U.S. Department of Education | Federal Student Aid

Annual Report 2010

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Dear Federal Student Aid Colleagues, Partners and Customers**:**

William J. Taggart
Chief Operating Officer

Federal Student Aid experienced an extraordinary year in 2010. The passage and enactment of the Health Care and Education Reconciliation Act of 2010 ushered in sweeping reforms to the federal student financial assistance programs, resulting in tens of billions of dollars in increased funding for low-income college-bound students. Federal Student Aid continued to update its systems and increase capacity to prepare for an exponential increase in Direct Loan volume. We provided training to thousands of financial aid professionals from schools across the world to assist them in preparing for this transition. I am pleased to report that Federal Student Aid met these challenges, successfully welcoming millions of students and thousands of schools into the Direct Loan Program. We also delivered a record level of support under the Pell Grant Program.

This past year, we further simplified the Free Application for Federal Student Aid[sm] (FAFSA[sm]), making it easier for millions of students to access postsecondary education. Federal Student Aid also piloted an initiative, modeled after a successful program in Chicago, to increase FAFSA completion in several school systems across the country. Federal Student Aid continues to partner with agencies from across the federal government, including the Securities and Exchange Commission, the Department of Labor, and the Federal Bureau of Investigation, to improve program compliance and monitor customer complaints.

We accomplished all of this while delivering more aid to more students than at any other time in the history of the Title IV Programs. In FY 2010, Federal Student Aid delivered $134 billion through 6,200 schools to 14 million students and their families.

The year also provided Federal Student Aid an opportunity to reflect on its business, past practices and priorities in order to chart its future path. We redefined Federal Student Aid's vision, core values, and mission in an effort to articulate a clear and common purpose: *Funding America's Future, One Student at a Time*. Achieving this mission demanded that we develop a long-term strategy to guide the organization in pursuit of this common goal. We developed a new Five-Year Strategic Plan for FY 2011–15 with concrete goals to help our organization meet the needs of the evolving educational landscape. We realigned Federal Student Aid's organizational structure to better position its business and its employees to achieve the goals outlined in the Strategic Plan.

In the year ahead, with the new FY 2011–15 Strategic Plan as our guide, we will strengthen Federal Student Aid's focus on the customer to ensure that the Title IV Programs and those that participate in them serve - first and foremost - the interests of students and their families. We will enhance our risk management strategies and augment our compliance functions to improve the integrity of the student aid programs. We will continue to refine our processes and procedures to efficiently meet the evolving needs of students and financial aid administrators while minimizing the cost to the American taxpayer.

Our success over the past year is attributed to the dedication, expertise, and professionalism of our workforce. I want to thank our staff for their public service and commitment to our mission of *Funding America's Future, One Student at a Time.* I am honored to represent them, and I am proud to present the 2010 Federal Student Aid Annual Report on their behalf.

Sincerely,

William J. Taggart
Chief Operating Officer

Management's Discussion and Analysis

Mission and Organizational Structure

Federal Student Aid (FSA), a principal office of the United States (U.S.) Department of Education (Department), seeks to ensure that all eligible individuals can benefit from federal financial assistance for education beyond high school. FSA is responsible for implementing and overseeing federal student financial assistance programs, authorized under Title IV of the *Higher Education Act (HEA) of 1965, as amended* (Title IV).

In order to execute the Title IV Programs, FSA is responsible for a range of functions across the student aid lifecycle, which includes:

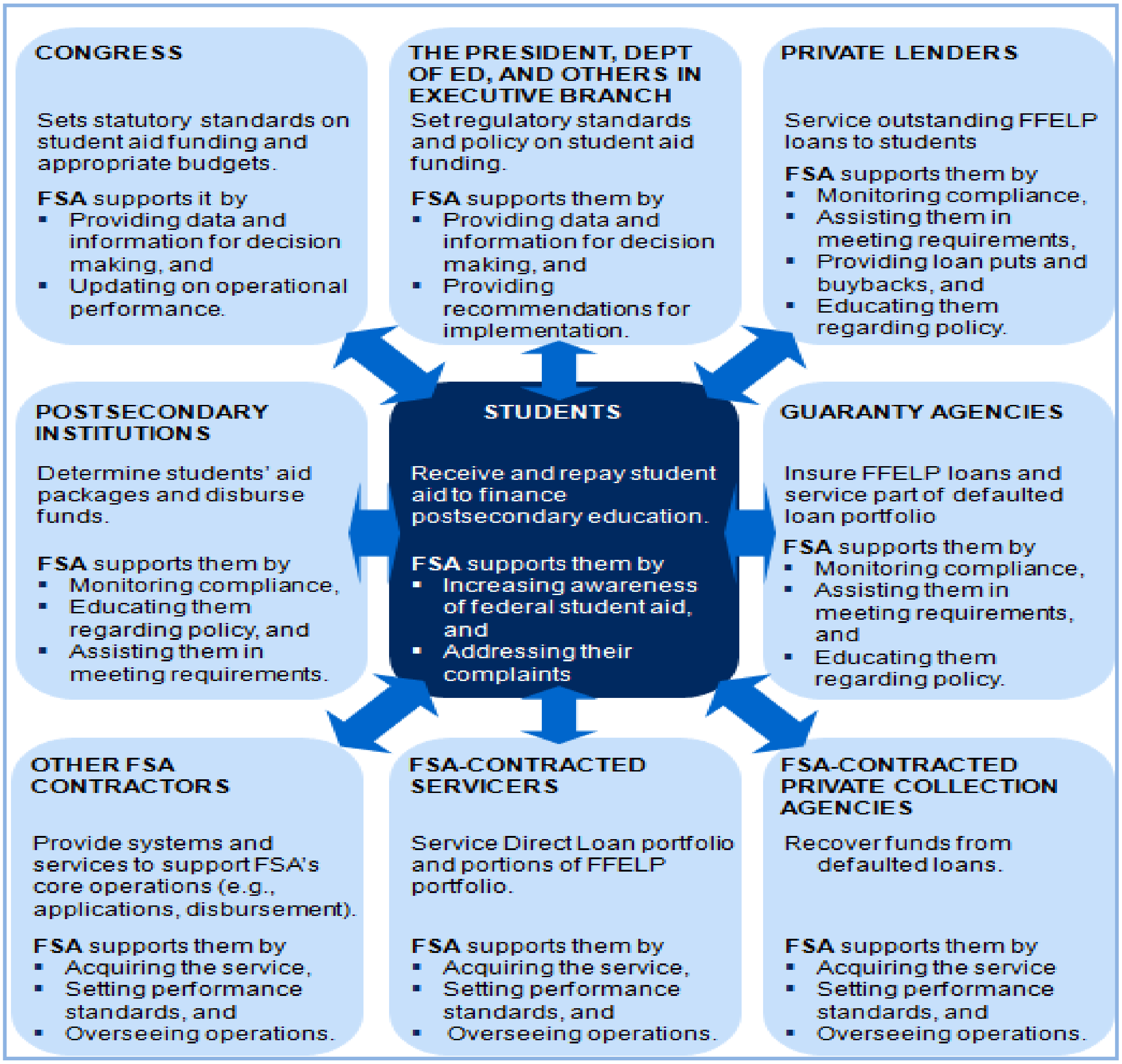
- Educating students and families about the process of obtaining aid;
- Processing millions of student financial aid applications;
- Disbursing billions of dollars in student aid;
- Insuring billions of dollars in existing student loans;
- Enforcing financial aid rules and regulations;
- Servicing millions of student loans;
- Securing repayment from borrowers who have defaulted on their loans; and
- Partnering with schools, financial institutions, and guaranty agencies to prevent program fraud, waste, and abuse.

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

FSA Stakeholders

The community of stakeholders in the student aid delivery system includes students and parents, Federal Family Education Loan (FFEL ^{sm}) Program ^{sm} loan holders, guaranty agencies, postsecondary institutions, contracted servicers and collection agencies, as well as the taxpayers and other federal entities, such as Congress and the Office of Management and Budget (OMB).

Role of FSA and Participants in the Federal Student Aid System

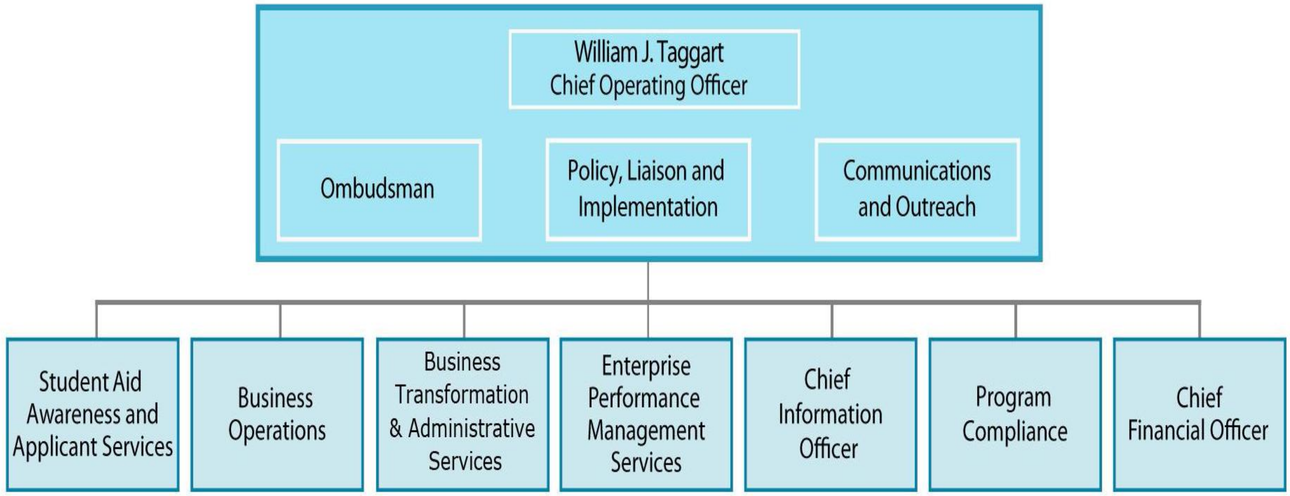


A major role of FSA is to coordinate and monitor the activity of the large number of federal, state, non-profit, and private entities involved in federal student aid delivery, within a statutory framework established by Congress and a regulatory framework established by the Department.

FSA Organizational Structure

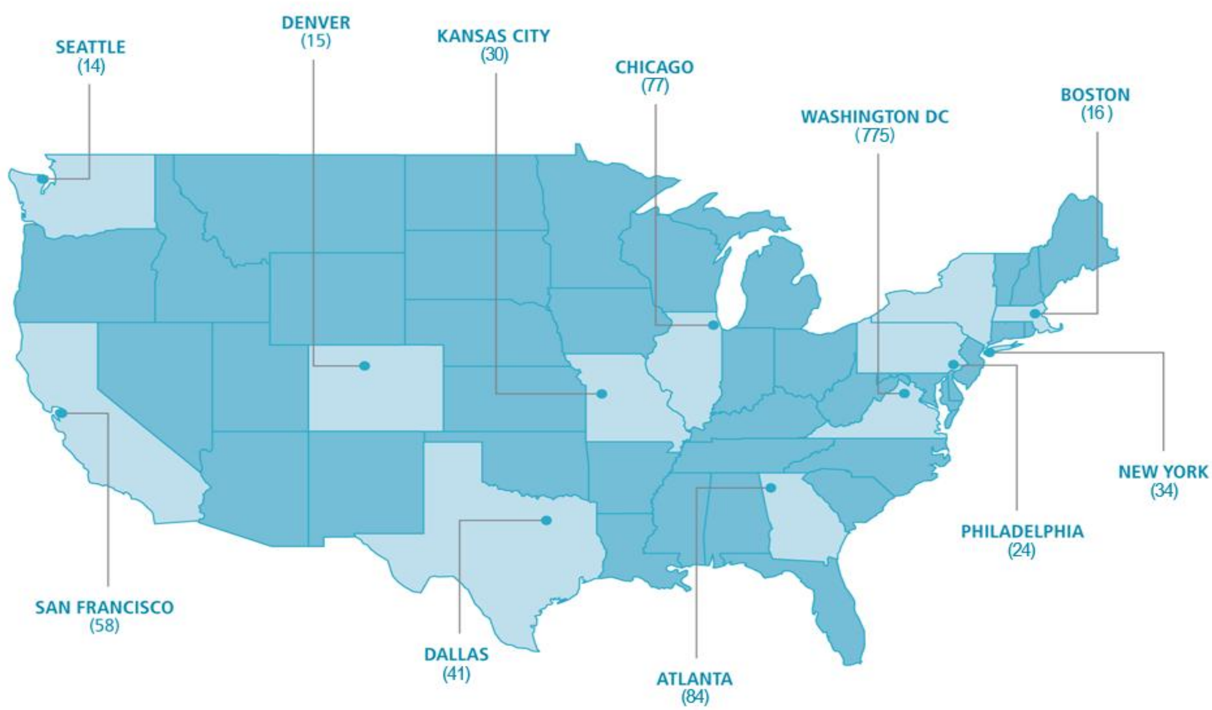
FSA currently operates under a functional organizational structure that aligns the organization closely with its strategic drivers, business objectives, and mission goals. A Chief Operating Officer (COO), who is appointed to a five-year term by the Secretary of Education (Secretary), leads FSA. In 2009, the Secretary appointed William J. Taggart as the organization's third COO. The following graphic illustrates the current functional organizational structure of FSA.

Federal Student Aid Organizational Structure



During fiscal year (FY) 2010, the organization operated on an annual administrative budget of approximately $946 million. FSA operates as a public-private partnership staffed by 1,168 full-time employees and is augmented by contractors who provide outsourced business operations. The workforce is based in Washington, D.C., with ten regional offices located throughout the country as reflected in the following graphic. The number of full-time employees at each location is shown in parentheses immediately following the location name.

Federal Student Aid Regional Map



Vision, Core Values, and Mission

In FY 2010, FSA developed new vision, core values, and mission (VVM) statements to capture the opportunities and meet rising challenges from the changing higher education environment. This action was in response to numerous discussions with, and feedback from, employees from each office within FSA.

FSA's mission and vision focus on students and position FSA as not only a provider of federal student financial aid and services, but also as a trusted source to provide information to help students and families make better decisions about their postsecondary education funding options. The core values reflect FSA employees' desire to create a high-performing organization and work environment while improving operations and services.

FSA's Vision, Core Values, and Mission

Mission

Funding America's Future, One Student at a Time

Vision

To be the most <u>trusted</u> and <u>reliable</u> source of student financial aid, information, and services in the nation

Core Values

- **Integrity** — Do the right thing above other interests and hold everyone accountable.
- **Customer service** — Know what our customers (students and borrowers) want and ensure we meet their expectations.
- **Excellence** — Strive to be the very best in all we do by embracing a culture of continuous improvement.
- **Respect** — Value individuals by acknowledging the diversity of their contributions, ideas, and beliefs.
- **Stewardship** — Uphold the sacred trust of taxpayers as we work to support the goals of Congress and the Administration.
- **Teamwork** — Work in collaboration with our colleagues and partners to produce the best possible results.

Programs

The federal student financial assistance programs collectively represent the nation's largest source of federal financial aid for postsecondary students. In FY 2010, FSA processed over 21 million Free Applications for Federal Student Aid^{sm} (FAFSA^{sm}), resulting in the delivery of approximately $134 billion in Title IV aid to over 14 million postsecondary students and their families. These students attend approximately 6,200 active institutions of postsecondary education accredited by dozens of agencies. Many of these students also received loans from 2,540 lenders with 33 agencies administering the guarantee on those loans.

The following table presents a comparison of the amounts of Title IV aid disbursed by program in 2010 and 2009. A summary of each of the Title IV student assistance programs is presented in the paragraphs that follow the table.

Summary of Federal Aid Disbursed to Students by Program
(Dollars in Millions)

Programs	2010 Aid Disbursed to Students	2009 Aid Disbursed to Students	Difference	Percent Increase
Grant Programs				
Federal Pell Grant Program	$ 29,103	$ 18,432	$ 10,671	58%
Academic Competitiveness Grants	503	343	160	47
National Science and Mathematics Access to Retain Talent Grants	361	201	160	80
The Teacher Education Assistance for College and Higher Education Grants	93	44	49	111
Federal Supplemental Educational Opportunity Grants	959	959	-	-
Leveraging Educational Assistance Partnerships Program	162	162	-	
Subtotal Grants	$ 31,181	$ 20,141	$ 11,040	55%
Loan Programs				
Federal Perkins Loan Program	$ 1,042	$ 1,103	$ (61)	(6%)
Federal Direct Loan Program	80,559	22,315	58,244	261
Federal Family Education Loan Program	19,909	67,908	(47,999)	(71)
Subtotal Loans	$ 101,510	$ 91,326	$ 10,184	11%
Work-Study Programs				
Federal Work-Study Program	$ 1,171	$ 1,417	$ (246)	(17%)
Grand Total	$ 133,862	$ 112,884	$ 20,978	19%

*Aid disbursed to students is based upon award year for all grants, except the Teacher Education Assistance for College and Higher Education Grants which is based upon fiscal year. Aid disbursed to students is based upon fiscal year for all loan programs, and Teacher Evaluation Assistance for College and Higher Education Grants.

The **Federal Pell Grant (Pell Grant) Program** helps ensure financial access to postsecondary education by providing grant aid to low-income and middle-income undergraduate students. As the most need-based of the Department's student aid programs, Pell Grants vary according to the financial circumstances of students and their families. For the 2009–10 award year, the Department disbursed $29 billion in Pell Grants averaging approximately $3,591 to approximately 8 million students. The maximum Pell Grant award was $5,350 for the 2009–10 award year. The maximum Pell Grant award increased to $5,550 for the 2010–11 award year.

The **Academic Competitiveness Grant (ACG)** and **National Science and Mathematics Access to Retain Talent (SMART) Grant Programs** were created by the *Higher Education Reconciliation Act of 2005 (HERA)*, signed into law in 2006, and expire at the end of award year 2010-11. The ACG is for undergraduates who meet Pell Grant eligibility requirements. The student must have completed a rigorous high school program, as determined by the state or local education agency and as recognized by the Secretary. First-year students may receive an ACG award up to $750, whereas second-year students may receive up to $1,300 if they have maintained a cumulative grade point average of at least 3.0. The ACG award became available in the 2006–07 school year for first-year students who graduated high school after January 1, 2006, and second-year students who graduated high school after January 1, 2005. The ACG award is in addition to the student's Pell Grant award. For the 2009–10 award year, $503 million in ACG awards were disbursed to approximately 716,000 students.

The National SMART Grant Program provides up to $4,000 to third- and fourth-year undergraduates, or fifth-year students in a five-year program, studying full-time and majoring in physical, life, or computer sciences, mathematics, technology, engineering, or a foreign language critical to national security. The student must meet Pell Grant eligibility requirements. The student must maintain a cumulative grade point average of at least 3.0 for coursework required for the major. The grant award is in addition to the student's Pell Grant award. A student cannot receive more than one ACG or National SMART Grant award in each academic year for which they are eligible. For the 2009–10 award year, $361 million in National SMART grants were disbursed to approximately 139,000 students. Funding for the ACG and National SMART Grant Programs expires at the end of FY 2011.

The Teacher Education Assistance for College and Higher Education (TEACH) Grant, originally authorized by the *College Cost Reduction and Access Act of 2007* (*CCRAA*), provides up to $4,000 per year to students agreeing to teach mathematics, science, or other specialized subjects in a high-poverty school for at least four years within eight years of their graduation. If students fail to fulfill the service requirements, TEACH Grants convert to Unsubsidized Stafford Loans, with interest accrued from the time of the award. This grant program began in the 2008–09 school year, starting July 1, 2008. In FY 2010, the Department disbursed approximately 39,000 grants for almost $93 million under TEACH.

The **Federal Supplemental Educational Opportunity Grant**, the **Federal Work-Study (FWS)** and the **Federal Perkins Loan Programs** are three campus-based programs through which the Department provides funds directly to eligible institutions, enabling them to offer grants, employment and low-interest loans to students based on need. For the

2009–10 award year, approximately $3.2 billion were disbursed through approximately 2.6 million campus-based awards.

There are two state grant programs. The **Leveraging Educational Assistance Partnership (LEAP) Program**, authorized by *Section 415A* of the *HEA*, makes federal funds available to assist states in providing student financial assistance programs for individuals with substantial financial need. The **Special Leveraging Educational Assistance Partnership (SLEAP) Program** was added to the LEAP Program in the 1998 Amendments to the *HEA* (*Section 415E*). SLEAP makes federal funds available to states to cover a third of the cost of supplementing their respective LEAP programs, supplementing their LEAP Community Service Work-Study programs and/or providing Merit and Academic Achievement or Critical Careers Scholarships to students with substantial financial need. For the 2009–10 award year, approximately $162 million in LEAP grants were disbursed to approximately 162,000 students. The 2010–2011 award year is the last award year in which states will be able to apply for SLEAP funding. The Grants for Access and Persistence (GAP) Program was authorized under section *415E* of the *HEA*, which was amended as a result of the *Higher Education Opportunity Act (HEOA) of 2008*, and assists states in establishing partnerships to provide eligible students with LEAP Grants under GAP to attend institutions of higher education and to encourage increased participation in early information and intervention, mentoring, or outreach programs.

In fulfilling its program responsibilities, FSA directly manages or oversees almost $722 billion in outstanding loans—representing over 128 million student loans to more than 34 million borrowers. These loans were primarily made through the two federal student loan programs described below:

The **William D. Ford Federal Direct Loan (Direct Loan** sm**) Program** sm 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 (Treasury), as well as an appropriation for subsidy costs. In FY 2010, the Department made $80.6 billion[1] in net loans to 8.3 million recipients. With the enactment of the *Student Aid and Fiscal Responsibility Act (SAFRA*), as part of the *Health Care and Education Reconciliation Act of 2010 (HCERA) (*Pub. L. 111-152), beginning in July 2010 no new loans will be originated under the FFEL Program. This means that there will be a greater volume of Direct Loans. This transition from the FFEL Program to the Direct Loan Program resulted in a 261 percent increase in Direct Loan Program disbursements for FY 2010.

Under the **FFEL Program**, students and parents obtained federal loans through lenders. Guaranty agencies insured these loans and were, in turn, reinsured by the federal government. In FY 2010, FSA supported the delivery of $19.9 billion[2] in net loans to 2.4 million FFEL borrowers. In addition, FSA made gross payments of approximately $3.9 billion to lenders for interest and special allowance subsidies and $12.2 billion to guaranty agencies for reinsurance claims and fees paid to guaranty agencies for loan processing, issuance and account maintenance.

[1]Excludes consolidation loans of $18.1 billion.
[2]Excludes consolidation loans of $79.0 million.

Although the passage of *SAFRA* ended the origination of new FFEL Program loans as of July 1, 2010, lenders and guaranty agencies will continue to service and collect outstanding FFEL Program loans. FFEL lenders and guaranty agencies held a FFEL Program loan portfolio of approximately $390 billion as of September 30, 2010.

