



U.S. Department of Education FY 2011 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, 2011

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

Office of the Chief Financial Officer
U.S. Department of Education
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Foreword

The United States Department of Education's (the Department's) *Agency Financial Report* (AFR) for fiscal year (FY) 2011 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 third 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 and to present more streamlined and timely information. 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 2011 annual reporting includes the following three documents:

Agency Financial Report (AFR) [available November 15, 2011]

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 reporting details and other statutory reporting requirements.

Annual Performance Report (APR)

[available February 2012]

The APR is produced in conjunction with the FY 2013 President's Budget Request and provides more detailed performance information and analysis of performance results.

Summary of Performance and Financial Information

[available February 2012]

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 statutory 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.
- *GPRA Modernization Act of 2010* guides the agency's strategic planning and annual planning and reporting.
- *Government Management Reform Act of 1994* (GMRA) requires audited financial statements from the agency.
- *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.
- *Improper Payments Elimination and Recovery Act of 2010* (IPERA), which amends the *Improper Payments Information Act of 2002*.

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

Message From the Secretary



November 15, 2011

I am pleased to present the Department's *Fiscal Year (FY) 2011 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 2011 Annual Performance Report* and the *FY 2011 Summary of Performance and Financial Information*, will be released in February 2012.

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 tenth consecutive year, the Department has earned a clean opinion from independent auditors on its financial statements and that for the ninth consecutive year, no material weaknesses were identified.

We are continuing to monitor our progress in areas of concern that could hinder efficiency, effectiveness, and integrity in our programs and operations, and to identify actions needed to address any deficiencies. Going forward into FY 2012, our Office of Inspector General has identified four challenges that the Department will work to address: improper payments, information technology security, oversight and monitoring, and data quality and reporting.

This financial report reflects that the Department continues to be an effective steward of taxpayer dollars that provide critical support to states and districts as they continue the difficult work of education reform. Education is the key to our long-term economic prosperity. Especially in areas related to science, technology, and math, we must ensure that all children and adults in America receive a world-class education, as the country that out-educates us today will outcompete us tomorrow. Over the past two and a half years, our country has undertaken a collective effort to reform our schools, work that is inextricably linked to the future of our nation's economy. As a result, we have seen more progress in reform in the past two years than in the previous two decades.

- 45 states have adopted a common set of college- and career-ready standards.
- 45 states are working together to create the next generation of assessments that will track students' growth toward college and career readiness.
- More than a thousand school districts are taking on the hard work of turning around their lowest-performing schools.
- Across the country, labor and management are working together to use the collective bargaining process to support reform and student success.

Education is more than an economic issue—it is the civil rights issue of our generation. To close the achievement gap, we must also close the opportunity gap for all Americans. From improving access to and the effectiveness of early learning programs; to reforming elementary and secondary education; to making higher education more accessible, effective, and meaningful; to working to attract more talented people to the teaching profession, we have made an unprecedented federal commitment to education. But it must be a national effort. I am proud that our Department has played a significant role in supporting these important reforms that are spreading throughout the country.

- Through Race to the Top, states are creating the next generation of reforms. We are seeing progress in the 12 states that won grants, as well as states that did not win an award.
- Through Investing in Innovation, 49 projects are developing and implementing breakthrough ideas that will accelerate student learning.
- In Promise Neighborhoods, community groups are creating comprehensive plans to fight poverty by putting a high-quality public school at the center of their work.

The role of the Department of Education is to support state and local districts as they lead reforms that improve instruction and increase student achievement, which is why the President recently announced that we will be offering states and districts relief from the *No Child Left Behind Act* (NCLB). NCLB benefited the education system by expanding the standards and accountability movement and by exposing achievement gaps that challenged schools to focus on the achievement of all children. But for all that NCLB got right, states and local school districts are buckling under the law's mandates, and too many schools are destined to fail. This is why, to help states, districts, and schools that are ready to move forward with education reform, the Administration is providing relief from NCLB in exchange for a real commitment to undertake change. The purpose is not to give states and districts a reprieve from accountability, but rather to unleash energy to improve our schools at the local level even as Congress continues to work to reform the law.

A period of unprecedented education reform is no time to be laying off scores of teachers and early childhood educators. Already, financially pinched school districts are reducing class time, shortening the school calendar, cutting after-school programs and early childhood education, and reducing top-notch arts and music instruction. This is why the President has proposed the *American Jobs Act*, which includes \$30 billion in investments for repairing and modernizing schools and community colleges. It will also support states and districts to protect up to 280,000 educators' jobs. The path to prosperity is to invest wisely in schools, remembering that children get only one chance at an education.

This financial report reflects the Department's work to make a positive contribution to what must become an "all-hands-on-deck" approach among communities across America—involving local leaders, educators, families, and the students themselves—to building the best-educated workforce and citizenry in the world.

Sincerely,

/s/

Arne Duncan

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Management's Discussion and Analysis



Mission and Organizational Structure

Our 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. In 1867, the federal government recognized that furthering education was a national priority, and created a federal education agency to collect and report statistical data. The Department was established as a cabinet-level agency in 1979.

Our Public Benefit. In the nation, the Department is committed to ensuring that 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. Internally, 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.

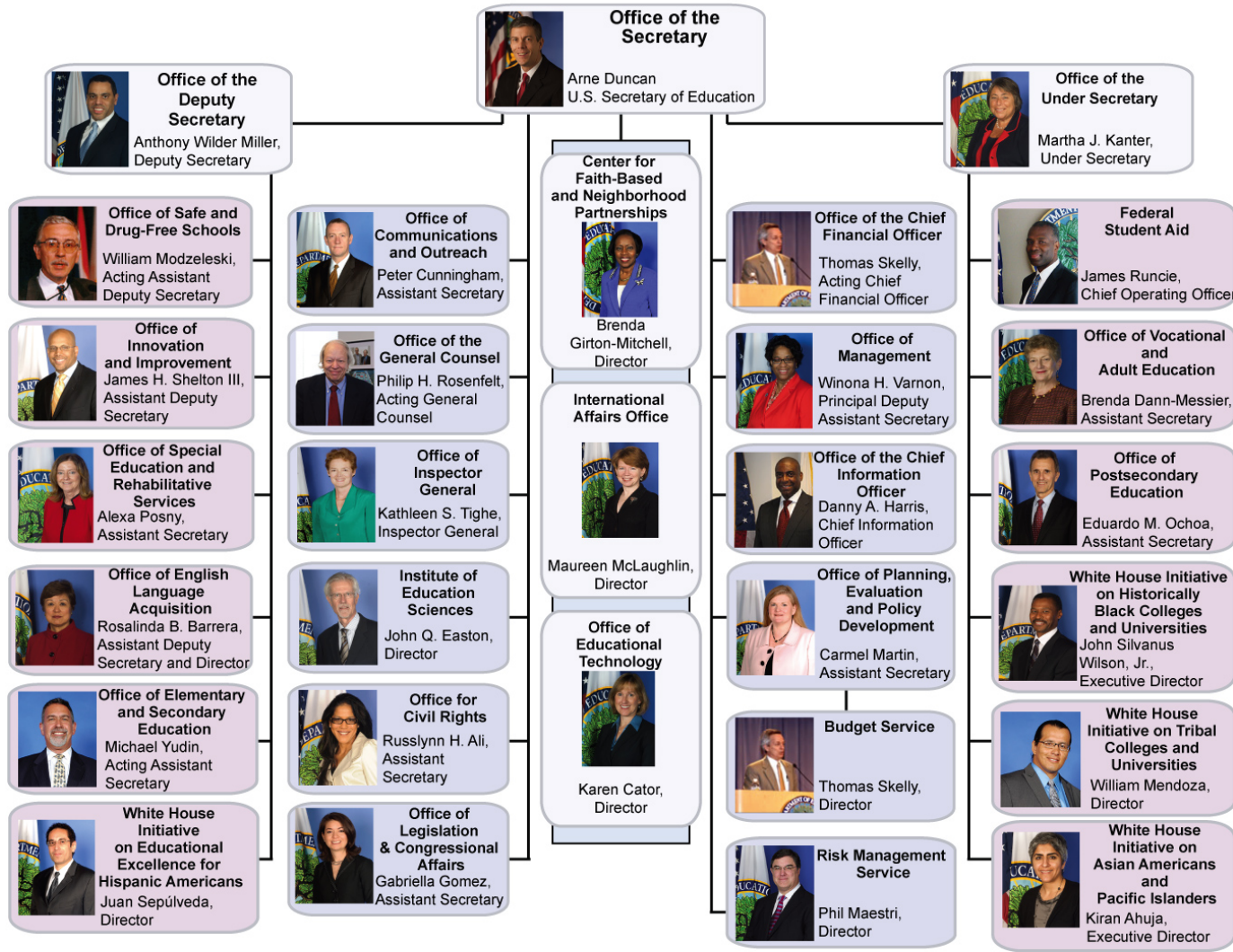
What We Do. The Department engages in four major types of activities: establishing policies related to federal education funding and administering distribution of funds and monitoring their use; providing oversight on data collection and research on America's schools; identifying major issues in education and focusing national attention on them; and enforcing federal laws prohibiting discrimination in programs that receive federal funds.

Who We Serve. During school year (SY) 2011–12, America's schools and colleges are serving larger numbers of students as the population increases and enrollment rates rise. As of the fall of 2011, more than 49.4 million students attend public elementary and secondary schools. Of these, 34.9 million are in pre-school through 8th grade; 14.5 million are in grades 9 through 12.

As of data published in early September 2011, expenditures for public elementary and secondary schools will be about \$525 billion for SY 2011–12, excluding capital and interest. The national average current expenditure per student is projected for SY 2011–12 at \$10,591, the same as actual expenditures in SY 2008–09. In fall 2011, a record 19.7 million students are expected to attend the nation's 2-year and 4-year colleges and universities, an increase of about 4.4 million since fall 2000.

Our Organization in FY 2011

The Required Supplementary Stewardship Information section of this report contains summary information about offices within the Department. Follow the link for more detail on how the Department is [organized](#) and the roles of the different offices, or view an [interactive chart](#) of current positions.



Department of Education Financial Highlights

The table below summarizes trend information concerning components of the Department's financial condition. The Consolidated Balance Sheet presents a snapshot of our financial condition as of September 30, 2011, compared to FY 2010, and displays assets, liabilities, and net position. Another component of the Department's financial picture is the Consolidated Statement of Net Cost. Each of these components is discussed in further detail in this section and in the Financial Details section of this report.

Financial Summary					
<i>Dollars in Millions</i>					
Consolidated Balance Sheet					
As of September 30, 2011, 2010, 2009, 2008					
	% Change 2011/2010	FY 2011	FY 2010	FY 2009	FY 2008
Fund Balance with Treasury	-14%	\$ 114,085	\$ 132,259	\$ 168,032	\$ 94,899
Credit Program Receivables, Net	+44%	530,491	367,904	234,254	134,725
Other	-44%	1,966	3,501	3,659	1,949
Total Assets		646,542	503,664	405,945	231,573
Debt	+46%	547,108	374,335	235,385	128,668
Liabilities for Loan Guarantees	-31%	10,025	14,479	20,543	43,322
Other	-24%	20,824	27,248	22,957	16,247
Total Liabilities		577,957	416,062	278,885	188,237
Unexpended Appropriations	-24%	71,729	94,371	127,269	49,506
Cumulative Results of Operations	-54%	(3,144)	(6,769)	(209)	(6,170)
Total Net Position		68,585	87,602	127,060	43,336
Total Liabilities and Net Position		\$ 646,542	\$ 503,664	\$ 405,945	\$ 231,573

Fiscal Year	Assets	Liabilities	Net Position
FY 2011	\$646.5	\$578.0	\$68.6
FY 2010	\$503.7	\$416.1	\$87.6
FY 2009	\$405.9	\$278.9	\$127.1
FY 2008	\$231.6	\$188.2	\$43.3

Consolidated Statement of Net Cost					
For the Years Ended September 30, 2011, 2010, 2009, 2008					
	% Change 2011/2010	FY 2011	FY 2010	FY 2009	FY 2008
Gross Cost	-23%	\$ 89,910	\$ 116,953	\$ 55,412	\$ 74,034
Earned Revenue	+18%	(20,397)	(17,279)	(11,251)	(9,217)
Total Net Cost of Operations		\$ 69,513	\$ 99,674	\$ 44,161	\$ 64,817

Federal Loan Programs

In FY 2011, the Department made \$116.1 billion in net student loans for postsecondary education to 11.5 million recipients. The *SAFRA Act*, which was included in the *Health Care and Education Reconciliation Act of 2010* and became effective July 1, 2010, provided that no Federal Family Education Loan (FFEL) loans would be originated after June 30, 2010. As a result, there was a greater volume of direct loans in FY 2011. The transition from the FFEL Program to the William D. Ford Federal Direct Loan (Direct Loan) Program resulted in a 44 percent increase in Direct Loan Program disbursements for FY 2011.

Under the FFEL Program, students and parents obtained federal loans through lenders. Guaranty agencies insured these loans, which were, in turn, reinsured by the federal government. Although the passage of the *SAFRA Act* ended the origination of new FFEL Program loans as of July 1, 2010, lenders and guaranty agencies continue to service and collect outstanding FFEL Program loans.

The Federal Perkins Loan Program is one of three campus-based programs through which the Department provides loan funds directly to eligible institutions. Funds provided through this program enable the eligible institutions to offer low-interest loans to students based on need.

Key trends and conditions for the financial aid environment include:

- the rising cost of attendance for postsecondary education,
- a decline in availability of nonfederal sources of postsecondary education funding, and
- an increased role of the federal government in providing funding for postsecondary education.

For additional information on key trends and conditions for the financial aid environment and more on Federal Student Aid, see the Department's Federal Student Aid FY 2011 [Annual Reports](#).

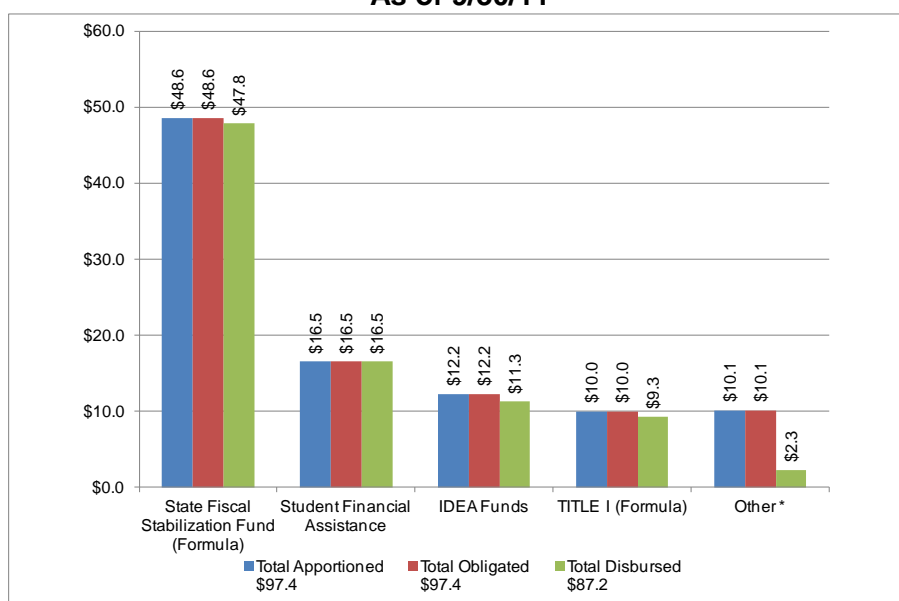
Loan Programs (dollars in millions)	2011 Aid Disbursed to Students	2010 Aid Disbursed to Students	Difference	Percent Difference
Federal Direct Loan Program	\$ 116,098	\$ 80,559	\$ 35,539	44%
Federal Family Education Loan Program	0	19,909	(19,909)	(100)%
Federal Perkins Loan Program	971	1,042	(71)	(7)%
Subtotal Loans	\$ 117,069	\$ 101,510	\$ 15,559	15%

SOURCE: Fiscal Year 2012 Budget Summary

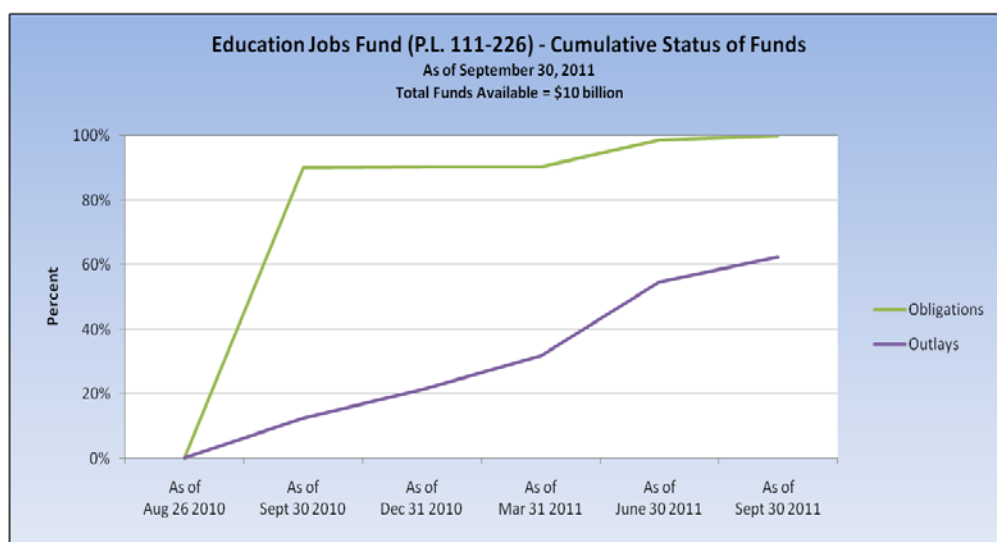
The American Recovery and Reinvestment Act of 2009 (Recovery Act) and Education Jobs Fund

The Recovery Act, enacted on February 17, 2009 as Public Law 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. Public Law 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. As of September 30, 2011, all of the \$97 billion Recovery Act and \$10 billion Education Jobs Fund monies have been fully obligated. Of those totals, 89.5 percent and 62.9 percent have been disbursed, respectively.

**Recovery Act Funding Summary (dollars in billions)
As of 9/30/11**



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



Ongoing Initiatives for the Department

Recent actions by President Obama's Administration addressed two important challenges facing the nation during FY 2011, creating implementation challenges for FY 2012. The actions will:

- provide steps to [increase college affordability](#) by making it easier to manage student loan debt (October 25, 2011); and
- provide state educational agencies and local educational agencies with [flexibility](#) regarding specific requirements of the *Elementary and Secondary Education Act of 1965 (ESEA)*, as amended, in exchange for rigorous and comprehensive state-developed plans designed to improve educational outcomes for all students, close achievement gaps, increase equity, and improve the quality of instruction (September 23, 2011).

In FY 2012, the Department will focus on implementation of these actions, as well as awarding grants under the [Race to the Top-Early Learning Challenge](#), expanding an initiative to identify and learn from [top-performing teacher preparation programs](#), and addressing a wide range of [challenges](#) with initiatives that focus on meeting National Outcome Goals and Department Strategic Goals (See Performance Highlights).

[Loan Defaults](#)

On September 12, 2011, the Department released the most recently available student default rates. The official FY 2009 national student loan cohort default rate has risen to 8.8 percent, up from 7.0 percent in FY 2008. The cohort default rates increased for all sectors: from 6.0 percent to 7.2 percent for public institutions, from 4.0 percent to 4.6 percent for private nonprofit institutions, and from 11.6 percent to 15.0 percent at for-profit schools.

The rates represent a snapshot in time, with the FY 2009 cohort consisting of borrowers whose first loan repayments came due between October 1, 2008, and September 30, 2009, and who defaulted before September 30, 2010. More than 3.6 million borrowers from 5,900 schools entered repayment during this window of time, and more than 320,000 defaulted. Those borrowers who defaulted after the two-year period are not counted as defaulters in this data set.

"These hard economic times have made it even more difficult for student borrowers to repay their loans, and that's why implementing education reforms and protecting the maximum Pell grant is more important than ever," said [U.S. Secretary of Education Arne Duncan](#). "We need to ensure that all students are able to access and enroll in quality programs that prepare them for well-paying jobs so they can enter the workforce and compete in our global marketplace."

[ESEA Flexibility Authority](#)

To support local and state education reform across the nation, the Department is assisting state and local educational agencies in obtaining waivers from certain provisions of the *Elementary and Secondary Education Act (ESEA)*, as amended.

Under this flexibility authority, states can request waivers from specific mandates if they are making progress in transitioning students, teachers, and schools to a system aligned with college- and career-ready standards for all students, developing differentiated accountability systems, and undertaking reforms to support effective classroom instruction and school leadership.

ESEA flexibility focuses on supporting state and local reform efforts in three critical areas:

- transitioning to college- and career-ready standards and assessments;
- developing systems of differentiated recognition, accountability, and support; and
- evaluating teacher and principal effectiveness.

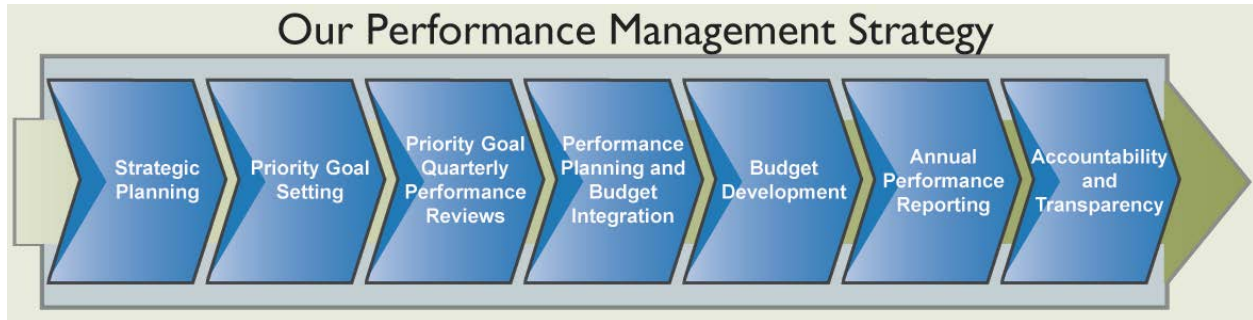
A state may request flexibility through waivers of several specific provisions, most notably:

- Flexibility regarding the 2013–14 timeline for achieving 100 percent proficiency in reading and mathematics by establishing ambitious but achievable goals and supporting academic improvement efforts.
- Flexibility regarding district and school improvement and accountability requirements that may over-identify schools as “failing” and enables the state to provide targeted interventions to the schools and districts that are the lowest performing and have the largest achievement gaps.
- Flexibility in the use of federal education funds that enables states to use several federal funding streams that best meet their unique needs.

To receive flexibility through these waivers, a state must develop a rigorous and comprehensive plan addressing three critical areas:

- A state must have adopted college- and career-ready standards in reading/language arts and mathematics and transition its schools and districts to those standards by administering statewide assessments.
- A state must develop systems of differentiated recognition, accountability, and support that give credit for progress towards college- and career-readiness by recognizing and rewarding the highest achieving schools that serve low income students and implement rigorous interventions to turn around the lowest-performing schools.
- A state must evaluate and support teacher and principal effectiveness by setting guidelines for teacher and principal evaluation and support systems using multiple measures including student progress over time.

Performance Highlights



GPRA Modernization Act of 2010

On January 4, 2011, President Obama signed into law the *GPRA Modernization Act of 2010*. The Act improves on the original *Government Performance and Results Act of 1993 (GPRA)* and modernizes the federal government's performance management framework. The *GPRA Modernization Act of 2010* builds on the performance management approach championed by President Obama to improve the effectiveness and efficiency of government by requiring that agency leaders set clear, ambitious goals for a number of outcome-focused and management priorities; federal agencies measure, analyze, and communicate performance information to identify successful practices; and agency leaders conduct in-depth performance reviews at least quarterly to identify progress on their priorities.

National Outcome Goals

The National Outcome Goals include the improvements in student achievement needed at every level of education to achieve the President's 2020 goal of once again having the highest proportion of college graduates in the world. Improving these outcomes will require a concerted effort from all stakeholders in the education system. These goals include outcomes in key areas:

- postsecondary education, career and technical education, and adult education,
- elementary and secondary education,
- early learning, and
- equity.

Department Strategic Goals

To meet the National Outcome Goals, changes are needed in how education is delivered. In President Obama's first address to Congress, he challenged America to meet an ambitious goal for education that by 2020, America will once again have the highest proportion of college graduates in the world. Investing in education means investing in America's future and is vital for maintaining our long-term economic security. The nation must work to ensure that all children and adults in America receive a world-class education that will prepare them to succeed in college and careers. The President's goal is the starting point for the work of the Department as described in its *FY 2011–2014 draft Strategic Plan*. Reaching the President's

goal will require comprehensive education reforms from cradle to career, beginning with children at birth, supporting them through postsecondary education, and helping them succeed as lifelong learners who can adapt to the constant changes in the technology-driven workplaces of the global economy. The draft Strategic Plan provides:

- A new emphasis on the importance of early learning.
- A commitment to ensuring that all students graduate from high school prepared to succeed in college and careers.
- An imperative for the Department to ensure that students have the support and information that they need to enter postsecondary education and earn a certificate, degree, or other credential.

