



# U.S. Department of Education FY 2012 Agency Financial Report

**U.S. Department of Education**

Arne Duncan  
*Secretary*

**Office of the Chief Financial Officer**

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

November 16, 2012

This report is in the public domain. Authorization to reproduce it in whole or in part is granted. While permission to reprint this publication is not necessary, the citation should be: U.S. Department of Education, *Agency Financial Report*, Washington D.C., 2012.

This report is available on the Department's website at: <http://www.ed.gov/about/reports/annual/index.html>.

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

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

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

Office of the Chief Financial Officer  
U.S. Department of Education  
Washington, D.C. 20202-0600

The following companies were contracted to assist in the preparation of the  
U.S. Department of Education *FY 2012 Agency Financial Report*:

For general layout and Web design: ICF Macro  
For database design: Plexus Corporation  
For accounting services: IBM Business Consulting Services  
FMR Consulting, Inc.  
Cotton & Company, LLP

## Foreword

The United States Department of Education's (the Department's) *Agency Financial Report* (AFR) for fiscal year (FY) 2012 provides an overview of the Department's financial performance and results and detailed information about our stewardship over the financial resources entrusted to us. Additionally, as required by the Office of Management and Budget's Circulars A-11 and A-136, the report provides information about our performance as an organization, our accomplishments and initiatives, and our challenges.

The AFR is the first of three integrated performance reports that focus on accomplishments, results, and challenges faced by the Department of Education in FY 2012. The Department's goal is to provide a more meaningful, transparent, and accountable approach to inform Congress, the President, and the American people about our progress in meeting our strategic and priority goals and objectives. Additionally, the AFR describes our stewardship and use of federal dollars for the achievement of educational excellence in our nation.

The Department's FY 2012 annual reporting includes these three documents:

### **Agency Financial Report (AFR)** [available November 16, 2012]

The AFR is organized into three major sections:

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

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

[available February 2013]

The APR is produced in conjunction with the FY 2014 President's Budget Request and provides more detailed performance information and analysis of performance results.

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

[available February 2013]

This document provides an integrated overview of performance and financial information that consolidates the AFR and the APR into a user-friendly format.

This report meets the following statutory reporting requirements:

- *Federal Managers' Financial Integrity Act of 1982* (FMFIA) requires a report on the status of internal controls and the agency's most serious problems.
- *GPRRA Modernization Act of 2010* guides the agency's strategic planning and annual planning and reporting.
- *Government Management Reform Act of 1994* (GMRA) requires audited financial statements from the agency.
- *Federal Financial Management Improvement Act of 1996* (FFMIA) requires an assessment of the agency's financial systems for adherence to governmentwide requirements.
- *Reports Consolidation Act of 2000* (RCA) requires the consolidated reporting of performance, financial, and related information.
- *Improper Payments Information Act of 2002* (IPIA) requires reporting on agency efforts to identify and reduce erroneous payments.
- *Improper Payments Elimination and Recovery Act of 2010* (IPERA), which amends the *Improper Payments Information Act of 2002*.

**All three annual reports will be available on the Department's website at**  
<http://www.ed.gov/about/reports/annual/index.html>.



---

## Message From the Secretary



November 16, 2012

In support of the Department's mission **to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access**, I am pleased to present the Department's *Fiscal Year (FY) 2012 Agency Financial Report*. This report focuses on financial, management, and program results and challenges in fiscal year 2012. The purpose is to ensure accountability for results and to inform Congress, the President, and the American people about progress in meeting goals.

The financial and performance data presented are complete and reliable. They provide an accurate and transparent accounting of the Department's financial situation and high-level performance results, and the financial statements earned an unqualified or "clean" opinion from the independent auditors. More detailed performance information and results will be released in the *Annual Performance Report* (in February 2013).

This financial report also includes information and assurances about the Department's financial management systems and controls as required by the *Federal Managers' Financial Integrity Act of 1982*. This Act requires a self-assessment. Our internal control reviews led us to believe that conversions of systems used to track servicing of student loans caused delays in the reliability of some financial reporting. The auditors deemed these challenges as a material weakness during FY 2012, and we agree. However, even the weakness from the conversions did not alter our financial statements in a way to prevent us from receiving an unqualified opinion for the eleventh year in a row. Steps have been taken to rectify the situation caused by the migration from legacy systems, and we will continue to address the deficiencies in FY 2013.

We continue to address any other areas that could hinder efficiency, effectiveness, and integrity in our programs and operations. We agreed with our Inspector General that we had to address four management challenges: improper payments, information technology security, oversight and monitoring, and data quality and reporting. While we made some progress, each remains an area where we can improve.

In 2012, the Department focused efforts on several priority program areas: *Elementary and Secondary Education Act* (ESEA) flexibility, reforming the teaching profession, college costs and access, education equity, and student achievement.

**ESEA Flexibility:** The role of the Department of Education is to support states and local districts as they lead reforms that improve instruction and increase student achievement. As a result of increased ESEA flexibility, states, schools, and teachers will be able to develop innovative ways to give children a better education. In 2012, in exchange for state-developed plans to prepare all students for college and careers, focus on the neediest students, and support effective teaching and leadership, many states and the District of



Columbia applied for and received waivers from certain provisions of the ESEA, also known as *No Child Left Behind*.

**Empowering States for Teacher Reform—the RESPECT Project:** In 2012, the Department launched an initiative to encourage bold reforms at every stage of the teaching profession—Recognizing Educational Success, Professional Excellence and Collaborative Teaching (RESPECT). The goal is to work with educators to elevate the teacher voice in shaping federal, state, and local education policy and to promote teaching as America’s most important and respected profession. RESPECT will support state and local efforts to attract top-tier talent. It will encourage creation of a professional career continuum with competitive compensation, and it will support evaluating teachers and leaders. And it will encourage school districts to place the best educators into the schools that need them most.

**Keeping Down College Costs and Improving Access:** The Administration highlighted the growing challenge of college costs and the burden of student debt. The President offered a plan to give schools an incentive for keeping college affordable while improving quality. Pell Grants helped 9.5 million students gain access to college and subsidized student loans continued at an interest rate of 3.4 percent. We also helped students better manage student loan debt, by capping monthly payments based on what people can afford through the “Pay as You Earn” initiative, which builds on the existing income-based repayment plan. In addition, we want students to “Know Before They Owe,” that is, to understand the financial implications of a loan by increasing the transparency of loan costs and requirements.

The Department also launched a website and social media tool to help students navigate the financial aid process. StudentAid.gov will eventually provide consumers with a one-stop website where they can access federal student aid information, apply for federal aid, and repay student loans.

**Equity in Education:** Education is the great equalizer in America. To close the achievement gap, we must also close the opportunity gap. The way to achieve equity in society is to achieve equity in the classroom. The Administration is investing and encouraging reform in what have historically been some of the nation’s lowest-achieving schools, aiming to transform them into safe and successful environments where all students can thrive.

**Leveraging Change to Improve Student Outcomes:** In 2012, we saw some very encouraging results from recent initiatives. The Race to the Top program has spurred comprehensive and unprecedented state-level reforms of policies and practices affecting our schools and early learning programs, and the School Improvement Grants program is turning around the lowest-performing schools through critical investments and intervention strategies. In higher education, the Administration is focused on boosting access, affordability, and attainment.

The Race to the Top program has had three components. First, it supports states that raise standards, build better data systems, evaluate and support principals and teachers, and dramatically transform their lowest-performing schools. It also supports the development of new and better assessments aligned with high standards.

Second, the Early Learning Challenge, part of the Race to the Top program, supports states that strengthen the quality of their early learning programs.

Third, in 2012, the Department has invested in a Race to the Top—District initiative, which is aimed at the classroom level and the all-important relationship between teachers and students. With this initiative, we are inviting districts to show us how they can personalize and individualize education for students in their schools.

Other programs such as Investing in Innovation (i3), the Teacher Incentive Fund, and Promise Neighborhoods are bringing needed change and new approaches to schools and communities across America.

Also in 2012, the Administration released a blueprint that aims to reform career and technical education (CTE). The blueprint aims to strengthen the linkages between secondary and postsecondary education, job-training providers, and employers. The goal of the CTE blueprint is that students earn an industry or postsecondary certificate or degree that will lead to a successful career.

Providing every student in America with a world-class education is a moral obligation, a civic necessity, and an economic imperative. Nations that best educate their students will be the best equipped to thrive in the 21<sup>st</sup> century. From improving access to early learning programs; to reforming elementary and secondary education; to making higher education more accessible and affordable; to working to attract talented people to the teaching profession, we have made an unprecedented commitment to education. I am proud that the Department has played a significant role in supporting important reforms.

Sincerely,

/s/

Arne Duncan

---

## Contents

Message From the Secretary .....	ii
<b>Management’s Discussion and Analysis</b>	
Mission and Organizational Structure.....	2
The Department’s Approach to Performance Management.....	4
FY 2012 Goals, Objectives, and Selected Programs.....	15
Financial Summary .....	28
Financial Highlights.....	29
Limitations of the Financial Statements .....	32
Management’s Assurances .....	33
Financial Management Systems Strategy .....	37
<b>Financial Details</b>	
Message From the Chief Financial Officer .....	40
Principal Financial Statements .....	41
Notes to Principal Financial Statements .....	45
Required Supplementary Information.....	88
Required Supplementary Stewardship Information.....	89
<b>Report of the Independent Auditors .....</b>	<b>93</b>
<b>Other Accompanying Information</b>	
Improper Payments Reporting Details.....	118
Schedule of Spending .....	139
Summary of Financial Statement Audit and Management Assurances.....	140
Memorandum From the Office of Inspector General.....	141
Office of Inspector General’s Management and Performance Challenges for Fiscal Year 2013 Executive Summary.....	142
<b>Appendices</b>	
Appendix A: Education Resources of the Department.....	146
Appendix B: Selected Department Web Links .....	148
Appendix C: Glossary of Acronyms and Abbreviations.....	150





# **Management's Discussion and Analysis**

## Mission and Organizational Structure

### Our Mission

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

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

**Our Public Benefit.** The Department is committed to ensuring that students throughout the nation develop the skills they need to succeed in school, college, and the workforce, while recognizing the primary role of states and school districts in providing a high-quality education, employing highly qualified teachers and administrators, establishing challenging content and achievement standards, and monitoring students' progress against those standards. The Department is also [setting high expectations](#) for its own employees and working to improve management practices, ensure fiscal integrity, and develop a culture of high performance.

**What We Do.** The [Department](#) engages in four major types of activities: establishing policies related to federal education funding, including the distribution of funds and monitoring their use; supporting data collection and research on America's schools; identifying major issues in education and focusing national attention on them; and enforcing federal laws prohibiting discrimination in programs that receive federal funds.

**Who We Serve.** [During school year \(SY\) 2012–13](#), America's schools and colleges are serving larger numbers of students as the population increases and enrollment rates rise. As of the fall of 2012, more than 49.8 million students attend public elementary and secondary schools. In fall 2012, a record 21.6 million students are expected to attend the nation's 2-year and 4-year colleges and universities.

**Organizational Structure.** To achieve our Strategic Goals, our staff is organized as shown in the organizational chart. The Department's program offices support aspects of external Goals 1, 2, 3, 4, and 5. Our administrative offices support external Goals 1, 2, 3, 4, and 5, as well as Goal 6, which is the Department's internal goal. Links are provided to web pages that provide a detailed [description of the principal offices](#) and [overview of the activities of the Department](#).

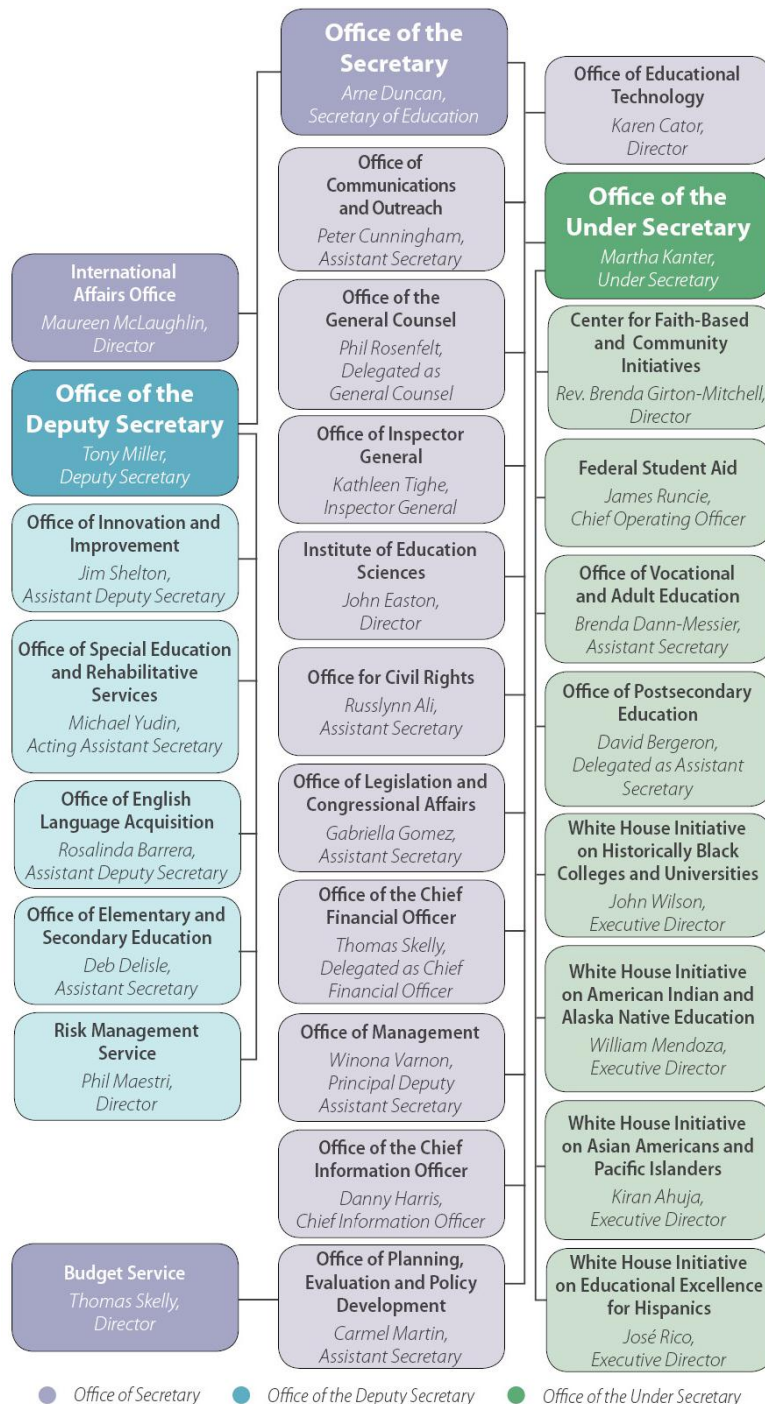
**Regional Offices.** The [Department has ten regional offices](#) that provide points of contact and assistance for schools, parents, and citizens. The primary support within the regional offices is that of communications, civil rights enforcement, and to promote efficiency, effectiveness, and integrity in the programs and operations of the Department. In addition to enforcement offices in federal regions, enforcement offices are located in Washington, D.C. and Cleveland.

**Web Presence.** The Department maintains a [comprehensive website](#) that focuses on most popular searches, latest news and events, and links to social media. A partial list of Education Resources of the Department and Selected Department Web Links can be found in the appendices of this report.

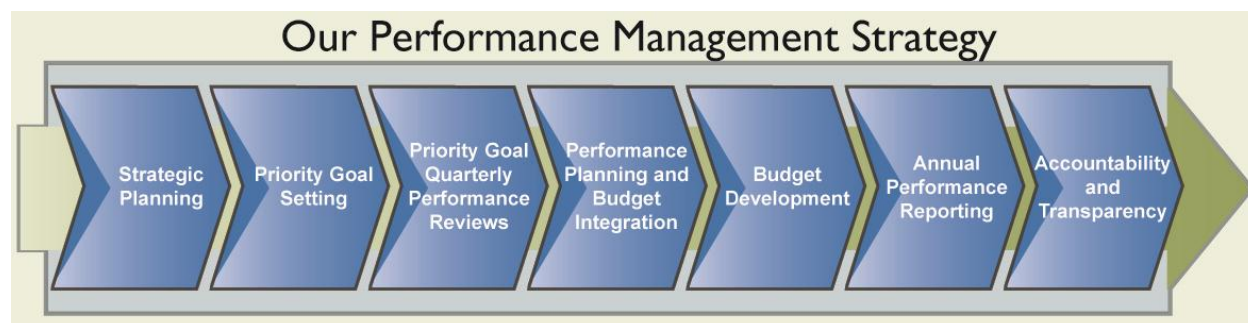


## Our Organization in Fiscal Year 2012

The Required Supplementary Stewardship Information section of this report contains summary information about offices within the Department. Links are provided to web pages that provide a detailed [description of the principal offices](#) of the Department and an [overview of Department activities](#). This chart reflects the Department organization as of September 30, 2012.



## The Department's Approach to Performance Management



### Implementing the GPRA Modernization Act of 2010

On January 4, 2011, President Obama signed into law the *GPRA Modernization Act of 2010*. The Act improves on the *Government Performance and Results Act of 1993 (GPRA)* and modernizes the federal government's performance management framework. The *GPRA Modernization Act of 2010* builds on the Department's approach to performance management to improve the effectiveness and efficiency of government by requiring that agency leaders set clear, ambitious goals for a number of outcome-focused and management priorities. Federal agencies measure, analyze, and communicate performance information to identify successful practices, and agency leaders conduct in-depth performance reviews at least quarterly to identify progress on their priorities. The *GPRA Modernization Act* serves as a foundation for engaging leaders in performance improvement and creating a culture where data and empirical information play a greater role in policy, budgetary, and management decisions.

The Department's performance management approach links strategic goals and policy priorities to program activities and outcomes. The strategic planning and performance reporting cycle results in ongoing programmatic assessment and continuous operational improvement to deliver meaningful outcomes for our nation's students.

### Our National Outcome Goals

The Department has identified a select number of National Outcome Goals that focus on making improvements in student achievement needed at every level of education to achieve the President's goal that, once again, America will have the highest proportion of college graduates in the world. Achieving that outcome will require a concerted effort from all stakeholders in the education system. These goals include outcomes in the following key areas:

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

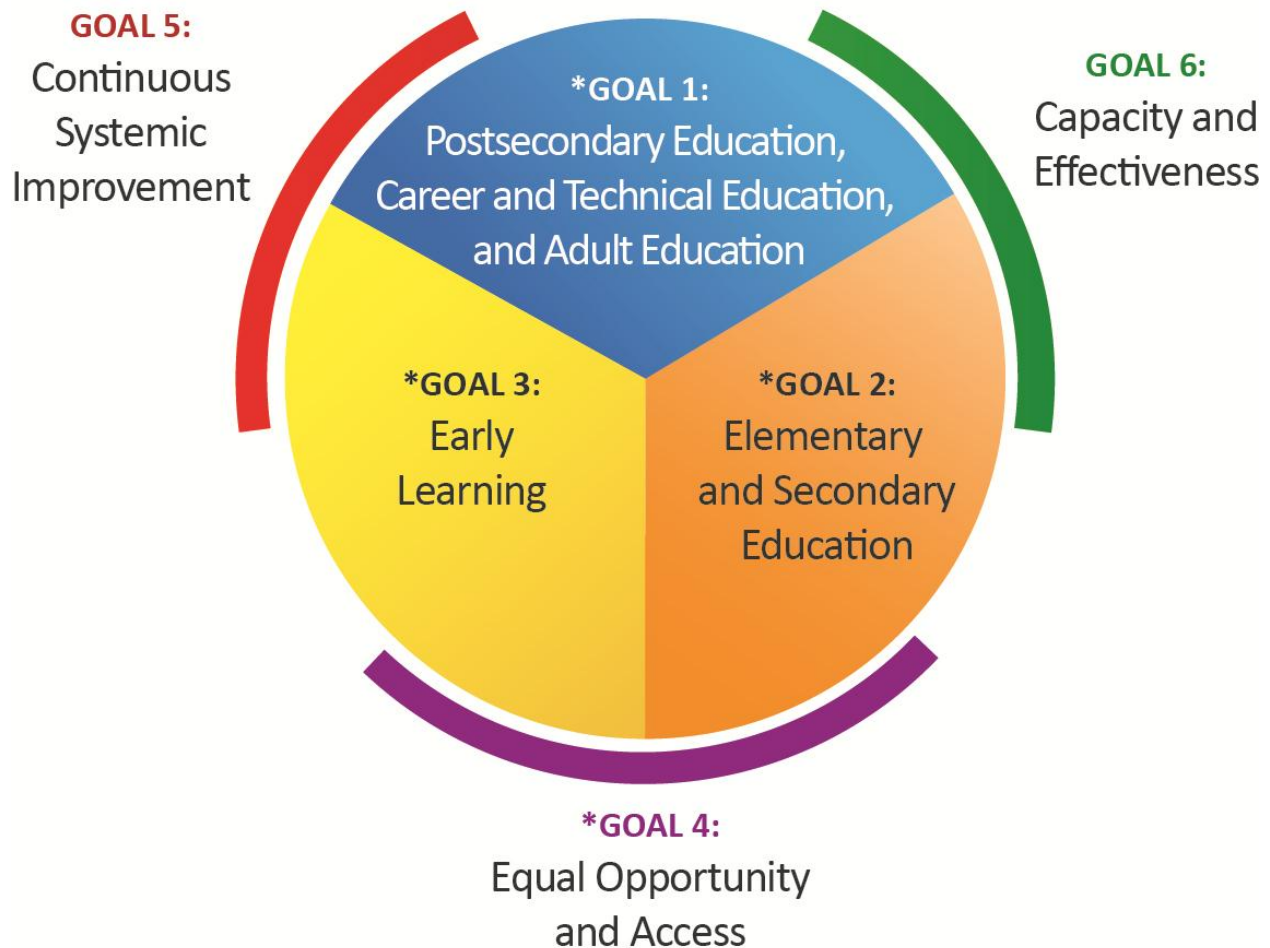
### The Department's Strategic Planning Process

To meet the National Outcome Goals, changes are needed in how education is delivered. Investing in education means investing in America's future and is vital for maintaining our long-

term economic security. The nation must work to ensure that all children and adults in America receive a world-class education that will prepare them to succeed in college and careers. Strategic planning is the starting point for the work of the Department as described in its *FY 2011–2014 Strategic Plan*. Reaching this goal will require comprehensive education reforms from cradle to career, beginning with children at birth, supporting them through postsecondary education, and helping them succeed as lifelong learners who can adapt to the constant changes in the technology-driven workplaces of the global economy.

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

## FY 2011-2014 Strategic Plan



\*Aligns with National Outcome Goals.



## The Department Priority Goals

The Department has identified a limited number of Agency Priority Goals for FY 2012–13 that serve as a particular focus for our activities. These Priority Goals reflect the Department's cradle-to-career education strategy, and will help concentrate efforts on the importance of teaching and learning at all levels of the education system.

### Progress on the Department's FY 2012–13 Priority Goals

**Priority Goal 1: Improve outcomes for all children from birth through third grade. By September 30, 2013, at least nine states will implement a high-quality plan to collect and report disaggregated data on the status of children at kindergarten entry.**

The Department made a major step in FY 2012 toward reaching the Priority Goal of at least nine states implementing a high-quality plan to collect and report disaggregated data on the status of children at kindergarten entry through the awarding of Race to the Top – Early Learning Challenge (RTT-ELC) grants to nine states. The RTT-ELC states have committed to comprehensive plans for expanding access to high-quality early learning, including collecting and reporting disaggregated data on the status of children at kindergarten entry. As with many of the Department's key reform programs, Department staff are working with states to ensure that they continue to meet their commitments, through the provision of high-quality, consistent technical assistance and monitoring.

**Priority Goal 2: Improve learning by ensuring that more students have an effective teacher. By September 30, 2013, at least 500 school districts will have comprehensive teacher and principal evaluation and support systems and the majority of states will have statewide requirements for comprehensive teacher and principal evaluation and support systems.**

The Department has made significant progress in leveraging its programs to support state-led efforts to train, recruit, identify, and retain effective teachers, especially in areas with high needs. In particular, the Department's efforts are focused on:

- encouraging teachers to play active roles in the development of these policies (through the RESPECT project and the Teacher Incentive Fund [TIF]);
- encouraging school districts to leverage best practices to recruit and retain effective teachers (through TIF programs);
- encouraging the development and adoption of innovative strategies to transform the teaching profession that will ultimately impact student outcomes (through TIF, investing in Innovation, and other programs); and
- creating a critical mass of states that have created the conditions for education innovation and reform (through Race to the Top, ESEA Flexibility, School Improvement Grants (SIG), and other initiatives).

**Priority Goal 3: Demonstrate progress in turning around the nation's lowest-performing schools. By September 30, 2013, 500 of the nation's persistently lowest-achieving schools will have demonstrated significant improvement and will have served as potential models for future turnaround efforts.**

The President and Congress have made significant investments in turning around the nation's persistently lowest-achieving schools, in large part through School Improvement Grants, Race to

the Top, and through the Department's work to grant states flexibility regarding specific requirements of the *No Child Left Behind Act of 2001* (NCLB). With more than 1,300 schools now implementing one of the four SIG intervention models, schools around the country have hired new leadership, recruited effective teachers, increased learning time, changed school climate, and offered teachers data-driven professional development aimed at increasing student achievement.

**Priority Goal 4: Make informed decisions and improve instruction through the use of data. By September 30, 2013, all states and territories will implement comprehensive statewide longitudinal data systems (SLDS).**

Based on the five rounds of funding, 47 states, the District of Columbia, Puerto Rico, and the Virgin Islands have received at least one SLDS grant. By the end of FY 2013, we expect all states and the District of Columbia to have a functioning K-12 SLDS, 12 states to link with early childhood systems, 21 to link with postsecondary data from state institutions, and 10 to link with labor. Linkages with workforce data have presented the greatest challenge for states due to a lack of a common ID, multiple privacy laws, and insufficient multi-agency coordination so we have increased our coordination with the Department of Labor. Also, because of the paucity of early childhood data sources, the Department is creating a series of best practice materials and workshops on early childhood data sharing.

**Priority Goal 5: Prepare all students for college and career. By September 30, 2013, all states will adopt internationally-benchmarked college-and career-ready standards.**

Forty-five states and the District of Columbia have adopted college- and career-ready standards (CCR) through adoption of the Common Core State Standards. Through ESEA Flexibility, 44 states and the District of Columbia have submitted requests indicating that they have adopted college- and career-ready standards. The total number of states that have approved applications is significantly more than the Department initially anticipated as nearly all states have requested flexibility.

**Priority Goal 6: Improve students' ability to afford and complete college. By September 30, 2013, the Department will develop a college scorecard designed to improve consumer decision-making and transparency about affordability for students and borrowers by streamlining information on all degree-granting institutions into a single, comparable, and simplified format, while also helping all states and institutions develop college completion plans.**

The Department successfully reached its goal of developing a college scorecard in October 2012. Our successes to date include identifying a funding source, developing and releasing a prototype for public comment, working with software developers to ensure that colleges and universities will be able to publish scorecards quickly, and soliciting university partners to be the first group to release a scorecard. The Department has little influence over state decisions to establish college completion goals, although we continue to encourage goal setting and highlight states that have goals in speeches, editorials, and conversations. In July 2012, the Department sent to all governors a chart showing the state's current attainment rate and our estimated target to reach the President's 2020 goal and to raise awareness of progress needed and encourage goal setting.

For more information on the Department's FY 2012–13 Priority Goals, please go to <http://goals.performance.gov/agency/ed>.

In addition to the Agency Priority Goals, the Department contributes to several Cross-Agency Priority (CAP) Goals as required by the *GPRRA Modernization Act of 2010*.

**Cross-Agency Priority Goal: Science, Technology, Engineering, and Math (STEM) Education**

**Improve the quality of science, technology, engineering, and math (STEM) education.** The federal government will work with education partners to improve the quality of science, technology, engineering, and math (STEM) education at all levels, and in support of the President's goal that the U.S. have the highest proportion of college graduates in the world by 2020, help increase the number of well-prepared graduates with STEM degrees by one-third over the next 10 years, resulting in an additional 1 million graduates with degrees in STEM subjects.

**Cross-Agency Priority Goal: Veteran Career Readiness**

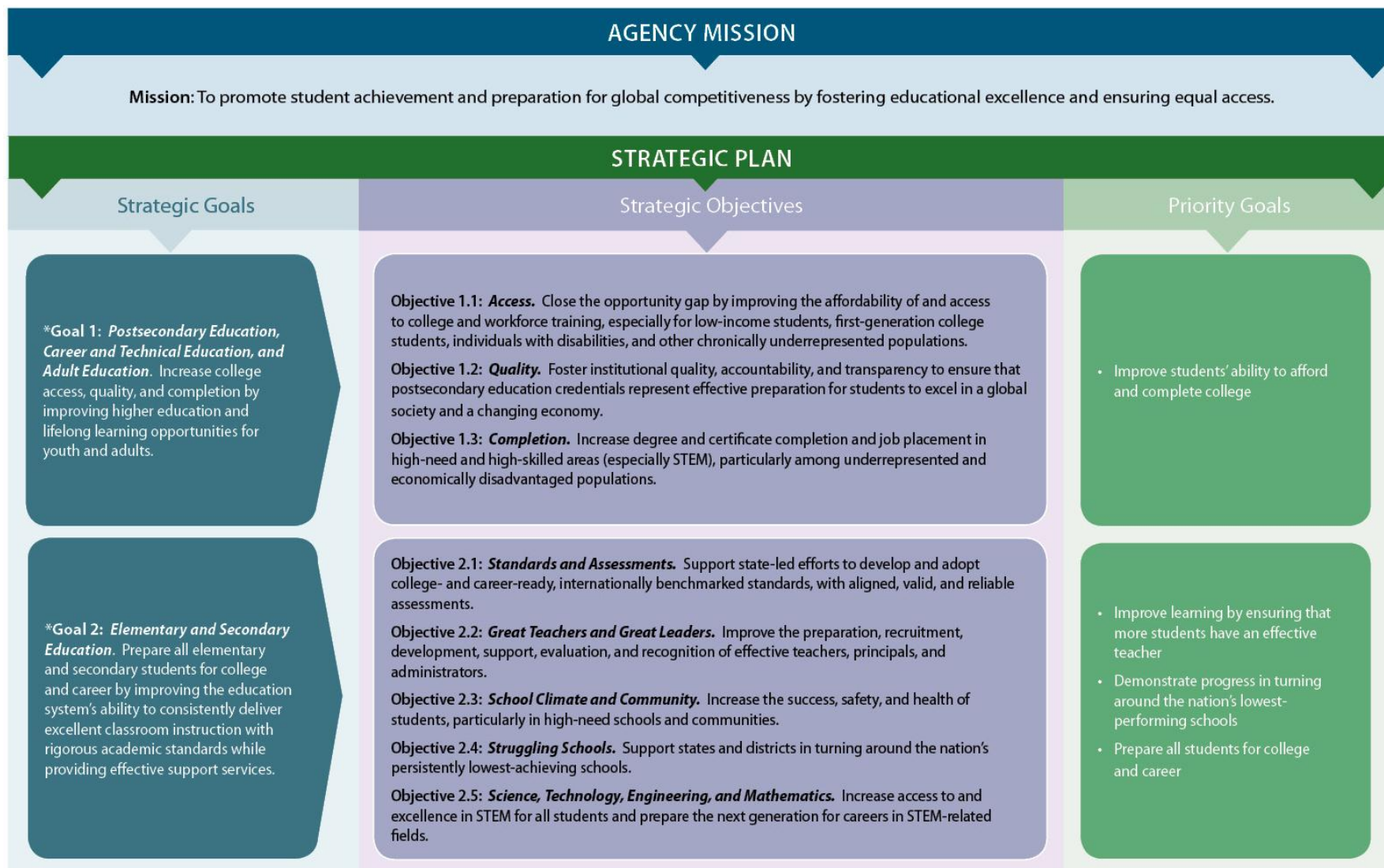
**Improve career readiness of veterans.** By September 30, 2013, the federal government will help to increase the percentage of eligible service members who will be served by career readiness and preparedness programs from 50 percent to 90 percent in order to improve their competitiveness in the job market.

**Cross-Agency Priority Goal: Job Training**

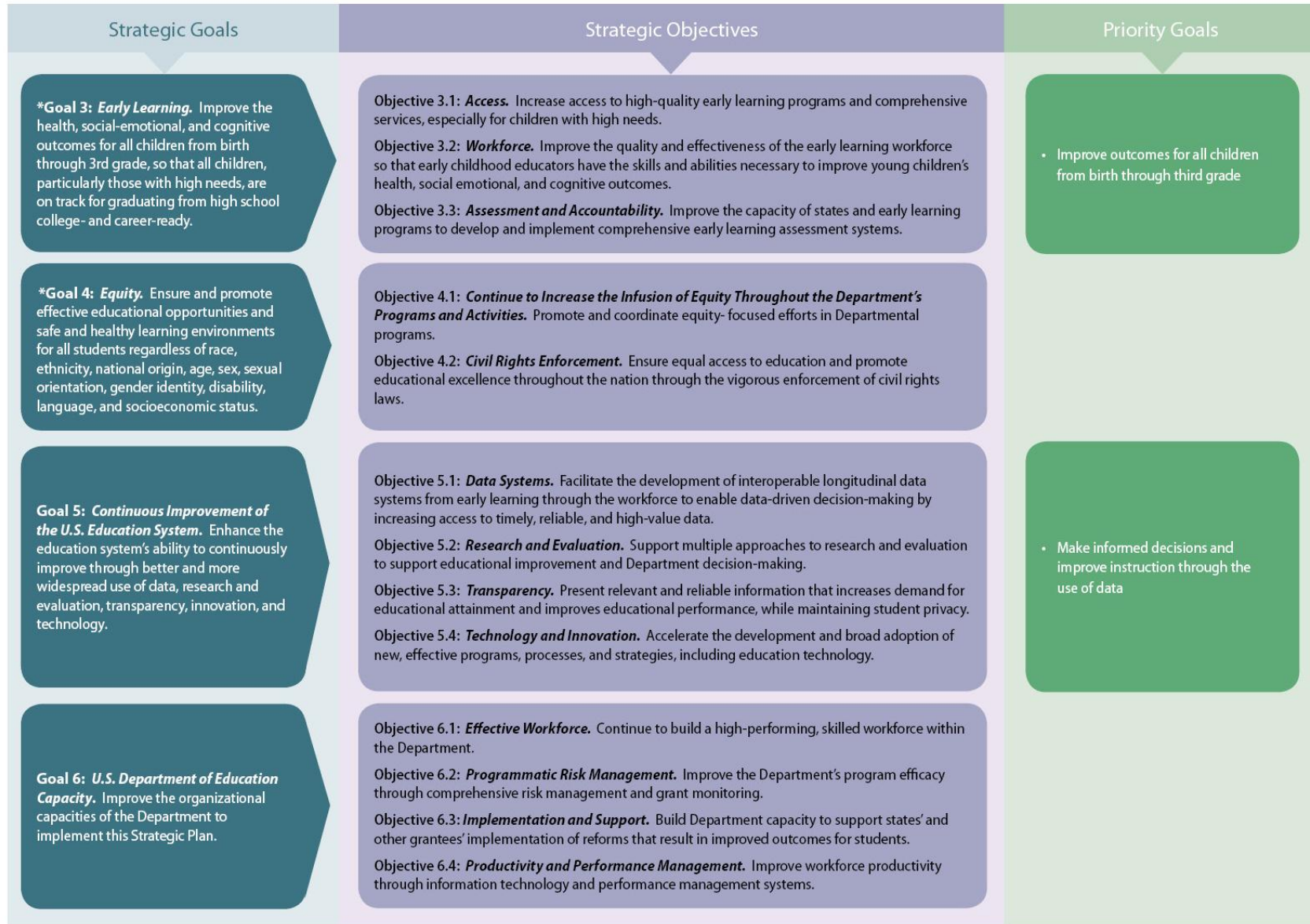
**Ensure our country has one of the most skilled workforces in the world.** Federal agencies will prepare 2 million workers with skills training by 2015 and improve the coordination and delivery of job training services.

For additional information on the Cross-Agency Priority Goals, please go to [http://goals.performance.gov/goals\\_2013](http://goals.performance.gov/goals_2013).





\*Aligns with National Outcome Goals.



\*Aligns with National Outcome Goals.