The *Ensuring Continued Access to Student Loans Act of 2008* (*ECASLA*)

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

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

Loan Participation Purchase Program. Under this program, lenders accessed capital to make new loans by selling the Department participation interests in eligible FFEL loans. Participation interests on loans made for the 2008–09 academic year had to have been redeemed, with interest, by lenders no later than October 15, 2009, either in cash or by selling the underlying loans to the Department; for loans made for academic year 2009–10, the deadline for redemption was October 15, 2010. For the 2008–09 loan period, the Department purchased over $33 billion in participation interests. As part of the process of redeeming the participation interests, $31 billion of those underlying loans were later sold to the Department. As of September 30, 2010, the Department had purchased over $38 billion in participation interests for the 2009–10 loan period. When the 2009-10 loan period ended October 15, 2010, participating lenders sold over $37 billion of those underlying loans to the Department as part of the process of redeeming the participation interests.

Loan Purchase Commitment Program. Under this program, lenders accessed capital to make new loans by directly selling the Department eligible FFEL loans. For the 2008–09 loan period, a total of over $48 billion in loans was sold to the Department, $31 billion from the Loan Participation Purchase Program and $17 billion directly. As of September 30, 2010, for the 2009–10 loan period, over $33 billion in loans had been sold to the Department, with nearly $12 billion from the Loan Participation Purchase Program and $21 billion directly. When the 2009–10 program ended October 15, 2010, participating lenders sold approximately $60 billion of FFEL loans to the Department, including approximately $37 billion from the Loan Participation Purchase Program, and approximately $23 billion directly. It is estimated that the 2009–10 volume accounts for approximately 95 percent of the total FFEL Program loans made for the period.

ABCP Conduit Program. The ABCP Conduit Program was developed to provide additional liquidity to support new lending. Under this program, which began operations in mid-2009, the Department entered into forward purchase commitments with a conduit. The Conduit issues commercial paper backed by qualifying student loans made between October 1, 2003 and September 30, 2009. If no other financing is available to retire this paper as it matures, the Department commits to provide the needed funds by purchasing the underlying student loans. Lenders were able to place loans into the Conduit until June 30, 2010. By that time, a total of 25 lenders had participated, and backed by their loans, the Conduit issued a total of $41 billion in commercial paper. Under the Put Agreement with the Conduit, the Department purchases loans subject to certain events, (for example, when a loan becomes 255 days delinquent). As of September 30, 2010, the Department has purchased $560 million in delinquent loans from the Conduit. The Conduit has not yet put any other loans to the Department. The option to sell loans to the Department ends January 2014. The ABCP Conduit Program is the single remaining active *ECASLA* program.

Performance Goals, Objectives, and Results

In FY 2010, FSA began developing a new five-year strategic plan. Although this new plan was approved during FY 2010, implementation begins in FY 2011. For the purposes of this Annual Report, FSA is reporting performance against the targets identified in the FY 2006–2010 Five-Year Plan.

This section provides a high-level overview of FSA's FY 2010 performance objectives and results. The information provides a summary of FSA's achievements and progress in meeting both the organization's stated performance standards and those critical functions that were not included in the FY 2006–2010 Five-Year Plan.

FSA has introduced many substantial and measurable improvements in how it plans and reports operational and portfolio performance in administering the federal student financial assistance programs since the organization became a PBO in 1998.

Strategic Planning and Reporting. Several key strategic drivers form the scope and content of FSA's long-term goals and objectives:

- *HEA* legislation.
- Federal financial management laws and regulations.
- Student and borrower needs.
- Key trends and conditions for the student lending environment.
- The Department's Five-Year Strategic Plan.
- The Office of Inspector General's Management Challenges.
- The Office of Inspector General and Government Accountability Office (GAO) audits.

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

FSA's core strategic objectives identified in the FY 2006–2010 Five-Year Plan are to:

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

With the FY 2006–2010 Five-Year Plan, FSA established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives.

Performance Reporting. The Annual Report provides the mechanism for reporting the organization's annual performance results. It includes the organization's audited financial statements, a summary of the organization's progress in meeting strategic goals, and the detailed results of the organization's success in meeting performance standards established in the five-year plan.

Key Performance Goals and Results

This section provides a high-level overview of FSA's FY 2010 performance objectives and results. The information provides a summary of its achievements and progress in meeting the organization's stated performance standards.

In the FY 2006–2010 Five-Year Plan, FSA established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, FSA published targets for FY 2006–10. However, FSA has not updated that plan, performance standards have changed, and interim year targets, where developed, may not have been published. All targets referenced in this report, whether previously published or not, are aligned with the FY 2010 targets and gauge FSA's incremental progress in achieving its objectives.

The underlying assumptions in FSA's performance planning and reporting processes stem from the Five-Year Plan and are based on current budgetary, operational and policy considerations. In FY 2010, the implementation of *SAFRA* required FSA to use its resources to ensure that students were able to access federal student loans for their postsecondary education. As a result, many previously identified tactical objectives were reprioritized contributing to the organization's inability to achieve many previously identified performance targets.

Nonetheless, during FY 2010, FSA was successful in meeting several of its performance standards. For the most recent data available, FSA met targets for seven key measures and did not meet targets for eight measures. FSA measured performance for six measures that did not have standards or targets established.

The actual results for each performance standard are presented in conjunction with each objective. The respective tables present whether the actual result met or failed to meet the target. In some cases, establishing a baseline is the target and is recognized as met if the baseline was established. Note: Because performance standards were established in the FY 2006–2010 Five-Year Plan, historical data may not be available for some of the indicated standards if the Department did not collect the data prior to FY 2007.

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

The Performance Results Summary Table on the following page uses the following notations:

- "Met" represents that performance results met or exceeded the target.
- "Not met" represents that performance results fell short of the target.
- "Improved" represents that the performance results improved over the prior year but fell short of the target.
- "PM" represents that the metric was tracked, but targets were not established.
- "NA" represents that the data is not available.

Performance Results Summary Table Fiscal Years 2008 – 2010

Performance Results Summary	FY 2008	FY 2009	FY 2010
Objective 1 – Integrate Federal Student Aid systems and provide new technology solutions.			
Integrated Partner Management (IPM)	Not met	Not met	PM
Integrate aid delivery systems	Not met	Met	PM
Acquisition strategy	Not met	Met	PM
Infrastructure	Met	Met	PM
Objective 2 – Improve program integrity to facilitate access to postsecondary education, while reducing vulnerability of the federal student financial assistance programs to fraud, waste, abuse and mismanagement.			
Cumulative Lifetime Default Rate (CLTDR) – Title IV student loan portfolio	PM	PM	PM
National Cohort Default Rate (CDR)	Met	Not met	Not Met
Direct Loan default recovery rate	Met	Not met	Not Met
FFEL default recovery rate	Met	Not met	Met
Objective 3 – Reduce program administration costs.			
Reduce electronic FAFSA[sm] direct unit cost	Met	Met	Met
Reduce origination and disbursement direct unit cost	Met	Met	Met
Reduce Direct Loan servicing direct unit cost	Improved	Improved	Not Met
Reduce collections direct unit cost	Not met	Improved	Not Met
Objective 4 – Improve human capital management.			
Leadership training	Met	Not met	Not met
Acquisitions training	Met	Met	Met
Project management training	Not met	Met	Met
FSA business knowledge training	Not met	Not met	Not met
School compliance officials training	Not met	Not met	Not met
General workforce training	Not met	Not met	Not met
Objective 5 – Improve products and services to provide better customer service.			
Student aid application	Met	Met	Met
Lender payment processing	Met	PM	Met
Direct Loan borrower servicing	Met	PM	PM

In addition to the above performance results, FSA successfully implemented *SAFRA*. Congress passed *SAFRA* in March 2010. *SAFRA* included significant changes to the Title IV Programs. Most notably, as of July 1, 2010, under provisions of *SAFRA*, no new loans will be originated under the FFEL Program. This resulted in a greater volume of Direct Loan originations. FSA prepared for these changes and was successful in the full implementation within a short timeframe. In order to meet the July 1, 2010 date, FSA revised its performance plans and reassessed priorities.

Achievements in Support of Federal Student Aid Strategic Goals

Objective 1: Integrate Federal Student Aid systems and provide new technology solutions. In FY 2010, FSA continued its focus on integration initiatives designed to improve accuracy and availability of the most critical information maintained throughout the financial aid lifecycle, specifically, borrower, school, and financial partner data. These initiatives are coordinated to present a more integrated and, thus, holistic view of borrower information to a variety of stakeholders within FSA and the financial aid community. FSA continued to establish the components of its new procurement and management approach to business application development.

Objective 2: Improve program integrity to facilitate access to postsecondary education, while reducing the vulnerability of the federal student financial assistance programs to fraud, waste, abuse, and mismanagement. FSA improved its oversight of schools by partnering with and utilizing the data of other federal agencies that have monitoring responsibilities of postsecondary institutions. FSA enhanced referral processes between FSA's Business Operations and Program Compliance offices, to more aggressively identify schools with program operational problems that may impact program integrity. Additionally, FSA continued to effectively monitor lenders, guaranty agencies and servicers that participate in the FFEL Program. Internally, FSA established the Enterprise Risk Management Group (ERMG) to better identify, understand, and mitigate all enterprise risks (operational, loan portfolio/credit, and market risks).

Objective 3: Reduce program administrative costs. FSA continued to focus on reducing costs through efficiency and productivity gains that could be achieved throughout the organization. In 2010, FSA experienced significant increases in workload volumes across several FSA programs and processes. This included an increase of approximately 12 percent in FAFSA applications processed, an increase of 137 percent[3] in the number of schools originating loans in the Direct Loan Program, and an increase of 64 percent[4] in Pell Grants disbursed. FSA anticipates these and other workload volumes will continue to increase in the coming years, driving down unit costs but increasing gross costs. In the future, FSA will look at a more balanced approach to cost management to ensure a "best value" proposition to the government and its customers. This approach will consider several variables to gauge cost management including measurement of unit cost and the relative impact of unit cost fluctuations on programmatic and systemic risk as well as customer service levels, among others.

Objective 4: Improve human capital management. In FY 2010, FSA made progress towards improving the work environment and engaging employees through four initiatives, which included: developing new vision, core values, and mission statements for the organization; redesigning the hiring process; designing a reward and recognition program; and designing an internal communication system. VVM workshops were conducted in February and March of 2010 to engage employees in shaping the new vision, core values, and mission described earlier in this report. In an effort to rapidly fill the current vacancies and increase the staff for strategically important areas, the Human Resources office also reviewed and improved the recruiting and employee orientation processes.

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[3] Represents the increase between the 2008-09 award year and the 2009-10 award year.
[4] Represents the increase between the 2008-09 award year and the 2009-10 award year.

Objective 5: Improve products and services to provide better customer service. In FY 2009, the President called for all Americans to seek at least one year of postsecondary education[5]. FSA's response to this charge was to improve access to a college education by making the FAFSA easier to complete. During FY 2010, FSA continued to simplify the application, by implementing an improved 2010–11 FAFSA that utilizes enhanced skip logic and the expanded use of data provided early in the application. Applicants are now presented with fewer questions and a more customized application process. This improved version resulted in a simpler experience for applicants. FSA began to coordinate with the Internal Revenue Service (IRS) to allow some applicants to import their tax form data directly into the FAFSA. In the 2009–10 award year, over 30 percent of eligible applicants used this new functionality.

Another priority of the new administration was to provide greater transparency in government. FSA expanded its online data center to provide the public with access to information on the most requested information, including *Clery Act* program reviews, financial composite scores and Direct Loan Program transition reports.

In addition to the initiatives mentioned above, FSA continued to increase awareness about the availability of student financial assistance by: leveraging a public service campaign; providing issue resolution resources to student borrowers via the FSA Ombudsman; and modifying systems and processes to support the increase in Direct Loan originations and servicing.

Quality of Performance Data

FSA developed a matrix as guidance for data providers who have the responsibility for reporting data in performance measures, to evaluate and identify issues of data integrity and credibility. The matrix provides a framework for validating and verifying performance data before it is consolidated and reported.

The data validation criteria require that:

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

The metrics employed to measure success are directly related to each of the objectives. As an example, targets for each of the metrics have been set at challenging, but realistic levels that are achievable within the time horizon.

[5] http://www.whitehouse.gov/issues/education/

FSA believes that the goals for each objective and the associated performance metrics and targets are understandable; however, there are opportunities for improving the explanation of these relationships in future editions of its performance plans.

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

Analysis of Federal Student Aid's Financial Statements

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

In FY 2010, FSA achieved an unqualified audit opinion on its financial statements. The Independent Auditor's Report cited no material weaknesses in internal control.

For FY 2010 and FY 2009, the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position were prepared on a consolidated basis, whereas the Statement of Budgetary Resources was prepared on a combined basis as required by the OMB Circular A-136, *Financial Reporting Requirement*s. The Report of Independent Auditors (Opinion) on these statements and accompanying Reports on Internal Control and Compliance with Laws and Regulations are included in this report.

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

A comparison between significant line items reported in FSA's FY 2010 and FY 2009 September financial statements is presented in the following table:

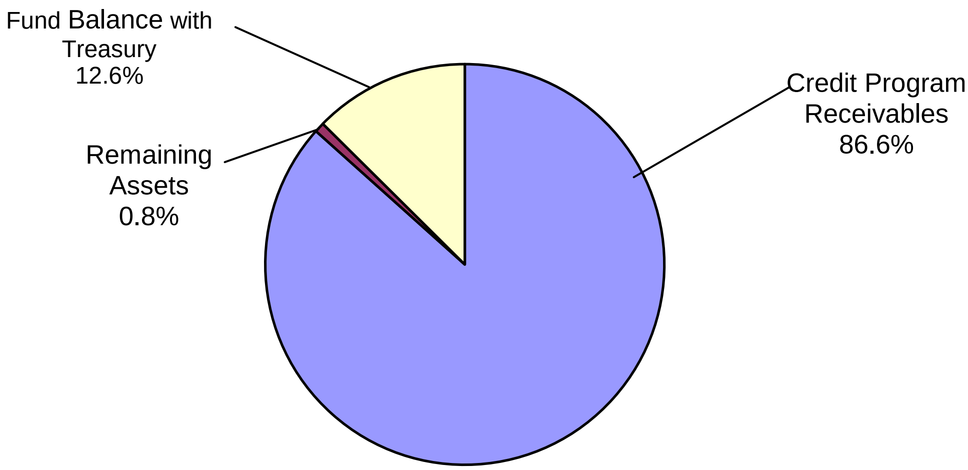
Summarized Financial Data as of September 30, 2010
(Dollars in Millions)

	Percentage Change	Dollar Difference	FY 2010	FY 2009
Total Assets	39.5%	$120,182	$424,169	$303,987
Total Liabilities	49.4%	$136,786	$413,722	$276,936
Net Position	(61.4)%	$(16,604)	$ 10,447	$ 27,051
Net Cost of Operations	235.1%	$ 34,246	$ 19,677	$ (14,569)

The Balance Sheet
Composition of FSA Assets

The Consolidated Balance Sheet shows FSA had total assets of $424.2 billion, as of September 30, 2010. This represents an increase of $120.2 billion over the previous year's total assets of $304.0 billion, as of September 30, 2009. The difference resulted primarily from an increase in the Credit Program Receivables net of a decrease in the various programs' Fund Balances with Treasury.

Composition of FSA Assets as of September 30, 2010



Fund Balance with Treasury decreased by $13.3 billion from September 30, 2009 to September 30, 2010. The Direct Loan fund balance increased by $3.2 billion, or 43.5 percent, primarily as a result of the *SAFRA* legislation, which requires all new federal student loan disbursements to be from the Direct Loan Program, eliminating new loan disbursements under the FFEL Program. The FFEL fund balance decreased by $7.3 billion, or 24.2 percent, primarily as a result of a reduction in new borrowings used to support the FFEL Program, as a result of the enactment of *SAFRA*. The fund balances for the Loan Purchase and Loan Participation Purchase Programs also all decreased slightly.

Credit Program Receivables, net of subsidy allowance, increased by $133.5 billion over the September 30, 2009 total. Credit Program Receivables are comprised of principal, interest and fees owed by students for Direct Loans, TEACH Grants, Perkins loans, and FFEL loans under the Conduit, Loan Participation Purchase, Loan Purchase Commitment, and defaulted guaranteed loans. As of September 30, 2010, the Credit Program Receivables' balance was $367.4 billion – the majority of which were Direct Loan Program receivables, Loan Participation Purchase and Loan Purchase Commitment Programs and defaulted FFEL loans receivables.

Receivables, net of the allowance for subsidy, increased primarily due to two factors. As a result of the enactment of the *SAFRA* legislation and the liquidity crisis in the financial markets, there has been a large influx of schools and participants into the Direct Loan Program, resulting in a significant increase in new loan originations, and an increase in the receivable balance of $75.4 billion, or 49.4 percent. Also, the continuation of the Loan Participation Purchase and Loan Purchase Commitment Programs, as well as the implementation of the ABCP Conduit Program, allowed FSA to purchase existing loans from FFEL loan holders.

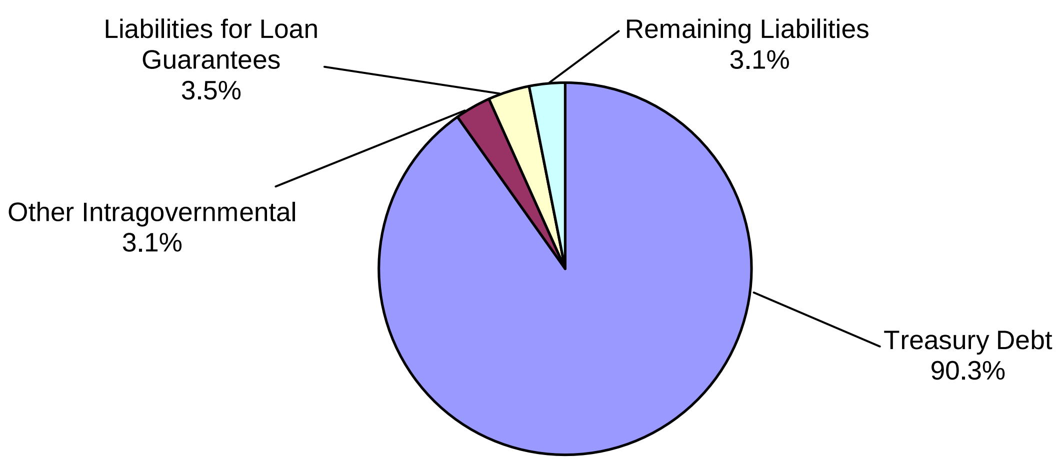
Receivables of defaulted guaranteed FFEL Program loans, net of allowance for subsidy, increased because of continued growth in the average amount of loans, growth in online schools, economic hardship and the expiration of both the Exceptional Performer designation and the Voluntary Flexible Agreements.

Composition of FSA Liabilities

FSA had total liabilities, as of September 30, 2010, of $413.7 billion, an increase of $136.8 billion over the previous year's total liabilities. The difference resulted primarily from an increase in Debt due to Treasury, Accounts Payable and Other Intragovernmental Liabilities offset by a decrease in the Liabilities for Loan Guarantees.

Debt increased as a result of the new borrowings to support the growing loan volume in the Direct Loan Program, an $83.0 billion increase, and new debt for the Loan Participation Purchase, Loan Purchase Commitment, ABCP Conduit and FFEL Programs. Other Intragovernmental Liabilities increased primarily as a result of the Direct Loan downward subsidy re-estimates. Net subsidy-related transactions resulted in a reduction of the Liability for Loan Guarantees.

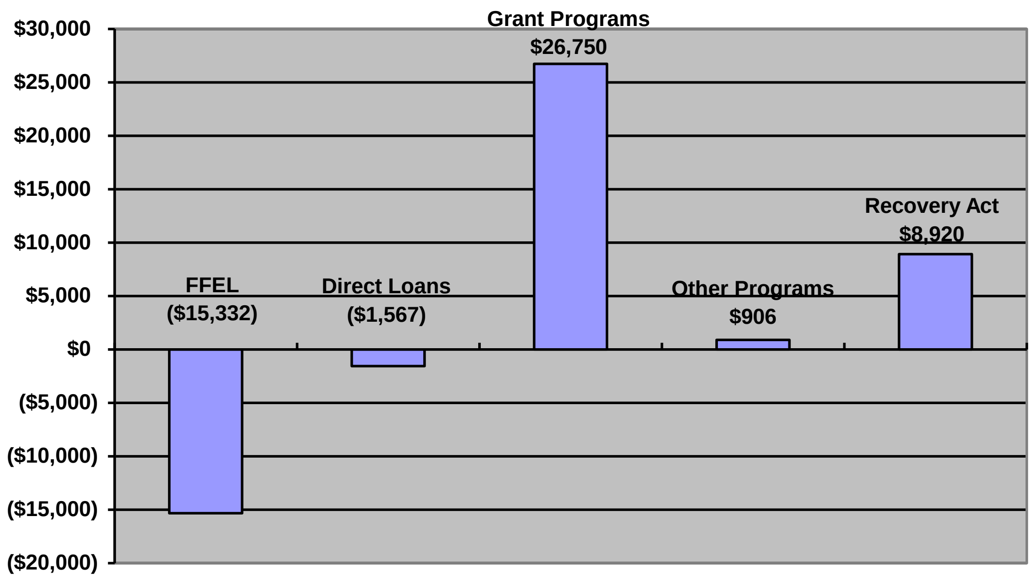
Composition of FSA Liabilities as of September 30, 2010



Statement of Net Cost

Through September 30, 2010, net costs reflected an increase of $34.2 billion from the previous year's total net cost of $(14.6) billion. This included a significant increase in net costs for the Direct Loan, FFEL, Grant and Other Programs, including the *American Recovery and Reinvestment Act* (*Recovery Act) of 2009.* The negative net cost amounts for FFEL and Direct Loan, as shown in the table below, are due to expenses for downward subsidy re-estimates, resulting in negative gross costs. Subsidy expenses are the estimated costs of funding the Direct Loans and loan guarantees. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows. Additional gross costs represent the funding of grants under the Pell Grant Program and the *Recovery Act*.

Composition of FSA's Net Cost
for the Year ended September 30, 2010
(Dollars in Millions)



Statement of Changes in Net Position

FSA's net position as of September 30, 2010, was $10.5 billion, a decrease of $16.6 billion over the previous year's total net position of $27.1 billion. The difference is primarily due to subsidy re-estimates and the unexpended appropriations for the various programs.

Statement of Budgetary Resources

The Statement of Budgetary Resources compares the budgetary resources provided with the status or execution of those resources. It also details the composition of the resources and shows the amount of net outlays. This statement shows that FSA had $280.7 billion in combined budgetary resources, of which $18.0 billion remained unobligated and not available.

FSA had total net outlays as of September 30, 2010, of $156.2 billion. There was an increase in total net outlays of $50.5 billion comparing September 2010 to September 2009. Net outlays increased primarily as a result of the enactment of the *SAFRA* legislation, which requires most new federal student loans to be from the Direct Loan Program.

Gross outlays for FSA increased $54.0 billion comparing September 2010 to September 2009 due to increased loan originations and consolidations in the Direct Loan Program.