The Department's draft Strategic Plan serves as a starting point from which to align the Department's yearly budget requests and statutory requirements with the Department's operational imperatives, and is the foundation for establishing overall long-term priorities and developing performance goals and measures by which the Department can gauge achievement of its stated outcomes. The plan is developed in collaboration with Congress, state and local partners, and other stakeholders.

Goal 1: Postsecondary Education, Career and Technical Education, and Adult Education. Increase college access, quality, and completion by improving higher education and lifelong learning opportunities for youth and adults.

Goal 2: Elementary and Secondary Education. Prepare all students for college and career by improving the elementary and secondary education system's ability to consistently deliver excellent classroom instruction and supportive services.

Goal 3: Early Learning. Improve the health, social-emotional, and cognitive outcomes for all children from birth through third grade, so that all children, particularly those with high needs, are on track for graduating from high school college- and career-ready.

Goal 4: Equity. Ensure equitable educational opportunities for all students regardless of race, ethnicity, national origin, age, sex, disability, language, and socioeconomic status.

Goal 5: Continuous Improvement of the U.S. Education System. Enhance the education system's ability to continuously improve through better and more widespread use of data, research and evaluation, transparency, innovation, and technology.

Goal 6. U.S. Department of Education Capacity. Improve the organizational capacities of the Department to implement this Strategic Plan.

Department Priority Goals

The Department has identified a limited number of Priority Goals that will be a particular focus over the coming years. These Priority Goals reflect the Department's cradle-to-career education strategy, and will help concentrate efforts on the importance of teaching and learning at all levels of the education system. The Department's Priority Goals are designed for success by the end of the term of this strategic plan. The Department set initial Priority Goals in the FY 2011 Budget, and is in the process of developing updated Priority Goals to accompany the FY 2013 Budget. To review the Department's initial Priority Goals, please visit our website.

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 2011 funds but to a combination of funds from across several fiscal years, as well as state and local investments, and to many external factors, including economic conditions. Furthermore, the results of some education programs may not be apparent for many years after the funds are expended. In addition, results may be due to the effects of multiple programs.

Selected Performance Measures for FY 2011

The performance measures in this table represent a subset of the performance measures that are being developed in support of the strategic goals in the Department's *FY 2011–2014 draft Strategic Plan*. The Department will be reporting on the full set of performance measures in the FY 2011 *Annual Performance Report* that will be released in conjunction with the President's FY 2013 Budget submission in February 2012. The measures included in this table reflect at a high level, student achievement data, Department management improvement initiatives, college and career initiatives, and state program activities to improve education in their respective states. The information in the cells includes the approximate dates by which data will be available in those cases where the data were not available while this report was being prepared.

Performance Measure	2007	2008	2009	2010	2011
Student Achievement					
Students who graduate from high school	74%	75%	76%	May 2012	TBD
Adult education students obtaining a high school credential	56%	58%	47%	54%	TBD
4th grade students at or above Proficient on the National Assessment of Educational Progress (NAEP) in reading	33%	N/A	33%	N/A	34%
4th grade students at or above Proficient on the NAEP in mathematics	39%	N/A	39%	N/A	40%
8th grade students at or above Proficient on the NAEP in reading	31%	N/A	32%	N/A	34%
8th grade students at or above Proficient on the NAEP in mathematics	32%	N/A	34%	N/A	35%

Performance Measure	2007	2008	2009	2010	2011
Department Management					
Department's rank in the report on the Best Places to Work (BPTW) in the Federal Government	28 out of 30 agencies	No rankings done in 2008.	27 out of 30 agencies	30 out of 32 agencies	Nov. 2011
Positive responses that the Department receives on the Talent Management measure in the Federal Viewpoint Survey	N/A	58%	54%	54%	58%
Positive responses that the Department receives on the Performance Culture measure in the Federal Viewpoint Survey	49%	52%	50%	52%	53%
States and other grantees reporting satisfaction with support provided by the Department	Customer Satisfaction Index (CSI): 63	CSI: 65	CSI: 68	CSI: 72	CSI: 72
Department's programs and initiatives that are evaluated using methods that include those consistent with What Works Clearinghouse Standards for evidence of effectiveness	N/A	N/A	N/A	10	13
Postsecondary					
Enrollments in undergraduate science, technology, engineering, and mathematics (STEM) credential/degree programs	N/A	N/A	N/A	1,541,704	1,580,036
25- to 34-year-olds who attain an associate's degree or higher	40%	42%	41%	42%	March 2012
Students who complete a bachelor's degree within 6 years	57%	57%	57%	Feb. 2012	TBD
Students who complete an associate's degree or certificate within 3 years	31%	31%	32%	Feb. 2012	TBD
Individuals completing and filing the Free Application for Federal Student Aid form (FAFSA) who come from low-income households	N/A	N/A	N/A	N/A	57%
Individuals completing and filing the FAFSA who are non-traditional students (25 years and above with no college degree)	N/A	N/A	N/A	N/A	3.80%
State Activities					
States that have published a plan for improving postsecondary access, quality, and completion leading to careers and positive civic engagement	N/A	N/A	N/A	18 states	19 states
States that have published a plan for pathways for school completers to careers	N/A	N/A	N/A	24 states	27 states
States with adopted internationally benchmarked college- and career-ready standards	N/A	N/A	N/A	30 states + DC	44 states + DC and the USVI

NOTE: N/A Refers to data either not collected or reported.

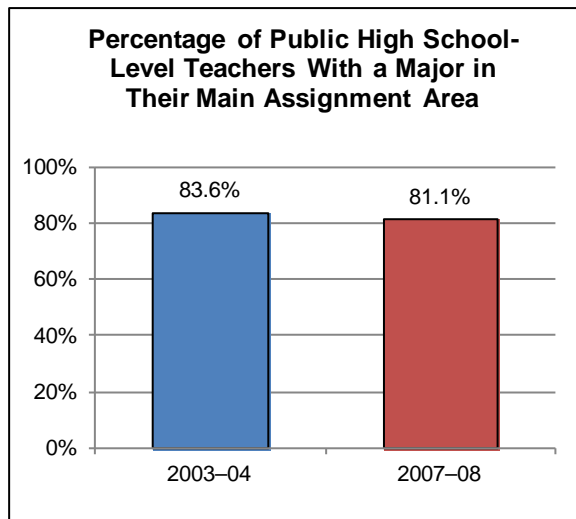
Data Resources of the Department: The Education Dashboard

In FY 2011, the Department took significant steps toward enhancing its ability to provide more timely and consistent information to the public by improving its use of education data through a variety of electronic formats.

The Department continues to implement and enhance a [data dashboard](#) that contains high-level indicators, ranging from student participation in early learning through completion of postsecondary education, as well as indicators on teachers and leaders and equity. The Department will continuously update the dashboard's data and improve upon its analytic tools.

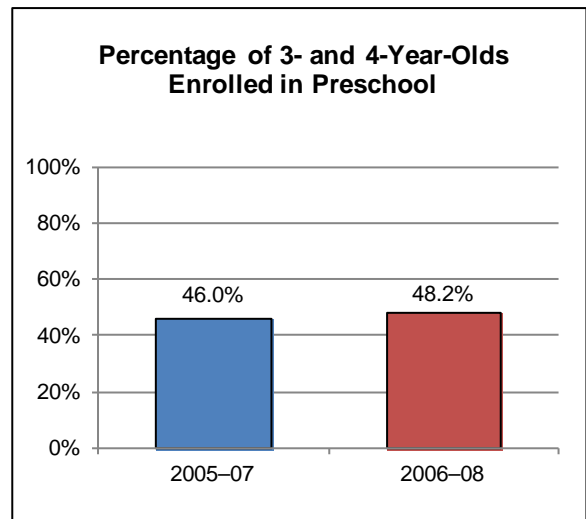
In FY 2011, the Department also introduced a new electronic feature that maps educational performance across states in the U.S. The [State of the States in Education](#) shows the 10 highest and lowest performing states (based on 2009 data) on basic indicators of educational performance. Disparities in educational performance highlight that state and local governments have a major [impact on student outcomes and the rigor of state standards](#).

Indicators focus on key education outcomes, including those shown below.

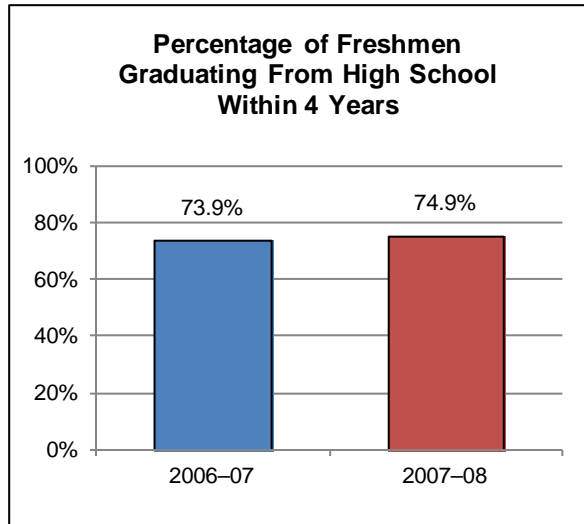


NOTE: Teachers include traditional public school and public charter school teachers who taught departmentalized classes to students in any of grades 10–12, or grade 9 and no grade lower. "Major in main assignment" includes all teachers, regardless of whether the major was earned within or outside a department, college, or school of education. Majors in main assignment are credited if they were earned at the bachelor's degree level or higher.

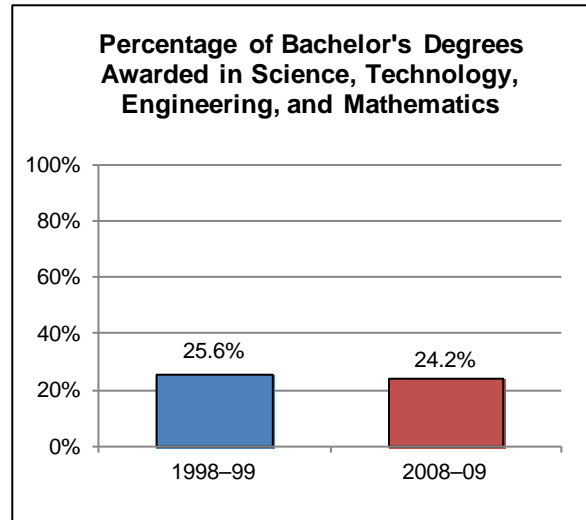
SOURCE: U.S. Department of Education, National Center for Education Statistics, Schools and Staffing Survey (SASS), "Public School Teacher Data File," 2003–04 and 2007–08.



SOURCE: U.S. Department of Commerce, Census Bureau, 2005–07 and 2006–08 American Community Survey (ACS) 3-year Public Use Microdata Sample (PUMS) data.



SOURCE: U.S. Department of Education, National Center for Education Statistics, "NCES Common Core of Data State Dropout and Completion Data File," 2006-07 and 2007-08 school years.



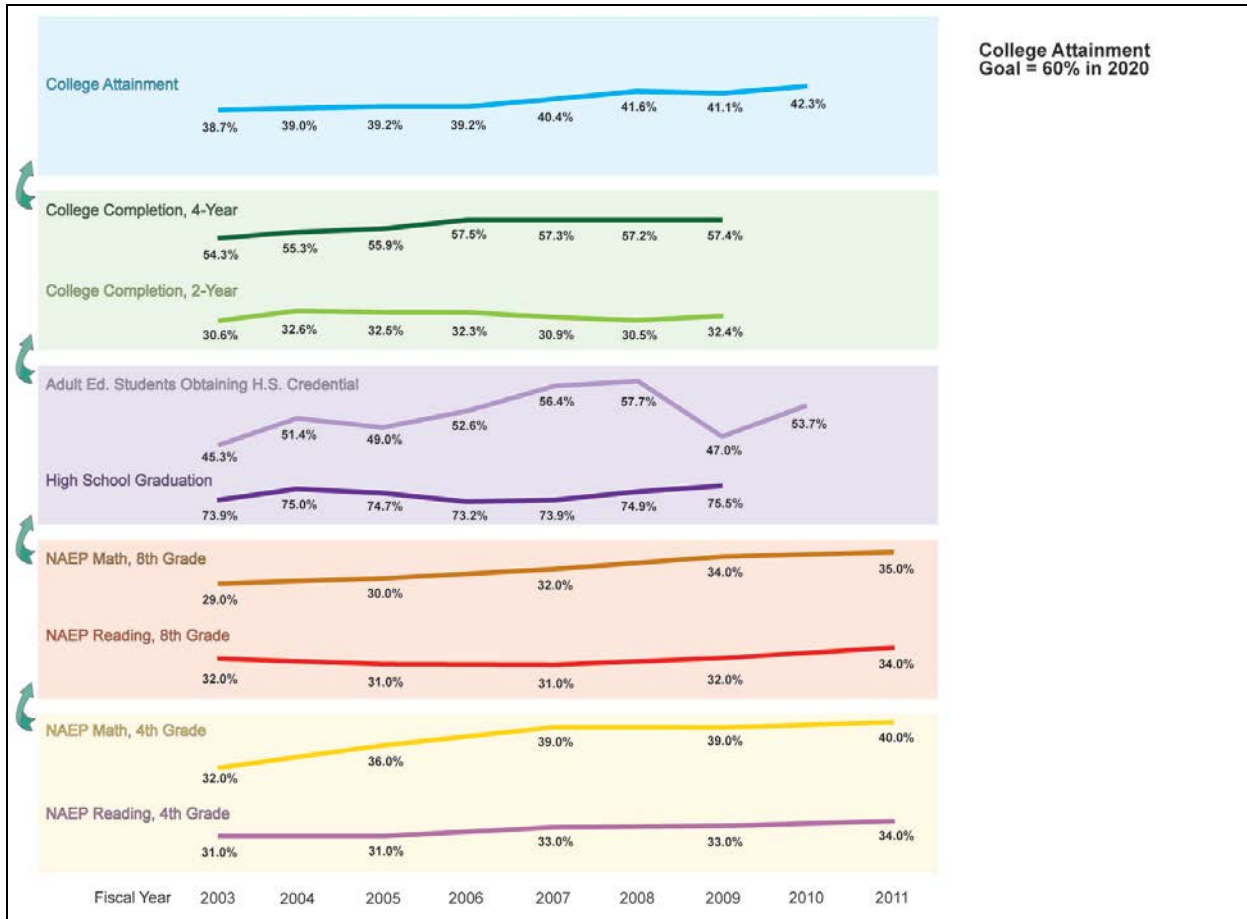
SOURCE: U.S. Department of Education, National Center for Education Statistics, 1998-99 and 2008-09 Integrated Postsecondary Education Data System, "Completions Survey" (IPEDS-C:99) and Fall 2009.

The indicators chosen for the dashboard are select factors that shed light on our nation's educational progress and support the goal that, by 2020, the United States will once again have the highest proportion of college graduates in the world. Meeting this goal is vital to the nation's long-term economic security and to preparing young people and adults to be active citizens.

Reaching the 2020 goal will require comprehensive education reforms from cradle to career, beginning with children at birth, supporting them through high school graduation and postsecondary education, and helping them to succeed as lifelong learners who can adapt to the constant changes in the demands of the global economy.

In addition to data provided on the dashboard, data.ed.gov provides links to the Department's various data sources, including: the Institute of Education Sciences' National Center for Education Statistics, ED Facts, the Federal Student Aid Data Center, and ED Data Express.

National Outcome Goals



Notes:

Data for college attainment reflect the percentage of 25-34-year-olds who attain an associate's degree or higher. Data for college completion reflect the percentage of students who complete a bachelor's degree within 6 years or an associate's degree or certificate within 3 years. Graduation rates presented are for school years (e.g., FY 2009 provides data for school year 2008–09). NAEP data reflect "at proficient or above" performance.

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>). 2009 Data: "Enrollment in Postsecondary Institutions, Fall 2009; Graduation Rates, 2003 & 2006 Cohorts; and Financial Statistics, Fiscal Year 2009," Table 7 (<http://nces.ed.gov/pubs2011/2011230.pdf>).

Adult Ed. Students Obtaining H.S. Credential: <http://wdcrocolp01.ed.gov/CFAPPS/OVAE/NRS/reports/index.cfm> (requires login).

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/sdr051bgen.pdf>, 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 (Math: http://nationsreportcard.gov/math_2011/math_2011_report/pages/graphs/fig_b.asp and http://nationsreportcard.gov/math_2011/math_2011_report/pages/graphs/fig_c.asp. Reading: http://nationsreportcard.gov/reading_2011/reading_2011_report/pages/graphs/fig_b.asp and http://nationsreportcard.gov/reading_2011/reading_2011_report/pages/graphs/fig_c.asp).

FY 2011 Selected Programs by Goal

In FY 2011, the Department continued a number of programs and initiated several new ones designed to be a cradle-to-career agenda to support states and districts as they reform their schools and make college more affordable for students. This agenda is designed around key principles, including:

- creating early learning systems that align resources to get the nation's youngest children ready for kindergarten;
- raising standards so they actually prepare students for success in college and careers;
- improving the quality of teaching in the classroom by improving the preparation, professional development, and evaluation of teachers and principals; and
- turning around persistently low-performing schools that have been failing students for decades or even generations.

A summary of the larger and more impactful programs, organized by draft strategic goal, follows.

Goal 1: Postsecondary Education, Career and Technical Education, and Adult Education

Increase college access, quality, and completion by improving higher education and lifelong learning opportunities for youth and adults.

In 2011, the Department continued to support President Obama's three-prong strategy (access, quality, and completion) for achieving the 2020 goal of America once again having the highest proportion of college graduates in the world.

[Gaining Early Awareness and Readiness for Undergraduate Programs](#) (GEAR UP) is a discretionary grant program designed to increase the number of low-income students who are prepared to enter and succeed in postsecondary education. GEAR UP provides six- and seven-year grants to states and partnerships to provide services at high-poverty middle and high schools. GEAR UP grantees serve an entire cohort of students beginning no later than the seventh grade and follow the cohort through high school. Grantees may choose to continue to serve students into their first year of college. GEAR UP funds are also used to provide college scholarships to low-income students. In FY 2011, the Department awarded:

- 19 new awards for more than \$77.3 million,
- 15 non-competing continuation grants totaling \$44.6 million,
- 47 new partnership award for \$100.1 million,
- and 73 non-competing continuation partnership grants (\$78.8 million).

There is a priority in the awarding of the grants, going to the applicants that agree to implement college- and career-ready standards, enable more data-based decision making, and aim to turn around persistently lowest achieving schools.

[The William D. Ford Federal Direct Loan Program](#) (Direct Loan) lends funds directly to students and parents through participating schools. Created in 1993, this program is funded by

borrowings from the U.S. Department of the Treasury, as well as an appropriation for subsidy costs.

[The Federal Pell Grant Program](#) (Pell Grant) helps ensure financial access to postsecondary education by providing grant aid to low-income and middle-income undergraduate students. Pell Grants vary according to the financial circumstances of students and their families. For the 2010–11 award year, the Department disbursed approximately \$37 billion in Pell Grants averaging approximately \$4,115 to nearly 9 million students. The maximum Pell Grant award was \$5,550 for the 2010–11 award year and remains \$5,550 for the 2011–12 award year.

The [Federal TRIO Programs](#) (TRIO) provides Federal outreach and student services programs designed to identify and provide services for individuals from disadvantaged backgrounds. TRIO includes eight programs targeted to serve and assist low-income individuals, first-generation college students, and individuals with disabilities to progress through the academic pipeline from middle school to postbaccalaureate programs. TRIO also includes a training program for directors and staff of TRIO projects. The *Full-Year Continuing Appropriations Act, 2011* (P.L. 112-10), provided \$826.5 million for TRIO programs in fiscal year FY 2011. In addition, there was \$57 million in mandatory appropriations for Upward Bound.

[Career and Technical Education, and Adult Education](#) programs include initiatives for literacy and community colleges.

In September 2011, the Department collaborated with the Department of Labor in Labor's award of nearly \$500 million in grants to [community colleges](#) for targeted training and workforce development to help economically dislocated workers who are changing careers. The grants support partnerships between community colleges and employers to develop programs that provide pathways to good jobs, including instructional programs that meet specific needs. This installment is the first in a \$2 billion, four-year investment designed in combination with the *American Jobs Act of 2011* to provide additional support for hiring and re-employment services to increase opportunities for the unemployed.

Carl D. Perkins Career and Technical Education Act of 2006 provides funds to state educational agencies to support programs that assist students to acquire academic and technical skills and be prepared for high-skill, high-wage, or high-demand occupations in the global economy.

In addition, the Department administers formula grant funds to states for [adult education and literacy programs](#). States distribute funds to local eligible entities to provide adult education and literacy services that provide educational opportunities below the postsecondary level for adults, 16 years of age and older, who are not currently enrolled in school, lack a high school diploma, or lack the basic skills to function effectively in the workplace and in their daily lives.

Goal 2: Elementary and Secondary Education

Prepare all students for college and career by improving the elementary and secondary education system's ability to consistently deliver excellent classroom instruction and supportive services

[Race to the Top](#)

In FY 2011, Congress appropriated \$700 million for the Race to the Top initiative and authorized a specific early learning initiative. In response, on May 25, 2011, the Department announced plans for \$200 million in state-level grants to support nine finalists that did not win grants in the

first two rounds of Race to the Top. The states— Arizona, California, Colorado, Illinois, Kentucky, Louisiana, New Jersey, Pennsylvania, and South Carolina—may seek grants ranging from \$10 million to \$50 million, depending on population and the final number of grants.

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.

Teacher Incentive Fund

The Department's Teacher Incentive Fund (TIF) has provided grants to states, rural and urban school districts, and nonprofit organizations to develop and implement performance-based teacher and principal compensation systems in high-need schools.

The Department did not conduct a competition in FY 2011, but supported the 2010 grantees with significant technical assistance. The Department is reviewing the program requirements and lessons learned from the current grantees to help inform its plans for a new competition in FY 2012.

The TIF 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.

School Improvement Grants

In conjunction with Title I funds for school improvement, School Improvement Grants are used to improve student achievement in Title I schools identified for improvement, corrective action, or restructuring so as to enable those schools to make adequate yearly progress and exit improvement status.

Investing in Innovation Fund

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.

On June 3, 2011, the Department kicked off the 2011 Investing in Innovation (i3) grant competition to continue support for evidence-based practices in education. This second round of i3 makes \$150 million available to local educational agencies (LEAs) and nonprofit organizations in partnership with LEAs or consortia of schools. Grants will be available within the same three categories as in round one:

- up to \$25 million each for scale-up grants to applicants with the strongest evidence and track record of success;
- up to \$15 million each for validation grants to verify effectiveness of programs with moderate levels of evidence; and
- up to \$3 million each for development grants to support new, high-potential practices whose impact should be studied further.

Grant recipients will be required to secure private sector matching funds of five percent, 10 percent, or 15 percent, respectively.

Three absolute priorities remain from last year's grant competition: supporting effective teachers and principals, implementing high standards and quality assessments, and turning around persistently low-performing schools. For this year's competition, the Department has included two new absolute priorities focusing on achievement and high school graduation rates in rural schools and promoting science, technology, engineering, and math education. All applicants must address one of these five areas. In addition, competitive preference will be given to applications that demonstrate support for improving early learning outcomes, increasing college access and success, addressing the unique needs of students with disabilities and limited English proficient students, or improving productivity or technology.

Promise Neighborhoods

Promise Neighborhoods, established under the legislative authority of the Fund for the Improvement of Education, provides funding to support eligible entities, including nonprofit organizations, which may include faith-based nonprofit organizations, institutions of higher education, and Indian tribes.

On July 6, 2011, the Department released the application for the next phase of the Promise Neighborhoods program, including a second round of planning grants and new implementation grants, totaling \$30 million. Non-profit organizations, institutions of higher education, and Indian tribes are all eligible to apply for funds to develop or execute plans that will improve educational and developmental outcomes for students in distressed neighborhoods. The Department expects to award four to six implementation grants with an estimated grant award of \$4 million to \$6 million. Grantees will receive annual grants over a period of three to five years, with total awards ranging from \$12 million to \$30 million. Remaining 2011 funding will go toward 10 new one-year planning grants with an estimated grant award of \$500,000.

The purpose of Promise Neighborhoods is to significantly improve the educational and developmental outcomes of children and youth in the nation's most distressed communities, and to transform those communities by—identifying and increasing the capacity of eligible entities that are focused on achieving results for children and youth throughout an entire neighborhood; building a complete continuum of cradle-to-career solutions of both educational programs and family and community supports, with great schools at the center; integrating programs and breaking down agency "silos" so that solutions are implemented effectively and efficiently across agencies; developing the local infrastructure of systems and resources needed to sustain and scale up proven, effective solutions across the broader region beyond the initial neighborhood; and learning about the overall impact of the Promise Neighborhoods program and about the relationship between particular strategies in Promise Neighborhoods and student outcomes, including through a rigorous evaluation of the program.

In FY 2011, the Promise Neighborhoods program awarded one-year grants to support the development of a plan to implement a Promise Neighborhood that includes the core features described above. At the conclusion of the planning grant period, grantees should have a feasible plan to implement a continuum of solutions that will significantly improve results for children in the community being served.

Goal 3: Early Learning

Improve the health, social-emotional, and cognitive outcomes for all children from birth through third grade, so that all children, particularly those with high needs, are on track for graduating from high school college- and career- ready.