## The Department's Organizational Performance Review Process

To manage agency performance, the Department has established quarterly performance reviews to assess and improve agencywide performance with a focus on the Department's Agency Priority Goals and other key policy priorities. At these reviews, senior leaders conduct real-time data-driven decision making, identify issues and best practices with significant inter-office implications, and ensure that the Department maintains a consistent focus on strategic priorities.

The Department engages individual principal operating components in organizational performance reviews to promote and focus on continuous operational improvement and capacity-building in key priority areas, including their core processes, people/organizational development, administrative management, and contributions to the department above and beyond expectations. The organizational reviews also provide a mechanism for identifying promising practices that can be applied to other areas of the agency to continuously improve and leverage the Department's internal capacity to deliver on its mission.

## Challenges Linking Performance to Resources

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

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

Therefore, program results cannot be attributed solely to the actions taken related to FY 2012 funds but to a combination of funds from across several fiscal years, as well as state and local investments, and to many external factors, including economic conditions. Furthermore, the results of some education programs may not be apparent for many years after the funds are expended. In addition, results may be due to the effects of multiple programs.

## Assessing the Completeness, Reliability, and Quality of Our Data

Ensuring that accurate and complete data are reported is critical in supporting transparency of management and budgetary decisions. The Department has established controls to ensure that data used by the Department to make funding decisions, evaluate program performance, and support a number of management and budgetary decisions are as accurate as possible. The Department has designed a procedure for ensuring that the best quality data are available for its planning and reporting purposes. The Department has developed guidance and a framework for principal offices to identify issues in data validation and verification for its strategic and program performance goals and measures prior to data reporting. In addition, limitations of data collected by the Department are noted and actions are planned to correct shortfalls in data completeness, accuracy, and reliability.

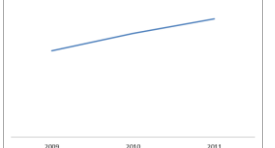
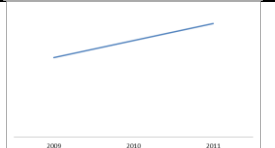

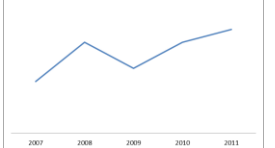
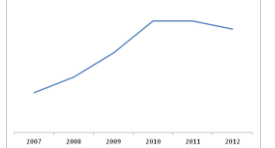
## Selected Outcome Measures for FY 2012

In support of the FY 2011–14 Strategic Goals, the table below presents trend information for selected performance measures for FY 2007–12.

Performance Results Summary		FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Trend*
<b>Student Achievement</b>								
Increase in the percentage of parents and teachers who believe that the effective implementation of technology within instruction is important to student success**	Parents	NA	78%	91%	89%	87%	Target: 89%	
	Teachers	NA	70%	80%	78%	79%	Target: 81%	
Increase the percentage of adult education students obtaining a high school credential***,†		61.5%	64.1%	52.4%††	60.2%	Target 56.0%‡	Target: 57.0%	
Increase the percentage of public high school students who graduate four years after starting 9th grade (Averaged Freshman Graduation Rate)***		74%	75%	76%	Target: 76%‡	Target: 76%‡	Target: 77%	
Increase the percentage of 4th-grade students at or above proficient on the NAEP in reading****,‡‡		32%	NA	32%	NA	32%	NA	
Increase the percentage of 8th-grade students at or above proficient on the NAEP in reading****,‡‡		29%	NA	30%	NA	32%	NA	

Performance Results Summary	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Trend*
Increase the percentage of 4th-grade students at or above proficient on the NAEP in mathematics****#	39%	NA	38%	NA	40%	NA	
Increase the percentage of 8th-grade students at or above proficient on the NAEP in mathematics****#	31%	NA	33%	NA	34%	NA	
<b>Postsecondary</b>							
Increase in the percentage of individuals completing and filing the FAFSA who are non-traditional students (25 years and above with no college degree)	NA	2.2%	2.9%	3.9%	3.8%	Target: 3.6%	
Increase in the number of undergraduate credentials/degrees (in millions)	2.3	2.3	2.4	2.5	2.7	Target: 2.7	
Increase in the number of STEM undergraduate degrees awarded***	NA	313,911	297,555	337,946	Target: 344,705 ‡	Target: 351,599	
Increase the percentage of 25- to 34-year-olds who attain an associate's or higher degree***	40.4%	41.6%	41.1%	42.3%	43.1%	Target: 44%	
Increase the percentage of students who complete a bachelor's degree within 6 years from their initial institution***	57%	57%	57%	58%	Target: 61% ‡	Target: 63%	



Performance Results Summary		FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Trend*
<b>State Activities</b>								
Increase in the number of states implementing comprehensive statewide longitudinal data systems***	Link students with teachers	NA	NA	30	36	41	Target: 47	
	Link P-12 with college	NA	NA	28	34	40	Target: 46	
<b>Department Management</b>								
Increase in the Department's rank in the report on the Best Places to Work (BPTW) in the Federal Government	28 out of 30	NA	27 out of 30	30 out of 32	29 out of 33	Target: 27	No trend displayed due to differences in the numbers of agencies ranked in FY 2007–11.	
Increase in the percentage of Department's positive responses that the Department receives on the Talent Management measure in the Federal Viewpoint Survey	NA	58%	54%	54%	58%	Target: 62%		
Increase in the percentage of positive responses that the Department receives on the Performance Culture measure in the Federal Viewpoint Survey	49%	52%	50%	52%	53%	Target: 58%		
Increase in the Department's American Customer Satisfaction Index rating and states and other grantees reporting satisfaction with support provided by the Department	63	65	68	72	72	71		

\* Trend lines display only years with actual data available. \*\* Data are a sum of "Important" and "Very Important" responses to the Project Tomorrow Teacher Survey. In the FY 2011 AFR, only "Important" responses were included. \*\*\* National Outcome Goal. † Data were recalculated and corrected from previous reporting year. †† The percentage of adults who earned a high school diploma was down in program year 2009–10 due to a reporting anomaly in one large state that resulted from an issue with goal setting in some of its programs. The state has provided technical assistance to these programs. An adjustment that omits this state's data from the two most recent years indicates that the national performance on the high school completion remains relatively the same at approximately 65 percent. ‡ Data not yet available for this fiscal year. ‡‡ NAEP data are collected biennially. Data reported for the NAEP measures in the FY 2012 AFR reflect public school students only. In previous AFRs, national totals that included both public and private school data were reported. ‡‡‡ Data from National Center for Education Statistics, Integrated Postsecondary Education Data System. For the FY 2011 AFR, National Science Foundation, National Center for Science and Engineering Statistics data were reported.

## FY 2012 Goals, Objectives, and Selected Programs

In FY 2012, the Department continued a number of programs and initiatives designed to focus on meeting the President's cradle-to-career priority to support states and districts as they reform their schools and make college more affordable for students. For FY 2012, these priorities focused on:

- granting flexibility to states under ESEA,
- reforming the teaching profession,
- reducing college costs and improving college access,
- achieving equity in education, and
- improving student achievement.

A summary of major Department programs, organized by Strategic Goal, follows.

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

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

**Objective 1.1: Access.** Close the opportunity gap by improving the affordability of and access to college and workforce training, especially for low-income students, first-generation college students, individuals with disabilities, and other chronically underrepresented populations.

**Objective 1.2: Quality.** Foster institutional quality, accountability, and transparency to ensure that postsecondary education credentials represent effective preparation for students to excel in a global society and a changing economy.

**Objective 1.3: Completion.** Increase degree and certificate completion and job placement in high-need and high-skilled areas (especially STEM), particularly among underrepresented and economically disadvantaged populations.

In 2012, the Department continued to support President Obama's three-prong strategy (access, quality, and completion) for achieving the 2020 goal of America once again having the highest proportion of college graduates in the world.

#### The William D. Ford Federal Direct Loan Program (Direct Loan)

The [Direct Loan Program](#) lends funds directly to students and parents through participating schools. Created in 1993, this program is funded by borrowings from the U.S. Department of the Treasury, as well as an appropriation for subsidy costs.

#### The Federal Pell Grant Program (Pell Grant)

The [Pell Grant Program](#) helps ensure financial access to postsecondary education by providing grant aid to low-income and middle-income undergraduate students. Pell Grants vary according to the financial circumstances of students and their families. The maximum Federal Pell Grant award is \$5,550 for the 2012–13 award year (July 1, 2012, to June 30, 2013). However, the

amount a student receives will depend on their financial need, cost of attendance, status as a full-time or part-time student, and plans to attend school for a full academic year or less. Students eligible for a Pell Grant will receive the full amount they qualify for—each school participating in the program receives enough funds each year from the Department to pay the Federal Pell Grant amounts for all its eligible students. The amount of any other student aid for which they might qualify does not affect the amount of the Pell Grant.

Effective with the 2012–13 award year, there was a reduction in the duration of a student's eligibility to receive a Pell Grant from 18 semesters (or its equivalent) to 12 semesters (or its equivalent). The calculation includes all earlier years of the student's receipt of Pell Grants.

### **The Federal TRIO Programs (TRIO)**

TRIO provides federal outreach and student services programs designed to identify and provide services for individuals from disadvantaged backgrounds. TRIO includes [eight programs](#) targeted to serve and [assist low-income individuals](#), first-generation college students, and individuals with disabilities to progress through the academic pipeline from middle school to postbaccalaureate programs. TRIO also includes a [training program](#) for TRIO programs and is designed to assist TRIO personnel in improving the operation and success of the TRIO projects. In FY 2012, \$840.0 million was available for TRIO programs.

### **Career and Technical Education**

[Career and Technical Education programs](#) (CTE) provide academic, technical, and employability skills to enable secondary students to graduate from high school and transition into postsecondary education, training, and employment in in-demand occupations in high-growth industry sectors. These programs also enable postsecondary students and adults to obtain industry-recognized credentials (in sectors where they exist and are appropriate) and postsecondary certificates or degrees that lead to employment in those sectors.

Under the *Carl D. Perkins Career and Technical Education Act of 2006*, the Department provides formula grants to eligible states and outlying areas to fund programs that assist secondary and postsecondary students to acquire academic and technical skills and to prepare for high-skill, high-wage, or high-demand occupations in the global economy.

The Perkins Act of 2006 also authorizes the Department to award discretionary grants to help improve CTE for Native Americans and Native Hawaiians, for CTE students at Tribally Controlled CTE Institutions, and for grants to organizations, institutions, and agencies for CTE research, evaluation, capacity building, dissemination, technical assistance, and promising practices. In addition, the Department supports a [collaborative resources network](#), as well as [statistics collection and reporting](#).

**Adult Education Programs.** In addition, the Department administers formula grant funds to states for adult education and literacy programs. States distribute funds to local eligible entities to provide adult education and literacy services that provide educational opportunities below the postsecondary level for young people and adults, 16 years of age and older, who are not currently enrolled in school, and who lack a high school diploma or the basic skills to function effectively in the workplace and in their daily lives, or are unable to speak, read, or write the English language. A weekly electronic newsletter, [OVAE Connection](#), published by the Office of Vocational and Adult Education, provides information to state officials involved in adult education, CTE, and community colleges, as well as to practitioners, researchers, education groups, and others interested in community colleges, CTE, and adult education.

## Goal 2: Elementary and Secondary Education

***Prepare all elementary and secondary students for college and career by improving the education system's ability to consistently deliver excellent classroom instruction with rigorous academic standards while providing effective support services.***

**Objective 2.1: Standards and Assessments.** Support state-led efforts to develop and adopt college- and career-ready, internationally benchmarked standards, with aligned, valid, and reliable assessments.

**Objective 2.2: Great Teachers and Great Leaders.** Improve the preparation, recruitment, development, support, evaluation, and recognition of effective teachers, principals, and administrators.

**Objective 2.3: School Climate and Community.** Increase the success, safety, and health of students, particularly in high-need schools and communities.

**Objective 2.4: Struggling Schools.** Support states and districts in turning around the nation's persistently lowest-achieving schools.

**Objective 2.5: Science, Technology, Engineering, and Mathematics.** Increase access to and excellence in STEM for all students and prepare the next generation for careers in STEM-related fields.

In FY 2012, the Department continued to support programs to help states to prepare students for college and careers, by consistently providing students with the education necessary to achieve that goal.

### Race to the Top

On August 12, 2012, the Department published the final application for the 2012 Race to the Top—District competition, which will provide support to school districts in implementing local education reforms that personalize instruction, close achievement gaps, and take full advantage of 21st century tools that prepare each student for college and careers.

The [Race to the Top](#) state competition provided support to states to strengthen standards and assessments, increase teacher and principal quality, turn around the lowest-performing schools, and improve the use of education data. In addition, the Department awarded [state grants](#) to develop a new generation of tests that assess students' knowledge of mathematics and English language arts from third grade through high school. The early childhood component is discussed in Goal 3.

Race to the Top requires that reform occur as part of a comprehensive approach but acknowledges that there is no one path to reform. The [Race to the Top Annual Performance Report](#) is a tool that permits the Department, grantees, and the public to follow grantees' progress in implementing comprehensive education reform plans and meeting ambitious goals for student outcomes, including increasing student achievement and closing achievement gaps.

### Teacher Incentive Fund

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

[a new competition](#) in FY 2012 that seeks to strengthen the education profession by rewarding excellence, attracting teachers and principals to high-need schools, and providing all teachers and principals with the feedback and support they need to succeed.

### **ESEA Flexibility**

The Department has invited each state educational agency (SEA) to [request flexibility](#) from certain requirements of the *Elementary and Secondary Education Act of 1965*, as reauthorized by the *No Child Left Behind Act of 2001*, on behalf of itself, its local educational agencies, and schools, in order to better focus on improving student learning and increasing the quality of instruction. During 2012, the Secretary approved requests from states and the District of Columbia to provide educators and state and local leaders with flexibility regarding specific requirements in exchange for rigorous and comprehensive state-developed plans designed to improve educational outcomes for all students, close achievement gaps, increase equity, and improve the quality of instruction.

### **School Improvement Grants**

[School Improvement Grants](#) (SIG) are used to improve student achievement in three tiers of schools: (1) Tier I schools, which are generally the lowest-achieving five percent of Title I schools identified for improvement, corrective action, or restructuring; (2) Tier II schools, which are generally the lowest-achieving five-percent of secondary schools that are eligible for, but do not receive, Title I funds; and (3) Tier III schools, which are all other Title I schools identified for improvement, corrective action, or restructuring. Under the School Improvement Grants program, SEAs give priority to awarding funds to enable Tier I and Tier II schools to implement dramatic interventions to help turn around their academic performance.

In August 2012, the White House welcomed state, district, and school leaders and educators for panel discussions on the transformative efforts underway in low-performing schools through the SIG program, including efforts to turnaround schools characterized by years of low attendance rates, low student achievement, and low graduation rates, as well as high rates of student disciplinary action and staff turnover.

### **Investing in Innovation Fund**

In FY 2012, the Department invited pre-applicants to submit an application for the FY 2012 Full Application Development Competition under the [Investing in Innovation](#) (i3) grant competition. The grants continue support for evidence-based practices in education. The purpose of this program is to provide competitive grants to applicants with a record of improving student achievement and attainment in order to expand the implementation of, and investment in, innovative practices that are demonstrated to have an impact on improving student achievement or student growth, closing achievement gaps, decreasing dropout rates, increasing high school graduation rates, or increasing college enrollment and completion rates.

### **Promise Neighborhoods**

[Promise Neighborhoods](#), established under the legislative authority of the Fund for the Improvement of Education, provides funding to support eligible entities, including nonprofit organizations, which may include faith-based nonprofit organizations, institutions of higher education, and Indian tribes. In FY 2012, the Department received applications and awards are expected no later than December 31, 2012.



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

### Goal 3: Early Learning

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

**Objective 3.1: Access.** Increase access to high-quality early learning programs and comprehensive services, especially for children with high needs.

**Objective 3.2: Workforce.** Improve the quality and effectiveness of the early learning workforce so that early childhood educators have the skills and abilities necessary to improve young children's health, social-emotional, and cognitive outcomes.

**Objective 3.3: Assessment and Accountability.** Improve the capacity of states and early learning programs to develop and implement comprehensive early learning assessment systems.

In FY 2012, the Department continued funding and assistance to help state education systems to prepare students for college and careers, by encouraging and creating incentives for states and local educational agencies to offer high-quality early learning programs, especially for children with high needs.

### Inter-Governmental Cooperation

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

## Race to the Top-Early Learning Challenge

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

RTT-ELC focuses on five key areas of reform:

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

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

### Goal 4: Equity

***Ensure and promote effective educational opportunities and safe and healthy learning environments for all students regardless of race, ethnicity, national origin, age, sex, sexual orientation, gender identity, disability, language, and socioeconomic status.***

**Objective 4.1: Continue to Increase the Infusion of Equity Throughout the Department's Programs and Activities.** Promote and coordinate equity-focused efforts in Departmental programs.

**Objective 4.2: Civil Rights Enforcement.** Ensure equal access to education and promote educational excellence throughout the nation through the vigorous enforcement of civil rights laws.

In FY 2012, the Department continued to support programs to help the education system, with a focus on technical assistance, data collection, and enforcement activities on critical issues including: school culture, by working to ensure students are free from harassment and sexual violence; issues of access, by ensuring equitable distribution of resources; ensuring that English learners get the services they need; ensuring that schools, including charter schools, do not engage in discriminatory recruitment practices or segregate students; and disparate discipline rates.

Under the *FY 2011–2014 Strategic Plan*, the Department focused on the pursuit of equity in two primary ways: (1) by increasing the infusion of equity throughout the Department's programs and activities and (2) by ensuring equal access to education and promoting educational excellence throughout the nation through the vigorous enforcement of civil rights laws.

For example, the Department worked to provide a greater focus on equity throughout its initiatives and programs, including in the awarding of competitive grants like Race to the Top—District and the Charter School Program; working to preserve accountability for subgroup performance while offering flexibility for states under the ESEA; improving the affordability of postsecondary education; ensuring a safe learning environment where students are free from bullying and harassment; ensuring the equitable distribution of effective teachers and resources in low-performing, high-poverty, and high-minority schools; increasing traditionally underrepresented students' access to college- and career-ready curricula such as STEM classes, advanced placement, and other high-level courses; and increasing access to high-quality early learning programs for high-need children.

### **Increasing the Infusion of Equity Throughout Department Programs and Activities**

In general, the Department's work includes major activities in the area of early education, elementary and secondary education, postsecondary education, and career and technical education. The Department supports White House initiatives; economically disadvantaged students; English learners; students with disabilities; women and girls; and lesbian, gay, bisexual, and transgender students. The Department continues to host and staff the ongoing work of the Equity and Excellence Commission, a group of 27 national education experts assembled to discuss ways to improve educational equity and excellence, which is expected to develop policy recommendations.

During FY 2012, senior leaders from across the Department met throughout the year to assess how equity is being pursued through current activities and what priorities or activities might be warranted, including how the Department could better promote equitable access to high quality teachers. The Office for Civil Rights (OCR), Office of English Language Acquisition, Office of Vocational and Adult Education, and Office of Special Education and Rehabilitative Services, play a leading role in planning how to increase the infusion of equity throughout the Department.

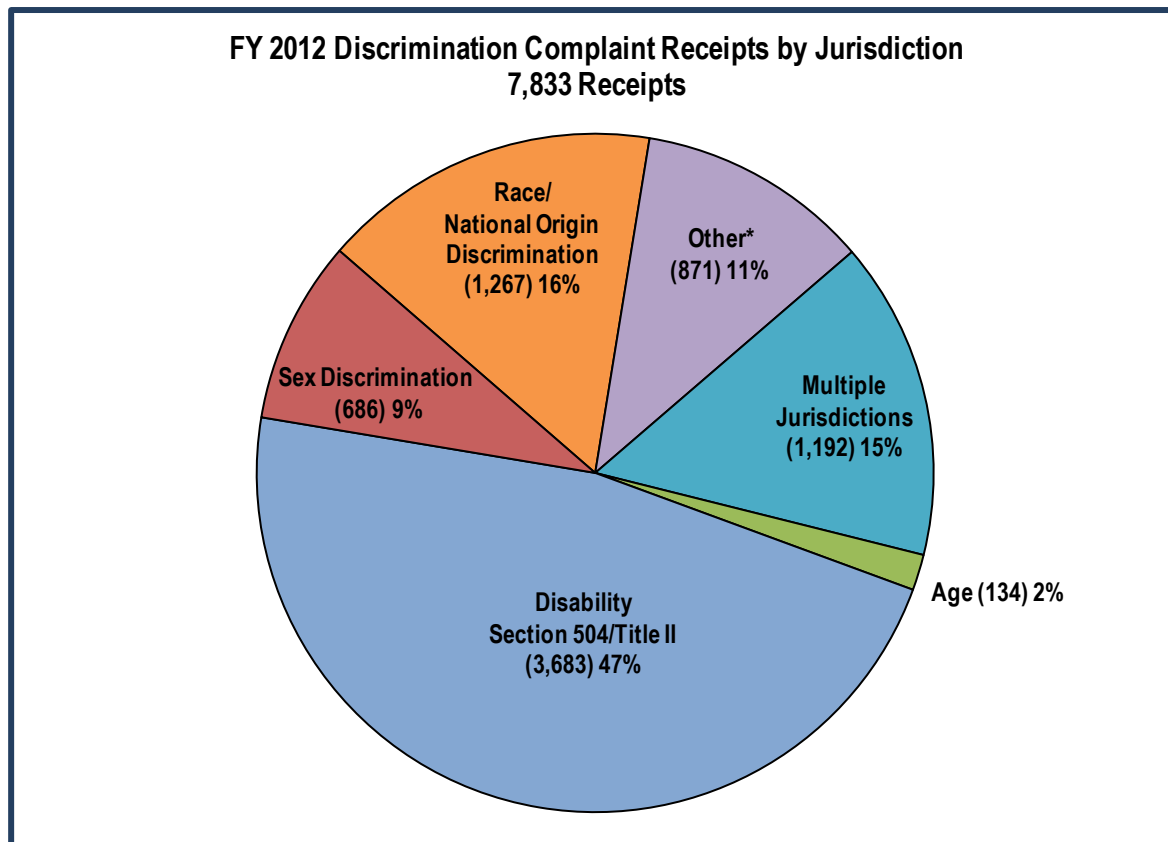
During FY 2012, the Department [launched a new website](#) and an enhanced set of data indicators for the Civil Rights Data Collection, a biannual survey. Data are disaggregated in most instances by race/ethnicity, sex, disability, and limited English proficient status. The data provided through the survey help tell the "equity story" about the nation's educational system. The data are fully accessible to the public through the website, so parents, educators, and advocates can compare and analyze schools and districts. This year, the data covered 85 percent of the nation's students and more than 70,000 public schools nationwide. Schools are now reporting more detailed and useful information related to incidents of school discipline, access to college preparatory math and science courses, bullying and harassment, restraint and seclusion, school finance, and other areas.

### **Ensuring Equal Access**

The Department enforces federal civil rights laws that prohibit discrimination on the basis of race, color, national origin, sex, disability, and age in our nation's schools, primarily in educational institutions that receive federal funds from the Department. OCR, a law enforcement agency within the Department, performs the Department's civil rights enforcement responsibilities in a variety of ways, including: investigating complaints alleging discrimination;

conducting proactive and systemic investigations in educational institutions to determine if they are in compliance with the laws; and providing technical assistance to educational institutions on how to comply with the law and to parents and students on their rights under the law. The Department also issues regulations on civil rights laws, develops policy guidance interpreting the laws, and distributes the information broadly.

In FY 2012, OCR received a total of 7,833 complaints alleging discrimination, comparable to FY 2011's all-time high of 7,841, and resolved 8,161 complaints, some of which were received the previous year. As shown in the chart below, close to half of the complaints received by the Department allege discrimination due to disability. In addition to the issues addressed through complaint processing, OCR resolved or negotiated the settlement of 32 proactive compliance reviews, which are among the most significant public statements that OCR makes concerning civil rights compliance. OCR also initiated 6 proactive compliance reviews, and conducted 42 proactive technical assistance activities. In addition, OCR developed policy guidance to address discrimination against students on the basis of race, color, national origin, sex, and disability. OCR's law enforcement work supports progress on the Department's efforts to address equity.



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

**Source:** Office for Civil Rights Case Management System

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

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

**Objective 5.1: Data Systems.** Facilitate the development of interoperable longitudinal data systems from early learning through the workforce to enable data-driven decision-making by increasing access to timely, reliable, and high-value data.

**Objective 5.2: Research and Evaluation.** Support multiple approaches to research and evaluation to support educational improvement and Department decision-making.

**Objective 5.3: Transparency.** Present relevant and reliable information that increases demand for educational attainment and improves educational performance, while maintaining student privacy.

**Objective 5.4: Technology and Innovation.** Accelerate the development and broad adoption of new, effective programs, processes, and strategies, including education technology.

In FY 2012, the Department continued to support programs to help the education system, by facilitating the development of the infrastructure necessary to collect and disseminate high-value education information for the improvement of child and student outcomes.

**Streamlining Data Content.** In FY 2012, a database hosted by the Department was merged with [Data.gov](#) to save the cost of hosting and maintaining a separate data website and to benefit from greater participation in the shared services of [Data.gov/Education](#), where the growing community of developers and researchers continues to be supported by an expanding platform of tools and features.

**The Data Quality Initiative.** The Data Quality Initiative (DQI), begun in 2006, is designed to improve the quality of the Department's program performance data and reporting. The DQI contractor has worked with the Department's program offices and with grantees to review grantee [evaluation plans and reports](#); develop annual performance reporting methodologies; develop data collection and reporting guidance; review and analyze grantee annual performance data; and deliver grantee briefings and workshops focused on evaluation issues.

In 2009, the Department initiated a companion DQI contract to conduct data audits for selected programs to examine the quality and methods used to report program performance information. A second DQI technical assistance contract, awarded in September 2012, builds on prior work and provides direct assistance to program offices regarding the review, development, analysis, and reporting on *GPRA Modernization Act* and other measures to inform programmatic and budget decisions. This work also helps staff to identify key indicators, and guide their collection and use of data.

**Consolidating Data Collection Through ED*Facts*.** Complete and accurate data are essential for effective decision-making. [ED\*Facts\*](#) is the Department's initiative to put performance data at the center of policy, management, and budget decision-making for elementary and secondary educational programs. ED*Facts* centralizes performance data supplied by state educational agencies and enables the Department to better analyze and use data in policy development, planning, and management. The ED*Facts* system enables the consolidation of separate data collections and reduces the reporting burden for states by eliminating redundant data requests.



Data are available for both state and local educational agencies and school data include data on demographics, program participation, implementation, and outcomes.

**Statewide Longitudinal Data Systems.** The [Statewide Longitudinal Data Systems \(SLDS\) grant program](#), as authorized by the *Educational Technical Assistance Act of 2002*, is designed to aid state educational agencies in developing and implementing longitudinal data systems. Most statewide longitudinal data systems funds are awarded as state grants, but a portion of the funds are used for activities to improve data quality, coordination, and use. Current activities include the Education Data Technical Assistance program, the Privacy Technical Assistance Center, and work on common education data standards. These initiatives are intended to enhance the ability of states to efficiently and accurately manage, analyze, and use education data, including individual student records. The data systems developed with funds from these grants should help states, districts, schools, and teachers make data-driven decisions to improve student learning, as well as facilitate research to increase student achievement and close achievement gaps.

**Data Strategy Team.** The Department's Data Strategy Team (DST) develops and promotes coordinated and consistent data strategies among the various principal offices within the Department. The mission of the DST is to coordinate the Department's public-facing data initiatives by building cohesiveness in internal processes and data policies and by improving transparency in matters related to the Department's collection of data. The DST supports states' use of education data through data websites and technical assistance to grantees and identifies best practices for the use and promotion of data policy.

## The Department's Evaluation Planning Initiatives

In May 2010, the Department launched a new agencywide evaluation planning process to better align its investments in knowledge building with the Department's Strategic Plan and its budget and policy priorities. This process, now in its second year, ensures that evaluation funds are used efficiently and effectively to advance the Department's goals. To determine the effectiveness of programs, policies, and strategies for improving education outcomes, funding is directed at evaluations that will yield reliable measures of effectiveness. For priority questions related to other issues, such as performance management and implementation support, the funding is directed to evaluations that use rigorous methods appropriate for answering those questions.

The evaluation planning team meets with the Department's policy and program offices and, based on their input, develops recommendations for future evaluation activities in the current fiscal year and beyond. Each office identifies its highest-priority research questions, as well as other program-specific research questions they would like addressed. The evaluation team examines the extent to which these research questions are supported by existing research or are being addressed through ongoing evaluations and then develops recommendations based on current and prospective resources. In FY 2011, the Department developed and approved a set of priority research questions to inform future investments in knowledge building. Planning for FY 2012 investments was largely completed this spring and planning for FY 2013 is underway, although final decisions are contingent on appropriations action.

## Goal 6: U.S. Department of Education Capacity

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

**Objective 6.1: Effective Workforce.** Continue to build a high-performing, skilled workforce within the Department.

**Objective 6.2: Programmatic Risk Management.** Improve the Department's program efficacy through comprehensive risk management and grant monitoring.

**Objective 6.3: Implementation and Support.** Build Department capacity to support states' and other grantees' implementation of reforms that result in improved outcomes for students.

**Objective 6.4: Productivity and Performance Management.** Improve workforce productivity through information technology and performance management systems.

### Human Capital and Client Services

The Department is committed to ensuring its workforce has the skills needed to accomplish its Strategic Goals and to further develop human capital skills that will be needed for the future. In FY 2011, the Department assessed its human capital needs and focused on ways to improve workforce competencies through the delivery of training courses, leadership development programs, tuition reimbursement, career and organizational counseling, and computer learning support. In FY 2012, the Department's Office of Management (OM) set goals for closing competency gaps in mission critical occupations and leadership positions. These targeted competencies included fiscal monitoring, policy, legislation, and administrative rulemaking.

Additionally, OM has invested in the development of grants management staff to ensure that the workforce has the knowledge and skills required to oversee the department's grants-making process through the design and implementation of a grants management competency model and certificate program.

Continuous development for the Department's leaders is critical to the success of accomplishing our mission and vital to human capital management and succession planning. To strengthen the skills of our leaders, a number of programs were developed to enhance the leadership skills of those who are in leadership positions and those aspiring to become leaders. These programs include our Pathways to Leadership Program and Transition to Supervision Program, as well as participation in the Excellence in Government Fellows Program.

### The Department Continues Risk-Based Grant Management Strategies

The Department continues to build its capacity to use data to continuously improve its grant management. In FY 2012, the Department advanced its use of data about grant applicants and recipients to inform its pre-award and post-award grant management decisions. The agency is developing its tools and procedures for grant risk management in a context of increasing governmentwide attention to grant risk, which includes significant attention to reducing improper payments through pre-payment screenings and the deployment of the Department of the Treasury's "Do Not Pay" system.

FY 2012 was the second year of the agency's consistent pre-award assessment of applicants' financial and grant management capacity. Because of new agency pre-award grant management procedures, 100 percent of programs conducted a risk assessment in FY 2012.

Each Department program staff employed a risk assessment rubric with indicators of an applicant's past performance with grants and potential financial and management weaknesses. The Department's Decision Support System Entity Risk Review (ERR), which was pilot tested in FY 2011, continued to provide program officers access to risk-related information from Dun & Bradstreet, the Department's grant management system, and the Federal Audit Clearinghouse of recipients' independent audit ("A-133 audit") results. Program officers use these data in conjunction with other performance information, including findings from on-site and desk monitoring of past and current awards, to review grant applicants' capability to manage federal funds. In FY 2012, the rubrics used to identify risk were refined based on last year's experiences to focus on the most useful and meaningful data.

In FY 2012, the agency substantially increased its resources for applying data analysis to its decision making. Guidance documents outline the allowable and recommended actions that program officers may take to mitigate risk when a recipient has past performance or management problems. The risk mitigation guidance emphasizes the use of special award conditions, such as extra reporting by the recipient, technical assistance, and increased oversight of a grant, as methods for promoting successful grant projects. Increased communication among programs—both in regular meetings and through web-based document sharing—is increasing the amount of information program officers have about their grantees. Program offices also used risk assessments to inform their annual grant monitoring plans. The agency is capturing information from risk assessments in order to improve the process over the next few years.

Programs requested and received 186 ERR reports during FY 2011. These reports were used during a Department pilot test of the ERR as a risk assessment tool. The total number of ERR reports requested and delivered for FY 2012 was 320. Grant officers use ERR reports for purposes in addition to discretionary grant pre-award risk reviews, such as oversight during the performance period of formula and discretionary grants. Therefore, the count of ERR reports used is not the same as the number of programs conducting pre-award risk reviews.

During FY 2011, 32 percent of Department programs making awards during the year participated in the pilot test, using an ERR report to inform risk assessments. Some programs that did not use ERRs may have used other sources of information for risk assessment.

During FY 2012, the Department implemented an internal policy that all discretionary grant programs will conduct a risk assessment of applicants prior to making awards. All programs used a risk index that included audit findings and information on the applicants' past performance prior to making awards. Most programs used ERR reports as a component of the risk assessment.

Because the Department has reached 100 percent program participation in the application of a risk index to conduct a risk assessment, a new measure and baseline of grant risk management will be established in 2013.

### **Customer Satisfaction with the Department of Education**

In FY 2012, in response to the President's April 27, 2011, Executive Order 13571, Streamlining Service Delivery and Improving Customer Service, the Department survey included 38 programs.

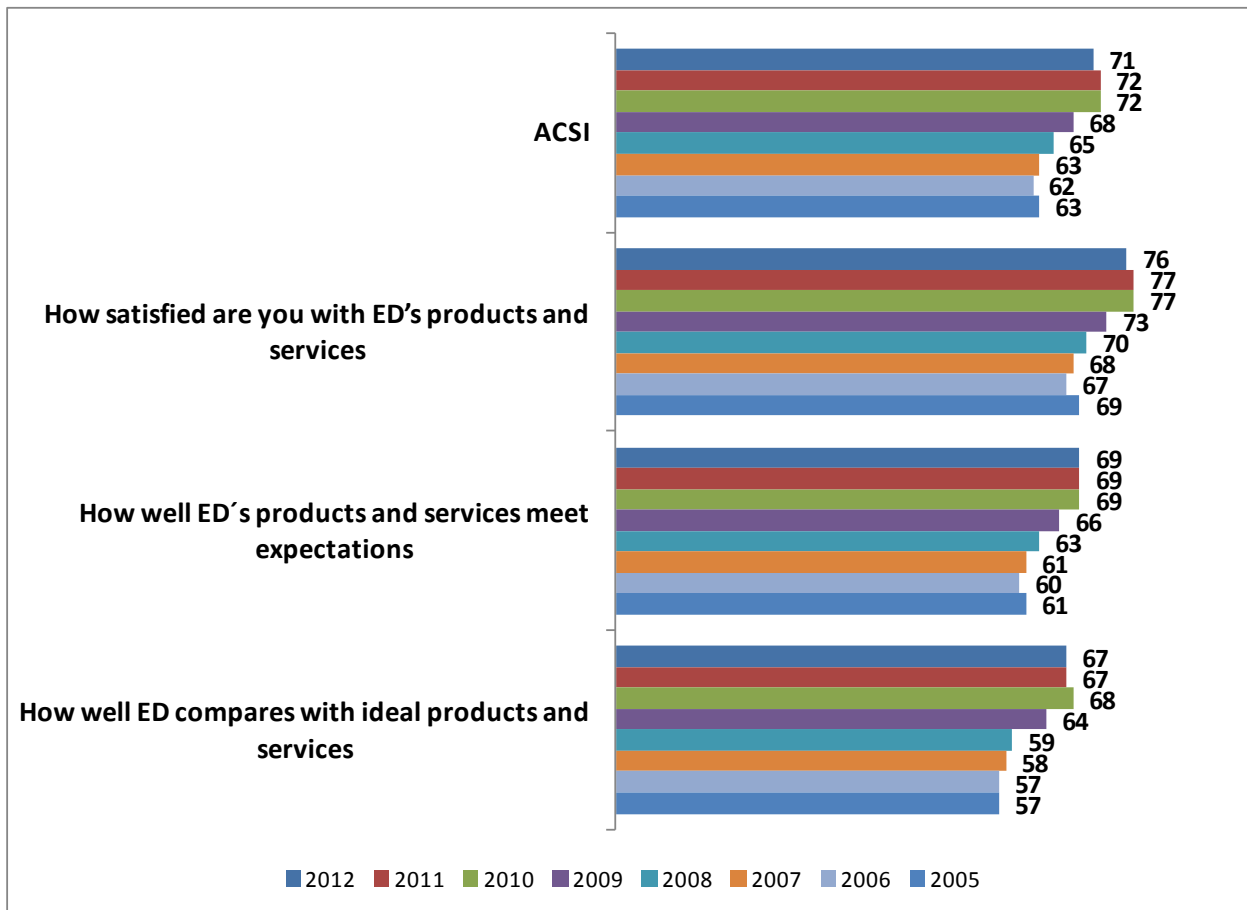
The survey uses the American Customer Satisfaction Index (ACSI). The ACSI is the national indicator of customer evaluations of the quality of goods and services. It is the only uniform benchmarking measure of customer satisfaction across agencies and private industry.