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

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

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

- Effectiveness and efficiency of operations, including the use of the entity's resources.
- Reliability of financial reporting, including reports on budget execution, financial statements and other reports for internal and external use.
- Compliance with applicable laws and regulations.[6]

FSA management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the *Federal Managers' Financial Integrity Act of 1982*. FSA conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of its operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this assessment, FSA reported to the Department's management that its internal control over the effectiveness and efficiency of its operations and compliance with applicable laws and regulations, as of September 30, 2010, were operating effectively.

In addition, FSA, working with the Department's management, conducted its current year assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123, *Management's Responsibility for Internal Control*. The scope of FSA's assessment included the following processes that impact the Department's financial statements:

[6] GAO Standards for Internal Control in the Federal Government, GAO/AIMD-00-21.3.1, November 1999, p. 4-5.

- Conditional Disability Discharge.
- ABCP Conduit Program.
- Debt Collection.
- Direct Loans – Servicing.
- Financial Partner Invoicing.
- Financial Partner Oversight.
- Financial Reporting.
- Funds Control Management.
- Information Technology (IT)/General Computer Controls, Financial Management System (FMS), Common Origination and Disbursement (COD) System, Direct Loan Consolidation System, Direct Loan Servicing System, Debt Management and Collection System (DMCS), Virtual Data Center.
- Pell Grant Program Operations.
- Portfolio Performance Division Operations.
- Procurement Management.
- School Eligibility Channel.
- Student Eligibility.
- Title IV Additional Servicers (TIVAS).

Based on the results of this evaluation, FSA provided reasonable assurance to the Department's management that its internal control over financial reporting as of June 30, 2010 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

FSA's participation in the Department's successful implementation of the requirements of OMB Circular A-123, Appendix A, enables it to continue to build upon its internal control framework. This framework will be used in continuing efforts to monitor and improve internal control.

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

Possible Future Effects of Existing Events and Conditions

The passage of *SAFRA* during FY 2010 resulted in FSA significantly altering its tactical plans. There are a number of possible future effects of existing events and conditions that FSA is tracking that may have an impact on its FY 2011 tactical plans. These events include the following:

Final FY 2011 Student Aid Administration Appropriation level. With the passage of *SAFRA*, the Congressional Budget Office estimates that the Federal government will save $68 billion between FY 2010 and FY 2020. The Congressional Budget Office also estimates that the Federal government will need to spend $6 billion over that same time period to cover the increased Direct Loan program administration cost resulting from increased Direct Loan volume. Prior to *SAFRA*, the program administration costs associated with this savings were paid for through mandatory FFEL funding. Meanwhile, the Federal government is under significant pressure to reduce discretionary spending. If FSA does not receive the necessary funding in the Student Aid Administration appropriation to cover this anticipated increase in administrative costs, then FSA will need to revisit its tactical plans for FY 2011.

Implementation of Not-For-Profit (NFP) servicers. FSA has issued a request for proposal for any eligible NFP servicer, as defined by *SAFRA*, to offer loan servicing activities. Final planning for the implementation of the NFP servicers is dependent on the contracts that are awarded.

Risks associated with variability of volume-driven costs. Many of FSA's costs are driven by volume activities, such as grant/loan origination and disbursement, and loan servicing. For example, loan servicing costs are driven by the number of borrower accounts, the status of a borrower's loan(s) (e.g. In-School, Repayment, Deferment\Forbearance), and when the borrowers' loans are disbursed. Grant and loan origination and disbursement costs are driven by the number of originations and disbursements. The budgeting formulation process generally sets the initial budget for a fiscal year 18 months before the start of that fiscal year. However, even a small variation in any of FSA's volumes can significantly impact its budget. This puts all other expenditures and plans associated with those expenditures at-risk. This risk must be managed as long as the Federal government pays for mandatory Direct Loan expenditures using discretionary administration funding.

Final Gainful Employment regulations. During FY 2012, FSA is expected to need to implement regulations that take into account the debt burden incurred by students in determining whether certain institutions are eligible to participate in the Title IV Programs. During FY 2011, FSA may need to commit resources to prepare for this task.

Final determination about transitioning Health Education Assistance Loan (HEAL) program to Federal Student Aid. The *Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2011* passed by the U.S. Senate requires the transfer of the HEAL program from the Department of Health and Human Services to the Department of Education, to be administered by FSA. If this provision is enacted, FSA will need to plan for and transition this program.

Limitations of Financial Statements

Management has prepared the accompanying financial statements to report the financial position and operational results for FSA, for FY 2010 and FY 2009 pursuant to the requirements of title 31 of the United States Code (U.S.C.), Section 3515(b).

While these statements have been prepared from the books and records of FSA 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 for FSA, a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities presented herein cannot be liquidated without the enactment of appropriations, and ongoing operations are subject to the enactment of future appropriations.

Annual Program Performance Report

Annual Program Performance

During FY 2010, FSA achieved significant accomplishments. The information presented herein provides details of FSA's achievements, by objective. For each objective, the corresponding Performance Standard has been identified, as well as the organization's progress in meeting the stated target. A narrative providing information on the data quality and analysis of progress is also presented under each objective. Unless otherwise noted, these performance standards and their respective ratings are based on criteria established by FSA.

The performance results for each objective are presented in tables that provide trend data including the latest available reported data. The Performance Column shows the relationship between the FY 2010 actual value and target as follows:

- "Met" represents that performance results met or exceeded the target.
- "Not met" represents that performance results fell short of the target.
- "Improved" represents that the performance results improved over the prior year but fell short of the target.
- "PM" represents that the metric was tracked, but targets were not established.
- "NA" represents that the data is not available.

An analysis of progress is provided as insight into FSA's progress. Data quality incorporates information such as the universe included in the measure, while target context explains the parameters or rationale or the targets.

The Goals, Objectives and Results used to report FY 2010 performance are from the FY 2006–2010 Five-Year Plan. FSA anticipated developing and implementing a new five-year strategic plan during FY 2010. Although FSA developed and finalized this new plan in FY 2010, implementation begins in FY 2011. Therefore, FSA will report its FY 2010 performance against the FY 2006–2010 Five-Year Plan.

The Goals, Objectives and Results presented in this report terminated effective September 30, 2010. They will be replaced based on the new Strategic Plan, FY 2011–15. Some items may be similar to new targets identified.

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

In FY 2010, FSA continued to focus on integration initiatives designed to improve the accuracy and availability of the most critical information maintained throughout the financial aid lifecycle: specifically borrower, school, and financial partner data. These initiatives are coordinated to present a more integrated and thus, holistic view of borrower information to a variety of stakeholders within FSA and the financial aid community. FSA also continued to establish the components of its new procurement and management approach to business application development.

The following narrative provides the details of FSA's achievements related to this objective.

National Student Loan Data System (NSLDS)

The development of the NSLDS was mandated by Congress in the *HEA*. NSLDS aims to collect, store and make available to authorized users detailed data about a recipient's Title IV aid. In addition, it simplifies and streamlines aid delivery processes used by schools, lenders and guarantors throughout the country, replacing paper driven techniques with an efficient online interface. Since its introduction, FSA has continuously improved NSLDS's functionality, and FY 2010 was no exception. In FY 2010, the four new student loan servicers started reporting loans to NSLDS through a new interface that improved the efficiency of data collection, timeliness of reporting, and ability to monitor portfolio and contractor performance. Also, NSLDS developed a new exit counseling module for borrowers to use on the NSLDS student web site, which was necessary to support both additional servicing capacity and the expansion of the Direct Loan Program. In addition, in FY 2010, four reengineering tasks were awarded that will:

- integrate NSLDS with a new DMCS that is being built;
- reengineer the business process for enrollment reporting to improve the collection and dissemination of enrollment statuses;
- implement a 3-year CDR calculation as required by statutory changes from the *HEA*; and
- modernize the structure of the NSLDS database, to enable adaptation to data standards, improve overall quality of the data, provide a common data framework to be used across aid programs for consistency, and increase data storage efficiency.

Debt Management and Collection System

The DMCS is used to manage and collect defaulted debt held by the Department from borrowers. System activities include generating Department collection correspondence to borrowers and supporting collection by Administrative Wage Garnishment, Treasury and Federal Salary Offset, as well as credit bureau reporting. Since DMCS was built in June 1989, the system has become very costly to maintain and many manual workarounds have been developed to address emerging requirements. In June 2010, FSA negotiated with the Common Services for Borrowers (CSB) contractor to upgrade DMCS at no cost to the government and to provide the DMCS "services" to the Department on a per-borrower basis. The new DMCS will be based on a commercially available off-the-shelf software package that will automate the workflow processes and provide a new web portal interface for borrowers, schools, employers, and guaranty agencies. The reengineering project was started in June 2010 and implementation is planned for January 2011, with full conversion of all defaulted debt to the new system by the end of June 2011.

Integrated Partner Management

Currently, many FSA applications support the eligibility, enrollment, and oversight of support organizations participating in the Title IV Programs, such as postsecondary institutions, servicers, lenders, and guaranty agencies. These individual applications result in duplicative and conflicting data storage issues, complex system architecture, excessive file exchange activities, and an absence of a centralized view of partners. Through process reengineering, automation, and integration of FSA's core systems, IPM will provide improved eligibility, enrollment, and oversight processes for Title IV partners in a consolidated solution. IPM will improve information security through a single point of access and increase efficiency by employing a modernized and scalable system platform to facilitate the receiving and processing of information from partners via a web-based application.

In FY 2010, the IPM Project finished the requirements and functional design phase, which consisted of completing business requirements, business functional design development, test scripts, and the logical data model design. The requirements and functional design documentation are now being used for the acquisition segment of the design, development and implementation work for the subsequent phases of the project. The Design, Development, and Implementation contract was awarded at the end of FY 2010.

Project Management and Governance

In FY 2010, FSA made a commitment to implement highly effective and disciplined Project Portfolio and Project Management practices. These actions included establishing the Strategic Investments Governance (SIG) office under the Chief Performance Officer. The SIG office provides Senior Program and Project Managers to manage FSA's complex projects, ensuring that project management standards and principles are consistently followed in the planning and execution of projects. In addition to the organizational changes, recruitment and integration of subject matter experts is critical to realizing the business objectives. Preliminary hiring efforts were completed in the fourth quarter of FY 2010 with additional foundational hiring expected to continue in FY 2011. Additionally, in FY 2010, FSA established and implemented a Project Management Toolkit, which consists of a set of project management planning and execution methodologies that align to the Project Management Body of Knowledge, the world standard for project management.

Performance Standards and Results

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

Objective 1 Performance Metrics and Results

Metric	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 (Target)	FY 2010 (Actual)	Performance
IPM	Design	In develop-ment	Development terminated. New approach and timeline developed.	Completed evaluation and inventory to determine usability of current requirements and development by 1/31/09; awarded contract on 9/25/09 to complete requirements and functional design.	PM	The IPM Project finished the Requirements and Functional Design Phase, which consisted of completing business requirements, business functional design development, test scripts, and the logical data model design. The Design, Development and Implementation contract was awarded at the end of FY 2010.	PM
Integrate aid delivery systems	*	Strategies completed	Issued request for information with a draft statement of work for person data management. High level planning completed.	High Level Requirements were developed for NSLDS redesign and used to make an award for design and build of phase I of the NSLDS reengineering project. High level requirements were drafted for DMCS and used to issue a sources sought possible vendors. A contract was also awarded to form more detailed requirements to issue a request for proposal in FY 2010 for a collections services contract.	PM	Implemented new interface to allow TIVAS to report loans to NSLDS. Developed new Exit Counseling capability for borrowers to use on the NSLDS student website. Awarded four reengineering tasks. Negotiated with the CSB contractor to upgrade the DMCS at no cost to the government and acquire DMCS "services" on a per borrower basis.	PM
Acquisition strategy	*	Approach and timeline completed	Developer pool established. Customer care not complete.	Additional loan servicing vendors established; Enterprise Development Support Services (EDSS) Project and Program Management vehicle established; EDSS requirements vehicle solicitation published; EDSS testing vehicle solicitation published.	PM	NA**	PM
Infrastructure	*	Phase 1 completed	Deployed enterprise portal infrastructure Enterprise Services Business (ESB).	Worked with development initiatives to establish plan for integration with portal and ESB as appropriate.	PM	NA**	PM

* Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established. **Acquisition strategy and Infrastructure were not measured in FY 2010 because these were not key elements in expanding the Direct Loan Program. However, in the future, the acquisition strategy will change in scope and become an important factor in the way that FSA delivers products and services.

Data Quality: IPM and Integrated aid delivery systems deliverables were achieved upon the completion of the prescribed phases of the corresponding projects.

Analysis of Progress: While the objectives of several of FSA's integration projects remain the same, the development and procurement strategies changed. FSA discovered that large contracts requiring multiple business capabilities and supporting a complex and multi-faceted business processes do not necessarily provide FSA with the best solution providers from the marketplace. In addition, the lack of post-award competition led to price, quality, and innovation issues, preventing FSA from being able to quickly transition services, potentially putting its business at risk.

Target Context: In the FY 2006–2010 Five-Year Plan, FSA established and documented strategic performance standards and targets to measure the organization's success in meeting the stated long-term objectives. Any revisions to the original FY 2010 targets may not have been published, since FSA has not updated this plan.

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

In FY 2010, FSA improved its oversight of schools by partnering with and utilizing the data of other federal agencies that have monitoring responsibilities of postsecondary institutions. FSA enhanced program review standards to strengthen monitoring of distance education programs. Additionally, FSA continued to effectively monitor lenders, guaranty agencies and servicers that participate in the FFEL Program. During FY 2010, FSA continued to focus its efforts in several areas including training and outreach, privacy and data protection, risk management, partnership with other departments and agencies, comprehensive compliance reviews (CCRs), 9.5 percent Special Allowance Payments (SAP), and accessibility to program data.

The following narrative provides the details of FSA's achievements related to this objective.

Privacy and Data Protection

In March 2010, Education Credit Management Corporation (ECMC), a guarantor of federal student loans in the FFEL Program, discovered that two locked safes had been stolen from a secured facility at its corporate headquarters in Oakdale, Minnesota. The stolen items included personally identifiable information – names, addresses, dates of birth and social security numbers for approximately 3.3 million individuals. Once contacted by ECMC, the Department's Privacy Incident Response Team was convened. The team performed an on-site evaluation of the incident location and found reasonable security at the site, but was able to provide some additional control recommendations. The data was recovered within 48 hours of the theft and law enforcement officials believe the data had not been compromised, so no impact from the personally identifiable information theft is anticipated.

As a follow-up to this incident, the Department and FSA developed an IT security self-examination checklist that all guaranty agencies were required to complete. Department and FSA IT Staff hosted a Security Summit for guaranty agencies at which ECMC provided a detailed briefing on the incident and the steps taken to ensure that the incident had no negative impact on borrowers. At the conference, experts from the National Institute of Standards and Technology, the Department's Office of Inspector General, and outside experts in areas of security best practices provided insight and advice to those in attendance. FSA plans to continue site visits to all guaranty agency locations, beginning with those at the highest risk, based on their response to the checklists provided.

Risk Management

During FY 2010, the ERMG began a transformation under an expanded framework to move from basic risk assessments to develop a best-in-class, risk-based, decision support framework. All key business unit oversight, program compliance, and assurance functions are being aligned under this expanded model with reporting and key activities also consolidated into the ERMG Office, led by a new Chief Risk Officer who reports directly to FSA's COO. The change ensures that all enterprise risks (operational, loan portfolio/credit, and market risks) are better identified, understood, and mitigated. During FY 2010, special focus was given to coordinating risk assurance activities across the organization and providing clear visibility into key risks and mitigation status.

Partnership with Other Federal Agencies

FSA entered into several partnerships with other agencies, such as the Department of Labor, the Securities and Exchange Commission, and the Federal Trade Commission, to share information in order to improve compliance and monitor consumer complaints. Other partnerships, such as with the Federal Bureau of Investigation, resulted in joint efforts to conduct program reviews, including campus security program reviews.

Comprehensive Compliance Reviews

FSA reviews schools' eligibility, financial statements, and deficient audits and program reviews as part of a CCR. In FY 2010, FSA conducted 2,923 CCRs. These CCRs were performed on schools that constituted 46 percent of participating schools and accounted for 47.5 percent of total Title IV funding. Liabilities were identified where audit or program review findings revealed non-compliance. In addition, 53 reviews were conducted on financial institutions to examine compliance with the Title IV Program requirements. FSA conducted reviews of 11 servicers: 7 commercial servicers and the 4 Departmental loan servicers. The most frequent finding was inconsistent reporting to the Lender Application and Reporting System and NSLDS. In FY 2010, FSA resolved 634 audits of lenders, guarantors, and lender and guarantor servicers. This number includes audits that were received in prior fiscal years, but were resolved in 2010. Approximately 22 percent of these audits resulted in findings. The most common findings were related to over or under billing as a result of interest and/or SAP.

Special Allowance Payments

Special allowance payments are a Federal subsidy authorized by *Section 438* of the *HEA* for FFEL Program lenders. Its purpose is to compensate lenders during periods when federally-mandated student loan rates do not by themselves provide the lender a rate of return on the loan comparable to that return which the lender might obtain from other loans in light of prevailing interest rates.

In 1980, the *HEA* was amended by reducing by 50 percent the special allowance subsidy paid on a loan that was financed by tax-exempt obligations (bonds), but setting a minimum SAP rate for those loans to provide a total rate of return sufficient for these lenders to meet their financing costs. The statute set the “floor” rate for SAP at whatever rate would, together with the interest paid by the borrower, give the lender at least a 9.5 percent rate of return.

The purpose of the change was to recognize that lenders using tax-exempt obligations to finance loans had a lower cost of funds than lenders using other sources, and thus, the rate of special allowance paid to the loan holder should be lower than the rate provided for loans financed from other sources. In 1980, when this amendment was enacted, interest rates were as high as 22 percent, with Treasury Bills at 16.5 percent. To ensure an established minimum rate of return to protect lenders and their bondholders, Congress provided a minimum gross yield of 9.5 percent.

As of September 30, 2006, 36 lenders claimed SAP at the 9.5 percent return rate on loans totaling $11 billion. Of the 36 lenders, 15 lenders elected to comply with a Departmental demand that these claims be thereafter supported by a special purpose audit. As a result of the audit requirement, loan payoffs and/or sales, the volume of loans that qualified for 9.5 percent SAP dropped to $1.3 billion, as of the end of FY 2009, an 88 percent decrease. In FY 2010, as a result of loan payoffs and/or sales, the ending principal balance has further declined to $516 million.

Performance Standards and Results
The following performance standards were established to gauge FSA's success in improving program integrity, while reducing the vulnerability of the Title IV programs to fraud, waste and abuse. The success relies on continuing to achieve low default rates and increasing the recovery rate.

Objective 2 Performance Metrics and Results

Metric	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 (Target)	FY 2010 (Actual)	Performance
CLTDR* Title IV student loan portfolio	FY 2004 5.9% FY 2003 7.3% FY 2002 9.2% FY 2001 10.9% FY 2000 12.7%	FY 2005 5.5% FY 2004 8.0% FY 2003 8.8% FY 2002 10.3% FY 2001 11.9%	FY 2006 5.8% FY 2005 7.4% FY 2004 9.5% FY 2003 10.0% FY 2002 11.3%	FY 2007 8.0% FY 2006 7.6% FY 2005 8.6% FY 2004 10.6% FY 2003 10.9%	PM	FY 2008 9.6% FY 2007 10.3% FY 2006 8.5% FY 2005 9.1% FY 2004 10.7%	PM
CDR**	FY 2004 5.1%	FY 2005 4.6%	FY 2006 5.2%	FY 2007 6.7%	< 6%	FY 2008 7.0%	Not Met
Direct Loan default recovery rate	19.0%	20.1%	21.0%	18.0%	22.9%	17.4%	Not Met
FFEL default recovery rate	19.4%	19.6%	23.6%	19.7%	20.6%	21.9%	Met

*The CLTDR was first published in FY 2006. Since that time, FSA has produced and published the FY 2005, FY 2006, FY 2007 and FY 2008 calculations for the relevant preceding five-year periods, respectively. FSA will continue to analyze the impact of portfolio performance on the CLTDR before identifying future performance targets.
**Indicates what year the data was reported. For example, during FY 2010, FSA calculated the FY 2008 CDR.

Data Quality: Indicates what year the data was reported. For example, during FY 2010, FSA calculated the FY 2008 CDR.

Analysis of Progress: FSA continues to make progress in improving program integrity as defined by the identified performance standards above. Although the Direct Loan default recovery rate decreased slightly, and did not meet the targeted amount, the total dollar amount recovered in FY 2010 increased by nearly $173 million to $2.3 billion.

Target Context: In the FY 2006–2010 Five-Year Plan, FSA established and documented strategic performance standards and targets to measure the organization's success in meeting the stated long-term objectives. Any revisions to the original FY 2010 targets may not have been published, since FSA has not updated this plan.

Objective 3: Reduce program administration costs.

FSA continued to focus on reducing costs through efficiency and productivity gains that can be achieved throughout the organization. In FY 2010, FSA experienced significant increases in workload volumes across several major FSA programs and processes. This included an increase of approximately 12 percent in FAFSA applications processed, an increase of 137 percent in the number of schools originating loans in the Direct Loan Program, and an increase of 64 percent in the number of Pell Grants disbursed. FSA anticipates these and other workload volumes will continue to increase in the coming years, driving down unit costs but increasing gross costs.

In the future, FSA will look at a more balanced approach to cost management to ensure a "best value" proposition to the government and its customers. This approach will consider several variables to gauge cost management including measurement of unit cost and the relative impact of unit cost fluctuations on programmatic and systemic risk as well as customer service levels, among others.

The following narrative provides the details of FSA's achievements related to this objective.

Contract Renegotiations

Contract renegotiations completed in FY 2010 resulted in cost savings and cost avoidance totaling approximately $11.6 million in FY 2010 and $78 million in succeeding fiscal years. Specifically, the CSB contract was modified to eliminate the account transfer fee. In FY 2010, this modification resulted in a savings of $5.3 million. Through the rest of the CSB contract term (12/31/2013), cost savings are estimated to be nearly $55 million for loan servicing and $15 million for DMCS. Additionally, the CSB contract was modified to eliminate $10 million in development costs for the enhancement, upgrade or replacement of the current DMCS; the contractor agreed to complete this development at no additional cost to the government. Savings of $2 million were realized in FY 2010 and the remainder of the savings ($8 million) will be realized in FY 2011. Finally, the COD contract was modified to replace letters to borrowers with electronic notices under certain circumstances, resulting in savings of $4.3 million in FY 2010.

FSA Conference

FSA annually hosts financial aid professionals from schools across the country for a week-long training conference on proper administration of the Title IV programs. To accommodate the large number of attendees, FSA historically held two identical conferences in different cities across the US. In FY 2010, FSA consolidated the two conferences into a single large conference in Nashville attracting almost 5,200 financial aid professionals. By consolidating the two conferences into a single event, FSA was able to save approximately $140,000.

