended September 30, 2010. These budgetary resources were composed of \$130.4 billion in appropriated budgetary resources and \$232.1 billion in non-budgetary credit reform resources that primarily consist of borrowing authority for the loan programs. Of the \$22.2 billion that remained unobligated for the period ended September 30, 2010, \$17.7 billion represents funding provided in advance for activities in future periods that were not available at year end. These funds will become available during the next, or future, fiscal years.

## Limitations of the 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 2010 and FY 2009, 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.



## Management's Assurances

### *Federal Managers' Financial Integrity Act*

As required under the *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*, the Department reviewed its internal control system. Internal controls are an integral component of an organization's management that provide reasonable assurance that the following objectives are being achieved:

- 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 internal controls are implemented in their areas of responsibility. Individual assurance statements from senior management serve as the primary basis for the Department's assurance that the controls are adequate. The assurance statement provided on page 25 is the result of our annual assessment and is based upon each senior officer's evaluation of controls.

Offices within the Department that identify material weaknesses 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 the Department's 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 only provide 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 non-compliance with *FFMIA*, as noted in the Compliance with Laws and Regulations Report located on pages 97–99 of this report. The Department continues to strengthen and improve its financial management systems.

*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 at 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 OMB 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, 2010, 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, 2010, 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 15, 2010

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# Financial Details

## Message From the Chief Financial Officer

The Department of Education continued its high standard of financial management and reporting during FY 2010. The Department's excellence in financial management has been a joint effort of its managers, employees, and business partners. In FY 2010, we:



- Strengthened management's controls over cash management activities and non-routine grant accrual procedures related to the *Recovery Act* funding, resulting in the removal of a deficiency noted in last year's "Report on Internal Controls;"
- Continued to implement 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 implement initiatives to ensure accessibility of federal student loans to eligible students and parents;
- Received an unqualified opinion on the principal financial statements for the ninth 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; and
- Continued to provide reasonable assurance of the effectiveness of the Department's internal controls.

In FY 2010, the Department also took steps to address the two remaining significant deficiencies identified in the "Report on Internal Controls" for FY 2009: credit reform and information systems.

Regarding credit reform, the Department improved its communication with both internal and external partners—re-instituting formal credit reform work group meetings among senior managers, as well as holding monthly student loan meetings with OMB. Additionally, the Department undertook a significant review and documentation effort of the assumptions used in the Student Loan Model and also enhanced the cohort analysis.

Steps on information systems included continued efforts to address security and control weaknesses identified in audit reports and internal assessments. The Department is working internally and partnering with other government agencies to address identified security challenges. Internally, the Department has revised employee procedures for identifying and addressing vulnerabilities and has adopted Federal Student Aid's Operational Vulnerability Management System as the departmental standard for collection of information on all systems. The Department has partnered with the Federal Aviation Administration on system certifications and security management, participated in Department of Homeland Security's Einstein program, and implemented security configurations for servers in accordance with National Institute of Standards and Technology guidelines.

During FY 2010, the Department also 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 the functions and duties of Chief Financial Officer  
November 15, 2010



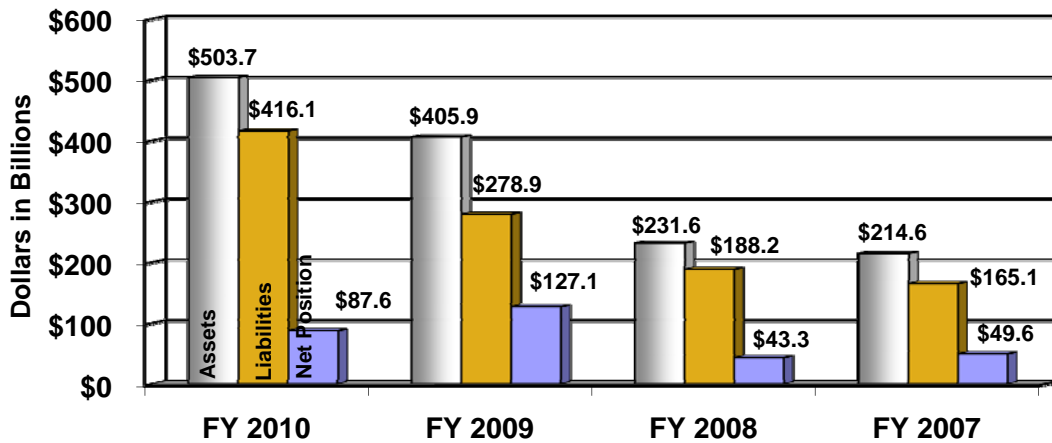
## Financial Summary

*Dollars in Millions*

### Balance Sheet

As of September 30, 2010, 2009, 2008, 2007

	% Change 2010/2009	FY 2010	FY 2009	FY 2008	FY 2007
Fund Balance with Treasury	-21%	\$ 132,259	\$ 168,032	\$ 94,899	\$ 97,532
Credit Program Receivables, Net	+57%	367,904	234,254	134,725	115,904
Other	-4%	3,501	3,659	1,949	1,202
<b>Total Assets</b>		<b>503,664</b>	<b>405,945</b>	<b>231,573</b>	<b>214,638</b>
Debt	+59%	374,335	235,385	128,668	104,287
Liabilities for Loan Guarantees	-30%	14,479	20,543	43,322	50,874
Other	+19%	27,248	22,957	16,247	9,896
<b>Total Liabilities</b>		<b>416,062</b>	<b>278,885</b>	<b>188,237</b>	<b>165,057</b>
Unexpended Appropriations	-26%	94,371	127,269	49,506	52,047
Cumulative Results of Operations	+3,139%	(6,769)	(209)	(6,170)	(2,466)
<b>Total Net Position</b>		<b>87,602</b>	<b>127,060</b>	<b>43,336</b>	<b>49,581</b>
<b>Total Liabilities and Net Position</b>		<b>\$ 503,664</b>	<b>\$ 405,945</b>	<b>\$ 231,573</b>	<b>\$ 214,638</b>



### Statement of Net Cost

For the Periods Ended September 30, 2010, 2009, 2008, 2007

	% Change 2010/2009	FY 2010	FY 2009	FY 2008	FY 2007
Gross Cost	+111%	\$ 116,953	\$ 55,412	\$ 74,034	\$ 72,316
Earned Revenue	+54%	(17,279)	(11,251)	(9,217)	(8,032)
<b>Total Net Cost of Operations</b>		<b>\$ 99,674</b>	<b>\$ 44,161</b>	<b>\$ 64,817</b>	<b>\$ 64,284</b>
<b>Net Cost Based on Program</b>		<b>FY 2010</b>	<b>FY 2009</b>		
Prog. 1 Ensure the Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement		\$ 15,414	\$ (17,451)		
Prog. 2 Promote Academic Achievement in Elementary and Secondary Schools		23,149	23,150		
Prog. 3 Transformation of Education		1,670	1,632		
Prog. 4 Special Education		15,362	15,212		
RA/JF American Recovery and Reinvestment Act and Education Jobs Fund		44,079	21,618		
<b>Total Net Cost of Operations</b>		<b>\$ 99,674</b>	<b>\$ 44,161</b>		

**United States Department of Education  
Consolidated Balance Sheet  
As of September 30, 2010 and 2009**  
(Dollars in Millions)

	FY 2010	FY 2009
<b>Assets:</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 132,259	\$ 168,032
Accounts Receivable (Note 4)	1	
Other Intragovernmental Assets (Note 8)	102	141
Total Intragovernmental	132,362	168,173
Cash and Other Monetary Assets (Note 5)	2,965	2,414
Accounts Receivable, Net (Note 4)	239	520
Credit Program Receivables, Net (Note 6)	367,904	234,254
General Property, Plant and Equipment, Net (Note 7)	28	38
Other Assets (Note 8)	166	546
<b>Total Assets (Note 2)</b>	<b>\$ 503,664</b>	<b>\$ 405,945</b>
 <b>Liabilities:</b>		
Intragovernmental:		
Accounts Payable	\$ 1	
Debt (Note 9)	374,335	\$ 235,385
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5)	2,965	2,414
Payable to Treasury (Note 6)	2,424	3,569
Other Intragovernmental Liabilities (Note 10)	12,958	11,503
Total Intragovernmental	392,683	252,871
Accounts Payable	4,810	1,919
Accrued Grant Liability (Note 11)	3,744	2,962
Liabilities for Loan Guarantees (Note 6)	14,479	20,543
Other Liabilities (Note 10)	346	590
<b>Total Liabilities</b>	<b>\$ 416,062</b>	<b>\$ 278,885</b>
Commitments and Contingencies (Note 21)		
 <b>Net Position:</b>		
Unexpended Appropriations		
Other Funds	\$ 94,371	\$ 127,269
Cumulative Results of Operations		
Earmarked Funds (Note 20)	4	8
Other Funds	(6,773)	(217)
<b>Total Net Position (Note 12)</b>	<b>\$ 87,602</b>	<b>\$ 127,060</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 503,664</b>	<b>\$ 405,945</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, 2010 and 2009**  
(Dollars in Millions)

<b>Program Costs</b>	<b>FY 2010</b>	<b>FY 2009</b>
<b>Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement</b>		
Gross Costs	\$ 32,530	\$ (6,344)
Less: Earned Revenue	17,116	11,107
Net Program Costs	15,414	(17,451)
<b>Total Program Costs</b>	<b>\$ 15,414</b>	<b>\$ (17,451)</b>
<b>Promote Academic Achievement in Elementary and Secondary Schools</b>		
Gross Costs	\$ 23,247	\$ 23,239
Less: Earned Revenue	98	89
Net Program Costs	23,149	23,150
<b>Total Program Costs</b>	<b>\$ 23,149</b>	<b>\$ 23,150</b>
<b>Transformation of Education</b>		
Gross Costs	\$ 1,711	\$ 1,667
Less: Earned Revenue	41	35
Net Program Costs	1,670	1,632
<b>Total Program Costs</b>	<b>\$ 1,670</b>	<b>\$ 1,632</b>
<b>Special Education</b>		
Gross Costs	\$ 15,386	\$ 15,232
Less: Earned Revenue	24	20
Net Program Costs	15,362	15,212
<b>Total Program Costs</b>	<b>\$ 15,362</b>	<b>\$ 15,212</b>
<b>American Recovery and Reinvestment Act and Education Jobs Fund</b>		
Gross Costs	\$ 44,079	\$ 21,618
Less: Earned Revenue	—	—
Net Program Costs	44,079	21,618
<b>Total Program Costs</b>	<b>\$ 44,079</b>	<b>\$ 21,618</b>
<b>Net Cost of Operations (Notes 13 &amp; 16)</b>	<b>\$ 99,674</b>	<b>\$ 44,161</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, 2010 and 2009**

(Dollars in Millions)

	FY 2010		FY 2009	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
<b>Beginning Balances</b>				
Earmarked Funds	\$ 8		\$ 17	
All Other Funds	\$ (217)	\$ 127,269	\$ (6,187)	\$ 49,506
<b>Budgetary Financing Sources:</b>				
Appropriations Received				
Earmarked Funds				
All Other Funds		\$ 92,900		\$ 164,927
Appropriations Transferred - in/out				
Earmarked Funds				
All Other Funds				1
Other Adjustments (rescissions, etc)				
Earmarked Funds				
All Other Funds	\$ (2)	(1,292)	\$ 2	(302)
Appropriations Used				
Earmarked Funds				
All Other Funds	124,506	(124,506)	86,863	(86,863)
Nonexchange Revenue				
Earmarked Funds				
All Other Funds	12			
Nonexpenditure Financing Sources				
Transfers-Out				
Earmarked Funds				
All Other Funds	(19)		(18)	
<b>Other Financing Sources:</b>				
Imputed Financing from Costs Absorbed by Others				
Earmarked Funds				
All Other Funds	\$ 30		\$ 32	
Others				
Earmarked Funds				
All Other Funds	(31,413)		(36,757)	
<b>Total Financing Sources</b>				
Earmarked Funds				
All Other Funds	\$ 93,114	\$ (32,898)	\$ 50,122	\$ 77,763
<b>Net Cost of Operations</b>				
Earmarked Funds	\$ (4)		\$ (9)	
All Other Funds	\$ (99,670)		\$ (44,152)	
<b>Net Change</b>				
Earmarked Funds	\$ (4)		\$ (9)	
All Other Funds	\$ (6,556)	\$ (32,898)	\$ 5,970	\$ 77,763
<b>Ending Balances (Note 12)</b>				
Earmarked Funds	\$ 4		\$ 8	
All Other Funds	\$ (6,773)	\$ 94,371	\$ (217)	\$ 127,269

*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, 2010 and 2009**

(Dollars in Millions)

	FY 2010		FY 2009	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
<b>Budgetary Resources:</b>				
Unobligated balance, brought forward, October 1	\$ 36,601	\$ 9,994	\$ 4,307	\$ 26,847
Recoveries of prior year Unpaid Obligations	1,077	4,436	1,012	8,038
Budgetary Authority:				
Appropriations	96,823	2	164,934	132
Borrowing Authority (Note 15)		183,079		200,265
Spending authority from offsetting collections (gross):				
Earned				
Collected	1,613	51,979	1,701	45,536
Change in Receivables from Federal Sources	(2)	3	1	(3)
Change in unfilled customer orders				
Advance Received			4	
Without advance from Federal Sources		4	1	10
Subtotal	\$ 98,434	\$ 235,067	\$ 166,641	\$ 245,940
Temporarily not available pursuant to Public Law	(561)		(887)	
Permanently not available	(5,204)	(17,355)	(980)	(13,141)
<b>Total Budgetary Resources (Note 15)</b>	<b>\$ 130,347</b>	<b>\$ 232,142</b>	<b>\$ 170,093</b>	<b>\$ 267,684</b>
<b>Status of Budgetary Resources:</b>				
Obligations incurred: (Note 15)				
Direct	\$ 123,731	\$ 216,488	\$ 133,398	\$ 257,690
Reimbursable	90		94	
Unobligated Balances:				
Apportioned	\$ 2,351	\$ 1,433	\$ 33,263	\$ 474
Unobligated Balance not available	4,175	14,221	3,338	9,520
<b>Total Status of Budgetary Resources</b>	<b>\$ 130,347</b>	<b>\$ 232,142</b>	<b>\$ 170,093</b>	<b>\$ 267,684</b>
<b>Change in Obligated Balance:</b>				
Obligated balance, net:				
Unpaid obligations, brought forward, October 1	\$ 95,488	\$ 133,797	\$ 49,875	\$ 41,440
Uncollected customer payments from Federal Sources, brought forward, October 1	(4)	(7)	(2)	
Total, unpaid obligated balance, brought forward, net	\$ 95,484	\$ 133,790	\$ 49,873	\$ 41,440
Obligations Incurred, net (+/-)	123,821	216,488	133,492	257,690
Gross Outlays	(123,539)	(195,018)	(86,867)	(157,295)
Recoveries of prior year unpaid obligations, actual	(1,077)	(4,436)	(1,012)	(8,038)
Change in uncollected customer payments from Federal Sources (+/-)	2	(7)	(2)	(7)
Obligated Balance, net, end of period:				
Unpaid Obligations	\$ 94,693	\$ 150,831	\$ 95,488	\$ 133,797
Uncollected customer payments from Federal Sources	(2)	(14)	(4)	(7)
<b>Total, Unpaid Obligated Balance, Net, End of Period</b>	<b>\$ 94,691</b>	<b>\$ 150,817</b>	<b>\$ 95,484</b>	<b>\$ 133,790</b>
<b>Net Outlays:</b>				
Gross Outlays	\$ 123,539	\$ 195,018	\$ 86,867	\$ 157,295
Offsetting collections	(1,613)	(51,979)	(1,705)	(45,536)
Distributed Offsetting receipts	(29,046)		(31,763)	
<b>Net Outlays (Note 15)</b>	<b>\$ 92,880</b>	<b>\$ 143,039</b>	<b>\$ 53,399</b>	<b>\$ 111,759</b>

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

## Notes to the Principal Financial Statements For the Years Ended September 30, 2010 and 2009

### 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*, authorizes the Department to make loans directly to eligible undergraduate and graduate students and their parents through participating schools. The FFEL Program, 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 while the students are in school or in a deferment period.