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

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

In FY 2012, there was a slight drop in satisfaction from the previous year—from 72 to 71 points on a 100-point scale. To review the complete results of the Department's customer satisfaction surveys: <http://www2.ed.gov/about/reports/annual/gss/index.html>.

**Customer Satisfaction With the Department of Education, 2005–2012**



## Financial Summary

The table below summarizes trend information concerning components of the Department's financial condition. The Consolidated Balance Sheet presents a snapshot of our financial condition as of September 30, 2012, compared to fiscal year (FY) 2011, and displays assets, liabilities, and net position. Another component of the Department's financial picture is the Consolidated Statement of Net Cost. Each of these components is discussed in further detail in this section and in the Financial Details section of this report.

<b>Financial Summary</b>					
<i>Dollars in Millions</i>					
<b>Consolidated Balance Sheet</b>					
<b>As of September 30, 2012, 2011, 2010, 2009</b>					
	<b>% Change 2012/2011</b>	<b>FY 2012</b>	<b>FY 2011</b>	<b>FY 2010</b>	<b>FY 2009</b>
Fund Balance with Treasury	+7%	\$ 121,993	\$ 114,085	\$ 132,259	\$ 168,032
Credit Program Receivables, Net	+27%	673,488	530,491	367,904	234,254
Other	-26%	1,446	1,966	3,501	3,659
<b>Total Assets</b>	<b>+23%</b>	<b>796,927</b>	<b>646,542</b>	<b>503,664</b>	<b>405,945</b>
Debt	+31%	715,303	547,108	374,335	235,385
Liabilities for Loan Guarantees	-90%	1,037	10,025	14,479	20,543
Other	-26%	15,432	20,824	27,248	22,957
<b>Total Liabilities</b>	<b>+27%</b>	<b>731,772</b>	<b>577,957</b>	<b>416,062</b>	<b>278,885</b>
Unexpended Appropriations	+1%	72,686	71,729	94,371	127,269
Cumulative Results of Operations	+140%	(7,531)	(3,144)	(6,769)	(209)
<b>Total Net Position</b>	<b>-5%</b>	<b>65,155</b>	<b>68,585</b>	<b>87,602</b>	<b>127,060</b>
<b>Total Liabilities and Net Position</b>	<b>+23%</b>	<b>\$ 796,927</b>	<b>\$ 646,542</b>	<b>\$ 503,664</b>	<b>\$ 405,945</b>

<b>Consolidated Statement of Net Cost</b>					
<b>For the Periods Ended September 30, 2012, 2011, 2010, 2009</b>					
	<b>% Change 2012/2011</b>	<b>FY 2012</b>	<b>FY 2011</b>	<b>FY 2010</b>	<b>FY 2009</b>
Gross Cost	-1%	\$ 89,263	\$ 89,910	\$ 116,953	\$ 55,412
Less: Earned Revenue	+25%	(25,490)	(20,397)	(17,279)	(11,251)
<b>Total Net Cost of Operations</b>	<b>-8%</b>	<b>\$ 63,773</b>	<b>\$ 69,513</b>	<b>\$ 99,674</b>	<b>\$ 44,161</b>



## Financial Highlights

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

### Financial Position

The Department's financial statements are prepared in accordance with established federal accounting standards, as promulgated by the Federal Accounting Standards Advisory Board (FASAB), and are audited by the independent accounting firm of Ernst & Young, LLP. The Office of Inspector General (OIG) provides audit oversight. Financial statements and footnotes for FY 2012 appear on pages 41–87.

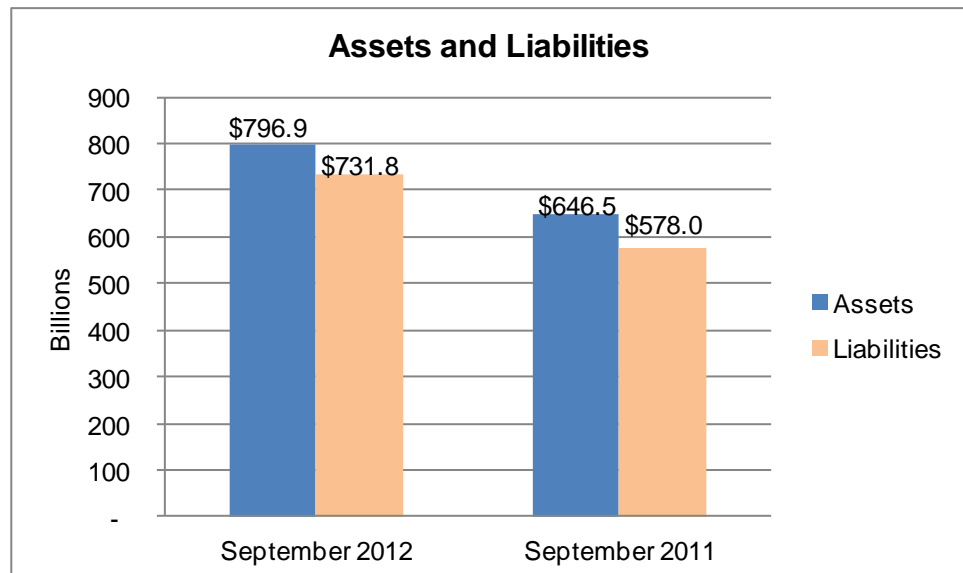
An analysis of the principal financial statements follows.

#### Balance Sheet.

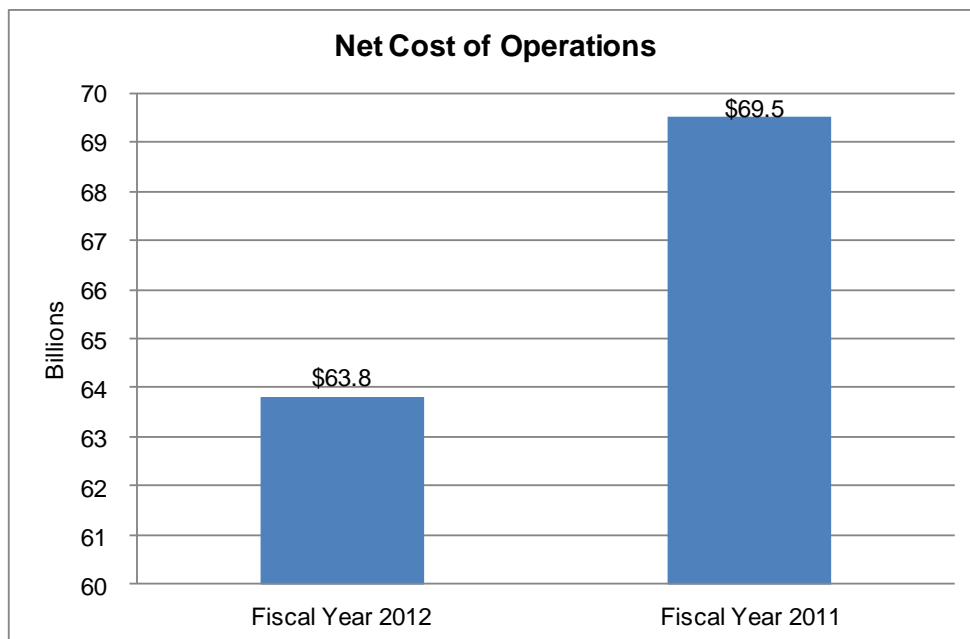
The Balance Sheet presents, as of a specific point in time, the recorded value of assets and liabilities retained or managed by the Department. The difference between assets and liabilities represents the net position of the Department.

The Balance Sheet displayed on page 41 reflects total assets of \$796.9 billion, a 23 percent increase over FY 2011. The vast majority of this increase is due to Credit Program Receivables, which increased by \$143.0 billion, a 27 percent increase over FY 2011. This increase is largely the result of Direct Loan disbursements for new loan originations and loan consolidations, net of borrower principal and interest collections, which increased the net portfolio for Direct Loans by \$144.6 billion.

Total liabilities for the Department increased by \$153.8 billion, a 27 percent increase over FY 2011. The increase is the result of current year borrowing for the Direct Loan and FFEL Programs that provided funding for Direct Loan disbursements and FFEL Program downward re-estimates. This current year borrowing, net of repayments, resulted in a \$168.2 billion increase in Debt. Liabilities for Loan Guarantees for the FFEL Program decreased by \$9.0 billion, a 90 percent decrease that is primarily due to FY 2012 subsidy re-estimates.



**Statement of Net Cost.** The Statement of Net Cost presents the components of the Department's net cost, which is the gross cost incurred less any revenues earned from the Department's activities. The Department's total program net costs, as reflected on the Statement of Net Cost, page 42, were \$63.8 billion during FY 2012,



an 8 percent decrease compared to total program net costs during the prior year. Significant components of this change include a \$20.3 billion decrease in Recovery Act and Education Jobs Fund disbursements and a \$17.9 billion increase in Direct Loan program subsidy related costs (negative subsidy transfers and re-estimated subsidy cost).

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

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

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

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

The goals of the Recovery Act and Education Jobs Fund are consistent with the Department's current *Strategic Plan* goals and programs.

**Statement of Budgetary Resources.** This statement provides information about the provision of budgetary resources and their status as of the end of the reporting period. The statement displayed on page 44 shows that the Department had \$375.0 billion in total budgetary resources for the year ended September 30, 2012. These budgetary resources were composed of \$104.7 billion in appropriated budgetary resources and \$270.3 billion in non-budgetary credit reform resources that primarily consist of borrowing authority for the loan programs. Of the \$31.6 billion that remained unobligated for the year ended September 30, 2012, \$20.5 billion represents funding provided in advance for activities in future periods that were not available at year end. These funds will become available during the next, or future, fiscal years.

### **Limitations of the Financial Statements**

Management has prepared the accompanying financial statements to report the financial position and operational results for the U.S. Department of Education for FY 2012 and FY 2011, pursuant to the requirements of Title 31 of the United States Code, section 3515(b).

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

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

## Management's Assurances

### ***Federal Managers' Financial Integrity Act of 1982 (FMFIA)***

FMFIA requires that agencies establish internal controls and financial systems that provide reasonable assurance that the integrity of Federal programs and operations is protected. It requires that the head of the agency provide an annual assurance statement as to whether the agency has met this requirement. Appendix A of OMB Circular A-123 provides specific requirements for conducting management's assessment of internal control over financial reporting, and also requires the agency head to provide an assurance statement on the effectiveness of internal controls over financial reporting.

The Department's rigorous FY 2012 assessment of internal controls identified two material weaknesses with Federal Student Aid servicing systems. These weaknesses reflect, in aggregate, a number of internal control deficiencies that resulted from system functionality issues occurring after large-scale system conversions in October 2011. The conversions involved extensive data transfers under two information technology system contracts. The systems—currently operated under contracts with Xerox, Inc.—help track and report on data from the Direct Loan and Federal Family Education Loan (FFEL) programs. Within the Department, these two contracts with the conversion challenges are known as: 1) ACS, Inc. Education Servicing (ACES); and 2) Debt Management Collection System (DMCS2).

### **Material Weakness in Internal Controls Over Financial Reporting of Federal Student Aid Data**

The Department's management teams responsible for implementation and oversight of these systems identified multiple internal control deficiencies with ACES and DMCS2 as a result of the system conversions that may adversely impact the accuracy of financial reporting, to include the reporting of loan balances, fund balance with Treasury, and suspense account balances; the processing of portfolio and cash reconciliations; and qualified Service Organization Control 1 (SOC 1) Reports. As of June 30, 2012, in management's judgment these reportable conditions, in the aggregate, would result in more than a remote likelihood that a material misstatement of the Department's financial statements would not be prevented or detected—if the conditions remained uncorrected.

Since June 30, 2012, the Department has taken aggressive action to correct these financial reporting deficiencies. Federal Student Aid (FSA) management actively monitored and tracked system functionality issues and worked closely with Xerox, Inc. to fully examine root causes, impacts, and affected processes. The Department took a number of corrective actions.

To correct inaccurate loan balances, FSA implemented a number of system fixes, and researched and corrected borrower balances. FSA conducted and eliminated a backlog of portfolio and cash reconciliations, and evaluated and corrected suspense account balances by adjusting the matching process. FSA also implemented other internal control improvements that resulted in system fixes, restored system functionality, and reduced backlogs (including administrative wage garnishment and Treasury offset to improve collections, rehabilitation of loans and transfer of loans to continue servicing, and file processing).

As a result of these aggressive actions, as of September 30, 2012, the Department is confident these corrective actions have reduced the potential adverse impacts of the underlying reportable conditions such that, in the aggregate, they do not result in more than a remote



likelihood that a material misstatement of the financial statements in this report would not be prevented or detected. In management's judgment, in the aggregate these reportable conditions and the potential errors that may fail to be prevented or detected are below the level that is material. Reportable conditions remain; however, the Department continues to take these remaining reportable conditions and potential errors very seriously and continues to take aggressive corrective action to fully resolve them.

### **Material Weakness in Internal Controls Over Operation of Direct Loan and FFEL Programs**

The internal control deficiencies related to ACES and DMCS2 impact multiple internal control objectives. In addition to internal control over financial reporting, some of these deficiencies impact internal control over the effectiveness and efficiency of operations. These include issues with the acceptance of loan assignments, transfers, and collection activities. These issues result in material weaknesses for FMFIA Section 2 reporting, for the year ended September 30, 2012.

The Department has taken similarly aggressive actions to begin to correct the root causes of these internal control deficiencies, but in management's assessment the outstanding deficiencies in this area, in the aggregate, remain significant as of September 30, 2012. These actions will continue into 2013 and include research into borrower balances and root cause analysis of system limitations to inform recommendations on system and process fixes.

### ***Federal Financial Management Improvement Act of 1996 (FFMIA)***

FFMIA requires that agencies implement and maintain financial management systems that comply substantially with the Federal financial management system requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. The agency head is to make an annual determination whether the financial systems substantially comply with FFMIA.

On account of the outstanding internal control deficiencies associated with the ACES and DMCS2 financial systems that affect financial reporting, the Secretary has determined the Department's financial systems do not substantially comply with all FFMIA requirements as of September 30, 2012. The previously described deficiencies that continue to impact borrower data elevate the risk of the Department's financial systems to a moderate level. In addition, the Department's assessment identified a number of system-related internal control deficiencies including: security management and user access issues (e.g., user access documentation, security awareness training, review and termination of inactive users, security documentation), application-level issues (e.g., change control, logging and monitoring, password parameters), and business process issues related to dormant data, edit checks, and transaction data processing. The Department believes the combination of these deficiencies support the non-compliance determination.

Consistent with OMB Circular A-123 requirements, the Department's plans for bringing all financial systems—namely ACES and DMCS2—into substantial compliance with FFMIA are summarized in the previous section. These efforts will increase the reliability and timeliness of financial information for managing current operations. The Department also will continue efforts to address security and control weaknesses with an emphasis on addressing their root cause uniformly across the organization. The goal of this action is to decrease the likelihood of similar weaknesses.

The Department continues to meet other key criteria for compliance with FFMA:

- Financial statements, both annual and quarterly presentations, and other required financial and budget reports are prepared using information generated by the Financial Management Support System (FMSS); and
- The FMSS operations and procedures remain consistent with Federal accounting standards and comply with the U.S. Government Standard General Ledger guidance at a transactional level.

## ***Federal Managers' Financial Integrity Act and Federal Financial Management Improvement Act***

### ***Federal Managers' Financial Integrity Act***

The Department of Education's 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* (FMFIA). The Department conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, the Department identified a material weakness in internal controls over the operation of the Direct Loan and FFEL programs. For all other program areas, the Department can provide reasonable assurance that internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2012, was operating effectively; no other material weaknesses were found in the design or operation of the internal controls.

In addition, the Department conducted its assessment of the effectiveness of internal controls 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. Based on the results of the evaluation, the Department identified a material weakness in internal controls over financial reporting of student loan data as of June 30, 2012. However, corrective actions were taken and, as of September 30, 2012, the Department can provide reasonable assurance that its internal controls over financial reporting were operating effectively and no material weaknesses were present in the design or operation of the internal controls.

### ***Federal Financial Management Improvement Act***

The *Federal Financial Management Improvement Act of 1996* (FFMIA) requires agencies to implement and maintain financial management systems that are substantially in compliance with Federal financial management systems requirements, Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. Based on the results of the Department's assessment and outstanding internal control deficiencies, the Department's financial management systems do not substantially comply with FFMIA as of September 30, 2012.

/s/

Arne Duncan  
November 16, 2012

## Financial Management Systems Strategy

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

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

Oracle has recently issued Release 12 of its software. This version has passed the necessary testing and is federally compliant for financial management. The Department has completed an analysis on the change between the 11i and Release 12 versions of the software to determine the benefits and level of effort to implement the new version. Based on the outcome of this analysis and budget constraints, the Department has decided to delay migration to Release 12 until FY 2017. Migration activities will begin during FY 2015 and will be completed in October 2016. These timeframes are subject to change based on funding levels and other priorities.







## Message From the Chief Financial Officer

The Department of Education continued its high standard of financial management during FY 2012. Independent auditors gave an unqualified or “clean” opinion on our financial statements for the 11th consecutive year. We are proud of the Department’s excellence in financial management which has been a joint effort of its managers, employees, and business partners. The Department is a large financial organization, and effective administration of the growing portfolio of loans and grants is important to taxpayers and the millions of students who benefit from our programs.



This year, the Department faced significant new challenges when it converted two old Information Technology systems used to track the servicing of student loans. Such system conversions often cause rough patches in the first year. We agree with our auditors that the problems were significant enough to be deemed what is called a material weakness. We have worked to correct the situation, but we have not finished.

We anticipate the correction of this material weakness during FY 2013. This ongoing process, as well as the results of management’s assessment of internal controls pursuant to the *Federal Managers’ Financial Integrity Act (FMFIA)* and compliance of financial management systems with the *Federal Financial Management Improvement Act of 1996 (FFMIA)* are discussed in the Management’s Discussion and Analysis section of this report. We approach the internal control requirements of these laws and OMB Circular A-123 very seriously. The examinations provide a valuable opportunity to review and improve internal controls and ensure integrity in financial management and reporting.

In FY 2012, the Department also took steps to address the two remaining significant deficiencies identified in the “Report on Internal Controls” for FY 2011: credit reform and information systems. We have made progress in both of these areas and look forward to continuous improvement next year.

/s/

Thomas P. Skelly  
Delegated to perform the functions and duties of Chief Financial Officer  
November 16, 2012

**United States Department of Education**  
**Consolidated Balance Sheet**  
**As of September 30, 2012 and 2011**  
(Dollars in Millions)

	FY 2012	FY 2011
<b>Assets:</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 121,993	\$ 114,085
Accounts Receivable (Note 4)	1	
Other Intragovernmental Assets (Note 8)	18	50
<b>Total Intragovernmental</b>	<b>122,012</b>	<b>114,135</b>
Cash and Other Monetary Assets (Note 5)	1,307	1,664
Accounts Receivable, Net (Note 4)	92	138
Credit Program Receivables, Net (Note 6)	673,488	530,491
General Property, Plant and Equipment, Net (Note 7)	7	16
Other Assets (Note 8)	21	98
<b>Total Assets (Note 2)</b>	<b>\$ 796,927</b>	<b>\$ 646,542</b>
<b>Liabilities:</b>		
Intragovernmental:		
Accounts Payable (Note 9)	\$ 31	\$ 34
Debt (Note 10)	715,303	547,108
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5)	1,307	1,664
Payable to Treasury (Note 6)	2,914	3,890
Other Intragovernmental Liabilities (Note 11)	4,030	6,843
<b>Total Intragovernmental</b>	<b>723,585</b>	<b>559,539</b>
Accounts Payable (Note 9)	4,098	4,248
Accrued Grant Liability (Note 12)	2,901	3,928
Liabilities for Loan Guarantees (Note 6)	1,037	10,025
Other Liabilities (Note 11)	151	217
<b>Total Liabilities</b>	<b>\$ 731,772</b>	<b>\$ 577,957</b>
Commitments and Contingencies (Note 21)		
<b>Net Position:</b>		
Unexpended Appropriations	\$ 72,686	\$ 71,729
Cumulative Results of Operations	(7,531)	(3,144)
<b>Total Net Position (Note 13)</b>	<b>\$ 65,155</b>	<b>\$ 68,585</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 796,927</b>	<b>\$ 646,542</b>

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

**United States Department of Education  
Consolidated Statement of Net Cost  
For the Years Ended September 30, 2012 and 2011**

(Dollars in Millions)

	FY 2012	FY 2011
<b>Program Costs:</b>		
<b><u>Increase College Access, Quality, and Completion</u></b>		
Gross Costs	\$ 40,410	\$ 21,785
Less: Earned Revenue	25,340	20,252
Net Program Costs	15,070	1,533
<b>Total Program Costs</b>	<b>\$ 15,070</b>	<b>\$ 1,533</b>
<b><u>Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs</u></b>		
Gross Costs	\$ 22,419	\$ 21,910
Less: Earned Revenue	70	83
Net Program Costs	22,349	21,827
<b>Total Program Costs</b>	<b>\$ 22,349</b>	<b>\$ 21,827</b>
<b><u>Ensure Effective Educational Opportunities for All Students</u></b>		
Gross Costs	\$ 17,114	\$ 16,409
Less: Earned Revenue	11	23
Net Program Costs	17,103	16,386
<b>Total Program Costs</b>	<b>\$ 17,103</b>	<b>\$ 16,386</b>
<b><u>Enhance the Education System's Ability to Continuously Improve</u></b>		
Gross Costs	\$ 1,660	\$ 1,841
Less: Earned Revenue	69	39
Net Program Costs	1,591	1,802
<b>Total Program Costs</b>	<b>\$ 1,591</b>	<b>\$ 1,802</b>
<b><u>American Recovery and Reinvestment Act and Education Jobs Fund</u></b>		
Gross Costs	\$ 7,660	\$ 27,965
Less: Earned Revenue	7,660	27,965
Net Program Costs	7,660	27,965
<b>Total Program Costs</b>	<b>\$ 7,660</b>	<b>\$ 27,965</b>
<b>Net Cost of Operations (Notes 14 &amp; 17)</b>	<b>\$ 63,773</b>	<b>\$ 69,513</b>

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

**United States Department of Education**  
**Consolidated Statement of Changes in Net Position**  
**For the Years Ended September 30, 2012 and 2011**

(Dollars in Millions)

	FY 2012		FY 2011	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
<b>Beginning Balances:</b>				
Beginning Balances	\$ (3,144)	\$ 71,729	\$ (6,769)	\$ 94,371
<b>Budgetary Financing Sources:</b>				
Appropriations Received		\$ 98,372		\$ 94,398
Other Adjustments (rescissions, etc)	\$ 1	(493)	\$ (1)	(1,051)
Appropriations Used	96,922	(96,922)	115,989	(115,989)
Nonexchange Revenue	1		3	
Donations and Forfeitures of Cash and Cash Equivalents	1		1	
Nonexpenditure Financing Sources				
Transfers-Out	(51)		(24)	
<b>Other Financing Sources:</b>				
Imputed Financing from Costs Absorbed by Others	\$ 34		\$ 38	
Others	(37,522)		(42,868)	
<b>Total Financing Sources:</b>				
Total Financing Sources	\$ 59,386	\$ 957	\$ 73,138	\$ (22,642)
<b>Net Cost of Operations:</b>				
Net Cost of Operations	\$ (63,773)		\$ (69,513)	
<b>Net Change:</b>				
Net Change	\$ (4,387)	\$ 957	\$ 3,625	\$ (22,642)
<b>Ending Balances (Note 13)</b>	<b>\$ (7,531)</b>	<b>\$ 72,686</b>	<b>\$ (3,144)</b>	<b>\$ 71,729</b>

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



**United States Department of Education**  
**Combined Statement of Budgetary Resources**  
**For the Years Ended September 30, 2012 and 2011**

(Dollars in Millions)

	FY 2012		FY 2011	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
<b>Budgetary Resources:</b>				
Unobligated balance, brought forward, October 1	\$ 5,434	\$ 15,402	\$ 6,526	\$ 15,654
Recoveries of prior year Unpaid Obligations	1,182	18,649	1,575	12,203
Other changes in unobligated balance	(638)	(20,697)	(353)	(17,494)
Unobligated balance from prior year budget authority, net	5,978	13,354	7,748	10,363
Appropriations (discretionary and mandatory)	98,284	36	94,209	2
Borrowing Authority (discretionary and mandatory)		209,614		211,980
Spending Authority from offsetting collections	448	47,270	1,537	40,542
<b>Total Budgetary Resources (Note 16)</b>	<b>\$ 104,710</b>	<b>\$ 270,274</b>	<b>\$ 103,494</b>	<b>\$ 262,887</b>
<b>Status of Budgetary Resources:</b>				
Obligations incurred (Note 16)	\$ 92,088	\$ 251,281	\$ 98,060	\$ 247,485
Unobligated balance, end of year:				
Apportioned	10,480	1	3,036	634
Unapportioned	2,142	18,992	2,398	14,768
Total unobligated balance, end of year	12,622	18,993	5,434	15,402
<b>Total Budgetary Resources</b>	<b>\$ 104,710</b>	<b>\$ 270,274</b>	<b>\$ 103,494</b>	<b>\$ 262,887</b>
<b>Change in Obligated Balance:</b>				
Unpaid obligations, brought forward, October 1	\$ 72,684	\$ 164,389	\$ 94,693	\$ 150,831
Uncollected customer payments from Federal Sources, brought forward, October 1	(6)	(27)	(2)	(14)
Obligated balance, start of the year (net)	72,678	164,362	94,691	150,817
Obligations Incurred	92,088	251,281	98,060	247,485
Outlays (gross) (-)	(98,533)	(224,791)	(118,494)	(221,724)
Change in uncollected customer payments from Federal Sources (+/-)	4	1	(4)	(13)
Recoveries of prior year unpaid obligations	(1,182)	(18,649)	(1,575)	(12,203)
Obligated Balance, end of year (net):				
Unpaid Obligations, end of year (gross)	65,057	172,230	72,684	164,389
Uncollected customer payments from Federal Sources, end of year	(2)	(26)	(6)	(27)
<b>Obligated balance, end of year (net)</b>	<b>\$ 65,055</b>	<b>\$ 172,204</b>	<b>\$ 72,678</b>	<b>\$ 164,362</b>
<b>Budget Authority and Outlays, Net:</b>				
Budget authority, gross (discretionary and mandatory)	\$ 98,732	\$ 256,920	\$ 95,746	\$ 252,524
Actual offsetting collections (discretionary and mandatory)	(655)	(64,687)	(1,818)	(53,169)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)	4	1	(4)	(13)
<b>Budget Authority, net (discretionary and mandatory)</b>	<b>\$ 98,081</b>	<b>\$ 192,234</b>	<b>\$ 93,924</b>	<b>\$ 199,342</b>
Outlays, gross (discretionary and mandatory)	\$ 98,533	\$ 224,791	\$ 118,494	\$ 221,724
Actual offsetting collections (discretionary and mandatory) (+/-)	(655)	(64,687)	(1,818)	(53,169)
Outlays, net (discretionary and mandatory)	97,878	160,104	116,676	168,555
Distributed offsetting receipts	(40,612)		(50,289)	
<b>Agency Outlays, net (discretionary and mandatory)</b>	<b>\$ 57,266</b>	<b>\$ 160,104</b>	<b>\$ 66,387</b>	<b>\$ 168,555</b>

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

## Notes to the Principal Financial Statements For the Years Ended September 30, 2012 and 2011

### Note 1. Summary of Significant Accounting Policies

#### Reporting Entity

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

The Department administers the William D. Ford Federal Direct Loan (Direct Loan) Program, the Federal Family Education Loan (FFEL) Program, the Federal Pell Grant (Pell Grant) Program, and the campus-based student aid programs to help students finance the costs of higher education.

The Direct Loan Program, added to the *Higher Education Act of 1965* (HEA) in 1993 by the *Student Loan Reform Act of 1993*, authorizes the Department to make loans directly to eligible undergraduate and graduate students and their parents through participating schools. Under this program, the loans are made to individuals who meet statutorily set eligibility criteria and attend eligible institutions of higher education—public or private two- and four-year institutions, graduate schools, and vocational training schools. Student borrowers who demonstrate financial need also receive federal interest subsidies while the students are in school or in a deferment period.

The FFEL Program, authorized by the HEA, operates through state and private nonprofit guaranty agencies to provide loan guarantees and interest subsidies on loans made by private lenders to eligible students. The *SAFRA Act*, which was included in the *Health Care and Education Reconciliation Act of 2010* and became effective July 1, 2010, provided that no new FFEL loans would be made after June 30, 2010.

The *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) authorized the Secretary to purchase or enter into forward commitments to purchase FFEL loans. The Department implemented three activities under this temporary loan purchase authority. These activities are: (1) loan purchase commitments; (2) loan participation purchases; and (3) an Asset-Backed Commercial Paper (ABCP) Conduit.

The Federal Pell Grant Program provides need-based grants to low-income undergraduate and certain post-baccalaureate students to promote access to postsecondary education. Additionally, the Department administers numerous other grant programs and facilities loan programs. Grant programs include grants to state and local entities for elementary and secondary education; special education and rehabilitative services grants; grants to support institutions of higher education; educational research and improvement grants; grants to assist low-income and first-generation college students prepare for and transition into college; grants to improve our global awareness and competitiveness; and fellowships for college and graduate students. Through the facilities loan programs, the Department administers low-interest loans to institutions of higher education for the construction and renovation of facilities.

The Teacher Education Assistance for College and Higher Education Grant (TEACH) Program was implemented beginning July 1, 2008. This program, added to the HEA by the *College Cost Reduction and Access Act*, awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students.

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

Public Law 111-226, enacted on August 10, 2010, created the Education Jobs Fund, which provided funding to the Department to assist in saving and creating jobs for the 2010–11 and 2011–12 school years. The Department was authorized to disburse these funds promptly to states through formula grants, while ensuring transparency and accountability overall.

## Reporting Groups

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

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

The "Other" reporting group consists of the Office of Vocational and Adult Education (OVAE), Office of Postsecondary Education (OPE), Institute of Education Sciences (IES), Office of English Language Acquisition (OELA), Office of Innovation and Improvement (OII), Office of Management, Office for Civil Rights (OCR), and Hurricane Education Recovery (HR) activities. (See Notes 12 and 14)

FSA, IES, OESE, OII, OSERS, and the Office of the Deputy Secretary's Implementation and Support Unit (ISU) are responsible for the administration of Recovery Act funds. ISU is responsible for administration of the Education Jobs Fund. Recovery Act and Education Jobs Fund activities are reported under the RA/JF reporting group. (See Notes 12, 14, 19, and 20)

## Basis of Accounting and Presentation

These financial statements have been prepared to report the financial position, net cost of operations, changes in net position, and budgetary resources of the Department, as required by the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994*. The financial statements were prepared from the books and records of the Department, in accordance with accounting principles generally accepted in the United States of America for federal entities, issued by the Federal Accounting Standards Advisory Board, and the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, as revised August 2012. These financial statements are different from the financial reports prepared by the Department pursuant to OMB directives that are used to monitor and control the Department's use of budgetary resources.

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

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

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

### **Use of Estimates**

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

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

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

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

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

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

Estimates reflected in these financial statements were prepared using assumptions developed for the FY 2013 Mid-Session Review, a government-wide exercise required annually by OMB. These estimates are based on the most current information available to the Department at the time the financial statements were prepared. Assumptions and their impact are updated after the Mid-Session Review to account for significant subsequent changes in activity. Management has a process to review these estimates in the context of subsequent changes in activity and assumptions, and to reflect the impact of changes, as appropriate.

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

### **Budget Authority**

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

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

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

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



## Assets

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

## Fund Balance with Treasury

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

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

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

## Accounts Receivable

Accounts Receivable are amounts due to the Department from the public and other federal agencies. Receivables from the public result from overpayments to recipients of grants and other financial assistance programs, and disputed costs resulting from audits of educational assistance programs. Amounts due from federal agencies result from reimbursable agreements entered into by the Department with other agencies to provide various goods and services. Accounts receivable are reduced to net realizable value by an allowance for uncollectible amounts. The estimate of an allowance for loss on uncollectible accounts is based on the Department's experience in the collection of receivables and an analysis of the outstanding balances. (See Note 4)

## Cash and Other Monetary Assets

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

Sections 422A and 422B of the HEA required FFEL guaranty agencies to establish a Federal Student Loan Reserve Fund (Federal Fund) and an Operating Fund by December 6, 1998. The Federal Fund and the non-liquid assets developed or purchased by a guaranty agency, in whole or in part with federal funds, are the property of the United States and reflected in the *Budget of the United States Government*. However, such ownership by the federal government

is independent of the actual control of the assets. Payments to the Department from guaranty agency Federal Funds, which increase the Fund Balance with Treasury, are remitted to Treasury.

The Department disburses funds to a guaranty agency; a guaranty agency, through its Federal Fund, pays lender claims and pays default aversion fees into its own Operating Fund. 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. (See Note 5)

### **Credit Program Receivables and Liabilities for Loan Guarantees**

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

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

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

### **General Property, Plant and Equipment**

The Department capitalizes single items of property and equipment with a cost of \$50,000 or more that have an estimated useful life of two years or more. Additionally, the Department capitalizes bulk purchases of property and equipment with an aggregate cost of \$500,000 or more. A bulk purchase is defined as the purchase of like items related to a specific project, or the purchase of like items occurring within the same fiscal year that have an estimated useful life of at least two years. Property and equipment are depreciated over their estimated useful lives using the straight-line method of depreciation. Internal Use Software meeting the above cost and useful life criteria is also capitalized. Internal Use Software is either purchased off the shelf, internally developed, or contractor developed solely to meet the Department's needs. (See Note 7)

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

### Depreciable Property and Equipment

(In Years)

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

### Other Assets

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

### Liabilities

Liabilities represent actual and estimated amounts to be paid as a result of transactions or events that have already occurred. However, no liabilities can be paid by the Department without budget authority. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources, and there is no certainty that an appropriation will be enacted. The government, acting in its sovereign capacity, can abrogate liabilities that arise from activities other than contracts. FFEL Program and Direct Loan Program liabilities are entitlements covered by permanent indefinite budget authority. (See Note 11)

### Accounts Payable

Accounts Payable include amounts owed by the Department for goods and services received from other entities and scheduled payments transmitted but not yet processed. The Department's accounts payable primarily consist of in-process grant and loan disbursements to the public. (See Note 9)

### Debt

The Department borrows to provide funding for the Direct Loan, FFEL, and TEACH Programs. The liability to Treasury from borrowings represents unpaid principal at year-end. The Department repays the principal based on available fund balances. Interest on the debt is calculated at fiscal year-end using rates set by Treasury, with such rates generally fixed based on the rate for 10-year Treasury securities. In addition, the Federal Financing Bank (FFB) holds bonds issued by a designated bonding authority, on behalf of the Department, for the HBCU Capital Financing Program. The Department reports the corresponding liability for full payment of principal and accrued interest on bonds as a payable to the FFB. (See Note 10)

### Accrued Grant Liability

Disbursements of grant funds are recognized as expenses at the time of disbursement. However, some grant recipients incur expenditures prior to initiating a request for disbursement based on the nature of the expenditures. A liability is accrued by the Department for expenditures incurred by grantees prior to their receiving grant funds to cover the expenditures. The amount is estimated using statistical sampling. (See Note 12)

## Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include undelivered orders and unobligated balances, except for federal credit financing and liquidating funds, and trust funds. Cumulative results of operations represent the net difference since inception between (1) expenses and (2) revenues and financing sources. (See Note 13)

## 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 11) Sick leave and other types of non-vested leave are expensed as taken.