Performance Standards and Results

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

Objective 3 Performance Metrics and Results

Metric	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 (Target)	FY 2010 (Actual)	Performance
Reduce electronic FAFSA direct unit cost	$ 5.04	$ 4.34	$ 3.91	$ 3.94	$ 3.78 (25% Reduction)	$ 3.45	Met
Reduce origination and disbursement direct unit cost	$ 4.42	$ 4.03	$ 3.65	$ 3.60	$ 3.76 (15% Reduction)	$ 3.35	Met
Reduce Direct Loan servicing direct unit cost	$20.95	$21.45	$19.59	$19.25	$ 18.44 (12% Reduction)	$ 19.96	Not Met
Reduce collections direct unit cost	$ 0.14	$ 0.13	$ 0.14	$ 0.13	$ 0.12 (14% Reduction)	$ 0.13	Not Met

Data Quality: Unit costs are based on prior year data. For example, in FY 2010, the unit costs were based on data from FY 2009. To calculate the unit cost of originating and disbursing Direct Loans and Pell Grants, the total amount spent on originating and disbursing Direct Loans and Pell Grants is divided by the total number of Direct Loan and Pell Grant disbursements. For 'Processing an Electronic FAFSA', 'Servicing a Direct Loan Borrower' and 'Collecting One Dollar in Default Status' the total amount spent for each output is divided by the number of units for the output.

Analysis of Progress: FSA has made significant progress in its efforts to reduce the administrative unit costs. All measures are below the baseline amounts from FY 2006. Due to the nature of the cost calculation for default collections, it will be difficult to meet the target of $0.12. This is due to the fact that this measure includes the costs for private collection agency (PCA) contracts, which increase in cost as the amount collected increases. While the unit cost of collecting one dollar in default is relatively steady, the actual amount collected has increased since the FY 2006 baseline. FSA reevaluated these standards during the development of the FY 2011–15, Strategic Plan. New costs measures will be implemented during FY 2011. Finally, although it was not a metric documented in the FY 2006–2010 Five-Year Plan, FSA also measures its administrative cost per FFEL loan. The FY 2010 result of $0.10 per loan showed a $0.01 reduction from the FY 2009 cost of $0.11 per loan. This calculation does not include any of the FFEL subsidy (e.g., SAP, interest benefit, account maintenance fee, etc.)

Target Context: In the FY 2006–2010 Five-Year Plan, FSA established and documented strategic performance standards and targets to measure the organization's success in meeting the stated long-term objectives. Any revisions to the original FY 2010 targets may not have been published, since FSA has not updated this plan.

Objective 4: Improve human capital management.

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

The following narrative provides the details of FSA's achievements related to this objective.

Vision, Core Values, and Mission Workshops

In February 2010, FSA began developing its VVM by holding "I am FSA" sessions. This included a series of forty 90-minute employee sessions focused on discussing FSA's vision, core values, and mission. The sessions were attended by over 250 employees. The workshops provided an opportunity for employee engagement, and as a result of input received from various sessions, the new FSA VVM was announced in April 2010 and formed the foundation for the development of the new Strategic Plan, FY 2011–15.

Hiring Process Redesign

In FY 2010, FSA continued to improve the hiring process, particularly in the recruiting stage, by establishing and testing new and innovative methods to streamline the orientation process as the organization attempted to fill extensive vacancies. For example, the Program Compliance Office recruited to fill 50 Institutional Review Specialist positions through eight vacancy announcements. FSA uses other hiring approaches including the Federal Career Intern Program that recruits at colleges and universities. In FY 2010, eight recent graduates were hired through the Federal Career Intern Program. Another important program used to attract college students is the Student Career Experience Program where the students are pursuing degrees related to the work to be performed here at FSA. In FY 2010, 10 Student Career Experience Program appointments were made. After students fulfill their academic requirements and complete their service requirements at FSA, they can be converted to career positions.

FSA placed better controls around the hiring approval process, which slowed the initial pace of hiring, but was a significant advantage as the volume of requests increased. Additional classification resources were used to clarify positions, and in some cases, helped identify ways to leverage existing positions and vacancies to ensure the most efficient staffing.

The Department also implemented a new human resource information system, known as the Workforce Transformation and Tracking System/Entrance on Duty System. This modular system is being implemented in phases and allows FSA to eliminate or reduce many manual processes. Despite the low staffing levels of the hiring team, FSA invested in training and advisory participation, to help implement this system. The preparation required FSA to begin contemplating how work would be processed differently under the new system, and had a positive impact on the hiring design, as staff began determining more efficient ways to transition from the “as-is” to the “to-be” state. FSA will begin its full implementation of the system in FY 2011.

FSA has made significant use of the excepted service appointment authorities granted by the PBO legislation. The current leadership has encouraged the judicious use of the authority to fill positions with highly qualified candidates necessary to fulfill FSA’s mission. In addition to excepted service appointments, FSA has also used two other direct hire authorities – one for computer specialists focusing on security, and one for contract specialists, to fill five positions. These two direct hire authorities enabled FSA to fill these shortage category positions expeditiously. Other hiring reform efforts include considering Peace Corps employees eligible for non-competitive appointments and Presidential Management Fellows. The focus has been on filling positions quickly with highly qualified candidates. For FY 2010, FSA reached an onboard strength of 1,168, or 95 percent of its operational goal for the fiscal year.

The combination of efforts undertaken by FSA in FY 2010, positions the organization to make additional improvements in its resourcing efforts.

Internal Communication

The FSA COO, William Taggart, made an early commitment to expand the agency’s internal communication efforts. After joining FSA in June 2009, Mr. Taggart toured each of FSA’s regional office locations, convening groups of employees and discussing the need for improvement within the organization. He has since implemented several key strategies, including:

- Utilization of periodic meetings with key groups of staff including senior managers, FSA supervisors and employees;
- Development of a weekly communiqué for employees called “Funtastic Fridays”, focusing on the FSA Core Values, and the employees and teams that exemplify them;
- Creation of an employee-centered team of Union, bargaining-unit and management members, focused on leveraging employee engagement to help FSA become a “Best Place to Work.” The team was named the FSA First Class team;
- Implementation of an employee-led strategic planning effort called “I am FSA”. One result of this initiative was the establishment of the new FSA Vision, Core Values, and Mission statements;
- Promotion of pivotal employee initiatives, such as leadership development, annual charitable campaigns, and awards and recognition opportunities;
- A greater commitment to senior leader interaction with customer-facing employees at FSA’s regional office locations—such as for the VVM and strategic plan rollouts, recognition events, the regional office tour, and engaging staff in school outreach events in those local areas; and
- Placement of video-teleconferencing capabilities in FSA regional training centers, located in every regional office. This allows greater numbers of employees to fully participate in multi-regional meetings.

Rewards and Recognition

FSA senior leaders and managers were encouraged to rethink how to reward and recognize employees. The Funtastic Fridays vignettes provided a fun and regular source of news, ideas and highlights of employee successes around the nation. In an effort to expand recognition alternatives at a time of tighter budgets, more emphasis was also placed on non-monetary resources. In FY 2010, the FSA First Class developed a non-monetary “Beyond the Call” award for managers to recognize extra effort and superior performance.

The Department is currently reviewing and soon is to implement a new performance management system. FSA will also re-evaluate its existing awards and recognition programs to align with this new system.

Performance Standards and Results

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

Objective 4 Performance Metrics and Results

Metric	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 (Target)	FY 2010 (Actual)	Performance
Use training resources to develop a highly skilled workforce to ensure competency in mission-critical skills/knowledge	Leadership: trained 100% of new supervisors and 52% of current supervisors	Leadership: trained 95% of new supervisors and 60% of current supervisors	Leadership: trained 96% of new and 96% of current supervisors	Leadership: trained 82% of new and 99% of current supervisors	Leadership: trained 95% of new and 75% of current supervisors	Leadership: trained 92% of new and 90% of current supervisors	Not met
	Acquisitions: trained 100% of contracting officials	Acquisitions: trained 100% of contracting officials	Acquisitions: trained 100% of contracting officials	Acquisitions: trained 100% of contracting officials	Acquisitions: trained 100% of contracting officials	Acquisitions: trained 100% of contracting officials	Met
	Project management: trained 100% of key IT project managers	Project management: trained 75% of key IT project managers	Project management: trained 67% of key IT managers	Project management: trained 64% of Key IT managers	Project management: trained 50% of Key IT managers	Project management: trained 100% of Key IT managers	Met
	FSA business knowledge: trained 90% of new employees	FSA business knowledge: trained 100% of new employees	FSA business knowledge: train 89% of new employees	FSA business knowledge: trained 53% of new employees	FSA business knowledge: trained 90% of new employees	FSA business knowledge: trained 83% of new employees	Not met
	FSA business knowledge: trained 100% of school compliance officials	FSA business knowledge: Trained 100% of school compliance officials	FSA business knowledge: Trained 76% of school compliance officials	FSA business knowledge: trained 77% of school compliance officials	FSA business knowledge: trained 80% of school compliance officials	FSA business knowledge: trained 40% of school compliance officials	Not met
	FSA business knowledge: trained 40% of general workforce	FSA business knowledge: trained 100% of general workforce	FSA business knowledge: train 34% of general workforce	FSA business knowledge: trained 39% of general workforce	FSA business knowledge: trained 40% of general workforce	FSA business knowledge: trained 33% of general workforce	Not met

Data Quality: Data was obtained from training class rosters and attendance records.

Analysis of Progress: While FSA exceed its target of training current supervisors, it was unable to meet the target of training new supervisors. Results varied for the FSA Business Knowledge training targets. FSA significantly improved and far exceeded its target for project management training. New employee training also improved, although the target completion rate was not met. Finally, training for school compliance officials and the general work force did not meet the established targets.

Target Context: FSA developed the above targets at the beginning of FY 2010 and immediately began tracking their progress in achieving these objectives.

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

In FY 2009, the President called for all Americans to seek at least one year of postsecondary education[7]. One way FSA was able to support this charge was to improve access to a college education and increase awareness of the resources available to students and their families to pay for it. In FY 2010, the organization continued making improvements to the FAFSA to make it easier for applicants to complete. To increase greater awareness about the availability of student financial assistance, FSA established a nationwide public service campaign. Another priority of the new administration was to provide greater transparency in government. FSA expanded its online data center to provide the public with access to information on the most requested information, including *Clery Act* program reviews, financial composite scores and Direct Loan Program transition reports. Finally, the FSA Ombudsman continued to be a world-class problem resolution resource for student borrowers.

The following narrative provides the details of FSA's achievements related to this objective.

Direct Loan Readiness

In response to uncertainty in the financial markets and ongoing legislative activity, the Department moved aggressively throughout FY 2010 to ensure a smooth transition for any schools that chose to participate in the Direct Loan Program. With the enactment in late March 2010 of *SAFRA*, which ended new lending in the FFEL Program and, as a result, significantly expanded the Direct Loan Program effective July 1, 2010, these efforts were expanded and accelerated dramatically.

[7] http://www.whitehouse.gov/issues/education/

FSA went to great lengths to update its systems and increase capacity to prepare for this change. Some of these accomplishments include:

- Increased Direct Loan front-end origination and disbursement capacity through three separate upgrades;
- Increased Direct Loan back-end servicing capacity with the award and migration onto the systems of four private-sector servicers; and
- Increased promissory note capacity.

Today, FSA is ready to support each and every institution that chooses to participate in the Direct Loan Program.

FSA also accelerated training to schools participating in the FFEL program to provide them with the information and resources they need to efficiently and effectively transition to the Direct Loan Program. Some of these accomplishments include:

- Offering webinar training to schools interested in participating in the Direct Loan Program;
- Training almost 5,200 financial aid professionals at its annual Fall Conference in Nashville;
- Conducting the Regional Direct Loan Training Conferences for domestic schools in 15 cities across the nation serving almost 2,500 financial aid professionals; and
- Conducting training in 8 cities across the world for foreign institutions transitioning into the Direct Loan Program.

FSA took a number of steps to ensure an efficient transition process. These steps included:

- **Establishing a specialist team.** A special integration team was established to contact and work directly with school financial aid offices on transition issues. These ten specialists worked to provide information, answer questions, and identify schools that needed more intensive intervention.

- **Providing technical assistance.** A technical assistance contract was awarded to provide targeted remote and on-site assistance on a range of Direct Loan system and process issues. Due in part to the work of the orientation (also known as the "on-boarding") team and FSA's normal customer service staff, only 31 of the over 2,500 schools transitioning in FY 2010 required targeted technical assistance.

- **Increasing capacity.** Capacity was expanded in the COD system and other Direct Loan applications to accommodate increased workload. As a result of the shift to Direct Loans, FSA processed over 10.4 million promissory notes, a more than 300 percent increase over the previous year; and originations increased by over 176 percent compared with the 2009–10 award year.

FSA also developed and implemented a new streamlined software interface that allows easier access for schools new to Direct Loans. This interface will be particularly useful for foreign schools, which had previously been prohibited by statute from participating in the Direct Loan Program.

As a result of these efforts, as of September 30, 2010, 98 percent of domestic schools that had participated in the federal student loan programs in the previous two years had successfully originated a Direct Loan, and no school wishing to participate has been unable to do so.

FSA Data Center

In September 2009, FSA launched the FSA Data Center, accessible at http://fsadatacenter.ed.gov. The Data Center was created in an effort to increase government transparency by proactively posting information useful to businesses, the media, and individuals. It contains data and reports related to application, loan and grant volume, default rates, program oversight, and more.

When the site was initially launched, it provided a compilation of existing data, such as default rates, coupled with several new reports, such as Title IV aid volume reports. In FY 2010, FSA increased the type and quantity of information posted to the FSA Data Center by adding *Clery Act* Program Review Reports, Financial Composite Scores for private and for-profit schools participating in the Title IV programs, trial 3-year cohort default rates, and Direct Loan transition reports, among others.

Federal Student Loan Servicing

To expand and diversify the FSA's loan servicing capacity, FSA entered into performance-based contracts with the following four companies in June 2009: American Education Services/Pennsylvania Higher Education Assistance Agency; Great Lakes Educational Loan Services; Nelnet Servicing, LLC and Sallie Mae Corporation. Prior to the award of these contracts, collectively referred to as the TIVAS, all FSA loan servicing was performed under the CSB contract, which is scheduled to expire December 31, 2013. Expanding the pool of servicers introduced competition among vendors and also built capacity to accommodate the eventual expiration of CSB as well as the anticipated expansion of the Direct Loan Program.

In September 2009, these servicers began absorbing the large volume of FFEL loans purchased by the Department under the *ECASLA*. By the end of July 2010, all four servicers began servicing new Direct Loans. Overall, the TIVAS were servicing roughly 10.7 million borrower accounts as of the end of FY 2010.

The servicing contracts foster improved performance by requiring vendors to compete for additional loan volume allocations. Each quarter, borrowers, school and Department employees are surveyed to assess customer satisfaction. Each vendor's success in avoiding defaults is also measured on a quarterly basis. The results of these assessments are compiled annually and used to determine the allocation of new borrower accounts for the coming year.

FAFSA Simplification

FSA has made significant improvements to the online application to make it less of a barrier to college access. The upgraded application includes new features, functionality and a level of user interaction not previously available. The General Services

Administration recognized FSA with its 2010 Citizen Services Award for simplifying its website, the online FAFSA and improving how applicants may retrieve income and tax information with the IRS. The new skip-logic functionality maximizes the use of responses to limit further questions. Examples of improvements to the site include:

- **Fewer Questions.** Questions are now asked only of applicants with relevant characteristics. For example, questions regarding the state and date of legal residency are asked only of applicants who have not had the same address for at least 5 years; questions regarding additional financial information and untaxed income are presented in a simplified keyword “check box” format on one page; and only returning students are asked about prior drug convictions because the question does not apply to students who have never before received federal aid.

- **Friendlier Navigation.** The entire online application has been redesigned, making it more user-friendly. Examples include: student and parent sections are clearly identified with side tabs; status indicators guide applicants through web modules, such as demographics, basic eligibility, and dependency status; dynamic question labels; help text; and instructions based on an applicant’s profile, such as marital status, tax filing status, and type of return filed, have been added for increased clarity and direction.

- **IRS Data Share.** Students applying for aid using the 2009–10 application were able to retrieve and import their tax data from the IRS. Over 30 percent of eligible applicants utilized this functionality. Starting in September 2010, students applying for aid for the 2010–11 year are able to retrieve and import their 2009 tax data.

There are several upcoming changes to complete FSA’s overhaul of the application experience. Planned enhancements for the upcoming application cycle will include the following changes:

- A more intuitive Web experience including enhanced technology, redesigned homepage, simplified login, and customized user options;
- Fully integrated application functionality with redesigned corrections module;
- Links to key resources and functionality incorporated throughout the user experience (e.g., Personal Identification Number (PIN) site, College Navigator, college websites);
- Continued access to the IRS Data Retrieval tool; starting January 30, 2011, applicants will have access to their 2010 tax data. The functionality will be bilingual (i.e. English and Spanish) and available in both application entry and correction; and
- Reduced redundancy throughout the aid delivery process. Every state grant agency is offered the opportunity to link their residents to a pre-populated state financial aid application form.

FAFSA Pilot

For low-income youth in particular, the accurate completion and early submission of the FAFSA is essential to entering and completing postsecondary education. The failure to file a FAFSA is a proven barrier to college attendance to such students. In 2007, Chicago Public Schools initiated a pilot program that demonstrated the strong role high schools can play in whether or not a student enrolls in college. Chicago Public Schools tracked FAFSA completion among its seniors, providing resources to ensure students had the support they needed to successfully complete and submit their FAFSAs. During the first two years after this program was implemented, the percentage of students that submitted FAFSAs rose from 65 percent to 81 percent. In addition, college enrollment in Chicago increased by nearly five percentage points during that same time period.

In 2010, FSA launched a pilot project, based on the successful program in Chicago Public Schools, to facilitate local outreach efforts to assist students and families in completing their FAFSAs. The pilot project has included twenty participants and identifies which students either did not submit a FAFSA or submitted a FAFSA but need to make corrections for their application to be complete. High school counselors can focus their efforts to provide the highest benefit to students.

Public Service Announcement (PSA) Campaign

In January 2010, FSA launched its fourth annual public service campaign to help ensure students and families are aware of the over $134 billion available in federal loans, grants, and work-study programs to help pay for college. In the "I'm Going: College.gov" PSAs, 22 high school and college students relate their personal goals and share the message that money is available to help students pay for college. The PSA concept is similar to that of past campaigns, which consistently ranked in the top one percent of all PSA campaigns tracked by Nielson. The new PSAs direct students and families to the College.gov website as the starting point for students and families to get the information they need to plan and pay for college. The PSA was distributed nationwide to television and radio stations. Announcements also appeared in selected cities in malls and on billboards. In FY 2010, the PSAs aired on radio and television resulted in 794 million television and radio audience impressions and approximately $18.5 million in media value.

Training and Outreach

FSA exceeded its training goal for FY 2010, setting records for the number of sessions offered and participants trained. Almost 5,200 participants attended FSA's Annual Fall Conference, which offered one-half of its sessions on Direct Loan training. In spring 2010, 15 Regional Direct Loan Conferences on program systems and processes were held around the nation. In total, these sessions were attended by over 2,500 student aid professionals, while over 26,000 individuals logged on to at least one of the many Webinars offered over the course of the year.

Because foreign schools are participating in the Direct Loan Program for the first time, FSA also developed and presented specialized training for foreign school personnel. Nearly 600 participants attended at least one of nine sessions held in Canada, Europe, Australia, New Zealand, and the Caribbean, while 244 participated in a Webinar on foreign school issues.

Performance Standards and Results

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

Objective 5 Performance Metrics and Results

Metric	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010 (Target*)	FY 2010 (Actual)	Performance
Student aid application	80	80	83	84	84	86	Met
Lender payment processing	71	75	77	74	71	75	Met
Direct Loan borrower servicing	79	80	80	78	PM	76	PM

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

Analysis of Progress: The FY 2010 ACSI ratings for FSA's highest volume products and services – including, FAFSA on the Web (FOTW®), Direct Loan Servicing, and the Lender Reporting System – rate in the "Excellent" or "Good" range in comparison to other entities that appear in the ACSI index. According to Claes Fornell International Group, who partners with National Quality Research Center and the American Society for Quality in conducting the survey, companies with:

- "business to consumer" customers scoring between 60 and 69 are considered "Fair", 70 and 79 are considered "Good", 80 and 89 are considered "Excellent", and 90 and 100 are considered "Hypothetical"; and
- "business to business" customers scoring between 55 and 64 are considered "Fair", 65 and 74 are considered "Good", 75 and 84 are considered "Excellent", and 85 and 100 are considered "Hypothetical".

Under the ASCI index, both the Student aid application and Lender payment processing metrics rated in the "Excellent" range while the and Direct Loan borrower servicing metric rated in the "Good" range.

Target Context: In the FY 2006–2010 Five-Year Plan, FSA established and documented strategic performance standards and targets to measure the organization's success in meeting the stated long-term objectives. Any revisions to the original FY 2010 targets may not have been published, since FSA has not updated this plan.

Changes to Federal Student Aid's Performance Plan over the Year

In recent years, there have been significant changes to the postsecondary education environment and uncertainties regarding FSA's budget that have required a shift in its FY 2010 plans. On March 30, 2010, *SAFRA* was enacted, significantly expanding the Direct Loan Program effective July 1, 2010. Meanwhile, the Federal government is under increased pressure to continue to limit costs. On July 22, 2010, $82 million was rescinded from FSA's budget in order to partially fund the *Unemployment Compensation Extension Act of 2010*. These two events led to significant changes to FSA's plans during this fiscal year.

The section describing Objective 5 of this Annual Program Performance Report details FSA's significant effort and positive outcome of becoming the sole originator of federal student loans. The following table is a summary of the more significant initiatives in FY 2010 that were canceled or delayed as a result of shifting capacity to successfully implement *SAFRA* in a year when budget was rescinded.

FY 2010 Initiatives Canceled or Delayed

Initiative Name	Impact
Person Record Management System (PRMS)	PRMS is a centralized system of record for person data for all FSA Application systems. PRMS eases the reduction in the use of social security numbers. This system will originate and help maintain a new identifier that will replace social security numbers to comply with Congressional mandate. No part of the PRMS development contract was awarded in FY 2010.
Integrated Student View (ISV)	ISV will integrate 17 student Web sites into four websites. No part of the ISV development contract was awarded in FY 2010. The elimination of the ISV budget will impact the online experience for our customers.
PIN Re-engineering	PIN Re-engineering will consolidate the management of all external accounts (approximately 70 million) into a single repository where each citizen receives one and only one account - regardless of whether they are functioning as a partner or aid recipient. The PIN Reengineering contract was not awarded in FY 2010.
IPM	FSA delayed the implementation of phase 1 (enrollment and eligibility phase) until FY 2011 and the development and implementation of phase 2 (oversight) until FY 2012. Phase 3 (participation management) was completely eliminated from the scope of work.
Program Compliance Eligibility & Oversight Standards	Based on re-engineering of oversight business processes (program review, audit, eligibility, financials, and method of payment) through IPM, there is a need to update and document standards to assure consistency of operations across ten regional locations for both domestic and foreign schools and financial partner monitoring. The delay in the implementation of IPM delayed the need to fund this effort.
Trusted Internet Connection	OMB Memorandum 08-05 announced the Trusted Internet Connections initiative which is expected to optimize individual network services into a common solution for the federal government. This common solution facilitates the reduction of external connections, including Internet points of presence, to a target of fifty. This effort remains unfunded, causing FSA to be non-compliant with OMB requirements.