The *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)* authorized 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 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 *Student Aid and Fiscal Responsibility Act (SAFRA)*, which became effective July 1, 2010, was included in the *Health Care and Education Reconciliation Act of 2010 (HCERA)*. *SAFRA* provides that no FFEL reinsurance or other benefits will be paid on loans made by private lenders after June 30, 2010. However, FFEL lenders are still obligated to make the subsequent disbursements after June 30, 2010 if the first disbursement of a FFEL loan was made by the FFEL lender on or before June 30, 2010.

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, provided 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.

P.L. 111-226, enacted on August 10, 2010, created the Education Jobs Fund, which provided funding to the Department to assist in saving and creating jobs for the 2010-11 school year. The Department was authorized to disburse these funds promptly to states through formula grants, while ensuring transparency and accountability overall.

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 and Education Jobs Fund (RA/JF)
- 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. The OESE reporting organization is responsible for administration of the Education Jobs Fund. *Recovery Act* and Education Jobs Fund activities are reported under the "American Recovery and Reinvestment Act and Education Jobs Fund" major reporting group. (See Notes 11, 13, 18 and 19) 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 20)

### **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 September 2010. 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 and the amounts recorded.

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 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 financial statements were prepared using assumptions developed for the FY 2011 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 and FY 2010, which are statutorily not available for obligation until the following fiscal year. Since this is a deferral made in law, it reduces total budgetary resources. (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 Federal Fund assets of state and nonprofit FFEL Program guaranty agencies. Guaranty agency Federal Fund 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.

Sections 422A and 422B 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 the 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 and 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 between the gross amount and the allowance for subsidy 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 of interest benefits and special allowance payments 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, FFEL, and TEACH Programs. 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 20)

### **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.

### **Additional Comparative Information**

Certain additional FY 2009 information is presented in the FY 2010 notes to the principal financial statements to conform to the current year presentation. (See Note 6)

**Note 2. Non-Entity Assets**

As of September 30, 2010 and 2009, non-entity assets consisted of the following:

**Non-Entity Assets**

(Dollars in Millions)

	2010	2009
<b>Non-Entity Assets</b>		
Intragovernmental		
Fund Balance with Treasury	\$ 93	\$ 45
<b>Total Intragovernmental</b>	<b>93</b>	<b>45</b>
With the Public		
Cash and Other Monetary Assets	2,965	2,414
Accounts Receivable, Net	21	16
Credit Program Receivables, Net	183	184
<b>Total With the Public</b>	<b>3,169</b>	<b>2,614</b>
<b>Total Non-Entity Assets</b>	<b>3,262</b>	<b>2,659</b>
Entity Assets	500,402	403,286
<b>Total Assets</b>	<b>\$ 503,664</b>	<b>\$ 405,945</b>

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

**Note 3. Fund Balance with Treasury**

The Fund Balance with Treasury, by fund type, as of September 30, 2010 and 2009, consisted of the following:

**Fund Balances**

(Dollars in Millions)

	2010	2009
General Funds	\$ 98,792	\$ 130,533
Revolving Funds	33,351	37,431
Trust Funds	5	9
Special Funds	18	14
Other Funds	93	45
<b>Fund Balance with Treasury</b>	<b>\$ 132,259</b>	<b>\$ 168,032</b>

The Status of Fund Balance with Treasury, as of September 30, 2010 and 2009, consisted of the following:

### Status of Fund Balance with Treasury

(Dollars in Millions)

	2010	2009
Unobligated Balance		
Available	\$ 3,784	\$ 33,737
Unavailable	15,431	10,444
Obligated Balance, Not Yet Disbursed	112,390	122,919
Authority Temporarily Precluded from Obligation	561	887
Non-Budgetary Fund Balance with Treasury	93	45
<b>Fund Balance with Treasury</b>	<b>\$ 132,259</b>	<b>\$ 168,032</b>

### Note 4. Accounts Receivable

Accounts Receivable, as of September 30, 2010 and 2009, consisted of the following:

### Accounts Receivable

(Dollars in Millions)

	2010		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	\$ 1	\$ -	\$ 1
With the Public	416	(177)	239
<b>Accounts Receivable</b>	<b>\$ 417</b>	<b>\$ (177)</b>	<b>\$ 240</b>
	2009		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	\$ -	\$ -	\$ -
With the Public	693	(173)	520
<b>Accounts Receivable</b>	<b>\$ 693</b>	<b>\$ (173)</b>	<b>\$ 520</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 Payable to Treasury. The table below presents Cash and Other Monetary Assets for the periods ended September 30, 2010 and 2009.

**Cash and Other Monetary Assets**

(Dollars in Millions)

	2010	2009
<b>Beginning Balance, Cash and Other Monetary Assets</b>	<b>\$ 2,414</b>	<b>\$ 1,663</b>
Increase in Guaranty Agency Federal Funds, net	989	751
Less: Collections Remitted to Treasury	438	-
<b>Ending Balance, Cash and Other Monetary Assets</b>	<b>\$ 2,965</b>	<b>\$ 2,414</b>

The \$551 million net increase in the Federal Fund in FY 2010 reflects the impact of guaranty agencies' operations. During FY 2010, \$438 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. Those 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 \$75 billion in Direct Loans to eligible borrowers in FY 2010 and approximately \$38 billion in FY 2009. 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. The substantial increase in Direct Loan Program disbursements during FY 2010 resulted from the increased use of the Direct Loan Program in accordance with the changes made by *SAFRA*.

Approximately 11 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 2010 cohort, an estimated \$11.7 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 loans directly from

lenders. As a result, the FFEL Program includes approximately \$103 billion and \$52 billion in direct federal assets as of September 30, 2010 and 2009, respectively.

*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 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. Credit Program Receivables are established for loans and participation interests in loans acquired through these activities.

Under the loan purchase 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, 2010, 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 conveys 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, 2010, the Department had \$27 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 issues short-term commercial paper to investors; this paper is backed by student loans pledged to the conduit. The conduit used the proceeds of sales of its commercial paper to acquire from lenders interests in student loans. Lenders must have used 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 purchases those pledged loans that become more than 210 days delinquent. The conduit has sold to the Department approximately \$544 million of these delinquent loans as of September 30, 2010. Under the terms of the Put Agreement with the conduit, the Department may purchase pledged loans 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 budget totals. Loans originated in academic years 2004-05 through 2007-08 are eligible to be purchased through the ABCP Conduit.

As of September 30, 2010, the Department has \$70 billion in obligations to cover any buyer-of-last-resort activities and potential purchases of underlying student loans under the ABCP Conduit. These obligations are supported by available borrowing authority. In FY 2009, the



Department estimated approximately \$4 billion in negative subsidy. The conduit, a separate legal entity, has approximately \$39 billion in commercial paper outstanding.

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.

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 \$24 billion and \$80 billion in gross non-consolidation loans to FFEL recipients during FY 2010 and FY 2009, respectively. In 2010, lenders disbursed \$20 billion in FFEL loans from the 2009 and 2010 cohorts; in 2009, lenders disbursed \$63 billion in FFEL loans from the 2008 and 2009 cohorts. As of September 30, 2010 and 2009, total principal balances outstanding of guaranteed loans held by lenders were approximately \$390 billion and \$457 billion, respectively. As of September 30, 2010 and 2009, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately \$382 billion and \$445 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 17 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 2010 cohort, an estimated \$4.0 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 assigned to the Department, which then collects them directly. Interest continues to accrue on assigned loans, but is only realized upon collection.

Under provisions of *SAFRA*, new loans under the FFEL Program were virtually ended as of July 1, 2010, giving the Department full responsibility for originating all federal student loans as of July 1, 2010. The new legislation effectively requires a transition from guaranteed student loans to full direct lending through the Department under the Direct Loan Program. Federal guarantees on FFEL Program loans and commitments remain in effect for loans made before July 1, 2010 until the loan is sold to the Department through an *ECASLA* program, consolidated into a direct loan, or otherwise disposed of. The FFEL Program will continue to be accounted for under credit reform accounting.

The Direct Loan Program operates as a public-private partnership leveraging the federal government's lower cost of capital with the expertise of the private sector. While the Department provides the capital for new loans through borrowing from the Treasury, private sector partners may disburse, service, and/or collect the loans. Approximately 5,000 domestic schools participating in the federal student loan programs have successfully transitioned to the

Direct Loan Program. The Department continues to work closely with higher education institutions to complete the transition to direct lending.

**Federal Perkins Loan Program.** The Federal Perkins Loan Program is a campus-based program providing low interest loans 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.** 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 can be converted to direct loans, for budget and accounting purposes the program is operated under 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

Student and parent 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, consolidation 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 \$12.5 billion as of September 30, 2009 to \$17.1 billion as of September 30, 2010. Under credit reform accounting, the subsidy costs of new consolidation loans are not reflected until the future fiscal year in which they are disbursed. The effect of the early pay-off of the existing loans – those being consolidated – is recognized in the future projected cash flows of the past cohort year those loans were originated. FFEL to Direct Loan consolidations are part of the \$17.1 billion.

### **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. The Department modified loans in FY 2009, but not during FY 2010.

**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.

**Credit Program Receivables**

Credit Program Receivables as of September 30, 2010 and 2009, consisted of the following:

**Credit Program Receivables, Net**

(Dollars in Millions)

	<u>2010</u>	<u>2009</u>
Direct Loan Program Loan Receivables, Net	\$ 228,208	\$ 152,771
FFEL Program		
FFEL Guaranteed Loan Program, Net (Pre-1992)	2,419	3,480
FFEL Program (Post-1991):		
FFEL Guaranteed Loan Program, Net	24,030	20,399
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	42,279	17,032
Loan Participation Purchase, Net	69,686	39,996
ABCP Conduit, Net	468	47
Federal Perkins Program Loan Receivables, Net	183	184
TEACH Program Receivables, Net	137	50
Facilities Loan Programs Loan Receivables, Net	494	295
<b>Credit Program Receivables, Net</b>	<b>\$ 367,904</b>	<b>\$ 234,254</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)

	<u>2010</u>	<u>2009</u>
Principal Receivable	\$ 220,522	\$ 149,437
Interest Receivable	9,655	7,370
Receivables	230,177	156,807
Less: Allowance for Subsidy	1,969	4,036
<b>Direct Loan Program Loan Receivables, Net</b>	<b>\$ 228,208</b>	<b>\$ 152,771</b>

Of the \$230.2 billion in receivables as of September 30, 2010, \$14.0 billion in loan principal was in default, compared to \$11.5 billion a year earlier.

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

**FFEL Program Receivables, Net**

(Dollars in Millions)

	<u>2010</u>	<u>2009</u>
<b><u>FFEL Guaranteed Loan Program (Pre-1992)</u></b>		
Principal Receivable	\$ 6,681	\$ 7,100
Interest Receivable	223	223
Receivables	<u>6,904</u>	<u>7,323</u>
Less: Allowance for Subsidy	<u>4,485</u>	<u>3,843</u>
<b>FFEL Guaranteed Loan Program, Net (Pre-1992)</b>	<b><u>2,419</u></b>	<b><u>3,480</u></b>
<b><u>FFEL Program (Post-1991)</u></b>		
FFEL Guaranteed Loan Program:		
Principal Receivable	26,358	22,403
Interest Receivable	<u>2,436</u>	<u>2,305</u>
Receivables	<u>28,794</u>	<u>24,708</u>
Less: Allowance for Subsidy	<u>4,764</u>	<u>4,309</u>
<b>FFEL Guaranteed Loan Program, Net</b>	<b><u>24,030</u></b>	<b><u>20,399</u></b>
Temporary Loan Purchase Authority:		
Loan Purchase Commitment:		
Principal Receivable	36,623	14,293
Interest Receivable	<u>1,400</u>	<u>379</u>
Receivables	<u>38,023</u>	<u>14,672</u>
Less: Allowance for Subsidy	<u>(4,256)</u>	<u>(2,360)</u>
<b>Loan Purchase Commitment, Net</b>	<b><u>42,279</u></b>	<b><u>17,032</u></b>
Loan Participation Purchase:		
Principal Receivable	62,931	37,020
Interest Receivable	<u>1,665</u>	<u>259</u>
Receivables	<u>64,596</u>	<u>37,279</u>
Less: Allowance for Subsidy	<u>(5,090)</u>	<u>(2,717)</u>
<b>Loan Participation Purchase, Net</b>	<b><u>69,686</u></b>	<b><u>39,996</u></b>
ABCP Conduit:		
Principal Receivable	544	50
Interest Receivable	<u>26</u>	<u>2</u>
Receivables	<u>570</u>	<u>52</u>
Less: Allowance for Subsidy	<u>102</u>	<u>5</u>
<b>ABCP Conduit, Net</b>	<b><u>468</u></b>	<b><u>47</u></b>
<b>FFEL Program Receivables, Net</b>	<b><u>\$ 138,882</u></b>	<b><u>\$ 80,954</u></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. Approximately \$36 billion and \$9 billion in participation interests were redeemed by selling the underlying loans to the Department during FY 2010 and FY 2009, respectively.

**Federal Perkins Loan Program.** At September 30, 2010 and 2009, loan receivables, net of an allowance for loss, were \$183 million and \$184 million, respectively. These loans are valued at historical cost.

**TEACH Program.** At September 30, 2010 and 2009, loan receivables, net of an allowance for subsidy, were \$137 million and \$50 million, respectively.