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

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

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

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

The FECA liability consists of two components. The first component is based on actual claims paid and recognized by the Department as a liability. Generally, the Department reimburses DOL within two to three years once funds are appropriated. The second component is the estimated liability for future benefit payments based on unforeseen events, such as death, disability, medical, and miscellaneous costs as determined by DOL annually. (See Note 11)

## Intragovernmental Transactions

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

## Reclassifications

Certain reclassifications were made to the FY 2011 financial statements and notes to conform to the current year presentation. These changes had no effect on total assets, liabilities, net position, net cost of operations, or budgetary resources. In accordance with requirements contained in OMB Circular A-136, *Financial Reporting Requirements*, and effective for FY 2012 reporting, the presentation of the Statement of Budgetary Resources was changed to better align with the new format of the SF-133 Report on Budget Execution and Budgetary Resources. Additionally, beginning in FY 2012, the Department reports earmarked funds combined with all other fund types on the Balance Sheet, Statement of Changes in Net Position, and related note disclosure (See Note 13). This change was made due to the immateriality of remaining earmarked funds. Reclassifications were made within Note 14, Intragovernmental Cost and Exchange Revenue by Program, to reflect the move of the Office of Safe and Drug-Free Schools and its programs into a new Office of Safe and Healthy Students within OESE. Additional reclassifications were made within the Loan Purchase Commitment and Loan Participation Purchase Reconciliation of Allowance for Subsidy sections of Note 6, Credit Programs for Higher Education.

## Additional Comparative Information

In FY 2012, the Department's notes to the financial statements include disclosure of the components of Accounts Payable. FY 2011 information is presented for comparative purposes. (See Note 9)

**Note 2. Non-Entity Assets**

As of September 30, 2012 and 2011, non-entity assets consisted of the following:

<b>Non-Entity Assets</b>		
(Dollars in Millions)		
	<u>2012</u>	<u>2011</u>
<b>Non-Entity Assets</b>		
Intragovernmental:		
Fund Balance with Treasury	\$ (39)	\$ 70
<b>Total Intragovernmental</b>	<u>(39)</u>	<u>70</u>
With the Public:		
Cash and Other Monetary Assets	1,307	1,664
Accounts Receivable, Net	(4)	34
Credit Program Receivables, Net	351	215
<b>Total With the Public</b>	<u>1,654</u>	<u>1,913</u>
<b>Total Non-Entity Assets</b>	<u>1,615</u>	<u>1,983</u>
Entity Assets	795,312	644,559
Total Assets	<u>\$ 796,927</u>	<u>\$ 646,542</u>

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



**Note 3. Fund Balance with Treasury**

The Fund Balance with Treasury, by fund type as of September 30, 2012 and 2011, consisted of the following:

<b>Fund Balances</b>		
(Dollars in Millions)		
	<u>2012</u>	<u>2011</u>
General Funds	\$ 76,351	\$ 76,432
Revolving Funds	45,664	37,562
Trust Funds	3	4
Special Funds	14	17
Other Funds	(39)	70
<b>Fund Balance with Treasury</b>	<b>\$ 121,993</b>	<b>\$ 114,085</b>

The Status of Fund Balance with Treasury, as of September 30, 2012 and 2011, consisted of the following:

<b>Status of Fund Balance with Treasury</b>		
(Dollars in Millions)		
	<u>2012</u>	<u>2011</u>
Unobligated Balance:		
Available	\$ 10,481	\$ 3,670
Unavailable	19,827	15,502
Obligated Balance, Not Yet Disbursed	91,724	94,843
Non-Budgetary Fund Balance with Treasury	(39)	70
<b>Fund Balance with Treasury</b>	<b>\$ 121,993</b>	<b>\$ 114,085</b>

**Note 4. Accounts Receivable**

Accounts Receivable, as of September 30, 2012 and 2011, consisted of the following:

<b>Accounts Receivable</b>			
(Dollars in Millions)			
<b>2012</b>			
	<b>Gross Receivables</b>	<b>Allowance</b>	<b>Net Receivables</b>
Intragovernmental	\$ 1	\$ -	\$ 1
With the Public	317	(225)	92
<b>Accounts Receivable</b>	<b>\$ 318</b>	<b>\$ (225)</b>	<b>\$ 93</b>
<b>2011</b>			
	<b>Gross Receivables</b>	<b>Allowance</b>	<b>Net Receivables</b>
Intragovernmental	\$ -	\$ -	\$ -
With the Public	322	(184)	138
<b>Accounts Receivable</b>	<b>\$ 322</b>	<b>\$ (184)</b>	<b>\$ 138</b>

**Note 5. Cash and Other Monetary Assets**

Cash and Other Monetary Assets consist of reserves held in the FFEL guaranty agency Federal Funds. Changes in the valuation of the Federal Fund increase or decrease the Department's Cash and Other Monetary Assets with a corresponding change in Guaranty Agency Federal and Restricted Funds Due to Treasury. The table below presents Cash and Other Monetary Assets for the years ended September 30, 2012 and 2011.

<b>Cash and Other Monetary Assets</b>		
(Dollars in Millions)		
	<b>2012</b>	<b>2011</b>
<b>Beginning Balance, Cash and Other Monetary Assets</b>	<b>\$ 1,664</b>	<b>\$ 2,965</b>
Increase/(Decrease) in Guaranty Agency Federal Funds, net	(357)	(1,301)
<b>Ending Balance, Cash and Other Monetary Assets</b>	<b>\$ 1,307</b>	<b>\$ 1,664</b>

The \$357 million net decrease in the Federal Fund in FY 2012 represents the change in the estimated value of net assets held in the FFEL guaranty agency Federal Funds. This decrease reflects the impact of guaranty agencies' operations. The \$1.3 billion net decrease in the Federal Fund in FY 2011 reflects the impact of guaranty agencies' operations and a refinement the Department made to the process for estimating the valuation of the Federal Fund.

## Note 6. Credit Programs for Higher Education

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

The Department disbursed approximately \$142 billion in Direct Loans to eligible borrowers in FY 2012 and approximately \$133 billion in FY 2011. Loans typically are disbursed in multiple installments over an academic period; as a result, loan disbursements for an origination cohort year often cross fiscal years. Half of all loan volume is obligated in the fourth quarter of a fiscal year. Regardless of the fiscal year in which they occur, disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

Approximately 8 percent of Direct Loan obligations made in an individual fiscal year are never disbursed. Loan obligations are established at a summary level based on estimates of schools' receipt of aid applications. The loan obligation may occur before a student has been accepted by a school or before the student begins classes. For Direct Loans obligated in the 2012 cohort, an estimated \$13 billion will never be disbursed. Eligible schools may originate direct loans through a cash advance from the Department or by advancing their own funds in anticipation of reimbursement from the Department.

**Federal Family Education Loan Program.** In FY 2008, the Department began administering activities under temporary loan purchase authority. ECASLA gave the Department temporary authority to purchase FFEL loans and participation interests in those loans. This authority was to expire on September 30, 2009; however, Public Law 110-350 extended the authority through September 30, 2010. The Department implemented three activities under this authority: loan purchase commitments; purchases of loan participation interests; and a put, or forward purchase commitment, with an ABCP Conduit. Credit Program Receivables are established for loans acquired through these activities.

Under the loan purchase commitment activity, lenders had the option to sell directly to the Department fully disbursed loans originated for academic years 2007–08, 2008–09, or 2009–10. In loan participation transactions, lenders transferred to a custodian FFEL loans originated in academic years 2008–09 or 2009–10 on which at least one disbursement had been made. The custodian issued participation certificates to the lenders, which conveyed a participation interest in the loans. The lenders sold the participation interest in the loans to the Department at the par value of these loans. The Department remitted the proceeds through the custodian to the lenders. Participation interests earned a yield payable from the lenders to the Department at the rate of the 91-day commercial paper rate plus 50 basis points and reset quarterly. Funds to redeem these loans from the Department's participation interest were obtained by selling the underlying loans to the Department or by other means. Lenders committed to redeem the participation certificates and sell loans by September 30, 2010; the Department finalized these transactions by October 15, 2010.

During FY 2009, the Department, Treasury, and OMB established the terms on which the Department would support an ABCP Conduit to provide liquidity to the student loan market. An ABCP Conduit issues short-term commercial paper to investors; this paper is backed by student loans pledged to the conduit. The conduit used the proceeds of sales of its commercial paper to acquire from lenders interests in student loans. Lenders must have used a portion of conduit payments to make new loans or acquire FFEL 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 certain pledged loans that become more than

210 days delinquent. The conduit has sold to the Department approximately \$2.2 billion of these delinquent loans as of September 30, 2012. Under the terms of the Put Agreement with the conduit, the Department may purchase pledged loans 45 days prior to the Put Agreement expiration on January 19, 2014. As required by the Credit Reform Act, all cash flows to and from the Government resulting from its transactions with the ABCP Conduit are recorded in a non-budgetary credit financing account. Amounts in this account are a means of financing and are not included in budget totals. Loans originated in academic years 2004–05 through 2007–08, and pledged to the conduit prior to July 1, 2010, are eligible to be purchased through the ABCP Conduit.

As of September 30, 2012, the Department has \$72 billion in obligations to cover any buyer-of-last-resort activities and potential purchases of underlying student loans under the ABCP Conduit. These obligations are supported by available borrowing authority. The conduit, a separate legal entity, has approximately \$41 billion in commercial paper outstanding.

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

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

Under the provisions of the *SAFRA Act*, no new loans were made under the FFEL Program after June 30, 2010. This legislation effectively required a transition for new loans from guaranteed student loans to full direct lending through the Department under the Direct Loan Program. Federal guarantees on FFEL Program loans and commitments remain in effect for loans made before July 1, 2010 until the loan is sold to the Department through an ECASLA program, consolidated into a direct loan, or otherwise satisfied, discharged, or cancelled.

As a result of the *SAFRA Act*, the Department did not guarantee any loans in FY 2012 or FY 2011. As of September 30, 2012 and 2011, total principal balances outstanding of guaranteed loans held by lenders were approximately \$291 billion and \$328 billion, respectively. As of September 30, 2012 and 2011, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately \$285 billion and \$321 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the guaranty agencies, based on the appropriate reinsurance rates, which range from 100 to 95 percent. Any remaining insurance not paid as reinsurance would be paid to lenders by the guaranty agencies from their Federal Fund. Payments by guaranty agencies do not reduce government exposure because they are made from the Federal Fund administered by the agencies, but owned by the federal government.

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

**Federal Perkins Loan Program.** The Federal Perkins Loan Program is a campus-based program that provides low-interest loans to eligible postsecondary school students. In some statutorily defined cases, funds are provided to reimburse schools for loan cancellations. For defaulted loans assigned to the Department, collections of principal, interest, and fees, net of

amounts paid by the Department to cover contract collection costs, are transferred to Treasury annually.

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

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

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

In FY 2006, Congress passed the *Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery* (Public Law 109-234). Section 2601 of this act created a new sub-program within the HBCU Capital Financing Program under the HEA to provide loans on advantageous terms to HBCUs affected by Hurricanes Rita and Katrina. Under this sub-program, the interest rate charged on loans is capped at 1 percent, fees associated with the program are less than fees for the rest of the program, and institutions are not required to participate in the program's pooled escrow account. In addition, principal and interest payments on loans already made to affected HBCUs can be deferred for up to 3 years, with the Department making any payments that come due during this period. The statute gave the Department authority to make loans under the new sub-program in excess of the overall program loan caps. The Department made four loans under the new sub-program. The disbursement period for these loans ended on June 1, 2012. In total, \$361 million was disbursed since inception.

## 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 \$24 billion during FY 2011 to \$36 billion during FY 2012. The \$36 billion includes approximately \$13 billion in Special Direct Consolidation Loans. Under credit reform accounting, the subsidy costs of new consolidation loans are not reflected until the future fiscal year in which they are disbursed. The effect of the early payoff of the existing loans—those being consolidated—is recognized in the future projected cash flows of the past cohort year in which the loans were originated.

### Modifications 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 fiscal year 2012, while no modifications occurred in fiscal year 2011. Two modifications were implemented in FY 2012; the first is related to the interest rates used in the calculation of special allowance payments and the second is the offering of Special Direct Consolidation Loans. Both modifications affect FFEL subsidy costs for cohort year 2010 and prior.

On December 23, 2011, the President signed H.R. 2055, the *Consolidated Appropriations Act, 2012* (Public Law 112-74). Section 309(e) of Public Law 112-74 amended section 438(b)(2)(I) of the Higher Education Act (HEA) to allow Federal Family Education Loan Program (FFEL) loan holders or an entity that holds a beneficial ownership interest in a FFEL loan to have the 1-month London Inter Bank Offered Rate (LIBOR) substituted for the 3-month commercial paper (CP) rate for the purposes of Special Allowance Payment (SAP) calculations on certain FFEL loans. If a FFEL lender or beneficial holder wished to have SAP calculated on LIBOR rather than on CP, no later than April 1, 2012, it must have waived any right to have SAP calculated on the basis of the previously-applicable 3-month CP rate. By doing so, the lender or beneficial holder elected to have SAP thereafter calculated at the LIBOR rate for its designated FFEL loans.

The Department began offering Special Direct Consolidation Loans to eligible borrowers in January 2012. This short-term consolidation initiative ended June 30, 2012, for borrowers with at least one student loan held by the Department and serviced by one of the Department's servicers and at least one commercially-held FFEL loan (a FFEL loan that is owned by a FFEL lender and serviced either by that lender or by a servicer contracted by that lender). Special Direct Consolidation Loans were intended to help borrowers manage their debt by ensuring all of their federal loans are serviced by the same entity, resulting in one bill and one payment. Borrowers received a 25 basis point interest rate reduction on Special Direct Consolidation Loans as incentive.

The net effect of loan modifications executed in FY 2012 was an upward subsidy cost of \$153 million in FFEL with a corresponding effect on Liability for Loan Guarantees. Of this amount, \$352 million in upward cost was related to the consolidation loan initiative while a net downward modification of \$199 million resulted from the LIBOR initiative. FFEL recognized a modification gain (appropriation) of \$35 million and a negative modification adjustment transfer loss of \$29 million.



## Credit Program Receivables

Credit Program Receivables, as of September 30, 2012 and 2011, consisted of the following:

### Credit Program Receivables, Net

(Dollars in Millions)

	<u>2012</u>	<u>2011</u>
Direct Loan Program Loan Receivables, Net	\$ 526,035	\$ 381,454
FFEL Program		
FFEL Guaranteed Loan Program, Net (Pre-1992)	2,697	3,675
FFEL Program (Post-1991):		
FFEL Guaranteed Loan Program, Net	29,644	28,627
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	41,145	42,116
Loan Participation Purchase, Net	70,888	72,682
ABCP Conduit, Net	1,731	943
Federal Perkins Program Loan Receivables, Net	351	215
TEACH Program Receivables, Net	344	253
Facilities Loan Programs Loan Receivables, Net	653	526
<b>Credit Program Receivables, Net</b>	<b><u>\$ 673,488</u></b>	<b><u>\$ 530,491</u></b>

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

### Direct Loan Program Loan Receivables, Net

(Dollars in Millions)

	<u>2012</u>	<u>2011</u>
Principal Receivable	\$ 472,877	\$ 341,822
Interest Receivable	21,082	14,286
Receivables	493,959	356,108
Less: Allowance for Subsidy	(32,076)	(25,346)
<b>Direct Loan Program Loan Receivables, Net</b>	<b><u>\$ 526,035</u></b>	<b><u>\$ 381,454</u></b>

Of the \$494.0 billion in receivables, as of September 30, 2012, \$20.9 billion in loan principal was in default and had been transferred to the Department's defaulted loan servicer, compared to \$16.1 billion a year earlier. As of September 30, 2012, an additional \$1.1 billion in defaulted loans held by servicers had not yet been transferred to the Department's defaulted loan servicer; this amount includes defaulted Direct Loans and defaulted loans from other loan programs.

**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)

	2012	2011
<b>FFEL Guaranteed Loan Program (Pre-1992)</b>		
Principal Receivable	\$ 5,519	\$ 6,228
Interest Receivable	5,358	4,034
Receivables	10,877	10,262
Less: Allowance for Subsidy	8,180	6,587
<b>FFEL Guaranteed Loan Program, Net (Pre-1992)</b>	<b>2,697</b>	<b>3,675</b>
<b>FFEL Program (Post-1991)</b>		
FFEL Guaranteed Loan Program:		
Principal Receivable	31,549	29,790
Interest Receivable	4,541	4,236
Receivables	36,090	34,026
Less: Allowance for Subsidy	6,446	5,399
<b>FFEL Guaranteed Loan Program, Net</b>	<b>29,644</b>	<b>28,627</b>
Temporary Loan Purchase Authority:		
Loan Purchase Commitment:		
Principal Receivable	34,012	35,822
Interest Receivable	1,875	1,879
Receivables	35,887	37,701
Less: Allowance for Subsidy	(5,258)	(4,415)
<b>Loan Purchase Commitment, Net</b>	<b>41,145</b>	<b>42,116</b>
Loan Participation Purchase:		
Principal Receivable	58,834	61,125
Interest Receivable	3,144	2,993
Receivables	61,978	64,118
Less: Allowance for Subsidy	(8,910)	(8,564)
<b>Loan Participation Purchase, Net</b>	<b>70,888</b>	<b>72,682</b>
ABCP Conduit:		
Principal Receivable	2,038	1,121
Interest Receivable	133	55
Receivables	2,171	1,176
Less: Allowance for Subsidy	440	233
<b>ABCP Conduit, Net</b>	<b>1,731</b>	<b>943</b>
<b>FFEL Program Receivables, Net</b>	<b>\$ 146,105</b>	<b>\$ 148,043</b>

All loans purchased by the Department under the temporary loan purchase authority are federal assets.

**Federal Perkins Loan Program.** As of September 30, 2012 and 2011, loan receivables, net of an allowance for loss, were \$351 million and \$215 million, respectively. These loans are valued at historical cost.

**TEACH Program.** As of September 30, 2012 and 2011, loan receivables, net of an allowance for subsidy, were \$344 million and \$253 million, respectively.

## Facilities Loan Programs

### Facilities Loan Programs Loan Receivables

(Dollars in Millions)

	2012	2011
Principal Receivable	\$ 1,056	\$ 932
Interest Receivable	12	7
Receivables	1,068	939
Less: Allowance for Subsidy/Loss	415	413
<b>Facilities Loan Programs Loan Receivables, Net</b>	<b>\$ 653</b>	<b>\$ 526</b>

## Reconciliation of Allowance for Subsidy and Liability for Loan Guarantees

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

### Direct Loan Program Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2012	2011
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ (25,346)</b>	<b>\$ 1,969</b>
<b>Components of Subsidy Transfers</b>		
Interest Rate Differential	(32,372)	(26,898)
Defaults, Net of Recoveries	2,356	2,342
Fees	(1,792)	(1,739)
Other	8,901	9,264
<b>Current Year Subsidy Transfers</b>	<b>(22,907)</b>	<b>(17,031)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates <sup>1</sup>	7,651	(8,084)
Technical and Default Re-estimates	4,536	(3,515)
<b>Subsidy Re-estimates</b>	<b>12,187</b>	<b>(11,599)</b>
<b>Activity</b>		
Fee Collections	1,585	1,623
Loan Cancellations <sup>2</sup>	(1,250)	(964)
Subsidy Allowance Amortization	3,778	1,638
Other	(123)	(982)
<b>Total Activity</b>	<b>3,990</b>	<b>1,315</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ (32,076)</b>	<b>\$ (25,346)</b>

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

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

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

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

(Dollars in Millions)

	2012	2011
<b>Beginning Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>\$ 9,984</b>	<b>\$ 14,407</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	-	(1)
Technical and Default Re-estimates	(11,735)	(11,220)
<b>Subsidy Re-estimates</b>	<b>(11,735)</b>	<b>(11,221)</b>
<b>Components of Loan Modifications</b>		
Loan Modification Costs	153	-
Modification Adjustment Transfers	6	-
<b>Loan Modifications</b>	<b>159</b>	<b>-</b>
<b>Activity</b>		
Interest Supplement Payments	(1,756)	(2,453)
Claim Payments	(9,291)	(9,707)
Fee Collections	2,344	2,600
Interest on Liability Balance	(1,440)	(867)
Other <sup>1</sup>	12,748	17,225
<b>Total Activity</b>	<b>2,605</b>	<b>6,798</b>
<b>Ending Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>1,013</b>	<b>9,984</b>
FFEL Liquidating Account Liability for Loan Guarantees	24	41
<b>Liabilities for Loan Guarantees</b>	<b>\$ 1,037</b>	<b>\$ 10,025</b>

<sup>1</sup> Activity primarily associated with negative special allowance payments; also composed of the transfer of subsidy for defaults; loan consolidation activity; and loan cancellations due to death, disability, and bankruptcy.

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

### Loan Purchase Commitment Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2012	2011
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ (4,415)</b>	<b>\$ (4,256)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	-	(518)
Technical and Default Re-estimates	(1,406)	(323)
<b>Subsidy Re-estimates</b>	<b>(1,406)</b>	<b>(841)</b>
<b>Activity</b>		
Subsidy Allowance Amortization	684	381
Direct Asset Activities and Other	(121)	301
<b>Total Activity</b>	<b>563</b>	<b>682</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ (5,258)</b>	<b>\$ (4,415)</b>

### Loan Participation Purchase Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2012	2011
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ (8,564)</b>	<b>\$ (5,090)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	-	(1,495)
Technical and Default Re-estimates	(1,393)	(2,569)
<b>Subsidy Re-estimates</b>	<b>(1,393)</b>	<b>(4,064)</b>
<b>Activity</b>		
Subsidy Allowance Amortization	1,167	635
Direct Asset Activities and Other	(120)	(45)
<b>Total Activity</b>	<b>1,047</b>	<b>590</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ (8,910)</b>	<b>\$ (8,564)</b>

### Financing Account Interest Expense and Interest Revenue

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

The Department accrues interest receivable and records interest revenue on performing Direct Loans and FFEL loans purchased by the Department. Interest receivable is accrued on defaulted guaranteed loans, with an offset to the allowance for subsidy. The Department does not record interest revenue on defaulted guaranteed loans. The Department implemented a new Debt Management Collection System in October FY 2012. As a result of the new system's capabilities, the Department is now accruing interest on a more frequent basis. Changes in the timing of interest accruals do not have an impact on the Department's financial statements due to the fact that the transactions posted for the interest accruals will have a zero net effect on the affected line items in the financial statements. In addition, no budgetary resources or status of resources are affected, including expended and unexpended obligations. The amounts reported in Footnote 6 and 15 disclosures are impacted by the timing of the interest accruals; however, the amounts related to these timing differences are not material to the fair presentation of these footnote disclosures.

Subsidy amortization is calculated as the difference between interest revenue and interest expense. For direct loans, the allowance for subsidy is adjusted with the offset to interest revenue. For guaranteed loans, the liability for loan guarantees is adjusted with the offset to interest expense.

**William D. Ford Federal Direct Loan Program.** The following schedule summarizes the Direct Loan financing account interest expense and interest revenue for the years ended September 30, 2012 and 2011:

#### Direct Loan Program

(Dollars in Millions)

	2012	2011
Interest Expense on Treasury Borrowing	\$ 20,643	\$ 14,321
<b>Interest Expense</b>	<b>\$ 20,643</b>	<b>\$ 14,321</b>
Interest Revenue from the Public	\$ 20,156	\$ 12,466
Amortization of Subsidy	(3,778)	(1,638)
Interest Revenue on Uninvested Funds	4,265	3,493
<b>Interest Revenue</b>	<b>\$ 20,643</b>	<b>\$ 14,321</b>



## Payable to Treasury

Payable to Treasury, for the years ended September 30, 2012 and 2011, consisted of the following:

<b>Payable to Treasury</b>		
(Dollars in Millions)		
	<b>2012</b>	<b>2011</b>
<b>Future Liquidating Account Collections, Beginning Balance</b>	<b>\$ 3,886</b>	<b>\$ 2,424</b>
Valuation of Pre-1992 Loan Liability and Allowance	(548)	1,787
Capital Transfers to Treasury	(424)	(325)
<b>Future Liquidating Account Collections, Ending Balance</b>	<b>2,914</b>	<b>3,886</b>
Other	-	4
<b>Payable to Treasury</b>	<b>\$ 2,914</b>	<b>\$ 3,890</b>

## Subsidy Expense

### William D. Ford Federal Direct Loan Program

#### Direct Loan Program Subsidy Expense

(Dollars in Millions)		
	<b>2012</b>	<b>2011</b>
<b>Components of Current Year Subsidy Transfers</b>		
Interest Rate Differential	\$ (32,372)	\$ (26,898)
Defaults, Net of Recoveries	2,356	2,342
Fees	(1,792)	(1,739)
Other	8,901	9,264
<b>Current Year Subsidy Transfers</b>	<b>(22,907)</b>	<b>(17,031)</b>
Subsidy Re-estimates	12,187	(11,599)
<b>Direct Loan Subsidy Expense</b>	<b>\$ (10,720)</b>	<b>\$ (28,630)</b>

William D. Ford Federal Direct Loan re-estimated subsidy cost was adjusted upward by \$12.2 billion in FY 2012. Costs increased \$10.3 billion due to updated economic assumptions, including probabilistic estimating, discount rates, and weighted consolidation loan interest rates. Direct Loan death, disability, and bankruptcy rates increased cost by \$478 million due to increased disability claims. Costs increased \$538 million due to slight decreases in loan volume, concentrated in negative subsidy loan types and default rates increased resulting in \$604 million in cost. 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 \$2.0 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994–2011.

William D. Ford Federal Direct Loan re-estimated subsidy cost was adjusted downward by \$11.6 billion in FY 2011. Costs decreased \$5.7 billion due to updated economic assumptions, including probabilistic estimating, discount rates, and weighted consolidation loan interest rates. The availability of new information allowed Direct Loan death, disability, and bankruptcy rates to be estimated directly rather than having to use the FFEL rates, reducing cost by \$1.5 billion. The decrease in costs is due to lower bankruptcy rates used in formulating the estimate for Direct Loans. Court action usually prevents discharges of Direct student loans.

Costs decreased by \$1.0 billion due to updated actual activity indicating slightly lower rates of prepayments, resulting in higher interest earnings from borrowers. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan subsidy cost \$1.1 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994–2010.

### Federal Family Education Loan Program

#### FFEL Program Subsidy Expense

(Dollars in Millions)

	2012	2011
FFEL Guaranteed Loan Program Subsidy Re-estimates	\$ (11,735)	\$ (11,221)
Loan Purchase Commitment Subsidy Re-estimates	(1,406)	(841)
Loan Participation Purchase Subsidy Re-estimates	(1,393)	(4,064)
<b>FFEL Program Subsidy Re-estimates</b>	<b>(14,534)</b>	<b>(16,126)</b>
FFEL Guaranteed Loan Program Modification Costs	153	-
<b>FFEL Program Subsidy Expense</b>	<b>\$ (14,381)</b>	<b>\$ (16,126)</b>

FFEL Guaranteed re-estimated subsidy cost was adjusted downward by \$11.7 billion in FY 2012. Costs decreased \$10.3 billion due to updated economic assumptions, including probabilistic deterministic rates, which reflected historically low commercial paper rates, resulting in substantially higher negative special allowance payments than were previously projected. Costs decreased \$1.2 billion given the lower than expected demand for Special Direct Consolidation Loans—a short-term consolidation initiative offered during FY 2012. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by \$13.1 billion. Re-estimated costs only include those cohorts that were 90 percent disbursed; cohort years 1992–2010.

FFEL Guaranteed subsidy cost was adjusted downward by \$11.2 billion in FY 2011. Costs decreased \$5.5 billion due to updated economic assumptions, including probabilistic deterministic rates, which reflected historically low commercial paper rates, resulting in substantially higher negative special allowance payments than were previously projected. Costs decreased \$2.0 billion due to multiple assumption changes affecting the Guaranteed ECASLA cash flows. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by \$13.4 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1992–2010.

## Subsidy Rates

The subsidy rates applicable to the 2012 loan cohort year follow:

<b>Subsidy Rates—Cohort 2012</b>					
	<b>Interest Differential/ Supplements</b>	<b>Defaults</b>	<b>Fees</b>	<b>Other</b>	<b>Total</b>
Direct Loan Program	(21.92%)	1.59%	(1.21%)	6.33%	(15.21%)
TEACH Program	1.55%	0.56%	0.00%	8.14%	10.25%

The subsidy rate represents the subsidy expense of the program in relation to the obligations or commitments made during the fiscal year. The subsidy expense for new direct loans reported in the current year relate to disbursements of loans from both current and prior years' cohorts. Subsidy expense is recognized when the Department disburses direct loans. The subsidy expense reported in the current year includes re-estimates. The subsidy rates shown above, which reflect aggregate negative subsidy in the FY 2012 cohort, cannot be applied to direct loans disbursed during the current reporting year to yield the subsidy expense, nor are these rates applicable to the portfolio as a whole.

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

## Administrative Expenses

Administrative Expenses, for the years ended September 30, 2012 and 2011, consisted of the following:

<b>Administrative Expenses</b>				
(Dollars in Millions)				
	<b>2012</b>		<b>2011</b>	
	<b>Direct Loan Program</b>	<b>FFEL Program</b>	<b>Direct Loan Program</b>	<b>FFEL Program</b>
Operating Expense	\$ 543	\$ 321	\$ 661	\$ 388
Other Expense	26	16	30	18
<b>Administrative Expenses</b>	<b>\$ 569</b>	<b>\$ 337</b>	<b>\$ 691</b>	<b>\$ 406</b>

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

General Property, Plant, and Equipment, as of September 30, 2012 and 2011, consisted of the following:

**General Property, Plant, and Equipment**

(Dollars in Millions)

	2012		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software, and Telecommunications Equipment	\$ 176	\$ (169)	\$ 7
Furniture and Fixtures	3	(3)	-
<b>General Property, Plant, and Equipment</b>	<b>\$ 179</b>	<b>\$ (172)</b>	<b>\$ 7</b>

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

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

**Leases**

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

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

**Leases**

(Dollars in Millions)

2012			2011		
FY	Lease Payment		FY	Lease Payment	
2013	\$	52	2012	\$	38
2014		45	2013		44
2015		47	2014		45
2016		49	2015		53
2017		50	2016		55
After 2017		52	After 2016		57
<b>Total</b>	<b>\$</b>	<b>295</b>	<b>Total</b>	<b>\$</b>	<b>292</b>

**Note 8. Other Assets**

Other Intragovernmental Assets primarily consist of advance payments to the Department of Interior's Bureau of Indian Education under terms of an interagency agreement. Other Intragovernmental Assets were \$18 million and \$50 million as of September 30, 2012 and 2011, respectively.

Other Assets with the public consist of payments made to grant recipients in advance of their expenditures and in-process invoices for interest benefits and special allowances for the FFEL Program. Other Assets with the public were \$21 million and \$98 million as of September 30, 2012 and 2011, respectively.

**Note 9. Accounts Payable**

Accounts Payable, as of September 30, 2012 and 2011, consisted of the following:

<b>Accounts Payable</b>		
(Dollars in Millions)		
	<b>2012</b>	<b>2011</b>
Direct Loan Booking Accrual	\$ 2,984	\$ 3,044
In Process Disbursements:		
Direct Loans	588	417
Grants	288	258
FFEL Claim Payments	163	271
Other	75	258
<b>Accounts Payable to the public</b>	<b>4,098</b>	<b>4,248</b>
<b>Intragovernmental Accounts Payable</b>	<b>31</b>	<b>34</b>
Total Accounts Payable	\$ 4,129	\$ 4,282

Accounts Payable to the public primarily consists of in-process grant and loan disbursements, including an accrued liability for schools that have disbursed loans prior to requesting funds.

**Note 10. Debt**

Debt, as of September 30, 2012 and 2011, consisted of the following:

	<b>Debt</b>				
	(Dollars in Millions)				
	<b>2012</b>				
	<b>Beginning Balance</b>	<b>Accrued Interest</b>	<b>Borrowing</b>	<b>Repayments</b>	<b>Ending Balance</b>
<b>Treasury Debt</b>					
Direct Loan Program	\$ 392,374	\$ -	\$ 175,881	\$ (18,923)	\$ 549,332
FFEL Program					
Guaranteed Loan Program	29,484	-	13,770	-	43,254
Loan Purchase Commitment	43,859	-	719	(2,237)	42,341
Loan Participation Purchase	79,302	-	1,621	(3,631)	77,292
ABCP Conduit	964	-	1,050	(279)	1,735
TEACH Program	281	-	119	(30)	370
Facilities Loan Program	58	-	-	(13)	45
<b>Total Treasury Debt</b>	<b>546,322</b>	<b>-</b>	<b>193,160</b>	<b>(25,113)</b>	<b>714,369</b>
<b>Debt to the FFB</b>					
HBCU	786	4	158	(14)	934
<b>Total Debt to the FFB</b>	<b>786</b>	<b>4</b>	<b>158</b>	<b>(14)</b>	<b>934</b>
<b>Total</b>	<b>\$ 547,108</b>	<b>\$ 4</b>	<b>\$ 193,318</b>	<b>\$ (25,127)</b>	<b>\$ 715,303</b>
	<b>2011</b>				
	<b>Beginning Balance</b>	<b>Accrued Interest</b>	<b>Borrowing</b>	<b>Repayments</b>	<b>Ending Balance</b>
<b>Treasury Debt</b>					
Direct Loan Program	\$ 237,190	\$ -	\$ 167,071	\$ (11,887)	\$ 392,374
FFEL Program					
Guaranteed Loan Program	10,730	-	18,754	-	29,484
Loan Purchase Commitment	45,205	-	1,394	(2,740)	43,859
Loan Participation Purchase	79,577	-	5,352	(5,627)	79,302
ABCP Conduit	804	-	250	(90)	964
TEACH Program	150	-	133	(2)	281
Facilities Loan Program	61	-	-	(3)	58
<b>Total Treasury Debt</b>	<b>373,717</b>	<b>-</b>	<b>192,954</b>	<b>(20,349)</b>	<b>546,322</b>
<b>Debt to the FFB</b>					
HBCU	618	1	176	(9)	786
<b>Total Debt to the FFB</b>	<b>618</b>	<b>1</b>	<b>176</b>	<b>(9)</b>	<b>786</b>
<b>Total</b>	<b>\$ 374,335</b>	<b>\$ 1</b>	<b>\$ 193,130</b>	<b>\$ (20,358)</b>	<b>\$ 547,108</b>

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



## Note 11. 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, 2012 and 2011, consisted of the following:

	2012		2011	
	Intragovernmental	With the Public	Intragovernmental	With the Public
<b>Other Liabilities</b> (Dollars in Millions)				
<b>Liabilities Covered by Budgetary Resources</b>				
<b>Current</b>				
Advances From Others	\$ 35	\$ -	\$ 89	\$ -
Employer Contributions and Payroll Taxes	5	-	6	-
Liability for Deposit Funds and Clearing Accounts	(73)	36	(4)	71
Accrued Payroll and Benefits	-	26	-	28
Deferred Revenue	-	36	-	62
Liabilities in Miscellaneous Receipt Accounts	3,716	-	6,533	-
<b>Total Other Liabilities Covered by Budgetary Resources</b>	<b>3,683</b>	<b>98</b>	<b>6,624</b>	<b>161</b>
<b>Liabilities Not Covered by Budgetary Resources</b>				
<b>Current</b>				
Accrued Unfunded Annual Leave	-	37	-	38
<b>Non-Current</b>				
Accrued Unfunded FECA Liability	5	-	4	-
Liabilities in Miscellaneous Receipt Accounts	342	-	215	-
Accrued FECA Actuarial Liability	-	16	-	18
<b>Total Other Liabilities Not Covered by Budgetary Resources</b>	<b>347</b>	<b>53</b>	<b>219</b>	<b>56</b>
<b>Other Liabilities</b>	<b>\$ 4,030</b>	<b>\$ 151</b>	<b>\$ 6,843</b>	<b>\$ 217</b>

## Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary resources include liabilities for which congressional action is needed before budgetary resources can be provided. Although future appropriations to fund these liabilities are likely, it is not certain that appropriations will be enacted to fund these liabilities. Liabilities not covered by budgetary resources totaled \$400 million and \$275 million as of September 30, 2012 and 2011, respectively.

As of September 30, 2012 and 2011, liabilities on the Balance Sheet totaled \$731.8 billion and \$578.0 billion, respectively. Of this amount, liabilities covered by budgetary resources totaled \$731.4 billion as of September 30, 2012, and \$577.7 billion as of September 30, 2011.