Legislative and Regulatory Recommendations

One of FSA's mission responsibilities is to provide input on legislative proposals (both from the Congress and from the administration) and to the Department's regulatory activity. FSA also may suggest legislative changes for consideration by the Department's senior policy officials. These recommendations customarily center on improving and simplifying the Title IV programs, minimizing administrative costs and improving program integrity. FSA's recommendations inform the Department's policymaking process, including its activities and decisions related to each year's budget process. These activities are usually accomplished by direct contact with colleagues within various offices of the Department, such as the Office of Postsecondary Education and the Office of the Under Secretary, at both the senior policy level and at a staff level. These efforts, while primarily carried out by FSA's Policy Liaison and Implementation Staff, also involve other FSA offices and senior managers. While a portion of this policy advising is accomplished on an ongoing, informal daily basis, FSA staff contributed to policy decision making in a more formalized way related to, among other things, the transition to 100 percent direct lending, the ending of the FFEL Program loan originations, and the Department's Program Integrity Rulemaking process.

Annual Bonus Awards

As of the end of FY 2010, there were 74 Federal Student Aid senior managers. In addition, there were 9 Senior Executive Service staff members. Seven of the 74 senior managers and three of the 9 Senior Executive Service staff served on the Federal Student Aid Operating Committee (known as the Executive Leadership Team before January, 2010), and reported directly to the COO. The remaining 67 senior managers and 6 Senior Executive Service staff served in a variety of senior positions and capacities within Federal Student Aid.

FY 2010 performance ratings and related awards for Federal Student Aid senior managers and Senior Executive Service staff were not finalized at the time this report was prepared.

At the end of FY 2009, there were 49 Federal Student Aid senior managers. There were also 12 Senior Executive Service members. Eight of the 49 senior managers and five of the 12 Senior Executive Service staff served on the Federal Student Aid Executive Leadership Team and reported directly to the Chief Operating Officer. The remaining 41 senior managers and seven Senior Executive Service staff served in a variety of senior positions and capacities within Federal Student Aid.

For FY 2009, the composition of ratings for the 41 senior managers who did not serve on the Executive Leadership Team last year were as follows: 20 achieved a performance rating of Outstanding, 14 achieved a performance rating of Highly Successful and 7 achieved a performance rating of Fully Successful.

Award amounts for those senior managers achieving an Outstanding rating ranged from a low of $6,985 to a high of $18,519 with a median award of $10,000. Award amounts for those achieving a Highly Successful rating ranged from a low of $3,020 to a high of $9,828, with a median award of $6,601.

In FY 2009, the Chief Operating Officer received a performance bonus of $15,000 for his work at Federal Student Aid. There were also FY 2009 ratings and awards for five senior manager members and five Senior Executive Service members of the Executive Leadership Team. Three additional senior managers joined Federal Student Aid too late in the performance cycle to be rated for FY 2009. The composition of those rated includes: four achieved a performance rating of Outstanding, five achieved a performance rating of Highly Successful and one received a performance rating of Fully Successful. Three senior managers who served on the Executive Leadership Team were not eligible for an award because they arrived at FSA at the end of the rating cycle. Of the six remaining Senior Executive Service members who were not on the Executive Leadership Team, one achieved a performance rating of Outstanding, four achieved a performance rating of Highly Successful, and one was not rated.

Award amounts for those Executive Leadership Team members achieving an Outstanding rating ranged from a low of $13,911 to a high of $31,564, with a median award of $25,813. Award amounts for those achieving a Highly Successful rating ranged from a low of $8,255 to a high of $21,105, with a median award of $8,429. Those receiving a rating of Fully Successful were not eligible for a performance-based award. The remaining six Senior Executive Service members' awards ranged from $7,965 to $19,884 with a median of $8,156 for the combined categories of Outstanding and Highly Successful performance ratings.

For additional information, please refer to:
http://www.ed.gov/policy/highered/leg/hea98/sec101D.html.

Report of the Federal Student Aid Ombudsman

The FSA Ombudsman entered its second decade of service to federal student aid recipients in FY 2010. Established by the 1998 amendments to the *HEA,* the Ombudsman began operations on September 30, 1999.

Consistent with its statutory mission, the Ombudsman uses informal dispute resolution processes to address complaints about Title IV financial aid programs. The Ombudsman applies a collaborative approach in working with institutions of higher education, lenders, guaranty agencies, loan servicers, and other participants in the student aid programs. Information about customer inquiries is compiled into the Ombudsman Case Tracking System. The data are analyzed, and the findings are included in internal and external reports for FSA and the industry in general, to identify systemic issues affecting Title IV programs. Implementation of systemic solutions can at times prevent problems, an approach preferable to resolving individual complaints as received.

Since 1999, the Ombudsman has received more than 192,554 assistance requests from customers, including 30,346 in FY 2010. The Ombudsman has generally received more customer contacts in each new year of operation. The annual increase is attributed to growing awareness of the Ombudsman and the increase in individuals receiving federal student aid. In the last two fiscal years, however, customer contacts have increased at a higher rate. Cases opened in FY 2008 were 9 percent greater than the previous year; FY 2009 was 25 percent greater than FY 2008; and FY 2010 increased by approximately 28 percent over the FY 2009 total.

Ombudsman data support the intuitive explanation that the current economic downturn is a factor in the increase of contacts. Customer inquiries in issue categories relating to economic hardship (e.g. repayment plans/amounts) have increased at a rate higher than overall case growth. A review of a sample of cases in the issue categories indicative of financial difficulties showed that almost half of the borrowers reported having at least one factor commonly linked to economic hardship, such as loss of job or reduced earnings, recent medical expenses, or a high level of federal student loan debt.

Borrowers expressing difficulty in repaying their student loans occasionally offer suggestions for changes in policy and practice that, they believe, would better enable them to repay the debt. One suggestion is to allow borrowers with high interest loans to refinance at a lower interest rate or otherwise restructure the debt. Others who have been unable to make scheduled payments point out that increasing the size of their debt through capitalized interest, fees and collection costs makes it less likely they will ever be able to repay.

Three related issues were responsible for some of the increase in Ombudsman cases – consolidation, income based repayment, and public service loan forgiveness (PSLF). Through FY 2007, consolidation was one of the leading issues for Ombudsman cases, driven in part by questionable marketing practices and interest rate fluctuations. After new federal legislation changed the rules for consolidation loans, borrower complaints to the Ombudsman about this issue declined precipitously. Consolidation re-emerged as an issue in FY 2010. This time, however, it appears that an increase in borrowers' wanting loan consolidation as a debt management tool, rather than marketing issues or other problems, is contributing to the growth in contacts to the Ombudsman.

Interest in PSLF is one reason for additional loan consolidation inquiries. PSLF allows for cancellation of any balance remaining after a borrower makes 120 qualifying payments while working full-time in eligible public service. PSLF is available only to holders of Direct Loans, and the authorizing legislation permitted most borrowers with existing FFEL consolidation loans to consolidate into the Direct Loan Program to establish eligibility for PSLF.

Effective July 1, 2009, the Income Based Repayment Plan enabled borrowers to establish monthly payments based on adjusted gross income, family size, and debt amount. Individuals unable to repay the full balance of their debt within 25 years on the Income Based Repayment Plan will not be required to pay further on the debt. The new option is important to borrowers with repayment challenges and has also been linked to PSLF.

The numbers of inquiries to the Ombudsman declined in FY 2010 in some issue areas. Despite the challenging economic climate, when compared to FY 2009, complaints about collection practices declined 16 percent in FY 2010, indicating strengthened PCA practices. Nonetheless, PCAs do not always work transparently with borrowers experiencing financial difficulty. One issue raised by borrowers contacting the Ombudsman concerns PCAs demanding a “down payment” or lump sum payment as a condition for rehabilitating a defaulted loan. The demand for a down payment or lump sum is a generally used collection tactic, but failure to agree to the lump sum payment may not be used to deny the defaulted borrower access to a rehabilitation agreement.

For a number of years, Total and Permanent Disability (TPD) discharge has been the leading single issue for Ombudsman cases. It is, therefore, noteworthy that Ombudsman TPD cases declined 14 percent in FY 2010. A number of operational changes that enhanced TPD processing were implemented in 2009. Revisions to the medical review protocol became effective; a new TPD application form was made available; and a new website with information for borrowers, doctors, and loan holders became operational. These changes, all of which provide the TPD applicant with more detailed information about the discharge process and documentation requirements, contributed to the decline in Ombudsman TPD cases. FSA’s Atlanta office, operationally responsible for new statutory discharge provisions for veterans, has been particularly responsive in assisting disabled veterans. Their efforts were critically important in implementing the new legislative provisions in a timely manner and in fulfilling Congress’ intent to create an expedited discharge process for veterans unable to work due to service connected disabilities.

Even with these improvements, the Ombudsman still works with many disabled borrowers whose TPD applications are rejected, often multiple times, for procedural deficiencies rather than for substantive medical reasons. The Ombudsman encourages continuance of initiatives to improve correspondence to TPD applicants in the belief this continuance will reduce rejections for procedural reasons. The Ombudsman also welcomes the exploration of accepting disability determinations made by other federal agencies to satisfy TPD discharge requirements. The most recent reauthorization of the *HEA* included a provision for the streamlined discharge of student loans for disabled veterans.

Borrowers with private education loans also contact the Ombudsman, although the Ombudsman has no direct jurisdiction over these loans. Assistance requests from borrowers with private loans increased slightly as a percentage of total cases in recent years. Private loan borrowers were 1.7 percent of total cases in FY 2006, 3.5 percent in FY 2008, and 3.9 percent in FY 2010. Those borrowers' concerns appear to parallel those raised by borrowers of federal loans.

Some borrowers carry a combination of federal and private loans and may contact the Ombudsman because they do not understand the differences in repayment terms or borrower protections between federal and private student loans. Many private education loans, for example, require a co-signer; some charge the borrower for each application for deferment or forbearance; and private education loans are not discharged if the student becomes disabled. The private student loan ombudsman function within the Consumer Financial Protection Bureau established through the recently-enacted *Wall Street Reform and Consumer Protection Act* (Pub. L. No. 111-203) creates an opportunity to address some of those concerns.

Customer satisfaction with the Ombudsman is measured, in part, through independently conducted telephone surveys. Closed cases are chosen at random and customers are asked to rate service accessibility, Ombudsman representatives' knowledge, timeliness of case resolution, level of satisfaction with the resolution, and overall service. On a scale of 1 – 5, with 5 the highest rating, survey results are calculated weekly and cumulatively for the fiscal year. Only ratings of 4.0 or higher meet the Ombudsman customer satisfaction performance goal. The average FY 2010 customer satisfaction rating was 4.56. Customers also write or call independently to express appreciation for assistance from the Ombudsman.

As the Ombudsman continues in its second decade, a key emphasis will be on enhancing data collection and analysis with the goal of improving root cause analysis, systemic issue identification, and preventive outreach.

Financial Section

Message from the Chief Financial Officer

In FY 2010, Federal Student Aid completed a challenging, but successful year. Thanks to the diligence of the talented staff at Federal Student Aid, we met these unprecedented challenges and continued to maintain our high standards of financial management and fiscal reporting. Below are the challenges Federal Student Aid successfully addressed during FY 2010:

John W. Hurt, III
Chief Financial Officer

- Implemented the *Student Aid and Fiscal Responsibility Act (SAFRA)* enacted by Congress in March 2010. *SAFRA* ended all federal support for student loans under the Federal Family Education Loan (FFEL) Program effective July 1, 2010 making the Direct Loan Program the primary source for loans for students and parents. Despite an extremely short timeframe, Federal Student Aid successfully implemented the requirements on time by modifying its loan origination processes and systems, transitioning schools that participated in the FFEL Program to the Direct Loan Program, increasing loan servicing capacity, and expanding its workforce. To accomplish this implementation, Federal Student Aid leveraged the foundation it established during FY 2009 in anticipation of the shift to 100 percent Direct Loans. This legislation is expected to save taxpayers over $68 billion in mandatory costs over the next 11 years (2010 through 2020).

- Continued execution of the *Ensuring Continued Access to Student Loans Act of 2008 (ECASLA)*, ensuring adequate capital was available to fund FFEL loans for the 2008–09 and 2009–10 academic years. Specifically, Federal Student Aid oversaw the successful closeout of the 2008–09 award year Loan Participation Purchase and Loan Purchase Commitment Programs by October 15, 2009. During the life of the 2008–09 programs, Federal Student Aid purchased over $48 billion of FFEL loans. For the Loan Participation Purchase and Loan Purchase Commitment 2009–10 academic year Programs, Federal Student Aid purchased a total of approximately $60 billion of FFEL loans by the program closeout date of October 15, 2010. In addition, Federal Student Aid successfully implemented the Asset Backed Commercial Paper Conduit Program during FY 2010. This program injected a total of $41 billion of capital into the financial system.

- Continued to address Federal Student Aid's administrative budget limitations by identifying cost savings, prioritizing internal projects, and identifying alternative sources of funding. These efforts enabled Federal Student Aid to resolve a significant budget shortfall and to offset the cost of transitioning to 100 percent originations through the Direct Loan Program, as required by *SAFRA*.

While successfully overcoming the above challenges, we continued to maintain operations to deliver Title IV aid. For FY 2010, Federal Student Aid delivered $134 billion of federal aid to14 million postsecondary students and their families. The 14 million students that received aid represent approximately 47 percent of all college students.

Federal Student Aid's new initiatives (i.e., implementation of *SAFRA* and *ECASLA*) significantly impacted not only policy decisions, program systems and performance reporting, but also financial management and internal control. In the context of our internal control framework, new processes and controls were documented and assessed for each of these new initiatives. In addition, Federal Student Aid continued to address previously reported problems. As a result of this focus on internal control, Federal Student Aid was able to achieve the following:

- An unqualified opinion was received on the principal financial statements for the ninth consecutive year, demonstrating a clear pattern of financial accountability.
- No material weaknesses were identified as part of our Report on Internal Control for the eighth consecutive year.
- Reasonable assurance was provided of our internal control over financial reporting. The successful results of this assessment effort are described further in the "Analysis of Federal Student Aid's Systems, Controls and Legal Compliance" section.
- Continuous successful implementation of the *ECASLA* initiatives, with no significant problems.
- Continued successful implementation of Title IV Additional Servicers to handle the significant increase in loan servicing volume as a result of FFEL loans purchased through *ECASLA* and the transition to 100 percent Direct Loan originations mandated by *SAFRA*.

Also, through cooperative efforts between Federal Student Aid and the Department's Office of the Chief Financial Officer, Office of Chief Information Officer, and Budget Service, the Department continued to correct two significant deficiencies in credit reform estimation and information systems controls that were identified in the FY 2009 Internal Control Report. The complexity of these two issues has required an ongoing multi-year effort. As a result of these concerted efforts, in the FY 2010 Report on Internal Control, the auditors recognized improvements in both areas.

FY 2010 has brought many financial management and internal control challenges. I am proud to be working with a group of professionals throughout the Department who enthusiastically accepted these challenges and worked in concert to ensure the Department's success.

Sincerely,

John W. Hurt, III
Chief Financial Officer
November 15, 2010

Principal Financial Statements and Notes to Principal Financial Statements

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

		FY 2010		FY 2009
Assets:				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$	53,465	$	66,807
Accounts Receivable (Note 4)				(3)
Total Intragovernmental		53,465		66,804
Cash and Other Monetary Assets (Note 5)		2,965		2,414
Accounts Receivable, Net (Note 4)		221		504
Credit Program Receivables, Net (Note 6)		367,410		233,959
General Property, Plant and Equipment, Net (Note 7)		25		34
Other Assets (Note 8)		83		272
Total Assets (Note 2)	**$**	**424,169**	**$**	**303,987**
Liabilities:				
Intragovernmental:				
Accounts Payable	$	1	$	
Debt (Note 9)		373,656		234,858
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5)		2,965		2,414
Payable to Treasury (Note 6)		2,424		3,569
Other Intragovernmental Liabilities (Note 10)		12,832		11,395
Total Intragovernmental		391,878		252,236
Accounts Payable		4,544		1,734
Accrued Grant Liability (Note 11)		2,619		1,929
Liabilities for Loan Guarantees (Note 6)		14,479		20,543
Other Liabilities (Note 10)		202		494
Total Liabilities	**$**	**413,722**	**$**	**276,936**
Commitments and Contingencies (Note 18)				
Net Position:				
Unexpended Appropriations	$	17,259	$	27,328
Cumulative Results of Operations		(6,812)		(277)
Total Net Position (Note 12)	**$**	**10,447**	**$**	**27,051**
Total Liabilities and Net Position	**$**	**424,169**	**$**	**303,987**

The accompanying notes are an integral part of these statements.

United States Department of Education
Federal Student Aid
Consolidated Statement of Net Cost
For the Years Ended September 30, 2010 and 2009
(Dollars in Millions)

	FY 2010	FY 2009
Program Costs		
Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement		
Gross Costs	$ 27,828	$ (11,062)
Less: Earned Revenue	17,071	11,079
Net Program Costs	10,757	(22,141)
Total Program Costs	**$ 10,757**	**$ (22,141)**
American Recovery and Reinvestment Act		
Gross Costs	$ 8,920	$ 7,572
Less: Earned Revenue		
Net Program Costs	**8,920**	**7,572**
Total Program Costs	**$ 8,920**	**$ 7,572**
Net Cost of Operations (Notes 13 &16)	**$ 19,677**	**$ (14,569)**

The accompanying notes are an integral part of these statements.

United States Department of Education
Federal Student Aid
Consolidated Statement of Changes in Net Position
For the Years Ended September 30, 2010 and 2009
(Dollars in Millions)

	FY 2010		FY 2009	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balance	$ (277)	$ 27,328	$ (6,273)	$ 13,472
Budgetary Financing Sources:				
Appropriations Received	$	$ 35,215	$	$ 41,951
Other Adjustments (rescissions, etc)		(941)	1	(26)
Appropriations Used	44,343	(44,343)	28,069	(28,069)
Nonexchange Revenue	12			
Other Financing Sources:				
Imputed Financing from Costs Absorbed by Others	10		9	
Others	(31,223)		(36,652)	
Total Financing Source	**$ 13,142**	**$ (10,069)**	**$ (8,573)**	**$ 13,856**
Net Cost of Operations	**$ (19,677)**	**$**	**$ 14,569**	**$**
Net Change	**$ (6,535)**	**$ (10,069)**	**$ 5,996**	**$ 13,856**
Ending Balances (Note 12)	**$ (6,812)**	**$ 17,259**	**$ (277)**	**$ 27,328**

The accompanying notes are an integral part of these statements.

United States Department of Education
Federal Student Aid
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2010 and 2009

(Dollars in Millions)

	FY 2010 Budgetary	FY 2010 Non-Budgetary Credit Reform Financing Accounts	FY 2009 Budgetary	FY 2009 Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:				
Unobligated balance, brought forward, October 1	$ 13,476	$ 9,690	$ 3,620	$ 26,517
Recoveries of prior year Unpaid Obligations	410	4,434	398	8,035
Budgetary Authority:				
Appropriations	39,140		41,960	130
Borrowing Authority (Note 15)		182,901		200,214
Spending authority from offsetting collections (gross):				
Earned				
Collected	1,499	51,912	1,569	45,512
Change in Receivables from Federal Sources		3		(3)
Change in unfilled customer orders Without advance from Federal Sources		4		
Subtotal	$ 40,639	$ 234,820	$ 43,529	$ 245,853
Temporarily not available pursuant to Public Law	(561)		(887)	
Permanently not available	(4,833)	(17,333)	(688)	(13,130)
Total Budgetary Resources (Note 15)	**$ 49,131**	**$ 231,611**	**$ 45,972**	**$ 267,275**
Status of Budgetary Resources:				
Obligations incurred: Direct (Note 15)	$ 44,957	$ 216,202	$ 32,496	$ 257,585
Unobligated Balances: Apportioned	192	1,433	10,376	474
Unobligated Balance not available	3,982	13,976	3,100	9,216
Total Status of Budgetary Resources	**$ 49,131**	**$ 231,611**	**$ 45,972**	**$ 267,275**
Change in Obligated Balance:				
Obligated balance, net: Unpaid obligations, brought forward, October 1	$ 17,730	$ 133,575	$ 12,927	$ 41,157
Uncollected customer payments from Federal Sources, brought forward, October 1		3		
Total, unpaid obligated balance, brought forward, net	$ 17,730	$ 133,578	$ 12,927	$ 41,157
Obligation Incurred, net (+/-)	44,957	216,202	32,496	257,585
Gross Outlays	(43,685)	(194,738)	(27,295)	(157,132)
Recoveries of prior year unpaid obligations, actual	(410)	(4,434)	(398)	(8,035)
Change in uncollected customer payments from Federal Sources (+/-)		(7)		3
Obligated Balance, net, end of period:				
Unpaid Obligations	$ 18,592	$ 150,605	$ 17,730	$ 133,575
Uncollected customer payments from Federal Sources		(4)		3
Total, unpaid obligated balance, net, end of period	**$ 18,592**	**$ 150,601**	**$ 17,730**	**$ 133,578**
Net Outlays:				
Gross Outlays	$ 43,685	$ 194,738	$ 27,295	$ 157,132
Offsetting collections	(1,499)	(51,912)	(1,569)	(45,512)
Distributed Offsetting receipts	(28,787)		(31,646)	
Net Outlays (Note 15)	**$ 13,399**	**$ 142,826**	**$ (5,920)**	**$ 111,620**

The accompanying notes are an integral part of these statements.

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

Note 1. Summary of Significant Accounting Policies

Reporting Entity

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

The Direct Loan Program, added to the *HEA* by the *Student Loan Reform Act of 1993*, authorizes FSA to make loans directly to eligible undergraduate and graduate students and their parents through participating schools. FSA borrows money from the Treasury to fund the loans. The program does not charge interest to eligible borrowers while they are in school or in qualified deferment periods.

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

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

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, P.L. 110-350 extended the authority through September 30, 2010. The Department implemented three activities under this temporary loan purchase authority. These activities are: (1) loan purchase commitments under which the Department purchases loans directly from FFEL lenders; (2) loan participation purchases in which the Department purchases participation interests in FFEL loans; and (3) an ABCP Conduit in which the Department enters into a forward commitment to purchase FFEL loans from a conduit, as needed, to allow the conduit to repay short-term liquidity loans used to re-finance maturing commercial paper.

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

The TEACH Program was implemented beginning July 1, 2008. This program, added to the *HEA* by the *CCRAA*, awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students.

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

The *Recovery Act*, enacted on February 17, 2009 as P.L. 111-5, provided funding 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. The *Recovery Act* funds provided to the Department include additional funding for student aid administration and student financial assistance grant programs managed and administered by FSA. These activities are accounted for separately from non-*Recovery Act* funds. (See Note 17)

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 FSA reporting group, as required by the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994*. The financial statements were prepared from the books and records of FSA, in accordance with accounting principles generally accepted in the United States of America for federal entities, issued by the Federal Accounting Standards Advisory Board, and OMB Circular No. A-136 *Financial Reporting Requirements*, as revised September 2010. These financial statements are different from the financial reports prepared by the Department pursuant to OMB directives that are used to monitor and control FSA's use of budgetary resources.