### Facilities Loan Programs

#### Facilities Loan Programs Loan Receivables

(Dollars in Millions)

	2010	2009
Principal Receivable	\$ 785	\$ 651
Interest Receivable	9	9
Receivables	794	660
Less: Allowance for Subsidy	300	365
<b>Facilities Loan Programs Loan Receivables, Net</b>	<b>\$ 494</b>	<b>\$ 295</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)

	2010	2009
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ 4,036</b>	<b>\$ 13,743</b>
<b>Components of Subsidy Transfers</b>		
Interest Rate Differential	(11,708)	(7,785)
Defaults, Net of Recoveries	1,307	1,070
Fees	(1,067)	(551)
Other	5,158	2,863
<b>Current Year Subsidy Transfers</b>	<b>(6,310)</b>	<b>(4,403)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates <sup>1</sup>	3,547	(322)
Technical and Default Re-estimates	1,196	(4,878)
<b>Subsidy Re-estimates</b>	<b>4,743</b>	<b>(5,200)</b>
<b>Activity</b>		
Fee Collections	1,056	628
Loan Cancellations <sup>2</sup>	(388)	(432)
Subsidy Allowance Amortization	(500)	40
Other	(668)	(340)
<b>Total Activity</b>	<b>(500)</b>	<b>(104)</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ 1,969</b>	<b>\$ 4,036</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 guarantees for the insurance portion of the FFEL Program:

**FFEL Program Reconciliation of Liabilities for Loan Guarantees**

(Dollars in Millions)

	<u>2010</u>	<u>2009</u>
<b>Beginning Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>\$ 20,448</b>	<b>\$ 43,185</b>
<b>Components of Subsidy Transfers</b>		
Interest Supplement Costs	(733)	(632)
Defaults, Net of Recoveries	212	494
Fees	(960)	(3,495)
Other <sup>1</sup>	878	2,108
<b>Current Year Subsidy Transfers</b>	<b>(603)</b>	<b>(1,525)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	59	(147)
Technical and Default Re-estimates	(12,727)	(21,542)
<b>Subsidy Re-estimates</b>	<b>(12,668)</b>	<b>(21,689)</b>
<b>Components of Loan Modifications</b>		
Loan Modification Costs	-	(2,641)
Modification Adjustment Transfers	-	130
<b>Loan Modifications</b>	<b>-</b>	<b>(2,511)</b>
<b>Activity</b>		
Interest Supplement Payments	(3,881)	(5,389)
Claim Payments	(8,987)	(8,634)
Fee Collections	3,736	4,115
Interest on Liability Balance	(152)	337
Other <sup>2</sup>	16,514	12,559
<b>Total Activity</b>	<b>7,230</b>	<b>2,988</b>
<b>Ending Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>14,407</b>	<b>20,448</b>
FFEL Liquidating Account Liability for Loan Guarantees	72	95
<b>Liabilities for Loan Guarantees</b>	<b>\$ 14,479</b>	<b>\$ 20,543</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 negative special allowance payments; also composed of the transfer of subsidy for defaults; loan consolidation activity; and loan cancellations due to death, disability, and bankruptcy.

The following schedules provide reconciliations between the beginning and ending balances of the allowance for subsidy for the Loan Purchase Commitment component and the Loan Participation Purchase component of the FFEL Program. These FFEL components are accounted for using credit reform accounting methodology and affect credit program receivables accordingly.

### Loan Purchase Commitment Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2010	2009
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ (2,360)</b>	<b>\$ (5)</b>
<b>Components of Subsidy Transfers</b>		
Interest Costs	(4,548)	(3,157)
Defaults, Net of Recoveries	178	102
Fees	520	268
Other	1,647	1,179
<b>Current Year Subsidy Transfers</b>	<b>(2,203)</b>	<b>(1,608)</b>
Subsidy Re-estimates	1,737	(245)
<b>Activity</b>		
Fee Disbursements	(644)	(370)
Subsidy Allowance Amortization	(314)	(296)
Direct Asset Activities and Other	(472)	164
<b>Total Activity</b>	<b>(1,430)</b>	<b>(502)</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ (4,256)</b>	<b>\$ (2,360)</b>

### Loan Participation Purchase Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2010	2009
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ (2,717)</b>	<b>\$ (183)</b>
<b>Components of Subsidy Transfers</b>		
Interest Costs	(3,662)	(6,419)
Defaults, Net of Recoveries	254	253
Fees	(693)	(275)
Other	2,194	3,281
<b>Current Year Subsidy Transfers</b>	<b>(1,907)</b>	<b>(3,160)</b>
Subsidy Re-estimates	1,300	930
<b>Activity</b>		
Fee Disbursements	(837)	(250)
Subsidy Allowance Amortization	(673)	(91)
Direct Asset Activities and Other	(256)	37
<b>Total Activity</b>	<b>(1,766)</b>	<b>(304)</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ (5,090)</b>	<b>\$ (2,717)</b>

For FY 2010, the Loan Participation Purchase net upward re-estimate of \$1.3 billion is composed of an upward cost interest rate re-estimate of \$2.6 billion along with a downward cost technical and default re-estimate of \$1.3 billion. The Loan Purchase Commitment net upward re-estimate of \$1.7 billion is composed of an upward cost interest rate re-estimate of \$1.3 billion along with an upward cost technical and default re-estimate of \$0.4 billion.

### 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)

	2010	2009
Interest Expense on Treasury Borrowing	\$ 10,514	\$ 7,094
<b>Interest Expense</b>	<b>\$ 10,514</b>	<b>\$ 7,094</b>
Interest Revenue from the Public	\$ 7,352	\$ 5,669
Amortization of Subsidy	500	(40)
Interest Revenue on Uninvested Funds	2,662	1,465
<b>Interest Revenue</b>	<b>\$ 10,514</b>	<b>\$ 7,094</b>

### Payable to Treasury

Payable to Treasury for the years ended September 30, 2010 and 2009 consisted of the following:

#### Payable to Treasury

(Dollars in Millions)

	2010	2009
<b>Future Liquidating Account Collections, Beginning Balance</b>	<b>\$ 3,569</b>	<b>\$ 3,766</b>
Valuation of Pre-1992 Loan Liability and Allowance	(717)	465
Capital Transfers to Treasury	(428)	(662)
<b>Future Liquidating Account Collections, Ending Balance</b>	<b>2,424</b>	<b>3,569</b>
<b>Payable to Treasury</b>	<b>\$ 2,424</b>	<b>\$ 3,569</b>

**Subsidy Expense****William D. Ford Federal Direct Loan Program****Direct Loan Program Subsidy Expense**

(Dollars in Millions)

	<u>2010</u>	<u>2009</u>
<b>Components of Current Year Subsidy Transfers</b>		
Interest Rate Differential	\$ (11,708)	\$ (7,785)
Defaults, Net of Recoveries	1,307	1,070
Fees	(1,067)	(551)
Other	5,158	2,863
<b>Current Year Subsidy Transfers</b>	<b>(6,310)</b>	<b>(4,403)</b>
Subsidy Re-estimates	4,743	(5,200)
<b>Direct Loan Subsidy Expense</b>	<b>\$ (1,567)</b>	<b>\$ (9,603)</b>

William D. Ford Direct Loan re-estimated subsidy cost increased \$4.7 billion in FY 2010. The majority of this increase was related to discount rate changes increasing costs \$2.2 billion. Changes in assumptions for income-based repayments and public service loan forgiveness increased subsidy cost \$611 million. Rising default rates increased subsidy cost \$226 million. Changes in other interest components, probabilistic methodology for estimating, and an uptick in consolidated weighted rates increased costs \$887 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 \$662 million. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994-2009.

For 2009 re-estimated subsidy cost, Direct Loan subsidy cost was decreased \$5.2 billion. Changes in the assumption for income-based repayments decreased subsidy cost by \$3.7 billion. Rising default rates increased subsidy cost \$374 million, interest rate changes increased costs \$350 million, and changes in deferments and forbearance rates increased costs \$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 \$455 million. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994-2008.

## Federal Family Education Loan Program

## FFEL Program Subsidy Expense

(Dollars in Millions)

	2010	2009
<b>FFEL Guaranteed Loan Program</b>		
<b>Components of Current Year Subsidy Transfers</b>		
Interest Supplement Costs	\$ (733)	\$ (632)
Defaults, Net of Recoveries	212	494
Fees	(960)	(3,495)
Other	878	2,108
<b>Current Year Subsidy Transfers</b>	<b>(603)</b>	<b>(1,525)</b>
Subsidy Re-estimates	(12,668)	(21,689)
Loan Modification Costs	-	(2,641)
<b>FFEL Guaranteed Loan Program Subsidy Expense</b>	<b>(13,271)</b>	<b>(25,855)</b>
<b>Temporary Loan Purchase Authority</b>		
<b>Loan Purchase Commitment</b>		
<b>Components of Current Year Subsidy Transfers</b>		
Interest Costs	(4,548)	(3,157)
Defaults, Net of Recoveries	178	102
Fees	520	268
Other	1,647	1,179
<b>Current Year Subsidy Transfers</b>	<b>(2,203)</b>	<b>(1,608)</b>
Subsidy Re-estimates	1,737	(245)
<b>Loan Purchase Commitment Subsidy Expense</b>	<b>(466)</b>	<b>(1,853)</b>
<b>Loan Participation Purchase</b>		
<b>Components of Current Year Subsidy Transfers</b>		
Interest Costs	(3,662)	(6,419)
Defaults, Net of Recoveries	254	253
Fees	(693)	(275)
Other	2,194	3,281
<b>Current Year Subsidy Transfers</b>	<b>(1,907)</b>	<b>(3,160)</b>
Subsidy Re-estimates	1,300	930
<b>Loan Participation Purchase Subsidy Expense</b>	<b>(607)</b>	<b>(2,230)</b>
<b>ABCP Conduit</b>		
<b>Components of Current Year Subsidy Transfers</b>		
Interest Costs	-	(6)
Defaults, Net of Recoveries	-	1
Fees	-	(3)
Other	-	6
<b>ABCP Conduit Subsidy Expense</b>	<b>-</b>	<b>(2)</b>
<b>FFEL Program Subsidy Expense</b>	<b>\$ (14,344)</b>	<b>\$ (29,940)</b>

FFEL Guaranteed re-estimated subsidy cost decreased \$12.7 billion in FY 2010. The change in consolidated weighted rates decreased subsidy cost \$6.6 billion. Interest rates and probabilistic methodology for estimating decreased subsidy costs \$3.7 billion. ECASLA and other volume adjustments decreased subsidy cost \$1.7 billion. Loan deferment increases produced an increase in subsidy cost of \$1 billion. 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 \$17 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1992-2009.

FFEL Participation Purchase subsidy components reported in last year's schedule were reclassified to more accurately disclose components of subsidy transfers. No change in overall subsidy expense, or allowance for subsidy, resulted from this change as of, and for the year ended, September 30, 2009.

For 2009 re-estimated subsidy cost, FFEL Guaranteed subsidy cost was decreased \$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 \$16.4 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1992-2008.

### Subsidy Rates

The subsidy rates applicable to the 2010 loan cohort year follow:

<b>Subsidy Rates—Cohort 2010</b>					
	<b>Interest Differential/ Supplements</b>	<b>Defaults</b>	<b>Fees</b>	<b>Other</b>	<b>Total</b>
Direct Loan Program	(13.43%)	1.58%	(1.48%)	6.18%	(7.15%)
TEACH Program	6.00%	0.53%	0.00%	7.10%	13.63%
FFEL Program (Post-1991):					
Guaranteed Loan Program	(1.71%)	0.05%	(1.53%)	1.40%	(1.79%)
Temporary Loan Purchase Authority:					
Loan Purchase Commitment	(12.40%)	1.22%	3.01%	2.87%	(5.30%)
Loan Participation Purchase	(15.01%)	1.57%	3.07%	6.41%	(3.96%)

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 may include modifications and re-estimates. The subsidy rates shown above, which reflect aggregate negative subsidy in the FY 2010 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, 2010 and 2009, consisted of the following:

<b>Administrative Expense</b>				
(Dollars in Millions)				
	2010		2009	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	\$ 536	\$ 314	\$ 458	\$ 269
Other Expense	22	13	23	13
<b>Administrative Expenses</b>	<b>\$ 558</b>	<b>\$ 327</b>	<b>\$ 481</b>	<b>\$ 282</b>

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

General Property, Plant, and Equipment, as of September 30, 2010 and 2009, consisted of the following:

<b>General Property, Plant, and Equipment</b>			
(Dollars in Millions)			
	2010		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software, and Telecommunications Equipment	\$ 172	\$ (144)	\$ 28
Furniture and Fixtures	3	(3)	-
<b>General Property, Plant, and Equipment</b>	<b>\$ 175</b>	<b>\$ (147)</b>	<b>\$ 28</b>
	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>

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.

### Leases

(Dollars in Millions)

2010			2009		
Fiscal Year	Lease Payment		Fiscal Year	Lease Payment	
2011	\$	48	2010	\$	44
2012		48	2011		48
2013		45	2012		53
2014		47	2013		55
2015		54	2014		58
After 2015		56	After 2014		60
<b>Total</b>	<b>\$</b>	<b>298</b>	<b>Total</b>	<b>\$</b>	<b>318</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 \$102 million and \$141 million as of September 30, 2010 and 2009, 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 \$166 million and \$546 million as of September 30, 2010 and 2009, respectively.

### Note 9. Debt

Debt as of September 30, 2010 and 2009 consisted of the following:

### Debt

(Dollars in Millions)

	Beginning Balance	Accrued Interest	2010		Ending Balance
			New Borrowing	Repayments	
<b>Treasury Debt</b>					
Direct Loan Program	\$ 154,218	\$ -	\$ 91,192	\$ (8,220)	\$ 237,190
FFEL Program					
Guaranteed Loan Program	1,474	-	9,285	(29)	10,730
Loan Purchase Commitment	24,877	-	21,744	(1,416)	45,205
Loan Participation Purchase	53,977	-	32,206	(6,606)	79,577
ABCP Conduit	244	-	650	(90)	804
TEACH Program	68	-	98	(16)	150
Facilities Loan Program	71	-	-	(10)	61
<b>Total Treasury Debt</b>	<b>234,929</b>	<b>-</b>	<b>155,175</b>	<b>(16,387)</b>	<b>373,717</b>
<b>Debt to the FFB</b>					
HBCU	456	2	171	(11)	618
<b>Total Debt to the FFB</b>	<b>456</b>	<b>2</b>	<b>171</b>	<b>(11)</b>	<b>618</b>
<b>Total</b>	<b>\$ 235,385</b>	<b>\$ 2</b>	<b>\$ 155,346</b>	<b>\$ (16,398)</b>	<b>\$ 374,335</b>

**Debt**

(Dollars in Millions)

	<b>2009</b>				
	<b>Beginning Balance</b>	<b>Accrued Interest</b>	<b>New Borrowing</b>	<b>Repayments</b>	<b>Ending Balance</b>
<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>

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 downward subsidy re-estimates, which when executed will be paid to Treasury.