**Note 12. Accrued Grant Liability**

The accrued grant liability by major reporting groups, as of September 30, 2012 and 2011, consisted of the following:

<b>Accrued Grant Liability</b>		
(Dollars in Millions)		
	<u>2012</u>	<u>2011</u>
FSA	\$ 2,269	\$ 3,036
OESE	211	124
OSERS	233	259
RA/JF	55	235
Other	133	274
<b>Accrued Grant Liability</b>	<b><u>\$ 2,901</u></b>	<b><u>\$ 3,928</u></b>

**Note 13. Net Position**

Unexpended appropriations, as of September 30, 2012 and 2011, consisted of the following:

<b>Unexpended Appropriations</b>		
(Dollars in Millions)		
	<u>2012</u>	<u>2011</u>
Unobligated Balances		
Available	\$ 10,479	\$ 2,936
Not Available	632	594
Undelivered Orders	61,575	68,199
<b>Unexpended Appropriations</b>	<b><u>\$ 72,686</u></b>	<b><u>\$ 71,729</u></b>

The Cumulative Results of Operations of \$(7,531) million as of September 30, 2012, and \$(3,144) million as of September 30, 2011, consists mostly of unfunded upward subsidy re-estimates, other unfunded expenses, and net investments of capitalized assets.

## Note 14. Intragovernmental Cost and Exchange Revenue by Program

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

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

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

The goals of the *Recovery Act* and Education Jobs Fund are consistent with the Department's current strategic goals and programs. For reporting purposes, a net cost program called American Recovery and Reinvestment Act and Education Jobs Fund has been created.

The following tables present the gross cost and exchange revenue by program for the Department for FY 2012 and FY 2011. Gross costs and earned revenue are classified as intragovernmental (exchange transactions between the Department and other entities within the federal government) or with the public (exchange transactions between the Department and non-federal entities).

### Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

	2012					Total
	FSA	OESE	OSERS	RA/JF	Other	
<b><i>Increase College Access, Quality, and Completion</i></b>						
Intragovernmental Gross Cost	\$ 26,750	\$ -	\$ -	\$ -	\$ 77	\$ 26,827
Public Gross Cost	<u>9,216</u>	-	-	-	<u>4,367</u>	<u>13,583</u>
Total Gross Program Costs	35,966	-	-	-	4,444	40,410
Intragovernmental Earned Revenue	5,343	-	-	-	26	5,369
Public Earned Revenue	<u>19,963</u>	-	-	-	<u>8</u>	<u>19,971</u>
Total Program Earned Revenue	<u>25,306</u>	-	-	-	<u>34</u>	<u>25,340</u>
<b>Total Program Cost</b>	<b><u>10,660</u></b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>4,410</u></b>	<b><u>15,070</u></b>
<b><i>Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs</i></b>						
Intragovernmental Gross Cost	-	227	-	-	-	227
Public Gross Cost	-	<u>22,175</u>	-	-	<u>17</u>	<u>22,192</u>
Total Gross Program Costs	-	22,402	-	-	17	22,419
Intragovernmental Earned Revenue	-	70	-	-	-	70
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	<u>70</u>	-	-	-	<u>70</u>
<b>Total Program Cost</b>	<b>-</b>	<b><u>22,332</u></b>	<b>-</b>	<b>-</b>	<b><u>17</u></b>	<b><u>22,349</u></b>
<b><i>Ensure Effective Educational Opportunities for All Students</i></b>						
Intragovernmental Gross Cost	-	-	44	-	32	76
Public Gross Cost	-	-	<u>16,235</u>	-	<u>803</u>	<u>17,038</u>
Total Gross Program Costs	-	-	16,279	-	835	17,114
Intragovernmental Earned Revenue	-	-	10	-	1	11
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	-	<u>10</u>	-	<u>1</u>	<u>11</u>
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b><u>16,269</u></b>	<b>-</b>	<b><u>834</u></b>	<b><u>17,103</u></b>
<b><i>Enhance the Education System's Ability to Continuously Improve</i></b>						
Intragovernmental Gross Cost	-	-	-	-	65	65
Public Gross Cost	-	-	-	-	<u>1,595</u>	<u>1,595</u>
Total Gross Program Costs	-	-	-	-	1,660	1,660
Intragovernmental Earned Revenue	-	-	-	-	9	9
Public Earned Revenue	-	-	-	-	<u>60</u>	<u>60</u>
Total Program Earned Revenue	-	-	-	-	<u>69</u>	<u>69</u>
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>1,591</u></b>	<b><u>1,591</u></b>
<b><i>American Recovery and Reinvestment Act and Education Jobs Fund</i></b>						
Intragovernmental Gross Cost	-	-	-	3	-	3
Public Gross Cost	-	-	-	<u>7,657</u>	-	<u>7,657</u>
Total Gross Program Costs	-	-	-	7,660	-	7,660
Intragovernmental Earned Revenue	-	-	-	-	-	-
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	-	-	-	-	-
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>7,660</u></b>	<b>-</b>	<b><u>7,660</u></b>
<b>Net Cost of Operations</b>	<b><u>\$ 10,660</u></b>	<b><u>\$ 22,332</u></b>	<b><u>\$ 16,269</u></b>	<b><u>\$ 7,660</u></b>	<b><u>\$ 6,852</u></b>	<b><u>\$ 63,773</u></b>

## Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

	2011					
	<u>FSA</u>	<u>OESE</u>	<u>OSERS</u>	<u>RA/JF</u>	<u>Other</u>	<u>Total</u>
<b><i>Increase College Access, Quality, and Completion</i></b>						
Intragovernmental Gross Cost	\$ 20,247	\$ -	\$ -	\$ -	\$ 77	\$ 20,324
Public Gross Cost	<u>(3,435)</u>	-	-	-	<u>4,896</u>	<u>1,461</u>
Total Gross Program Costs	16,812	-	-	-	4,973	21,785
Intragovernmental Earned Revenue	5,304	-	-	-	17	5,321
Public Earned Revenue	<u>14,908</u>	-	-	-	<u>23</u>	<u>14,931</u>
Total Program Earned Revenue	<u>20,212</u>	-	-	-	<u>40</u>	<u>20,252</u>
<b>Total Program Cost</b>	<b><u>(3,400)</u></b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>4,933</u></b>	<b><u>1,533</u></b>
<b><i>Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs</i></b>						
Intragovernmental Gross Cost	-	210	-	-	-	210
Public Gross Cost	-	<u>21,670</u>	-	-	<u>30</u>	<u>21,700</u>
Total Gross Program Costs	-	21,880	-	-	30	21,910
Intragovernmental Earned Revenue	-	64	-	-	-	64
Public Earned Revenue	-	<u>19</u>	-	-	-	<u>19</u>
Total Program Earned Revenue	-	<u>83</u>	-	-	-	<u>83</u>
<b>Total Program Cost</b>	<b>-</b>	<b><u>21,797</u></b>	<b>-</b>	<b>-</b>	<b><u>30</u></b>	<b><u>21,827</u></b>
<b><i>Ensure Effective Educational Opportunities for All Students</i></b>						
Intragovernmental Gross Cost	-	-	43	-	32	75
Public Gross Cost	-	-	<u>15,463</u>	-	<u>871</u>	<u>16,334</u>
Total Gross Program Costs	-	-	15,506	-	903	16,409
Intragovernmental Earned Revenue	-	-	2	-	-	2
Public Earned Revenue	-	-	<u>19</u>	-	<u>2</u>	<u>21</u>
Total Program Earned Revenue	-	-	<u>21</u>	-	<u>2</u>	<u>23</u>
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b><u>15,485</u></b>	<b>-</b>	<b><u>901</u></b>	<b><u>16,386</u></b>
<b><i>Enhance the Education System's Ability to Continuously Improve</i></b>						
Intragovernmental Gross Cost	-	-	-	-	68	68
Public Gross Cost	-	-	-	-	<u>1,773</u>	<u>1,773</u>
Total Gross Program Costs	-	-	-	-	1,841	1,841
Intragovernmental Earned Revenue	-	-	-	-	2	2
Public Earned Revenue	-	-	-	-	<u>37</u>	<u>37</u>
Total Program Earned Revenue	-	-	-	-	<u>39</u>	<u>39</u>
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>1,802</u></b>	<b><u>1,802</u></b>
<b><i>American Recovery and Reinvestment Act and Education Jobs Fund</i></b>						
Intragovernmental Gross Cost	-	-	-	60	-	60
Public Gross Cost	-	-	-	<u>27,905</u>	-	<u>27,905</u>
Total Gross Program Costs	-	-	-	27,965	-	27,965
Intragovernmental Earned Revenue	-	-	-	-	-	-
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	-	-	-	-	-
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b><u>27,965</u></b>	<b>-</b>	<b><u>27,965</u></b>
<b>Net Cost of Operations</b>	<b><u>\$ (3,400)</u></b>	<b><u>\$ 21,797</u></b>	<b><u>\$ 15,485</u></b>	<b><u>\$ 27,965</u></b>	<b><u>\$ 7,666</u></b>	<b><u>\$ 69,513</u></b>

**Note 15. Interest Expense and Interest Revenue**

For FY 2012 and FY 2011, interest expense and interest revenue by program consisted of the following:

**Interest Expense and Interest Revenue**

(Dollars in Millions)

	2012					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	\$ 20,643	\$ -	\$20,643	\$ 4,265	\$ 16,378	\$20,643
FFEL Program						
Guaranteed Loan Program	2,083	(1,440)	643	643	-	643
Loan Purchase Commitment	1,318	-	1,318	73	1,245	1,318
Loan Participation Purchase	2,471	-	2,471	237	2,234	2,471
ABCP Conduit	90	-	90	32	58	90
TEACH Program	15	-	15	4	11	15
Other Programs	23	-	23	18	24	42
<b>Total</b>	<b>\$ 26,643</b>	<b>\$ (1,440)</b>	<b>\$25,203</b>	<b>\$ 5,272</b>	<b>\$ 19,950</b>	<b>\$25,222</b>

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

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



## Note 16. Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) compares budgetary resources with the status of those resources. As of September 30, 2012, budgetary resources were \$374,984 million and net outlays were \$217,370 million. As of September 30, 2011, budgetary resources were \$366,381 million and net outlays were \$234,942 million.

### Permanent Indefinite Budget Authority

The Direct Loan, FFEL, and TEACH Programs have permanent indefinite budget authority through legislation. Parts B and D of the HEA (for the FFEL Program and Direct Loan Program, respectively) pertain to the existence, purpose, and availability of this permanent indefinite budget authority.

### Reauthorization of Legislation

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

### Obligations Incurred by Apportionment Type and Category

Obligations incurred by apportionment type and category, as of September 30, 2012 and 2011, consisted of the following:

<b>Obligations Incurred by Apportionment Type and Category</b>		
(Dollars in Millions)		
	<u>2012</u>	<u>2011</u>
Direct:		
Category A	\$ 1,594	\$ 649
Category B	341,320	342,649
Exempt from Apportionment	419	2,167
	<u>343,333</u>	<u>345,465</u>
Reimbursable:		
Exempt from Apportionment	36	80
	<u>36</u>	<u>80</u>
<b>Obligations Incurred</b>	<b><u>\$ 343,369</u></b>	<b><u>\$ 345,545</u></b>

Obligations incurred can be either direct or reimbursable. Reimbursable obligations are those financed by offsetting collections received in return for goods and services provided, while all other obligations are direct. Category A apportionments are those resources that can be obligated without restriction on the purpose of the obligation, other than to be in compliance with legislation underlying programs for which the resources were made available. Category B apportionments are restricted by purpose for which obligations can be incurred. In addition, some resources are available without apportionment by OMB.

## Unused Borrowing Authority

Unused borrowing authority, as of September 30, 2012 and 2011, consisted of the following:

<b>Unused Borrowing Authority</b>		
(Dollars in Millions)		
	<b>2012</b>	<b>2011</b>
<b>Beginning Balance, Unused Borrowing Authority</b>	<b>\$ 142,194</b>	<b>\$ 133,120</b>
Current Year Borrowing Authority	209,614	211,980
Funds Drawn From Treasury	(193,318)	(193,130)
Borrowing Authority Withdrawn	(12,958)	(9,776)
<b>Ending Balance, Unused Borrowing Authority</b>	<b>\$ 145,532</b>	<b>\$ 142,194</b>

The Department is given authority to draw funds from Treasury to finance the Direct Loan, FFEL, and TEACH Programs. Unused borrowing authority is a budgetary resource and is available to support obligations. The Department periodically reviews its borrowing authority balances in relation to its obligations and may cancel unused amounts.

## Undelivered Orders at the End of the Period

Undelivered orders, as of September 30, 2012 and 2011, consisted of the following:

<b>Undelivered Orders</b>		
(Dollars in Millions)		
	<b>2012</b>	<b>2011</b>
Budgetary	\$ 61,713	\$ 68,223
Non-Budgetary	169,062	161,016
<b>Undelivered Orders (Unpaid)</b>	<b>\$ 230,775</b>	<b>\$ 229,239</b>

Undelivered orders at the end of the period, as presented above, will differ from the undelivered orders included in the Net Position, Unexpended Appropriations. Undelivered orders for trust funds, reimbursable agreements, and federal credit financing and liquidating funds are not funded through appropriations and are not included in Net Position. (See Note 13)

## Distributed Offsetting Receipts

The majority of the Distributed Offsetting Receipts line item on the SBR represents amounts paid from the Direct Loan Program and FFEL Program financing accounts to general fund receipt accounts for downward re-estimates and negative subsidies. Distributed Offsetting Receipts, for the years ended September 30, 2012 and 2011, consisted of the following:

<b>Distributed Offsetting Receipts</b>			
(Dollars in Millions)			
	<b>2012</b>		<b>2011</b>
Negative Subsidies and Downward Re-estimates:			
FFEL Program	\$ 16,371	\$	24,670
Direct Loan Program	24,258		25,502
Facilities Loan Programs	20		23
TEACH Program	-		6
Subtotal	40,649		50,201
Other	(37)		88
<b>Distributed Offsetting Receipts</b>	<b>\$ 40,612</b>	<b>\$</b>	<b>50,289</b>

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

The FY 2014 *Budget of the United States Government* (President's Budget), which presents the actual amounts for the year ended September 30, 2012, has not been published as of the issue date of these financial statements. The FY 2014 President's Budget is scheduled for release in February 2013. A reconciliation of the FY 2011 SBR to the FY 2013 President's Budget (FY 2011 actual amounts) for budgetary resources, obligations incurred, distributed offsetting receipts, and net outlays is presented below.

### SBR to Budget of the United States Government

(Dollars in Millions)				
	<b>Budgetary Resources</b>	<b>Obligations Incurred</b>	<b>Distributed Offsetting Receipts</b>	<b>Net Outlays</b>
<b>Combined Statement of Budgetary Resources</b>	<b>\$ 366,381</b>	<b>\$ 345,545</b>	<b>\$ 50,289</b>	<b>\$ 234,942</b>
Expired Funds	(1,952)	(1,324)	-	-
Amounts Included in the President's Budget	10,089	10,037	-	-
Amounts Excluded from President's Budget and Rounding	(3)	-	1	(888)
<b>Budget of the United States Government*</b>	<b>\$ 374,515</b>	<b>\$ 354,258</b>	<b>\$ 50,290</b>	<b>\$ 234,054</b>

\*Amounts obtained from the Appendix, Budget of the United States Government, FY 2013.

The President's Budget includes a public enterprise fund that reflects the gross obligations by the FFEL Program for the estimated activity of the consolidated Federal Funds of the guaranty agencies. Ownership by the federal government is independent of the actual control of the assets. Because the actual operation of the Federal Fund is independent from the Department's direct control, budgetary resources and obligations are estimated and disclosed in the President's Budget to approximate the gross activities of the combined Federal Funds. Amounts reported on the FY 2011 SBR for the Federal Fund are compiled through combining all guaranty agencies' annual reports to determine a net valuation amount for the Federal Fund.

## Note 17. Reconciliation of Budgetary Obligations to Net Cost of Operations

The Reconciliation of Budgetary Obligations to Net Cost of Operations provides information on how budgetary resources obligated during the period relate to the net cost of operations by: (1) removing resources that do not fund net cost of operations, and (2) including components of net cost of operations that did not generate or use resources during the year.

The Reconciliation of Budgetary Obligations to Net Cost of Operations, as of September 30, 2012 and 2011, are presented below:

### Reconciliation of Budgetary Obligations to Net Cost of Operations

(Dollars in Millions)

	2012	2011
<b>Resources Used to Finance Activities:</b>		
Obligations Incurred	\$ 343,369	\$ 345,545
Spending Authority from Offsetting Collections and Recoveries	(85,170)	(68,782)
Offsetting Receipts	(40,612)	(50,289)
<b>Net Budgetary Resources Obligated</b>	<b>217,587</b>	<b>226,474</b>
Imputed Financing from Costs Absorbed by Others	34	38
Other Financing Sources	(37,522)	(42,868)
<b>Net Other Resources</b>	<b>(37,488)</b>	<b>(42,830)</b>
<b>Net Resources Used to Finance Activities</b>	<b>180,099</b>	<b>183,644</b>
<b>Less: Resources Used or Generated for Items Not Part of the Net Cost of Operations:</b>		
Increase/(Decrease) in Budgetary Resources Obligated but Not Yet Provided	997	(8,933)
Resources that Fund Subsidy Re-estimates Accrued in Prior Period	(3,329)	(5,785)
Credit Program Collections	(52,238)	(43,451)
Acquisition of Fixed Assets	-	4
Acquisition of Net Credit Program Assets or Liquidation of Liabilities for Loan Guarantees	198,020	201,658
Resources from Non-Entity Activity	(37,447)	(42,856)
<b>Net Resources That Do Not Finance the Net Cost of Operations</b>	<b>106,003</b>	<b>100,637</b>
<b>Net Resources Used to Finance the Net Cost of Operations</b>	<b>74,096</b>	<b>83,007</b>
<b>Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:</b>		
Depreciation	9	16
Subsidy Amortization and Interest on the Liability for Loan Guarantees	4,259	1,823
Other	(17)	-
<b>Total Components Not Requiring or Generating Resources</b>	<b>4,251</b>	<b>1,839</b>
Increase/(Decrease) in Annual Leave Liability	(1)	1
Accrued Re-estimates of Credit Subsidy Expense	3,922	(3,329)
Increase in Exchange Revenue Receivable from the Public	(18,448)	(12,008)
Change in Accrued Interest with Treasury	1	1
Other	(48)	2
<b>Total Components Requiring or Generating Resources in Future Periods</b>	<b>(14,574)</b>	<b>(15,333)</b>
<b>Total Components That Will Not Require or Generate Resources in the Current Period</b>	<b>(10,323)</b>	<b>(13,494)</b>
<b>Net Cost of Operations</b>	<b>\$ 63,773</b>	<b>\$ 69,513</b>

**Note 18. Incidental Custodial Collections**

The Department administers certain activities associated with the collection of non-exchange revenues. The Department collects these amounts in a custodial capacity and transfers the amounts collected to the General Fund of the Treasury at the end of each fiscal year. These collections primarily consist of penalties on accounts receivable and are considered incidental to the primary mission of the Department. During FY 2012 and FY 2011, the Department collected \$1.2 million and \$1.3 million, respectively, in custodial revenues.

**Note 19. American Recovery and Reinvestment Act of 2009**

The Recovery Act provided \$97,407 million to the Department in supplemental appropriations for job preservation and state and local fiscal stabilization. This investment was made available for use in saving jobs, supporting states and local school districts, and advancing reforms and improvements in the education of the nation's children and youth from early learning programs through postsecondary education.

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

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

The status of Recovery Act funding, as of September 30, 2012 and 2011, is presented below:

### American Recovery and Reinvestment Act of 2009

(Dollars in Millions)

	Cumulative Totals as of September 30, 2012		
	Appropriations	Obligations	Outlays
State Fiscal Stabilization Fund:			
SFSF Formula Grants	\$ 48,600	\$ 48,600	\$ 48,558
Investing in Innovation and Race to the Top	5,000	5,000	1,178
<b>Subtotal</b>	<b>53,600</b>	<b>53,600</b>	<b>49,736</b>
Student Financial Assistance:			
Federal Pell Grants	15,640	15,640	15,639
Mandatory Add-on Pell Grants	643	643	643
Federal Work Study Grants	200	200	200
<b>Subtotal</b>	<b>16,483</b>	<b>16,483</b>	<b>16,482</b>
Education for the Disadvantaged:			
Title I Targeted/ Finance Incentive Grants	10,000	10,000	9,906
School Improvement Grants	3,000	3,000	1,461
<b>Subtotal</b>	<b>13,000</b>	<b>13,000</b>	<b>11,367</b>
Special Education:			
IDEA Part B Grants to States	11,300	11,300	11,264
IDEA Part B Preschool Grants	400	400	395
IDEA Part C Grants for Infants and Families	500	500	491
<b>Subtotal</b>	<b>12,200</b>	<b>12,200</b>	<b>12,150</b>
School Improvement Programs:			
Enhancing Education through Technology	650	650	634
Education for Homeless Children and Youths	70	70	69
<b>Subtotal</b>	<b>720</b>	<b>720</b>	<b>703</b>
Rehabilitation Services and Disability Research:			
Vocational Rehabilitation	540	540	540
Independent Living Centers	88	88	53
Services for Older Blind Individuals	34	34	33
State Grants	18	18	18
<b>Subtotal</b>	<b>680</b>	<b>680</b>	<b>644</b>
Institute of Education Sciences	250	250	100
Innovation and Improvement	200	170	99
Impact Aid:			
Section 8007(a) Formula Grants	40	40	40
Section 8007(b) Competitive Grants	60	60	59
<b>Subtotal</b>	<b>100</b>	<b>100</b>	<b>99</b>
Higher Education	100	100	37
Student Aid Administration	60	60	60
Office of Inspector General	14	14	14
<b>Total</b>	<b>\$ 97,407</b>	<b>\$ 97,377</b>	<b>\$ 91,491</b>



**American Recovery and Reinvestment Act of 2009**

(Dollars in Millions)

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

**Note 20. Education Jobs Fund**

Public Law 111-226, enacted on August 10, 2010, created an Education Jobs Fund, which allows the Department to provide assistance in saving and creating education jobs. This investment of \$10 billion was made available to states through formula grants for use in the 2010–11 and 2011–12 school years for teachers and other employees of the nation's children and youth from early learning programs through secondary education. As of September 30, 2012, \$10,000 million has been obligated and \$9,771 million has been expended to support states and local school districts in their effort to save jobs. As of September 30, 2011, \$10,000 million had been obligated and \$6,287 million had been expended.

**Note 21. Contingencies**  
**Guaranty Agencies**

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

**Federal Perkins Loan Program Reserve Funds**

The Federal Perkins Loan Program is a campus-based program that provides financial assistance to eligible postsecondary school students. In FY 2012, the Department provided funding of 82.7 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 17.3 percent of program funding. For the latest academic year ended June 30, 2012, approximately 483 thousand loans were made, totaling approximately \$945.0 million at 1,519 institutions, averaging \$1,956 per loan. The Department's share of the Federal Perkins Loan Program was approximately \$6.7 billion as of June 30, 2012.

In FY 2011, the Department provided funding of 82.6 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 17.4 percent of program funding. For the academic year ended June 30, 2011, approximately 459 thousand loans were made, totaling approximately \$853.9 million at 1,505 institutions, averaging \$1,859 per loan. The Department's share of the Federal Perkins Loan Program was approximately \$6.6 billion as of June 30, 2011.

Federal Perkins Loan Program borrowers who meet statutory eligibility requirements—such as those who provide service as teachers in low-income areas or as Peace Corps or AmeriCorps VISTA volunteers, as well as those who serve in the military, law enforcement, nursing, or family services—may receive partial loan forgiveness for each year of qualifying service. In these circumstances, a contingency is deemed to exist. The Department may be required to compensate Federal Perkins Loan Program institutions for the cost of the partial loan forgiveness.

**Litigation and Other Claims**

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

**Other Matters**

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

**United States Department of Education**  
**Combining Statement of Budgetary Resources**  
**For the Year Ended September 30, 2012**

*Dollars in Millions*

	Combined		Federal Student Aid		Office of Elementary and Secondary Education		Office of Special Education and Rehabilitative Services		American Recovery and Reinvestment Act and Education Jobs Fund		Other	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
<b>Budgetary Resources:</b>												
Unobligated balance, brought forward, October 1	\$ 5,434	\$ 15,402	\$ 3,415	\$ 15,004	\$ 713		\$ 132		\$ 5		\$ 1,169	\$ 398
Recoveries of prior year Unpaid Obligations	1,182	18,649	465	18,649	524		26		52		115	
Other changes in unobligated balance	(638)	(20,697)	(499)	(20,691)	(60)		(18)				(61)	(6)
Unobligated balance from prior year budget authority, (net)	5,978	13,354	3,381	12,962	1,177		140		57		1,223	392
Appropriations	98,284	36	52,919	35	21,940		15,660				7,765	1
Borrowing Authority (discretionary and mandatory)		209,614		209,379								235
Spending authority from offsetting collections (discretionary and mandatory)	448	47,270	372	47,210	6		2				68	60
<b>Total Budgetary Resources (Note 15)</b>	<b>\$ 104,710</b>	<b>\$ 270,274</b>	<b>\$ 56,672</b>	<b>\$ 269,586</b>	<b>\$ 23,123</b>	<b>\$ 0</b>	<b>\$ 15,802</b>	<b>\$ 0</b>	<b>\$ 57</b>	<b>\$ 0</b>	<b>\$ 9,056</b>	<b>\$ 688</b>
<b>Status of Budgetary Resources:</b>												
Obligations incurred: (Note 15)	\$ 92,088	\$ 251,281	\$ 46,306	\$ 251,007	\$ 21,321		\$ 15,488		\$ 27		\$ 7,946	\$ 274
Unobligated balance, end of year:												
Apportioned	10,480	1	8,562		713		199				1,006	1
Unapportioned	2,142	18,992	1,804	18,579	89		115		30		104	413
Total unobligated balance, end of year	12,622	18,993	10,366	18,579	802		314		30		1,110	414
<b>Total Budgetary Resources</b>	<b>\$ 104,710</b>	<b>\$ 270,274</b>	<b>\$ 56,672</b>	<b>\$ 269,586</b>	<b>\$ 23,123</b>	<b>\$ 0</b>	<b>\$ 15,802</b>	<b>\$ 0</b>	<b>\$ 57</b>	<b>\$ 0</b>	<b>\$ 9,056</b>	<b>\$ 688</b>
<b>Change in Obligated Balance:</b>												
Unpaid obligations, brought forward, October 1	\$ 72,684	\$ 164,389	\$ 23,218	\$ 164,196	\$ 16,328		\$ 9,967		\$ 13,941		\$ 9,230	\$ 193
Uncollected customer payments from Federal Sources, brought forward, October 1	(6)	(27)		(5)	(2)						(4)	(22)
Obligated balance, start of year (net), before adjustments	72,678	164,362	23,218	164,191	16,326	\$ 0	9,967	\$ 0	13,941	\$ 0	9,226	171
Obligated balance, start of year (net), as adjusted	72,678	164,362	23,218	164,191	16,326		9,967		13,941		9,226	171
Obligation Incurred	92,088	251,281	46,306	251,007	22,321		15,488		27		7,946	274
Outlays (gross)	(98,533)	(224,791)	(44,966)	(224,595)	(22,223)		(16,181)		(7,801)		(7,362)	(196)
Change in uncollected customer payments from Federal Sources	4	1		1	2		(26)		(52)		2	
Recoveries of prior year unpaid obligations	(1,182)	(18,649)	(465)	(18,649)	(524)						(115)	
Obligated Balance, end of year (net):												
Unpaid Obligations, end of year (gross)	\$ 65,057	\$ 172,230	\$ 24,093	\$ 171,959	\$ 15,902		\$ 9,248		\$ 6,115		\$ 9,699	\$ 271
Uncollected customer payments from Federal Sources, end of year	(2)	(26)		(4)							(2)	(22)
<b>Obligated balance, end of year (net)</b>	<b>\$ 65,055</b>	<b>\$ 172,204</b>	<b>\$ 24,093</b>	<b>\$ 171,955</b>	<b>\$ 15,902</b>	<b>\$ 0</b>	<b>\$ 9,248</b>	<b>\$ 0</b>	<b>\$ 6,115</b>	<b>\$ 0</b>	<b>\$ 9,697</b>	<b>\$ 249</b>
<b>Budget Authority and Outlays, Net:</b>												
Budget authority, gross (discretionary and mandatory)	\$ 98,732	\$ 256,920	\$ 53,291	\$ 256,624	\$ 21,946		\$ 15,662				\$ 7,833	\$ 296
Actual offsetting collections (discretionary and mandatory)	(655)	(64,687)	(559)	(64,607)	(7)		(2)				(87)	(80)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)	4	1		1	2						2	
<b>Budgetary Authority, net (discretionary and mandatory)</b>	<b>\$ 98,081</b>	<b>\$ 192,234</b>	<b>\$ 52,732</b>	<b>\$ 192,018</b>	<b>\$ 21,941</b>	<b>\$ 0</b>	<b>\$ 15,660</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 7,748</b>	<b>\$ 216</b>
Outlays, gross (discretionary and mandatory)	\$ 98,533	\$ 224,791	\$ 44,966	\$ 224,595	\$ 22,223		\$ 16,181		\$ 7,801		\$ 7,362	\$ 196
Actual offsetting collections (discretionary and mandatory)	(655)	(64,687)	(559)	(64,607)	(7)		(2)				(87)	(80)
Outlays, net (discretionary and mandatory)	97,878	160,104	44,407	159,988	22,216		16,179		7,801		7,275	116
Distributed offsetting receipts	(40,612)		(40,654)								42	
<b>Net Outlays (Note 15)</b>	<b>\$ 57,266</b>	<b>\$ 160,104</b>	<b>\$ 3,753</b>	<b>\$ 159,988</b>	<b>\$ 22,216</b>	<b>\$ 0</b>	<b>\$ 16,179</b>	<b>\$ 0</b>	<b>\$ 7,801</b>	<b>\$ 0</b>	<b>\$ 7,317</b>	<b>\$ 116</b>

## Required Supplementary Stewardship Information

### Stewardship Expenses

In the Department, discretionary spending constitutes the majority of the budget and includes nearly all programs, the notable exceptions being student loan subsidy costs and vocational rehabilitation state grants. Education in the United States is primarily a state and local responsibility. States, communities, and public and private organizations establish schools and colleges, develop curricula, and determine requirements for enrollment and graduation. In addition, most of the governmental funding for education in the United States comes from state and local governments.

### Investment in Human Capital

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

**Office of Federal Student Aid.** The Office of Federal Student Aid administers need-based financial assistance programs for students pursuing postsecondary education and makes available federal grants, direct loans, guaranteed loans, and work-study funding to eligible undergraduate and graduate students. See more detail at:  
<http://www.ed.gov/about/offices/list/fsa/index.html?src=oc>.

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

**Office of Special Education and Rehabilitative Services.** The Office of Special Education and Rehabilitative Services supports state and local programs that assist in educating children, youth, and adults with special needs to increase their level of employment, productivity, independence, and integration into the community. Funding also is provided for research to improve the quality of their lives. See more detail at:  
<http://www.ed.gov/about/offices/list/osers/index.html?src=oc>.

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

**Institute of Education Sciences.** Established by the *Education Sciences Reform Act of 2002*, the Institute of Education Sciences is the research arm of the Department of

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

**Office of English Language Acquisition.** The Office of English Language Acquisition directs programs designed to enable students with limited English proficiency to become proficient in English and meet state academic content and student academic achievement standards. Enhanced instructional opportunities are provided to children and youths of Native American, Alaska Native, Native Hawaiian, Pacific Islander, and immigrant backgrounds who are limited English proficient. See more detail at: <http://www.ed.gov/about/offices/list/oela/index.html?src=oc>.

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

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

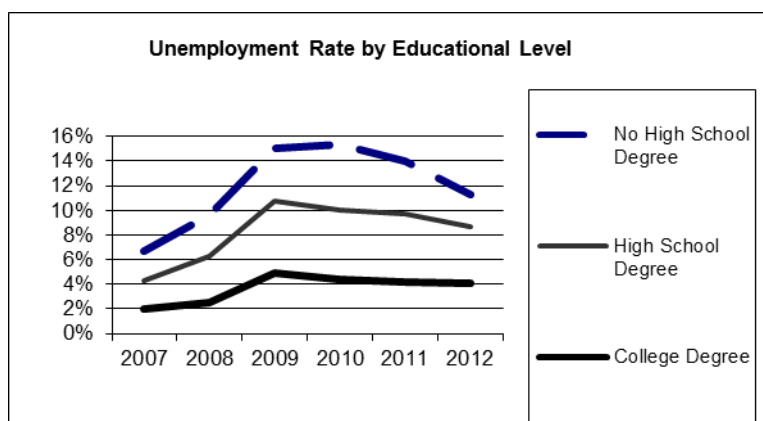


Summary of Human Capital Expenses					
(Dollars in Millions)	2012	2011	2010	2009	2008
<b>Federal Student Aid Expense</b>					
Direct Loan Subsidy	\$ (10,720)	\$ (28,630)	\$ (1,567)	\$ (9,603)	\$ 5,236
Federal Family Education Loan Program Subsidy	(14,381)	(16,126)	(14,344)	(29,940)	(2,852)
Grant Programs	34,310	39,008	26,799	17,302	17,464
Salaries and Administrative	192	193	208	186	189
<b>Subtotal</b>	<b>9,401</b>	<b>(5,555)</b>	<b>11,096</b>	<b>(22,055)</b>	<b>20,037</b>
<b>Other Departmental</b>					
Elementary and Secondary Education	22,137	21,195	21,608	21,443	21,583
Special Education and Rehabilitative Services	16,139	15,357	15,227	15,075	15,730
American Recovery and Reinvestment and Education Jobs Fund	7,651	27,945	44,019	21,616	
Other Departmental Programs	6,211	7,341	7,067	7,150	4,911
Salaries and Administrative	481	504	502	472	491
<b>Subtotal</b>	<b>52,619</b>	<b>72,342</b>	<b>88,423</b>	<b>65,756</b>	<b>42,715</b>
<b>Grand Total</b>	<b>\$ 62,020</b>	<b>\$ 66,787</b>	<b>\$ 99,519</b>	<b>\$ 43,701</b>	<b>\$ 62,752</b>

## Program Outcomes

Education is the stepping stone to higher living standards for American citizens, and it is vital to national economic growth. However, education can lead to more than increased productivity and incomes. Education can help improve health, promote social change, and open doors to a better future for children and adults.

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



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

learning or developing skills through education. Like all investments, developing higher-level skills involves costs and benefits.

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

**Unemployment Rate.** Individuals with lower levels of educational attainment are more likely to be unemployed than those who had higher levels of educational attainment. The September 2012 unemployment rate for adults (25 years old and over) who had not completed high school was 11.3 percent, compared with 8.7 percent for those with four years of high school and 4.1 percent for those with a bachelor's degree or higher. Younger people with only high school diplomas tended to have higher unemployment rates than adults 25 and over with similar levels of education.

**Annual Income.** As of September 2012, the annualized median income for adults (25 years old and over) varied considerably by education level. Men with a high school diploma earned \$37,752, compared with \$71,032 for men with a college degree. Women with a high school diploma earned \$29,692, compared with \$52,208 for women with a college degree. Men and women with college degrees earned 80 percent more than men and women with high school diplomas. These returns of investing in education directly translate into the advancement of the American economy as a whole.

# **Report of the Independent Auditors**



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

THE INSPECTOR GENERAL

NOV 16 2012

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

Dear Secretary Duncan:

The enclosed reports present the results of the annual audits of the U.S. Department of Education's financial statements for fiscal years 2012 and 2011 to comply with the Government Management Reform Act of 1994 (GMRA). The reports should be read in conjunction with the Department's financial statements and notes to fully understand the context of the information contained therein.

We contracted with the independent certified public accounting firm of Ernst & Young, LLP (Ernst & Young) to audit the financial statements of the Department as of September 30, 2012 and 2011, and for the years then ended. The contract required that the audits be performed in accordance with U.S. generally accepted government auditing standards and OMB's bulletin, *Audit Requirements for Federal Financial Statements*.

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

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

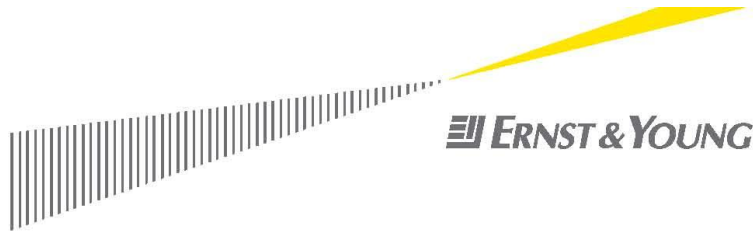
Sincerely,

A handwritten signature in cursive script that reads "Kathleen S. Tighe".