Inter-Governmental Cooperation

The Department prioritizes improving the health, social, emotional, and educational outcomes for young children from birth through 3rd grade by enhancing the quality of early learning programs, and increasing the access to high-quality early learning programs—especially for young children at risk for school failure. The Department's role in promoting early learning is significant and includes: administering several early learning programs; collaborating and coordinating early learning programs, research, and technical assistance with the U.S. Department of Health and Human Services; encouraging states and local districts to target resources for early learning; promoting state and local education agency partnerships with other early learning agencies and programs in the state or community; conducting research on early learning through the Institute of Education Sciences (IES); funding technical assistance on early learning topics, including early literacy and social and emotional development; and supporting the development of state longitudinal data systems that include early learning programs.

Race to the Top-Early Learning Challenge

The Race to the Top-Early Learning Challenge (RTT-ELC) will provide \$500 million in state competitive grants to improve early learning and development programs. The goal of the RTT-ELC is to better prepare more children with high needs for kindergarten, because children from birth to age five, including those from low-income families, need a strong foundation for success.

RTT-ELC will focus on five key areas of reform:

- Establishing Successful State Systems by building on the state's existing strengths, ambitiously moving forward the state's early learning and development agenda, and carefully coordinating programs across agencies to ensure consistency and sustainability beyond the grant;
- Defining High-Quality, Accountable Programs by creating a common tiered quality rating and improvement system that is used across the state to evaluate and improve program performance and to inform families about program quality;
- Promoting Early Learning and Development Outcomes for Children to develop common standards within the state and assessments that measure child outcomes, address behavioral and health needs, as well as inform, engage, and support families;
- Supporting A Great Early Childhood Education Workforce by providing professional development, career advancement opportunities, appropriate compensation, and a common set of standards for workforce knowledge and competencies; and
- Measuring Outcomes and Progress so that data can be used to inform early learning instruction and services and to assess whether children are entering kindergarten ready to succeed in elementary school.

The RTT-ELC program is jointly administered with the Department of Health and Human Services.

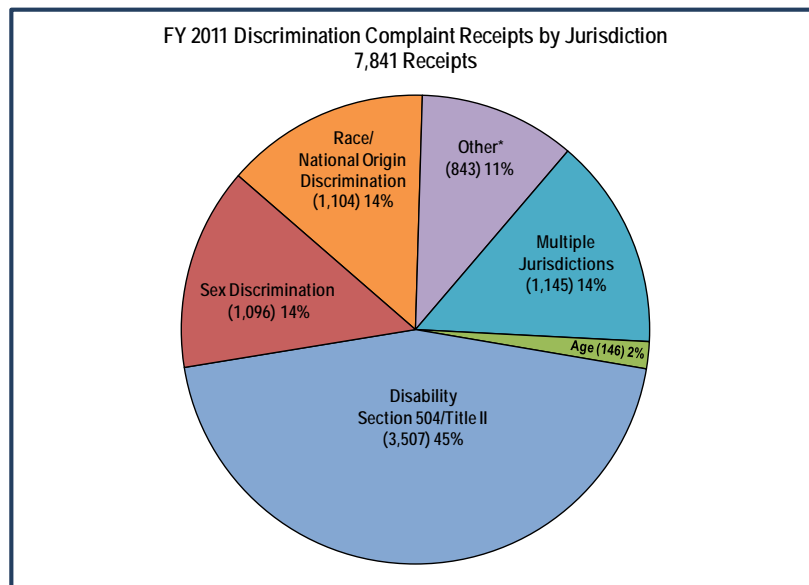
Goal 4: Equity

Ensure equitable educational opportunities for all students regardless of race, ethnicity, national origin, age, sex, disability, language, and socioeconomic status.

Office for Civil Rights

The Department of Education enforces federal civil rights laws that prohibit discrimination on the basis of race, color, national origin, sex, disability and age, in our nation's schools primarily in educational institutions that receive federal funds from the Department. In addition, the Department ensures that the Boy Scouts of America and other designated youth groups have equal access to meet in elementary and secondary schools that receive funds through the Department. The Office for Civil Rights (OCR), a law enforcement agency within the Department, performs the Department's civil rights enforcement responsibilities in a variety of ways including: investigating complaints alleging discrimination; conducting compliance reviews in educational institutions to determine if they are in compliance with the laws; and providing technical assistance to educational institutions on how to comply with the law and parents and students on their rights under the law. The Department also issues regulations on civil rights laws, develops policy guidance interpreting the laws, and distributes the information broadly.

In FY 2011, OCR received a record total of 7,841 complaints alleging discrimination, a 13 percent increase in complaint receipts over the previous fiscal year and resolved 7,434 complaints, some of which were received the previous year. As shown in the chart below, close to half of the complaints received by the Department allege discrimination due to disability. To augment the issues addressed through complaint processing, OCR implemented a proactive docket of compliance activities that included initiating 37 proactive compliance reviews and 73 proactive technical assistance activities. In addition, OCR developed policy guidance, including investigative guidance, to address discrimination against students on the basis of race, color, national origin, sex and disability. OCR's law enforcement work supports progress on the Department's efforts to address equity.



* This category reflects new complaint receipts for which jurisdiction has not yet been determined. It also includes complaint receipts under the *Boy Scouts of America Equal Access Act* and those with issues over which OCR has no jurisdiction.

Source: Office for Civil Rights Case Management System

Goal 5: Continuous Improvement of the U.S. Education System

Enhance the education system's ability to continuously improve through better and more widespread use of data, research and evaluation, transparency, innovation, and technology.

Widespread Use of Data

Data Strategy Team. The Data Strategy Team (DST) was organized in August 2010 to address the issue of inconsistent and uncoordinated data strategies among the various principal offices within the Department. The mission of the DST is to coordinate the Department's public-facing data initiatives by building cohesiveness in internal processes and data policies and by improving transparency in all matters surrounding the Department's collection of data. The DST supports states' use of education data through data websites and technical assistance to grantees. Specifically, the DST will find best practices for the use and promotion of data policy.

The DST is an open group, available to all those within the Department who wish to participate. The goal of meetings is to increase communication and awareness of data-related projects across the Department. Nearly every principal office has an official representative who participates in the larger DST meetings, and there are approximately 100 DST members.

There are currently four active workgroups for the DST to address the following topics: Data Dashboard, Data Inventory, Open Government, and Data Release. The Data Dashboard group is planning for the transition of the Dashboard.Ed.Gov website from its current version 1.0, launched in January, 2011, to an intermediate update, and on to an eventual version 2.0 with significantly improved features. Members of the Data Inventory group have begun the challenging task of defining what are "data" across the Department and also have made initial steps in cataloging the Department's data holdings. Responding to initiatives from the White House and OMB, the Open Government group is helping the Department navigate the requirements for transparency and openness mandated for all federal agencies. Finally, the newest group, Data Release, is designing a coordination process to improve the way that the Department releases data and data-based reporting to the public, while balancing the need to protect privacy and confidentiality.

Mapping State Standards. In FY 2011, the Department released a report comparing the relative rigor of state proficiency standards in reading and mathematics using the National Assessment of Educational Progress (NAEP) scale as a common yardstick. Each individual state develops its own state assessments in reading and math and sets its own proficiency standard. As a result, states vary widely in the standards they set for students. By using NAEP as a benchmark, it was possible to compare state proficiency standards.

Uniform Graduation Rate. In FY 2011, states will begin reporting high school graduation rates for the 2010-11 school year using a more rigorous four-year adjusted cohort, as developed by the nation's governors in 2005. Since data reporting requirements were first implemented under No Child Left Behind, states have calculated graduation rates using varying methods, creating inconsistent data from one state to the next. The transition to a uniform high school graduation rate requires all states to report the number of students who graduate in four years with a standard high school diploma, divided by the number of students who entered high school four years earlier, and accounting for student transfers in and out of school. The Department anticipates that the more rigorous method will result in lower reported graduation rates, but it will reflect a more accurate calculation of how many U.S. students complete high school on time.

Version 2.0 ED Data Express. During FY 2011, the Department launched an interactive website to make more accurate and timely K-12 education data available to the public. The new version provides the public with more dynamic tools to interact with the data, such as a mapping feature that allows users to view the data displayed on a map of the United States; a trend line tool, which displays a data element graphed across multiple school years; and a conditional analysis tool, which allows users to view one data element based on conditions set by another data element.

The site currently includes data from the Department's *EDFacts* data system, Consolidated State Performance Reports (CSPR), State Accountability Workbooks, and the National Center for Education Statistics (NCES), the College Board, and the Department's Budget Service office. In addition, the site has improved documentation and added the ability to share information from the site using social networking tools, such as Facebook or Twitter.

The Department's Evaluation Initiative

In May 2010, the Department launched a new agency-wide evaluation planning process to better align its investments in knowledge building with the Department's strategic plan and its budget and policy priorities and to support appropriate resource allocation. The process—led jointly by the Department's Office of Planning, Evaluation and Policy Development (OPEPD) and the Institute of Education Sciences—was developed to identify the Department's key priorities for evaluations that can provide reliable measures of the impacts of programs, policies, and strategies, as well as for a range of research and evaluation activities that build knowledge important to inform policy and practice more broadly (e.g., performance measurement, grantee evaluation, and support).

This planning process includes regular discussions with program and policy offices within the Department and reviews of existing research and recent and ongoing evaluation investments in the Department. While the planning process is informed by the knowledge generated through the Department's investments in long term programs of research, it focuses on knowledge building activities initiated and carried out by the Department.

In FY 2011, the Department developed and approved a set of priority research questions which will help shape its future investments in knowledge building. Planning for FY 2011 investments was completed this spring and planning for FY 2012 is underway, although final decisions are contingent on appropriations action. The evaluation planning process consists of the evaluation planning team meeting with the Department's policy and program offices and based on their input, developing recommendations for the evaluation activities the Department will support.

Each office is asked to identify its highest priority research questions, as well as any program-specific research questions they would like addressed in that year and beyond. The evaluation planning team's recommendations are designed to ensure that the evaluation activities supported annually by the Department, as a whole and to the extent possible, respond to those research questions identified as highest priority to the policy and program offices. Program offices are given the opportunity to raise any concerns they have with the evaluation planning team's recommendations.

The Department plans to engage annually in a similar strategic planning process for investments in knowledge building.

Goal 6: U.S. Department of Education Capacity

Improve the organizational capacities of the Department to implement this Strategic Plan.

Department Decision Support System Tool for Grant Risk Management

For both FY 2011 and FY 2012, the Department has placed a high priority on using data to continuously improve its grant-making processes. To that end, the Department's Risk Management Service (RMS) developed the Decision Support System Entity Risk Review (support review).

The support review is a data analysis tool that has been developed in collaboration with leadership and staff from various Principal Offices. The support review facilitates program officers' access to risk-related information and consolidates disparate data sources into one report.

The support review (example summary page shown above) provides financial, administrative, and internal controls data about grantees. Specifically, the support review includes data from: Dun & Bradstreet, the grants management system (G5), the Federal Audit Clearinghouse, and the Adverse Accreditation Actions list distributed by OPE. The Administrative Risk Score represents previous compliance history with the Department and is comprised mainly of data elements from the Department's grant management system (G5).

Applicant Name	Administrative Risk Score	Financial Risk Score	Internal Control Risk Score
Entity A	0	0	139
Entity B	0	0	139
Entity C	0	20	39
Entity D	0	120	69
Entity E	0	15	5

The Financial Risk Score presents an overview of the applicant's management of its finances using data elements related to its payments activities and credit scores. The Internal Controls Risk Score is based on the entities A-133 audit finding data. Each data element has an associated point value—the higher the score, the greater the potential risk that may require the application of risk mitigation strategies.

To make the summary page more user-friendly, the scores are color-coded such that green indicates low potential risk, yellow indicates an elevated potential risk, and salmon indicates a significant potential risk. When used in conjunction with other relevant programmatic information, the support review results in informed monitoring and decision-making, and highlights potential areas of risk.

RMS piloted the support review during FY 2011, making reviews available upon request by the program office. The pilot included four program offices: Office of Elementary and Secondary Education, Office of Innovation and Improvement, Office of Special Education and Rehabilitative Services, and Office of Postsecondary Education.

As of August 2011, RMS has delivered more than 150 review reports to both pilot and non-pilot programs and collected user feedback to assess the efficacy of the review reports. This feedback will be used to enhance and refine the tool for the upcoming FY 2012 release.

As a result of the FY 2011 pilot, RMS identified new ways to promote data-driven decision making in the grants management process. For FY 2012 and beyond, the long-term goal for the use of the support review is to formalize and streamline the processes the Department uses to:

identify areas of potential risk in the Department's grant portfolio; determine when grant conditions could be used to mitigate risk; encourage consistent treatment of grantees across program offices; and develop appropriate monitoring, technical assistance, and oversight plans as a part of grants management.

Customer Satisfaction with the Department of Education

For FY 2011, the Department significantly expanded its external survey of customer satisfaction with its products and services. The survey began seven years ago in response to a key metric in the Department's Strategic Plan. In FY 2010, metrics of customer satisfaction, both internal and external, were added to the Department's Organizational Performance Review, which contains metrics for a variety of assessments of principal office strategic and organizational performance and the survey was expanded to include 15 programs.

This year, in response to the President's April 27, 2011, Executive Order 13571 Streamlining Service Delivery and Improving Customer Service, the Department expanded its survey to include 45 programs with a future goal of surveying 20 percent of Department programs representing the top 80 percent of program dollars.

The survey uses the American Customer Satisfaction Index (ACSI). The ACSI is the national indicator of customer evaluations of the quality of goods and services. It is the only uniform benchmarking measure of customer satisfaction across agencies and private industry.

The ACSI allows benchmarking between federal agencies and provides information unique to each agency on how activities that interface with the public affect the satisfaction of its customers. The ACSI is a weighted average of three questions that measure: overall satisfaction, satisfaction compared to expectations, and satisfaction compared to an ideal organization.

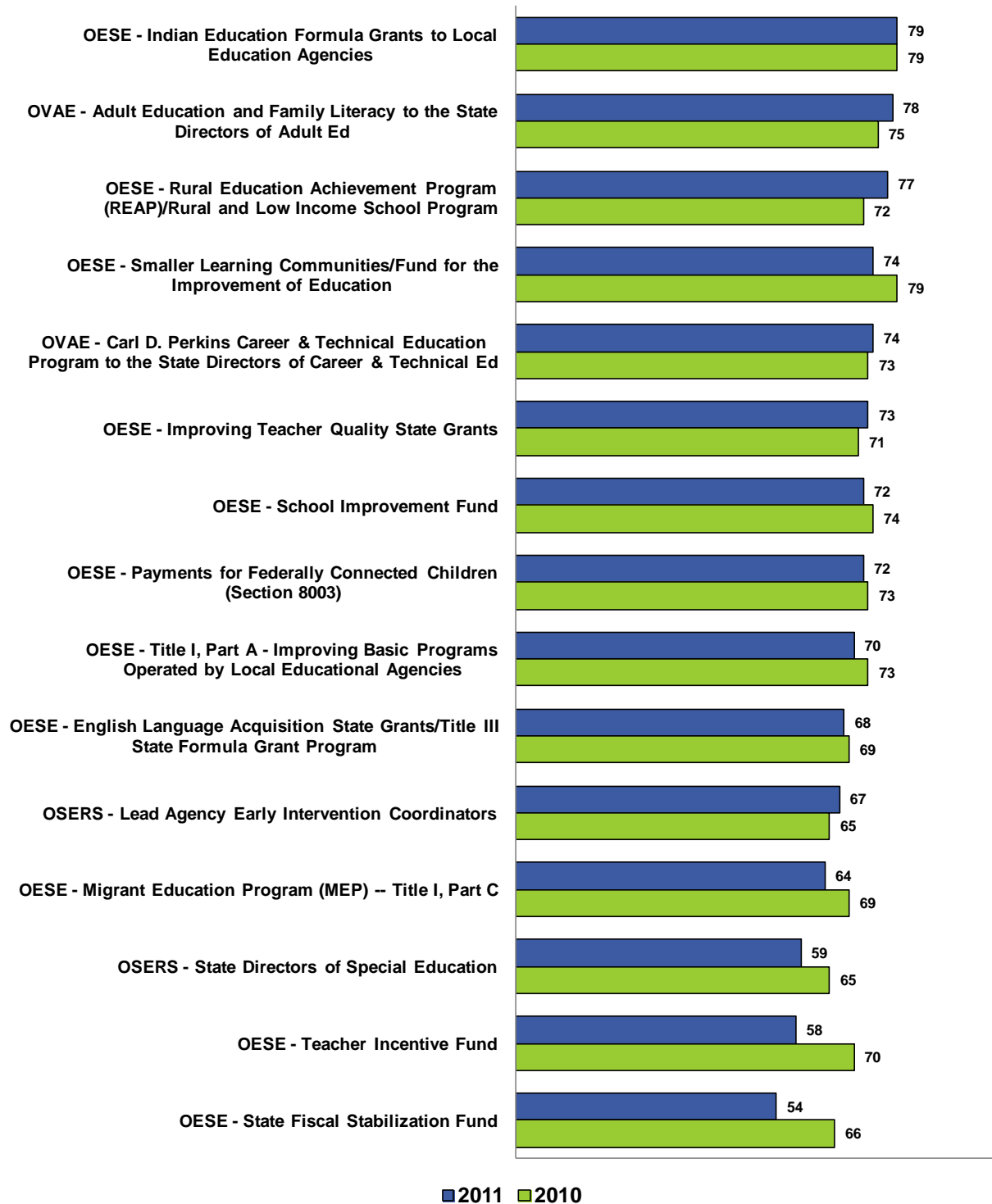
Additionally, each principal office in the Department surveys their stakeholders on the effective use of technology, clarity and organization of documents, staff knowledge, responsiveness, collaboration with other Department offices, provision of technical assistance, and ease of accessing online resources.

In FY 2011, there was no change in satisfaction from the previous year—72 points on a 100-point scale. The Department is now six points above the federal government average of 65. Staff scores were up two points, while technology and online resources were down two points from FY 2010. Complaints remained at one percent. Below is a comparison of the results of major Department programs from FY 2010 and FY 2011.

To review the complete results of the FY 2011 survey and previous surveys:

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

Satisfaction With Major Department Programs, FY 2010 and FY 2011



Financial Highlights

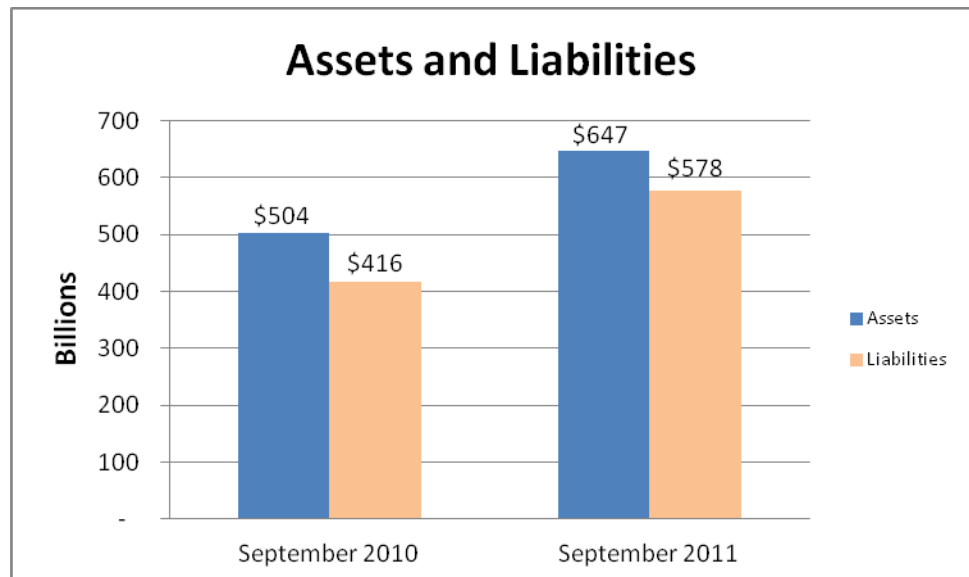
The Department consistently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operation. For the tenth consecutive year, the Department achieved an unqualified (clean) opinion from independent auditors on the annual 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.

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 Office of Inspector General (OIG) provides audit oversight. Financial statements and footnotes for FY 2011 appear on pages 37–86. 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 37 reflects total assets of



\$647 billion, a 28 percent increase over FY 2010. The vast majority of this increase is due to Credit Program Receivables, which increased by \$162.6 billion, a 44 percent increase over FY 2010. This increase is largely the result of Direct Loan disbursements, net of borrower principal and interest collections, which increased the net portfolio for Direct Loans by \$153.2 billion. The volume of Direct Loans greatly increased this year because of the transition from the Federal Family Education Loan program (FFEL) to the Direct Loan program. The Fund Balance with Treasury decreased by \$18.2 billion, a 14 percent decrease from FY 2010. This decrease is largely due to Recovery Act and Education Jobs Fund disbursements during FY 2011.

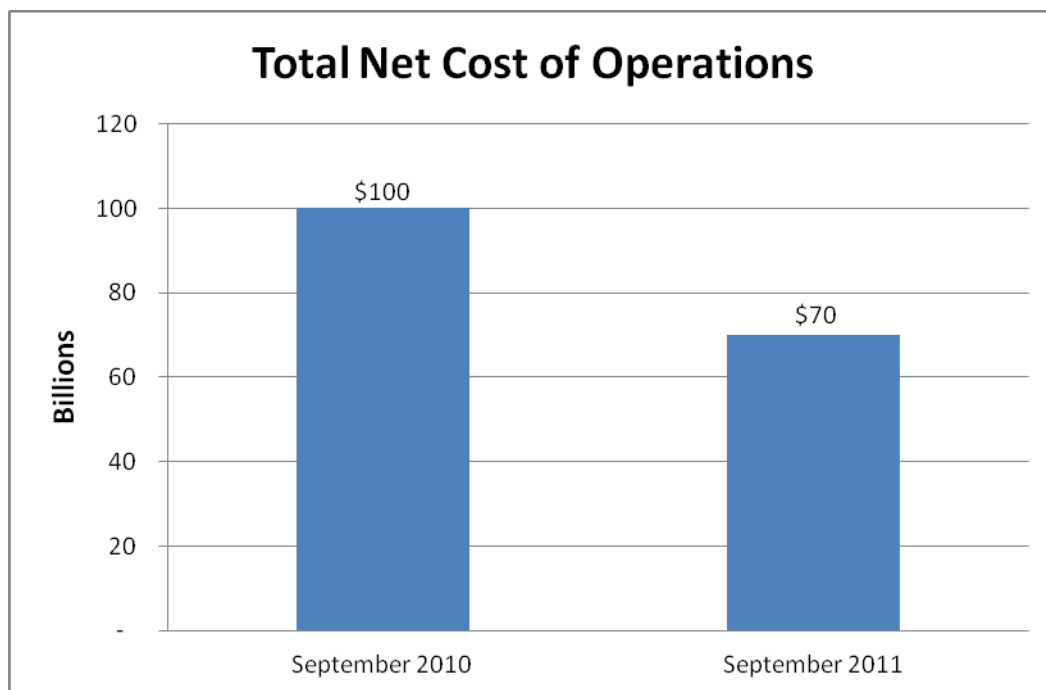
Total liabilities for the Department increased by \$161.9 billion, a 39 percent increase over FY 2010. The increase is the result of current year borrowing for the Direct Loan and FFEL Programs that provided funding for Direct Loan disbursements and FFEL Program downward re-estimates. This current year borrowing, net of repayments, resulted in a \$172.8 billion

increase in Debt. Liabilities for Loan Guarantees for the FFEL Program decreased by \$4.5 billion, a 31 percent decrease that is primarily due to FY 2011 subsidy re-estimates.

The Department's Net Position as of September 30, 2011, was \$68.6 billion, a \$19.0 billion decrease from FY 2010. This decrease is largely due to Recovery Act and Education Jobs Fund disbursements during this time period.

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 38, were \$69.5 billion for the period



ended September 30, 2011, a 30 percent decrease from the prior year. This decrease is largely the result of a \$27.1 billion decrease in Direct Loan program subsidy related costs and a \$16.1 billion decrease in Recovery Act and Education Jobs Fund disbursements. The reduction in Direct Loan program subsidy related costs reflects an increase in negative subsidy transfers and re-estimated subsidy costs. This represents an overall decrease in net costs.

As required by the *GPRRA Modernization Act of 2010*, each of the Department's reporting groups and major program offices have been aligned with the goals presented in the Department's draft *Strategic Plan 2011–2014*.

Net Cost Program	Reporting Group/ Program Office	Draft Strategic Goal
Increase College Access, Quality, and Completion	Federal Student Aid Office of Postsecondary Education Office of Vocational and Adult Education	1. Increase college access, quality, and completion by improving higher education and lifelong learning opportunities for youth and adults.