Other Liabilities as of September 30, 2010 and 2009 consisted of the following:

<b>Other Liabilities</b>				
(Dollars in Millions)				
	2010		2009	
	Intragovern- mental	With the Public	Intragovern- mental	With the Public
<b>Liabilities Covered by Budgetary Resources</b>				
<b>Current</b>				
Advances From Others	\$ 96	\$ -	\$ 96	\$ -
Employer Contributions and Payroll Taxes	5	-	4	-
Liability for Deposit Funds and Clearing				
Accounts	8	86	(5)	52
Accrued Payroll and Benefits	-	25	-	21
Deferred Revenue	-	182	-	467
Liabilities in Miscellaneous Receipt Accounts	12,663	-	11,221	-
<b>Total Other Liabilities Covered by Budgetary Resources</b>	<b>12,772</b>	<b>293</b>	<b>11,316</b>	<b>540</b>
<b>Liabilities Not Covered by Budgetary Resources</b>				
<b>Current</b>				
Accrued Unfunded Annual Leave	-	37	-	34
<b>Non-current</b>				
Accrued Unfunded FECA Liability	3	-	3	-
Liabilities in Miscellaneous Receipt Accounts	183	-	184	-
Accrued FECA Actuarial Liability	-	16	-	16
<b>Total Other Liabilities Not Covered by Budgetary Resources</b>	<b>186</b>	<b>53</b>	<b>187</b>	<b>50</b>
<b>Other Liabilities</b>	<b>\$ 12,958</b>	<b>\$ 346</b>	<b>\$ 11,503</b>	<b>\$ 590</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 \$239 million and \$237 million as of September 30, 2010 and 2009, respectively.

As of September 30, 2010 and 2009, liabilities on the Balance Sheet totaled \$416.1 billion and \$278.9 billion respectively. Of this amount, liabilities covered by budgetary resources totaled \$415.9 billion as of September 30, 2010, and \$278.7 billion as of September 30, 2009.

**Note 11. Accrued Grant Liability**

The accrued grant liability by major reporting groups as of September 30, 2010 and 2009, consisted of the following:

<b>Accrued Grant Liability</b>		
(Dollars in Millions)		
	<b>2010</b>	<b>2009</b>
FSA	\$ 2,016	\$ 1,295
OESE	281	265
OSERS	182	263
RA/JF	1,070	860
Other	195	279
<b>Accrued Grant Liability</b>	<b>\$ 3,744</b>	<b>\$ 2,962</b>

**Note 12. Net Position**

Unexpended appropriations as of September 30, 2010 and 2009, consisted of the following:

<b>Unexpended Appropriations</b>		
(Dollars in Millions)		
	<b>2010</b>	<b>2009</b>
Unobligated Balances		
Available	\$ 2,323	\$ 33,243
Not Available	1,181	770
Undelivered Orders, end of period	90,306	92,369
Authority Temporarily Precluded from Obligation	561	887
<b>Unexpended Appropriations</b>	<b>\$ 94,371</b>	<b>\$ 127,269</b>

The Cumulative Results of Operations - Earmarked Funds of \$4 million as of September 30, 2010, and \$8 million as of September 30, 2009, 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 20)

The Cumulative Results of Operations - Other Funds of \$(6,773) million as of September 30, 2010, and \$(217) million as of September 30, 2009, 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 and Education Jobs Fund	RA/JF	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* and Education Jobs Fund are consistent with the Department's current Strategic Goals and programs. For reporting purposes, a net cost program called American Recovery and Reinvestment Act and Education Jobs Fund has been created.

The following table presents the gross cost and exchange revenue by program for the Department for September 30, 2010 and 2009. 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, 2010 and 2009, consisted of the following:

**Gross Cost and Exchange Revenue by Program**

(Dollars in Millions)

	2010					
	<u>FSA</u>	<u>OESE</u>	<u>OSERS</u>	<u>RA/JF</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	\$ 16,286	\$ -	\$ -	\$ -	\$ 80	\$ 16,366
Public Gross Cost	<u>11,542</u>	-	-	-	<u>4,622</u>	<u>16,164</u>
Total Gross Program Costs	27,828	-	-	-	4,702	32,530
Intragovernmental Earned Revenue	5,862	-	-	-	12	5,874
Public Earned Revenue	<u>11,209</u>	-	-	-	<u>33</u>	<u>11,242</u>
Total Program Earned Revenue	<u>17,071</u>	-	-	-	<u>45</u>	<u>17,116</u>
<b>Total Program Cost</b>	<b><u>10,757</u></b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>4,657</u></b>	<b><u>15,414</u></b>
<b><i>Promote Academic Achievement in Elementary and Secondary Schools</i></b>						
Intragovernmental Gross Cost	-	141	-	-	15	156
Public Gross Cost	-	<u>21,664</u>	-	-	<u>1,427</u>	<u>23,091</u>
Total Gross Program Costs	-	21,805	-	-	1,442	23,247
Intragovernmental Earned Revenue	-	-	-	-	72	72
Public Earned Revenue	-	<u>20</u>	-	-	<u>6</u>	<u>26</u>
Total Program Earned Revenue	-	<u>20</u>	-	-	<u>78</u>	<u>98</u>
<b>Total Program Cost</b>	<b>-</b>	<b><u>21,785</u></b>	<b>-</b>	<b>-</b>	<b><u>1,364</u></b>	<b><u>23,149</u></b>
<b><i>Transformation of Education</i></b>						
Intragovernmental Gross Cost	-	-	-	-	80	80
Public Gross Cost	-	-	-	-	<u>1,631</u>	<u>1,631</u>
Total Gross Program Costs	-	-	-	-	1,711	1,711
Intragovernmental Earned Revenue	-	-	-	-	3	3
Public Earned Revenue	-	-	-	-	<u>38</u>	<u>38</u>
Total Program Earned Revenue	-	-	-	-	<u>41</u>	<u>41</u>
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>1,670</u></b>	<b><u>1,670</u></b>
<b><i>Special Education</i></b>						
Intragovernmental Gross Cost	-	-	43	-	-	43
Public Gross Cost	-	-	<u>15,343</u>	-	-	<u>15,343</u>
Total Gross Program Costs	-	-	15,386	-	-	15,386
Intragovernmental Earned Revenue	-	-	2	-	-	2
Public Earned Revenue	-	-	<u>22</u>	-	-	<u>22</u>
Total Program Earned Revenue	-	-	<u>24</u>	-	-	<u>24</u>
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b><u>15,362</u></b>	<b>-</b>	<b>-</b>	<b><u>15,362</u></b>
<b><i>American Recovery and Reinvestment Act and Education Jobs Fund</i></b>						
Intragovernmental Gross Cost	-	-	-	89	-	89
Public Gross Cost	-	-	-	<u>43,990</u>	-	<u>43,990</u>
Total Gross Program Costs	-	-	-	44,079	-	44,079
Intragovernmental Earned Revenue	-	-	-	-	-	-
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	-	-	-	-	-
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>44,079</u></b>	<b>-</b>	<b><u>44,079</u></b>
<b>Net Cost of Operations</b>	<b><u>\$ 10,757</u></b>	<b><u>\$ 21,785</u></b>	<b><u>\$ 15,362</u></b>	<b><u>\$ 44,079</u></b>	<b><u>\$ 7,691</u></b>	<b><u>\$ 99,674</u></b>

## Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

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



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

For FY 2010 and FY 2009, interest expense and interest revenue by program consisted of the following:

**Interest Expense and Interest Revenue**

(Dollars in Millions)

	2010					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	\$ 10,514	\$ -	\$10,514	\$ 2,662	\$ 7,852	\$10,514
FFEL Program						
Guaranteed Loan Program	474	(152)	322	322	-	322
Loan Purchase Commitment	1,771	-	1,771	631	1,140	1,771
Loan Participation Purchase	3,397	-	3,397	1,222	2,175	3,397
ABCP Conduit	41	-	41	29	12	41
TEACH Program	7	-	7	3	4	7
Other Programs	18	-	18	12	37	49
<b>Total</b>	<b>\$ 16,222</b>	<b>\$ (152)</b>	<b>\$16,070</b>	<b>\$ 4,881</b>	<b>\$ 11,220</b>	<b>\$16,101</b>

	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>

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, 2010, budgetary resources were \$362,489 million and net outlays were \$235,919 million. As of September 30, 2009, budgetary resources were \$437,777 million and net outlays were \$165,158 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, 2010 and 2009, consisted of the following:

<b>Obligations Incurred by Apportionment Type and Category</b>		
(Dollars in Millions)		
	<b>2010</b>	<b>2009</b>
Direct:		
Category A	\$ 1,547	\$ 1,385
Category B	338,668	389,623
Exempt from Apportionment	4	80
	<u>340,219</u>	<u>391,088</u>
Reimbursable:		
Category A	-	-
Category B	-	-
Exempt from Apportionment	90	94
	<u>90</u>	<u>94</u>
<b>Obligations Incurred</b>	<b><u>\$ 340,309</u></b>	<b><u>\$ 391,182</u></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, 2010 and 2009, consisted of the following:

**Unused Borrowing Authority**

(Dollars in Millions)

	<b>2010</b>	<b>2009</b>
<b>Beginning Balance, Unused Borrowing Authority</b>	<b>\$ 106,355</b>	<b>\$ 25,930</b>
Current Year Borrowing Authority	183,079	200,265
Funds Drawn From Treasury	(155,346)	(117,101)
Borrowing Authority Withdrawn	(968)	(2,739)
<b>Ending Balance, Unused Borrowing Authority</b>	<b>\$ 133,120</b>	<b>\$ 106,355</b>

The Department is given authority to draw funds from Treasury to finance the Direct Loan, FFEL, and TEACH Programs. 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, 2010 and 2009, consisted of the following:

**Undelivered Orders**

(Dollars in Millions)

	<b>2010</b>	<b>2009</b>
Budgetary	\$ 90,281	\$ 92,035
Non-Budgetary	147,260	132,500
<b>Undelivered Orders (Unpaid)</b>	<b>\$ 237,541</b>	<b>\$ 224,535</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.

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

The FY 2012 *Budget of the United States Government* (President's Budget) presenting the actual amounts for the year ended September 30, 2010, has not been published as of the issue date of these financial statements. The FY 2012 President's Budget is scheduled for release in February 2011. A reconciliation of the FY 2009 SBR to FY 2011 President's Budget (FY 2009 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)

	<u>Budgetary Resources</u>	<u>Obligations Incurred</u>	<u>Distributed Offsetting Receipts</u>	<u>Net Outlays</u>
<b>Combined Statement of Budgetary Resources</b>	\$ 437,777	\$ 391,182	\$ 31,763	\$ 165,158
Expired Funds	(1,377)	(630)	-	-
Amounts included in the President's Budget	11,787	11,787	-	-
Funds excluded from President's Budget and Rounding	(3)	2	(4)	-
<b><i>Budget of the United States Government*</i></b>	<b><u>\$ 448,184</u></b>	<b><u>\$ 402,341</u></b>	<b><u>\$ 31,759</u></b>	<b><u>\$ 165,158</u></b>

\*Amounts obtained from the Appendix, Budget of the United States Government, FY 2011.

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 2009 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 includes subsidy re-estimates that will be executed in future periods. The Reconciliation of Net Cost of Operations to Budget as of September 30, 2010 and 2009, are presented below:

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

(Dollars in Millions)

	<b>2010</b>	<b>2009</b>
<b>Resources Used to Finance Activities</b>		
Obligations Incurred	\$ (340,309)	\$ (391,182)
Spending Authority from Offsetting Collections and Recoveries	59,110	56,300
Offsetting Receipts	29,046	31,763
Imputed Financing from Costs Absorbed by Others	(30)	(32)
<b>Total Resources Used to Finance Activities</b>	<b>(252,183)</b>	<b>(303,151)</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 (+/-)	(13,755)	(137,170)
Resources that Fund Expenses Recognized in Prior Period	10,883	1,091
Credit Program Collections which Increase/Decrease Liabilities for Loan Guarantees, or Credit Program Receivables, Net including Allowances for Subsidy	43,806	39,495
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	(180,400)	(147,800)
<b>Total Resources Used to Finance Items Not Part of the Net Cost of Operations</b>	<b>(139,466)</b>	<b>(244,384)</b>
<b>Components Not Requiring or Generating Resources</b>		
Depreciation and Amortization	1,469	325
Other (+/-)	-	448
<b>Total Components of the Net Cost of Operations that Will Not Require or Generate Resources</b>	<b>1,469</b>	<b>773</b>
<b>Components Requiring or Generating Resources in Future Periods</b>		
Increase in Annual Leave Liability	(3)	-
Upward/Downward Re-estimates of Credit Subsidy Expense	5,785	10,883
Increase in Exchange Revenue Receivable from the Public	5,868	2,957
Other (+/-)	(76)	(7)
<b>Total Components of the Net Cost of Operations that Will Require or Generate Resources in Future Periods</b>	<b>11,574</b>	<b>13,833</b>
<b>Net Cost of Operations</b>	<b>\$ (99,674)</b>	<b>\$ (44,161)</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 2010 and FY 2009, the Department collected \$0.6 million and \$1.0 million, respectively, in custodial revenues.

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

The *Recovery Act* provided \$97,407 million to the Department in supplemental appropriations for job preservation and state and local fiscal stabilization. This 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 children and youth from early learning programs through postsecondary education.

The *Recovery Act* created the State Fiscal Stabilization Fund (SFSF), a new program in which the Department awards grants to governors to help save jobs and drive education reform. The majority of SFSF funding was provided for awards made by formula in exchange for a commitment to advance essential education reforms to benefit children and youth from early learning through postsecondary education, increasing teacher effectiveness and ensuring an equitable distribution of qualified teachers, and turning around the lowest-performing schools. There are also two competitive programs within the SFSF: Race to the Top and Investing in Innovation. Race to the Top grants are being awarded to states that are leading the way with ambitious yet achievable plans for implementing coherent, compelling, and comprehensive education reform. Innovation and Improvement awards will support the development, validation, and expansion of revolutionary approaches to improving student achievement.

*Recovery Act* funding also was provided for several of the Department's key programs, including Student Financial Assistance, Education for the Disadvantaged, Special Education, School Improvement Programs, Rehabilitation Services and Disability Research, Institute of Education Sciences, Innovation and Improvement, Impact Aid, and Higher Education. In addition, *Recovery Act* funding was provided for Student Aid Administration and to the Office of Inspector General.