Kathleen S. Tighe  
Inspector General

Enclosures

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



Ernst & Young LLP  
Westpark Corporate Center  
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 the U.S. Department of Education (the Department) as of September 30, 2012 and 2011, and the related consolidated statements of net cost, and changes in net position, and the combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

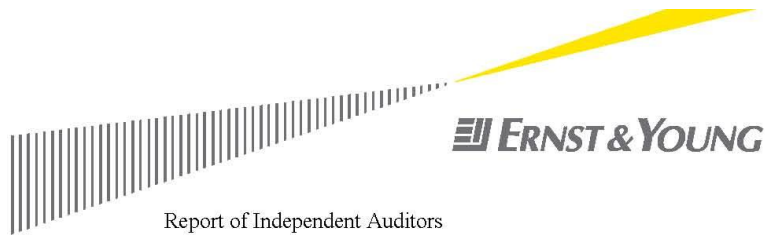
We conducted our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of September 30, 2012 and 2011, 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 16, 2012, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an

A member firm of Ernst & Young Global Limited





Report of Independent Auditors  
Page 2

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

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information as identified on the Contents page of the Department's Agency Financial Report, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

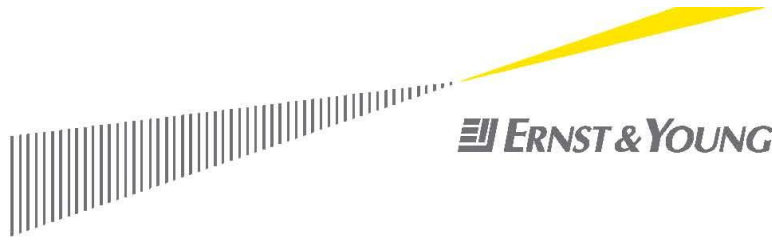
Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The other accompanying information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

*Ernst & Young LLP*

November 16, 2012

A member firm of Ernst & Young Global Limited





Ernst & Young LLP  
Westpark Corporate Center  
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***

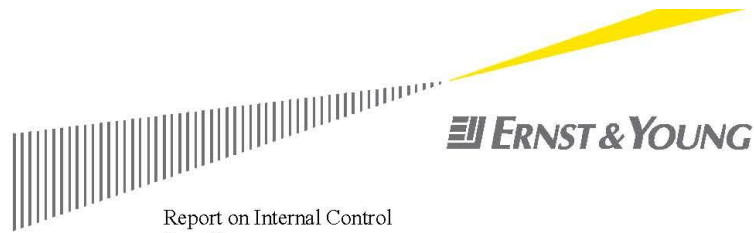
To the Inspector General  
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2012, 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 16, 2012. 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.

Management of the Department is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04, as amended. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

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 over financial reporting such that there is a reasonable possibility that a material misstatement of the entity's financial statements



Report on Internal Control  
Page 2

will not be prevented, or detected and corrected on a timely basis. We consider the first deficiency described below to be a material weakness.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the second and third deficiencies described below to be significant deficiencies.

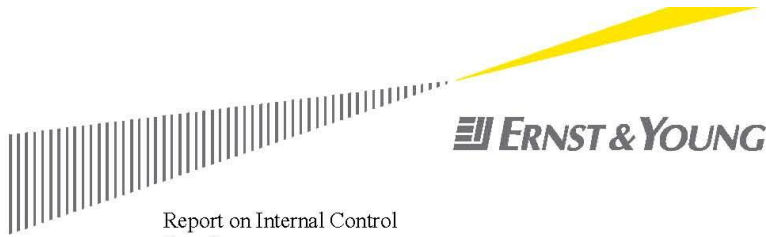
### MATERIAL WEAKNESS

#### **1. Controls Surrounding the Department's Debt Management Collection System and ACS, Inc. Education Servicing System Need Improvement.**

##### *DMCS2*

The Department utilizes a debt management collection system to manage defaulted student loans and grant overpayments that require reimbursement. The system facilitates the storage, retrieval, and editing of debtor information and uses this information to help collect defaulted loans and grant overpayments. When direct loans and Department-held FFEL loans being serviced by the Department's loan servicers reach 360 days of non-payment, they are transferred to the Department's Debt Management Collection System (DMCS2). Similarly, defaulted guaranteed loans being collected by the guaranty agencies are to be transferred to the Department's DMCS2 after meeting certain criteria. Under certain circumstances, grants (including Pell Grants) may need to be repaid if a student withdraws from school, or under certain other circumstances where a student receives a grant greater than they are entitled to receive. The Department began transitioning from its legacy debt collection system to DMCS2 in late FY 2011, with the system conversion largely occurring in October 2011 (early FY 2012).

The Department has experienced significant difficulties with DMCS2 during FY 2012, including the inability of the system to process certain types of transactions, the untimely preparation of certain reconciliations, inadequate transaction processing related to the reporting of Fund Balance with Treasury, untimely reporting of interest accrual calculations, untimely reporting of transactions from DMCS2 to FMS, and ineffective oversight of the Department's contractors responsible for the servicing system. In addition, IT general controls and business process controls surrounding the system were considered ineffective during the year, as evidenced by receiving a qualified opinion on the Service Organization Control (SOC-1) report from the service auditor for the DMCS2 system. The Department and its contractors devoted substantial time and effort during the fiscal year and beyond to remedy and/or alleviate the significance of such issues, with progress being made in many areas. However, certain issues existed for the majority of the fiscal year and others have continued past the end of FY 2012. In addition, these



Report on Internal Control  
Page 3

issues resulted in several errors in financial reporting that impacted the draft financial statements and notes. The remainder of this section discusses these issues.

*Issues with System Functionality*

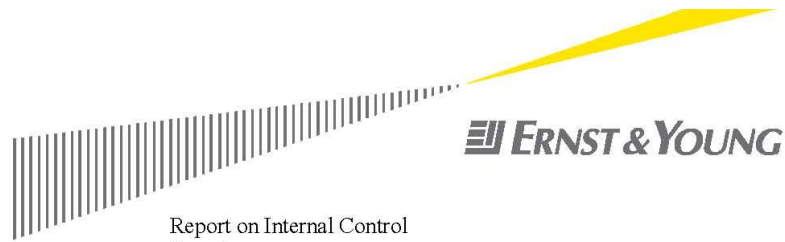
As the Department began utilizing DMCS2 in FY 2012, problems with the functionality of certain aspects of the system became apparent. For example, the processing of rehabilitated loans, where borrowers have met the requirements to bring their loans out of default status through making a series of 9 voluntary on-time payments within 10 months, did not begin functioning until late April 2012. As a result, loans which should have been transferred out of DMCS2 and to other loan servicers were not able to be transferred out for more than the first half of FY 2012. In addition, the Department was unable to initiate new Treasury Offset Program (TOP) collections until February 2012 or make administrative wage garnishments (AWG) for newly defaulted borrowers until approximately June 2012. In some instances, such as with AWG, management informed us that they had not tested all of the functionality of the system for procedures related to the entire wage garnishment life cycle prior to the DMCS2 system conversion as the amount of time required to do so would have been prohibitive. Additionally, certain requirements of the system are not yet fully functional and do not work under all scenarios.

*Loans meeting the criteria for default were not transferred to DMCS2*

Certain direct loan receivables that met the criteria for default could not be accepted into DMCS2. These principally relate to re-defaulted loans, which are loans which previously defaulted, were rehabilitated and assigned to a loan servicer for normal loan servicing, and have subsequently defaulted again. Management informed us that while active borrower accounts were converted from the legacy system to DMCS2, information from zero balance and closed borrower accounts is not on DMCS2 and still currently resides on the legacy system. Since the historical information on these previously closed accounts is not available on DMCS2, the system is currently unable to accept these re-defaulted accounts. As of September 2012 there were approximately \$1.1 billion of direct loans receivable which should have been transferred to DMCS2 which were residing on other loan servicing systems. We noted that management did not take these defaulted direct loans receivable into account when preparing its draft financial statement note disclosure regarding the amount of defaulted direct loans receivable, which resulted in an understatement of the amount of defaulted direct loans in the note disclosure. Management subsequently corrected the note disclosure.

In addition, certain defaulted guaranteed loans under the FFEL program which have met the criteria for mandatory assignment to DMCS2 have not been transferred. At management's request, the guaranty agencies are continuing to pursue collection of these defaulted loans. Management anticipates that these defaulted guaranteed loans will be transferred to DMCS2 during FY 2013. As of September 2012, there were approximately \$1.9 billion of defaulted guaranteed loans that met the criteria for assignment to DMCS2 but have not yet been transferred.





Report on Internal Control  
Page 4

*Loan portfolio reconciliations were not completed timely*

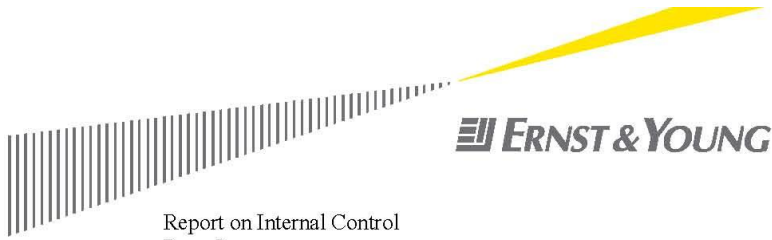
Many reconciliations between DMCS2 and the FMS sub ledger were not completed on a timely basis, within management's guidelines for completing reconciliations within 45 days after month-end. We noted that over 40% of the loan portfolio reconciliations for DMCS2 principal, interest, and fees were completed late during FY 2012, including nearly half of the principal reconciliations. These reconciliations, which are completed monthly for each loan program / fund code, are an important detect internal control tool to identify errors and anomalies. However, completing the preparation and review of such reconciliations substantially after management's stated timeframes decreases their utility. We noted improvement in the timely completion of reconciliations near the end of FY 2012.

*Fund Balance with Treasury*

The Department's loan servicers have access to the Department's reconciliation tool for Fund Balance with Treasury (FBWT) and should be accessing the tool daily to resolve unmatched differences between amounts reported by Treasury and amounts reported from the servicing system to FMS and FMSS. In addition, borrower payments are initially recorded in the Department's suspense fund, and the summary deposit is then applied to the borrower's account and posted to the appropriate fund code. During FY 2012, DMCS2 was unable to timely and consistently perform these functions, resulting in thousands of schedules that were unmatched or in suspense at any point in time. Most borrower payment transactions are expected to be applied in 1-2 business days. Management has established a monitoring metric with its servicers that less than 5% of FBWT schedules should be unmatched for over 60 days. DMCS2 was consistently unable to meet these thresholds during FY 2012.

*Untimely interest accruals*

After implementing DMCS2, the Department recorded an interest accrual in the first quarter of FY 2012 related to FY 2011 and prior years that was calculated by DMCS2. This amount had not been previously accrued in FY 2011 or prior years, but was recorded in FY 2012. Additionally, it was noted that interest on DMCS2 loans receivable was not being calculated through September 30, 2012. Instead, the system calculated interest through the date of last activity on the borrower's account during the month of September 2012. This resulted in an under-accrual of interest as of September 30, 2012. Changes in the timing of interest accruals have no net effect on the Department's primary financial statements. In addition, no budgetary resources or status of resources are affected, including expended and unexpended obligations. The amounts reported in certain footnote disclosures are impacted by the timing of the interest accruals; however, such changes, while enhancing the accuracy of the information in the disclosures, do not have a material impact on the fair presentation of the financial statements. Consequently, the Department did not make any adjustments for these items. However, management had not performed a rigorous and comprehensive analysis to arrive at these conclusions during the financial statement close process or in drafting the current fiscal year financial statements.



Report on Internal Control  
Page 5

*Untimely reporting of financial transactions from DMCS2 to FMS*

During the year, DMCS2 did not timely report all financial transactions to the FMS system, which is analogous to a sub-ledger used to record loan-related transactions. Data from FMS is transmitted to the FMSS general ledger. During much of FY 2012, DMCS2 was unable to completely or timely submit daily accounting files to FMS within 24 hours, and was unable to submit other required monthly detail files to FMS, including records of loans transferred in or out. In addition, in reviewing reconciliations between DMCS2 and FMS, we noted that certain duplicate files were transmitted to FMS, while other files were not transmitted and accepted by FMS.

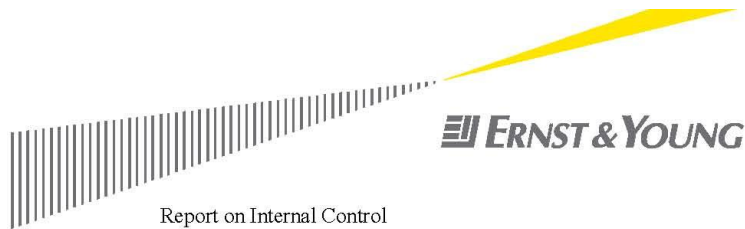
*Ineffective IT Controls*

A SOC-1 report on the DMCS2 application was prepared for the period January 1 to June 30, 2012. The service auditors issued a qualified opinion on the DMCS2 application and noted several weaknesses within information technology security and systems that need to be addressed, including deficiencies in the areas of change management, administrative access, and data transmission / encryption. Specifically, deficiencies in change management included inappropriate access to migrate changes to the production environment, lack of approval for changes prior to implementation, and the lack of post-implementation reviews of the changes. Additionally, administrative access was not restricted to authorized individuals. Further, data transmissions were not appropriately monitored, and the encryption of sensitive information across data transmissions was not appropriate.

In addition, we also noted that the service auditors had identified deficiencies in the following business process control areas related to the service organization: (1) correspondence related to borrowers' loan discharge requests was not processed completely, accurately and in a timely manner; and (2) loan assignment activities were not processed completely, accurately and in a timely manner.

*ACS, Inc. Education Servicing System (ACES)*

The Department's legacy direct loan servicer transitioned from its legacy servicing system to a new loan servicing system, ACES, at the beginning of FY 2012. The Department has experienced difficulties with the transition to ACES during FY 2012, including the incorrect processing of certain types of transactions by the system, the untimely preparation of certain reconciliations, and inadequate transaction processing related to the reporting of Fund Balance with Treasury. In addition, the SOC-1 report for the ACES imaging system, Panagon, covering the period January 1 to June 30, 2012 was qualified. In their qualification, the service auditors noted several weaknesses and deficiencies in the areas of change management (inappropriate access to migrate changes to production), administrative access (with access not being restricted to authorized personnel), and the lack of timely and complete processing of deferments, student status confirmation records, and forbearances. During our confirmation of borrower loan balance procedures, we noted several borrowers with unusually large balances. When we inquired of management regarding these items, we were informed that certain loan balances were



Report on Internal Control  
Page 6

misstated as the ACES system had not correctly processed all aspects of reapplication transactions that relate to a prior fiscal year.

*Management's Self-Assessment of Internal Control and Financial Management Systems*

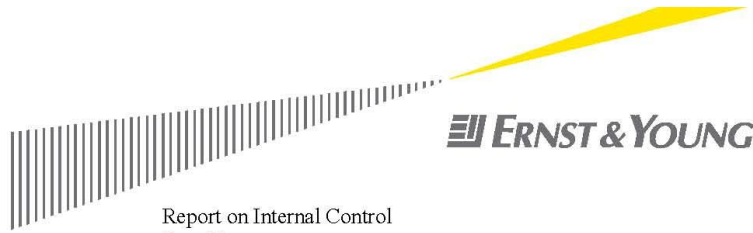
The Department performs an annual self-assessment of its internal control over financial reporting as part of OMB Circular A-123, *Management's Responsibility for Internal Control*, Appendix A, and is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). As part of this process for FY 2012, the Department self-identified the issues with DMCS2 and ACES as a material weakness as of June 30. Additionally, the Department reported a non-conformance with FMFIA Section 4 as of September 30, resulting in non-compliance with certain requirements of the Federal Financial Integrity Act.

**Recommendations:**

We recommend that the Department of Education perform the following:

1. Ensure that the DMCS2 servicer resolves and completes the remaining system requirements in order to bring DMCS2 to a fully operational status. In the interim, establish temporary work-around solutions for the remaining requirements, where applicable.
2. Complete system fixes to resolve the issues surrounding interest accruals (DMCS2) and incorrect loan balances (ACES). If necessary, establish temporary work-around solutions to ensure that interest will be appropriately recorded on the Department's interim and year-end financial statements.
3. Review controls and operating procedures related to the Service Organization and understand the demarcation of the control environment between the servicer and the Department.
4. Require conformance and effectiveness of the previously noted controls and coordinate closely with the servicer to closely manage progress, status and corrective actions.
5. Improve contract management and oversight of contractors on mission critical systems especially as it relates to servicers and providers that provide the Department or FSA with a Service Organization Control (SOC 1) report.





Report on Internal Control  
Page 7

## SIGNIFICANT DEFICIENCIES

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

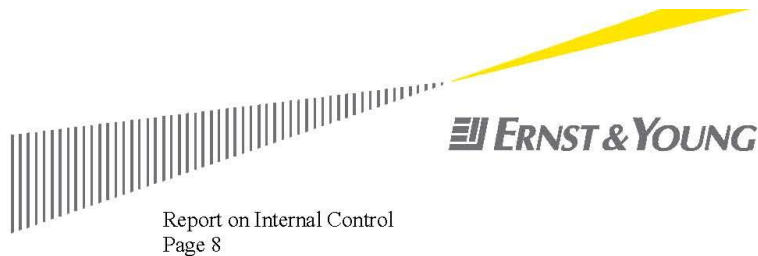
The Federal Credit Reform Act of 1990, as amended, was enacted to require agencies to more accurately measure and budget for the cost of federal loan programs. In implementing the requirements of the Credit Reform Act, and in complying with Federal accounting standards, agencies are required to estimate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

During the last few years, the Department has been challenged by the enactment of several pieces of legislation, as *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) and *Student Aid and Financial Responsibility Act* (SAFRA), that have had a significant impact on the Department's loan programs. SAFRA provided that no new FFEL loans were originated after June 30, 2010 increasing the Department's responsibility for originating federal student loans, primarily through the William D. Ford Federal Direct Loan program (direct loan program). As part of this process, the Department has spent significant time and effort managing the transition to the direct loan program, which has resulted in a significant increase in direct loans during FY 2011 and FY 2012. The Department brought together representatives from throughout the organization to implement and administer the activities surrounding the transition to direct lending and the wind-down of the other programs. Representatives included individuals from the Office of the Chief Financial Officer (OCFO), Federal Student Aid (FSA), and Budget Service.

OMB A-11, *Preparation, Submission, and Execution of the Budget*, the Credit Reform Act and other accounting guidance strongly recommend that agencies be able to analyze loan portfolios at the cohort level. The Department's financial systems are not configured to account for cash flows on a precise cohort level; consequently, over the last several years the Department developed and refined a methodology to analyze and maintain student loan activity at the origination cohort level. The result of this analysis, the cohort analysis tool, is currently the Department's primary repository of cohort-level data. Another tool, the forecast, consists of expected cash flows, that, when discounted, can be used to compare to the recorded activity in the general ledger and point out variances. Using the cohort analysis tool, the Department has been able to research any variances and demonstrate that balances in the Department's financial records are supported by its estimates.

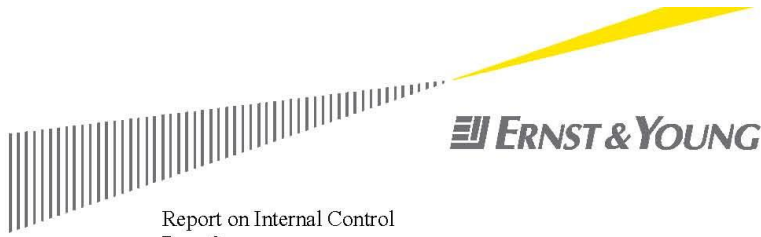
A member firm of Ernst & Young Global Limited





After identifying the challenges faced by the Department and the key improvements made or being made by the Department, we noted the following items that indicate management controls and analysis can be strengthened:

- The long-term cost for the credit programs is reflected in the financial statements through periodic charges for subsidy costs, adjustments or re-estimates to those subsidy costs, and loan activity, which is all recognized in the allowance for the receivables related to the direct loan program and the temporary loan purchase authority, and in the liability for the guaranteed loan (FFEL) program. The loan activity that flows through this allowance and liability is determined by the accounting standards and it is accounted and reported by the Department using business object classes. Recent programs changes have required the Department to reorganize many of these object classes to better account for the new conditions. During our review of the allowance and liability activity for the last several years, we have identified large and unusual fluctuations that the Department didn't note in their review and was unable to explain. Our inquiries caused the Department to initiate their analysis which eventually found misclassifications that required re-classes to the notes of the financial statements. The Department prepares monthly analytical reports that, among other things, presents and analyzes changes in the object class activities related to these loan programs. Additionally, the Department occasionally conducts Credit Reform Work Group (CRWG) meetings where different area managers get together to discuss the reasonableness of the credit reform estimates based on their experiences with the actual program activity. Holding more frequent CRWG meetings which focus on these analytical reports to have robust discussions about loan activity and the impact on the estimates can serve as a strong internal control.
- The Department uses a computer-based cash flow projection model (i.e., Student Loan Model or SLM) and OMB calculator to calculate subsidy estimates related to the loan programs that are then recorded in the allowance for subsidy or liability accounts. The model uses multiple sources of loan data and hundreds of complex assumptions. In order to perform a check of estimates resulting from the SLM and OMB calculator, the Department prepares a backcast, which compares the model's estimates to actual activity for the current and prior fiscal years. The SLM also produces a forecast of the expected cash flows in the current year for the outstanding loans which, when discounted, can be used to compare to the recorded activity in the general ledger. Comparisons using the backcast and forecast tools, and to the extent practical, recomputation of expected amounts based on loan volumes, interest rates, and simplified cash flow assumptions, can serve as key detect controls for potential undetected errors that may exist in the development of the assumption data and credit reform estimates. During our testing, we noted that management has no formal detailed review procedures surrounding the input of the many variables into the SLM, the input of cash flows into the OMB calculator or the process surrounding the analytical tools. Management does perform a high-level review of such data; however, this review is not sufficient to identify errors that may occur at a detailed level. For example, after the current year's financial statements were



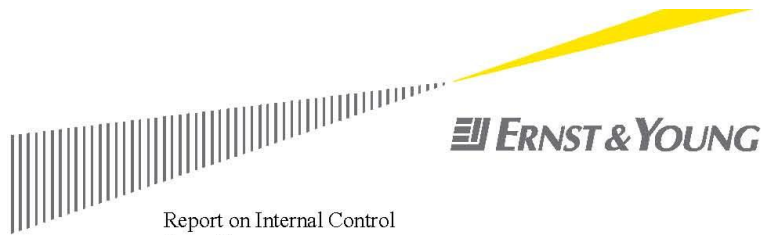
Report on Internal Control  
Page 9

prepared, management noted an inconsistency in the re-estimate between interest rate and technical and default that resulted in a reclassification on the notes to the financial statements. Additionally, we noted calculation errors in certain of the analytical tools used by the Department, including the back of the envelope reasonableness analytical tool. 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 internal control. Implementing a detailed review process may reduce the potential for errors occurring in all aspects of this complex re-estimate and also in the analytical tools.

- The early phase of the loan estimation process includes the development of the assumptions, which are used to populate the SLM with data that, in turn, feeds into the OMB calculator, which arrives at the actual cost re-estimates. In order to develop many of the assumptions, the Department utilizes the National Student Loan Database System to extract a sample of loan data, which is known as the Statistical Abstract (STAB). The Department then executes internally developed computer programs to arrive at the assumption data that is entered into the SLM. During our review of the development of the death, disability and bankruptcy (DD&B) assumption, we noted that in FY 2012 the Department did not calibrate the NSLDS data to other general ledger or any other sources as done in prior years as part of the data quality control. The Department should consider developing calibrating processes to ensure data quality and model accuracy. Additionally, during our review of the default assumption development, we noted that the process by which defaults are estimated for FFEL loans was modified to separately account for loans that are repurchased from the Asset-Backed Commercial Paper Conduit program as they appear to have higher default rates than the other FFEL loans. We consider this approach to be reasonable, however, we noted that while the documentation describes the need to adjust the actual default rates downward due to expected increase in future repurchases, the adjustment factor is not described or justified in the documentation. The Department should consider documenting a rationale for choosing this adjustment factor as well as document any supporting analyses. Furthermore, during our review of the Teacher Loan Forgiveness (TLF) assumption development, we noted that a change in the methodology included a “take-up factor” to reflect the fact that not all eligible teachers will apply for the forgiveness to which they are entitled. We note that the determination of the “take-up factor” is highly judgmental, and, while the approach is generally reasonable, would benefit from additional discussion, justification and documentation. Also, we noted further opportunities for documentation improvements in this area. For example, the TLF projections are performed using Excel worksheets, using the calculations generated by the SAS programs. This documentation could be enhanced by including a description of the purpose of each worksheet, description of formulas used, and how each work step corresponds to the methodology.
- Consistent with credit reform implementation guidance, the Department relies significantly on prior patterns to estimate future cash flow activity. However, the

A member firm of Ernst & Young Global Limited





Report on Internal Control  
Page 10

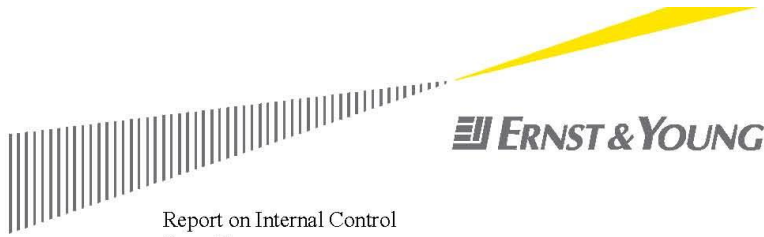
Department should be more proactive in identifying conditions in which a refinement of such estimates should be made when circumstances suggest that fundamental patterns will change. For example, to the extent that lender or borrower behavior appears likely to have changed, or be changing, deviations from the use of historical data, or consideration of additional information to capture the impact of such changes, may be warranted in developing credit reform estimates. The current economic conditions, including high unemployment, reductions in credit availability for borrowers, and declines in home prices may have a significant impact on student loan borrowers and consequently on the Department's credit reform results. Many of these impacts have not been explicitly reflected in the Department's estimates. During our review of the development of the DD&B assumption, we noted a change in the calculation of the FFEL bankruptcy rates where weighted averages are calculated using only the last four-year period rates in order to capture the most recent economic trends. While this approach is reasonable, the Department may want to consider evaluating the selection of time period used for weighted average calculations on a periodic basis as economic conditions change.

- Management's assessment of internal control over financial reporting required under OMB Circular A-123, *Management's Responsibility for Internal Control*, Appendix A may also provide management with an additional opportunity to objectively review its controls over the credit reform estimation process by individuals independent of the process. During FY 2011 and 2012, the Department did not test controls surrounding the credit reform estimation process and instead the Department focused on evaluating the adequacy of existing controls and identifying potential control gaps. To the extent that management is able to leverage the testing performed under OMB A-123, Appendix A, such results may provide additional feedback in refining and improving controls over the estimation process.

#### **Recommendations:**

We recommend that the Department of Education perform the following:

1. Continue to improve the analytical tools used for the loan estimation process, working to develop formats and content that synthesize and capture loan level data available in the Department's systems. Specifically:
  - Critically assess death, disability and bankruptcy rates and other assumptions by cohort in light of recent changes in the economic environment to determine the extent to which there may be differences in performance across cohorts.
  - For a subset of borrowers, obtain credit rating data and track the borrower's ability to pay over time. Utilize the results for further analysis.
2. Increase the frequency of the CRWG meetings and take full advantage of their analytical reports to have robust discussions about loan activity and the impact on the estimates with different area managers.



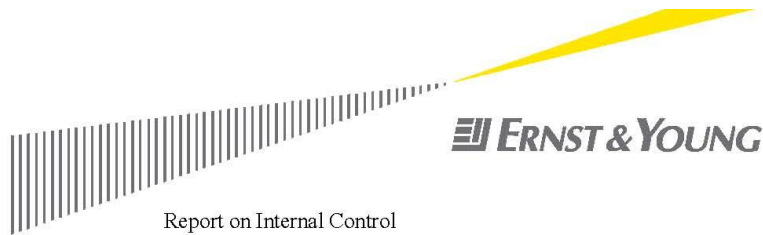
Report on Internal Control  
Page 11

3. 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.
4. Strengthen the documentation related to assumption development, including documentation, discussion and rationale of changes in the methodologies. Furthermore, improve documentation detail by including a description of the purpose of worksheets, description of formulas used, and how each work step corresponds to the methodology. Additionally, consider developing calibrating processes to ensure data quality and model accuracy.
5. Consider the impact of changes in general economic conditions when developing assumptions. Evaluate the selection of time periods used for weighted average calculations on a periodic basis as economic conditions change.
6. Consider ways to better leverage management's efforts under Appendix A of OMB Circular A-123 as a way to provide additional focus and attention to the controls surrounding the credit reform estimation process.

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

In connection with the annual audit of the Department's FY 2012 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 Revised, *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 uniform and consistent internal information resource management policies and procedures and oversee the development and promote the use of information management principles, standards, and guidelines, evaluate agency information resources management practices in order to determine their adequacy and efficiency; and (4) determine compliance of such practices with the policies, principles, standards, and guidelines.

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:



Report on Internal Control  
Page 12

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

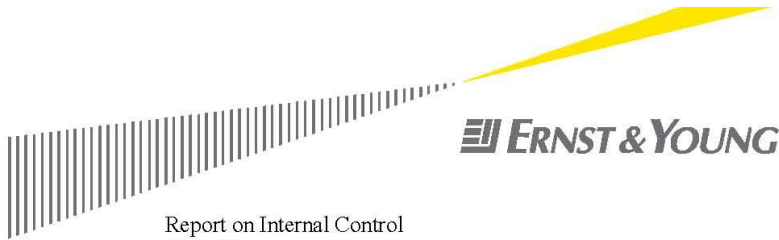
While the Department has worked toward strengthening and improving controls over information technology processes during FY 2012, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of IT general controls at the Department and FSA, we identified deficiencies in the following areas: (1) access for terminated users was not removed in a timely manner or not removed at all; (2) 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; (3) documentation and related approvals required to provision user access are not consistently maintained; (4) accounts with elevated administrative access being shared without appropriate monitoring or review procedures; (5) IT General Control issues indicated in Service Organization Control (SOC-1)<sup>1</sup> reports for key applications across change management, user access and privileged user access.

The OIG has identified information technology-related deficiencies for the Department and FSA in reports issued during FY 2012, including its FY 2012 Federal Information Security Management Act (FISMA) review, and Education Central Automated Processing System (EDCAPS) Information Security Audit. In its EDCAPS Information Security Audit report, the OIG noted the following:

1. Risk management framework is not sufficiently designed or implemented to address risk from an organizational perspective and reflect change within the system in a timely manner.
2. Monitoring and oversight controls were not sufficiently implemented to address patch management control deficiencies.
3. Security controls weaknesses existed for hardware and software configurations.
4. Monitoring controls are not sufficiently designed to ensure that corrective actions for incidents are taken in a timely manner and properly documented.

<sup>1</sup> Please refer to the Material Weakness related to Debt Management and Collection including the DMCS2 application.





Report on Internal Control  
Page 13

5. Configuration Management Database was not adequately maintained and updated to track EDCAPS hardware changes.
6. Security configuration baselines have not been established for operating systems, databases, and network infrastructure devices used for EDCAPS.
7. Business application control procedures are not sufficient to ensure ongoing monitoring of information system connection.

In addition, the OIG FISMA Audit reports note issues related to compliance with National Institute of Standards and Technology (NIST) 800-37 guidelines, including in the areas of Configuration Management, Identity and Access Management, Incident Response and Reporting, Risk Management, Security Training, Plan of Action and Milestones, Remote Access Management, and Contingency Planning. In addition the OIG FISMA audit report noted that the areas noted as being non-compliant relate to agency-operated and contractor-operated systems; whether systems are contractor-operated or agency-operated, all Departmental systems reported in the system's inventory are required to comply with security requirements set forth by FISMA OMB and NIST.

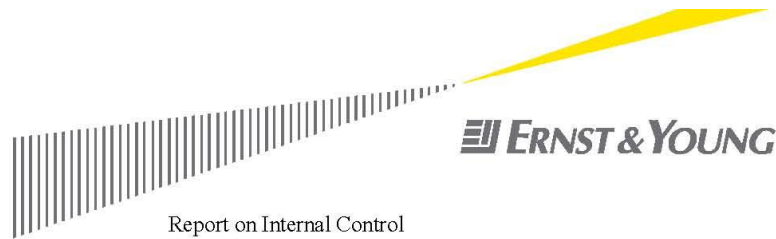
Several of the above deficiencies are repeat conditions (although for different platforms or systems) that were noted in our work and in the OIG's audit reports, an indication that the control environment and monitoring components of internal controls at the Department require additional focus.

**Recommendations:**

Applications and related infrastructure are supported by a number of separate groups within the Department and FSA. While these groups have attempted to implement controls promulgated by Department, FSA, OMB, and NIST guidelines, control processes and practices continue to be implemented in a disparate manner across these groups. In addition, audit resolution activities have traditionally been performed by each separate group and have largely focused around addressing the immediate security and control weaknesses identified by audit reports. While the OCIO has begun to implement a comprehensive risk management program across the Department and FSA, we noted that in FY 2012 these efforts have not yet allowed for a consistent control environment.

We recommend that the Department continue its efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness uniformly across the organization, which should decrease the likelihood of similar weaknesses being identified in future audit assessments and internal self-assessments. Examples of addressing root causes may include, but are not limited to, additional training for the information technology professionals within the organization, allocating appropriate resources and subject matter resources to information technology process areas, maintaining updated procedures to ensure proper





Report on Internal Control  
Page 14

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 the Department migrates existing IT systems to vendors, additional focus in contracts the Department executes with service providers is required to monitor and achieve compliance with Departmental and Federal guidelines.

More specifically, the Department should: (1) strengthen access controls to protect mission-critical systems (e.g., periodic access revalidation, timely removal of user access, and enforcement of changes in access due to changes in roles and responsibilities); (2) 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; (3) enhance its security training and awareness program, specifically around actions to be taken in the event an employee encounters suspicious activity; (4) revise current methods of identifying and logging suspicious activity as it relates to unauthorized access to accounts and data; (5) improve incident response and reporting procedures; (6) improve contract management and oversight of contractors on mission critical systems especially as it relates to servicers and providers that provide the Department or FSA with a Service Organization Control (SOC 1) report; and (7) holistically address the information systems environment throughout the Department and implement improvements by considering the vulnerabilities and corrective actions reported for the organization as part of the POA&Ms system and reports.