Net Cost Program	Reporting Group/ Program Office	Draft Strategic Goal
Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs	Office of Elementary and Secondary Education Office of Safe and Drug-Free Schools Hurricane Education Recovery	2. Prepare all students for college and career by improving the elementary and secondary education system's ability to consistently deliver excellent classroom instruction and supportive services. 3. Improve the health, social-emotional, and cognitive outcomes for all children from birth through third grade, so that all children, particularly those with high needs, are on track for graduating from high school college- and career-ready.
Ensure Equitable Educational Opportunities for All Students	Office of English Language Acquisition Office for Civil Rights Office of Special Education and Rehabilitative Services	4. Ensure equitable educational opportunities for all students regardless of race, ethnicity, national origin, age, sex, disability, language, and socioeconomic status.
Enhance the Education System's Ability to Continuously Improve	Institute of Education Sciences Office of Innovation and Improvement	5. Enhance the education system's ability to continuously improve through better and more widespread use of data, research and evaluation, transparency, innovation and technology
American Recovery and Reinvestment Act and Education Jobs Fund	American Recovery and Reinvestment Act Education Jobs Fund	Cuts across draft Strategic Goals 1–5

Draft *Strategic Plan* Goals 1-5 are sharply defined directives that guide the Department's program offices to carry out the vision and programmatic mission, and the net cost programs can be specifically associated with these five draft strategic goals. The Department also has a cross-cutting draft *Strategic Plan* Goal 6, U.S. Department of Education Capacity, which focuses on improving the organizational capacities of the Department to implement the draft *Strategic Plan*. As a result, the Department do not assign specific programs to draft *Strategic Plan* Goal 6 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 draft Strategic Plan goals and programs.

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 40 shows that the Department had \$366.4 billion in total budgetary resources

for the period ended September 30, 2011. These budgetary resources were composed of \$103.5 billion in appropriated budgetary resources and \$262.9 billion in non-budgetary credit reform resources that primarily consist of borrowing authority for the loan programs. Of the \$20.8 billion that remained unobligated for the period ended September 30, 2011, \$16.6 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 2011 and FY 2010, 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. The implications of this are that the liabilities presented herein cannot be liquidated without the enactment of appropriations, and that ongoing operations are subject to the enactment of future appropriations.

Office of Inspector General's (OIG) Management Challenges for Fiscal Year 2012 Highlights

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 we presented four management challenges: implementation of new programs/statutory changes, oversight and monitoring, data quality and reporting, and information technology security. All of the prior management challenges remain challenges for FY 2012. The first FY 2011 challenge, implementation of new programs/statutory changes, which incorporated aspects of the Recovery Act, and the *Ensuring Continued Access to Student Loans Act of 2008*, has been incorporated into the oversight and monitoring challenge. In addition, we have added a new challenge related to improper payments. The FY 2012 management challenges are:

- Improper Payments,
- Information Technology Security,
- Oversight and Monitoring, and
- Data Quality and Reporting.

The Executive Summary of Management Challenges for FY 2012 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>.

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 33 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 instances of noncompliance generally relate to user access issues, e.g. the timely removal of access for terminated employees, inconsistent maintenance of access approval documentation, revalidation of user rights not consistently performed, password configuration not in compliance with Department policy, lack of monitoring of the activities of administrators, etc. The Department will continue its efforts to address security and control weaknesses with an emphasis on addressing the root cause of the security or control weakness uniformly across the organization. The goal of this action is to decrease the likelihood of similar weaknesses being identified in future audit assessments.

The Department continues to meet the criteria for achieving compliance because the Department has demonstrated that the deficiencies do not have an impact on the following:

- Financial statements, both annual and quarterly preparations, and other required financial and budget reports are prepared using information generated by the Financial Management Support System (FMSS).
- Reliable and timely financial information for managing current operation is provided by the financial management system. Financial information is available both via online and standard reports to provide for financial analysis and support decision making. Reporting is in compliance with OMB guidance.
- The Financial Management Support System operations and procedures remain consistent with Federal accounting standards and comply with the U.S. Government Standard General Ledger guidance at a transactional 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 and financial management systems as of September 30, 2011, 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, 2011, 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, 2011

Financial Management Systems Strategy

The Department's FMSS is designated a mission-critical system of the Department that provides department-wide core financial management services. These services include funds control, budget planning, general ledger, administrative payments, accounts receivable; financial management system and access controls; financial system reports, including financial statements, FACTS, SF224, etc. The Department expects to continue on its improvements in the following performance outcomes from this initiative: continued control over and accountability of Department financial management services including, financial management system controls and practices, including cross-validation rules that prevent erroneous accounting transactions from being processed; financial system reporting capabilities that continued the ability to respond quickly to internal and external financial information inquiries. Additional outcomes are continued tight integration and streamlining with the Office of Federal Student Aid and business processes; reduced manual reconciliation efforts for the Financial Management Operations Group within the Office of the Chief Financial Officer; reduction of errors and improved funds control; better data sharing and centralized data edits and controls that could otherwise get out of synchronization between the FMSS and its feeder systems; and budget planning that integrates with the general ledger.

Currently, the FMSS resides on an Oracle database and uses the Oracle 11.5.10 (11i) version of the software. The Oracle system has operated successfully for the Department since its implementation in January 2002. Since this time, the Department has met all of its financial management performance measures, which include receiving unqualified financial statement audit opinions for each year since implementation, system availability rates of better than 99% of the scheduled time and closing periods within three days of the end of the month.

Oracle has recently issued Release 12 of its software. This version has passed the necessary testing and is federally compliant for financial management. The Department has completed an analysis on the change between the 11i and Release 12 versions of the software to determine the benefits and level of effort to implement the new version. Based on the outcome of this analysis the Department has decided to delay migration to Release 12 until 2015. The Department will develop an implementation plan during 2013. Implementation activities will begin during 2014 and will be completed by October 2015. These timeframes are subject to change based on funding levels and other priorities. The FMSS is in compliance with FFMIA, Federal Accounting Standards Advisory Board, U. S. Government Standard General Ledger, and Financial Systems Integration Office guidelines for financial management systems. No remediation actions are necessary.

Financial Details



Message From the Chief Financial Officer

The Department of Education continued its high standard of financial management and reporting during FY 2011. The Department's excellence in financial management has been a joint effort of its managers, employees, and business partners. In FY 2011, we:

- 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 tenth consecutive year, continuing a clear pattern of financial accountability; and
- Continued to have no material weaknesses identified by our auditors as part of their Report on Internal Control.



In FY 2011, the Department also took steps to address the two remaining significant deficiencies identified in the "Report on Internal Controls" for FY 2010: credit reform and information systems.

The Department continued to improve communication around its credit reform programs by holding monthly credit reform work group meetings among senior managers to review assumptions and procedures. A team from Budget Service and the Chief Financial Officer also completed a comprehensive cohort analysis for both the Direct Loan and Federal Family Education Loan programs to identify and reconcile any differences in estimated cash flows and general ledger entries. The cohort analysis was requested by our external auditors as a tool to validate the credit reform estimates.

Steps on information systems included continued efforts to improve security and controls. For example, the Department is transforming its Information Assurance and Cyber Security Program, including undertaking a full vulnerability assessment of the EDUCATE and Virtual Data Center IT environments and employing a new continuous monitoring program to automate the *Federal Information Security Management Act of 2002* (FISMA) reporting tool. The Department has also expanded the scope and functionality of the Education Computer Incident Response Center to provide improved oversight of information technology operations and security and to leverage additional and more efficient security functionality.

During FY 2011, 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, 2011

**United States Department of Education
Consolidated Balance Sheet
As of September 30, 2011 and 2010**
(Dollars in Millions)

	FY 2011	FY 2010
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 114,085	\$ 132,259
Accounts Receivable (Note 4)		1
Other Intragovernmental Assets (Note 8)	50	102
Total Intragovernmental	114,135	132,362
Cash and Other Monetary Assets (Note 5)	1,664	2,965
Accounts Receivable, Net (Note 4)	138	239
Credit Program Receivables, Net (Note 6)	530,491	367,904
General Property, Plant and Equipment, Net (Note 7)	16	28
Other Assets (Note 8)	98	166
Total Assets (Note 2)	\$ 646,542	\$ 503,664
Liabilities:		
Intragovernmental:		
Accounts Payable	\$ 34	\$ 1
Debt (Note 9)	547,108	374,335
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5)	1,664	2,965
Payable to Treasury (Note 6)	3,890	2,424
Other Intragovernmental Liabilities (Note 10)	6,843	12,958
Total Intragovernmental	559,539	392,683
Accounts Payable	4,248	4,810
Accrued Grant Liability (Note 11)	3,928	3,744
Liabilities for Loan Guarantees (Note 6)	10,025	14,479
Other Liabilities (Note 10)	217	346
Total Liabilities	\$ 577,957	\$ 416,062
Commitments and Contingencies (Note 21)		
Net Position:		
Unexpended Appropriations		
Other Funds	\$ 71,729	\$ 94,371
Cumulative Results of Operations		
Earmarked Funds (Note 20)	4	4
Other Funds	(3,148)	(6,773)
Total Net Position (Note 12)	\$ 68,585	\$ 87,602
Total Liabilities and Net Position	\$ 646,542	\$ 503,664

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, 2011 and 2010**

(Dollars in Millions)

Program Costs	FY 2011	FY 2010
Increase College Access, Quality, and Completion		
Gross Costs	\$ 21,785	\$ 32,504
Less: Earned Revenue	20,252	17,116
Net Program Costs	1,533	15,388
Total Program Costs	\$ 1,533	\$ 15,388
Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs		
Gross Costs	\$ 21,910	\$ 22,522
Less: Earned Revenue	83	96
Net Program Costs	21,827	22,426
Total Program Costs	\$ 21,827	\$ 22,426
Ensure Equitable Educational Opportunities for All Students		
Gross Costs	\$ 16,409	\$ 16,163
Less: Earned Revenue	23	26
Net Program Costs	16,386	16,137
Total Program Costs	\$ 16,386	\$ 16,137
Enhance the Education System's Ability to Continuously Improve		
Gross Costs	\$ 1,841	\$ 1,685
Less: Earned Revenue	39	41
Net Program Costs	1,802	1,644
Total Program Costs	\$ 1,802	\$ 1,644
American Recovery and Reinvestment Act and Education Jobs Fund		
Gross Costs	\$ 27,965	\$ 44,079
Less: Earned Revenue	27,965	44,079
Net Program Costs	27,965	44,079
Total Program Costs	\$ 27,965	\$ 44,079
Net Cost of Operations (Notes 13 & 16)	\$ 69,513	\$ 99,674

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, 2011 and 2010

(Dollars in Millions)

	FY 2011		FY 2010	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances				
Earmarked Funds	\$ 4		\$ 8	
All Other Funds	\$ (6,773)	\$ 94,371	\$ (217)	\$ 127,269
Budgetary Financing Sources:				
Appropriations Received				
Earmarked Funds				
All Other Funds		\$ 94,398		\$ 92,900
Other Adjustments (rescissions, etc)				
Earmarked Funds	\$ 1			
All Other Funds	(2)	(1,051)	(2)	(1,292)
Appropriations Used				
Earmarked Funds				
All Other Funds	115,989	(115,989)	124,506	(124,506)
Nonexchange Revenue				
Earmarked Funds				
All Other Funds		3		12
Donations and Forfeitures of Cash and Cash Equivalents				
Earmarked Funds	1			
All Other Funds				
Nonexpenditure Financing Sources				
Transfers-Out				
Earmarked Funds				
All Other Funds		(24)		(19)
Other Financing Sources:				
Imputed Financing from Costs Absorbed by Others				
Earmarked Funds				
All Other Funds	\$ 38		\$ 30	
Others				
Earmarked Funds				
All Other Funds		(42,868)		(31,413)
Total Financing Sources				
Earmarked Funds	\$ 2			
All Other Funds	73,136	\$ (22,642)	\$ 93,114	\$ (32,898)
Net Cost of Operations				
Earmarked Funds	\$ (2)		\$ (4)	
All Other Funds	(69,511)		(99,670)	
Net Change				
Earmarked Funds			\$ (4)	
All Other Funds	\$ 3,625	\$ (22,642)	(6,556)	\$ (32,898)
Ending Balances (Note 12)				
Earmarked Funds	\$ 4		\$ 4	
All Other Funds	\$ (3,148)	\$ 71,729	\$ (6,773)	\$ 94,371

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, 2011 and 2010

(Dollars in Millions)

	FY 2011		FY 2010	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:				
Unobligated balance, brought forward, October 1	\$ 6,526	\$ 15,654	\$ 36,601	\$ 9,994
Recoveries of prior year Unpaid Obligations	1,575	12,203	1,077	4,436
Budgetary Authority:				
Appropriations	94,967	2	96,823	2
Borrowing Authority (Note 15)		211,980		183,079
Spending authority from offsetting collections (gross):				
Earned				
Collected	1,825	53,169	1,613	51,979
Change in Receivables from Federal Sources			(2)	3
Change in unfilled customer orders				
Advance Received	(7)			
Without advance from Federal Sources	4	13		4
Subtotal	\$ 96,789	\$ 265,164	\$ 98,434	\$ 235,067
Temporarily not available pursuant to Public Law			(561)	
Permanently not available	(1,396)	(30,134)	(5,204)	(17,355)
Total Budgetary Resources (Note 15)	\$ 103,494	\$ 262,887	\$ 130,347	\$ 232,142
Status of Budgetary Resources:				
Obligations incurred: (Note 15)				
Direct	\$ 97,980	\$ 247,485	\$ 123,731	\$ 216,488
Reimbursable	80		90	
Unobligated Balances:				
Apportioned	\$ 3,036	\$ 634	\$ 2,351	\$ 1,433
Unobligated Balance not available	2,398	14,768	4,175	14,221
Total Status of Budgetary Resources	\$ 103,494	\$ 262,887	\$ 130,347	\$ 232,142
Change in Obligated Balance:				
Obligated balance, net:				
Unpaid obligations, brought forward, October 1	\$ 94,693	\$ 150,831	\$ 95,488	\$ 133,797
Uncollected customer payments from Federal Sources, brought forward, October 1	(2)	(14)	(4)	(7)
Total, unpaid obligated balance, brought forward, net	\$ 94,691	\$ 150,817	\$ 95,484	\$ 133,790
Obligations Incurred, net (+/-)	98,060	247,485	123,821	216,488
Gross Outlays	(118,494)	(221,724)	(123,539)	(195,018)
Recoveries of prior year unpaid obligations, actual	(1,575)	(12,203)	(1,077)	(4,436)
Change in uncollected customer payments from Federal Sources (+/-)	(4)	(13)	2	(7)
Obligated Balance, net, end of period:				
Unpaid Obligations	\$ 72,684	\$ 164,389	\$ 94,693	\$ 150,831
Uncollected customer payments from Federal Sources	(6)	(27)	(2)	(14)
Total, Unpaid Obligated Balance, Net, End of Period	\$ 72,678	\$ 164,362	\$ 94,691	\$ 150,817
Net Outlays:				
Gross Outlays	\$ 118,494	\$ 221,724	\$ 123,539	\$ 195,018
Offsetting collections	(1,818)	(53,169)	(1,613)	(51,979)
Distributed Offsetting receipts	(50,289)		(29,046)	
Net Outlays (Note 15)	\$ 66,387	\$ 168,555	\$ 92,880	\$ 143,039

The accompanying notes are an integral part of these statements.

Notes to the Principal Financial Statements For the Years Ended September 30, 2011 and 2010

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 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. Under this program, 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 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. The *SAFRA Act*, which was included in the *Health Care and Education Reconciliation Act of 2010* and became effective July 1, 2010, provided that no new FFEL loans would be made after June 30, 2010.

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; (2) loan participation purchases; and (3) an Asset-Backed Commercial Paper (ABCP) Conduit.

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 grants; grants to support institutions of higher education; educational research and improvement grants; grants to assist low-income and first-generation college students prepare for and transition into college; grants to improve our global awareness and competitiveness; and fellowships for college and graduate students. Through the facilities loan programs, the Department administers low-interest loans to institutions of higher education for the construction and renovation of facilities.

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*, 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 *American Recovery and Reinvestment Act of 2009* (Recovery Act), enacted on February 17, 2009 as Public Law 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 of stabilizing state and local government budgets to avoid reductions in education and other essential public services while driving education reform. The Department was tasked with promptly disbursing these funds through a variety of existing and new grant programs, while ensuring the transparency and accountability of every dollar spent.

Public Law 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.

Reporting Groups

The financial reporting structure of the Department presents operations based on five reporting groups that administer the loan and grant programs. The reporting groups are shown below.

- Federal Student Aid (FSA)
- Office of Elementary and Secondary Education (OESE)
- American Recovery and Reinvestment Act and Education Jobs Fund (RA/JF)
- Office of Special Education and Rehabilitative Services (OSERS)
- Other

The "Other" reporting group consists of the 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, Office for Civil Rights (OCR), and Hurricane Education Recovery (HR) activities. (See Notes 11, 13, and 20)

FSA, IES, OESE, OII, and OSERS are responsible for the administration of Recovery Act funds. OESE is responsible for administration of the Education Jobs Fund. Recovery Act and Education Jobs Fund activities are reported under the RA/JF reporting group. (See Notes 11, 13, 18, and 19)

Basis of Accounting and Presentation

These financial statements have been prepared to report the financial position, net cost of operations, changes in net position, and budgetary resources of the Department, as required by the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994*. The financial statements were prepared from the books and records of the Department, in accordance with accounting principles generally accepted in the United States of America for federal entities, issued by the Federal Accounting Standards Advisory Board, and the Office of Management and Budget (OMB) Circular No. A-136, *Financial*

Reporting Requirements, as revised October 2011. 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 fiscal year (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 for 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 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 2012 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 unobligated balances of resources from prior years; recoveries of prior-year obligations; and 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, the Historically Black Colleges and Universities (HBCU) Capital Financing 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 principal and interest collections from borrowers, related fees, and interest from Treasury on balances in 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, activities under the temporary loan purchase authority, and the HBCU Capital Financing Program. 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 the 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 2010, which were statutorily not available for obligation until the following fiscal year. Because 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)

Accounts Payable

Accounts Payable include amounts owed by the Department for goods and services received from other entities and scheduled payments transmitted but not yet processed. The Department's accounts payable primarily consist of in-process grant and loan disbursements to the public.

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 HBCU 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 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, match voluntary employee contributions up to 3 percent of the employee's basic pay, and match one-half of contributions between 3 percent and 5 percent of the employee's 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 fund the programs fully 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, employees who have incurred work-related occupational diseases, and 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.

Reclassifications

Certain reclassifications were made to the FY 2010 financial statements and notes to conform to the current year presentation. These changes had no effect on total assets, liabilities, net position, net cost of operations, or budgetary resources. The FY 2010 Statement of Net Cost and related note were reclassified to align with the strategic goals presented in the Department's draft *Strategic Plan 2011-2014*. (See Note 13) Additional reclassifications were made within the FFEL Program Receivables, Net section of Note 6, Credit Programs for Higher Education, and within Note 16, Reconciliation of Budgetary Obligations to Net Cost of Operations.

Additional Comparative Information

In FY 2011, the Department's notes to the financial statements include disclosure of the components of Distributed Offsetting Receipts. FY 2010 information is presented for comparative purposes. (See Note 15)

Note 2. Non-Entity Assets

As of September 30, 2011 and 2010, non-entity assets consisted of the following:

Non-Entity Assets

(Dollars in Millions)

	2011	2010
Non-Entity Assets		
Intragovernmental:		
Fund Balance with Treasury	\$ 70	\$ 93
Total Intragovernmental	70	93
With the Public:		
Cash and Other Monetary Assets	1,664	2,965
Accounts Receivable, Net	34	21
Credit Program Receivables, Net	215	183
Total With the Public	1,913	3,169
Total Non-Entity Assets	1,983	3,262
Entity Assets	644,559	500,402
Total Assets	\$ 646,542	\$ 503,664

Non-entity intragovernmental assets primarily 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, 2011 and 2010, consisted of the following:

Fund Balances

(Dollars in Millions)

	2011	2010
General Funds	\$ 76,432	\$ 98,792
Revolving Funds	37,562	33,351
Trust Funds	4	5
Special Funds	17	18
Other Funds	70	93
Fund Balance with Treasury	\$ 114,085	\$ 132,259

The Status of Fund Balance with Treasury, as of September 30, 2011 and 2010, consisted of the following:

Status of Fund Balance with Treasury

(Dollars in Millions)

	2011	2010
Unobligated Balance:		
Available	\$ 3,670	\$ 3,784
Unavailable	15,502	15,431
Obligated Balance, Not Yet Disbursed	94,843	112,390
Authority Temporarily Precluded from Obligation	-	561
Non-Budgetary Fund Balance with Treasury	70	93
Fund Balance with Treasury	\$ 114,085	\$ 132,259

Note 4. Accounts Receivable

Accounts Receivable, as of September 30, 2011 and 2010, consisted of the following:

Accounts Receivable

(Dollars in Millions)

	2011		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	\$ -	\$ -	\$ -
With the Public	322	(184)	138
Accounts Receivable	\$ 322	\$ (184)	\$ 138
	2010		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	\$ 1	\$ -	\$ 1
With the Public	416	(177)	239
Accounts Receivable	\$ 417	\$ (177)	\$ 240

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 Guaranty Agency Federal and Restricted Funds Due to Treasury. The table below presents Cash and Other Monetary Assets for the years ended September 30, 2011 and 2010.

Cash and Other Monetary Assets

(Dollars in Millions)

	2011	2010
Beginning Balance, Cash and Other Monetary Assets	\$ 2,965	\$ 2,414
Increase/(Decrease) in Guaranty Agency Federal Funds, net	(1,301)	989
Less: Excess Collections Remitted by Guaranty Agencies	-	438
Ending Balance, Cash and Other Monetary Assets	\$ 1,664	\$ 2,965

The \$1.3 billion net decrease in the Federal Fund in FY 2011 represents the change in the estimated value of net assets held in the FFEL guaranty agency Federal Funds. This decrease reflects the impact of guaranty agencies' operations and a refinement the Department made to the process for estimating the valuation of the Federal Fund.

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 \$133 billion in Direct Loans to eligible borrowers in FY 2011 and approximately \$75 billion in FY 2010. 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 2011 resulted from the increased use of the Direct Loan Program in accordance with the changes made by the *SAFRA Act*.

Approximately 9 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 before the student begins classes. For Direct Loans obligated in the 2011 cohort, an estimated \$14.5 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.

Federal Family Education Loan Program. In FY 2008, the Department began administering activities under temporary loan purchase authority. ECASLA gave the Department temporary authority to purchase FFEL loans and participation interests in those loans. This authority was to expire on September 30, 2009; however, Public Law 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 commitment activity, lenders had the option to sell directly to the Department fully disbursed loans originated for academic years 2007-08, 2008-09, or 2009-10. In loan participation transactions, lenders transferred to a custodian FFEL loans originated in academic years 2008-09 or 2009-10 on which at least one disbursement had been made. The custodian issued participation certificates to the lenders, which conveyed a participation interest in the loans. The lenders sold the participation interest in the loans to the Department at the par value of these loans. The Department remitted the proceeds through the custodian to the lenders. Participation interests earned a yield payable from the lenders 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 were obtained by selling the underlying loans to the Department or by other means. Lenders committed to redeem the participation certificates and sell loans by September 30, 2010; the Department finalized these transactions by October 15, 2010.

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 \$1.2 billion of these delinquent loans as of September 30, 2011. 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, and pledged to the conduit prior to July 1, 2010, are eligible to be purchased through the ABCP Conduit.

As of September 30, 2011, the Department has \$72.6 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. The conduit, a separate legal entity, has approximately \$41.5 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.

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.

Under the provisions of the *SAFRA Act*, no new loans were made under the FFEL Program after June 30, 2010. This legislation effectively required a transition for new loans 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 satisfied, discharged, or cancelled.

As a result of the *SAFRA Act*, the Department did not guarantee any loans in FY 2011. The Department guaranteed \$24 billion in gross non-consolidation loans to FFEL recipients during FY 2010. As of September 30, 2011 and 2010, total principal balances outstanding of guaranteed loans held by lenders were approximately \$328 billion and \$390 billion, respectively. As of September 30, 2011 and 2010, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately \$321 billion and \$382 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.

Guaranteed loans that default are initially turned over to guaranty agencies for collection. In most cases, after approximately four years, defaulted guaranteed loans not in repayment are turned over to the Department for collection.

Federal Perkins Loan Program. The Federal Perkins Loan Program is a campus-based program that provides 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 who agree 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* (Public Law 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 82.19 percent. The current subsidy estimate for the sub-program is \$327 million on a loan volume of \$398 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 \$17 billion during FY 2010 to \$24 billion during FY 2011. 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 payoff of the existing loans—those being consolidated—is recognized in the future projected cash flows of the past cohort year in which the loans were originated. FFEL to Direct Loan consolidations are part of the \$24 billion.