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

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

Transactions and balances among FSA funds have been eliminated from the consolidated financial statements.

Use of Estimates

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

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

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

FSA and the Department estimate 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).

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

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

Estimates reflected in these financial statements were prepared using assumptions developed for the FY 2011 Mid-Session Review, a government-wide exercise required annually by OMB. These estimates are based on the most current information available to FSA and the Department at the time the financial statements were prepared. Assumptions and their impact are updated after the Mid-Session Review to account for significant subsequent changes in activity. 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.

FSA and the Department recognize that cash flow projections and the sensitivity of changes in assumptions can have a significant impact on estimates. Management has attempted to mitigate fluctuations in the estimates by using trend analysis to project future cash flows. Changes in assumptions could significantly affect the amounts reflected in these 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 and FSA to incur financial obligations that will result in outlays. FSA's budgetary resources include (1) unobligated balances of resources from prior years, (2) recoveries of prior-year obligations, and (3) new resources, which include appropriations, authority to borrow from Treasury, and spending authority from collections.

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

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

Borrowing authority is an indefinite budgetary resource authorized under the *Credit Reform Act*. This resource, when realized, finances the unsubsidized portion of the Direct Loan Program, the TEACH Program, and activities under the temporary loan purchase authority. In addition, borrowing authority is requested in advance of expected collections to cover negative subsidy. Treasury prescribes the terms and conditions of borrowing authority and lends to the financing account amounts as appropriate. Amounts borrowed, but not yet disbursed, are included in uninvested funds and earn interest. Treasury uses the same weighted average interest rates for both the interest charged on borrowed funds and the interest earned on uninvested funds. The Department may carry forward borrowing authority to future fiscal years provided that cohorts are disbursing loans. All borrowings from Treasury are effective on October 1 of the current fiscal year, regardless of when the Department borrowed the funds, except for amounts borrowed to make annual interest payments.

Assets

Assets are classified as either entity or non-entity assets. Entity assets are those that the Department has authority to use for its operations. Non-entity assets are those held by the Department but not available for use in its operations. The Department combines its entity and non-entity assets on the 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, 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 FSA. FSA's records are reconciled with those of Treasury.

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

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

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

Accounts Receivable

Accounts Receivable are amounts due to FSA from the public and other federal agencies. Receivables from the public result from overpayments to recipients of grants and other financial assistance programs, and disputed costs resulting from audits of educational assistance programs. Amounts due from other federal agencies result from reimbursable agreements entered into by FSA with these agencies to provide various goods and services. Accounts receivable are reduced to net realizable value by an allowance for uncollectible amounts.

Estimates for the allowance for loss on uncollectible accounts are based on historical data. (See Note 4)

Cash and Other Monetary Assets

Cash and Other Monetary Assets consist of guaranty agency reserves that represent the federal government's interest in the net 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.

FSA and the Department disburse funds to a guaranty agency. A guaranty agency, through its Federal Fund, pays lender claims and default aversion fees. The Operating Fund is the property of the guaranty agency 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 FSA 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 FSA less the present value of related inflows. The estimated present value of net long-term cash outflows of FSA for subsidized costs is net of recoveries, interest supplements, and offsetting fees. FSA 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 and FSA 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

In accordance with the Department's policy, FSA 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, FSA capitalizes bulk purchases of property and equipment with an aggregate cost of $500,000 or more. A bulk purchase is defined as the purchase of like items related to a specific project or the purchase of like items occurring within the same fiscal year that have an estimated useful life greater than two years. Property and equipment are depreciated over their estimated useful lives using the straight-line method of depreciation. Internal Use Software meeting the above cost and useful life criteria is also capitalized. Internal Use Software is either purchased off the shelf, internally developed, or contractor developed solely to meet the agency's needs. (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. FSA'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 FSA or the Department without budget authority. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources, and there is no certainty that an appropriation will be enacted. The government, acting in its sovereign capacity, can abrogate liabilities that arise from activities other than contracts. FFEL Program and Direct Loan Program liabilities are entitlements covered by permanent indefinite budget authority. (See Note 10)

Debt

The Department borrows to provide funding for the Direct Loan, FFEL, and TEACH Programs. The liability to Treasury from borrowings represents unpaid principal at year-end. FSA repays the principal based on available fund balances. Interest on the debt is calculated at fiscal year-end using rates set by Treasury, with such rates generally fixed based on the rate for 10-year Treasury securities. As discussed in Note 6, the interest received by FSA from borrowers will vary from the rate paid to Treasury. Principal and interest payments to Treasury are made annually. (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 FSA 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. Cumulative results of operations represent the net difference since inception between (1) expenses and (2) revenues and financing sources. (See Note 12)

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

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

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

Federal Employees' Compensation Act. The *Federal Employees' Compensation Act* (*FECA*) provides income and medical cost protection to covered federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The *FECA* Program is administered by the 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

FSA'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 FSA were a separate, unrelated entity.

Additional Comparative Information

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

Note 2. Non-Entity Assets

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

Non-Entity Assets

(Dollars in Millions)

	2010	2009
Non-Entity Assets		
Intragovernmental		
Fund Balance with Treasury	$ -	$ 7
Total Intragovernmental	-	7
With the Public		
Cash and Other Monetary Assets	2,965	2,414
Accounts Receivable, Net	3	-
Credit Program Receivables, Net	183	184
Total With the Public	3,151	2,598
Total Non-Entity Assets	**3,151**	**2,605**
Entity Assets	421,018	301,382
Total Assets	$ 424,169	$ 303,987

Non-entity assets with the public primarily consist of guaranty agency reserves and Federal Perkins Program loan receivables. (See Notes 5 and 6)

Note 3. Fund Balance with Treasury

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

Fund Balances

(Dollars in Millions)

	2010	2009
General Funds	$ 20,341	$ 29,662
Revolving Funds	33,106	37,124
Special Funds	18	14
Other Funds	-	7
Fund Balance with Treasury	**$ 53,465**	**$ 66,807**

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

Status of Fund Balance with Treasury

(Dollars in Millions)

	2010	2009
Unobligated Balance		
Available	$ 1,625	$ 10,850
Unavailable	14,993	9,902
Obligated Balance, Not Yet Disbursed	36,286	45,161
Authority Temporarily Precluded from Obligation	561	887
Non-Budgetary Fund Balance with Treasury	-	7
Fund Balance with Treasury	**$ 53,465**	**$ 66,807**

Note 4. Accounts Receivable

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

Accounts Receivable

(Dollars in Millions)

	2010		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ -	$ -	$ -
With the Public	261	(40)	221
Accounts Receivable	**$ 261**	**$ (40)**	**$ 221**

	2009		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ (3)	$ -	$ (3)
With the Public	536	(32)	504
Accounts Receivable	**$ 533**	**$ (32)**	**$ 501**

Note 5. Cash and Other Monetary Assets

Cash and Other Monetary Assets consist of reserves held in the FFEL Guaranty Agency Federal Funds. Changes in the valuation of the Federal Fund increase or decrease the Department's Cash and Other Monetary Assets with a corresponding change in Payable to Treasury. The table below presents Cash and Other Monetary Assets for the periods ended September 30, 2010 and 2009.

Cash and Other Monetary Assets
(Dollars in Millions)

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

The $551 million net increase in the Federal Fund in FY 2010 reflects the impact of guaranty agencies' operations. During FY 2010, $438 million was remitted to the Department by a guaranty agency whose agreement with the Department requires the agency to remit funds in excess of agreed-upon working capital levels. Those remitted funds were returned to Treasury.

Note 6. Credit Programs for Higher Education

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

The Department disbursed approximately $75 billion in Direct Loans to eligible borrowers in FY 2010 and approximately $38 billion in FY 2009. Loans typically are disbursed in multiple installments over an academic period; as a result, loan disbursements for an origination cohort year often cross fiscal years. Half of all loan volume is obligated in the fourth quarter of a fiscal year. Regardless of the fiscal year in which they occur, disbursements are tracked by cohort as determined by the date of obligation rather than disbursement. The substantial increase in Direct Loan Program disbursements during FY 2010 resulted from the increased use of the Direct Loan Program in accordance with the changes made by *SAFRA*.

Approximately 11 percent of Direct Loan obligations made in an individual fiscal year are never disbursed. Loan obligations are established at a summary level based on estimates of schools' receipt of aid applications. The loan obligation may occur before a student has been accepted by a school or begins classes. For Direct Loans obligated in the 2010 cohort, an estimated $11.7 billion will never be disbursed. Eligible schools may originate direct loans through a cash advance from the Department or by advancing their own funds in anticipation of reimbursement from the Department.

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

Federal Family Education Loan Program. Prior to FY 2008, the FFEL Program included only private lender loans to students and parents insured against default by the federal government.

In FY 2008, the Department began administering activities under the temporary loan purchase authority by purchasing FFEL loans and participation interests in those loans directly from lenders. As a result, the FFEL Program includes approximately $103 billion and $52 billion in direct federal assets as of September 30, 2010 and 2009, respectively.

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

Under the loan purchase activity, lenders have the option to sell directly to the Department fully disbursed loans originated for academic years 2007-08, 2008-09 or 2009-10. As of September 30, 2010 only loans originated for the 2009-10 academic year remain eligible for future purchase.

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

The terms of these two purchase activities permit lenders to sell loans and participation interests in loans to the Department and require them to redeem the participated loans. Lenders must commit to redeem the certificates and sell loans by September 30; the Department must finalize all related transactions by October 15. As of September 30, 2010, the Department had $27 billion in notices of intent to sell from lenders in the purchase commitment and loan participation purchase activities.

During FY 2009, the Department, Treasury, and OMB established the terms on which the Department would support an ABCP Conduit to provide liquidity to the student loan market. An ABCP Conduit issues short-term commercial paper to investors; this paper is backed by student loans pledged to the conduit. The conduit used the proceeds of sales of its commercial paper to acquire from lenders interests in student loans. Lenders must have used a portion of conduit payments to make new loans. Though the intent is for the conduit to meet demands on maturing paper by reissuing commercial paper, the Department, using its *ECASLA* authority, will purchase loans from the conduit as needed to ensure the conduit will be able to meet the demands on its paper if it is unable to refinance maturing commercial paper. The Department purchases those pledged loans that become more than 210 days delinquent. The conduit has sold to the Department approximately $544 million of these delinquent loans as of September 30, 2010. Under the terms of the Put Agreement with the conduit, the Department may purchase pledged loans 45 days prior to the Put Agreement expiration on January 19, 2014. As required by the *Credit Reform Act*, all cash flows to and from the Government resulting from its transactions with the ABCP Conduit are recorded in a non-budgetary credit financing account. Amounts in this account are a means of financing and are not included in budget totals. Loans originated in academic years 2004-05 through 2007-08 are eligible to be purchased through the ABCP Conduit.

As of September 30, 2010, the Department has $70 billion in obligations to cover any buyer-of-last-resort activities and potential purchases of underlying student loans under the ABCP Conduit. These obligations are supported by available borrowing authority. In FY 2009, the Department estimated approximately $4 billion in negative subsidy. The conduit, a separate legal entity, has approximately $39 billion in commercial paper outstanding.

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

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

The Department guaranteed $24 billion and $80 billion in gross non-consolidation loans to FFEL recipients during FY 2010 and FY 2009, respectively. In 2010, lenders disbursed $20 billion in FFEL loans from the 2009 and 2010 cohorts; in 2009, $63 billion were disbursed from the 2008 and 2009 cohorts. As of September 30, 2010 and 2009, total principal balances outstanding of guaranteed loans held by lenders were approximately $390 billion and $457 billion, respectively. As of September 30, 2010 and 2009, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately $382 billion and $445 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the guaranty agencies, based on the appropriate reinsurance rates, which range from 100 to 95 percent. Any remaining insurance not paid as reinsurance would be paid to lenders by the guaranty agencies from their Federal Fund. Payments by guaranty agencies do not reduce government exposure because they are made from the Federal Fund administered by the agencies but owned by the federal government.

Approximately 17 percent of guaranteed loan commitments made in an individual fiscal year are never disbursed due to the nature of the loan commitment process. For guaranteed loans committed in the 2010 cohort, an estimated $4.0 billion will never be disbursed.

Guaranteed loans that default are initially turned over to guaranty agencies for collection, and interest receivable is accrued and recorded on the loans as the collection rate is substantial. After approximately four years, defaulted guaranteed loans not in repayment are assigned to the Department, which then collects them directly. Interest continues to accrue on assigned loans, but is only realized upon collection.

Under provisions of *SAFRA*, new loans under the FFEL Program were virtually ended as of July 1, 2010, giving the Department full responsibility for originating all federal student loans as of

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

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

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

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

Loan Consolidations

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

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

Modification of Subsidy Cost

The recorded subsidy cost of a loan is based on a set of assumed future cash flows. Government actions that change these assumed future cash flows change subsidy cost and are recorded as loan modifications. Loan modifications are recognized under the same accounting principle as subsidy re-estimates. Modification adjustment transfers are required to adjust for the difference between current discount rates used to calculate modification costs and the discount rates used to calculate cohort interest expense and revenue. Separate amounts are calculated for modification costs and modification adjustment transfers. The Department modified loans in FY 2009, but not during FY 2010.

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

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

Credit Program Receivables

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

Credit Program Receivables, Net
(Dollars in Millions)

	2010	2009
Direct Loan Program Loan Receivables, Net	$ 228,208	$ 152,771
FFEL Program		
Guaranteed Loan Program, Net (Pre-1992)	2,419	3,480
FFEL Program (Post-1991):		
FFEL Guaranteed Loan Program, Net	24,030	20,399
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	42,279	17,032
Loan Participation Purchase, Net	69,686	39,996
ABCP Conduit, Net	468	47
Federal Perkins Program Loan Receivables, Net	183	184
TEACH Program Receivables, Net	137	50
Credit Program Receivables, Net	**$ 367,410**	**$ 233,959**

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)

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

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

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

FFEL Program Receivables, Net

(Dollars in Millions)

	2010	2009
FFEL Guaranteed Loan Program (Pre-1992)		
Principal Receivable	$ 6,681	$ 7,100
Interest Receivable	223	223
Receivables	6,904	7,323
Less: Allowance for Subsidy	4,485	3,843
FFEL Guaranteed Loan Program, Net (Pre-1992)	**2,419**	**3,480**
FFEL Program (Post-1991)		
FFEL Guaranteed Loan Program:		
Principal Receivable	26,358	22,403
Interest Receivable	2,436	2,305
Receivables	28,794	24,708
Less: Allowance for Subsidy	4,764	4,309
FFEL Guaranteed Loan Program, Net	**24,030**	**20,399**
Temporary Loan Purchase Authority:		
Loan Purchase Commitment:		
Principal Receivable	36,623	14,293
Interest Receivable	1,400	379
Receivables	38,023	14,672
Less: Allowance for Subsidy	(4,256)	(2,360)
Loan Purchase Commitment, Net	**42,279**	**17,032**
Loan Participation Purchase:		
Principal Receivable	62,931	37,020
Interest Receivable	1,665	259
Receivables	64,596	37,279
Less: Allowance for Subsidy	(5,090)	(2,717)
Loan Participation Purchase, Net	**69,686**	**39,996**
ABCP Conduit:		
Principal Receivable	544	50
Interest Receivable	26	2
Receivables	570	52
Less: Allowance for Subsidy	102	5
ABCP Conduit, Net	**468**	**47**
FFEL Program Receivables, Net	**$ 138,882**	**$ 80,954**

All loans and participation interests in loans purchased by the Department under the temporary loan purchase authority are federal assets; the loan receivable represents all outstanding loans and participation interests. Approximately $36 billion and $9 billion in participation interests were redeemed by selling the underlying loans to the Department during FY 2010 and FY 2009, respectively.

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

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

Reconciliation of Allowance for Subsidy and Liability for Loan Guarantees

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

Direct Loan Program Reconciliation of Allowance for Subsidy

(Dollars in Millions)

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

[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)

	2010	2009
Beginning Balance, FFEL Financing Account Liability for Loan Guarantees	**$ 20,448**	**$ 43,185**
Components of Subsidy Transfers		
Interest Supplement Costs	(733)	(632)
Defaults, Net of Recoveries	212	494
Fees	(960)	(3,495)
Other[1]	878	2,108
Current Year Subsidy Transfers	**(603)**	**(1,525)**
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	59	(147)
Technical and Default Re-estimates	(12,727)	(21,542)
Subsidy Re-estimates	**(12,668)**	**(21,689)**
Components of Loan Modifications		
Loan Modification Costs	-	(2,641)
Modification Adjustment Transfers	-	130
Loan Modifications	**-**	**(2,511)**
Activity		
Interest Supplement Payments	(3,881)	(5,389)
Claim Payments	(8,987)	(8,634)
Fee Collections	3,736	4,115
Interest on Liability Balance	(152)	337
Other[2]	16,514	12,559
Total Activity	**7,230**	**2,988**
Ending Balance, FFEL Financing Account Liability for Loan Guarantees	**14,407**	**20,448**
FFEL Liquidating Account Liability for Loan Guarantees	72	95
Liabilities for Loan Guarantees	**$ 14,479**	**$ 20,543**

[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)

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

Loan Participation Purchase Reconciliation of Allowance for Subsidy

(Dollars in Millions)

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

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

Financing Account Interest Expense and Interest Revenue

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

Subsidy amortization is calculated, in accordance with Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees*, as the difference between interest revenue and interest expense. For direct loans, the allowance for subsidy is adjusted with the offset to interest revenue. For guaranteed loans, the liability for loan guarantees is adjusted with the offset to interest expense.

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

Direct Loan Program

(Dollars in Millions)

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

Payable to Treasury

Payable to Treasury for the Years Ended September 30, 2010 and 2009 consisted of the following:

Payable to Treasury

(Dollars in Millions)

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

Subsidy Expense

William D. Ford Federal Direct Loan Program

Direct Loan Program Subsidy Expense
(Dollars in Millions)

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

William D. Ford Direct Loan re-estimated subsidy cost increased $4.7 billion in FY 2010. The majority of this increase was related to discount rate changes increasing costs $2.2 billion. Changes in assumptions for income-based repayments and public service loan forgiveness increased subsidy cost $611 million. Rising default rates increased subsidy cost $226 million. Changes in other interest components, probabilistic methodology for estimating, and an uptick in consolidated weighted rates increased costs $887 million. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan subsidy cost $662 million. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994-2009.

For 2009 re-estimated subsidy cost, Direct Loan subsidy cost was decreased $5.2 billion. Changes in the assumption for income-based repayments decreased subsidy cost $3.7 billion. Rising default rates increased subsidy cost by $374 million, interest rate changes increased costs $350 million, and changes in deferments and forbearance rates increased costs $313 million. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan subsidy cost $455 million. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994-2008.

Federal Family Education Loan Program

FFEL Program Subsidy Expense

(Dollars in Millions)

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

FFEL Guaranteed re-estimated subsidy cost decreased $12.7 billion in FY 2010. The change in consolidated weighted rates decreased subsidy cost $6.6 billion. Interest rates and probabilistic methodology for estimating decreased subsidy costs $3.7 billion. ECASLA and other volume adjustments decreased subsidy cost $1.7 billion. Loan deferment increases produced an increase in subsidy cost of $1 billion. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by $17 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1992-2009.

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

For 2009 re-estimated subsidy cost, FFEL Guaranteed subsidy cost was decreased $21.7 billion. Interest rate changes related to updated economic assumptions accounted for approximately $18 billion in decreased subsidy cost. A $1.5 billion increase in subsidy cost related to changes in deferment and forbearance rates was offset by other changes in assumptions such as $966 million decreased cost for changes in repayment rates; loan volume changes produced a decreased subsidy cost of $790 million. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs $16.4 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994-2008.

Subsidy Rates

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

Subsidy Rates—Cohort 2010

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

The subsidy rate represents the subsidy expense of the program in relation to the obligations or commitments made during the fiscal year. The subsidy expense for new direct or guaranteed loans reported in the current year relate to disbursements of loans from both current and prior years' cohorts. Subsidy expense is recognized when the Department disburses direct loans or third-party lenders disburse guaranteed loans. The subsidy expense reported in the current year may include modifications and re-estimates. The subsidy rates shown above, which reflect aggregate negative subsidy in the FY 2010 cohort, cannot be applied to direct or guaranteed loans disbursed during the current reporting year to yield the subsidy expense, nor are these rates applicable to the portfolio as a whole.

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

Administrative Expenses

Administrative Expense for the years ended September 30, 2010 and 2009, consisted of the following:

Administrative Expense

(Dollars in Millions)

	2010		2009	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	$ 536	$ 314	$ 458	$ 269
Other Expense	22	13	23	13
Administrative Expenses	**$ 558**	**$ 327**	**$ 481**	**$ 282**

Note 7. General Property, Plant, and Equipment

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

General Property, Plant, and Equipment

(Dollars in Millions)

	2010		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software, and Telecommunications Equipment	$ 122	$ (97)	$ 25
Furniture and Fixtures	2	(2)	-
General Property, Plant, and Equipment	**$ 124**	**$ (99)**	**$ 25**

	2009		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software, and Telecommunications Equipment	$ 112	$ (78)	$ 34
Furniture and Fixtures	2	(2)	-
General Property, Plant, and Equipment	**$ 114**	**$ (80)**	**$ 34**

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

Leases

FSA 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 right to extend the lease term by exercising additional one-year options.

Note 8. Other Assets

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 $83 million and $272 million as of September 30, 2010 and 2009, respectively.

Note 9. Debt

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

Debt
(Dollars in Millions)

	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
Total	**$ 234,858**	**$ -**	**$ 155,175**	**$ (16,377)**	**$ 373,656**

Debt
(Dollars in Millions)

	2009				
	Beginning Balance	**Accrued Interest**	**New Borrowing**	**Repayments**	**Ending Balance**
Treasury Debt					
Direct Loan Program	$ 117,419	$ -	$ 47,179	$ (10,380)	$ 154,218
FFEL Program					
Guaranteed Loan Program	-	12	1,462	-	1,474
Loan Purchase Commitment	69	-	24,811	(3)	24,877
Loan Participation Purchase	10,754	-	43,223	-	53,977
ABCP Conduit	-	-	250	(6)	244
TEACH Program	14	-	56	(2)	68
Total	**$ 128,256**	**$ 12**	**$ 116,981**	**$ (10,391)**	**$ 234,858**

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

Note 10. Other Liabilities

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

The current liabilities covered by budgetary resources primarily consist of downward subsidy re-estimates, which when executed will be paid to Treasury.

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

Other Liabilities

(Dollars in Millions)

	2010		2009	
	Intragovern-mental	With the Public	Intragovern-mental	With the Public
Liabilities Covered by Budgetary Resources				
Current				
Employer Contributions and Payroll Taxes	$ 1	$ -	$ 1	$ -
Liability for Deposit Funds	-	-	-	8
Accrued Payroll and Benefits	-	7	-	6
Deferred Revenue	-	182	-	467
Liabilities in Miscellaneous Receipt Accounts	12,647	-	11,209	-
Total Other Liabilities Covered by Budgetary Resources	**12,648**	**189**	**11,210**	**481**
Liabilities Not Covered by Budgetary Resources				
Current				
Accrued Unfunded Annual Leave	-	9	-	8
Non-current				
Accrued Unfunded FECA Liability	1	-	1	-
Liabilities in Miscellaneous Receipt Accounts	183	-	184	-
Accrued FECA Actuarial Liability	-	4	-	5
Total Other Liabilities Not Covered by Budgetary Resources	**184**	**13**	**185**	**13**
Other Liabilities	**$ 12,832**	**$ 202**	**$ 11,395**	**$ 494**

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 $197 million and $198 million as of September 30, 2010 and 2009, respectively.