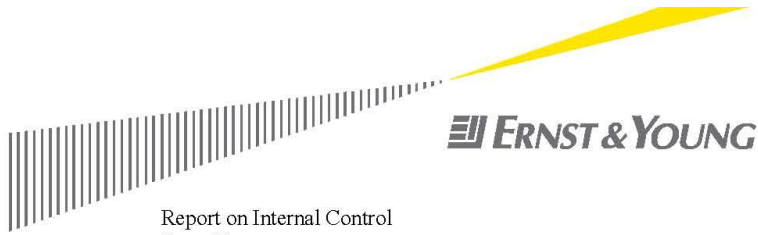
**STATUS OF PRIOR YEAR FINDINGS**

In the reports on the results of the FY 2011 audit of the U.S. Department of Education’s financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

Summary of FY 2011 Significant Deficiencies

Issue Area	Summary Control Issue	FY 2012 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

A member firm of Ernst & Young Global Limited



Report on Internal Control  
Page 15

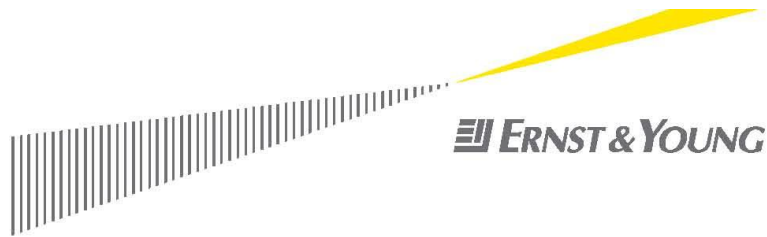
We have reviewed our findings and recommendations with Department management. Management generally concurs with our findings and recommendations in their response and will provide a corrective action plan to the OIG in accordance with applicable Department directives. We did not audit management's response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

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

*Ernst & Young LLP*

November 16, 2012

A member firm of Ernst & Young Global Limited



Ernst & Young LLP  
8484 Westpark Drive  
McLean, VA 22102

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

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

To the Inspector General  
U.S. Department of Education

We have audited the consolidated balance sheet of the U.S. Department of Education (the Department) as of September 30, 2012, 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 16, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

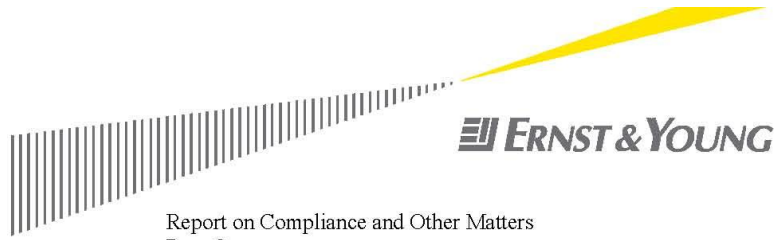
As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

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

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

A member firm of Ernst & Young Global Limited





Report on Compliance and Other Matters  
Page 2

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

During FY 2012, the Department performed large scale systems conversions for two loan servicing systems – Debt Management Collection System (DMCS2) and ACS, Inc. Education Servicing (ACES). The Department experienced significant IT issues with these systems, including a qualified Service Organization Control (SOC-1) report on the DMCS2 application for the period January 1 to June 30, 2012. The SOC-1 report noted several weaknesses within information technology security and systems that need to be addressed. We noted that the service auditors identified deficiencies in the areas of change management, administrative access, and data transmission / encryption. Specifically, deficiencies in change management included inappropriate access to migrate changes to the production environment, lack of approval for changes prior to implementation, and the lack of post-implementation reviews of the changes. Additionally, administrative access was not restricted to authorized individuals. Further, data transmissions were not appropriately monitored, and the encryption of sensitive information across data transmissions was not appropriate. We also noted that the service auditors had identified deficiencies in the following business process control areas related to the service organization: (1) loan correspondence related to discharge requests was not processed completely, accurately and in a timely manner; and (2) loan assignment activities were not processed completely, accurately and in a timely manner. Similarly, the SOC-1 report for the ACES imaging system, Panagon, covering the period January 1 to June 30, 2012 was also qualified. In their qualification, the service auditors noted several weaknesses and deficiencies in the areas of change management (inappropriate access to migrate changes to production), administrative access (with access not being restricted to authorized personnel), and the lack of timely and complete processing of deferments, student status confirmation records, and forbearances. In addition, we and management noted additional deficiencies surrounding other aspects of these systems, including incorrect loan balances, Fund Balance with Treasury, suspense account balances, and late portfolio reconciliations. Based on the deficiencies noted, management considered ACES and DMCS2 financial systems not in conformance with Section 4 of the Federal Managers' Financial Integrity Act (FMFIA) as of September 30, 2012, and also identified these items as a material weakness in internal control over financial reporting as of June 30, 2012 as part of its OMB Circular A-123 Appendix A self-assessment. A Section 4 non-conformance under FMFIA also results in non-compliance with FFMIA federal financial management systems requirements.

Our Report on Internal Control dated November 16, 2012, 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 internal controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMIA, and our recommendations related to the specific issues. We have reviewed our findings and recommendations with management of the Department. Management concurs with

A member firm of Ernst & Young Global Limited



Report on Compliance and Other Matters  
Page 3

our recommendations and, to the extent findings and recommendations were noted in prior years, has provided a proposed action plan to the OIG in accordance with applicable Department directives. We did not audit management's proposed action plan and, accordingly, we express no opinion on it.

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

*Ernst + Young LLP*

November 16, 2012

A member firm of Ernst & Young Global Limited

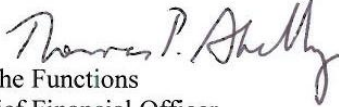



**UNITED STATES DEPARTMENT OF EDUCATION**

NOV 14 2012

**MEMORANDUM**

TO: Kathleen S. Tighe  
Inspector General

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

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

SUBJECT: DRAFT AUDIT REPORTS  
Financial Statement Audits for Fiscal Years 2012 and 2011  
U.S. Department of Education  
ED-OIG/A17M0001

Please convey our sincere thanks and appreciation to everyone on your staff who worked diligently on this financial statement audit. The Department reviewed the draft Fiscal Years 2012 and 2011 Financial Statement Audit Reports. Without exception, we concur and agree with the Report of Independent Auditors and the Report on Internal Control. We also concur and agree with the Report on Compliance with Laws and Regulations.

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

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

Please contact Gary Wood, Director, Financial Management Operations, at (202) 245-8118 with any questions or comments.

400 Maryland Avenue, Washington, DC 20202  
*Our Mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access*





**Other  
Accompanying  
Information**

## Improper Payments Reporting Details

The *Improper Payments Elimination and Recovery Act of 2010* (IPERA) (Public Law 111-204), which amends the *Improper Payments Information Act of 2002* (IPIA) (Public Law 107-300), and the Office of Management and Budget's (OMB) Circular A-123, Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments*, define requirements to reduce improper/erroneous payments made by the federal government. OMB also has established specific reporting requirements for agencies with programs that possess a significant risk of erroneous payments and for reporting on the results of recovery auditing activities. Agencies are required to review and assess all programs and activities to identify those susceptible to significant improper payments. The guidance in OMB Circular A-123, Appendix C, defines a significant improper payment as those in any particular program that exceed both 2.5 percent of program payments and \$10 million annually or that exceed \$100 million. For each program identified as susceptible and determined to be at risk, agencies are required to report to the President and the Congress the annual amount of estimated improper payments, along with steps taken and actions planned to reduce them.

The Department has divided its improper payment activities into the following segments: Student Financial Assistance Programs; *Elementary and Secondary Education Act of 1965* Title I, Part A Program; Other Grant Programs; and Recovery Auditing.

### Student Financial Assistance Programs

#### Risk-Susceptible Programs

As required by the OMB Circular A-123, Appendix C, Federal Student Aid (FSA) inventoried all its programs during FY 2011 (the year after IPERA's enactment) and, for each program, assessed the risk of improper payments. The result of the FY 2011 assessment is found in the FY 2011 AFR. OMB Circular A-123, Appendix C, requires all programs not deemed risk susceptible to improper payments to be reviewed at least once every three years. Thus, FSA did not perform a risk assessment during FY 2012.

As a result of the FY 2011 risk assessment, the Direct Loan Program, Federal Family Education Loan (FFEL) Program, and Pell Grant Program were identified as potentially susceptible to the risk of significant improper payments based on the OMB Circular A-123, Appendix C criteria described above.

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

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

**FFEL Program.** During FY 2012, the FFEL Program made no new loan originations. FY 2012 payment types and cash flows associated with the guarantees on loans originated

in prior years (i.e., the existing FFEL portfolio) include: Special Allowance (SAP), Interest Benefits, Lender Fees, Origination Fees, Consolidation Loan Rebate Fees, Reinsurance, and Account Maintenance Fees.

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

### Estimation Methodology

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

For FY 2012, FSA implemented new estimation methodologies for all risk-susceptible programs reported (i.e., Pell, Direct Loan, and FFEL); however, these new methodologies have not been approved by OMB and are provided here as supplemental information only. As of the publication date of this FY 2012 AFR, FSA is working with OMB to obtain approval of the new estimation methodologies. The new estimation methodologies produce statistically valid estimates with a higher level of confidence than the prior methodologies (as defined by OMB Circular A-123, Appendix C) for each program. FSA contracted with statisticians to develop the overall approach for each program. These statisticians designed and executed the statistical samples, and they compiled the results and calculated the rates for each program. FSA will consider the results of the FY 2012 process and input from OMB in making improvements to the methodologies in FY 2013 and subsequent years. Information is presented below for both the previously approved methodologies and the new unapproved FY 2012 methodologies for all programs reported.

### Pell Grant Program

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

As in previous years, the Department conducted a statistical study with the Internal Revenue Service (IRS) using FAFSA data to calculate an improper payment rate for the

Pell Grant program. The FY 2011 Pell Grant improper payment rate of 2.72 percent was based on the results of the study. The preliminary rate FY 2012 from the study is 2.49 percent which results in estimated improper payments of \$829 million. In the most recent completed study, which compared 2011–12 FAFSA data with 2010 IRS data (the tax year that was used to calculate 2011-12 Pell Grant eligibility), a sample was drawn from the Title IV Central Processing system that included 3,299,819 applicants to be used in various studies. A match with the SSNs of the parents and students was sought from the IRS database. Two files were provided to the IRS. The first contained the social security numbers (SSNs) of the sample records along with a sampling program designed to select the desired analysis sample for the baseline analysis from the larger file. This was done to preserve IRS confidentiality requirements. This file was used to match against the main IRS database and select the matching records. IRS data for these records was then used with the second file provided by the Department which contained other applicant data specific to the filer that could be used, along with the relevant IRS data, to calculate an EFC and Federal Pell Grant award amount for each applicant in the sample, to explain discrepancies, and to identify the types of applicants who over- and under-reported their income information on the FAFSA.

The IRS matched student SSN, and parent SSN (if the student was dependent), in this file against SSNs in the IRS master file. If a match occurred, the IRS extracted adjusted gross income (AGI), taxes paid, type of return filed, earned income credit, exemptions, and itemized deductions for the tax filer and compared this information to FAFSA-reported data. Using a program supplied by the Department, the IRS calculated the EFC and Pell awards for matching records by substituting the IRS income information for the FAFSA income information. The IRS provided aggregated statistical tables to the Department that showed the results of these comparisons. Data provided by the IRS as a result of the match were analyzed and used to model projections for income, EFC, and Pell award discrepancies.

The IRS statistical study used application and disbursement level data to recalculate student awards where income figures were mismatched between tax returns and aid applications. The IRS study was based on interim data where not all of the applications expected to be processed for the cycle had been processed and moreover, additional corrections were still to be made by applicants to their original data. Therefore, the IRS data did not reflect subsequent corrections that were made nor did it reflect applicants for summer school of the second year who applied late. These limitations in the study resulted in changes to the Pell methodology for FY 2012. In contrast to the methodology used in the study, the new methodology for Pell is based on onsite reviews used disbursement level data and tested actual payments that were made. The Pell improper payment rate going forward will be based on the new Pell methodology.

A new estimated improper payment rate calculation was completed for the Pell Grant Program in FY 2012 to quantify precision of the estimate and to consider additional root causes and corrective actions. This estimation methodology is pending OMB approval and was based on onsite reviews conducted at a sample of schools. FSA conducts onsite program reviews at schools to assess a variety of compliance requirements of the Pell Grant program. FSA identified individual transaction points of the Pell Grant program that were deemed to pose the highest risk of improper payments. The program review schedule of schools is focused on high-risk institutions as determined by an annual risk assessment.

In FY 2012, the Pell payment error rates for 802 students sampled across 61 institutions, with program reviews conducted between October 1, 2011, and May 31, 2012, were used to estimate a statistical confidence interval range of rates, representing the likely range of error rate in the population. Any error rate in that range may be chosen, and potentially complemented by the supplemental compliance audit estimate covering 96 schools, considering the impact on the estimated range of the risk-based selection methodology. Student file records for a sample of payments made to Pell recipients at each selected school were verified for overall eligibility, or subsequent events that would disqualify all or a portion of the payment made. The ratio of the errors identified to the total payments reviewed for all sampled students was extrapolated using a 90 percent confidence interval to estimate the improper payment rate for the Pell Grant Program. Based on this analysis, the error rate was 2.10 percent, or \$699 million, at a 90 percent confidence level and 1.26 percent precision.

FSA also reviewed compliance audits as a supplemental estimate of improper payments. Public and private schools that receive more than \$500,000 of Title IV funds must submit compliance audits in accordance with OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Proprietary institutions must submit compliance audits in accordance with the Department of Education's Office of Inspector General Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institution Servicers (2000)*. Thus, both A-133 audits and annual compliance audits of proprietary schools were used as the basis for the supplemental estimates. The Department randomly sampled 96 A-133 compliance audits of the total population of schools participating in the Pell Program. Since the sampling methodology is rarely reported in A-133 compliance audits, it was assumed that 15 students were sampled in each compliance audit with a disbursement value that is equal to the average disbursement amount for the Pell program. The assumption of 15 students was made to compare to the sample methodology used in the general assessment program reviews conducted by FSA. Findings related to improper payments were logged from these audits and divided by an estimated sample value computed based on the assumed sample size and disbursement values. This result was used to provide an alternate, supplemental estimate to the one computed based on the onsite reviews discussed above. This resulting estimate was 1.47 percent.

Additionally, FSA performed analytical procedures on its internal disbursement system to include transactional rule sets to assess whether any control deficiencies exist that result in systemic improper payments for the Pell program for schools that recorded disbursements for the 2010–11 award year as of September 30, 2011. The conclusion of this analysis was that no material deficiencies exist.

### **Direct Loan Program**

The Direct Loan Program improper payment rate is composed of estimates of improper payments from the following activities: loan disbursements from institutions to students, loan consolidations, and refunds. In FY 2011, an estimated improper payment rate calculation, similar to the calculation used in years prior to FY 2011, was completed resulting in an overall improper payment rate of 0.22 percent. As noted below, improvements to this methodology can be made and, in accordance with instruction from OMB, FSA does not provide a rate for the Direct Loan Program under the FY 2011



methodology. As noted in the data tables in the improper payment summary section, no approved FY 2012 rate is reported.

A new estimated improper payment rate calculation was completed for the Direct Loan Program in FY 2012 to quantify precision of the estimate and to consider additional root causes and corrective actions. The new FY 2012 methodology is pending OMB approval. This estimate was based on tests of the three components of the Direct Loan program: 1) onsite reviews conducted at a sample of schools for disbursements to students, 2) tests of loan consolidation overpayment and underpayment activity, and 3) tests of loan refund activity.

For the first component test of onsite program reviews, FSA identified individual transaction points of the Direct Loan Program that were deemed to pose the highest risk of improper payments. The ratio of the high-risk improper payment errors identified to the total payments reviewed for all sampled students was computed to estimate the overall error rate for Direct Loan disbursement of funds from the school to students. The estimate of improper payments from institutions to students uses the same methodology as used in the Pell Grant Program where the error rates of Direct Loan payments for 747 students sampled at 56 institutions with program reviews conducted between October 1, 2011, and May 31, 2012, were used to estimate a statistical confidence interval range of rates. Again, any error rate in that range may be chosen, and complemented by the supplemental compliance audit estimate covering 97 schools, considering the impact on the estimate range of the risk-based selection methodology. Based on this analysis, the overall extrapolated loan disbursement error rate was 0.6 percent at a 90 percent confidence level and 0.7 percent precision.

The second component test of loan consolidation activity was computed based on the same source data as in FY 2011, but the sample design was modified to measure precision and demonstrate representativeness to the past estimation methodology. The loan consolidation improper payment estimate was computed by sampling five overpayments and five underpayments, from the universe of all underpayment and overpayment activities for each of the 12 months from July 2011 through June 2012 for a total sample size of 120. Any improper payments found in the sample were extrapolated to create a 90 percent statistical confidence interval range of the overall improper payment rate for loan consolidation activity. Note that the sample selection methodology for loan consolidations was representative versus risk-based. Based on this analysis, the program review extrapolated loan consolidation component error rate was 0.39 percent at a 90 percent confidence level and 0.14 percent precision.

The third component test is the test of loan refund activity. A refund on a borrower's account can occur when a payment is received for more than the amount due, resulting in a credit balance. In the case that the credit balance is less than \$5, the account is closed out and written up to zero, unless the borrower requests a refund. A refund can also occur when a payment resides in an unapplied state in suspense and cannot be matched to a borrower's account. The calculation of the loan refunds improper payment estimate was computed by sampling 15 refunds, from the universe of all refund activity for each of the 12 months from July 2011 through June 2012 for a total sample size of 180. No improper payments were found in the sample, resulting in a loan refund component error rate of 0 percent. The sample selection was not risk-based.

The loan disbursement, consolidation, and refund rates were then applied to their representative FY 2012 balances. The aggregate estimated improper payment amount for all three components was then applied to the total disbursement activity for the Direct Loan program to come up with the overall Direct Loan improper payment rate of 0.58 percent, or \$614 million, at a 90 percent confidence level and 0.63 percent precision.

A supplemental estimate based on A-133 Compliance Audits for public and private institutions and compliance audits for proprietary institutions was conducted in the same fashion as the Pell supplemental estimate. Findings related to improper payments were logged from a sample of 97 compliance audits and divided by an estimated sample value computed based on the assumed sample size and disbursement values. The resulting estimate was 0.36 percent.

FSA also performed analytical procedures on its internal disbursement system to include transactional rule sets to assess whether any control deficiencies exist that result in systemic improper payments for the Direct Loan program for a sample set of 66 institutions for the Direct Loan program disbursements recorded for the 2010–11 award year as of September 30, 2011. The conclusion of this analysis was that no material deficiencies exist.

### **FFEL Program**

In past years, Special Allowance Payment (SAP) has been among the largest categories of payments to lenders or guarantors. However, the *College Cost Reduction Act of 2007* reduced SAP rates and, combined with a historically low interest rate environment, changed this trend and resulted in SAP amounts due to the Department beginning in FY 2007. A significant increase in the Direct Loan Program from the transition to 100 percent Direct Loans at the end of FY 2010 has also resulted in a lower risk related to the potential for FFEL improper payments.

Federal Student Aid performed a FFEL Special Allowance Payment (SAP) risk analysis in lieu of an improper payment measurement in FY 2009 and FY 2010. The results determined through the FY 2009 and FY 2010 SAP risk analyses could not conclude in an informed measurement of improper payments; therefore, the SAP analysis was suspended after FY 2010 and no estimate of improper payments was calculated in FY 2011. For FY 2012, FSA does not report an improper payment rate for the FFEL program under this old methodology.

In FY 2012, an estimated improper payment rate calculation was completed for the FFEL Program based on new methodology which is pending OMB approval. This estimate was based on onsite reviews conducted at a sample of financial institutions holding or servicing commercially held FFEL loans. FSA developed an improper payment measurement for the FFEL program in FY 2012 that estimated improper payments based on transaction points posing the highest risk of improper payments. FSA identified the high risk areas for improper payment as SAP and Interest Benefit (IB) payments for lenders, and reinsurance claims paid for Guaranty Agencies (GAs). A component of SAP is Negative SAP, which represents the net amount due to a Lender. In the last few years, Negative SAP has outpaced regular SAP, and this resulted in negative net SAP amounts due to lenders. Therefore, the FY 2012 sampling methodology included consideration for this shift in SAP balances. The results from program reviews at seven servicers and two lenders, where loan accounts were tested, were used to estimate improper payments for the FFEL program.

The sample represents 362 loan accounts where average daily balances were tested for the purpose of estimating potentially erroneous SAP and IB payments. The ratio of lender-reported average daily balances to correctly calculated average daily balances in the sample population was computed to estimate improper SAP and IB payments to come up with the overall improper payment rate of 1.93 percent, or \$552 million, at a 90 percent confidence level and 0.53 percent precision.

Although the sample selection methodology was risk-based, the improper payment rate was conservatively chosen since an estimate for the FFEL program was not previously reported. Additionally, no actual payments were tested. Errors in reported average daily balances were used as a proxy for payments. Reinsurance claims paid to GAs were tested on a limited basis due to scheduling/timing issues and limited data available from the program reviews sampled. There were insufficient data points collected to produce a statistically valid estimate for this population. Furthermore, the result of the limited review of GA payments suggests that the error rate for GAs would be lower than the FFEL error rate calculated. FSA will work to adjust the FFEL methodology in FY 2013 to integrate these payment types in the overall FFEL improper payment estimate.

Similar to the review of A-133 compliance audits used in the Pell and Direct Loan estimates, supplemental estimates were calculated based on A-133 compliance audit findings of 53 for-profit FFEL lenders and servicers and the lender accounting system reconciliation results of 101 lenders conducted by FSA and its financial partners. While there were both SAP and IB findings logged when completing these supplemental procedures, the effective error rate was less than 0.01 percent and hence the supplemental estimates did not influence the estimates based on program reviews.

### Root Causes and Corrective Actions

During the FY 2012 improper payment assessment, the root causes of improper payments were categorized under the following two of three error categories, as defined by OMB Circular A-123, Appendix C:

- **Documentation and Administrative Errors:** Errors caused by the absence of supporting documentation necessary to verify the accuracy of a payment; or errors caused by incorrect inputting, classifying, or processing of applications or payments by a relevant federal agency, state agency, or third party who is not the beneficiary; and
- **Verification Errors:** Errors caused by the failure or inability to verify recipient information, including earnings, income, assets, or work status, even though verifying information does exist in third-party databases or other resources (in this situation, as contrasted with “authentication” errors, the “inability” to verify may arise due to legal or other restrictions that effectively deny access to an existing database or resource), or errors due to beneficiaries failing to report correct information to an agency.

The category of Authentication and Medical Necessity Errors, as defined by OMB Circular A-123, Appendix C, was not applicable to the Pell, Direct Loan, or FFEL programs in FY 2012. A summary of the root causes of improper payments identified for each program are outlined in the sections below.

### Pell Grant and Direct Loan Programs—Root Causes

The root causes of improper payments identified through improper payment testing for both the Pell Grants and Direct Loan Programs were distributed across the major risk areas identified, and are outlined in the chart below:

IPIA Error Category	Root Causes of Improper Payments Identified for Pell Grants and Direct Loans
<b>Documentation and Administrative Errors</b>	Incorrect Awards based on Expected Family Contribution (EFC)
	Incorrect Processing of Student Data During Normal Operations
	Student Account Data Changes Not Applied or Processed Correctly
<b>Verification Errors</b>	Ineligibility for a Pell Grant/Direct Loan (e.g., validity of high school attended, history of degrees obtained)
	Satisfactory Academic Progress (SAP) Not Achieved
	Incorrectly Calculated Return Record

### Direct Loan Consolidations—Root Causes

As reported in the FY 2011 AFR, many Direct Loan improper payments relate to the loan consolidation component. Additional departmental analysis has found that the most significant root cause for FFEL-to-Direct Loan consolidation pay-off errors relates to the erroneous processing of loan consolidations. Examples include funds returned due to duplicate funding or multiple Loan Verification Certificates (LVCs), inclusion of student loans that the borrower desired to exclude or were determined to be ineligible, and payoffs sent to the wrong address.

In FY 2012, six root causes of improper payments were identified through testing for the Direct Loan Consolidation Program and are outlined in the chart below:

IPIA Error Category	Root Causes of Improper Payments Identified for Direct Loan Consolidations
<b>Documentation and Administrative Errors</b>	Incorrect Processing of Loan Verification Certificate (LVC) (e.g., LVC not certified)
	Processing of Duplicate LVCs
	Incorrect Information Submitted on the LVC and Processed
	Loan Not Intended for Consolidation Processed
	Consolidation Processed for Loans Sold to Other Lenders
<b>Verification Errors</b>	Ineligibility for Direct Loan Consolidation

### FFEL Program—Root Causes

Three root causes of improper payments were identified for the FFEL Program and are outlined in the chart below:

IPIA Error Category	Root Causes of Improper Payments Identified for FFEL
<b>Documentation and Administrative Errors</b>	Manual Entries Processed Erroneously (e.g., as failure to apply the 3-day delay, or to adjust the Lender Report System (LaRS) billing date, or to use only one payment code during the billing quarter)
	Incorrect Calculation of the Average Daily Balance due to Erroneous Manual Entries
	Incorrect Calculation of the Average Daily Balance due to Software Formula Errors
	Incorrect calculation of Guaranty Agency reinsurance claims

### Root Cause Summary

In FY 2012, the results of the root cause analysis of improper payments across all risk-susceptible programs highlighted that the underlying root cause was due to the processing errors which occur at the institution level.

Further analysis of the improper payment findings identified through testing and associated root causes resulted in the following percentages of improper payment findings in dollars, attributed to Documentation and Administrative Errors (i.e., the absolute dollar amount of improper payments identified within the category proportional to the total dollar amount in the sample reviewed) and Verification Errors (i.e., the absolute dollar amount of improper payments identified within the category proportional to the total dollar amount in the sample reviewed), as follows:

IPIA Error Category	Pell Grants	Direct Loans	Direct Loan Consolidations	FFEL
<b>Documentation and Administrative Errors</b>	36%	39%	61%	100%
<b>Verification Errors</b>	64%	61%	39%	0%

### Corrective Actions

Corrective actions as described in the FY 2011 AFR are ongoing efforts and have continued to be refined during FY 2012. Additional actions are being planned to address other root causes identified during FY 2012. FSA will continue to evaluate corrective actions for these root causes in FY 2013 and refine our Program Compliance initiatives and other corrective actions. Corrective actions for each program and corrective actions applicable to all programs are described below.

The discussion below on program reviews is applicable to all the risk-susceptible programs. In addition, Federal Student Aid addresses audit findings from Department of Education OIG audits such as the OIG audit of the Department of Education's Compliance with the *Improper Payments Elimination and Recovery Act of 2010* for Fiscal Year 2011 (ACN: A03M0001, issued March 15, 2012). In an effort to address the improper payment findings from that audit and root causes noted during the FY 2012 improper payments testing, Federal Student Aid is currently working toward resolving the findings with corrective actions which are scheduled for completion on November 21, 2012. Federal Student Aid is



also working to complete corrective actions for the OIG's Investigative Program Advisory Report (IPAR) on Distance Education Fraud Rings (L42L0001, issued September 26, 2011). Corrective actions taken by FSA for the IPERA audit findings include replacing or modifying the existing improper payment estimation methodology in FY 2012 for the Pell, Direct Loan, and FFEL programs. The new FY 2012 estimation methodology addresses issues identified in findings, such as including a detailed description of all estimation methodology in the AFR, excluded populations in the Pell program, and incorporating the use of Program Compliance reviews and OIG audits and investigations. Corrective actions taken by FSA for the Distance Education Fraud Rings IPAR include steps toward promulgating new regulations over institutions that enroll students exclusively in distance education programs and publishing a Dear Colleague Letter (GEN-11-17) that provides guidance to institutions that offer distance education programs.

**Pell Grant Program.** Federal Student Aid continues to utilize the Internal Revenue Service Data Retrieval Tool (IRS DRT), which enables Title IV student aid applicants and, as needed, parents of applicants, to transfer certain tax return information from an IRS website directly to their online FAFSA. For the 2012–13 cycle, 4,842,207 students and parents transferred their tax data from the IRS to the FAFSA using the IRS DRT between February 5, 2012 and September 23, 2012. This usage translates to approximately 26 percent of the 18,621,335 FAFSAs submitted including IRS data for the 2012–13 academic year.

In addition, customized verification processes have been implemented in FY 2012. Verification is the process required by the Department that schools conduct to confirm specific information reported on the FAFSA by the applicant. As noted in the FY 2011 AFR, for the 2012–13 award year, schools are required to verify all applications selected for verification. For the 2013–14 award year, the Department has begun transitioning to a customized selection approach where students are selected based on an analysis of applicant data and require verification of only the data element(s) that caused the selection. Enhanced system edits within NSLDS have also been implemented to flag students with unusual enrollment history to assist in identifying applications for verification.

Institutions administering the Pell Grant Program are also subject to corrective actions through program reviews. Please see the section on program review below.

**Direct Loan Program.** To address the findings noted during the FY 2012 improper payments testing of Direct Loan Consolidations, Federal Student Aid will work to reevaluate the current procedures of processing Loan Verification Certificate LVCs and will consider improvements in system edits to prevent the processing of duplicate LVCs and ineligible loans. Additionally, management will consider additional trainings on processing LVCs to ensure the correct account, lender, and loan information is processed in an effort to reduce the risk of potential improper payments.

As reported in the FY 2011 AFR, FSA has a number of existing internal controls integrated into its Direct Loan systems and activities to prevent and detect errors and continually evaluates how to improve these controls. These include:

- System edits and data matches—The front end student eligibility and origination and disbursement systems include edits and data matches with external data sources to prevent erroneous information from being entered into the system and prevent potential improper payments.



- **Servicer oversight**—Management and oversight of Title IV Additional Servicers includes: process monitoring, financial data reconciliations, NSLDS reporting, program compliance reviews, SAS70/SSAE16 assessments of servicer controls performed by independent public accountants (IPAs), and A-123A assessments of internal controls over financial reporting performed by FSA.
- **Internal reporting**—FSA’s Business Operations works with the Servicers to track overpayments and/or underpayments that occur during the course of business, through an internal reporting process. Using internal reporting methods allows FSA to identify the causes of the overpayments and/or underpayments, track the progress of resolution, and, make necessary adjustments to correct them.
- **Program reviews**—Institutions administering the Direct Loan Program are also subject to corrective actions through program reviews. Please see the section on program review below.

**FFEL Program.** The FFEL program continues to have a number of existing internal controls integrated into its systems and activities including program reviews. Some of these are described below:

- **System edits**—The system used by guaranty agencies, lenders, and servicers to submit bills and remit payments includes “hard” and “soft” edits to prevent erroneous information from being entered into the system and prevent potential improper payments. The hard edits require correction before proceeding with payment processing. The soft edits alert the user and FSA to potential errors. FSA reviews these warnings prior to approval of payment.
- **Reasonability analysis**—Data reported by guaranty agencies to the NSLDS are used to determine payment amounts for account maintenance and loan issuance processing fees. FSA also performs trend analysis of previous payments to guaranty agencies and lenders as a means of evaluating reasonableness of changes in payment activity and payment levels.
- **Focused monitoring and analysis**—FSA targets specific areas of FFEL payment processing that are at an increased risk for improper payments as areas of focus for increased monitoring and oversight.
- **Program reviews**—Institutions administering the FFEL Program are also subject to corrective actions through program reviews. Please see the section on program review below.

**All Risk-Susceptible Programs.** In addition to the control activities and corrective actions identified above for each individual risk-susceptible program, the following activities and related corrective actions (both internally at FSA and at the institution level) mitigate the risk of improper payments and facilitate identification and recovery for all programs.

### **Program Review Process**

As mentioned in the Estimation Methodology section, the improper payment rate calculations for FY 2012 were partially based upon the results of onsite program reviews conducted at a sample of schools or financial institutions for the Pell Grant, Direct Loan and FFEL Programs. FSA’s Program Compliance office works to promote accountability in the administration of Title IV student financial aid through institutional oversight and

enforcement. As part of its ongoing enforcement activities, Program Compliance issues loss of eligibility determinations to schools, closes main campuses and additional locations, assesses millions of dollars in Program Review final determinations and final audit determinations, and debars individuals from receiving assistance or benefits from any federal agency as a result of financial aid fraud or other criminal convictions.

For each program review completed, Federal Student Aid Program Compliance review teams issue a Program Review Report (PRR), a preliminary report of the findings identified during the program reviews which includes statutes and regulations applicable to each finding identified per school or financial institution. To address each finding identified, the PRR includes corrective actions required by the school/financial institution to resolve the findings of noncompliance. The review team may optionally include recommendations in the PRR regarding actions the institution should consider that are not necessarily related to identified findings; but, may improve the process of administering student aid or address certain matters in the PRR that can potentially affect the administration of Title IV program at the school/financial institution. These requirements and recommendations contribute to fewer future instances of inaccurate processing of financial aid at the institutional level and subsequently, the reduction of improper payments.

The school/financial institution is required to respond to the initial PRR within a specified timeframe and, if available, provide additional supporting detail on the findings. Federal Student Aid receives a response from the school/institution, the information and any supporting documentation provided is reviewed to determine if the institution has included adequate information required by the report for the identified finding or if further follow-up with the school/financial institution is required prior to issuing the Final Program Review Determination.

Once the PRR response is considered complete, a Final Program Review Determination (FPRD) is issued to: (1) inform the institution of the liabilities identified based on the findings reported in the PRR, (2) provide instructions for payment of liabilities, (3) notify the school/financial institution of the right to appeal, and (4) close the program review process. Furthermore, the FPRD may address requirements for subsequent A-133 Compliance Audits (see detail on corrective actions related to the A-133 Compliance Audits in the section below). The findings and final determinations are detailed within the FPRD and include the corrective actions taken by the school/financial institution to either resolve the finding or finding(s) that contain liabilities or detail the ongoing corrective actions from the school/ financial institution.

Overall, Federal Student Aid necessitates that all findings identified during the program reviews are tracked through the Postsecondary Education Participants System (PEPS). Tracking practices allow FSA to increase the focus on monitoring findings identified through program reviews and alert FSA to potential future errors related to improper payments.

Specifically related to FFEL improper payments, Federal Student Aid engages stakeholder offices to share issues and to identify relevant risk areas in the FFEL program. The results of this collaboration brings these risk areas into focus in their program review and compliance audits conducted over financial institutions that participate in the FFEL program, and include testing areas related to improper payments. For instance, FSA works closely with the OIG in updating the audit guides for Guaranty Agencies, Lender and Lender Servicers, and also exerts considerable influence in establishing the scope of the

Common Review Initiative (CRI), which are peer reviews conducted by Guaranty Agency staff on a biennial basis, where tests are performed on lender portfolios for which the Guaranty Agency holds the loan guarantees.

### **A-133 Compliance Audits and Other External Assessments**

Independent public accountants and the Inspector General perform audits of guaranty agencies, lenders, and servicers. Such audits include A-133 Compliance Audits (i.e., Single Audit Act Audits) that are required to be performed at schools and financial institutions. Furthermore, for-profit entities holding more than \$5 million in FFEL loans during their fiscal year must submit an independent annual compliance audit for that year conducted by a qualified independent organization or person. Please refer to the Estimation Methodology section for further information related to A-133 Compliance Audits. The Department requires external auditors to work with the auditee's management to develop corrective action plans as part of the audit report package to assist in resolving instances of noncompliance, reportable conditions, and material weaknesses in the internal controls of the school/financial institution.

The corrective action plans developed by the external auditor must describe the corrective action taken or planned in response to findings identified. Additionally, the Department requires the school/financial institution to develop a separate corrective action plan based on the findings identified by the external auditor that includes projected dates for completion of corrective activities. The external auditor will report on the status of the findings and corrective actions annually until the finding is resolved by the school/financial institution.

### **Other Activities to Improve Institutional Level Administration of Title IV Aid**

As noted in the sections above, the underlying source for the majority of the root causes of improper payments identified for FY 2012 are due to the processing errors which occur at the institutional level, and do not reside within controls at Federal Student Aid. In addition to the corrective actions described in the preceding section, including institutional program reviews, Federal Student Aid makes available information, resources, and tools to institutions to facilitate efforts to improve institutional control. These include, but are not limited to, the following:

- **Annual FSA Conferences:** A (no registration fee) conference is held annually in November to provide the most up-to-date information on Title IV programs and the evolving federal policies and procedures affecting FSA customers and partners. Topics generally covered range from the technologies associated with information systems to improved practices for supporting aid applicants and recipients. This conference hosted almost 7,000 financial aid community members in 2011. One of the highlights of this conference is the "Top 10 Audit & Program Review Findings" presentation, which is updated annually. The presentation for FY 2012 identified many of the root causes of improper payments.
- **FSA Assessments:** FSA designed this online tool to help schools with compliance and improvement activities by performing self-assessments.
- **Information for Financial Aid Professionals (IFAP) Website:** This website consolidates guidance, resources, and information related to the administration and processing of Title IV federal student aid into one online site for use by the entire

financial aid community and includes training resources, as well as worksheets, schedules, and table templates to be used for day-to-day operations.

- **Federal Student Aid Call Centers:** The Research and Customer Care Center (RCCC) is a call center that assists schools with questions about the Title IV federal student aid programs, policies, and regulations.
- **Dear Colleague Letters:** Announcements sent from FSA Management to disseminate pertinent information and guidance on changes or updates in policies and procedures, create awareness and provide comment to common issues identified, and share information about tools and trainings that are becoming available. There were 60 Dear Colleague Letters publicized during the fiscal year.
- **FSA COACH:** A free, comprehensive, introductory course on school requirements for administering the Federal Student Aid programs, which spans 37 lessons.