Credit Program Receivables

Credit Program Receivables, as of September 30, 2011 and 2010, consisted of the following:

Credit Program Receivables, Net

(Dollars in Millions)

	2011	2010
Direct Loan Program Loan Receivables, Net	\$ 381,454	\$ 228,208
FFEL Program		
FFEL Guaranteed Loan Program, Net (Pre-1992)	3,675	2,419
FFEL Program (Post-1991):		
FFEL Guaranteed Loan Program, Net	28,627	24,030
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	42,116	42,279
Loan Participation Purchase, Net	72,682	69,686
ABCP Conduit, Net	943	468
Federal Perkins Program Loan Receivables, Net	215	183
TEACH Program Receivables, Net	253	137
Facilities Loan Programs Loan Receivables, Net	526	494
Credit Program Receivables, Net	\$ 530,491	\$ 367,904

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)

	2011	2010
Principal Receivable	\$ 341,822	\$ 220,522
Interest Receivable	14,286	9,655
Receivables	356,108	230,177
Less: Allowance for Subsidy	(25,346)	1,969
Direct Loan Program Loan Receivables, Net	\$ 381,454	\$ 228,208

Of the \$356.1 billion in receivables, as of September 30, 2011, \$16.1 billion in loan principal was in default, compared to \$14.0 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>2011</u>	<u>2010</u>
<u>FFEL Guaranteed Loan Program (Pre-1992)</u>		
Principal Receivable	\$ 6,228	\$ 6,681
Interest Receivable	4,034	3,849
Receivables	10,262	10,530
Less: Allowance for Subsidy	6,587	8,111
FFEL Guaranteed Loan Program, Net (Pre-1992)	3,675	2,419
<u>FFEL Program (Post-1991)</u>		
FFEL Guaranteed Loan Program:		
Principal Receivable	29,790	26,358
Interest Receivable	4,236	4,049
Receivables	34,026	30,407
Less: Allowance for Subsidy	5,399	6,377
FFEL Guaranteed Loan Program, Net	28,627	24,030
Temporary Loan Purchase Authority:		
Loan Purchase Commitment:		
Principal Receivable	35,822	36,623
Interest Receivable	1,879	1,400
Receivables	37,701	38,023
Less: Allowance for Subsidy	(4,415)	(4,256)
Loan Purchase Commitment, Net	42,116	42,279
Loan Participation Purchase:		
Principal Receivable	61,125	62,931
Interest Receivable	2,993	1,665
Receivables	64,118	64,596
Less: Allowance for Subsidy	(8,564)	(5,090)
Loan Participation Purchase, Net	72,682	69,686
ABCP Conduit:		
Principal Receivable	1,121	544
Interest Receivable	55	26
Receivables	1,176	570
Less: Allowance for Subsidy	233	102
ABCP Conduit, Net	943	468
FFEL Program Receivables, Net	\$ 148,043	\$ 138,882

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.

Federal Perkins Loan Program. As of September 30, 2011 and 2010, loan receivables, net of an allowance for loss, were \$215 million and \$183 million, respectively. These loans are valued at historical cost.

TEACH Program. As of September 30, 2011 and 2010, loan receivables, net of an allowance for subsidy, were \$253 million and \$137 million, respectively.

Facilities Loan Programs

Facilities Loan Programs Loan Receivables

(Dollars in Millions)

	2011	2010
Principal Receivable	\$ 932	\$ 785
Interest Receivable	7	9
Receivables	939	794
Less: Allowance for Subsidy/Loss	413	300
Facilities Loan Programs Loan Receivables, Net	\$ 526	\$ 494

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)

	2011	2010
Beginning Balance, Allowance for Subsidy	\$ 1,969	\$ 4,036
Components of Subsidy Transfers		
Interest Rate Differential	(26,898)	(11,708)
Defaults, Net of Recoveries	2,342	1,307
Fees	(1,739)	(1,067)
Other	9,264	5,158
Current Year Subsidy Transfers	(17,031)	(6,310)
Components of Subsidy Re-estimates		
Interest Rate Re-estimates ¹	(8,084)	3,547
Technical and Default Re-estimates	(3,515)	1,196
Subsidy Re-estimates	(11,599)	4,743
Activity		
Fee Collections	1,623	1,056
Loan Cancellations ²	(964)	(388)
Subsidy Allowance Amortization	1,638	(500)
Other	(982)	(668)
Total Activity	1,315	(500)
Ending Balance, Allowance for Subsidy	\$ (25,346)	\$ 1,969

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

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

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

FFEL Program Reconciliation of Liabilities for Loan Guarantees

(Dollars in Millions)

	<u>2011</u>	<u>2010</u>
Beginning Balance, FFEL Financing Account Liability for Loan Guarantees	\$ 14,407	\$ 20,448
Components of Subsidy Transfers		
Interest Supplement Costs	-	(733)
Defaults, Net of Recoveries	-	212
Fees	-	(960)
Other ¹	-	878
Current Year Subsidy Transfers	-	(603)
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	(1)	59
Technical and Default Re-estimates	(11,220)	(12,727)
Subsidy Re-estimates	(11,221)	(12,668)
Activity		
Interest Supplement Payments	(2,453)	(3,881)
Claim Payments	(9,707)	(8,987)
Fee Collections	2,600	3,736
Interest on Liability Balance	(867)	(152)
Other ²	17,225	16,514
Total Activity	6,798	7,230
Ending Balance, FFEL Financing Account Liability for Loan Guarantees	9,984	14,407
FFEL Liquidating Account Liability for Loan Guarantees	41	72
Liabilities for Loan Guarantees	\$ 10,025	\$ 14,479

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

² 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)

	2011	2010
Beginning Balance, Allowance for Subsidy	\$ (4,256)	\$ (2,360)
Components of Subsidy Transfers		
Interest Costs	-	(4,548)
Defaults, Net of Recoveries	-	178
Fees	-	520
Other	-	1,647
Current Year Subsidy Transfers	-	(2,203)
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	(518)	1,299
Technical and Default Re-estimates	(323)	438
Subsidy Re-estimates	(841)	1,737
Activity		
Fee Disbursements	(31)	(644)
Subsidy Allowance Amortization	381	(314)
Direct Asset Activities and Other	332	(472)
Total Activity	682	(1,430)
Ending Balance, Allowance for Subsidy	\$ (4,415)	\$ (4,256)

Loan Participation Purchase Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2011	2010
Beginning Balance, Allowance for Subsidy	\$ (5,090)	\$ (2,717)
Components of Subsidy Transfers		
Interest Costs	-	(3,662)
Defaults, Net of Recoveries	-	254
Fees	-	(693)
Other	-	2,194
Current Year Subsidy Transfers	-	(1,907)
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	(1,495)	2,621
Technical and Default Re-estimates	(2,569)	(1,321)
Subsidy Re-estimates	(4,064)	1,300
Activity		
Fee Disbursements	(655)	(837)
Subsidy Allowance Amortization	635	(673)
Direct Asset Activities and Other	610	(256)
Total Activity	590	(1,766)
Ending Balance, Allowance for Subsidy	\$ (8,564)	\$ (5,090)

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, and Fund Balance with Treasury.

The Department accrues interest receivable and records interest revenue on performing Direct Loans and FFEL loans purchased by the Department. Interest receivable is accrued on defaulted guaranteed loans, with an offset to the allowance for subsidy. The Department does not record interest revenue on defaulted guaranteed loans.

Subsidy amortization is calculated 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 for the years ended September 30, 2011 and 2010:

Direct Loan Program

(Dollars in Millions)

	2011	2010
Interest Expense on Treasury Borrowing	\$ 14,321	\$ 10,514
Interest Expense	\$ 14,321	\$ 10,514
Interest Revenue from the Public	\$ 12,466	\$ 7,352
Amortization of Subsidy	(1,638)	500
Interest Revenue on Uninvested Funds	3,493	2,662
Interest Revenue	\$ 14,321	\$ 10,514

Payable to Treasury

Payable to Treasury, for the years ended September 30, 2011 and 2010, consisted of the following:

Payable to Treasury

(Dollars in Millions)

	2011	2010
Future Liquidating Account Collections, Beginning Balance	\$ 2,424	\$ 3,569
Valuation of Pre-1992 Loan Liability and Allowance	1,787	(717)
Capital Transfers to Treasury	(325)	(428)
Future Liquidating Account Collections, Ending Balance	3,886	2,424
Other	4	-
Payable to Treasury	\$ 3,890	\$ 2,424

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

(Dollars in Millions)

	2011	2010
Components of Current Year Subsidy Transfers		
Interest Rate Differential	\$ (26,898)	\$ (11,708)
Defaults, Net of Recoveries	2,342	1,307
Fees	(1,739)	(1,067)
Other	9,264	5,158
Current Year Subsidy Transfers	(17,031)	(6,310)
Subsidy Re-estimates	(11,599)	4,743
Direct Loan Subsidy Expense	\$ (28,630)	\$ (1,567)

William D. Ford Federal Direct Loan re-estimated subsidy cost was adjusted downward by \$11.6 billion in FY 2011. Costs decreased \$5.7 billion due to updated economic assumptions, including probabilistic estimating, discount rates, and weighted consolidation loan interest rates. The availability of new information allowed Direct Loan death, disability, and bankruptcy rates to be estimated directly rather than having to use the FFEL rates, reducing cost by \$1.5 billion. The decrease in costs is due to lower bankruptcy rates used in formulating the estimate for Direct Loans. Court action usually prevents discharges of Direct student loans. Costs decreased by \$1.0 billion due to updated actual activity indicating slightly lower rates of prepayments, resulting in higher interest earnings from borrowers. 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 \$1.1 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994-2010.

William D. Ford Federal 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 by \$2.2 billion. Changes in assumptions for income-based repayments and public service loan forgiveness increased subsidy cost by \$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 by \$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.

Federal Family Education Loan Program

FFEL Program Subsidy Expense

(Dollars in Millions)

	2011	2010
FFEL Guaranteed Loan Program		
Components of Current Year Subsidy Transfers		
Interest Supplement Costs	\$ -	\$ (733)
Defaults, Net of Recoveries	-	212
Fees	-	(960)
Other	-	878
Current Year Subsidy Transfers	-	(603)
Subsidy Re-estimates	(11,221)	(12,668)
FFEL Guaranteed Loan Program Subsidy Expense	(11,221)	(13,271)
Temporary Loan Purchase Authority		
Loan Purchase Commitment		
Components of Current Year Subsidy Transfers		
Interest Costs	-	(4,548)
Defaults, Net of Recoveries	-	178
Fees	-	520
Other	-	1,647
Current Year Subsidy Transfers	-	(2,203)
Subsidy Re-estimates	(841)	1,737
Loan Purchase Commitment Subsidy Expense	(841)	(466)
Loan Participation Purchase		
Components of Current Year Subsidy Transfers		
Interest Costs	-	(3,662)
Defaults, Net of Recoveries	-	254
Fees	-	(693)
Other	-	2,194
Current Year Subsidy Transfers	-	(1,907)
Subsidy Re-estimates	(4,064)	1,300
Loan Participation Purchase Subsidy Expense	(4,064)	(607)
FFEL Program Subsidy Expense	\$ (16,126)	\$ (14,344)

FFEL Guaranteed subsidy cost was adjusted downward \$11.2 billion in FY 2011. Costs decreased \$5.5 billion due to updated economic assumptions, including probabilistic deterministic rates, which reflected historically low commercial paper rates, resulting in substantially higher negative special allowance payments than were previously projected. Costs decreased \$2.0 billion due to multiple assumption changes affecting the Guaranteed ECASLA cash flows. 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 \$13.4 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1992-2010.

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.

Subsidy Rates

The subsidy rates applicable to the 2011 loan cohort year follow:

Subsidy Rates—Cohort 2011					
	Interest Differential/ Supplements	Defaults	Fees	Other	Total
Direct Loan Program	(20.55%)	1.69%	(1.22%)	6.18%	(13.90%)
TEACH Program	4.29%	0.52%	0.00%	7.92%	12.73%

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 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. The subsidy expense reported in the current year includes re-estimates. The subsidy rates shown above, which reflect aggregate negative subsidy in the FY 2011 cohort, cannot be applied to direct 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 Expenses, for the years ended September 30, 2011 and 2010, consisted of the following:

Administrative Expenses				
(Dollars in Millions)				
	2011		2010	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	\$ 661	\$ 388	\$ 536	\$ 314
Other Expense	30	18	22	13
Administrative Expenses	\$ 691	\$ 406	\$ 558	\$ 327

Note 7. General Property, Plant, and Equipment

General Property, Plant, and Equipment, as of September 30, 2011 and 2010, consisted of the following:

General Property, Plant, and Equipment

(Dollars in Millions)

	2011		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software, and Telecommunications Equipment	\$ 176	\$ (160)	\$ 16
Furniture and Fixtures	3	(3)	-
General Property, Plant, and Equipment	\$ 179	\$ (163)	\$ 16

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

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)

2011		2010	
FY	Lease Payment	FY	Lease Payment
2012	\$ 38	2011	\$ 48
2013	44	2012	48
2014	45	2013	45
2015	53	2014	47
2016	55	2015	54
After 2016	57	After 2015	56
Total	\$ 292	Total	\$ 298

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 \$50 million and \$102 million as of September 30, 2011 and 2010, 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 \$98 million and \$166 million as of September 30, 2011 and 2010, respectively.

Note 9. Debt

Debt, as of September 30, 2011 and 2010, consisted of the following:

Debt					
(Dollars in Millions)					
	2011				
	Beginning Balance	Accrued Interest	New Borrowing	Repayments	Ending Balance
Treasury Debt					
Direct Loan Program	\$ 237,190	\$ -	\$ 167,071	\$ (11,887)	\$ 392,374
FFEL Program					
Guaranteed Loan Program	10,730	-	18,754	-	29,484
Loan Purchase Commitment	45,205	-	1,394	(2,740)	43,859
Loan Participation Purchase	79,577	-	5,352	(5,627)	79,302
ABCP Conduit	804	-	250	(90)	964
TEACH Program	150	-	133	(2)	281
Facilities Loan Program	61	-	-	(3)	58
Total Treasury Debt	373,717	-	192,954	(20,349)	546,322
Debt to the FFB					
HBCU	618	1	176	(9)	786
Total Debt to the FFB	618	1	176	(9)	786
Total	\$ 374,335	\$ 1	\$ 193,130	\$ (20,358)	\$ 547,108
	2010				
	Beginning Balance	Accrued Interest	New Borrowing	Repayments	Ending Balance
Treasury Debt					
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
Total Treasury Debt	234,929	-	155,175	(16,387)	373,717
Debt to the FFB					
HBCU	456	2	171	(11)	618
Total Debt to the FFB	456	2	171	(11)	618
Total	\$ 235,385	\$ 2	\$ 155,346	\$ (16,398)	\$ 374,335

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, 2011 and 2010, consisted of the following:

Other Liabilities				
(Dollars in Millions)				
	2011		2010	
	Intragovern- mental	With the Public	Intragovern- mental	With the Public
Liabilities Covered by Budgetary Resources				
Current				
Advances From Others	\$ 89	\$ -	\$ 96	\$ -
Employer Contributions and Payroll Taxes	6	-	5	-
Liability for Deposit Funds and Clearing Accounts	(4)	71	8	86
Accrued Payroll and Benefits	-	28	-	25
Deferred Revenue	-	62	-	182
Liabilities in Miscellaneous Receipt Accounts	6,533	-	12,663	-
Total Other Liabilities Covered by Budgetary Resources	6,624	161	12,772	293
Liabilities Not Covered by Budgetary Resources				
Current				
Accrued Unfunded Annual Leave	-	38	-	37
Non-Current				
Accrued Unfunded FECA Liability	4	-	3	-
Liabilities in Miscellaneous Receipt Accounts	215	-	183	-
Accrued FECA Actuarial Liability	-	18	-	16
Total Other Liabilities Not Covered by Budgetary Resources	219	56	186	53
Other Liabilities	\$ 6,843	\$ 217	\$ 12,958	\$ 346

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 \$275 million and \$239 million as of September 30, 2011 and 2010, respectively.

As of September 30, 2011 and 2010, liabilities on the Balance Sheet totaled \$578.0 billion and \$416.1 billion, respectively. Of this amount, liabilities covered by budgetary resources totaled \$577.7 billion as of September 30, 2011, and \$415.9 billion as of September 30, 2010.

Note 11. Accrued Grant Liability

The accrued grant liability by major reporting groups, as of September 30, 2011 and 2010, consisted of the following:

Accrued Grant Liability		
(Dollars in Millions)		
	2011	2010
FSA	\$ 3,036	\$ 2,016
OESE	124	281
OSERS	259	182
RA/JF	235	1,070
Other	274	195
Accrued Grant Liability	\$ 3,928	\$ 3,744

Note 12. Net Position

Unexpended appropriations, as of September 30, 2011 and 2010, consisted of the following:

Unexpended Appropriations		
(Dollars in Millions)		
	2011	2010
Unobligated Balances		
Available	\$ 2,936	\$ 2,323
Not Available	594	1,181
Undelivered Orders	68,199	90,306
Authority Temporarily Precluded from Obligation	-	561
Unexpended Appropriations	\$ 71,729	\$ 94,371

The Cumulative Results of Operations - Earmarked Funds of \$4 million, as of September 30, 2011 and 2010, 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 \$(3,148) million as of September 30, 2011, and \$(6,773) million as of September 30, 2010, 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 *GPRRA Modernization Act of 2010*, each of the Department's reporting groups and major program offices have been aligned with the goals presented in the Department's draft *Strategic Plan 2011–2014*.

Net Cost Program	Reporting Group/ Program Office	Draft Strategic Goal
Increase College Access, Quality, and Completion	FSA OPE OVAE	1. Increase college access, quality, and completion by improving higher education and lifelong learning opportunities for youth and adults.
Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs	OESE OSDFS HR	2. Prepare all students for college and career by improving the elementary and secondary education system's ability to consistently deliver excellent classroom instruction and supportive services. 3. Improve the health, social-emotional, and cognitive outcomes for all children from birth through third grade, so that all children, particularly those with high needs, are on track for graduating from high school college- and career-ready.
Ensure Equitable Educational Opportunities for All Students	OELA OCR OSERS	4. Ensure equitable educational opportunities for all students regardless of race, ethnicity, national origin, age, sex, disability, language, and socioeconomic status.
Enhance the Education System's Ability to Continuously Improve	IES OII	5. Enhance the education system's ability to continuously improve through better and more widespread use of data, research and evaluation, transparency, innovation, and technology.
American Recovery and Reinvestment Act and Education Jobs Fund	RA/JF	Cuts across draft Strategic Goals 1-5

Draft *Strategic Plan* Goals 1–5 are sharply defined directives that guide the Department's program offices to carry out the vision and programmatic mission, and the net cost programs can be specifically associated with these five draft strategic goals. The Department also has a cross-cutting draft *Strategic Plan* Goal 6, U.S. Department of Education Capacity, which focuses on improving the organizational capacities of the Department to implement the draft *Strategic Plan*. As a result, the Department does not assign specific programs to draft *Strategic Plan* Goal 6 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 draft 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 tables present the gross cost and exchange revenue by program for the Department for September 30, 2011 and 2010. 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

(Dollars in Millions)

	2011					Total
	FSA	OESE	OSERS	RA/JF	Other	
<i>Increase College Access, Quality, and Completion</i>						
Intragovernmental Gross Cost	\$ 20,247	\$ -	\$ -	\$ -	\$ 77	\$ 20,324
Public Gross Cost	(3,435)	-	-	-	4,896	1,461
Total Gross Program Costs	16,812	-	-	-	4,973	21,785
Intragovernmental Earned Revenue	5,304	-	-	-	17	5,321
Public Earned Revenue	14,908	-	-	-	23	14,931
Total Program Earned Revenue	20,212	-	-	-	40	20,252
Total Program Cost	(3,400)	-	-	-	4,933	1,533
<i>Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs</i>						
Intragovernmental Gross Cost	-	201	-	-	9	210
Public Gross Cost	-	21,172	-	-	528	21,700
Total Gross Program Costs	-	21,373	-	-	537	21,910
Intragovernmental Earned Revenue	-	-	-	-	64	64
Public Earned Revenue	-	16	-	-	3	19
Total Program Earned Revenue	-	16	-	-	67	83
Total Program Cost	-	21,357	-	-	470	21,827
<i>Ensure Equitable Educational Opportunities for All Students</i>						
Intragovernmental Gross Cost	-	-	43	-	32	75
Public Gross Cost	-	-	15,463	-	871	16,334
Total Gross Program Costs	-	-	15,506	-	903	16,409
Intragovernmental Earned Revenue	-	-	2	-	-	2
Public Earned Revenue	-	-	19	-	2	21
Total Program Earned Revenue	-	-	21	-	2	23
Total Program Cost	-	-	15,485	-	901	16,386
<i>Enhance the Education System's Ability to Continuously Improve</i>						
Intragovernmental Gross Cost	-	-	-	-	68	68
Public Gross Cost	-	-	-	-	1,773	1,773
Total Gross Program Costs	-	-	-	-	1,841	1,841
Intragovernmental Earned Revenue	-	-	-	-	2	2
Public Earned Revenue	-	-	-	-	37	37
Total Program Earned Revenue	-	-	-	-	39	39
Total Program Cost	-	-	-	-	1,802	1,802
<i>American Recovery and Reinvestment Act and Education Jobs Fund</i>						
Intragovernmental Gross Cost	-	-	-	60	-	60
Public Gross Cost	-	-	-	27,905	-	27,905
Total Gross Program Costs	-	-	-	27,965	-	27,965
Intragovernmental Earned Revenue	-	-	-	-	-	-
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	-	-	-	-	-
Total Program Cost	-	-	-	27,965	-	27,965
Net Cost of Operations	\$ (3,400)	\$ 21,357	\$ 15,485	\$ 27,965	\$ 8,106	\$ 69,513

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>
<i>Increase College Access, Quality, and Completion</i>						
Intragovernmental Gross Cost	\$ 16,286	\$ -	\$ -	\$ -	\$ 73	\$ 16,359
Public Gross Cost	<u>11,542</u>	-	-	-	<u>4,603</u>	<u>16,145</u>
Total Gross Program Costs	27,828	-	-	-	4,676	32,504
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>
Total Program Cost	<u>10,757</u>	-	-	-	<u>4,631</u>	<u>15,388</u>
<i>Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs</i>						
Intragovernmental Gross Cost	-	136	-	-	12	148
Public Gross Cost	-	<u>21,649</u>	-	-	<u>725</u>	<u>22,374</u>
Total Gross Program Costs	-	21,785	-	-	737	22,522
Intragovernmental Earned Revenue	-	-	-	-	72	72
Public Earned Revenue	-	<u>20</u>	-	-	<u>4</u>	<u>24</u>
Total Program Earned Revenue	-	<u>20</u>	-	-	<u>76</u>	<u>96</u>
Total Program Cost	-	<u>21,765</u>	-	-	<u>661</u>	<u>22,426</u>
<i>Ensure Equitable Educational Opportunities for All Students</i>						
Intragovernmental Gross Cost	-	-	37	-	28	65
Public Gross Cost	-	-	<u>15,327</u>	-	<u>771</u>	<u>16,098</u>
Total Gross Program Costs	-	-	15,364	-	799	16,163
Intragovernmental Earned Revenue	-	-	2	-	-	2
Public Earned Revenue	-	-	<u>22</u>	-	<u>2</u>	<u>24</u>
Total Program Earned Revenue	-	-	<u>24</u>	-	<u>2</u>	<u>26</u>
Total Program Cost	-	-	<u>15,340</u>	-	<u>797</u>	<u>16,137</u>
<i>Enhance the Education System's Ability to Continuously Improve</i>						
Intragovernmental Gross Cost	-	-	-	-	73	73
Public Gross Cost	-	-	-	-	<u>1,612</u>	<u>1,612</u>
Total Gross Program Costs	-	-	-	-	1,685	1,685
Intragovernmental Earned Revenue	-	-	-	-	3	3
Public Earned Revenue	-	-	-	-	<u>38</u>	<u>38</u>
Total Program Earned Revenue	-	-	-	-	<u>41</u>	<u>41</u>
Total Program Cost	-	-	-	-	<u>1,644</u>	<u>1,644</u>
<i>American Recovery and Reinvestment Act and Education Jobs Fund</i>						
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	-	-	-	-	-	-
Total Program Cost	-	-	-	<u>44,079</u>	-	<u>44,079</u>
Net Cost of Operations	<u>\$ 10,757</u>	<u>\$ 21,765</u>	<u>\$ 15,340</u>	<u>\$ 44,079</u>	<u>\$ 7,733</u>	<u>\$ 99,674</u>

Note 14. Interest Expense and Interest Revenue

For FY 2011 and FY 2010, interest expense and interest revenue by program consisted of the following:

Interest Expense and Interest Revenue

(Dollars in Millions)

	2011					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	\$ 14,321	\$ -	\$14,321	\$ 3,493	\$ 10,828	\$14,321
FFEL Program						
Guaranteed Loan Program	1,331	(867)	464	464	-	464
Loan Purchase Commitment	1,552	-	1,552	77	1,475	1,552
Loan Participation Purchase	2,916	-	2,916	385	2,531	2,916
ABCP Conduit	48	-	48	18	30	48
TEACH Program	9	-	9	3	6	9
Other Programs	20	-	20	17	37	54
Total	\$ 20,197	\$ (867)	\$19,330	\$ 4,457	\$ 14,907	\$19,364

	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
Total	\$ 16,222	\$ (152)	\$16,070	\$ 4,881	\$ 11,220	\$16,101

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, 2011, budgetary resources were \$366,381 million and net outlays were \$234,942 million. As of September 30, 2010, budgetary resources were \$362,489 million and net outlays were \$235,919 million.