As of September 30, 2010 and 2009, liabilities on the Balance Sheet totaled $413.7 billion and $276.9 billion respectively. Of this amount, liabilities covered by budgetary resources totaled $413.5 billion as of September 30, 2010, and $276.7 billion as of September 30, 2009.

Note 11. Accrued Grant Liability

FSA's accrued grant liability was $2,619 million and $1,929 million as of September 30, 2010 and 2009, respectively. These amounts include $603 million and $634 million accrued grant liability for *Recovery Act* funds administered by FSA for FY 2010 and FY 2009, respectively.

Note 12. Net Position

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

Unexpended Appropriations

(Dollars in Millions)

	2010	2009
Unobligated Balances		
Available	$ 166	$ 10,360
Not Available	988	533
Undelivered Orders	15,544	15,548
Authority Temporarily Precluded from Obligation	561	887
Unexpended Appropriations	**$ 17,259**	**$ 27,328**

FSA had Cumulative Results of Operations of $(6,812) million as of September 30, 2010, and $(277) million as of September 30, 2009. Cumulative Results of Operations consists mostly of unfunded upward subsidy re-estimates, other unfunded expenses, and net investments of capitalized assets.

Note 13. Intragovernmental Cost and Exchange Revenue by Program

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

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

The following table presents FSA's gross cost and exchange revenue by program for FY 2010 and FY 2009. Gross costs and earned revenue are classified as intragovernmental (exchange transactions between FSA and other entities within the federal government) or with the public (exchange transactions between FSA and non-federal entities).

Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

	2010	2009
Ensure Accessibility, Affordability and Accountability of Higher Education and Career and Technical Advancement		
Intragovernmental Gross Cost	$ 16,286	$ 10,079
Public Gross Cost	11,542	(21,141)
Total Gross Program Costs	27,828	(11,062)
Intragovernmental Earned Revenue	5,862	4,644
Public Earned Revenue	11,209	6,435
Total Program Earned Revenue	17,071	11,079
Total Program Cost	**10,757**	**(22,141)**
American Recovery and Reinvestment Act		
Intragovernmental Gross Cost	-	-
Public Gross Cost	8,920	7,572
Total Gross Program Costs	8,920	7,572
Intragovernmental Earned Revenue	-	-
Public Earned Revenue	-	-
Total Program Earned Revenue	-	-
Total Program Cost	**8,920**	**7,572**
Net Cost of Operations	**$ 19,677**	**$ (14,569)**

Note 14. Interest Expense and Interest Revenue

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

Interest Expense and Interest Revenue
(Dollars in Millions)

	2010					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	$ 10,514	$ -	$ 10,514	$ 2,662	$ 7,852	$ 10,514
FFEL Program						
Guaranteed Loan Program	474	(152)	322	322	-	322
Loan Purchase Commitment	1,771	-	1,771	631	1,140	1,771
Loan Participation Purchase	3,397	-	3,397	1,222	2,175	3,397
ABCP Conduit	41	-	41	29	12	41
TEACH Program	7	-	7	3	4	7
Total	**$ 16,204**	**$ (152)**	**$ 16,052**	**$ 4,869**	**$ 11,183**	**$ 16,052**

	2009					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	$ 7,094	$ -	$ 7,094	$ 1,465	$ 5,629	$ 7,094
FFEL Program						
Guaranteed Loan Program	32	337	369	369	-	369
Loan Purchase Commitment	861	-	861	563	298	861
Loan Participation Purchase	1,876	-	1,876	1,410	466	1,876
ABCP Conduit	6	-	6	5	1	6
TEACH Program	2	-	2	1	1	2
Total	**$ 9,871**	**$ 337**	**$10,208**	**$ 3,813**	**$ 6,395**	**$10,208**

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 compares budgetary resources with the status of those resources. As of September 30, 2010, budgetary resources were $280,742 million and net outlays were $156,225 million. As of September 30, 2009, budgetary resources were $313,247 million and net outlays were $105,700 million.

Permanent Indefinite Budget Authority

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

Reauthorization of Legislation

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

Obligations Incurred by Apportionment Category

Obligations incurred by apportionment category, as of September 30, 2010 and 2009, consisted of the following:

Obligations Incurred by Apportionment Category

(Dollars in Millions)

	2010	2009
Direct		
Category A	$ 910	$ 766
Category B	260,245	289,236
Exempt from Apportionment	4	79
Obligations Incurred	**$ 261,159**	**$ 290,081**

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

Unused Borrowing Authority

Unused borrowing authority, as of September 30, 2010 and 2009, consisted of the following:

Unused Borrowing Authority

(Dollars in Millions)

	2010	2009
Beginning Balance, Unused Borrowing Authority	**$ 106,147**	**$ 25,650**
Current Year Borrowing Authority	182,901	200,214
Funds Drawn From Treasury	(155,175)	(116,981)
Borrowing Authority Withdrawn	(968)	(2,736)
Ending Balance, Unused Borrowing Authority	**$ 132,905**	**$ 106,147**

FSA 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. FSA periodically reviews its borrowing authority balances in relation to its obligations and may cancel unused amounts.

Undelivered Orders at the End of the Period

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

Undelivered Orders

(Dollars in Millions)

	2010	2009
Budgetary	$ 15,589	$ 15,513
Non-Budgetary	147,032	132,278
Undelivered Orders (Unpaid)	**$ 162,621**	**$ 147,791**

Undelivered orders at the end of the period, as presented above, will differ from the undelivered orders included in the Net Position, Unexpended Appropriations. Undelivered orders for federal credit financing and liquidating funds are not funded through appropriations and are not included in Net Position. (See Note 12)

Distributed Offsetting Receipts

The majority of the Distributed Offsetting Receipts line item on the SBR represents amounts paid from the Direct Loan Program and FFEL Program financing accounts to general fund receipt accounts for downward re-estimates and negative subsidies.

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

Budgetary accounting as shown in the President's Budget includes a public enterprise fund that reflects the gross obligations by the FFEL Program for the estimated activity of the consolidated Federal Funds of the guaranty agencies. Ownership by the federal government is independent of the actual control of the assets. Since the actual operation of the Federal Fund is independent from the Department's direct control, budgetary resources and obligations are estimated and disclosed in the President's Budget to approximate the gross activities of the combined Federal Funds. Amounts reported on the FY 2009 Statement of Budgetary Resources for the Federal Fund are compiled through combining all guaranty agencies' annual reports to determine a net valuation amount for the Federal Fund.

Note 16. Reconciliation of Net Cost of Operations to Budget

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

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

Reconciliation of Net Cost of Operations to Budget

(Dollars in Millions)

	2010	2009
Resources Used to Finance Activities		
Obligations Incurred	$ (261,159)	$ (290,081)
Spending Authority from Offsetting Collections and Recoveries	58,262	55,511
Offsetting Receipts	28,787	31,646
Imputed Financing from Costs Absorbed by Others	(10)	(9)
Total Resources Used to Finance Activities	**(174,120)**	**(202,933)**
Resources Used to Finance Items Not Part of Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided (+/-)	(15,810)	(95,775)
Resources that Fund Expenses Recognized in Prior Period	10,883	1,091
Credit Program Collections which Increase/Decrease Liabilities for Loan Guarantees, or Credit Program Receivables, Net including Allowances for Subsidy	43,735	39,460
Resources Used to Finance the Acquisition of Fixed Assets, or Increase/Decrease Liabilities for Loan Guarantees or Credit Program Receivables, Net in the Current or Prior Period	(180,123)	(147,641)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**(141,315)**	**(202,865)**
Components Not Requiring or Generating Resources		
Depreciation and Amortization	1,472	330
Other (+/-)	1	448
Total Components of the Net Cost of Operations that Will Not Require or Generate Resources	**1,473**	**778**
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	(1)	-
Upward/Downward Re-estimates of Credit Subsidy Expense	5,785	10,883
Increase in Exchange Revenue Receivable from the Public	5,868	2,957
Other (+/-)	3	19
Total Components of the Net Cost of Operations that Will Require or Generate Resources in Future Periods	**11,655**	**13,859**
Net Cost of Operations	**$(19,677)**	**$ 14,569**

Note 17. American Recovery and Reinvestment Act of 2009

The *Recovery Act* provided $16,543 million for student aid administration and student financial assistance programs managed and administered by FSA. Funds provided for student financial assistance programs included additional Pell Grant authority for low and middle-income undergraduate students, an increase to the per Pell grant amount, and additional funding made available in the federal work study program. Additional student aid administration funding was provided to increase the number of Title IV student loan servicing vehicles and to improve operational performance to collect and deliver loan and grant data.

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

American Recovery and Reinvestment Act of 2009

(Dollars in Millions)

	Cumulative Totals as of September 30, 2010		
	Appropriations	**Obligations**	**Outlays**
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
Total Student Financial Assistance	**16,483**	**16,483**	**15,792**
Student Aid Administration	60	60	52
Total	**$ 16,543**	**$ 16,543**	**$ 15,844**

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

American Recovery and Reinvestment Act of 2009

(Dollars in Millions)

	Cumulative Totals as of September 30, 2009		
	Appropriations	**Obligations**	**Outlays**
Student Financial Assistance:			
Federal Pell Grants	$ 15,640	$ 7,854	$ 6,300
Mandatory Add-on Pell Grants	643	643	549
Federal Work Study Grants	200	200	55
Total Student Financial Assistance	**16,483**	**8,697**	**6,904**
Student Aid Administration	60	29	1
Total	**$ 16,543**	**$ 8,726**	**$ 6,905**

Note 18. Contingencies

Guaranty Agencies

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

Federal Perkins Loan Program Reserve Funds

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

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

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

Litigation and Other Claims

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

Required Supplementary Stewardship Information

Investment in Human Capital

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

Expenses incurred for human capital investments consisted of the following for FY 2010 and the preceding four years:

Summary of Human Capital Expenses
(Dollars in Millions)

	2010	2009	2008	2007	2006
Federal Student Aid Expense					
Direct Loan Subsidy	$ (1,567)	$ (9,603)	$ 5,236	$ (499)	$ 6,655
FFEL Program Subsidy	(14,344)	(29,940)	(2,852)	4,884	28,062
Recovery Act	8,869	7,571			
Grant Programs	26,799	17,302	17,464	15,092	15,447
Salaries and Administrative	208	186	189	173	172
Total	**$ 19,965**	**$ (14,484)**	**$ 20,037**	**$ 19,650**	**$ 50,336**

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

The FFEL Loan Program operates with state and private nonprofit guaranty agencies to provide loan guarantees and interest supplements through permanent budget authority on loans by private lenders to eligible students. The FFEL Loan Program expenses include the Loan Participation Purchase and Loan Purchase Commitment expenses of $(607) million and $(466) million respectively.

The TEACH Grant program, authorized by the *CCRAA*, awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students. If the students do not satisfy their agreement to serve, the grants are converted to Direct Unsubsidized Loans.

ECASLA authorized the Secretary to buy guaranteed student loans for the 2008-2009 academic year. This authority to buy guaranteed student loans was extended to include eligible loans for the 2009-2010 academic year. The Department used this authority to purchase fully disbursed Stafford, Unsubsidized Stafford, and PLUS loans, through the Loan Purchase Commitment Program. In addition to buying fully disbursed loans, the Department had established agreements with FFEL lenders to buy participation interests in fully or partially disbursed loans, through its Loan Participation Purchase Program. Under the latter, a lender, through an approved sponsor, transferred the title of an eligible loan to a custodian who issued a participation certificate. The Department purchased a participation interest issued by the custodian, who in turn remitted funds to the lender. The participation interests must have been redeemed and amounts provided under these agreements remitted to the Department. Lenders could obtain outside funding or opt to have the Department purchase fully disbursed loans that were part of the participation agreement. Loans purchased by the Department under the Loan Purchase Commitment

Program and Loan Participation Purchase Program are subsequently treated for budget purposes as direct loans. The participation agreements and the Department's commitment to purchase guaranteed loans terminated September 30, 2010, and all sales were completed by October 15, 2010.

In addition to the Loan Purchase and Loan Participation Purchase Programs, the Department has entered into a Put Agreement with an ABCP conduit. Under a Conduit program, the Conduit issues commercial paper to investors to finance its acquisition of interests in federally-reinsured student loans. The commercial paper is backed by the Conduit's interest in these loans. The Conduit uses proceeds of these sales to acquire these interests from lenders. Lenders that sell interests to the conduit must commit to provide new loans for the coming academic years with a portion of the proceeds of the sale. To ensure that the Conduit will have the resources to meet investor demands on maturing commercial paper if it is unable to reissue that paper or meet that demand from its own resources, the Department entered into a forward purchase commitment (a Put Agreement) with the Conduit, under which the Department agreed to purchase pledged loans from the Conduit at a prearranged price as and when needed to ensure that the Conduit can meet these demands of its investors. In addition, the Federal Financing Bank has entered into a Liquidity Loan Agreement with the Conduit to provide immediate advances as needed by the Conduit.

Under the *SAFRA*, effective July 1, 2010, no new student loans will be made under the FFEL Program. However, FFEL lenders are obligated to make the subsequent disbursements after June 30, 2010 if the first disbursement of a FFEL loan was made by the FFEL lender on or before June 30, 2010.

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

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

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

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

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

Required Supplementary Information

United Stated Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year ended September 30, 2010
(Dollars in Millions)

	Combined		American Recovery and Reinvestment Act	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
Budgetary Resources:				
Unobligated balance, brought forward, October 1	$ 13,476	$ 9,690	$ 7,817	$
Recoveries of prior year Unpaid Obligations	410	4,434	9	
Budgetary Authority:				
Appropriations	39,140		831	
Borrowing Authority (Note 15)		182,901		
Spending authority from offsetting collections (gross):				
Earned				
Collected	1,499	51,912		
Change in Receivables from Federal Sources		3		
Change in unfilled customers orders Without advances from Federal Sources		4		
Subtotal	$ 40,639	$ 234,820	$ 831	$
Nonexpenditure Transfers, net, anticipated and actual				
Temporarily not available pursuant to Public Law	(561)			
Permanently not available	(4,833)	(17,333)	(831)	
Total Budgetary Resources (Note 15)	**$ 49,131**	**$ 231,611**	**$ 7,826**	**$ 0**
Status of Budgetary Resources:				
Obligations incurred: Direct (Note 15)	$ 44,957	$ 216,202	$ 7,826	$
Unobligated Balances: Apportioned	192	1,433		
Unobligated Balance not available	3,982	13,976		
Total Status of Budgetary Resources	**$ 49,131**	**$ 231,611**	**$ 7,826**	**$ 0**
Change in Obligated Balance:				
Obligated balance, net: Unpaid obligations, brought forward, October 1	$ 17,730	$ 133,575	$ 1,821	$
Uncollected customer payments from Federal Sources, brought forward, October 1		3		
Total, unpaid obligated balance, brought forward, net	17,730	133,578	1,821	
Obligation Incurred, net (+/-)	44,957	216,202	7,826	
Gross Outlays	(43,685)	(194,738)	(8,939)	
Recoveries of prior year unpaid obligations, actual	(410)	(4,434)	(9)	
Change in uncollected customer payments from Federal Sources (+/-)		(7)		
Obligated Balance, net, end of period:				
Unpaid Obligations	$ 18,592	$ 150,605	$ 699	$
Uncollected customer payments from Federal Sources		(4)		
Total, unpaid obligated balance, net, end of period	**$ 18,592**	**$ 150,601**	**$ 699**	**$ 0**
Net Outlays:				
Gross Outlays	$ 43,685	$ 194,738	$ 8,939	$
Offsetting collections	(1,499)	(51,912)		
Distributed Offsetting receipts	(28,787)			
Net Outlays (Note 15)	**$ (13,399)**	**$ 142,826**	**$ 8,939**	**$ 0**

United States Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year ended September 30, 2010

(Dollars in Millions)

	Non ARRA Combined		Direct Student Loan Program	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:				
Unobligated balance, brought forward, October 1	$ 5,659	$ 9,690	$ 36	$ 1,123
Recoveries of prior year Unpaid Obligations	401	4,434		3,061
Budgetary Authority:				
Appropriations	38,309		3,482	
Borrowing Authority (Note 15)		182,901		129,880
Spending authority from offsetting collections (gross):				
Earned				
Collected	1,499	51,912		19,619
Change in Receivables from Federal Sources		3		
Change in unfilled customers orders Without advances from Federal Sources		4		
Subtotal	$ 39,808	$ 234,820	$ 3,482	$ 149,499
Nonexpenditure Transfers, net, anticipated and actual				
Temporarily not available pursuant to Public Law	(561)			
Permanently not available	(4,002)	(17,333)	(13)	(9,188)
Total Budgetary Resources (Note 15)	**$ 41,305**	**$ 231,611**	**$ 3,505**	**$ 144,495**
Status of Budgetary Resources:				
Obligations incurred: Direct (Note 15)	$ 37,131	$ 216,202	$ 3,482	$ 142,161
Unobligated Balances: Apportioned	192	1,433		104
Unobligated Balance not available	3,982	13,976	23	2,230
Total Status of Budgetary Resources	**$ 41,305**	**$ 231,611**	**$ 3,505**	**$ 144,495**
Change in Obligated Balance:				
Obligated balance, net: Unpaid obligations, brought forward, October 1	$ 15,909	$ 133,575	$	$ 15,618
Uncollected customer payments from Federal Sources, brought forward, October 1		3		
Total, unpaid obligated balance, brought forward, net	$ 15,909	$ 133,578	$ 0	$ 15,618
Obligation Incurred, net (+/-)	37,131	216,202	3,482	142,161
Gross Outlays	(34,746)	(194,738)	(3,482)	(99,427)
Recoveries of prior year unpaid obligations, actual	(401)	(4,434)		(3,061)
Change in uncollected customer payments from Federal Sources (+/-)		(7)		
Obligated Balance, net, end of period:				
Unpaid Obligations	$ 17,893	$ 150,605	$	$ 55,291
Uncollected customer payments from Federal Sources		(4)		
Total, unpaid obligated balance, net, end of period	**$ 17,893**	**$ 150,601**	**$ 0**	**$ 55,291**
Net Outlays:				
Gross Outlays	$ 34,746	$ 194,738	$ 3,482	$ 99,427
Offsetting collections	(1,499)	(51,912)		(19,619)
Distributed Offsetting receipts	(28,787)		(12,375)	
Net Outlays (Note 15)	**$ 4,460**	**$ 142,826**	**$ (8,893)**	**$ 79,808**

United States Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year ended September 30, 2010

(Dollars in Millions)

	Teach Grant Program		Federal Family Education Loan Program	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:				
Unobligated balance, brought forward, October 1	$ 7	$	$ 2,580	$ 8,567
Recoveries of prior year Unpaid Obligations		34	8	1,339
Budgetary Authority:				
Appropriations	27		4,274	
Borrowing Authority (Note 15)		97		52,924
Spending authority from offsetting collections (gross):				
Earned				
Collected		26	1,499	32,267
Change in Receivables from Federal Sources				3
Change in unfilled customers orders Without advances from Federal Sources		4		
Subtotal	$ 27	$ 127	$ 5,773	$ 85,194
Nonexpenditure Transfers, net, anticipated and actual				
Temporarily not available pursuant to Public Law				
Permanently not available		(16)	(865)	(8,129)
Total Budgetary Resources (Note 15)	**$ 34**	**$ 145**	**$ 7,496**	**$ 86,971**
Status of Budgetary Resources:				
Obligations incurred: Direct (Note 15)	$ 27	$ 145	$ 4,475	$ 73,896
Unobligated Balances: Apportioned			27	1,329
Unobligated Balance not available	7		2,994	11,746
Total Status of Budgetary Resources	**$ 34**	**$ 145**	**$ 7,496**	**$ 86,971**
Change in Obligated Balance:				
Obligated balance, net: Unpaid obligations, brought forward, October 1	$	$ 47	$ 23	$ 117,910
Uncollected customer payments from Federal Sources, brought forward, October 1				3
Total, unpaid obligated balance, brought forward, net	$ 0	$ 47	$ 23	$ 117,913
Obligation Incurred, net (+/-)	27	145	4,475	73,896
Gross Outlays	(22)	(111)	(4,466)	(95,200)
Recoveries of prior year unpaid obligations, actual		(34)	(8)	(1,339)
Change in uncollected customer payments from Federal Sources (+/-)		(4)		(3)
Obligated Balance, net, end of period:				
Unpaid Obligations	$ 5	$ 47	$ 24	$ 95,267
Uncollected customer payments from Federal Sources		(4)		
Total, unpaid obligated balance, net, end of period	**$ 5**	**$ 43**	**$ 24**	**$ 95,267**
Net Outlays:				
Gross Outlays	$ 22	$ 111	$ 4,466	$ 95,200
Offsetting collections		(26)	(1,499)	(32,267)
Distributed Offsetting receipts	(1)		(16,389)	
Net Outlays (Note 15)	**$ (21)**	**$ 85**	**$ (13,422)**	**$ 62,933**

United States Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year ended September 30, 2010
(Dollars in Millions)

	Grant Programs		Administrative Funds	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
Budgetary Resources:				
Unobligated balance, brought forward, October 1	$ 2,972	$	$ 64	$
Recoveries of prior year Unpaid Obligations	362		31	
Budgetary Authority:				
Appropriations	29,532		994	
Borrowing Authority (Note 15)				
Spending authority from offsetting collections (gross):				
Earned				
Collected				
Change in Receivables from Federal Sources				
Change in unfilled customers orders Without advances from Federal Sources				
Subtotal	$ 29,532	$	$ 994	$
Nonexpenditure Transfers, net, anticipated and actual	(18)		18	
Temporarily not available pursuant to Public Law	(561)			
Permanently not available	(3,039)		(85)	
Total Budgetary Resources (Note 15)	**$ 29,248**	**$ 0**	**$ 1,022**	**$ 0**
Status of Budgetary Resources:				
Obligations incurred: Direct (Note 15)	$ 28,133	$	$ 1,014	$
Unobligated Balances: Apportioned	154		11	
Unobligated Balance not available	961		(3)	
Total Status of Budgetary Resources	**$ 29,248**	**$ 0**	**$ 1,022**	**$ 0**
Change in Obligated Balance:				
Obligated balance, net: Unpaid obligations, brought forward, October 1	$ 15,567	$	$ 319	$
Uncollected customer payments from Federal Sources, brought forward, October 1				
Total, unpaid obligated balance, brought forward, net	$ 15,567	$ 0	$ 319	$ 0
Obligation Incurred, net (+/-)	28,133		1,014	
Gross Outlays	(25,951)		(825)	
Recoveries of prior year unpaid obligations, actual	(362)		(31)	
Change in uncollected customer payments from Federal Sources (+/-)				
Obligated Balance, net, end of period:				
Unpaid Obligations	$ 17,387	$	$ 477	$
Uncollected customer payments from Federal Sources				
Total, unpaid obligated balance, net, end of period	**$ 17,387**	**$ 0**	**$ 477**	**$ 0**
Net Outlays:				
Gross Outlays	$ 25,951	$	$ 825	$
Offsetting collections				
Distributed Offsetting receipts	(22)			
Net Outlays (Note 15)	**$ 25,929**	**$ 0**	**$ 825**	**$ 0**

Other Accompanying Information

Management Challenges

For details on FSA Management Challenges, please refer to relevant items included in the Management Challenges for FY 2011 narrative in the Management Discussion and Analysis section in the Department's AFR located at http://www.ed.gov/about/reports/annual/index.html.

