



# U.S. Department of Education FY 2013 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*

December 11, 2013

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



## About This Report

The purpose of the United States Department of Education's (the Department) FY 2013 *Agency Financial Report* (AFR) is to assist Congress, the President, and the American people to assess the Department's stewardship over resources with which it is entrusted. This annual report is required by legislation and complies with the requirements of the Office of Management and Budget's Circulars A-11, *Preparation, Submission, and Execution of the Budget*, and A-136, *Financial Reporting Requirements*.

Federal Student Aid, a principal office of the Department and a designated Performance-Based Organization, is required by legislation to produce a separate *Annual Report*, which details Federal Student Aid's financial and program performance. A summary of the information included in the *Federal Student Aid Annual Report* can be found in the applicable sections of the Department's AFR. For more detail on Federal Student Aid's performance and financial information, refer to [StudentAid.gov](http://StudentAid.gov).

The AFR is organized into four major sections:

**Management's Discussion and Analysis**—This section provides information about the Department's mission and organizational structure, our high-level performance results, financial highlights, and management assurances regarding internal controls.

**Financial Section**—This section provides a message from the Chief Financial Officer, the financial statements and notes, required supplementary information and required supplementary stewardship information, and the report from our independent auditors.

**Other Information**—This section provides improper payments reporting details, the schedule of spending, a summary of financial statement audit and management assurance, and the Office of Inspector General's Management and Performance Challenges for Fiscal Year 2014 Executive Summary.

**Appendices**—This section provides a listing of selected Department web links and education resources and a glossary of acronyms and abbreviations.

This report satisfies the reporting requirements contained in the following legislation:

- *Federal Managers' Financial Integrity Act of 1982*
- *Government Management Reform Act of 1994*
- *Federal Financial Management Improvement Act of 1996*
- *Reports Consolidation Act of 2000*
- *Improper Payments Elimination and Recovery Act of 2010*
- *Government Performance and Results Modernization Act of 2010*

In FY 2013, the Department chose to produce an *Agency Financial Report* (AFR) and *Annual Performance Report* (APR). The APR and the Congressional Budget Justification will be posted on the Department's website at <http://www.ed.gov/about/reports/annual/index.html> when the FY 2015 budget is released.

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

[available February 2014]

The APR is produced in conjunction with the FY 2015 President's Budget Request and provides more detailed performance information and analysis of performance results.

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

[available February 2014]

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

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## Message From the Secretary



December 11, 2013

I am pleased to present the Department of Education's *Fiscal Year (FY) 2013 Agency Financial Report*. In this report, we share the Department's financial and performance highlights over the past 12 months.

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

Providing every student in America with a world-class education is an economic imperative. 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.

### Performance Highlights

In the Department's *Strategic Plan for FY 2011–2014*, our mission is reflected in six strategic goals and 21 objectives. In FY 2013, we designated six programmatic two-year Department Priority Goals that are essential to achieving our mission. The Management's Discussion and Analysis section contains more details on the Agency Priority Goals and a high-level discussion about our approach to performance management.

For those seeking additional details regarding our performance and progress toward achieving our strategic goals, I invite you to read our *Annual Performance Report*, which will be released with the Congressional Budget Justification and the President's FY 2015 budget. Additionally, the Department's Priority Goals are posted on [performance.gov](http://performance.gov).

### Financial Management

Although we are the smallest of the 15 cabinet level agencies in terms of government staff, the Department is the third largest of the 26 federal grant-making organizations, manages the second largest loan portfolio in the federal government. It is imperative that we demonstrate that we are good stewards and that we have well controlled and managed financial systems and business processes.

I am proud to report that we have received our 12th consecutive unqualified audit opinion. Along with the unqualified opinion for 2013, our auditors reported that there were no material internal control weaknesses and no instances of noncompliance with applicable laws and regulations, except for one compliance issue with the *Federal Financial Management Improvement Act* (FFMIA). Last year, we reported a material weakness in internal controls over the operation of the Direct Loan and FFEL programs and that our financial management systems did not substantially comply with FFMIA. We took steps in 2013 to correct the material weakness and to ensure that our financial management systems substantially comply with FFMIA.



I am confident that the financial and summary performance data included in this AFR are complete and reliable in accordance with federal requirements. 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*, as well as a discussion of the one item mentioned above.

### **Management Challenges**

We remain committed to improved governance and better business processes. Management has worked closely with the Office of Inspector General (OIG) to gain its perspective about our most significant management and performance challenges. These are presented in the Other Information section of this report. The OIG's review addresses five FY 2014 management challenges: improper payments, information technology security, oversight and monitoring, data quality and reporting, and information technology system development and implementation.

The Department takes these challenges seriously, as well as other issues identified through our own self-assessments of operations and external audits. The Department is responding to each challenge with initiatives designed to improve our systems and process.

### **Outreach and Partnerships**

The Department leverages free web resources to connect directly with an ever-growing online community of educators, parents, students, and other stakeholders. Our most popular Twitter page, @used.gov, has grown to reach more than 250,000 followers who have joined us in real-time conversations about the challenges facing their schools and communities. Through Twitter town halls and impromptu exchanges, we answer questions and gain feedback that help to shape our outreach activities and discussions about education policy. The Department's official Facebook page shares photos, videos, and information with its active members.