Permanent Indefinite Budget Authority

The Direct Loan, FFEL, and TEACH Programs have permanent indefinite budget authority through legislation. Parts B and D of the HEA (for the FFEL Program and Direct Loan Program, respectively) 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, 2011 and 2010, consisted of the following:

Obligations Incurred by Apportionment Type and Category

(Dollars in Millions)

	2011	2010
Direct:		
Category A	\$ 649	\$ 1,547
Category B	342,649	338,668
Exempt from Apportionment	2,167	4
	<u>345,465</u>	<u>340,219</u>
Reimbursable:		
Exempt from Apportionment	80	90
	<u>80</u>	<u>90</u>
Obligations Incurred	<u>\$ 345,545</u>	<u>\$ 340,309</u>

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, 2011 and 2010, consisted of the following:

Unused Borrowing Authority

(Dollars in Millions)

	2011	2010
Beginning Balance, Unused Borrowing Authority	\$ 133,120	\$ 106,355
Current Year Borrowing Authority	211,980	183,079
Funds Drawn From Treasury	(193,130)	(155,346)
Borrowing Authority Withdrawn	(9,776)	(968)
Ending Balance, Unused Borrowing Authority	\$ 142,194	\$ 133,120

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, 2011 and 2010, consisted of the following:

Undelivered Orders

(Dollars in Millions)

	2011	2010
Budgetary	\$ 68,223	\$ 90,281
Non-Budgetary	161,016	147,260
Undelivered Orders (Unpaid)	\$ 229,239	\$ 237,541

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. Distributed Offsetting Receipts, for the years ended September 30, 2011 and 2010, consisted of the following:

Distributed Offsetting Receipts

(Dollars in Millions)

	2011	2010
Negative Subsidies and Downward Re-estimates:		
FFEL Program	\$ 24,670	\$ 16,389
Direct Loan Program	25,502	12,375
Facilities Loan Programs	23	92
TEACH Program	6	1
Subtotal	50,201	28,857
Other	88	189
Distributed Offsetting Receipts	\$ 50,289	\$ 29,046

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

The FY 2013 *Budget of the United States Government* (President's Budget), which presents the actual amounts for the year ended September 30, 2011, has not been published as of the issue date of these financial statements. The FY 2013 President's Budget is scheduled for release in February 2012. A reconciliation of the FY 2010 SBR to the FY 2012 President's Budget (FY 2010 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>
Combined Statement of Budgetary Resources	\$ 362,489	\$ 340,309	\$ 29,046	\$ 235,919
Expired Funds	(1,387)	(679)	-	-
Amounts Included in the President's Budget	11,593	11,593	-	-
Funds Excluded from President's Budget and Rounding	(85)	2	3	(2)
<i>Budget of the United States Government*</i>	<u>\$ 372,610</u>	<u>\$ 351,225</u>	<u>\$ 29,049</u>	<u>\$ 235,917</u>

*Amounts obtained from the Appendix, Budget of the United States Government, FY 2012.

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. Because 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 2010 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 Budgetary Obligations to Net Cost of Operations

The Reconciliation of Budgetary Obligations to Net Cost of Operations provides information on how budgetary resources obligated during the period relate to 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.

The Reconciliation of Budgetary Obligations to Net Cost of Operations, as of September 30, 2011 and 2010, are presented below:

Reconciliation of Budgetary Obligations to Net Cost of Operations

(Dollars in Millions)

	2011	2010
<u>Resources Used to Finance Activities:</u>		
Obligations Incurred	\$ 345,545	\$ 340,309
Spending Authority from Offsetting Collections and Recoveries	(68,782)	(59,110)
Offsetting Receipts	(50,289)	(29,046)
Net Budgetary Resources Obligated	226,474	252,153
Imputed Financing from Costs Absorbed by Others	38	30
Other Financing Sources	(42,868)	(31,413)
Net Other Resources	(42,830)	(31,383)
Net Resources Used to Finance Activities	183,644	220,770
<u>Less: Resources Used or Generated for Items Not Part of the Net Cost of Operations:</u>		
Increase/(Decrease) in Budgetary Resources Obligated but Not Yet Provided	(8,933)	13,755
Resources that Fund Subsidy Re-estimates Accrued in Prior Period	(5,785)	(10,883)
Credit Program Collections	(43,451)	(43,466)
Acquisition of Fixed Assets	4	12
Acquisition of Net Credit Program Assets or Liquidation of Liabilities for Loan Guarantees	201,658	179,895
Resources from Non-Entity Activity	(42,856)	(31,483)
Net Resources That Do Not Finance the Net Cost of Operations	100,637	107,830
Net Resources Used to Finance the Net Cost of Operations	83,007	112,940
<u>Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:</u>		
Depreciation	16	22
Subsidy Amortization and Interest on the Liability for Loan Guarantees	1,823	(1,627)
Other	-	-
Total Components Not Requiring or Generating Resources	1,839	(1,605)
Increase in Annual Leave Liability	1	3
Accrued Re-estimates of Credit Subsidy Expense	(3,329)	(5,785)
Increase in Exchange Revenue Receivable from the Public	(12,008)	(5,877)
Accrued Interest with Treasury	1	4
Other	2	(6)
Total Components Requiring or Generating Resources in Future Periods	(15,333)	(11,661)
Total Components That Will Not Require or Generate Resources in the Current Period	(13,494)	(13,266)
Net Cost of Operations	\$ 69,513	\$ 99,674

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 2011 and FY 2010, the Department collected \$1.3 million and \$0.6 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 the 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 two types of formula grants: Education State Grants and Government Services Grants. These awards are 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. Investing in Innovation awards will support the development, validation, and expansion of approaches with demonstrated effectiveness at improving student achievement.

Recovery Act funding was also 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 Teacher Quality Partnerships. 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, 2011 and 2010, are presented below:

American Recovery and Reinvestment Act of 2009

(Dollars in Millions)

	Cumulative Totals as of September 30, 2011		
	Appropriations	Obligations	Outlays
State Fiscal Stabilization Fund:			
SFSF Formula Grants	\$ 48,600	\$ 48,600	\$ 47,806
Investing in Innovation and Race to the Top	5,000	5,000	338
Subtotal	53,600	53,600	48,144
Student Financial Assistance:			
Federal Pell Grants	15,640	15,640	15,618
Mandatory Add-on Pell Grants	643	643	643
Federal Work Study Grants	200	200	200
Subtotal	16,483	16,483	16,461
Education for the Disadvantaged:			
Title I Targeted/ Finance Incentive Grants	10,000	10,000	9,276
School Improvement Grants	3,000	3,000	595
Subtotal	13,000	13,000	9,871
Special Education:			
IDEA Part B Grants to States	11,300	11,300	10,494
IDEA Part B Preschool Grants	400	400	352
IDEA Part C Grants for Infants and Families	500	500	429
Subtotal	12,200	12,200	11,275
School Improvement Programs:			
Enhancing Education through Technology	650	650	520
Education for Homeless Children and Youths	70	70	61
Subtotal	720	720	581
Rehabilitation Services and Disability Research:			
Vocational Rehabilitation	540	540	504
Independent Living Centers	88	88	34
Services for Older Blind Individuals	34	34	29
State Grants	18	18	16
Subtotal	680	680	583
Institute of Education Sciences	250	250	33
Innovation and Improvement	200	200	60
Impact Aid:			
Section 8007(a) Formula Grants	40	40	40
Section 8007(b) Competitive Grants	60	60	40
Subtotal	100	100	80
Higher Education	100	100	17
Student Aid Administration	60	60	60
Office of Inspector General	14	9	9
Total	\$ 97,407	\$ 97,402	\$ 87,174

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
Subtotal	53,600	53,600	35,717
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
Subtotal	16,483	16,483	15,792
Education for the Disadvantaged:			
Title I Targeted/ Finance Incentive Grants	10,000	10,000	5,089
School Improvement Grants	3,000	3,000	44
Subtotal	13,000	13,000	5,133
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
Subtotal	12,200	12,200	6,080
School Improvement Programs:			
Enhancing Education through Technology	650	650	218
Education for Homeless Children and Youths	70	70	35
Subtotal	720	720	253
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
Subtotal	680	680	258
Institute of Education Sciences	250	250	2
Innovation and Improvement	200	200	23
Impact Aid:			
Section 8007(a) Formula Grants	40	40	40
Section 8007(b) Competitive Grants	60	60	6
Subtotal	100	100	46
Higher Education	100	100	2
Student Aid Administration	60	60	52
Office of Inspector General	14	3	3
Total	\$ 97,407	\$ 97,396	\$ 63,361

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

Note 19. Education Jobs Fund

Public Law 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 2010-11 school year for teachers and other employees of the nation's children and youth from early learning programs through secondary education. As of September 30, 2011, \$10,000 million has been obligated and \$6,287 million has been expended to support states and local school districts in their effort to save jobs. As of September 30, 2010, \$9,007 million had been obligated and \$1,232 million had been expended.

Note 20. 2005 Hurricane Relief

The *Hurricane Education Recovery Act* (Public Law 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 \$1,945 million 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, 2011, \$1,875 million has been expended and \$24 million remains available for future expenditure. During FY 2011, the Department returned to the Treasury \$46 million that had reached the end of the period of availability. As of September 30, 2010, \$1,845 million had been expended and \$100 million remained available for future expenditure.

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, 2011, \$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, 2010, \$61 million had been obligated and \$57 million had 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 that provides financial assistance to eligible postsecondary school students. In FY 2011, the Department provided funding of 82.6 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 17.4 percent of program funding. For the latest academic year ended June 30, 2011, approximately 459 thousand loans were made, totaling approximately \$853.9 million at 1,505 institutions,

averaging \$1,859 per loan. The Department's share of the Federal Perkins Loan Program was approximately \$6.6 billion as of June 30, 2011.

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 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.

Federal Perkins Loan Program borrowers who meet statutory eligibility requirements—such as those who provide service as teachers in low-income areas or as Peace Corps or AmeriCorps VISTA volunteers, as well as those who serve in the military, law enforcement, nursing, or 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, 2011

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	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary	Budgetary	Non-Budgetary
		Credit Reform Financing Accounts		Credit Reform Financing Accounts		Credit Reform Financing Accounts		Credit Reform Financing Accounts		Credit Reform Financing Accounts		Credit Reform Financing Accounts
Budgetary Resources:												
Unobligated balance, brought forward, October 1	\$ 6,526	\$ 15,654	\$ 4,174	\$ 15,409	\$ 877	\$ 47	\$ 1,004	\$ 424	\$ 245			
Recoveries of prior year Unpaid Obligations	1,575	12,203	942	12,192	409	43	43	138	11			
Budgetary Authority:												
Appropriations	94,967	2	48,532		21,577	16,257		8,601	2			
Borrowing Authority (Note 15)		211,980		211,802					178			
Contract Authority												
Spending authority from offsetting collections (gross):												
Earned												
Collected	1,825	53,169	1,719	53,011	3	2		101	158			
Change in unfilled customer orders												
Advance Received	(7)					1		(8)				
Without advance from Federal Sources	4	13		1				4	12			
Subtotal	\$ 96,789	\$ 265,164	\$ 50,251	\$ 264,814	\$ 21,580	\$ 0	\$ 16,260	\$ 0	\$ 0	\$ 8,698	\$ 350	
Permanently not available	(1,396)	(30,134)	(1,057)	(30,122)	(116)	(51)	(51)	(172)	(12)			
Total Budgetary Resources (Note 15)	\$ 103,494	\$ 262,887	\$ 54,310	\$ 262,293	\$ 22,750	\$ 0	\$ 16,299	\$ 0	\$ 1,047	\$ 0	\$ 9,088	\$ 594
Status of Budgetary Resources:												
Obligations incurred: (Note 15)												
Direct	\$ 97,980	\$ 247,485	\$ 50,895	\$ 247,289	\$ 22,099	\$ 16,165	\$ 1,042	\$ 7,779	\$ 196			
Reimbursable	80					2		78				
Unobligated Balances:												
Apportioned	3,036	634	1,214	512	610	79	2	1,131	122			
Unobligated Balance not available	2,398	14,768	2,201	14,492	41	53	3	100	276			
Total Status of Budgetary Resources	\$ 103,494	\$ 262,887	\$ 54,310	\$ 262,293	\$ 22,750	\$ (0)	\$ 16,299	\$ (0)	\$ 1,047	\$ (0)	\$ 9,088	\$ 594
Change in Obligated Balance:												
Obligated balance, net:												
Unpaid obligations, brought forward, October 1	\$ 94,693	\$ 150,831	\$ 17,893	\$ 150,605	\$ 15,338	\$ 9,137	\$ 41,810	\$ 10,515	\$ 226			
Uncollected customer payments from Federal Sources, brought forward, October 1	(2)	(14)		(4)				(2)	(10)			
Total, unpaid obligated balance, brought forward, net	\$ 94,691	\$ 150,817	\$ 17,893	\$ 150,601	\$ 15,338	\$ 9,137	\$ 41,810	\$ 10,513	\$ 216			
Obligation Incurred, net (+/-)	98,060	247,485	50,895	247,289	22,099	16,167	1,042	7,857	196			
Gross Outlays	(118,494)	(221,724)	(44,628)	(221,506)	(21,341)	(15,294)	(28,868)	(8,363)	(218)			
Recoveries of prior year unpaid obligations, actual	(1,575)	(12,203)	(942)	(12,192)	(409)	(43)	(43)	(138)	(11)			
Change in uncollected customer payments from Federal Sources (+/-)	(4)	(13)		(1)				(4)	(12)			
Obligated Balance, net, end of period:												
Unpaid Obligations	\$ 72,684	\$ 164,389	\$ 23,218	\$ 164,196	\$ 15,687	\$ 9,967	\$ 13,941	\$ 9,871	\$ 193			
Uncollected customer payments from Federal Sources	(6)	(27)		(5)				(6)	(22)			
Total, unpaid obligated balance, net, end of period	\$ 72,678	\$ 164,362	\$ 23,218	\$ 164,191	\$ 15,687	\$ (0)	\$ 9,967	\$ 13,941	\$ (0)	\$ 9,865	\$ 171	
Net Outlays:												
Gross Outlays	\$ 118,494	\$ 221,724	\$ 44,628	\$ 221,506	\$ 21,341	\$ 15,294	\$ 28,868	\$ 8,363	\$ 218			
Offsetting collections	(1,818)	(53,169)	(1,719)	(53,011)	(3)	(3)		(93)	(158)			
Distributed Offsetting receipts	(50,289)		(50,197)					(92)				
Net Outlays (Note 15)	\$ 66,387	\$ 168,555	\$ (7,288)	\$ 168,495	\$ 21,338	\$ (0)	\$ 15,291	\$ 28,868	\$ (0)	\$ 8,178	\$ 60	

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. In addition, most of the governmental funding for education in the United States comes from State and local governments.

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. Effective on September 26, 2011 the Office of Safe and Drug-Free Schools and its programs were

moved into a new **Office of Safe and Healthy Students** within the Office of Elementary and Secondary Education. This change will provide new opportunities for staff from Office of Elementary and Secondary Education and Office of Safe and Drug-Free Schools to work together to improve school environments and support children's learning, health, and well-being. See more detail at: <http://www.ed.gov/about/offices/list/osdfs/index.html?src=oc>.

Office of Innovation and Improvement. The Office of Innovation and Improvement makes strategic investments in educational practices through grants to states, schools, and community and nonprofit organizations. The office leads the movement for greater parental options such as charter schools. The office also supports special grants designed to raise student achievement by improving teachers' knowledge and understanding of and appreciation for traditional U.S. history. See more detail at: <http://www.ed.gov/about/offices/list/oii/index.html?src=oc>.

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

Office of English Language Acquisition. The Office of English Language Acquisition directs programs designed to enable students with limited English proficiency to become proficient in English and meet state academic content and student 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>.

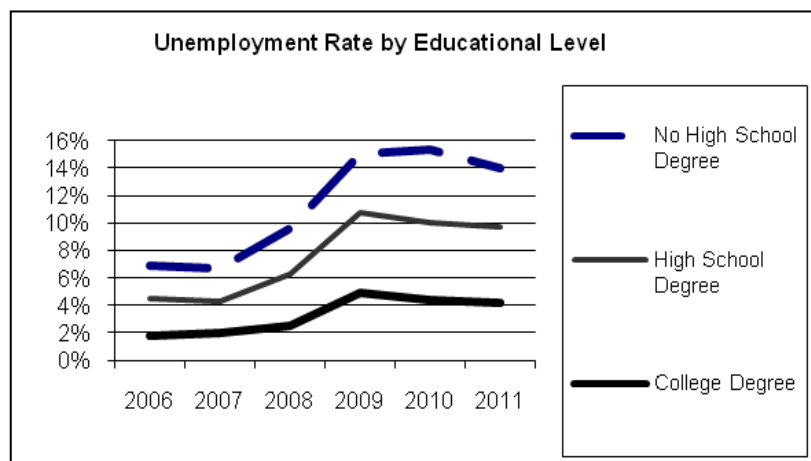
Office of Postsecondary Education. The Office of Postsecondary Education provides grants to colleges and universities, as well as to nonprofit organizations, to promote reform, innovation, and improvement in postsecondary education; increase access to and completion of postsecondary education by disadvantaged 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)	2011	2010	2009	2008	2007
Federal Student Aid Expense					
Direct Loan Subsidy	\$ (28,630)	\$ (1,567)	\$ (9,603)	\$ 5,236	\$ (499)
Federal Family Education Loan Program Subsidy	(16,126)	(14,344)	(29,940)	(2,852)	4,884
Grant Programs	39,008	26,799	17,302	17,464	15,092
Salaries and Administrative	193	208	186	189	173
Subtotal	(5,555)	11,096	(22,055)	20,037	19,650
Other Departmental					
Elementary and Secondary Education	21,195	21,608	21,443	21,583	21,199
Special Education and Rehabilitative Services	15,357	15,227	15,075	15,730	15,402
American Recovery and Reinvestment and Education Jobs Fund	27,945	44,019	21,616		
Other Departmental Programs	7,341	7,067	7,150	4,911	5,109
Salaries and Administrative	504	502	472	491	467
Subtotal	72,342	88,423	65,756	42,715	42,177
Grand Total	\$ 66,787	\$ 99,519	\$ 43,701	\$ 62,752	\$ 61,827

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.



Source: Bureau of Labor Statistics (Dept of Labor) Economic News Release, Table A-4: <http://www.bls.gov/news.release/empsit.t04.htm>

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 2011 unemployment rate for adults (25 years old and over) who had not completed high school was 14 percent, compared with 9.7 percent for those with four years of high school and 4.2 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 September 2011, the annualized median income for adults (25 years old and over) varied considerably by education level. Men with a high school diploma earned \$37,492, compared with \$68,328 for men with a college degree. Women with a high school diploma earned \$28,964, compared with \$51,376 for women with a college degree. Men and women with college degrees earned 77 percent more than men and women with high school diplomas. These returns of investing in education directly translate into the advancement of the American economy as a whole.

Report of the Independent Auditors



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 15, 2011

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 2011 and 2010 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, 2011 and 2010, 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 enclosed 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 cursive script 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, 2011 and 2010, 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, 2011 and 2010, 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, 2011, 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

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Report of Independent Auditors
Page 2

integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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, 2011

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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

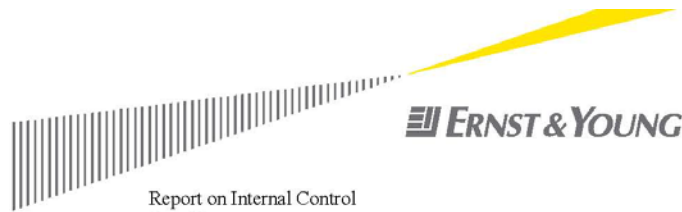
We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2011, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 15, 2011. 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, 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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Report on Internal Control
Page 2

SIGNIFICANT DEFICIENCIES

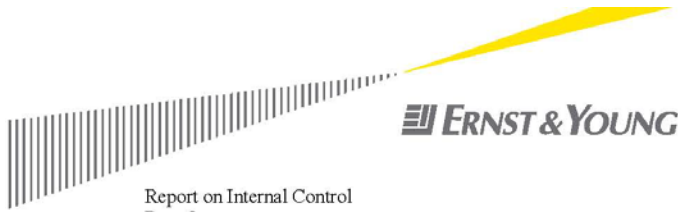
1. Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Modified Repeat Condition)

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 allowance for subsidy estimates should be maintained and further refined to ensure that appropriate estimates are prepared.

During the last few years, the Department has been challenged by the enactment of several pieces of legislation that have had a significant impact on the Department's loan programs. The *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) legislation, amended the Federal Family Education Loan (FFEL) program and provided the Secretary of Education with temporary authority to purchase student loans from private lenders and enter into forward commitments to purchase FFEL loans. Authority for the majority of the temporary loan purchase programs under ECASLA expired as of September 30, 2010, with the Department finalizing transactions in early fiscal year (FY) 2011. The *Student Aid and Financial Responsibility Act* (SAFRA) included in the *Health Care and Education Reconciliation Act of 2010* provided that 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 part of this process, the Department has spent significant time and effort managing the transition to the direct loan program, which has resulted in a significant increase in direct loans during FY 2011. The Department brought together representatives from throughout the organization to implement and administer the activities surrounding the transition to direct loans and the wind-down of many activities under 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 2011, the Department completed a cohort-level analysis for both the direct loan and FFEL programs. The Department's financial systems are not configured to account for cash flows on a precise cohort level; consequently, over the last several years the Department developed and refined a methodology to analyze and maintain student loan activity at the origination cohort level. The result of this analysis, the cohort analysis tool, is currently the

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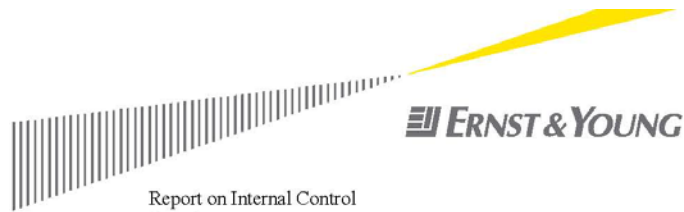
Report on Internal Control
Page 3

Department's primary repository of cohort-level data. OMB A-11, *Preparation, Submission, and Execution of the Budget*, the Credit Reform Act and other accounting guidance strongly recommend agencies be able to analyze loan portfolios at the cohort level. Another tool, the forecast, consists of expected cash flows, that, when discounted, can be used to compare to the recorded activity in the general ledger and point out variances. In recent years, growth in unexplained variances has forced the Department to devote substantial resources to analyze and evaluate these differences. Using the cohort analysis tool, the Department has been able to research these variances and demonstrate that balances in the Department's financial records are supported by its estimates.

After identifying the challenges faced by the Department and the key improvements made or 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. For example, after the current year's financial statements were prepared, management noted an error in the re-estimate calculations that resulted in an adjustment to the financial statements of approximately \$240 million. Additionally, we noted calculation errors in certain of the analytical tools used by the Department, including the back of the envelope reasonableness analytical tool, and fluctuation analysis. While these calculation errors in certain analytical tools did not directly impact amounts in the financial statements, the

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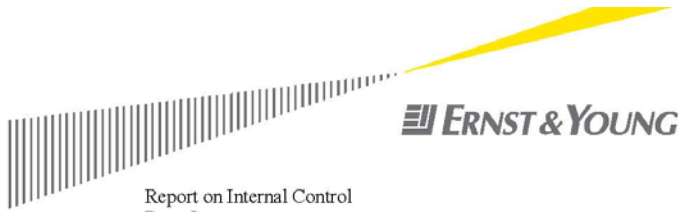


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analytical tools should contain accurate information if they are to serve their purpose as a detect control. Implementing a detail review process may reduce the potential for errors occurring in all aspects of this complex re-estimate and also in the analytical tools, which may facilitate their use in a formalized cross-functional review of the estimates.

- 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 many of the assumptions, the Department utilizes the National Student Loan Database System 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 development of the death, disability and bankruptcy (DD&B) assumption, we noted that documentation can be further strengthened by performing an attribution analysis that isolates the impact of changes in the methodology from those changes resulting from updated data. Furthermore, we noted that the DD&B rate for the direct loan sample had a very different distribution from that of the FFEL sample. The Department should consider a discussion of the difference between the distribution of the samples from the different loan programs and the reasons for such differences should be incorporated into the Department's documentation. Additionally, during our review of the development of the prepayment assumption, we noted that the description of how future prepayment rates are forecast using the existing actual cohort prepayment rate data could be enhanced by explaining the methodology in greater detail and with more examples or illustrations. Also, we noted further opportunities for documentation improvements in this area. For example, the Department performs certain intermediate data processing steps for this assumption in Excel worksheets. The calculations are complex and can be difficult to follow, and would be enhanced by adding descriptions related to work flow and formulas. Prepayment rate documentation could be further strengthened by including descriptions surrounding the need for manual adjustments and including additional comments to the Department's SAS programs to enhance the clarity of the code.
- 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. During our review of the development of the

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prepayment assumption, we noted that the Department does not take into account changes in general economic conditions. On occasion, manual overrides are done where rate results are known to be unreasonable and a prepayment rate from an earlier year is used instead. The Department should consider a modeling approach that would allow the prepayment rates to reflect changes in general economic conditions. Additionally, the Department uses the actual prepayment rate pattern from earlier cohorts to predict the future prepayment rates for later cohorts. When calculating the prepayment rate, the denominator reflects only past prepayments, but not scheduled principal payments, defaults, deferments, or forbearances which may cause the prepayment rates to be underestimated. The Department should consider the interactions between prepayments, principal payments, defaults, deferments and forbearance.