The status of *Recovery Act* funding as of September 30, 2010 and 2009 are presented below:

### American Recovery and Reinvestment Act of 2009

(Dollars in Millions)

	Cumulative Totals as of September 30, 2010		
	Appropriations	Obligations	Outlays
State Fiscal Stabilization Fund:			
SFSF Formula Grants	\$ 48,600	\$ 48,600	\$ 35,709
Investing in Innovation and Race to the Top	5,000	5,000	8
<b>Subtotal</b>	<b>53,600</b>	<b>53,600</b>	<b>35,717</b>
Student Financial Assistance:			
Federal Pell Grants	15,640	15,640	14,950
Mandatory Add-on Pell Grants*	643	643	643
Federal Work Study Grants	200	200	199
<b>Subtotal</b>	<b>16,483</b>	<b>16,483</b>	<b>15,792</b>
Education for the Disadvantaged:			
Title I Targeted/ Finance Incentive Grants	10,000	10,000	5,089
School Improvement Grants	3,000	3,000	44
<b>Subtotal</b>	<b>13,000</b>	<b>13,000</b>	<b>5,133</b>
Special Education:			
IDEA Part B Grants to States	11,300	11,300	5,660
IDEA Part B Preschool Grants	400	400	167
IDEA Part C Grants for Infants and Families	500	500	253
<b>Subtotal</b>	<b>12,200</b>	<b>12,200</b>	<b>6,080</b>
School Improvement Programs:			
Enhancing Education through Technology	650	650	218
Education for Homeless Children and Youths	70	70	35
<b>Subtotal</b>	<b>720</b>	<b>720</b>	<b>253</b>
Rehabilitation Services and Disability Research:			
Vocational Rehabilitation	540	540	230
Independent Living Centers	88	88	10
Services for Older Blind Individuals	34	34	11
State Grants	18	18	7
<b>Subtotal</b>	<b>680</b>	<b>680</b>	<b>258</b>
Institute of Education Sciences	250	250	2
Innovation & Improvement	200	200	23
Impact Aid:			
Section 8007(a) Formula Grants	40	40	40
Section 8007(b) Competitive Grants	60	60	6
<b>Subtotal</b>	<b>100</b>	<b>100</b>	<b>46</b>
Higher Education	100	100	2
Student Aid Administration	60	60	52
Office of Inspector General	14	3	3
<b>Total</b>	<b>\$ 97,407</b>	<b>\$ 97,396</b>	<b>\$ 63,361</b>

\* An additional \$831 million provided by the Recovery Act was to be made available during FY 2010; however, this funding was repealed by *HCERA*, effective July 1, 2010.

## American Recovery and Reinvestment Act of 2009

(Dollars in Millions)

	<b>Cumulative Totals as of September 30, 2009</b>		
	<b>Appropriations</b>	<b>Obligations</b>	<b>Outlays</b>
State Fiscal Stabilization Fund:			
SFSF Formula Grants	\$ 48,600	\$ 35,429	\$ 12,433
Investing in Innovation and Race to the Top	5,000	-	-
<b>Subtotal</b>	<b>53,600</b>	<b>35,429</b>	<b>12,433</b>
Student Financial Assistance:			
Federal Pell Grants	15,640	7,854	6,300
Mandatory Add-on Pell Grants	643	643	549
Federal Work Study Grants	200	200	55
<b>Subtotal</b>	<b>16,483</b>	<b>8,697</b>	<b>6,904</b>
Education for the Disadvantaged:			
Title I Targeted/ Finance Incentive Grants	10,000	9,936	804
School Improvement Grants	3,000	-	-
<b>Subtotal</b>	<b>13,000</b>	<b>9,936</b>	<b>804</b>
Special Education:			
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>Subtotal</b>	<b>12,200</b>	<b>12,200</b>	<b>791</b>
School Improvement Programs:			
Enhancing Education through Technology	650	641	1
Education for Homeless Children and Youths	70	70	6
<b>Subtotal</b>	<b>720</b>	<b>711</b>	<b>7</b>
Rehabilitation Services and Disability Research:			
Vocational Rehabilitation	540	539	21
Independent Living Centers	88	-	-
Services for Older Blind Individuals	34	34	-
State Grants	18	18	1
<b>Subtotal</b>	<b>680</b>	<b>591</b>	<b>22</b>
Institute of Education Sciences	250	-	-
Innovation & Improvement	200	1	-
Impact Aid:			
Section 8007(a) Formula Grants	40	40	40
Section 8007(b) Competitive Grants	60	-	-
<b>Subtotal</b>	<b>100</b>	<b>40</b>	<b>40</b>
Higher Education	100	-	-
Student Aid Administration	60	29	1
Office of Inspector General	14	1	1
<b>Total</b>	<b>\$ 97,407</b>	<b>\$ 67,635</b>	<b>\$ 21,003</b>

**Note 19. Education Jobs Fund**

P.L. 111-226, enacted on August 10, 2010, created an Education Jobs Fund which allows the Department to provide assistance in saving and creating education jobs. This investment of \$10 billion was made available to states through formula grants for use in the 2010-2011 school year for teachers and other employees of our nation's children and youth from early learning programs through secondary education. As of September 30, 2010, \$9,007 million has been obligated and \$1,232 million has been expended to support states and local school districts in their effort to save jobs.

**Note 20. 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 estimated 370,000 students affected by Hurricanes Katrina and Rita. As of September 30, 2010, \$1,945 million has been appropriated to the Department, of which \$1,939 million has been obligated to assist local educational agencies and non-public schools, and \$1,845 million has been expended. As of September 30, 2009, \$1,945 million had been appropriated to the Department, of which \$1,941 million had been obligated to assist local educational agencies and non-public schools, and \$1,818 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, 2010, \$61 million has been obligated from the earmarked funds to assist in the relief and recovery efforts and \$57 million has been expended. 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.

**Note 21. 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 FY 2010, the Department provided funding of 82.5 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 17.5 percent of program funding. For the latest academic year ended June 30, 2010, approximately 441 thousand loans were made, totaling approximately \$816.4 million at 1,540 institutions, averaging \$1,852 per loan. The Department's share of the Federal Perkins Loan Program was approximately \$6.6 billion as of June 30, 2010.

In FY 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 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.

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, 2010**

*Dollars in Millions*

	Combined		Federal Student Aid		Office of Elementary and Secondary Education		Office of Special Education and Rehabilitative Services		American Recovery and Reinvestment Act and Education Jobs Fund		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	\$ 36,601	\$ 9,994	\$ 5,659	\$ 9,690	\$ 790		\$ 60		\$ 29,772		\$ 320	\$ 304
Recoveries of prior year Unpaid Obligations	1,077	4,436	401	4,434	519		24		13		120	2
Budgetary Authority:												
Appropriations	96,823	2	38,309		22,547		16,310		10,831		8,826	2
Borrowing Authority (Note 15)		183,079		182,901								178
Spending authority from offsetting collections (gross):												
Earned												
Collected	1,613	51,979	1,499	51,912			5				109	67
Change in Receivables from Federal Sources	(2)	3		3			(1)				(1)	
Change in unfilled customer orders												
Without advance from Federal Sources		4		4								
Subtotal	\$ 98,434	\$ 235,067	\$ 39,808	\$ 234,820	\$ 22,547		\$ 16,314		\$ 10,831		\$ 8,934	\$ 247
Temporarily not available pursuant to Public Law	(561)		(561)									
Permanently not available	(5,204)	(17,355)	(4,002)	(17,333)	(205)		(35)		(831)		(131)	(22)
<b>Total Budgetary Resources (Note 15)</b>	<b>\$ 130,347</b>	<b>\$ 232,142</b>	<b>\$ 41,305</b>	<b>\$ 231,611</b>	<b>\$ 23,651</b>	<b>\$ 0</b>	<b>\$ 16,363</b>	<b>\$ 0</b>	<b>\$ 39,785</b>	<b>\$ 0</b>	<b>\$ 9,243</b>	<b>\$ 531</b>
<b>Status of Budgetary Resources:</b>												
Obligations incurred: (Note 15)												
Direct	\$ 123,731	\$ 216,488	\$ 37,131	\$ 216,202	\$ 22,774		\$ 16,314		\$ 38,781		\$ 8,731	\$ 286
Reimbursable	90						2				88	
Unobligated Balances:												
Apportioned	2,351	1,433	192	1,433	838		13		996		312	
Unobligated Balance not available	4,175	14,221	3,982	13,976	39		34		8		112	245
<b>Total Status of Budgetary Resources</b>	<b>\$ 130,347</b>	<b>\$ 232,142</b>	<b>\$ 41,305</b>	<b>\$ 231,611</b>	<b>\$ 23,651</b>	<b>\$ (0)</b>	<b>\$ 16,363</b>	<b>\$ (0)</b>	<b>\$ 39,785</b>	<b>\$ (0)</b>	<b>\$ 9,243</b>	<b>\$ 531</b>
<b>Change in Obligated Balance:</b>												
Obligated balance, net:												
Unpaid obligations, brought forward, October 1	\$ 95,488	\$ 133,797	\$ 15,909	\$ 133,575	\$ 14,705		\$ 8,168		\$ 46,632		\$ 10,074	\$ 222
Uncollected customer payments from Federal Sources, brought forward, October 1	(4)	(7)		3			(1)				(3)	(10)
Total, unpaid obligated balance, brought forward, net	\$ 95,484	\$ 133,790	\$ 15,909	\$ 133,578	\$ 14,705		\$ 8,167		\$ 46,632		\$ 10,071	\$ 212
Obligation Incurred, net	123,821	216,488	37,131	216,202	22,774		16,316		38,781		8,819	286
Gross Outlays	(123,539)	(195,018)	(34,746)	(194,738)	(21,622)		(15,323)		(43,590)		(8,258)	(280)
Recoveries of prior year unpaid obligations, actual	(1,077)	(4,436)	(401)	(4,434)	(519)		(24)		(13)		(120)	(2)
Change in uncollected customer payments from Federal Sources	2	(7)		(7)			1				1	
Obligated Balance, net, end of period:												
Unpaid Obligations	\$ 94,693	\$ 150,831	\$ 17,893	\$ 150,605	\$ 15,338		\$ 9,137		\$ 41,810		\$ 10,515	\$ 226
Uncollected customer payments from Federal Sources	(2)	(14)		(4)							(2)	(10)
<b>Total, unpaid obligated balance, net, end of period</b>	<b>\$ 94,691</b>	<b>\$ 150,817</b>	<b>\$ 17,893</b>	<b>\$ 150,601</b>	<b>\$ 15,338</b>	<b>\$ (0)</b>	<b>\$ 9,137</b>	<b>\$ (0)</b>	<b>\$ 41,810</b>	<b>\$ (0)</b>	<b>\$ 10,513</b>	<b>\$ 216</b>
<b>Net Outlays:</b>												
Gross Outlays	\$ 123,539	\$ 195,018	\$ 34,746	\$ 194,738	\$ 21,622		\$ 15,323		\$ 43,590		\$ 8,258	\$ 280
Offsetting collections	(1,613)	(51,979)	(1,499)	(51,912)			(5)				(109)	(67)
Distributed Offsetting receipts	(29,046)		(28,787)								(259)	
<b>Net Outlays (Note 15)</b>	<b>\$ 92,880</b>	<b>\$ 143,039</b>	<b>\$ (4,460)</b>	<b>\$ 142,826</b>	<b>\$ 21,622</b>	<b>\$ (0)</b>	<b>\$ 15,318</b>	<b>\$ (0)</b>	<b>\$ 43,590</b>	<b>\$ (0)</b>	<b>\$ 7,890</b>	<b>\$ 213</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. The Department's FY 2010 appropriations of \$63.1 billion represent less than 2 percent of the federal government's \$3.6 trillion FY 2010 budget.

### Investment in Human Capital

The Department of Education invests in human capital through its grant and loan programs, research, leadership, and technical assistance.

**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 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 also is 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 also is 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/oi/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 academic 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. 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>.

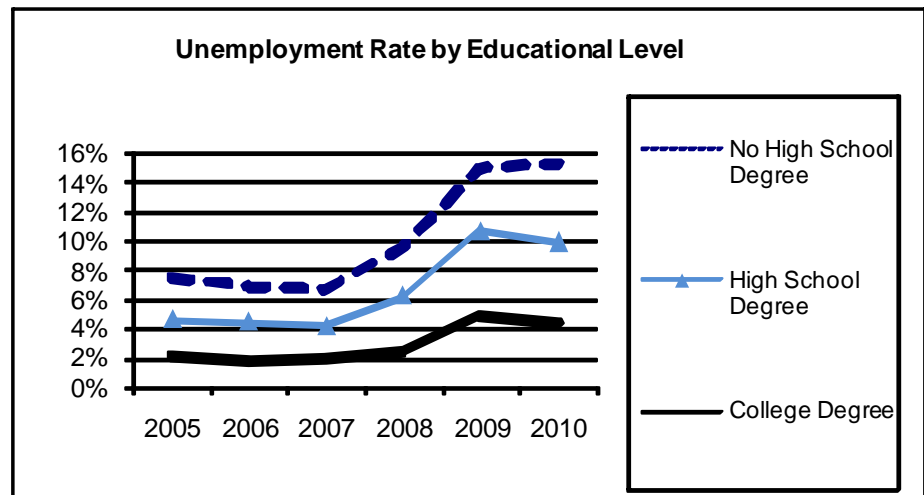
**Office of Postsecondary Education.** The Office of Postsecondary Education provides grants to colleges and universities, as well as to nonprofit organizations, to promote reform, innovation, and improvement in postsecondary education; increase access to and completion of postsecondary education by 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)	2010	2009	2008	2007	2006
<b>Federal Student Aid Expense</b>					
Direct Loan Subsidy	\$ (1,567)	\$ (9,603)	\$ 5,236	\$ (499)	\$ 6,655
FFEL Program Subsidy	(14,344)	(29,940)	(2,852)	4,884	28,062
Grant Programs	26,799	17,302	17,464	15,092	15,447
Salaries and Administrative	208	186	189	173	172
<b>Subtotal</b>	<b>11,096</b>	<b>(22,055)</b>	<b>20,037</b>	<b>19,650</b>	<b>50,336</b>
<b>Other Departmental</b>					
Elementary and Secondary Education	21,608	21,443	21,583	21,199	21,710
Special Education and Rehabilitative Services	15,227	15,075	15,730	15,402	15,215
American Recovery and Reinvestment and Education Jobs Fund	44,019	21,616			
Other Departmental Programs	7,067	7,150	4,911	5,109	5,353
Salaries and Administrative	502	472	491	467	467
<b>Subtotal</b>	<b>88,423</b>	<b>65,756</b>	<b>42,715</b>	<b>42,177</b>	<b>42,745</b>
<b>Grand Total</b>	<b>\$ 99,519</b>	<b>\$ 43,701</b>	<b>\$ 62,752</b>	<b>\$ 61,827</b>	<b>\$ 93,081</b>

## Program Outcomes

Education is the stepping stone to higher living standards for American citizens, and it is vital to national economic growth. However, education can lead to more than increased productivity and incomes. Education can help improve health, promote social change, and open 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 September 2010 unemployment rate for adults (25 years old and over) who had not completed high school was 15.4 percent, compared with 10.0 percent for those with four years of high school and 4.4 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 2010, 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 \$68,172 for men with a college degree. Women with a high school diploma earned \$28,184, compared with \$51,636 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.