Summary of Financial Statement Audit and Management Assurances

For details on FSA's programs, please refer to the Management's Assurance in the Management Discussion and Analysis "Analysis of Federal Student Aid's Systems, Controls and Legal Compliance" section of this document as well as the Summary of Financial Statement Audit and Management Assurance narrative in the Other Accompanying Information section in the Department's AFR located at http://www.ed.gov/about/reports/annual/index.html.

Improper Payment Information Act of 2002 Reporting Details

For improper payments information, FSA's activities are part of an overall Department integrated reporting effort. Please refer to the *Improper Payment Information Act of 2002* narrative in the Other Accompanying Information section in the Department's AFR located at http://www.ed.gov/about/reports/annual/index.html.

Office of Inspector General Transmittal Letter

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 15, 2010

William Taggart
Chief Operating Officer
Federal Student Aid
Washington, D.C. 20202

Dear Mr. Taggart:

The enclosed reports present the results of the annual audits of Federal Student Aid's (FSA) financial statements for fiscal years 2010 and 2009, to comply with the Higher Education Act Amendments of 1998. The reports should be read in conjunction with FSA's financial statements and notes to fully understand the context of the information contained therein.

We contracted with the independent certified public accounting firm of Ernst & Young, LLP (Ernst & Young) to audit the financial statements of FSA as of September 30, 2010 and 2009, and for the years then ended. The contract required that the audits be performed in accordance with U.S. generally accepted government auditing standards and OMB's bulletin, *Audit Requirements for Federal Financial Statements.*

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

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

Sincerely,

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.

Report of Independent Auditors

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Tel: 703-747-1000
www.ey.com

Report of Independent Auditors

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheets of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department), as of September 30, 2010 and 2009, and the related consolidated statements of net cost, and changes in net position, and the combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of FSA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FSA as of September 30, 2010 and 2009, and its net cost, changes in net position, and budgetary resources, for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 15, 2010, on our consideration of FSA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

ERNST & YOUNG

Report of Independent Auditors
Page 2

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information presented in the Management's Discussion and Analysis, required supplementary stewardship information, required supplementary information, and other accompanying information is not a required part of the basic financial statements but is supplementary information required by OMB Circular No. A-136, *Financial Reporting Requirements*. The other accompanying information has not been subjected to the auditing procedures applied in our audits of the basic financial statements and, accordingly, we express no opinion on it. For the remaining information, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Ernst + Young LLP

November 15, 2010

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

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Tel: 703-747-1000
www.ey.com

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 Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2010, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 15, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered FSA'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 FSA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of FSA's internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04, as amended. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

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.

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

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

SIGNIFICANT DEFICIENCIES

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

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

During the last few years, several pieces of legislation have been enacted that have had a significant impact on the Department's loan programs. The *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) legislation, which was enacted during FY 2008, amended the Federal Family Education Loan (FFEL) program and provided the Secretary of Education with the authority to purchase student loans from private lenders and enter into forward commitments to purchase FFEL loans. In October 2008, the enactment of Public Law (P.L.) 110-350 extended this temporary loan purchase authority through September 30, 2010. Additionally, the *Student Aid and Financial Responsibility Act* (SAFRA) included in the *Health Care and Education Reconciliation Act of 2010* (HCERA) was enacted during FY 2010. Under SAFRA, no new FFEL loans were authorized after June 30, 2010. This increased the Department's responsibility for originating federal student loans, primarily through the William D. Ford

Federal Direct Loan program (direct loan program). As a result of SAFRA, the Department and FSA were required to implement the necessary processes surrounding the transition to originating a much increased volume of direct loans within a short time frame. The Department brought together representatives from throughout the organization to develop, implement and administer the activities surrounding the transition to direct loans and the temporary loan purchase authority. Representatives included individuals from OCFO, FSA, and Budget Service.

During FY 2010, we noted that the Department documented certain meetings in these areas as part of the Credit Reform Workgroup meetings. Management informed us that representatives maintained communication throughout the year on both the activities related to the transition to direct loans and the temporary loan purchase authority. These meetings occurred on both a formal and informal basis. Such discussions are an important part in developing the periodic re-estimates for the direct and FFEL loan programs, since all the programs are interrelated. To the extent such groups execute critical review activities, they constitute a key control for the Department, and further structure and documentation around their activities can enhance confidence in the Department's estimation processes.

After identifying the challenges faced by the Department and FSA, as well as the improvements in communication made or currently being made by the Department and FSA, we noted the following items that indicate management controls and analysis can be strengthened:

- The long-term cost for the credit programs is reflected in the financial statements through periodic charges for subsidy costs, adjustments or re-estimates to those subsidy costs, and loan activity, which is all recognized in the allowance for the receivables related to the direct loan program and the temporary loan purchase authority, and in the liability for the guaranteed loan (FFEL) program. The Department uses a computer-based cash flow projection model (i.e., Student Loan Model, or SLM) and OMB calculator to calculate subsidy estimates related to the loan programs that are then recorded in the allowance for subsidy or liability accounts. The model uses multiple sources of loan data and hundreds of complex assumptions. In order to perform a check of estimates resulting from the SLM and OMB calculator, the Department prepares a backcast, which compares the model's estimates to actual activity for the current and prior fiscal years. The SLM also produces a forecast of the expected cash flows in the current year for the outstanding loans which, when discounted, can be used to compare to the recorded activity in the general ledger. Comparisons using the backcast and forecast tools, and to the extent practical, recomputation of expected amounts based on loan volumes, interest rates, and simplified cash flow assumptions, can serve as key detect controls for potential undetected errors that may exist in the development of the assumption data and credit reform estimates. During our testing, we noted that management has no formal detailed review procedures surrounding the input of the many variables into the SLM, the input of cash flows into the OMB calculator or the process surrounding the analytical tools.

Management does perform a high-level review of such data; however, this review is not sufficient to identify errors that may occur at a detailed level. In one instance during our testing, we noted an error in one of the allowance calculations that resulted in an adjustment to the financial statements of approximately $900 million. Additionally, we noted calculation errors in certain of the analytical tools used by the Department, including the backcast, back of the envelope, and fluctuation analysis. While these calculation errors in certain analytical tools did not directly impact amounts in the financial statements, the analytical tools should contain accurate information if they are to serve their purpose as a detect control. Implementing a detail review process may reduce the potential for errors occurring in all aspects of this complex re-estimate and also in the analytical tools, leading to further refinement of the tools and facilitate their use in a formalized cross-functional review of the estimates.

- As noted above, the SLM produces a forecast of the expected cash flows in the current year for the outstanding loans which, when discounted, can be used to compare to the recorded activity in the general ledger. Additionally, other data analysis tools prepared by the Department, such as the cohort analysis, support more disaggregated reviews of data by cohort. The Department's financial systems are not configured to account for cash flows on a precise cohort level. Rigorous examinations and reconciliations using the cohort analysis data have not been fully successful in relating the net present value of estimated future cash flows embedded in the SLM to the corresponding amounts of: (1) adjusted debt balance and net receivables for the direct loan program, or (2) the adjusted Fund Balance with Treasury and liabilities for loan guarantees for FFEL guaranteed loans. Recent growth in the unexplained variances between these amounts highlights the need for management to devote substantial resources to comprehensively and definitively analyze the differences and work with OMB and Treasury to ensure complete transparency into this matter and the resolution thereof. Pending completion of this thorough cohort analysis, the advent of the temporary loan purchase authority programs and substantial increases in the volume of the direct loan program provide opportunities for the Department to implement rigorous cohort level accounting consistent with the requirements of the Credit Reform Act and applicable OMB guidance.

- The early phase of the loan estimation process includes the development of the assumptions, which are used to populate the SLM with data that, in turn, feeds into the OMB calculator, which arrives at the actual cost re-estimates. In order to develop a majority of the assumptions, the Department utilizes the National Student Loan Database System (NSLDS) to extract a sample of loan data, which is known as the Statistical Abstract (STAB). The Department then executes internally developed computer programs to arrive at the assumption data that is entered into the SLM. During our review of the program logs for defaults, deferment, and forbearance, we encountered errors in certain of the computer programs for defaults, which appear to have stopped the program from processing certain steps. Additionally, based on a review of the log files for the deferment and forbearance assumptions, we noted that two of the models associated with the FFEL program did not converge. Lack of convergence may render estimation parameters unreliable, as the estimation process has not completed. After further inquiry, management informed us that the program errors and impact of the non-convergence were assessed and addressed as management deemed appropriate. However, management did not retain documentation surrounding their assessment of these issues. We noted enhancements in the detailed documentation for the deferment and default assumptions; however, the documentation could be further strengthened by adding additional detail, such as an assessment of the impact of the log errors and non-convergence issues, or reasons for adding to or removing variables from the models. We also noted that in some instances documentation of the steps performed by the Department did not precisely correspond with the computer programs themselves.

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

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

Recommendations:

We recommend that Federal Student Aid perform the following:

1. Continue to improve the analytical tools used for the loan estimation process, working to develop formats and content that synthesize and capture loan level data available in the

Department's and FSA's systems. Specifically:

- Critically assess deferment, forbearance and default rates by cohort in light of recent changes in the economic environment to determine the extent to which there may be differences in performance across cohorts.
- Perform additional forms of stress-testing estimates with additional variables, such as alternative unemployment, interest rate, Gross Domestic Product growth, and inflation scenarios.

2. Implement formal detail review procedures over the input of variables into the SLM, input of cash flows into the OMB calculator and other calculations surrounding the process to avoid potential errors that may negatively affect the re-estimates. Also, perform a detailed review of the input of source data included in the Department's analytical tools to avoid errors and ensure that all analytical tools reconcile with one another to allow for their use as detect controls for loan program cost estimates.

3. Strengthen the documentation related to internally developed computer programs, including documentation of changes in the programs and variables used, review and resolution of errors appearing in logs, and adding detailed comments to the programs to enhance clarity of the code.

4. Dedicate appropriate time and resources to thoroughly analyze, evaluate, and resolve the unexplained variances between the net present value of the future cash flows and adjusted debt balance or Fund Balance with Treasury. Also continue efforts to more fully implement cohort reporting with specific research on whether balances in the Department's and FSA's financial records are supported by estimates, by cohort, from the SLM and the cohort analysis tool and that remaining credit reform estimates for each cohort are appropriate in relation to the remaining outstanding loans for such cohorts. Beginning initially with direct loans, utilize detail loan level data in NSLDS to develop summary cohort level data for each year of outstanding balances for comparison to projected future cash flows from liquidation of the loans as reflected in the SLM and cohort analysis tool.

5. Document in detail the consideration and ultimate resolution of scenarios under which early warnings from patterns in Department and FSA data and other indicators of stress on program participants would be expected to lead to model adjustments in anticipation of likely changes in cash flows and result in changes in credit reform estimates. Similarly, capture the value of financial-related data for the programs to provide information for decision-makers regarding possible prospective changes in the programs based upon indications of program participant performance, stress, and anticipated changes in behavior in response to changing market and economic conditions.

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

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

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

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

While the Department and FSA have worked toward strengthening and improving controls over information technology processes during FY 2010, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of IT general controls at the Department and FSA, we identified the following deficiencies: (1) lack of monitoring of the activities of administrator and privileged user accounts at the application layer; (2) access for terminated users was not removed in a timely manner or not removed at all; (3) revalidation of users' rights is not consistently performed for all applications and users, and for those revalidations that are performed, we noted instances in which there was no validation of the appropriateness of user access or users were not revalidated by the appropriate members of management; (4) password configurations for applications did not comply with the relevant Department or FSA policy; (5) documentation and related approvals required to provision user access are not consistently maintained; (6) administrator level access was assigned to individuals not requiring elevated privileges; (7) controls related to the change management process were not consistently applied during the audit period, specifically, documentation of approvals for application changes were not consistently maintained, improper segregation of environments exists where users have access to make changes to code and migrate changes to production, and select code elements are migrated to production without being tested; and (8) documentation related to interfaces, including but not limited to Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding, were not up to date.

The OIG has identified information technology related deficiencies for the Department and FSA in reports issued during fiscal year 2010. In its review of the Virtual Data Center, the OIG noted that FSA did not have adequate operational controls in place over configuration management, system and information integrity, contingency planning, media protection, and awareness and training. In addition, FSA needs to improve all four technical controls of access controls, systems and communications protection, identification and authentication, and audit and accountability. As it relates to OIG's Investigative Program Advisory Report, the OIG noted that the Department and FSA have not performed adequate log reviews as it relates to the identification of unauthorized activity for compromised accounts. In addition, FSA does not keep adequate records of its remediation efforts for compromised accounts. The OIG reviewed the implementation of the Managed Security Services Provider (MSSP) contract and noted that the Department has not implemented measures to effectively support the MSSP contract. Specifically, the current contractor is unable to provide the level of service required by the contract due to lack of required access. As a result, while the Department has procured services from the MSSP contractor, the Department has not ensured that its information technology network is adequately protected. Finally, during OIG's review of FSA's Financial Management System, the OIG found FSA did not have adequate controls in place over personnel security and security and awareness training.

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

Recommendations:

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

We recommend that the Department and FSA continue their efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness uniformly across the organization, which should decrease the likelihood of a similar weaknesses being identified in future audit assessments and internal self-assessments. Examples of addressing root causes may include, but are not limited to, additional training for the information technology professionals within the organization, 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 and FSA should: (1) implement standards around the logging of privileged user access and activities and establish controls over the monitoring of that access; (2) strengthen access controls to protect mission critical systems (e.g., periodic access revalidation, timely removal of user access, enforcement of changes in access due to changes in roles and responsibilities); (3) improve the configuration management process to ensure consistent security configuration of servers and mainframe security packages across the organization and improve configuration settings to comply with Department and FSA policy; (4) enhance its security training and awareness program, specifically around actions to be taken in the event an employee encounters suspicious activity; (5) revise current methods of identifying and logging suspicious activity as it relates to unauthorized access accounts and data; (6) document and update as required information pertaining to system interfaces including Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding; and (7) implement two-factor authentication on any system where a user can log into a privileged account from the Internet. In addition, the Department should evaluate alternatives for obtaining MSSP services and proceed with a solution that will allow for adequate network protection.

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STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the FY 2009 audit of Federal Student Aid's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

<u>Summary of FY 2009 Significant Deficiencies</u>

Issue Area	Summary Control Issue	FY 2009 Status
Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Significant Deficiency)	Management controls and analysis need to be strengthened over credit reform estimation and financial reporting processes.	Modified Repeat Condition classified as a Significant Deficiency
Controls Surrounding Information Systems Need Enhancement (Significant Deficiency)	Improvements are needed in overall information technology security and systems.	Modified Repeat Condition classified as a Significant Deficiency

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

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

Ernst + Young LLP

November 15, 2010

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

ERNST & YOUNG

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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 Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2010, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 15, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

As part of obtaining reasonable assurance about whether the entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to FSA. 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 FSA's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this reporting requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

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Report on Compliance and Other Matters
Page 2

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

While the Department and FSA have worked toward strengthening and improving controls over information technology processes during FY 2010, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of information technology general controls at the Department and FSA, we identified the following deficiencies: (1) lack of monitoring of the activities of administrator and privileged user accounts at the application layer; (2) access for terminated users was not removed in a timely manner or not removed at all; (3) revalidation of users' rights is not consistently performed for all applications and users and for those revalidations that are performed, we noted instances in which there was no validation of the appropriateness of user access or users were not revalidated by the appropriate members of management; (4) password configurations for applications did not comply with the relevant Department or FSA policy; (5) documentation and related approvals required to provision user access are not consistently maintained; (6) administrator level access was assigned to individuals not requiring elevated privileges; and (7) controls related to the change management process were not consistently applied during the audit period, specifically, documentation of approvals for application changes were not consistently maintained, improper segregation of environments exists where users have access to make changes to code and migrate changes to production, and select code elements are migrated to production without being tested; and (8) documentation related to interfaces, including but not limited to Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding, were not up to date. The OIG has identified information technology related deficiencies for the Department and FSA in reports issued during fiscal year 2010. In its review of the Virtual Data Center, the OIG noted that FSA did not have adequate operational controls in place over configuration management, system and information integrity, contingency planning, media protection, and awareness and training. In addition, FSA needs to improve all four technical controls of access controls, systems and communications protection, identification and authentication, and audit and accountability. As it relates to OIG's Investigative Program Advisory Report, the OIG noted that the Department and FSA have not performed adequate log reviews as it relates to the identification of unauthorized activity for compromised accounts. In addition, FSA does not keep adequate records of its remediation efforts for compromised accounts. The OIG reviewed the implementation of the Managed Security Services Provider (MSSP) contract and noted that the Department has not implemented measures to effectively support the MSSP contract. Specifically, the current contractor is unable to provide the level of service required by the contract due to lack of required access. As a result, while the Department has procured services from the MSSP contractor, the Department has not ensured that its information technology network is adequately protected. Finally, during OIG's review of FSA's Financial Management System, the OIG found FSA did not have adequate controls in place over personnel security and security and awareness training.

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Report on Compliance and Other Matters
Page 3

Our Report on Internal Control dated November 15, 2010, includes additional information related to the financial management systems that were found not to comply with the requirements of FFMIA relating to information technology security and controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMIA, and our recommendations related to the specific issues. We have reviewed our findings and recommendations with management of the Department and FSA. Management concurs with our recommendations and, to the extent findings and recommendations were noted in prior years, has provided a proposed action plan to the OIG in accordance with applicable Department directives. We did not audit management's proposed action plan and, accordingly, we express no opinion on it.

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

Ernst + Young LLP

November 15, 2010

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Management's Response

START HERE
GO FURTHER
FEDERAL STUDENT AID

November 10, 2010

MEMORANDUM

TO: Kathleen S. Tighe
Inspector General

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

SUBJECT: DRAFT AUDIT REPORTS
Fiscal Years 2010 and 2009 Financial Statement Audit
U.S. Department of Education
ED-OIG/A17K0002

Federal Student Aid appreciates the efforts and professionalism of the Office of Inspector General and our auditors, Ernst & Young, LLP, in their audit of our fiscal year 2010 financial statements. We concur with the findings and recommendations as identified in the Report on Internal Control and in the Report on Compliance with Laws and Regulations provided to Federal Student Aid on November 9, 2010.

Federal Student Aid continues to support the Department of Education's efforts to address the significant deficiencies related to the Credit Reform Estimation and Financial Reporting Processes. Although we made progress during fiscal year 2010, we recognize there are opportunities for continued improvement to adapt existing practices to accommodate changes in credit reform programs and address noted deficiencies. Our goal is to assist the Department with fully institutionalizing these processes. In addition, we continue to work with the Department to further strengthen controls over Information Systems.

We remain committed to maintaining an unqualified opinion in future fiscal years and we will continue to prioritize corrective actions to eliminate significant deficiencies and other matters as noted in the reports.

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

Glossary of Acronyms and Terms

Acronym	Description
ABCP	Asset-Backed Commercial Paper
ACG	Academic Competitiveness Grant
ACSI	American Customer Satisfaction Index
AFR	Agency Financial Report
CCR	Comprehensive Compliance Reviews
CCRAA	*College Cost Reduction and Access Act of 2007*
CDR	National Cohort Default Rate
CLTDR	Cumulative Lifetime Default Rate
COD	Common Origination and Disbursement System
COO	Chief Operating Officer
Credit Reform Act	*Federal Credit Reform Act of 1990*
CSB	Common Services for Borrowers
CSRS	Civil Service Retirement System
DMCS	Debt Management and Collection System
Department	U.S. Department of Education
Direct Loan	William D. Ford Federal Direct Loan
ECASLA	*Ensuring Continued Access to Student Loans Act of 2008*
EDSS	Enterprise Development Support Service
ECMC	Education Credit Management Corporation
ERMG	Enterprise Risk Management Group
ESB	Enterprise Services Business
FAFSA	Free Application for Federal Student Aid
FECA	*Federal Employees' Compensation Act*
Federal Fund	Federal Student Loan Reserve Fund
FERS	Federal Employees Retirement System
FFEL	Federal Family Education Loan
FFELP	Federal Family Education Loan Program
FMS	Financial Management System
FOTW	FAFSA on the Web
FSA	Federal Student Aid
FWS	Federal Work-Study
FY	Fiscal Year
GAP	Grants for Access and Persistence
GAO	Government Accountability Office
HCERA	*Health Care and Education Reconciliation Act of 2010*
HEA	*Higher Education Act of 1965, as amended*
HEAL	Health Education Assistance Loan
HEOA	*Higher Education Opportunity Act of 2008*
HERA	*Higher Education Reconciliation Act of 2005*
Improved	Performance results improved over the prior year, but fell short of target
IPM	Integrated Partner Management
IRS	Internal Revenue Service
ISV	Integrated Student View
IT	Information Technology

Acronym	Description
LEAP	Leveraging Educational Assistance Partnership
Met	Performance results met or exceeded target
NA	Data is not available
NSLDS	National Student Loan Data System
Not met	Performance results fell short of target
NFP	Not-For-Profit
OMB	Office of Management and Budget
OPM	Office of Personnel Management
Opinion	Report of Independent Auditors
PBO	Performance-Based Organization
PCA	Private Collection Agency
Pell Grant	Federal Pell Grant Program
PIN	Personal Identifiable Number
PM	Performance results tracked, but targets were not established
PRMS	Person Record Management System
PSA	Public Service Announcement
PSLF	Public Service Loan Forgiveness
Recovery Act	*American Recovery and Reinvestment Act of 2009*
SAFRA	*Student Aid and Fiscal Responsibility Act*
SAP	Special Allowance Payment
Secretary	Secretary of Education
SIG	Strategic Investments Governance
SLEAP	Special Leveraging Educational Assistance Partnership
SMART	National Science and Mathematics Access to Retain Talent Grant Program
TEACH	Teacher Education Assistance for College and Higher Education
Title IV	Title IV of the *Higher Education Act of 1965, as amended*
TIVAS	Title IV Additional Servicers
TPD	Total and Permanent Disability
Treasury	U.S. Department of the Treasury
U.S.	United States
U.S.C.	United States Code
VVM	Vision-Core Values-Mission

Availability of Federal Student Aid's Annual Report

The following company was contracted to assist in the preparation of FSA's *FY 2010 Annual Report*:

For Web design: ICF Macro

FSA's publicly available *FY 2010 Annual Report* is accessible on FSA's and the Department's Web sites at:

http://www.federalstudentaid.ed.gov

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

The front and back cover of this report each consist of 50,000 individual dots. Lay this report flat to see 100,000 dots across both covers. You would need 140 covers, laid flat open like this, to represent each of the 14 million students FSA provided aid to this year alone.