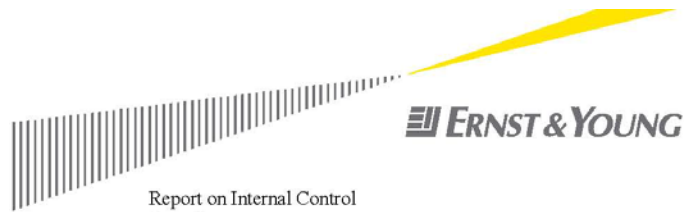
- Management's assessment of internal control over financial reporting required under OMB Circular A-123, *Management's Responsibility for Internal Control*, Appendix A may also provide management with an additional opportunity to objectively review its controls over the credit reform estimation process by individuals outside of Budget Service. The Department's procedures with respect to evaluating the controls over credit reform estimation are evolving and, during FY 2011, focused on evaluating the adequacy of existing controls and identifying potential control gaps. To the extent that management is able to leverage the testing performed under OMB A-123, Appendix A, such results may provide additional feedback in refining and improving controls over the estimation process.

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 prepayment, death, disability and bankruptcy 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.
 - For a subset of borrowers, obtain credit rating data and track the borrower's ability to pay over time. Utilize the results for further analysis.
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, 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.

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3. Strengthen the documentation related to assumption development, including documentation and discussion of changes in the methodology and the impact of those changes. Furthermore, improve documentation detail by adding additional descriptions for intermediate data processing steps between SAS programs and Excel worksheets, Excel worksheet work flow and formulas, manual adjustments and comments to SAS programs. Consider the impact of changes in general economic conditions when developing assumptions. The Department should consider a modeling approach that would allow the prepayment rates to reflect these types of factors. Additionally, the Department should consider the interactions between prepayments, scheduled principal payments, defaults, deferments and forbearance.
4. Consider ways to better leverage management's efforts under Appendix A of OMB Circular A-123 as a way to provide additional focus and attention to the controls surrounding the credit reform estimation process.

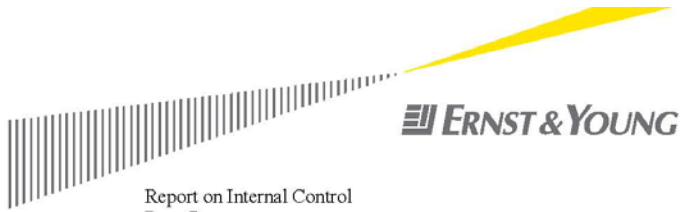
2. Controls Surrounding Information Systems Need Enhancement (Modified Repeat Condition)

In connection with the annual audit of the Department's FY 2011 financial statements, we conducted a controls review of the information technology processes related to the significant accounting and financial reporting systems. OMB Circular A-130, *Management of Federal Information Resources*, requires: (1) standard documentation and procedures for certification and accreditation of systems; (2) records management programs that provide adequate and proper documentation of agency activities; (3) agencies to develop internal information policies and procedures and oversee, evaluate, and otherwise periodically review agency information resource management activities; and (4) agency plans to assure that there is an ability to recover and provide service sufficient to meet the minimal needs of users of the system.

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

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

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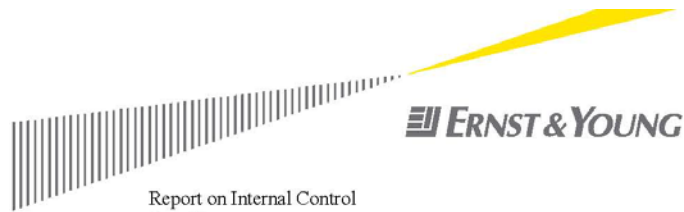
While the Department has worked toward strengthening and improving controls over information technology processes during FY 2011, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of IT general controls at the Department and FSA, we identified deficiencies in the following areas: (1) lack of monitoring of the activities of administrator and privileged user accounts at the application, operating system, and database 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 did not comply with the relevant Department or FSA policy; (5) documentation and related approvals required to provision user access are not consistently maintained; (6) administrator level access was assigned to individuals not requiring elevated privileges; and (7) controls related to the change management process were not consistently applied during the audit period. Specifically, documentation of approvals for application changes was 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.

The OIG has identified information technology-related deficiencies for the Department and FSA in reports issued during FY 2011, including its FY 2011 Federal Information Security Management Act (FISMA) review, EDUCATE Information Security Audit, and Department's Processes for Validating the EDUCATE Contractor's Performance. In its EDUCATE Information Security Audit report, the OIG noted that the Department's account and identity management processes need significant improvement. The review noted dormant accounts, inappropriate or inappropriately enforced password settings and issues related to access provisioning and terminated accounts.

In addition, the OIG FISMA and EDUCATE Information Security Audit reports note issues related to compliance with National Institute of Standards and Technology (NIST) 800-37 guidelines, including in the areas of Risk Management, Configuration Management, Remote Access Management, Contingency Planning, Security Management, and Security Capital Planning.

The OIG reports also noted that the Department's incident response and reporting procedures are not sufficient to handle computer security incidents. During the year, the Department was exposed to several information technology security incidents. Some of the incidents pertained to "spear phishing" attacks where targeted emails were used to gain access to the Department's networks and systems. OIG reported that these attacks had not been detected timely and appropriately blocked.

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In its review of EDUCATE Contractor's Performance, the OIG noted that the Department did not have adequate controls in place to validate the EDUCATE contractor's performance. The Department's processes do not provide independent assurance of contractor performance or assurance of the quality of the data being relied upon to assess performance. In addition, the Department has not always assigned personnel with the appropriate qualifications to validate contractor-submitted service level agreement (SLA) performance data. The Department needs to improve processes for validation of chargeback reports of unit-based expenses. The Department's current SLA framework is ineffective in encouraging the EDUCATE contractor to improve performance.

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.

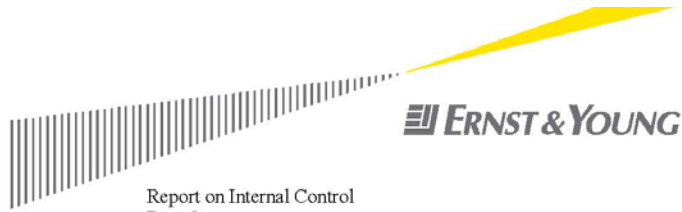
Recommendations:

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 NIST guidelines, control processes and practices continue to be implemented in a disparate manner across these groups. In addition, audit resolution activities have traditionally been performed by each separate group and have largely focused around addressing the immediate security and control weaknesses identified by audit reports.

We recommend that the Department continue its efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness uniformly across the organization, which should decrease the likelihood of 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.

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,

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timely removal of user access, enforcement of changes in access due to changes in roles and responsibilities, and compliance with password policies); (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 to accounts and data; (6) improve change management processes to control migration of changes to production and approvals of change testing; and (7) improve incident response and reporting procedures.

STATUS OF PRIOR YEAR FINDINGS

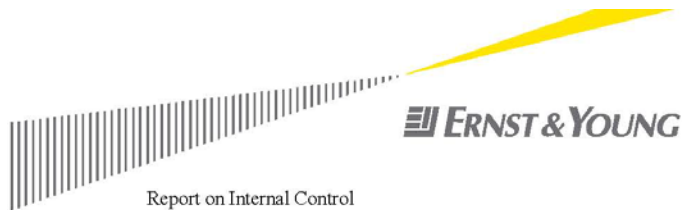
In the reports on the results of the FY 2010 audit of the U.S. Department of Education's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

Summary of FY 2010 Significant Deficiencies

Issue Area	Summary Control Issue	FY 2010 Status
Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Significant Deficiency)	Management controls and analysis need to be strengthened over credit reform estimation and financial reporting processes.	Modified Repeat Condition classified as a Significant Deficiency
Controls Surrounding Information Systems Need Enhancement (Significant Deficiency)	Improvements are needed in overall information technology security and systems.	Modified Repeat Condition classified as a Significant Deficiency

We have reviewed our findings and recommendations with Department management. Management generally concurs with our findings and recommendations 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.

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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, 2011

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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, 2011, 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, 2011. 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
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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 2011, 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 deficiencies in the following areas: (1) lack of monitoring of the activities of administrator and privileged user accounts at the application, operating system, and database 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 did not comply with the relevant Department or FSA policy; (5) documentation and related approvals required to provision user access are not consistently maintained; (6) administrator level access was assigned to individuals not requiring elevated privileges; and (7) controls related to the change management process were not consistently applied during the audit period. Specifically, documentation of approvals for application changes was 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. The OIG has identified information technology-related deficiencies for the Department and FSA in reports issued during FY 2011, including its FY 2011 Federal Information Security Management Act (FISMA) review, EDUCATE Information Security Audit, and Department's Processes for Validating the EDUCATE Contractor's Performance. In its EDUCATE Information Security Audit report, the OIG noted that the Department's account and identity management processes need significant improvement. The review noted dormant accounts, inappropriate or inappropriately enforced password settings and issues related to access provisioning and terminated accounts. In addition, the OIG FISMA and EDUCATE Information Security Audit reports note issues related to compliance with National Institute of Standards and Technology (NIST) 800-37 guidelines, including in the areas of Risk Management, Configuration Management, Remote Access Management, Contingency Planning, Security Management, and Security Capital Planning. The OIG reports also noted that the Department's incident response and reporting procedures are not sufficient to handle computer security incidents. During the year, the Department was exposed to several information technology security incidents. Some of the incidents pertained to "spear phishing" attacks where targeted emails were used to gain access to the Department's networks and systems. OIG reported that these attacks had not been detected timely and appropriately blocked. In its review of EDUCATE Contractor's Performance, the OIG noted that the Department did not have adequate controls in place to validate the EDUCATE contractor's performance. The Department's processes do not provide independent assurance of contractor performance or

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Report on Compliance and Other Matters
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assurance of the quality of the data being relied upon to assess performance. In addition, the Department has not always assigned personnel with the appropriate qualifications to validate contractor-submitted service level agreement (SLA) performance data. The Department needs to improve processes for validation of chargeback reports of unit-based expenses. The Department's current SLA framework is ineffective in encouraging the EDUCATE contractor to improve performance.

Our Report on Internal Control dated November 15, 2011, includes additional information related to the financial management systems that were found not to comply with the requirements of FFMIA relating to information technology security and controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMIA, and our recommendations related to the specific issues. We have reviewed our findings and recommendations with management of the Department. Management concurs with our recommendations and, to the extent findings and recommendations were noted in prior years, has provided a proposed action plan to the OIG in accordance with applicable Department directives. We did not audit management's proposed action plan and, accordingly, we express no opinion on it.

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, 2011

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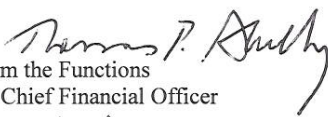



UNITED STATES DEPARTMENT OF EDUCATION

NOV - 9 2011

MEMORANDUM

TO: Kathleen S. Tighe
Inspector General

FROM: Thomas P. Skelly 
Delegated to Perform the Functions
and Duties of the Chief Financial Officer

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

SUBJECT: DRAFT AUDIT REPORTS
Financial Statement Audits for Fiscal Years 2011 and 2010
U.S. Department of Education
ED-OIG/A17L0001

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 2011 and 2010 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, Director, Financial Management Operations, at (202) 245-8118 with any questions or comments.

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Our Mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access

**Other
Accompanying
Information**

Improper Payments Reporting Details

The *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 payments made by the federal government. OMB also has established specific reporting requirements for agencies with programs that possess a significant risk of improper 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 or that exceed \$100 million. For each program identified as susceptible to significant improper payments 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 IPERA, Federal Student Aid (FSA) inventoried its programs during FY 2011 and, for each program, assessed the risk of improper payments. See the table below for the Grant, Loan, and Work-Study Programs identified.

Programs
Grant Programs
Federal Pell Grant
Academic Competitiveness Grant (ACG)
National Science and Mathematics Access to Retain Talent Grant (SMART)
The Teacher Education Assistance for College and Higher Education Grant (TEACH)
Federal Supplemental Educational Opportunity Grant (FSEOG)
Leveraging Educational Assistance Partnership (LEAP)/Special Leveraging Educational Assistance Partnership (SLEAP)
Iraq and Afghanistan Service Grant (IASG)
Loan Programs
Federal Perkins Loan Program
Federal Direct Loan Program
Federal Family Education Loan Program (FFEL)
Work - Study Programs
Federal Work - Study Program

For each program, risk assessment meetings were held with program owners, key personnel, and other designees to discuss the following ten risk factors to determine susceptible risk within the programs: Volume of Payments; Prior Improper Payments Reporting Results; Newness of Program or Transactions; Complexity of Program or Transactions; Level of Manual Intervention; Changes in Program Funding Authorities, Practices, or Procedures; History of Audit Issues; Human Capital Management; Nature of Program Recipients; and Management Oversight.

A risk rating was assigned to each factor based on risk factor criteria established and consensus from the participants in the meetings. Weighted percentages were assigned to each risk factor rating based on probability of an improper payment. An overall risk score was then computed for each program, calculated by the average of the sum of the weighted scores for each risk factor and overall rating scale.

In addition to the A-123 guidance, another criteria for determining susceptible risk within the programs were programs that were previously required to report improper payment information under OMB Circular A-11, Budget Submission, former Section 57.2.¹

The Direct Loan, FFEL, and Pell Grant Programs were identified as risk susceptible to improper payments, and are described in the next section. The ACG, SMART, TEACH, FSEOG, LEAP/SLEAP, and IASG Grant Programs, Perkins Loan Program, and the Federal Work-Study Program were deemed to be low-risk programs.

- The ACG and SMART programs are budgeted together and had a five-year life, which will end with the academic school year 2010–2011.
- For TEACH Grants in FY 2011, approximately 45,000 grants were disbursed for almost \$125 million, which is relatively low in volume and dollar amount.
- For the LEAP/SLEAP Grant Program 2010–11 award year, approximately \$162 million in grants were disbursed to approximately 162,000 students. The 2010–2011 award year was the last award year in which states will be able to apply for SLEAP funding.
- The IASG Program began in the 2010–2011 award year, and is very small with approximately \$181,995 in total awards and 37 recipients.
- The Federal Perkins Loan Program and Work-Study Programs are campus-based programs and funds are provided directly to eligible institutions. These programs had a larger number of awards and disbursement amounts, but resulted in a low risk rating for improper payments.

No further information on these low risk programs is included herein.

¹ 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.

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 Pell Grant Direct Loan, and FFEL.

Pell Grant Program. The Pell Grant Program includes the drawdown of funds by schools and the disbursement of aid from the school to the student; year-end closeout and the return of unsubstantiated funds; return to Title IV collections from schools; and collections on overpayments from recipients.

An estimated improper payment rate calculation was completed for the Pell Grant Program in FY 2011. There were no changes to the sampling process from prior years. The overall improper payment rate, based on this analysis, was 2.72 percent.

In FY 2011, OMB designated Pell a “high-priority” program per Executive Order 13520 and OMB Circular A-123, Appendix C (as updated by OMB Memo M-10-13), because estimated FY 2010 Pell improper payments of \$1,005 million exceeded the OMB FY 2010 high-priority program threshold of \$750 million. The Department is coordinating with OMB to establish and execute a plan to implement all applicable high priority program requirements. These include, in FY 2011, the designation of accountable officials, the establishment of supplemental measures, and new reporting on program measures on PaymentAccuracy.gov.

Direct Loan Program. The Direct Loan Program includes the drawdown of funds by schools, the origination of a loan and disbursement of funds from the school to the student (or their account); consolidations; servicing of the loan and collections from borrowers; and return to Title IV collections from schools.

An estimated improper payment rate calculation was completed for the Direct Loan Program in FY 2011. There were no changes to the sampling process from prior years. The overall improper payment rate, based on this analysis, was 0.22 percent.

FFEL Program. During FY 2011, the FFEL Program made no new loan originations. FY 2011 payment types and cash flows associated with loans originated in prior years (i.e., the existing FFEL portfolio) include: Special Allowance (SAP), Interest Benefits, Lender Fees, Origination Fees, Consolidation Loan Rebate Fees, Reinsurance, Account Maintenance Fee, and Loan Processing and Issuance Fees.

Starting with 2008, the FFEL program also included the Loan Purchase Commitment Program, Loan Participation Purchase Program, and the Asset Backed Commercial Paper (ABCP) Conduit Program authorized in the *Ensuring Continued Access to Student Loans Act* (ECASLA). The Loan Purchase Commitment Program and Loan Participation Purchase Program ended on 10/15/2010. The Conduit Program is scheduled to end in 2014. These programs resulted in the purchase of significant volumes and amounts of FFEL loans from 2008 to 2010. The on-going servicing of these FFEL loans acquired through ECASLA is a part of the FFEL Program.

Beginning in FY 2009 and ending in FY 2010, Federal Student Aid initiated FFEL SAP risk analyses in lieu of a measurement. As described in the Department’s FY 2010 *Agency Financial Report* (AFR), these analyses did not yield any result that could help inform

decisions on improper payment measurement and were suspended. Accordingly, Federal Student Aid did not use these risk analyses to calculate an FY 2011 error rate and no estimate of FY 2011 improper payments is provided.

Estimation Methodology

The size and complexity of the student aid programs make it difficult to consistently identify “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.

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 2011 and additional details about the study can be found in the FY 2009 AFR, under Corrective Actions (<http://www2.ed.gov/about/reports/annual/2009report/5-otherinfo.pdf>).

Direct Loan Program. For the Direct Loan program, the estimation methodology considers the risk for each payment type within the program, and for each component, an independent error rate is determined, via sample or other process, so as to calculate an aggregate error rate.

The estimated improper payment rate for FY 2011 is 0.22 percent in the aggregate. Consistent with prior years, this percentage estimate is well below the historical threshold for risk susceptible programs of 2.5 percent. The FY 2011 estimated improper payment amount at \$264 million, however, exceeds the new IPERA reporting threshold for risk susceptible programs effective this year of \$100 million.

Historically, and in FY 2011, a significant percentage of the program’s total outlays come from the origination and disbursement front end of the loan life cycle. In FY 2011, approximately 90 percent of the \$116.1 billion in total outlays are from loan disbursements. Because of strong controls within the Common Origination and Disbursement system and supporting processes, and other factors, there is low risk of improper payment for these payment types and an estimated error rate of approximately \$8 million or less than 0.01 percent. In FY 2011, approximately 10 percent of total program outlays are related to consolidations. Due to the nature of consolidations and timing of payments, we expect to see a small percentage of over and under payments annually, with some portion of the over/under payments having been caused by error, and most being attributable to the fact that loan consolidations are not performed with a date-certain settlement date. In FY 2011, the error rate estimate for consolidations is approximately \$253 million or 2.1 percent. Last, a negligible percentage of total outlays (i.e., less than 0.1 percent in FY 2011) is composed of servicing and collection refunds. These too have a small expected percentage of over and under payments annually, mostly composed of cancellations. The FY 2011 error rate for refunds, on average, was approximately \$3 million or 2.6 percent.

FFEL Program. Prior year risk analyses that were undertaken in lieu of a measurement did not yield any result that could help inform decisions on improper payment estimation. Accordingly, FSA did not use these risk analyses to calculate a FY 2011 error rate and no estimate of FY 2011 improper payments is provided. Federal Student Aid is in the process of assessing the feasibility of new assessment methodologies and is developing a comprehensive plan for implementation in FY 2012 to develop an estimate of FFEL improper payments to be reported in the FY 2012 AFR.

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 SAP to lenders. In past years, SAP has been among the largest categories of payments to lenders. 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.

Root Causes and Corrective Actions

Pell Grant Program. Departmental analysis found that the inaccuracy of self-reported financial income on the Free Application for Federal Student Aid (FAFSA) was the most significant root cause of potential Pell improper payments. This root cause is considered a verification category error, as defined by OMB Circular A-123. As a result, one of the key actions aimed at addressing the issue has been the establishment of a data exchange process with the Internal Revenue Service (IRS). FSA in conjunction with the IRS implemented a pilot version of the IRS Data Retrieval Tool (IRS DRT) on January 28, 2010, for the remaining six months of the 2009–10 application cycle. The tool enables Title IV student aid applicants and, as needed, parents of applicants, to transfer certain tax return information from an IRS Web site directly to their online FAFSA.

The IRS DRT was made available to students for ten months in the 2010–11 cycle becoming available in September of 2010. For the 2011–12 cycle, the availability of the IRS DRT was aligned more closely with the beginning of the FAFSA cycle, becoming available on January 30, immediately after the IRS began processing tax returns for the year. For the 2011–12 cycle, 3,427,891 students and parents transferred their tax data from the IRS to the FAFSA using the IRS DRT. This usage represents approximately 21.2 percent of the 16,205,543 FAFSAs submitted for the 2011–12 academic year between January 30, 2011 through September 04 2011.

Another key action of note in addressing the inaccuracies on the FAFSA, are the changes in verification regulations. Verification is the process required by the Department that schools conduct to confirm specific information reported on the FAFSA by the applicant. Previously, the Department required postsecondary educational institutions to verify key items on up to 30 percent of their students' FAFSA forms, focusing on those individuals that qualify for Pell Grants. Beginning with the 2012–13 cycle, schools will be required to verify all applicants selected for verification.

Both actions contribute to fewer instances of inaccurate financial information and subsequently, reduce improper payments. 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 and promote the real-time use of the IRS DRT. These enhancements, coupled with improved error detection, should allow FSA to further reduce improper payments.

Direct Loan Program. The root causes for improper payments within the Direct Loan program vary by payment type, and are considered administrative category errors, as defined by OMB Circular A-123, Appendix C. As noted in the preceding section, most of the Direct Loan estimated improper payment amount relates to the consolidation process. Departmental analysis has found that the most significant root cause for consolidation payoff errors is erroneous manual processing of information received from borrowers and lenders. Examples are manual errors of data entry, inclusion of student loans that the borrower desired to exclude, or failure to cancel a consolidation upon the borrower's request. Given that the loan consolidation process does not make payoffs on a prearranged date certain, an improper payment (for example to buy one loan too many) has the same characteristics as an overpayment (for example a borrower made a payment the day before consolidation). In either case, the lender is required to return the funds to the Direct Loan Consolidation program. The program conducts sampling of returned funds so as to determine the root cause, and conduct continuous process improvement.

FSA has a number of existing internal controls integrated into its Direct Loan systems and activities to prevent and detect errors and continually evaluates how to improve these controls. These include:

- **System Edits and data matches**—The front end student eligibility and origination and disbursement systems include edits and data matches with external data sources to prevent erroneous information from being entered into the system and prevent potential improper payments.
- **Certification**—In the Loan Consolidation Program, the key control is FSA's usage of lender certified loan balances and FSA's ability to compare borrower and lender provided information to the National Student Loan Data System (NSLDS) data set. A recent enhancement completed in March 2011 has been to lengthen the time between borrower final notice and lender payment so as to give the borrower additional time to respond in the event of the rare erroneous data. Another recent enhancement completed in December 2010 was the automation of a computer interface between COD and the FSA federal loan servicers. The result of this action was to reduce the potential for human error. The prior process used the Treasury's IPAC system for inter-governmental funds transfers, and usage of that system involved manual transaction processing, subject to error.
- **Servicer Oversight**—Management and oversight of Title IV Additional Servicers includes: process monitoring, financial data reconciliations, NSLDS reporting, operational and finance meetings and oversight activities, program compliance reviews, SAS70/SSAE16 assessments of servicer controls performed by independent public accountants (IPAs), and A-123A assessments of internal controls over financial reporting performed by FSA.

FFEL Program. Past experiences with managing the FFEL program have shown that the highest risk areas with the potential to lead to improper payments reside in the accurate

and timely reporting of borrower status to calculate interest benefits and SAP. These are considered administrative category errors, as defined by OMB Circular A-123.

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 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 improper 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 NSLDS 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 reviews of guaranty agencies’ establishment of the federal and operating funds in 1998 in response to an Office of Inspector General (OIG) recommendation. Those reviews and resulting corrective actions have been completed.

Federal Student Aid Improper Payment Reporting Summary

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

Federal Student Aid Improper Payment Reduction Outlook (\$ in millions)									
Year	Pell ^(1,2)			Direct Loan ⁽³⁾			FFEL ^(4,5,6)		
	Outlays \$	IP %	IP \$	Outlays \$	IP %	IP \$	Outlays \$	IP %	IP \$
FY 2010	32,215	3.12	1,005	99,428	0.30	298	94,875	N/A	N/A
FY 2011	36,515	2.72	993 ⁽⁷⁾	116,098	0.22	255 ⁽⁸⁾	42,616	N/A	N/A
FY 2012	37,090	2.72	1,009	190,266	0.22	419	15,561	N/A	N/A
FY 2013	38,505	2.72	1,047	207,179	0.22	456	14,619	N/A	N/A
FY 2014	35,199	2.72	957	220,474	0.22	485	14,517	N/A	N/A

¹⁾ The source of FY 2010 Pell outlays is the FY 2010 AFR. The source of FY 2011 estimated Pell outlays is supporting documentation for the FY 2012 President’s Budget request. The source of the FY 2012–14 estimated Pell outlays is the Mid-Session Review update to the FY 2012 President’s Budget Request.

²⁾ The chart above uses a preliminary Pell improper payment (IP) percentage for FY 2011. The improper payment amount is considered an estimate because the Pell rate is preliminary. The FY 2011 IP percentage is scheduled to be finalized after issuance of the Department’s AFR. The final Pell error rate for FY 2010 was

3.12 percent. This 3.12 percent rate was reported as “preliminary” in the FY 2010 AFR; however, it did not change.