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# **Report of the Independent Auditors**



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

THE INSPECTOR GENERAL

November 15, 2010

The 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 2010 and 2009, 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, 2010 and 2009, 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.

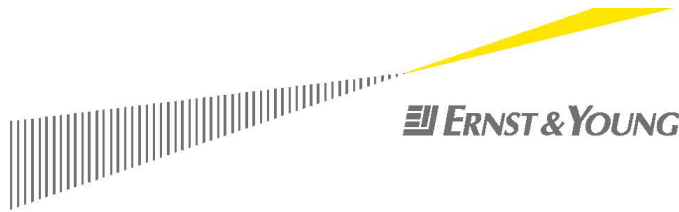
Sincerely,

A handwritten signature in blue ink that reads "Kathleen S. Tighe".

Kathleen S. Tighe  
Inspector General

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, 2010 and 2009, 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, 2010 and 2009, and its net cost, 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 15, 2010, 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.

A member firm of Ernst & Young Global Limited



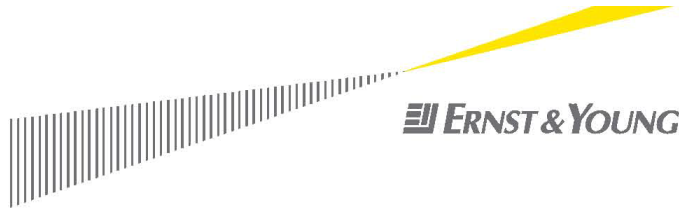
Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information presented in the Management’s Discussion and Analysis, required supplementary stewardship information, required supplementary information, and other accompanying information 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 15, 2010

A member firm of Ernst & Young Global Limited





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**Report on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

To the Inspector General  
U.S. Department of Education

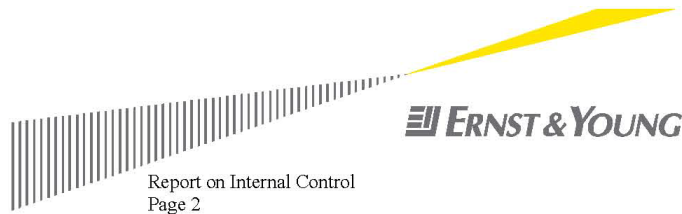
We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2010, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 15, 2010. 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.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the second 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 above. 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 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.

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## SIGNIFICANT DEFICIENCIES

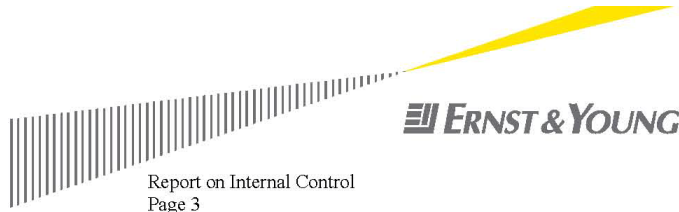
### **1. Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Modified Repeat Condition) –**

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 net 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 the last few years, several pieces of legislation have been enacted that have had a significant impact on the Department's loan programs. The *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) legislation, which was enacted during FY 2008, amended the Federal Family Education Loan (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. Additionally, the *Student Aid and Financial Responsibility Act* (SAFRA) included in the *Health Care and Education Reconciliation Act of 2010* (HCERA) was enacted during FY 2010. Under SAFRA, no new FFEL loans were authorized after June 30, 2010. This increased the Department's responsibility for originating federal student loans, primarily through the William D. Ford Federal Direct Loan program (direct loan program). As a result of SAFRA, the Department was required to implement the necessary processes surrounding the transition to originating a much increased volume of direct loans within a short time frame. The Department brought together representatives from throughout the organization to develop, implement and administer the activities surrounding the transition to direct loans and the temporary loan purchase authority. Representatives included individuals from the Office of the Chief Financial Officer (OCFO), Federal Student Aid (FSA), and Budget Service.

During FY 2010, we noted that the Department documented certain meetings in these areas as part of the Credit Reform Workgroup meetings. Management informed us that representatives maintained communication throughout the year on both the activities related to the transition to direct loans and the temporary loan purchase authority. These meetings occurred on both a formal and informal basis. Such discussions are an important part in developing the periodic re-

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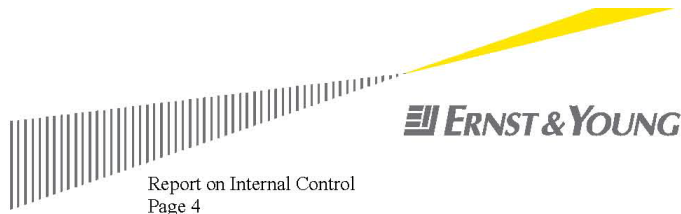
estimates for the direct and FFEL loan programs, since all the programs are interrelated. To the extent such groups execute critical review activities, they constitute a key control for the Department, and further structure and documentation around their activities can enhance confidence in the Department's estimation processes.

After identifying the challenges faced by the Department and the 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 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 accounts. 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. 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. During our testing, we noted that management has no formal detailed review procedures surrounding the input of the many variables into the SLM, the input of cash flows into the OMB calculator or the process surrounding the analytical tools. Management does perform a high-level review of such data; however, this review is not sufficient to identify errors that may occur at a detailed level. In one instance during our testing, we noted an error in one of the allowance calculations that resulted in an adjustment to the financial statements of approximately \$900 million. Additionally, we noted calculation errors in certain of the analytical tools used by the Department, including the backcast, back of the envelope, and fluctuation analysis. While these calculation errors in certain analytical tools did not directly impact amounts in the financial statements, the analytical tools should contain accurate information if they are to serve their purpose as a detect control. Implementing a detail review process may reduce the potential for errors occurring in all aspects of this complex re-estimate and also in the analytical tools, leading to further refinement of the tools and facilitate their use in a formalized cross-functional review of the estimates.

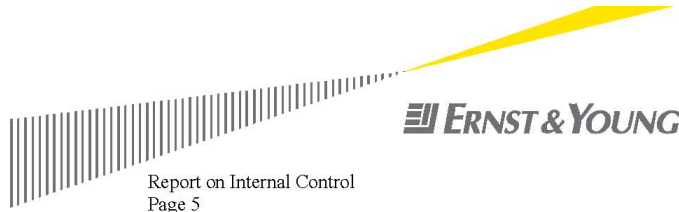
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- As noted above, the SLM produces a forecast of the expected cash flows in the current year for the outstanding loans which, when discounted, can be used to compare to the recorded activity in the general ledger. Additionally, other data analysis 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 and reconciliations using the cohort analysis data have not been fully successful in relating the net present value of estimated future cash flows embedded in the SLM to the corresponding amounts of: (1) adjusted debt balance and net receivables for the direct loan program, or (2) the adjusted Fund Balance with Treasury and liabilities for loan guarantees for FFEL guaranteed loans. Recent growth in the unexplained variances between these amounts highlights the need for management to devote substantial resources to comprehensively and definitively analyze the differences and work with OMB and Treasury to ensure complete transparency into this matter and the resolution thereof. Pending completion of this thorough cohort analysis, the advent of the temporary loan purchase authority programs and substantial increases in the volume of the direct loan program provide opportunities for the Department to implement rigorous cohort level accounting consistent with the requirements of the Credit Reform Act and applicable OMB guidance.
- The early phase of the loan estimation process includes the development of the assumptions, which are used to populate the SLM with data that, in turn, feeds into the OMB calculator, which arrives at the actual cost re-estimates. In order to develop a majority of the assumptions, the Department utilizes the National Student Loan Database System (NSLDS) to extract a sample of loan data, which is known as the Statistical Abstract (STAB). The Department then executes internally developed computer programs to arrive at the assumption data that is entered into the SLM. During our review of the program logs for defaults, deferment, and forbearance, we encountered errors in certain of the computer programs for defaults, which appear to have stopped the program from processing certain steps. Additionally, based on a review of the log files for the deferment and forbearance assumptions, we noted that two of the models associated with the FFEL program did not converge. Lack of convergence may render estimation parameters unreliable, as the estimation process has not completed. After further inquiry, management informed us that the program errors and impact of the non-convergence were assessed and addressed as management deemed appropriate. However, management did not retain documentation surrounding their assessment of these issues. We noted enhancements in the detailed documentation for the deferment and default assumptions; however, the documentation could be further strengthened by adding additional detail, such as an assessment of the impact of the log errors and non-convergence issues, or reasons for adding to or removing variables from the models. We also noted that in some instances documentation of the steps performed by the Department did not precisely correspond with the computer programs themselves.

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- 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 economic conditions, including high 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.

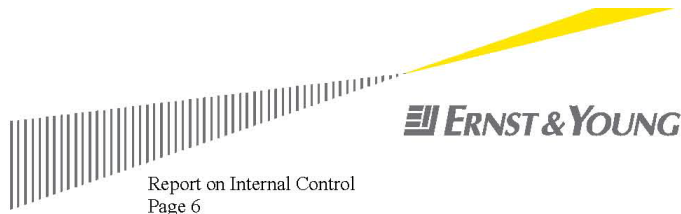
Since the Department's approach to estimating deferment, forbearance, and default rates includes unemployment rates for selected loan products, and since forecasts of these external factors are used in arriving at the projected deferment, forbearance, and default amounts, the Department's estimates would be expected to capture some of the indirect impact of the economic environment. However, since the models produce estimates 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 conditions last for varying lengths of time.

#### **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 deferment, forbearance and default rates by cohort in light of recent changes in the economic environment to determine the extent to which there may be differences in performance across cohorts.
  - Perform additional forms of stress-testing estimates with additional variables, such as alternative unemployment, interest rate, Gross Domestic Product growth, and inflation scenarios.
2. Implement formal detail review procedures over the input of variables into the SLM, input of cash flows into the OMB calculator and other calculations surrounding the process to avoid potential errors that may negatively affect the re-estimates. Also,

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perform a detailed review of the input 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.

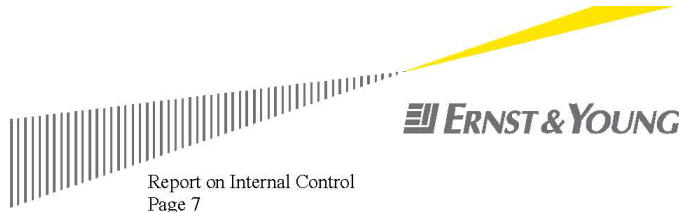
3. Strengthen the documentation related to internally developed computer programs, including documentation of changes in the programs and variables used, review and resolution of errors appearing in logs, and adding detailed comments to the programs to enhance clarity of the code.
4. Dedicate appropriate time and resources to thoroughly analyze, evaluate, and resolve the unexplained variances between the net present value of the future cash flows and adjusted debt balance or Fund Balance with Treasury. Also 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.
5. 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 indications of program participant performance, stress, and anticipated changes in behavior in response to changing market and economic conditions.

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

In connection with the annual audit of the Department's FY 2010 financial statements, we conducted a controls review of the information technology processes related to the significant accounting and financial reporting systems. OMB Circular A-130, *Management of Federal Information Resources*, requires: (1) standard documentation and procedures for certification and accreditation of systems; (2) records management programs that provide adequate and proper documentation of agency activities; (3) agencies to develop internal information policies and procedures and oversee, evaluate, and otherwise periodically review agency information resource management activities; and (4) agency plans to assure that there is an ability to recover and provide service sufficient to meet the minimal needs of users of the system.

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

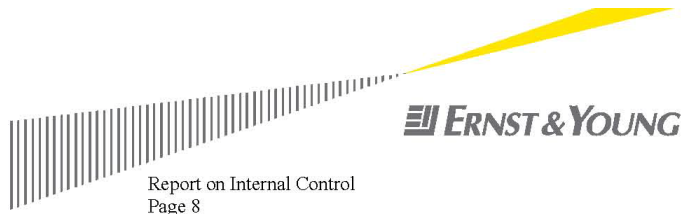
- “management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control and conscientious management,” and
- “internal control monitoring should assess the quality of performance over time and ensure that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

While the Department has worked toward strengthening and improving controls over information technology processes during FY 2010, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of IT general controls at the Department and FSA, we identified the following deficiencies: (1) lack of monitoring of the activities of administrator and privileged user accounts at the application layer; (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 or users were not revalidated by the appropriate members of management; (4) password configurations for applications 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; (7) controls related to the change management process were not consistently applied during the audit period, specifically, documentation of approvals for application changes were not consistently maintained, improper segregation of environments exists where users have access to make changes to code and migrate changes to production, and select code elements are migrated to production without being tested; and (8) 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 fiscal year 2010. In its review of the Virtual Data Center, the OIG noted that FSA did not have adequate operational controls in place over configuration management, system and information integrity, contingency planning, media protection, and awareness and training. In addition, FSA needs to improve all four technical controls of access controls, systems and communications protection, identification and authentication, and audit and accountability. As it relates to OIG's Investigative Program Advisory Report, the OIG noted that the

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Department and FSA have not performed adequate log reviews as it relates to the identification of unauthorized activity for compromised accounts. In addition, FSA does not keep adequate records of its remediation efforts for compromised accounts. The OIG reviewed the implementation of the Managed Security Services Provider (MSSP) contract and noted that the Department has not implemented measures to effectively support the MSSP contract. Specifically, the current contractor is unable to provide the level of service required by the contract due to lack of required access. As a result, while the Department has procured services from the MSSP contractor, the Department has not ensured that its information technology network is adequately protected. Finally, during OIG's review of FSA's Financial Management System, the OIG found FSA did not have adequate controls in place over personnel security and security and awareness training.

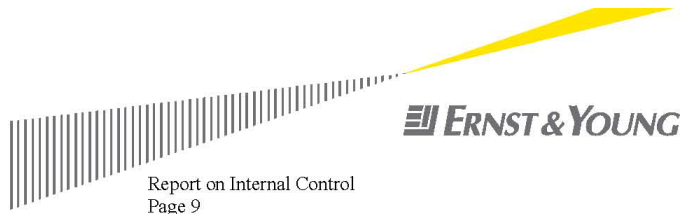
In addition, several of the above deficiencies are repeat conditions (although for different platforms or systems) that were noted in our work and in the OIG's audit reports, an indication that the control environment and monitoring components of internal controls at the Department require additional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

**Recommendations:**

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 National Institute of Standards and Technology 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 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 information technology process areas, 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.

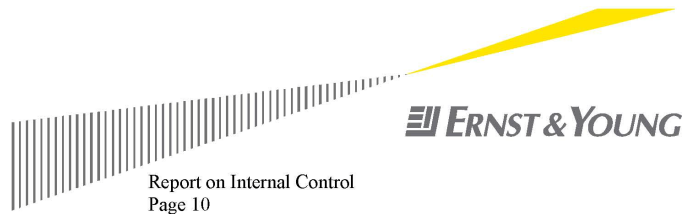
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More specifically the Department should: (1) implement standards around the logging of privileged user access and activities and establish controls over the monitoring of that access; (2) strengthen access controls to protect mission critical systems (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) enhance its security training and awareness program, specifically around actions to be taken in the event an employee encounters suspicious activity; (5) revise current methods of identifying and logging suspicious activity as it relates to unauthorized access accounts and data; (6) document and update as required information pertaining to system interfaces including Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding; (7) implement two-factor authentication on any system where a user can log into a privileged account from the Internet; and (8) evaluate alternatives for obtaining MSSP services and proceed with a solution that will allow for adequate network protection.