### Federal Student Aid Improper Payment Reporting Summary

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

Federal Student Aid Payment Outlook (\$ in millions)									
Year	Pell			Direct Loan			FFEL		
	Outlays \$( <sup>(1)</sup> / <sub>(2)</sub> )	IP%	IP \$ <sup>(5)</sup>	Outlays \$( <sup>(1)</sup> / <sub>(2)</sub> )	IP%	IP \$	Outlays/ Collections \$( <sup>(1)</sup> / <sub>(3)</sub> / <sub>(4)</sub> )	IP%	IP \$
FY 2011	36,515 <sup>(1)</sup>	2.72	993	116,098 <sup>(1)</sup>	0.22	255	42,616 <sup>(1)</sup>	N/A	N/A
FY 2012	33,299 <sup>(2)</sup>	2.49	829 <sup>(5)</sup>	105,810 <sup>(2)</sup>	N/A	N/A	28,620 <sup>(3)</sup>	N/A	N/A
FY 2013	35,463 <sup>(2)</sup>	2.49	883	171,075 <sup>(2)</sup>	N/A	N/A	9,180 <sup>(4)</sup>	N/A	N/A
FY 2014	36,419 <sup>(2)</sup>	2.49	907	179,440 <sup>(2)</sup>	N/A	N/A	8,363 <sup>(4)</sup>	N/A	N/A
FY 2015	37,924 <sup>(2)</sup>	2.49	944	186,367 <sup>(2)</sup>	N/A	N/A	8,267 <sup>(4)</sup>	N/A	N/A

<sup>(1)</sup> The source of FY 2011 outlays for all programs is the FY 2012 President's Budget request at the Mid-Session Review as presented in the FY 2011 AFR. The FY 2011 FFEL outlays include projected ECASLA put transactions related to participation and purchase agreements and the conduit.

<sup>(2)</sup> The source of the FY 2012 Pell and Direct Loan outlays amount is FMS. The source of FY 2013–2015 Pell and Direct Loan outlay amounts is the supporting documentation for the FY 2013 President's Budget request at the Mid-Session Review.

<sup>(3)</sup> FY 2012 FFEL outlays include related disbursements (e.g., Special Allowance Payments [SAP]) and collections (e.g., Negative SAP). The source of data for these 2012 FFEL disbursements and collections is FMS.

<sup>(4)</sup> The source of FY 2013–2015 FFEL outlays is supporting documentation for the FY 2013 President's Budget request at the Mid-Session Review. These amounts exclude ECASLA put transactions, which are anticipated to drop off significantly with the end of the participation and purchase agreements in 2010.

<sup>(5)</sup> The FY 2011 Pell overaward improper payment rate estimate is 1.80 percent or \$599 million and the underaward improper payment rate estimate is 0.69 percent or \$230 million.

The target IP percentage used for FY 2012–15 is baselined from the FY 2012 preliminary estimate.

Federal Student Aid presents below the outlook table for FY 2012 under the new methodology which is pending OMB approval.

Federal Student Aid Payment Outlook (\$ in millions)									
Year	Pell			Direct Loan			FFEL		
	Outlays \$( <sup>1</sup> / <sup>2</sup> )	IP%	IP \$	Outlays \$( <sup>1</sup> / <sup>2</sup> )	IP%	IP \$	Outlays/ Collections \$( <sup>1</sup> / <sup>3</sup> / <sup>4</sup> )	IP%	IP \$
FY 2011	36,515 <sup>(1)</sup>	2.72	993	116,098 <sup>(1)</sup>	0.22	255	42,616 <sup>(1)</sup>	N/A	N/A
FY 2012	33,299 <sup>(2)</sup>	2.10	699	105,810 <sup>(2)</sup>	0.58	614	28,620 <sup>(3)</sup>	1.93	552
FY 2013	35,463 <sup>(2)</sup>	2.10	745	171,075 <sup>(2)</sup>	0.58	992	9,180 <sup>(4)</sup>	1.93	177
FY 2014	36,419 <sup>(2)</sup>	2.10	765	179,440 <sup>(2)</sup>	0.58	1,041	8,363 <sup>(4)</sup>	1.93	161
FY 2015	37,924 <sup>(2)</sup>	2.10	796	186,367 <sup>(2)</sup>	0.58	1,081	8,267 <sup>(4)</sup>	1.93	160

<sup>(1)</sup> The source of FY 2011 outlays for all programs is the FY 2012 President's Budget request at the Mid-Session Review as presented in the FY 2011 AFR. The FY 2011 FFEL outlays include projected ECASLA put transactions related to participation and purchase agreements and the conduit.

<sup>(2)</sup> The source of the FY 2012 Pell and Direct Loan outlays amount is FMS. The source of FY 2013–2015 Pell and Direct Loan outlay amounts is the supporting documentation for the FY 2013 President's Budget request at the Mid-Session Review.

<sup>(3)</sup> FY 2012 FFEL outlays include related disbursements (e.g., Special Allowance Payments [SAP]) and collections (e.g., Negative SAP). The source of data for these 2012 FFEL disbursements and collections is FMS.

<sup>(4)</sup> The source of FY 2013–2015 FFEL outlays is supporting documentation for the FY 2013 President's Budget request at the Mid-Session Review. These amounts exclude ECASLA put transactions, which are anticipated to drop off significantly with the end of the participation and purchase agreements in 2010.

Although FSA is able to disclose the dollar value of overpayments and underpayments observed in the samples tested in our new methodology, a limitation to the approach is that we were not able to separately extrapolate overall program over and underpayment rates and dollars with the same precision as the gross estimate. The dollar value of Pell overpayments and underpayments that were observed in the sample of schools and students for tests of improper payments were \$81,764 in overpayments and \$21,151 in underpayments. The dollar value of Direct Loan overpayments and underpayments that were observed in the sample of schools and students for tests of improper payments were \$93,362 in overpayments and \$1,481 in underpayments. The dollar value of loan consolidation overpayments and underpayments observed in the sample of loan consolidation activity were \$264,309 in overpayments and \$277,914 in underpayments. The dollar value of FFEL overpayments and underpayments that were observed in the sample of lenders and lender servicers for tests of improper payments were \$2,867 in overpayments and \$15,268 in underpayments.

## Internal Control, Human Capital, Information Systems and Infrastructure

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

### Manager Accountability

The Federal Student Aid offices, managers, and staff responsible for these programs are accountable for establishing and maintaining sufficient internal controls, including a control environment that prevents improper payments from being made, and promptly detects and recovers any improper payments that may occur. Offices and managers are held accountable through a variety of mechanisms and controls, including annual performance measures aligned to the strategic plan, organizational performance review criteria, and individual annual performance appraisal criteria. Federal Student Aid contractors are held accountable through various contract management and oversight activities and functions, control assessments, and audits. All relevant Federal Student Aid key controls are assessed annually for design and operating effectiveness to support management's FMFIA and A-123A assurance statements.

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

### Statutory and Regulatory Barriers

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

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

The Department performed a risk assessment of the *Elementary and Secondary Education Act of 1965* Title I Grants to Local Educational Agencies, during FY 2012. The assessment, based primarily on FY 2011 audit data (the most recent available), yielded an estimated improper payment rate of 0.186 percent. This is consistent with previously reported data indicating that Title I does not meet the statutory 2.5 percent of expenditures threshold for susceptibility to improper payments.

The Department continues to rely on questioned cost data in audit reports to assess susceptibility by calculating a reasonable estimate of improper payments. The Department notes that questioned costs may not capture all potential improper payments to a recipient given that audits generally review only a small sample of transactions. However, it is difficult to estimate how findings from a sample may reflect a larger problem given that most individual audit findings cannot be projected with statistical confidence to 100 percent of an entity's payments.



On April 23, 2012, the OIG issued its first annual report on the Department's compliance with IPERA. The report found the Department to be in compliance. The report also noted that procedures for estimating improper payments for grant programs including Title I could be strengthened. As a result of the OIG report, the Department has undertaken several initiatives to address improper payments and strengthen its processes, one of which was to modify the methodology for calculating the estimated improper payment rate for Title I.

To develop this estimate for FY 2012, the Department conducted an analysis of audit data, including findings of questioned costs and sustained questioned costs from OIG audits, and their relationship to A-133 single audits. Following is a detailed discussion of the revised methodology.

As the nature and frequency of the OIG audits are different from that of the A-133 single audits, and the rate of questioned costs on average are higher in OIG audits, the Department conducted an analysis to determine how the statistically representative A-133 questioned cost data could be combined with the OIG data to produce a more accurate improper payment estimate. In the FY 2011 estimate, all questioned costs from FY 2010 A-133 and OIG audits were applied to the improper payment estimate with equal weight. However, a limited number of OIG audits were available to include in the estimate at the time of reporting.

For the FY 2012 estimate, based on the differences between the two types of audits, the Department developed a weighting system for the audit data. To determine these weights, a trending analysis of sustained questioned costs for the OIG audits for grant recipients and sub-recipients was conducted for the last five audit cycles. The analysis indicated that *sustained* question costs from OIG audits, weighted as a percentage of all A-133 and OIG audit findings in a given fiscal year, adjusted for the differences between the two types of audits and provided a more accurate estimate. Those differences included the OIG's authority to make audit assumptions that resulted in questioned costs beyond the sampled data, its focus on high-risk grantees and its judgmental sampling approaches, and the inclusion of a larger scale of payment records in their samples. The trend of sustained costs in OIG audits were compared to all questioned costs identified in A-133 audits for the same grantees over the same period of time. The differences identified in these rates served as the basis for weighting the data to estimate improper payments.

The Department's assessment of these factors and estimate of improper payments result in the conclusion that Title I is not susceptible to significant improper payments. All previous risk assessments have similarly indicated there is not a significant risk of improper payments in the Title I program. Recoveries of improper payments in Title I are discussed in the next section. The following table presents an estimate of the improper payment outlook for Title I. No reduction targets are proposed since the Department's risk assessments have not identified Title I as a program susceptible to significant improper payments. This table is presented because Title I is a [Section 57 program](#).

<b>Title I Improper Payment Reduction Outlook</b>			
(\$ in millions)			
	<b>Outlays \$<sup>(1)</sup></b>	<b>IP %</b>	<b>IP \$</b>
<b>FY 2011</b>	17,926	.05	9.0
<b>FY 2012</b>	15,208	.186 <sup>(2)</sup>	28.3
<b>FY 2013</b>	14,546	.186	27.1
<b>FY 2014</b>	14,511	.186	27.0
<b>FY 2015</b>	14,516	.186	27.0

<sup>(1)</sup> The sources of Title I outlays are FACTS II reports and the FY 2013 President's Budget request. These include ARRA outlays.

<sup>(2)</sup> The estimated amount of improper payments has been increased due to greater inclusion of OIG audit findings.

## Other Grant Programs

### Risk Assessments

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

### Recovery Auditing

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

**Contract Payment Recapture Audits.** The Department findings from payment recapture audits of contracts have been consistently insignificant. For FY 2004–11, the Department relied on several different approaches to conduct payment recapture audits for the Department's contracts and purchase orders, which total approximately \$1.5 billion annually. The amount recovered has consistently been insignificant, less than one percent (.0025 percent). Between 2007 and 2011 the Department conducted payment recapture audits of contract payments as part of its A-123 review process. The findings from these reviews, which are based on a random sample of contract payments, consistently demonstrated the low risk of improper payments in contract administration. In 2011, the quantitative results of these reviews (which found minimal improper payments) were combined with the Department's qualitative A-123 risk assessments of procurement management processes to determine that Department contracts are not susceptible to significant improper payments, as defined by OMB Circular A-123, Appendix C. The Department will continue to rely on the cyclical A-123 risk assessments and annual recapture audit activities to determine the susceptibility of contracts to improper payments.

In 2012, the Department refocused its resources and took the initiative to strengthen and expand its payment recapture efforts by leveraging recent advances in data mining technologies. The Department is in the final stages of awarding a contingency-based contract; proposals are currently being paneled with an anticipated award date of December 2012. The awarded contractor will conduct a payment recapture audit of all Department contract payments for fiscal years 2007–12 beginning with the most recent fiscal years. The audit will focus on identifying improper payments including overpayments, duplicate payments, payments to the wrong recipient, and payments for ineligible goods or services. Further, the data yielded will be used to investigate and report the root causes of all identified improper payments so corrective actions can be implemented. The Department anticipates the use of new data mining approaches may identify a small but significant number of improper payments that were previously undetected. A payment recapture audit of this kind supports the Department's strategic goal to improve its organizational capacity by increasing the efficient and effective use of contract resources.

The following chart presents the results of previous recapture efforts:

<b>Contract Payment Recapture Audit Reporting</b> <b>(\$ in millions)</b>	
Amount Subject to Review for Current Year (2012) Reporting	\$0
Actual Amount Reviewed and Reported (2012)	\$0
Amounts Identified for Recovery (2012)	\$0
Amounts Recovered (2012)	\$0
% of Amount Recovered out of Amount Identified (2012)	NA
Amount Outstanding (2012)	\$0
% Amount Outstanding out of Amount Identified (2012)	NA
Amount Determined Not to be Collectable (2012)	\$0
% Amount Determined Not to be Collectable out of Amount Identified (2012)	NA
Amounts Identified for Recovery Prior Years (2005–12)	\$0
Amounts Recovered (2005–12)	\$0
Cumulative Amounts Identified for Recovery (2005–12)	\$0
Cumulative Amounts Recovered (2005–12)	\$0
Cumulative Amounts Outstanding (2005–12)	\$0
Cumulative Amounts Determined Not to be Collectable (2005–12)	\$0

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

**Federal Student Aid Post-Award Audits.** Audits and reviews of Title IV program participants identify potential improper payments within these programs and assess liabilities that are recovered through the Department's accounts receivable process and are included in the chart below.

For the Pell Grant Program, recoveries also occur when overpayments to students are assigned to Federal Student Aid for collection. Pell amounts recovered through student

Debt Collection were approximately \$6.2 million in FY 2012, \$8.7 million in FY 2011, and \$87.8 million cumulative from FY 2012 to FY 2004. While all programs may have student debts transferred to debt collection, the categorization of resulting collections as an improper payment recovery is unique to Pell. Unlike loans, Pell grant payments transferred to debt collection commonly indicate a potential improper payment at time of disbursement.

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

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

The following chart provides estimates of the amounts identified and recovered through all Department A-133 Single Audits, OIG Audits, and program reviews.

<b>Overpayments Recaptured Outside of Payment Recapture Audits (\$ in millions)</b>						
Agency Source	Amount Identified (FY 2012)	Amount Recovered (FY 2012)*	Amount Identified (FY 2011)	Amount Recovered (FY 2011)*	Cumulative Amount Identified (FY 2011–12)	Cumulative Amount Recovered (FY 2011–12)
Single Audit Reports	21.7	4.3	28.7	4.2	50.4	8.5
OIG Audit Reports	2.7	.2	13.5	3.4	16.2	3.6
Program Reviews	30.7	6.7	38.3	9.8	69	16.5

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

**Information Systems and Infrastructure.** Program staff must assess grantee risk and determine whether new or continuing grants should include “special conditions” (including grantees designated “high-risk” pursuant to EDGAR at 34 CFR §80.12). Program staffs work with the Department’s Risk Management Service (RMS) to use the Decision Support System (DSS) Entity Risk Review (ERR) to assess grantee risk and assist in the determination of special conditions for grant awards. DSS is a suite of software tools and support services used to perform risk analysis and reveal to the Department information that can be used to effectively administer grants.

Appropriate uses of the information are to inform the work of (1) identifying fiscal or performance risks with the Department's applicants or grant recipients; (2) determining if special conditions are needed for the award; and (3) developing risk-based monitoring and technical assistance plans. For more information on ERR see page 28 in the Management Discussion Analysis section of this report.

Additionally, post-audit follow-up courses have been developed to associate audit corrective actions with monitoring to minimize future risk and audit findings. Managerial compliance with monitoring procedures is reviewed and tested during the assurance process under OMB Circular A-123.

The Department recently implemented continuous controls monitoring software to help detect anomalies and potential issues in agency payment-related data. These include all Department and FSA payments made through the G5 system. Staff follow up when anomalies are identified, aggressively investigate root causes of improper payments when they do occur, and develop corrective action plans to address any systemic weaknesses. This new automated tool is used to examine payment records and identify problems such as duplicate payments, unduly large payments, overpayments, and potential fictitious vendors. This software enhances the Department's analytical capacity to monitor potential improper payments, thereby assisting the Department in reducing the risk of improper payments.

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

## Summary

The Department is enhancing its efforts for identifying and reducing the potential for improper payments to comply with the IPERA. Although there are still challenges to overcome, the Department is committed to ensuring the integrity of its programs.

The Department is focused on identifying and managing the risk of improper payments and mitigating the risk with adequate control activities. In FY 2013, we will continue to work with OMB and the OIG to explore additional opportunities for identifying and reducing potential improper payments and to ensure compliance with the IPERA.

**Department of Education  
Schedule of Spending  
For the Years Ended September 30, 2012 and 2011**  
(Dollars in Millions)

	FY 2012		FY 2011	
	Budgetary	Non-Budgetary Credit reform Financing Accounts	Budgetary	Non-Budgetary Credit reform Financing Accounts
<b>What Money is Available to Spend?</b>				
Total Resources	\$ 104,710	\$ 270,274	\$ 103,494	\$ 262,887
Less Amount Available but Not Agreed to be Spent	10,480	1	3,036	634
Less Amount Not Available to be Spent	2,142	18,992	2,398	14,768
<b>Total Amounts Agreed to be Spent</b>	<b>\$ 92,088</b>	<b>\$ 251,281</b>	<b>\$ 98,060</b>	<b>\$ 247,485</b>
<b>How was the Money Spent?</b>				
<b><u>Increase College Access, Quality, and Completion</u></b>				
Credit Program Loan Disbursements and Claim Payments	\$ 56	\$ 154,449	\$ 99	\$ 146,686
Credit Program Subsidy Transfers	8,337	40,650	3,081	50,202
Federal Interest Payments		26,629		20,181
Other Credit Program Payments	4	2,581	4	4,296
Federal Student Loan Reserve Fund Valuation	419		2,166	
Grants	39,364		42,926	
Personnel Compensation and Benefits	258		256	
Contractual Services	1,073	474	962	343
Other <sup>1/</sup>	37	8	38	16
	<b>49,548</b>	<b>224,791</b>	<b>49,532</b>	<b>221,724</b>
<b><u>Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Need</u></b>				
Grants	22,154		21,786	
Personnel Compensation and Benefits	74		78	
Contractual Services	114		103	
Other <sup>1/</sup>	14		16	
	<b>22,356</b>		<b>21,983</b>	
<b><u>Ensure Effective Educational Opportunities for All Students</u></b>				
Grants	16,889		16,055	
Personnel Compensation and Benefits	168		166	
Contractual Services	64		65	
Other <sup>1/</sup>	25		23	
	<b>17,146</b>		<b>16,309</b>	
<b><u>Enhance the Education System's Ability to Continuously Improve</u></b>				
Grants	1,179		1,276	
Personnel Compensation and Benefits	88		88	
Contractual Services	399		423	
Other <sup>1/</sup>	16		15	
	<b>1,682</b>		<b>1,802</b>	
<b><u>American Recovery and Reinvestment Act and Education Jobs Fund</u></b>				
Grants	7,787		28,840	
Personnel Compensation and Benefits	4		6	
Contractual Services	10		22	
	<b>7,801</b>		<b>28,868</b>	
<b>Total Spending</b>	<b>98,533</b>	<b>224,791</b>	<b>118,494</b>	<b>221,724</b>
Amounts Remaining to be Spent <sup>2/</sup>	(6,445)	26,490	(20,434)	25,761
<b>Total Amounts Agreed to be Spent</b>	<b>\$ 92,088</b>	<b>\$ 251,281</b>	<b>\$ 98,060</b>	<b>\$ 247,485</b>

<sup>1/</sup> Other primarily consists of building rental payments, equipment purchases and transportation.

<sup>2/</sup> The "Amounts remaining to be spent" line item shown in the schedule above represents the difference between spending and amounts agreed to be spent during the given fiscal year. Actual spending during a particular fiscal year may include spending associated with amounts agreed to be spent during previous fiscal years, which may result in negative amounts shown for the "Amounts Remaining to be Spent" line item.



## Summary of Financial Statement Audit and Management Assurances

The following tables provide a summarized report on the Department's financial statement audit and its management assurances. For more details the auditor's report can be found on pages 93–116 and the Department's management assurances on pages 33–36.

### Summary of Financial Statement Audit

Audit Opinion: Unqualified

Restatement: No

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
<b>Total Material Weaknesses</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>

### Summary of Management Assurances

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

Statement of Assurance: Unqualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
<b>Total Material Weaknesses</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>

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

#### Effectiveness of Internal Control over Operations—*FMFIA 2*

Statement of Assurance: Qualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
<b>Total Material Weaknesses</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>

#### Conformance with Financial Management System Requirements—*FMFIA 4*

Statement of Assurance: The Department systems do not conform to financial management system requirements.

Non-Conformance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
<b>Total Non-Conformance</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>

#### Compliance with *Federal Financial Management Improvement Act*

	Agency	Auditor
<b>Overall Substantial Compliance</b>	No	No
1. System Requirements	No	No
2. Federal Accounting Standards	Yes	Yes
3. United States Standard General Ledger at Transaction Level	Yes	Yes




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

The Inspector General

October 11, 2012

**MEMORANDUM**

**TO:** The Honorable Arne Duncan  
Secretary of Education

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

**SUBJECT:** Management Challenges for Fiscal Year 2013

The Reports Consolidation Act of 2000 requires the U.S. Department of Education (Department), Office of Inspector General, to identify and report annually on the most serious management challenges the Department faces. The Government Performance and Results Modernization Act of 2010 requires the Department to include in its agency performance plan information on its planned actions, including performance goals, indicators, and milestones, to address these challenges. To identify management challenges, we routinely examine past audit, inspection, and investigative work, as well as issued reports where corrective actions have yet to be taken; assess ongoing audit, inspection, and investigative work to identify significant vulnerabilities; and analyze new programs and activities that could pose significant challenges because of their breadth and complexity.

Last year we presented four management challenges: improper payments, information technology security, oversight and monitoring, and data quality and reporting. While we noted some progress by the Department in addressing these areas, each remains as a management challenge for Fiscal Year (FY) 2013.

The FY 2013 management challenges are:

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

We look forward to working with the Department to address the FY 2013 management challenges in the coming year. If you have any questions or would like to discuss these issues, please contact me at (202) 245-6900. You may also contact either Patrick Howard, Assistant Inspector General for Audit, at (202) 245-6949, William Hamel, Assistant Inspector General for Investigations, at (202) 245-6922, or Charles Coe, Assistant Inspector General for Information Technology Audits and Computer Crime Investigations, at (202) 245-7033.

## Office of Inspector General's (OIG) Management and Performance Challenges for Fiscal Year 2013 Executive Summary

The Office of Inspector General (OIG) works to promote efficiency, effectiveness, and integrity in the programs and operations of the U.S. Department of Education (Department). Through our audits, inspections, investigations, and other reviews, we continue to identify areas of concern within the Department's programs and operations and recommend actions the Department should take to address these weaknesses. The *Reports Consolidation Act of 2000* requires the OIG to identify and report annually on the most serious management challenges the Department faces. The *Government Performance and Results Modernization Act of 2010* requires the Department to include in its agency performance plan information on its planned actions, including performance goals, indicators, and milestones, to address these challenges.

Last year we presented four management challenges: improper payments, information technology security, oversight and monitoring, and data quality and reporting. While we noted some progress by the Department in addressing these areas, each remains as a management challenge for Fiscal Year (FY) 2013.

The FY 2013 management challenges are:

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

**Improper Payments.** In FY 2010, the President established a goal to avoid \$50 billion in improper payments government-wide by the end of FY 2012. Legislation was enacted and implementing guidance was issued to assist in meeting this goal. While PaymentAccuracy.gov reported that the Federal Government avoided over \$20 billion in improper payments in FYs 2010 and 2011 combined, Federal agencies still reported an estimated \$115 billion in improper payments for FY 2011. The Department estimated its Pell Grant program had more than \$1 billion in improper payments in FY 2011, making it one of 14 programs identified as "high-error" at PaymentAccuracy.gov. A recent OIG audit identified weaknesses in the methodologies and data used to calculate the estimated improper payment rates for the Title I, Pell, and Direct Loan programs. In addition, OIG audit and investigative work over the past several years have identified improper payments in the Student Financial Assistance (SFA) programs, to or by State educational agencies (SEA) and local educational agencies (LEA), to other grantees, and to contractors. The Department, as well as other agencies, must be able to ensure that the billions of dollars entrusted to it are reaching the intended recipients. Overall, the Department remains challenged to meet new requirements and to intensify its efforts to successfully prevent, identify, and recapture improper payments.

**Information Technology Security.** Recent audit work performed by the Department's financial statement auditor and OIG continue to identify control weaknesses within Information Technology (IT) security and systems that need to be addressed. The Department's financial statement auditor has identified IT controls as a significant deficiency for the past 3 years based on weaknesses related to access controls,

noncompliant passwords, configuration management, and administrator account monitoring. The OIG has found similar issues through its own work and identified additional weaknesses in operational, managerial, and technical security controls. Recent OIG reports identified weaknesses in compliance with configuration management, identity and access management, incident response and reporting, risk management, security training, remote access management, and contingency planning. Compromise of the Department's data or systems could cause substantial harm to the Department, negatively impact operations, and lead to identity theft or other fraudulent use of information. The Department provided corrective action plans to address the recommendations in our audits and has reported that some corrective actions are completed. However, vulnerabilities continue to exist and the Department needs to effectively address and eliminate IT security deficiencies where possible, continue to provide mitigating controls for vulnerabilities, and implement remaining planned actions to correct system weaknesses.

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

- **SFA Program Participants.** The Department must provide effective oversight and monitoring of participants in the SFA programs under Title IV of the Higher Education Act of 1965 as amended to ensure that the programs are not subject to fraud, waste, abuse, and mismanagement. The Department estimated \$193.5 billion will be used for SFA programs in FY 2013. This level of funding will provide an estimated 15.2 million students with assistance in paying the cost of their postsecondary education. Participants in the SFA programs include postsecondary institutions, lenders, guaranty agencies, and third-party servicers. Our work has identified weaknesses in the Department's oversight and monitoring of these participants and our external audits of individual SFA program participants frequently identified noncompliance, waste, and abuse of SFA program funds. The Department needs to continue to assess and improve its oversight and monitoring of program participants and take effective actions when problems are identified.
- **Distance Education.** Distance education refers to courses or programs offered through telecommunication, such as through an Internet connection, with a postsecondary institution. The flexibility offered is popular with students pursuing education on a non-traditional schedule. Many institutions offer distance education programs as a way to increase their enrollment. Management of distance education programs presents a challenge for the Department and school officials because of limited or no physical contact to verify the student's identity or attendance. OIG audit work has found that for distance education programs, schools face a challenge in determining when a student attends, withdraws from school, or drops a course. Attendance is critical because it is used to determine the student's eligibility for Federal student aid and to calculate the return of funds if the student withdraws or drops out. Our investigative work has also identified numerous instances of fraud involving distance education programs. These cases involved the exploitation of vulnerabilities in distance education programs to



fraudulently obtain Federal student aid. The OIG also reported that the control weaknesses in distance education programs increase their susceptibility to “fraud rings”—large, loosely affiliated groups of criminals that seek to exploit distance education programs in order to fraudulently obtain Federal student aid. The Department has taken corrective actions to address many of the recommendations contained in our reports. However, the Department needs to increase its monitoring and oversight of schools providing distance education and develop requirements specifically to address potential problems inherent in distance education.

- **Grantees.** Effective monitoring and oversight are essential to ensure that grantees meet grant requirements and achieve program goals and objectives. Our work on Recovery Act and other grant programs has identified a number of weaknesses in grantee oversight and monitoring. These include LEA and SEA fiscal control issues; internal control weaknesses in the Department's oversight processes; and fraud perpetrated by LEA, SEA, and charter school officials. The Department is responsible for monitoring the activities of grantees to ensure compliance with applicable Federal requirements and that performance goals are being achieved. The Department has taken corrective actions to address many of the recommendations contained in our reports. However, the Department needs to continue to assess and improve its oversight and monitoring of grantees and take effective actions when issues are identified.
- **Contractors.** The Department relies heavily on contractor support to accomplish its mission and to ensure the effective operations of its many systems and activities. The value of the Department's active contracts as of April 2012 was approximately \$6.3 billion. Once a contract is awarded, the Department must effectively monitor performance to ensure that it receives the quality and quantity of products or services for which it is paying. The OIG has identified issues relating to the lack of effective oversight and monitoring of contracts and contractor performance, primarily related to the appropriateness of contract prices and payments, and the effectiveness of contract management. OIG investigations have noted inappropriate activities by contractor employees that resulted in improper billings and payments. The Department has taken action to address many of the issues noted. However, because the Department relies on its contractors to help run its various programs and operations, effective contract management is critical for ensuring effective performance, that the Department receives the specified level and quality of products or services, and that payments made are appropriate. The Department still needs to work to ensure that it has an appropriately qualified staff in place and in sufficient numbers to provide effective oversight of its contracts.

**Data Quality and Reporting.** The Department, its grantees, and its subrecipients must have controls in place and effectively operating to ensure that accurate, reliable data are reported. Data are used by the Department to make funding decisions, evaluate program performance, and support a number of management decisions. SEAs annually collect data from LEAs and report various program data to the Department. Our work has identified a variety of weaknesses in the quality of reported data and recommended improvements at the SEA and LEA level, as well as actions the Department can take to clarify requirements and provide additional guidance. Ensuring that accurate and complete data are reported is critical to support effective management decisions.

# Appendices



## Appendix A: Education Resources of the Department

### Education Dashboard

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

### College Cost Lists

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

### College Preparation Checklist

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

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

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

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

### College Completion Toolkit

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

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

### Resources for Career and Technical Education

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

## Federal Resources for Educational Excellence

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

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

## Practice Guides for Educators

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

## Doing What Works: Research Based Educational Practices

The purposes of this tool are to provide a convenient and easy way for educators to find research proven teaching methods and to translate research-based practices into practical applications in the classroom. The site is easy to navigate and offers useful tools.

<http://ies.ed.gov/ncee/wwc/FindWhatWorks.aspx?o=1,9,13&n=Mathematics%20achievement>

## Appendix B: Selected Department Web Links

### Department Evaluation Studies

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

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

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

### Performance Data

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

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

### FY 2013 President's Budget

Details the amounts requested for the programs and activities of the Department in the FY 2013 President's Budget. It also shows appropriations for fiscal years 2011 and 2012.

<http://www2.ed.gov/about/overview/budget/budget13/13pbapt.pdf>

### Condition of Education and Digest of Education Statistics

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

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

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

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

### Projections of Education Statistics to 2020

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

<http://nces.ed.gov/pubsearch/pubsinfo.asp?pubid=2011026>

## Discretionary Grant Programs for FY 2012

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

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

## Open Government Initiative

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

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

## Research and Statistics

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

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

## National Assessment of Educational Progress

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

<http://nationsreportcard.gov/>

## Government Accountability Office

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

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

## Office of Inspector General

The Office of Inspector General has four primary business functions: audit, investigation, cyber security, and evaluation and inspection.

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

For a list of recent reports, go to:

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

## Appendix C: Glossary of Acronyms and Abbreviations

ABCP	Asset-Backed Commercial Paper
ACG	Academic Competitiveness Grant
ACS	American Community Survey
ACSI	American Customer Satisfaction Index
AFR	<i>Agency Financial Report</i>
APG	Agency Priority Goals
APR	<i>Annual Performance Report</i>
ARRA	<i>American Recovery and Reinvestment Act of 2009 (Recovery Act)</i>
BPTW	Best Places to Work
CCRAA	<i>College Cost Reduction and Access Act of 2007</i>
CFO	Chief Financial Officer
CRA	<i>Civil Rights Act of 1964</i>
CSI	Customer Satisfaction Index
CSPR	<i>Consolidated State Performance Report</i>
CSRS	Civil Service Retirement System
CTEA	<i>Carl D. Perkins Career and Technical Education Act of 2006</i>
DD&B	Death, Disability and Bankruptcy
DOL	U.S. Department of Labor
DQI	Data Quality Initiative
DSS	Decision Support System
DST	Data Strategy Team
ECASLA	<i>Ensuring Continued Access to Student Loans Act of 2008</i>
ESEA	<i>Elementary and Secondary Education Act of 1965</i>
ESRA	<i>Education Sciences Reform Act of 2002</i>
FAFSA	Free Application for Federal Student Aid
FASAB	Federal Accounting Standards Advisory Board
FECA	<i>Federal Employees' Compensation Act</i>

FERS	Federal Employees Retirement System
FFB	Federal Financing Bank
FFEL	Federal Family Education Loan
FFMIA	<i>Federal Financial Management Improvement Act of 1996</i>
FISMA	<i>Federal Information Security Management Act of 2002</i>
FMFIA	<i>Federal Managers' Financial Integrity Act of 1982</i>
FMSS	Financial Management Support System
FREE	Federal Resources for Educational Excellence
FSA	Federal Student Aid
FSEOG	Federal Supplemental Educational Opportunity Grant
FY	Fiscal Year
G5	Grants Management System
GAO	Government Accountability Office
GEAR UP	Gaining Early Awareness and Readiness for Undergraduate Programs
GEPA	<i>General Education Provisions Act</i>
GMRA	<i>Government Management Reform Act of 1994</i>
GPRA	<i>Government Performance and Results Act of 1993</i>
GPRAMA	<i>GPRAMA Modernization Act of 2010</i>
GSA	General Services Administration
HBCUs	Historically Black Colleges and Universities
HEA	<i>Higher Education Act of 1965</i>
HR	Hurricane Education Recovery
IASG	Iraq and Afghanistan Service Grant
IDEA	<i>Individuals with Disabilities Education Act</i>
IES	Institute of Education Sciences
IP	Improper Payments
IPA	Independent Public Accountant
IPEDS	Integrated Postsecondary Education Data System



IPERA	<i>Improper Payments Elimination and Recovery Act</i>
IPIA	<i>Improper Payments Information Act of 2002</i>
IRS	Internal Revenue Service
IRS DRT	IRS Data Retrieval Tool
i3	Investing in Innovation fund
IT	Information Technology
LEA	Local Educational Agency
LEAP	Leveraging Educational Assistance Partnership
LLR	Lender of Last Resort
LVC	Loan Verification Certificates
MD&A	Management's Discussion and Analysis
MEP	Migrant Education Program
NAEP	National Assessment of Educational Progress
NCES	National Center for Education Statistics
NCLB	<i>No Child Left Behind Act of 2001</i>
NIST	National Institute of Standards and Technology
NSLDS	National Student Loan Data System
OCR	Office for Civil Rights
OELA	Office of English Language Acquisition
OESE	Office of Elementary and Secondary Education
OIG	Office of Inspector General
OII	Office of Innovation and Improvement
OMB	Office of Management and Budget
OPE	Office of Postsecondary Education
OPEPD	Office of Planning, Evaluation, and Policy Development
OPM	Office of Personnel Management
OPR	Organizational Performance Report
OSERS	Office of Special Education and Rehabilitative Services

OVAE	Office of Vocational and Adult Education
PAR	<i>Performance and Accountability Report</i>
PARCC	Partnership for Assessment of Readiness for College and Careers
PBO	Performance-Based Organization
PIC	Performance Improvement Council
PII	Personally Identifiable Information
PIO	Performance Improvement Officer
PUMS	Public Use Microdata Sample
QPR	Quarterly Performance Report
RA/JF	<i>American Recovery and Reinvestment Act of 2009 (Recovery Act)/Education Jobs Fund</i>
RCA	<i>Reports Consolidation Act of 2000</i>
REAP	Rural Education Achievement Program
RFI	Request for Information
RMS	Risk Management Service
RTT-ELC	Race to the Top-Early Learning Challenge
SAFRA	<i>SAFRA Act</i>
SAP	Special Allowance Payment
SASS	Schools and Staffing Survey
SBR	Statement of Budgetary Resources
SEA	State Educational Agency
SFSF	State Fiscal Stabilization Fund
SIG	School Improvement Grant
SLA	Service Level Agreement
SLEAP	Special Leveraging Educational Assistance Partnership
SLM	Student Loan Model
SMART	National Science and Mathematics Access to Retain Talent Grant
STEM	Science, Technology, Engineering, and Mathematics
SY	School Year

TEACH	The Teacher Education Assistance for College and Higher Education Grant
TIF	Teacher Incentive Funds
VR	Vocational Rehabilitation





**OUR MISSION IS TO PROMOTE STUDENT ACHIEVEMENT AND PREPARATION FOR  
GLOBAL COMPETITIVENESS BY FOSTERING EDUCATIONAL EXCELLENCE AND  
ENSURING EQUAL ACCESS.**

**[WWW.ED.GOV](http://WWW.ED.GOV)**