³⁾ The source of FY 2010 Direct Loan outlays is the FY 2012 President’s Budget request. The source of FY 2011 estimated Direct Loan outlays is supporting documentation for the FY 2012 President’s Budget request. The source of the FY 2012–14 estimated Direct Loan outlays is the Mid-Session Review update to the FY 2012 President’s Budget Request.

⁴⁾ As noted in the preceding “Estimation Methodology” section, FSA will continue to work with OMB in FY 2012 to develop improper payment estimation methodology for the FFEL program. Accordingly, improper payment estimates for the FFEL program are not provided.

⁵⁾ The source for the FY 2010 FFEL outlays is FY2012 President’s Budget request. The source for the FY 2011 FFEL outlays is the supporting documentation for the FY 2012 President’s Budget request. The source for the FY 2012–14 estimated outlays is the Mid-Session Review update to the FY 2012 President’s Budget request.

⁶⁾ The annual Guaranty Agency Financial report provides information on transfers from the Federal Fund to Operating Fund for default aversion fees that are received in the winter of the current fiscal year for prior fiscal year activity. The amount of FY 2010 default aversion fees transferred from the Federal Fund was \$166 million (non-cash transaction) and is not included in the FY 2011 outlay number. The FY 2011 default aversion fee will not be available until approximately the second quarter of the next fiscal year (FY 2012) and is not included in the FY 2011 outlays.

⁷⁾ The FY 2011 Pell overaward improper payment rate estimate is 1.84 percent or \$672 million and the underaward improper payment rate estimate is 0.88 percent or \$321 million.

⁸⁾ The FY 2011 Direct Loan overpayment improper payment rate estimate is 0.19 percent or \$220 million and the underpayment improper payment rate estimate is 0.03 percent or \$35 million.

The final FY 2010 improper payment rate estimate for Pell of 3.12 percent was lower than the FY 2010 reduction target of 3.5 percent as reported in the FY 2009 AFR. The preliminary FY 2011 improper payment rate estimate for Pell of 2.72 percent was lower than the FY 2011 reduction target of 3.3 percent as reported in the FY 2010 AFR. The target Pell 2.72 IP percentage used for 2012–2014 is base-lined from the FY 2011 preliminary estimate. Analysis of the FY 2011 data will be performed through early 2012 to determine whether the decrease from prior years is statistically significant, and if so, what caused it (e.g., ongoing efforts to expand and improve IRS DRT usage and recipient verification).

FY 2011 is the base year IP measurement for Direct Loan. No reduction targets were reported in the FY 2009 or FY 2010 AFRs. The target Direct Loan 0.22 IP percentage used for 2012–2014 is base-lined from the FY 2011 estimate.

Internal Control, Human Capital, Information Systems and Infrastructure

Federal Student Aid has the internal controls, human capital, and information systems and other infrastructure it needs in order to reduce improper payments to the levels the agency has targeted.

Manager Accountability

The Federal Student Aid offices, managers, and staff responsible for these programs are accountable for establishing and maintaining sufficient internal controls, including a control environment that prevents improper payments from being made, and promptly detects and

recovers any improper payments that may occur. Offices and managers are held accountable through a variety of mechanisms and controls, including annual performance measures aligned to the strategic plan, organizational performance review criteria, and individual annual performance appraisal criteria. Federal Student Aid contractors are held accountable through various contract management and oversight activities and functions, control assessments, and audits. All relevant Federal Student Aid key controls are assessed annually for design and operating effectiveness to support management's FMFIA and A-123A assurance statements.

Important controls to prevent and detect improper payments are administered at the school level. For example, schools are responsible and held accountable for recipient verification for need based aid. Federal Student Aid certifies a school's eligibility for participation in Title IV programs, conducts periodic program reviews of schools to verify compliance, and evaluates school financial statement and compliance audits to ensure any potential compliance issues or control weaknesses are resolved.

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 2011. The assessment, based on FY 2010 audit data (the most recent available), yielded an estimated improper payment rate of 0.05 percent. This is consistent with previously reported data indicating that Title I does not meet the statutory threshold for susceptibility to improper payments.

The risk assessment was conducted by analyzing the questioned costs reflected in A-133 single audits and OIG audits for both grant recipients and sub-recipients. Questioned costs were identified in 91 of the total 10,455 Title I audits included in the review. Only 33 of these 91 audits included questioned costs greater than 2.5 percent of expenditures.

Questioned costs are a reasonable, upper-bound estimate of improper payments. Some questioned costs are not sustained during the audit resolution process and, as such, are not considered improper; however, additional improper payments, to a lesser extent, are identified during audit resolution. We also note that questioned costs may not include all questionable payments to a recipient given that audits generally review only a small sample of transactions. Yet this is difficult to estimate given that most individual audit findings cannot be projected with statistical confidence to 100 percent of an entity's payments.

The Department's assessment of these factors and estimate of improper payments result in the conclusion that Title I is not susceptible to significant improper payments. All previous risk assessments have similarly indicated there is not a significant risk of improper payments in the Title I program. Recoveries of improper payments in Title I are discussed in the next section. The following table presents an estimate of the improper payment outlook for Title I. No reduction targets are proposed since the Department's risk assessments have not identified Title I as a program susceptible to significant improper payments. This table is

presented because Title I was previously required to report improper payments under [Section 57](#) of OMB Circular A-11 (2002).

Title I Improper Payment Reduction Outlook (\$ in millions)			
	Outlays \$⁽¹⁾	IP %	IP \$⁽²⁾
FY 2010	18,141	.04	7.3
FY 2011	17,926	.05	9.0
FY 2012	14,825	.05	7.4
FY 2013	14,487	.05	7.2
FY 2014	14,492	.05	7.2

¹⁾ The sources of Title I outlays are FACTS II reports and the FY 2012 President's Budget request. These include ARRA outlays.

²⁾ The estimated amount of improper payments has been increased from the amount reported in the FY 2010 AFR due to the inclusion of ARRA totals.

Other Grant Programs

Risk Assessments

The Department's approach to the risk assessment process for other non-Federal Student Aid grant programs is the same as for Title I. The intent is 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. Risk assessments for programs other than Title I are conducted on a three-year cycle. None of these programs were deemed susceptible to significant improper payments in the most recent risk assessment included in the *FY 2010 Agency Financial Report*. Despite this determination, the Department is concerned about the risk of improper payments in grant programs, especially at the sub-recipient level and for programs for which audits have identified higher rates of questioned costs. The Department is working to identify root causes of improper grantee expenditures to improve grant monitoring and technical assistance to reduce improper payments.

Recovery Auditing

IPERA requires agencies to conduct recovery audits for programs that expend one million dollars or more annually if conducting such audits would be cost-effective.

Contract Payment Recapture Audits. The Department's findings from payment recapture audits of contracts have been consistently insignificant. For FY 2004–2006, the Department hired an independent CPA firm to conduct payment recapture audits for the Department's contracts and purchase orders, which total approximately \$1.5 billion annually. Due to the amount the firm recovered, which is less than one percent (.0025 percent) for the entire contract period, the Department decided not to continue the work for FY 2007. Therefore, the Department has been conducting payment recapture audits of contracts since FY 2007 as part of the A-123 review process. The findings from these reviews have consistently demonstrated the low risk of improper payments in contracts.

The following chart presents the results of the Department's contract payment recapture auditing program.

Contract Payment Recapture Audit Reporting (\$ in millions)	
Amount Subject to Review for Current Year (2011) Reporting	\$1,571
Actual Amount Reviewed and Reported (2011)	\$20.6
Amounts Identified for Recovery (2011)	\$0
Amounts Recovered (2011)	\$0
% of Amount Recovered out of Amount Identified (2011)	NA
Amount Outstanding (2011)	\$0
% of Amount Outstanding out of Amount Identified (2011)	NA
Amount Determined Not to be Collectable (2011)	\$0
% Amount Determined Not to be Collectable out of Amount Identified (2011)	NA
Amounts Identified for Recovery Prior Years (2004–2010)	\$0
Amounts Recovered (2004–2010)	\$0
Cumulative Amounts Identified for Recovery (2004–2011)	\$0
Cumulative Amounts Recovered (2004–2011)	\$0
Cumulative Amounts Outstanding (2004–2011)	\$0
Cumulative Amounts Determined Not to be Collectable (2004–2011)	\$0

The Department has not established formal recovery targets for contract payments given the consistently insignificant findings. Since FY 2004, the Department's audits have found no improper payments for recovery, and there are no outstanding overpayments to report. Should future contract payments be identified for recovery, the Department will establish recovery targets, taking into consideration the nature of the overpayments and any potential barriers to recovering funds.

Federal Student Aid Post-Award Audits. Audits and reviews of Title IV program participants identify potential improper payments within these programs and assess liabilities that are recovered through the Department's accounts receivable process and are included in the chart below. Federal Student Aid will continue to explore recovery audit methods, as defined by IPERA, during fiscal year 2012 and determine if they are cost beneficial.

For the Pell Grant Program, recoveries also occur when overpayments to students are assigned to Federal Student Aid for collection. Pell amounts recovered through student Debt Collection were approximately \$8.7 million in FY 2011, \$6.7 million in FY 2010, and \$81.5 million cumulative from FY 2011 to FY 2004. While all programs may have student debts transferred to debt collection, the categorization of resulting collections as an improper payment recovery is unique to Pell. Unlike loans, Pell grant payments transferred to debt collection commonly indicate a potential improper payment at time of disbursement.

Overpayments Recaptured Outside of Payment Recapture Audits. The Department works with grantees to resolve amounts identified in A-133 Single Audits, OIG Audits and Department conducted Program Reviews as potential improper payments. The Department published a Request for Information (RFI) on February 17, 2011, to seek information from potential contractors to conduct more formal recovery audits in accordance with IPERA. The results of the RFI and an analysis of Department audit recoveries suggest that grant payment recapture audits would not be cost-effective.

The Department is exploring the possibility of leveraging IPERA to create incentives for State governments that administer Education-funded programs to conduct payment recapture audits to identify and recover overpayments, payments for ineligible goods or services, excess interest earned on advances, and other improper payments. In 2005, the Department’s OIG noted that, for programs where the funds are substantially passed-through the state, in general there is a lower risk of improper payments at the state level than at the local level where the services are delivered. Under OMB Circular A-133 and other Federal grants management requirements, states are responsible for conducting programmatic and fiscal monitoring of sub-grantees at the local level. States are also responsible for addressing most Single Audit findings pertaining to sub-grantees. The Department will provide additional details as our plans progress.

The following chart provides estimates of the amounts identified and recovered through A-133 Single Audits, OIG Audits, and Program Reviews.

Overpayments Recaptured Outside of Payment Recapture Audits						
(\$ in millions)						
Agency Source	Amount Identified (FY 2011)	Amount Recovered (FY 2011)*	Amount Identified (FY 2010)	Amount Recovered (FY2010)*	Cumulative Amount Identified (FY 2010-2011)	Cumulative Amount Recovered (FY 2010-2011)
Single Audit Reports	28.7	4.2	16.9	9.3	45.6	13.5
OIG Audit Reports	13.5	3.4	.5	.6	14.0	4.0
Program Reviews	38.3	9.8	21.0	7.1	59.3	16.9

*Includes all amounts recovered during the year, not just the recoveries of amounts identified during the year.

Manager Accountability. Program staff must assess grantee risk and determine whether new or continuing grants should include “special conditions” (including grantees designated “high-risk” pursuant to EDGAR at 34 CFR §80.12). Program staffs work with the Department’s Risk Management Service (RMS) to use the Decision Support System (DSS) to assess grantee risk and assist in the determination of special conditions for grant awards. DSS is a suite of software tools and support services used to perform risk analysis and reveal to the Department information that can be used to effectively administer grants. Appropriate uses of the information are to inform the work of (1) identifying fiscal or performance risks with ED’s applicants or grant recipients; (2) determining if special conditions are needed for the award; and (3) developing risk-based monitoring and technical assistance plans. For more information on DSS see page 22 in the Management Discussion Analysis section of this report.

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.

Information Systems and Infrastructure. The Department recently acquired continuous monitoring software to help detect anomalies and potential issues in agency financial data prior to payment, staff follow-up when anomalies are identified, aggressively investigate

root causes of improper payments when they do occur, and develop corrective action plans to address the systemic weaknesses. This new technological tool will be used to examine payment records and identify challenges such as duplicate payments, payments for services not rendered, overpayments, and fictitious vendors before payments are actually made. This software will allow the Department to shift our focus from traditional retrospective/detective activities to proactive/preventive activities, thereby assisting the Department in reducing the risk of improper payments.

Statutory and Regulatory Barriers. The high burden of proof in the requirements of the General Education Provisions Act (GEPA) is a significant reason why the Department generally recovers a small percentage of the original questioned costs in audits. The GEPA, 20 U.S.C. 31 Subchapter IV § 1234a, requires the Department to establish a prima facie case for the recovery of funds, including an analysis reflecting the value of services obtained. In accordance with 20 U.S.C. 31 Subchapter IV § 1234b, any amount returned must be proportionate to the extent of harm the violation caused to an identifiable Federal interest.

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 2012, we will continue to work with OMB and the OIG 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 87–104 and the Department's management assurances on pages 32–33.

Summary of Financial Statement Audit

Audit Opinion: Unqualified

Restatement: No

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weaknesses	0	0	0	0	0

Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting—*Federal Managers' Financial Integrity Act (FMFIA) 2*

Statement of Assurance: Unqualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	0	0	0	0	0	0

The Department had no material weaknesses in the design or operation of the internal control over financial reporting.

Effectiveness of Internal Control over Operations—*FMFIA 2*

Statement of Assurance: Unqualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	0	0	0	0	0	0

Conformance with Financial Management System Requirements—*FMFIA 4*

Statement of Assurance: The Department systems conform to financial management system requirements.

Non-Conformance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Non-Conformance	0	0	0	0	0	0

Compliance with Federal Financial Management Improvement Act

	Agency	Auditor
Overall Substantial Compliance	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**

Date OCT - 3 2011

MEMORANDUM

TO: Secretary Arne Duncan

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

SUBJECT: Management Challenges for Fiscal Year 2012

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. The Government Performance and Results Modernization Act of 2010 requires the Department to include in its agency performance plan information on its planned actions, including performance goals, indicators, and milestones, to address these challenges. To identify management challenges, we routinely examine past audit, inspection, and investigative work, as well as issued reports where corrective actions have yet to be taken; assess ongoing audit, inspection, and investigative 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 draft challenges report to Department officials and considered all comments received.

Last year we presented four management challenges: implementation of new programs/statutory changes, oversight and monitoring, data quality and reporting, and information technology security. All of the prior management challenges remain challenges for FY 2012. The first FY 2011 challenge, implementation of new programs/statutory changes, which incorporated aspects of the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Ensuring Continued Access to Student Loans Act of 2008, has been incorporated into the oversight and monitoring challenge. In addition, we have added a new challenge related to improper payments.

The FY 2012 management challenges are:

- (1) Improper Payments,
- (2) Information Technology Security,
- (3) Oversight and Monitoring, and
- (4) Data Quality and Reporting.

We look forward to working with the Department to address the FY 2012 management challenges in the coming year. If you have any questions or would like to discuss these issues, please contact me at (202) 245-6900. You may also contact either Keith West, Assistant Inspector General for Audit, at (202) 245-7041, or William Hamel, Assistant Inspector General for Investigations, at (202) 245-6922.

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 (OIG) Management Challenges for Fiscal Year 2012 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 the OIG to identify and report annually on the most serious management challenges the Department faces. The Government Performance and Results Modernization Act of 2010 requires the Department to include in its agency performance plan information on its planned actions, including performance goals, indicators, and milestones, to address these challenges.

Last year we presented four management challenges: implementation of new programs/statutory changes, oversight and monitoring, data quality and reporting, and information technology security. All of the prior management challenges remain challenges for FY 2012. The first FY 2011 challenge, implementation of new programs/statutory changes, which incorporated aspects of the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Ensuring Continued Access to Student Loans Act of 2008, has been incorporated into the oversight and monitoring challenge. In addition, we have added a new challenge related to improper payments.

The FY 2012 management challenges are:

- (1) Improper Payments,
- (2) Information Technology Security,
- (3) Oversight and Monitoring, and
- (4) Data Quality and Reporting.

Improper Payments. A significant challenge for management in FY 2012 is the prevention, identification, and recapturing of improper payments. Across the Federal Government, agencies reported an estimated \$125.4 billion in improper payments for FY 2010. The Department estimated that it had more than \$1 billion in improper payments in the Pell Grant program alone in FY 2010. The Department, as well as other agencies, must be able to ensure that the billions of dollars entrusted to it are reaching the intended recipients. The President has established an aggressive goal to reduce government-wide improper payments by \$50 billion by FY 2012. To meet these goals, various pieces of legislation were enacted and implementing guidance was issued. The Department will be challenged to take actions to meet all the new requirements, and to intensify its efforts to prevent, identify, and recapture improper payments.

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 Information Technology (IT) security and noted increasing threats and vulnerabilities to Department

systems and data. For the last several years, OIG's IT audits and Investigative Program Advisory Reports 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 could lead to identity theft or other fraudulent use of the information.

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. Five areas are included in this management challenge—student financial assistance (SFA) program participants, distance education, Recovery Act programs, grantees, and contractors.

- **Student Financial Assistance Program Participants.** The Department must provide effective oversight and monitoring of participants in the SFA programs under Title IV of the Higher Education Act of 1965 as amended 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 \$189 billion in grants, loans, and work-study assistance for these programs in FY 2012. An estimated 15.9 million students and their families will 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 school, 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 funds if the student withdraws or drops out. Our investigative work has also identified numerous instances of fraud involving distance education programs. These cases involved the exploitation of vulnerabilities in distance education programs to fraudulently obtain Federal student aid. Also, some 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.

- **Recovery Act Programs.** 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. Over the last year, the challenge for the Department has moved from implementing the programs to monitoring the programs to ensure that program funds are expended for the purposes intended and that the goals and objectives of the programs are being met. In FY 2012, the Department will also be providing oversight of the winding down of the programs and funding provided. The OIG and the Government Accountability Office 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 and monitoring of Recovery Act programs. The Department has taken proactive measures to coordinate the effective implementation and oversight 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. The Department must continue to provide guidance and assistance to recipients on these programs, identify and obtain additional resources for program monitoring, and take timely corrective actions to address issues noted in audits and other reviews.
- **Grantees.** Effective monitoring and oversight are essential to ensure that grantees meet grant requirements and achieve program goals and objectives. In addition to our work on Recovery Act programs, our work on other grant programs has identified a number of weaknesses in grantee oversight and monitoring. We have identified pervasive fiscal control weaknesses at a number of grantees, weaknesses in a grant payback program, 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 that performance goals are being achieved. 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 current value of the Department's active contracts is nearly \$5.4 billion. 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 included numerous deficiencies in the area of contract monitoring, and we have made 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. A concerted effort is needed to develop and implement an aggressive human capital plan to address this issue.

- **Data Quality and Reporting.** The Department, its grantees, and its 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, evaluate program performance, and support a number of management decisions. State education agencies (SEAs) annually collect data from LEAs and report various program data to the Department. 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 a publicly available Web site authorized by the statute. The new reporting requirements required Federal, State, and local agencies to develop the systems and infrastructure quickly 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 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. For Recovery Act programs, our work noted 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, as well as supporting effective management decisions.

The FY 2012 Management Challenges 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>.

Appendices

Appendix A: Education Resources of the Department

Education Dashboard

The Department supports a data dashboard that contains high-level indicators, ranging from student participation in early learning through completion of postsecondary education, as well as indicators on teachers and leaders and equity. The Department will regularly update the dashboard's data and enhance tools. <http://dashboard.ed.gov/>

College Cost Lists

The Department provides college affordability and transparency lists under the *Higher Education Opportunity Act of 2008*. Each list is broken out into nine different sectors, to allow students to compare costs at similar types of institutions, including career and technical programs. <http://collegecost.ed.gov/catc/>

College Preparation Checklist

This Departmental tool gives prospective college students step-by-step instructions on how to prepare academically and financially for education beyond high school. Each section is split into subsections for students and parents, explaining what needs to be done and which publications or websites might be useful to them. <https://fafsa.ed.gov>

Additional resources within the checklist assist students in finding scholarships and grants.

<http://studentaid.ed.gov/students/publications/checklist/main.html>

<http://studentaid.ed.gov/students/publications/checklist/MoreSourcesOfStudentAid.html>

Resources for Adult Education

The Department, through the Perkins Collaborative Resource Network, offers resources and tools for the development and implementation of comprehensive career guidance programs. This includes guides for students, parents, teachers, counselors, and administrators across relevant topics, such as planning and exploring careers, selecting institutions, finances, and guidance evaluation. This source is an example of interdepartmental cooperation between the Department and the U.S. Department of Labor. http://cte.ed.gov/nationalinitiatives/gandctools.cfm?&pass_dis=1

Federal Resources for Educational Excellence

Federal Resources for Educational Excellence (FREE) provides easily accessible resources in a wide gamut of subjects for educators. The tool breaks resources into categories, ranging from art and music to science and mathematics. It also offers a wide variety of primary documents, photos, and videos. In addition, FREE allows educators to follow via Twitter, a social network, which facilitates the sharing of ideas. This tool acts as a depository of ideas and resources for educators to help them supplement their lessons. <http://free.ed.gov/>

College Completion Toolkit

The College Completion Toolkit provides information that governors and other state leaders can use to help colleges in their state increase student completion rates. It highlights key strategies and offers models to learn from, as well as other useful resources.

<http://www.ed.gov/sites/default/files/cc-toolkit.pdf>

Practice Guides for Educators

The Department offers guides that help educators address everyday challenges they face in their classrooms and schools. Developed by a panel of nationally recognized experts, practice guides consist of actionable recommendations, strategies for overcoming potential roadblocks, and an indication of the strength of evidence supporting each recommendation. The guides themselves are subjected to rigorous external peer review. Users can sort by subject area, academic level, and intended audience to find the most recent, relevant, and useful guides. <http://ies.ed.gov/ncee/wwc/aboutus.aspx>

Doing What Works: Research Based Educational Practices

The purposes of this tool are to provide a convenient and easy way for educators to find research proven teaching methods and to translate research-based practices into practical applications in the classroom. The site is easy to navigate and offers useful tools for teachers to practice skills in key subject areas. <http://dww.ed.gov/>

TEACH

The Department's TEACH campaign is designed to raise awareness of the teaching profession and to get a new generation of teachers to join the ones who are already making a difference in the classroom. The website provides valuable tools for educators around the country: from advice on building a career in teaching to connecting teachers to employers. Another component of TEACH is creating a network of teachers and mentors. Teachers can sign up to receive news and updates from TEACH. The purpose is for users to connect and share opportunities. <http://www.teach.gov/>

Appendix B: Selected Department Web Links

The American Recovery and Reinvestment Act

- **Important Recovery Act Reference Sites**

- Recovery.Gov

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>

Condition of Education and Digest of Education Statistics

The Condition of Education is a congressionally mandated annual report that summarizes developments and trends in education using the latest available statistics. The report presents statistical indicators containing text, figures, and from early childhood learning through graduate-level education.

<http://nces.ed.gov/programs/coe/>

The primary purpose of the Digest of Education Statistics is to provide a compilation of statistical information covering the broad field of American education from pre-kindergarten through graduate school. The Digest includes a selection of data from many sources, both government and private, and draws especially on the results of surveys and activities carried out by the National Center for Education Statistics.

<http://nces.ed.gov/programs/digest/>

Projections of Education Statistics to 2019

For the 50 states and the District of Columbia, the tables, figures, and text in this report contain data on projections of public elementary and secondary enrollment and public high school graduates to the year 2019. The report includes a methodology section that describes the models and assumptions used to develop national and state-level projections.

<http://nces.ed.gov/programs/projections/projections2019/>

Discretionary Grant Programs for FY 2010–2011

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 within the Department to provide research, evaluation, and statistics to the 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 Government Accountability Office 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 Office of Inspector General 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 C: 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 of 2007</i>
CFAAA	<i>Compact of Free Association Amendments Act of 2003</i>
CFO	Chief Financial Officer
CFDA	<i>Catalog of Federal Domestic Assistance</i>
COO	Chief Operating Officer
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>
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
FREE	Federal Resources for Educational Excellence
FSA	Federal Student Aid
FY	Fiscal Year
G5	Grants Management System
GA	Guaranty Agency
GAPS	Grant Administration and Payment System
GPRA	<i>Government Performance and Results Act of 1993</i>
GPRAMA	<i>GPRAMA Modernization Act of 2010</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>
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
OPEPD	Office of Planning, Evaluation, and Policy Development
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>
PARCC	Partnership for Assessment of Readiness for College and Careers
PBO	Performance-Based Organization
PIC	Performance Improvement Council
PII	Personally Identifiable Information
PIO	Performance Improvement Officer
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)/Education Jobs Fund</i>
RMS	Risk Management Service
RTT-ELC	Race to the Top-Early Learning Challenge
SAFRA	<i>SAFRA Act</i>
SAP	Special Allowance Payment
SBAC	SMARTER Balanced Assessment Consortium
SEA	State Educational Agency
SFSF	State Fiscal Stabilization Fund
SIG	School Improvement Grant
SOF	Statement of Financing
STEM	Science, Technology, Engineering, and Mathematics
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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