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**STATUS OF PRIOR YEAR FINDINGS**

In the reports on the results of the FY 2009 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 2009 Significant Deficiencies

<b>Issue Area</b>	<b>Summary Control Issue</b>	<b>FY 2010 Status</b>
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
Additional Focus on Controls and Financial Reporting Processes Related to the American Recovery and Reinvestment Act is Needed	Management controls need to be strengthened over cash management activities and non-routine grant accrual procedures related to <i>American Recovery and Reinvestment Act of 2009</i> funding.	Improvements Noted – Not classified as a significant deficiency at September 30, 2010

We have reviewed our findings and recommendations with Department management. Management generally concurs with our findings and recommendations in their response and will provide a corrective action plan to the OIG in accordance with applicable Department directives. We did not audit management’s response, and accordingly, we express no opinion on it.

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 15, 2010

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**Report on Compliance and Other Matters Based on an Audit of Financial Statements  
Performed in Accordance with *Government Auditing Standards***

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, 2010, 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 15, 2010. 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.

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 and Other Matters  
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 toward strengthening and improving controls over information technology processes during FY 2010, 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 and privileged user accounts at the application layer; (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 or users were not revalidated by the appropriate members of management; (4) password configurations for applications 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; (7) controls related to the change management process were not consistently applied during the audit period, specifically, documentation of approvals for application changes were not consistently maintained, improper segregation of environments exists where users have access to make changes to code and migrate changes to production, and select code elements are migrated to production without being tested; and (8) 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 fiscal year 2010. In its review of the Virtual Data Center, the OIG noted that FSA did not have adequate operational controls in place over configuration management, system and information integrity, contingency planning, media protection, and awareness and training. In addition, FSA needs to improve all four technical controls of access controls, systems and communications protection, identification and authentication, and audit and accountability. As it relates to OIG's Investigative Program Advisory Report, the OIG noted that the Department and FSA have not performed adequate log reviews as it relates to the identification of unauthorized activity for compromised accounts. In addition, FSA does not keep adequate records of its remediation efforts for compromised accounts. The OIG reviewed the implementation of the Managed Security Services Provider (MSSP) contract and noted that the Department has not implemented measures to effectively support the MSSP contract. Specifically, the current contractor is unable to provide the level of service required by the contract due to lack of required access. As a result, while the Department has procured services from the MSSP contractor, the Department has not ensured that its information technology network is adequately protected. Finally, during OIG's review of FSA's Financial Management System, the OIG found FSA did not have adequate controls in place over personnel security and security and awareness training.

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Our Report on Internal Control dated November 15, 2010, includes additional information related to the financial management systems that were found not to comply with the requirements of FFMA relating to information technology security and controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMA, 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.

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 15, 2010

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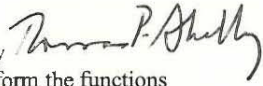



UNITED STATES DEPARTMENT OF EDUCATION  
WASHINGTON, D.C. 20202-\_\_\_\_\_

NOV 10 2010

MEMORANDUM

TO: Kathleen S. Tighe  
Inspector General

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

Danny A. Harris, Ph.D.   
Chief Information Officer

SUBJECT: DRAFT AUDIT REPORTS  
Fiscal Years 2010 and 2009 Financial Statement Audit  
U.S. Department of Education  
ED-OIG/A17K0001

Please convey our sincere thanks and appreciation to everyone on your staff who worked diligently on this financial statement audit. The Department reviewed the draft Fiscal Years 2010 and 2009 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 the preparation of corrective action plans to be used in the resolution process.

Again, please convey our appreciation to everyone on your staff whose efforts permitted the Department to complete the audit within the established timeframe.

Please contact Gary Wood at (202) 245-8118 with questions or comments.

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# **Other Accompanying Information**

## ***Improper Payments Information Act Reporting Details***

The recently enacted *Improper Payments Elimination and Recovery Act of 2010 (IPERA)* (Public Law 111-204), which amends 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, Part A Program; Other Grant Programs; and Recovery Auditing.

### **Student Financial Assistance Programs**

#### **Risk Assessment**

As required by the IPIA, Federal Student Aid (FSA) inventoried its programs during FY 2010 and reviewed program payments made during FY 2009 (the most recent complete fiscal year available) to assess the risk of improper payments. The review identified and then focused on the following key Title IV programs: William D. Ford Federal Direct Loan (Direct Loan) Program, Federal Family Education Loan (FFEL) Program, to include the legacy FFEL Program, the *Ensuring Continued Access to Student Loans Act (ECASLA)* programs, and servicing of FFEL loans acquired through ECASLA, and the Federal Pell Grant Program.

The ACG/SMART Grant Programs were deemed to be low risk programs for FY2010. These programs are budgeted together and have a five-year life, ending with the academic school year 2010-2011. A risk assessment was completed for the ACG/SMART Programs in FY 2009, and was not repeated in FY 2010 because of the prior favorable results (i.e., estimated improper payment rates of .0045 percent and .00001 percent, respectfully), and upcoming program termination. The FY 2009 improper payment risk assessment methodology is described in the *FY 2009 Agency Financial Report*. No further information on these programs is included herein.

In addition to the A-123 guidance, the criteria for determining susceptible risk within the programs were defined as those 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>2</sup>

### 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 Direct Loan, FFEL, and Pell Grant.

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 2011.

**Direct Loan Program.** A risk assessment was completed for the Direct Loan Program in FY 2010. There were no changes to the sampling process from prior years. The overall improper payment rate, based on this risk analysis, was 0.30 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 (Legacy).** The FFEL legacy programs include Special Allowance Payment (SAP), Interest Benefits, Lender Fees, Origination Fees, Consolidation Loan Rebate Fees, Claims Paid, Account Maintenance Fee, VFA Payments, Loan Processing & Issuance Fees, and various other payments/collections to/from Guaranty Agencies (GAs). The FFEL SAP risk analyses that were undertaken last year in lieu of a measurement and described in the Department's FY 2009 AFR did not yield any result that could help inform decisions on improper payment measurement and were suspended. Accordingly, FSA did not use these risk analyses to calculate an FY 2010 error rate and no estimate of FY 2010 improper payments is provided.

**FFEL Program (ECASLA; Servicing of FFEL loans acquired through ECASLA).** 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 *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:

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

FSA determined that each of these, as well as the servicing of acquired FFEL loans, constitute a risk-susceptible program. A risk assessment for each of these components and

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<sup>2</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.

in the aggregate was completed during FY 2010. The overall improper payment rate, based on the risk analysis, was 0.000011 percent. Since this rate is below the threshold of reporting on improper payments, no further information on *ECASLA* or servicing of FFEL loans acquired through *ECASLA* is included herein.

**Pell Grant Program.** A risk assessment was completed for Pell Grant Program in FY 2010. There were no changes to the sampling process from prior years. The overall improper payment rate, based on this risk analysis, was 3.12 percent.

### 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 (Legacy).** The FFEL SAP risk analyses that were undertaken last year in lieu of a measurement as described in the *FY 2009 Agency Financial Report* did not yield any result that could help inform decisions on improper payment estimation. Accordingly, FSA did not use these risk analyses to calculate an FY 2010 error rate and no estimate of FY 2010 improper payments is provided.

In FY 2009, Federal Student Aid worked with OMB to target their improper payment 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 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.

**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 did not change in FY 2010 and additional details about the study can be found in the FY 2009 AFR, under Corrective Actions.

### Corrective Actions

**FFEL Program.** In addition to the payment data analyses mentioned above, FSA 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 hard edits require correction before proceeding with payment processing. The soft edits alert the user and FSA to potential errors. FSA reviews these warnings prior to approval of payment.
- **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. FSA 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**—FSA 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, FSA 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.** FSA implemented the 2009-10 Internal Revenue Service (IRS) data retrieval process, as a pilot on January 28, 2010, as planned. As of June 2010, over 600,000 users had gone to the IRS Web site to retrieve their income information. Approximately half of those users then transferred their income tax return data to the FAFSA on the Web (FOTW) application.

As a follow up to the successful 2009–10 pilot, the IRS data retrieval process for initial and renewal applications is enabled on the 2010–2011 FOTW site. This went live in September 2010. The IRS data retrieval process again enables Title IV student aid applicants and parents of dependent applicants to transfer certain tax return information from an IRS Web site directly to their 2010–2011 FOTW application. For 2010–2011, FSA is also expanding the availability of the IRS data retrieval process to include applicants using the Spanish version of the FOTW application. For the 2011–12 cycle year, the data match will be implemented in late January 2011 with hopes that the 2011–12 applicants and parents of dependent students can access and transfer IRS data earlier in the year directly into their 2011–12 FOTW.

FSA will continue to explore ways to facilitate the detection of error, based on the results of the FAFSA/IRS Data Statistical Study. Additionally, FSA continues to simplify the application process, which now includes real-time access for applicants and their parents to previously filed IRS tax information. These enhancements, coupled with improved error detection, should allow FSA to further reduce improper payments.

## Federal Student Aid Improper Payment Reporting Summary

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

Program	FY 2010 Actual			FY 2011 Estimated			FY 2012 Estimated			FY 2013 Estimated			FY 2014 Estimated		
	Outlays \$	IP %	IP \$	Outlays \$	IP %	IP \$	Outlays \$	IP %	IP \$	Outlays \$	IP %	IP \$	Outlays \$	IP %	IP \$
Pell Grant <sup>(1)</sup>	32,215	3.12	1,005	32,454	3.3	1,071	35,058	3.3	1,157	35,630	3.3	1,176	36,639	3.3	1,209

<sup>(1)</sup> The source of FY 2010 Pell outlays reflects total expenditures from FMSS. These numbers are considered estimates because the Pell rate is preliminary.

The chart above uses a preliminary Pell improper payment (IP) percentage for FY 2010. The FY 2010 IP percentage is scheduled to be finalized after issuance of the Department's AFR. The target 3.3 IP percentage used for 2011–2014 is based on potential improvements over the FY 2009 rate. Analysis of the FY 2010 data will be performed through early 2011 to determine whether the decrease from FY 2009 is statistically significant, and if so, what caused it. The IRS data retrieval study may affect the rate in FY 2012, but should not affect the rate for FY 2011 because the process went live late in the award year.

Note: The final Pell error rate for FY 2009 was 3.5 percent. This 3.5 percentage rate was reported as “preliminary” in the FY 2009 AFR; 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 2005 through September 30, 2010, are presented in the following table.

<b><u>Pell Recoveries</u></b> <b>(Dollars in Millions)</b>					
<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
11.2	13.6	14.2	10.8	6.6	6.7

### Statutory and Regulatory Barriers

There are currently no identified barriers which may limit Federal Student Aid's corrective actions in reducing improper payments.

## ***Elementary and Secondary Education Act of 1965, Title I, Part A Program***

The Department performed a risk assessment of the *Elementary and Secondary Education Act of 1965* Title I Grants to Local Educational Agencies, during FY 2010. The assessment, based on FY 2008 single audit data (the most recent available), yielded an estimated improper payment rate of 0.04 percent or \$4.7 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.

### **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 2010, 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.

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 2008), none of the functional programs exceed the threshold value of 2.5 percent. Consequently, none of the programs would be labeled as susceptible to significant erroneous payments.

**Managing Risk in Discretionary Grants.** In FY 2010, 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, 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 2011 and FY 2012 for information system infrastructure improvements. A portion of the funds will be used to continue the refinement of data mining efforts and the possible extension of recapture auditing efforts. 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 \$97.4 billion. The law created the new \$53.6 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 the *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 on a statistical sample of payment transactions. No improper payments were indicated in the review. The following chart presents the results of the Department's recovery auditing program.

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	\$1,033	\$19.1	\$0	\$0	\$0.3	\$0.1	\$0.3	\$0.1

## Summary

The Department is enhancing its efforts for identifying and reducing the potential for improper payments to comply with the *IPERA*. 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 2011, 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 *IPERA*.

## 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 83–100 and the Department's Management assurances on pages 25–26.

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	Consolidated	Reassessed	Ending Balance
<b>Total Material Weaknesses</b>	<b>0</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	Consolidated	Reassessed	Ending Balance
<b>Total Material Weaknesses</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</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	Consolidated	Reassessed	Ending Balance
<b>Total Non-Conformance</b>	<b>0</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		



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL

The Inspector General

October 6, 2010

**MEMORANDUM**

**TO:** Secretary Arne Duncan

**FROM:** Kathleen S. Tighe *Kathleen S. Tighe*  
Inspector General

**SUBJECT:** Management Challenges for Fiscal Year 2011

The Reports Consolidation Act of 2000 requires the U.S. Department of Education (Department), Office of Inspector General (OIG), to identify and report annually on the most serious management challenges the Department faces. To identify management challenges, we routinely examine issued audit reports where corrective actions have yet to be taken, assess ongoing investigative and audit work to identify significant vulnerabilities, and analyze new programs and activities that could pose significant challenges because of their breadth and complexity. We provided our current challenges report to Department officials and considered all comments received.

Last year we presented three management challenges: the *American Recovery and Reinvestment Act of 2009* (Recovery Act); student financial assistance (SFA) programs, with a focus on the *Ensuring Continued Access to Student Loans Act of 2008*; and information security and management. All three FY 2010 challenges have been carried over as challenges for FY 2011. Data Quality and Reporting, previously a sub-area under the Recovery Act challenge in FY 2010, has been expanded to include other programs and is presented as a challenge for FY 2011.

The FY 2011 management challenges are:

- (1) **Implementation of New Programs/Statutory Changes**, including the Recovery Act and changes to the SFA loan programs;
- (2) **Oversight and Monitoring**, including SFA program participants, distance education, grantees, and contractors;
- (3) **Data Quality and Reporting**, including program data and Recovery Act reporting requirements; and
- (4) **Information Technology Security**.

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

## Office of Inspector General's Management Challenges for Fiscal Year 2011 Executive Summary

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 to identify and summarize the most significant management challenges facing the Department each year.

Last year, we reported three management challenges: the *American Recovery and Reinvestment Act of 2009 (Recovery Act)*; student financial assistance (SFA) programs, with a focus on the *Ensuring Continued Access to Student Loans Act of 2008*; and information security and management. All three have been updated as challenges for FY 2011, and Data Quality and Reporting, previously a sub-area, is presented as a separate challenge. The FY 2011 management challenges are:

- (1) Implementation of New Programs/Statutory Changes, including the *Recovery Act* and changes to the SFA loan programs;
- (2) Oversight and Monitoring, including SFA program participants, distance education, grantees, and contractors;
- (3) Data Quality and Reporting, including program data and *Recovery Act* reporting requirements; and
- (4) Information Technology Security.

### Implementation of New Programs and Statutory Changes

New programs or changes to existing programs often require the development of new guidance, grant applications, or other documents, new competitions, and other activities. Technical assistance and outreach activities are needed to ensure that recipients and/or other program participants understand the new requirements and any new responsibilities. Internal training efforts are required to ensure that responsible U.S. Department of Education (Department) staff fully understand the requirements. These activities often must take place within very short timeframes and generally without additional resources. This places a strain on Department staff to absorb the increased workload.

**Recovery Act.** The *Recovery Act* provided significant additional funding to help improve the economy and enhance education reforms. This included funding for new educational programs and existing programs. The Office of Inspector General (OIG) and the Government Accountability Office (GAO) have conducted significant amounts of work at the Department, State agencies, and Local Educational Agencies (LEAs). This work identified a number of control weaknesses related to the use of funds, cash management, subrecipient monitoring, and impacts on maintaining levels of funding for education programs. We made recommendations to improve implementation of *Recovery Act* programs. The Department has taken proactive measures to coordinate the effective implementation of the *Recovery Act* and to provide technical assistance to recipients. Additional oversight and monitoring could enhance the Department's ability to ensure that Federal funds are effectively managed and that deficiencies noted in audits and other reviews are corrected timely. Congress recently authorized an additional \$10 billion for the Education Jobs Fund to be

administered by the Department. The Department must provide further guidance and assistance to recipients on this new program, which includes *Recovery Act* reporting provisions as well as the previously authorized *Recovery Act* programs, identify and obtain additional resources for program monitoring, and take timely corrective actions to address issues noted in audits and other reviews.

**Changes to the SFA Loan Programs.** The *Student Aid and Financial Responsibility Act (SAFRA)* prohibited the making (origination) of new Federal Family Education Loan Program (FFELP) loans after June 30, 2010. New loans will be originated under the William D. Ford Federal Direct Loan (Direct Loan) Program. The Department's challenge is to expand its capacity to originate and service the increased Direct Loan volume, train and monitor schools new to the program, and continue oversight of FFELP lenders and guaranty agencies that service the existing portfolios. If the Department's implementation of *SAFRA* is not successful, the availability and delivery of student loans may be disrupted, impacting students and their families. The Department has taken actions to prepare for the transition, including providing outreach and technical support to schools, enhancing the key information systems, contracting with additional loan servicers, hiring additional staff, and developing contingency plans. We suggested that the Department establish effective contract monitoring practices and require appropriate system testing to ensure that systems perform adequately under the increased loan volume.

## Oversight and Monitoring

Effective oversight and monitoring of the Department's programs and operations are critical to ensure that funds are used for the purposes intended, programs are achieving goals and objectives, and the Department is obtaining the products and level of services for which it has contracted. This is a significant responsibility for the Department given the numbers of different entities and programs requiring monitoring and oversight, the amount of funding that flows through the Department, and the impact that ineffective monitoring could have on the students and taxpayers. Four areas are included in this management challenge—SFA program participants, distance education, grantees, and contractors.

**SFA Program Participants.** Effective oversight and monitoring of participants in the SFA programs under Title IV of the *Higher Education Act of 1965*, as amended (*HEA*) are needed to ensure that the programs are not subject to fraud, waste, abuse, and mismanagement. Under the President's budget, the Department expects to provide more than \$173.6 billion in grants, loans, and work-study assistance in FY 2011. Each year, approximately 14.8 million students and their families—47 percent of all students and 62 percent of full-time undergraduates—rely on the SFA programs to help fund their postsecondary educations. Participants in the SFA programs include postsecondary institutions, lenders, guaranty agencies, and third-party servicers. Our work has identified weaknesses in the Department's oversight and monitoring of these participants. The Department has taken corrective actions to address many of the recommendations contained in our prior reports. However, the Department needs to continue to assess and improve its oversight and monitoring of program participants and take effective actions when problems are identified.

**Distance Education.** Distance education refers to courses or programs offered through telecommunication, such as through Internet connection with a postsecondary institution. The flexibility offered is popular with students pursuing education on a non-traditional



schedule. Many institutions offer distance education programs as a way to increase their enrollment. Management of distance education programs presents a challenge for the Department and school officials because of limited or no physical contact to verify the student's identity or attendance. OIG audit work has found that for distance education programs, schools face a challenge in determining when a student attends, withdraws from, or drops a course. Attendance is critical because it is used to determine the student's eligibility for Federal student aid and to calculate the return of Federal student aid if the student withdraws from or drops out. Our investigative work has also found that those interested in defrauding the Federal student aid programs find it easier to enroll numerous times under different names, to falsify information on the Free Application for Federal Student Aid, and to initiate other schemes to receive funds illegally. Also, some program requirements for residential programs do not translate clearly for distance education programs, and guidance is not available to address these issues. The Department needs to develop requirements specific to distance education and to increase its oversight of schools providing programs through distance education.

**Grantees.** Effective monitoring and oversight is essential to ensure that grantees meet grant requirements and achieve program goals and objectives. Our work has identified a number of weaknesses in grantee oversight and monitoring. We have found pervasive fiscal control weaknesses among a number of grantees, weaknesses in grant payback programs, as well as fraud committed by LEA and charter school officials. The Department is responsible for monitoring the activities of grantees to ensure compliance with applicable Federal requirements and achievement of performance goals. The Department has taken corrective actions to address many of the recommendations contained in our reports. However, the Department needs to continue to assess and improve its oversight and monitoring of grantees and take effective actions when issues are identified.

**Contractors.** The Department relies heavily on contractor support to accomplish its mission and to ensure the effective operations of its many systems and activities. The Department spends more than \$1 billion each year on contracts for products and services. Once a contract is awarded, the Department must effectively monitor performance to ensure that it receives the quality and quantity of products or services for which it is paying. OIG reports have identified numerous deficiencies in the area of contract monitoring and recommendations for corrective action. The Department has taken action to address many of the issues noted. A critical issue hampering significant improvement, however, is the shortage of appropriately qualified staff to adequately monitor contractor performance. The Department needs to ensure its human capital plans address this critical area.

## Data Quality and Reporting

The Department, its grantees, and subrecipients must have controls in place and effectively operating to ensure that accurate, reliable data are reported. Data are used by the Department to make funding decisions, to evaluate program performance, and to support a number of management decisions. Under the *Recovery Act*, data reported provide transparency and allow access by the general public as to how funds are being spent. Two areas are included in this management challenge—program data reporting and *Recovery Act* reporting requirements.

**Program Data Reporting.** State educational agencies (SEAs) annually collect data from LEAs and report various program data to the Department. The Department evaluates

program data to make critical funding and other management decisions. Our work has identified a variety of weaknesses in the quality of reported data and recommended improvements at the SEA and LEA level, as well as actions the Department can take to clarify requirements and provide additional guidance. Establishing more consistent definitions for data terms will enhance reporting accuracy and comparability.

**Recovery Act Reporting Requirements.** The *Recovery Act* places a heavy emphasis on accountability and transparency, including reporting requirements related to the awarding and use of funds. All recipients and subrecipients are mandated to provide information about their awards on [www.federalreporting.gov](http://www.federalreporting.gov), a publicly available Web site authorized by the statute. The new reporting requirements required Federal, State, and local agencies to quickly develop the systems and infrastructure to collect and report the required information. The Department must educate recipients about the reporting requirements, assess the quality of the reported information, and use the collected information effectively to monitor and oversee *Recovery Act* programs and performance. Our initial work has noted a number of weaknesses in controls over data quality and reporting, both externally at SEAs and LEAs, and internally at the Department. Ensuring that accurate and complete data are reported is critical to achieving the transparency goals of the *Recovery Act*.

## Information Technology Security

The Department collects, processes, and stores a large amount of personally identifiable information regarding employees, students, and other program participants. OIG has identified repeated problems in IT security and noted increasing threats and vulnerabilities to Department systems and data. For the last 3 years, OIG's IT audits have identified management, operational, and technical security controls that need improvement to adequately protect the confidentiality, integrity, and availability of Department systems and data. We have identified security weaknesses in the incident handling process and procedures, personnel security controls, and configuration management. Compromise of the Department's data would cause substantial harm and embarrassment to the Department and may lead to identity theft or other fraudulent use of the information.

## An Additional Area of Emphasis—Improper Payments

One additional area will be a focus of Department and OIG activity for FY 2011 and beyond—improper payments. Across the Federal Government, agencies reported nearly \$100 billion in improper payments for FY 2009. The Department must be able to ensure that the billions of dollars entrusted to it are reaching the intended recipients. A number of new requirements related to improper payments were issued in FY 2010. In November 2009, the President signed an Executive Order entitled, Reducing Improper Payments and Eliminating Waste in Federal Programs, to reduce improper payments by holding agencies accountable. In March 2010, a Presidential Memorandum entitled, Finding and Recapturing Improper Payments, was issued to expand the use of recovery audits. In July, the *Improper Payments Elimination and Recovery Act of 2010* was passed to amend the *Improper Payments Information Act of 2002*, incorporating changes to requirements for identifying and reporting improper payments. In addition to actions required by the Department, there are new requirements for OIG to monitor and evaluate Department activities related to improper payments. To view the full report, go to:

<http://www2.ed.gov/about/offices/list/oig/managementchallenges.html>



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# Appendices

## Appendix A: Selected Department Web Links

### The American Recovery and Reinvestment Act

- **Important Recovery Act Reference Sites**

- [Recovery.Gov](#)
- [Department Weekly and Communication Reports](#)
- <http://www2.ed.gov/about/overview/budget/budget11/index.html>
- [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>

### Open Government Initiative

The Department's Open Government Initiative is designed to improve the way the Department shares information, learns from others, and collaborates to develop the best solutions for America's students.

<http://www2.ed.gov/about/open.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>



## Appendix B: Glossary of Acronyms and Abbreviations

ABCP	Asset-Backed Commercial Paper
ACG	Academic Competitiveness Grant
ACSI	American Customer Satisfaction Index
AFR	<i>Agency Financial Report</i>
AGI	Adjusted Gross Income
APR	<i>Annual Performance Report</i>
ARRA	<i>American Recovery and Reinvestment Act of 2009 (Recovery Act)</i>
ATA	<i>Assistive Technology Act of 2004</i>
CAROI	Cooperative Audit Resolution and Oversight Initiative
CCRAA	<i>College Cost Reduction and Access Act</i>
CFAAA	<i>Compact of Free Association Amendments Act of 2003</i>
CFDA	<i>Catalog of Federal Domestic Assistance</i>
CRA	<i>Civil Rights Act of 1964</i>
CSPR	<i>Consolidated State Performance Report</i>
CSRS	Civil Service Retirement System
CTEA	<i>Carl D. Perkins Career and Technical Education Act of 2006</i>
ECASLA	<i>Ensuring Continued Access to Student Loans Act of 2008</i>
EDA	<i>Education of the Deaf Act of 1986</i>
EDEN	Education Data Exchange Network
EFC	Expected Family Contribution
EMAPS	EDFacts Metadata and Process System
ESEA	<i>Elementary and Secondary Education Act of 1965</i>
ESRA	<i>Education Sciences Reform Act of 2002</i>
ESS	EDEN Submission System
FAFSA	Free Application for Federal Student Aid
FASAB	Federal Accounting Standards Advisory Board
FECA	<i>Federal Employees' Compensation Act</i>

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FERS	Federal Employees Retirement System
FFB	Federal Financing Bank
FFEL	Federal Family Education Loan
FFMIA	<i>Federal Financial Management Improvement Act of 1996</i>
FISMA	<i>Federal Information Security Management Act of 2002</i>
FMFIA	<i>Federal Managers' Financial Integrity Act of 1982</i>
FOTW	FAFSA on the Web
FSA	Federal Student Aid
FY	Fiscal Year
GA	Guaranty Agency
GAPS	Grant Administration and Payment System
GPRA	<i>Government Performance and Results Act of 1993</i>
GSA	General Services Administration
HBCUs	Historically Black Colleges and Universities
HC	Human Capital
HCERA	<i>Health Care and Education Reconciliation Act of 2010</i>
HCMS	Human Capital Management Staff
HEA	<i>Higher Education Act of 1965</i>
HPPG	High Priority Performance Goals (Priority Goals)
HR	Human Resources
IDEA	<i>Individuals with Disabilities Education Act</i>
IES	Institute of Education Sciences
IP	Improper Payments
IPERA	<i>Improper Payments Elimination and Recovery Act</i>
IPIA	<i>Improper Payments Information Act of 2002</i>
IRS	Internal Revenue Service
i3	Investing in Innovation fund
IT	Information Technology

IUS	Internal Use Software
IV&V	Independent Verification and Validation
LEA	Local Educational Agency
LLR	Lender of Last Resort
MD&A	Management's Discussion and Analysis
MECEA	<i>Mutual Educational and Cultural Exchange Act of 1961</i>
NAEP	National Assessment of Educational Progress
NCLB	<i>No Child Left Behind Act of 2001</i>
NLA	<i>National Literacy Act of 1991</i>
OA	Organizational Assessment
OCR	Office for Civil Rights
OECD	Organization for Economic Cooperation and Development
OELA	Office of English Language Acquisition
OESE	Office of Elementary and Secondary Education
OIG	Office of Inspector General
OII	Office of Innovation and Improvement
OM	Office of Management
OMB	Office of Management and Budget
OPE	Office of Postsecondary Education
OPM	Office of Personnel Management
OSDFS	Office of Safe and Drug-Free Schools
OSERS	Office of Special Education and Rehabilitative Services
OVAE	Office of Vocational and Adult Education
PAR	<i>Performance and Accountability Report</i>
PBO	Performance-Based Organization
PIC	Performance Improvement Council
PII	Personally Identifiable Information
PIO	Performance Improvement Officer

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PIRLS	Progress in International Reading Literacy Study
PLUS	Parent Loans for Undergraduate Students
RA/JF	<i>American Recovery and Reinvestment Act of 2009 (Recovery Act)</i> /Education Jobs Fund
RMS	Risk Management Service
SAFRA	<i>Student Aid Fiscal Responsibility Act (SAFRA Act)</i>
SAP	Special Allowance Payment
SEA	State Educational Agency
SFSF	State Fiscal Stabilization Fund
SIG	School Improvement Grant
SOF	Statement of Financing
SY	School Year
TASSIE	Title I Accountability Systems and School Improvement Efforts
TIF	Teacher Incentive Funds
TIMSS	Trends in International Mathematics and Science Study
USC	United States Code
VPS	Visual Performance Suite
VR	Vocational Rehabilitation
WWC	What Works Clearinghouse



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GLOBAL COMPETITIVENESS BY FOSTERING EDUCATIONAL EXCELLENCE AND  
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**[WWW.ED.GOV](http://WWW.ED.GOV)**