Our blog, Homeroom, provides stakeholders with the opportunity to learn about financing college, combating bullying, supporting teachers, and other important topics. Homeroom readers—like our Twitter followers and Facebook fans—share the information that matters to them. Blog posts reach thousands of people with just a few clicks. On our YouTube channel, the Department shares stories about schools where reform efforts and innovations are making a difference for students. We were also proud to host our first Google+ Hangout this year, when I connected with student athletes and both Women's National Basketball Association and National Basketball Association players to discuss how sports can play an important role in students' maturation on and off the court.

The Department also interacts with hundreds of key national associations and organizations, which represent the interests of the K-12 education, civil rights and advocacy, and higher education communities by keeping them apprised of our programs' progress, major policy decisions, and funding opportunities. The information we convey through e-mail blasts and stakeholder forums is made available through our national partners, who share updates with their state and local affiliate networks. When key policy decisions or shifts are pending, the Department makes it a priority to inform leaders of these groups and gain their feedback.

## Looking Ahead

Guided by our new strategic plan for FY 2014–2018, we have charted a roadmap for future success, and we will continue to evaluate how best to accomplish our strategic goals and objectives during these fiscally challenging times. Our *FY 2014–2018 Strategic Plan* will be published in February 2014 and can be found on both [ed.gov](http://ed.gov) and [performance.gov](http://performance.gov). We look forward to working with our partners and colleagues in Congress, the states, and across the education community by keeping foremost in our minds why we care about education.

I am proud of the progress we are making at the Department. I salute the efforts of our dedicated employees who carry out the day-to-day work of the Department and of their continued commitment to provide every student in America with a world-class education.

Sincerely,

/s/

Arne Duncan



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# **Management's Discussion and Analysis**

## About the Management's Discussion and Analysis

The Department of Education (the Department) continues to enhance the usefulness of the *Agency Financial Report* (AFR) as a roadmap to relevant web content. The AFR is designed to be read online to take full advantage of the information presented. Links replace static pages in earlier reports allowing for current information to be drawn from our websites. The Department's intent is to provide users with access to useful information about the Department and its financial activities, while meeting the intent of the Federal Accounting Standards Advisory Board (FASAB) [Financial Reporting Model Task Force](#) recommendation on web-based reporting and complying with existing Office of Management and Budget (OMB) reporting requirements.

To help continue to improve the content of the AFR, readers are encouraged to provide their feedback at: [PARcomments@ed.gov](mailto:PARcomments@ed.gov).

## Mission and Organizational Structure

This section provides information about the Department's mission, an overview of its history and its structure. The active links include: the organization chart and principal offices, a map of its regional offices, and a full list of Department programs and funding for the current year.

## Discussion of Performance

The Department has elected to produce separate financial and performance reports for the last five years. The *Agency Financial Report* for fiscal year (FY) 2013 provides a high-level description of key performance measures and goals based on the [FY 2011–2014 Strategic Plan](#) with a focus on the Priority Goals for 2012–13. A detailed discussion of performance information for FY 2013 will be provided in the Department's *Annual Performance Report* to be published in February 2014 with the President's Budget. Additional information on data from the *FY 2011–2014 Strategic Plan* can be found in the [FY 2012 Annual Performance Report and FY 2014 Annual Performance Plan](#).

The section includes an overview of performance reporting, a report on the Agency Priority Goals for 2012–13, and high-level discussion of performance information.

The Department has identified a small number of priority goals that have been focus areas over the last two years. These goals, which will help measure the success of the Department's cradle-to-career education strategy, reflect the importance of teaching and learning at all levels of the education system. These goals are consistent with the Department's *Strategic Plan*, which will be used to regularly monitor and report progress. To view information on all Department programs, please visit the [Department's website](#).

Looking Ahead and Addressing Challenges describes how the Department's *FY 2014–2018 Strategic Plan* charts future success during these fiscally challenging times.

## Financial Highlights

The Department has significantly expanded information in the Financial Highlights section of the report to provide a more comprehensive depiction of its key financial activities for FY 2013 and to identify and explain significant trends.

The Department expends a substantial amount of its budgetary resources and disburses large cash amounts on grant and loan programs intended to increase college access, quality, and



completion; improve preparation for college and career from birth through 12th grade, especially for children with high needs; and ensure effective educational opportunities for all students. Therefore, the Department has included more high-level details about the sources and uses of these funds and a composition of and summary of net costs by program.

The primary sources of funds are borrowings from Treasury (Debt), appropriations from Congress, and spending authority from offsetting collections. Most borrowings and collections are associated with student loans.

As a nine-time recipient of the Association of Government Accountants Certificate of Excellence in Accountability Reporting and having earned unqualified (or “clean”) audit opinions for 12 consecutive years, the Department has demonstrated its commitment to continuous improvement in its financial management, operations, and reporting.

### **Analysis of Controls, Systems, and Legal Compliance**

The Department is the smallest of the 15 cabinet level agencies in terms of government staff, yet it has the third largest grant portfolio among the 26 federal grant-making organizations. The Department manages the second largest loan portfolio in the federal government. In order to demonstrate effective stewardship of these resources, the Department has to implement effective controls over operations, systems, and financial reporting as described in the Analysis of Controls, Systems, and Legal Compliance section of the report.

The three objectives of internal controls are to ensure the effectiveness and efficiency of operations, reliability of financial reporting and systems controls, and compliance with applicable laws and regulations. The Department categorizes and assesses controls in three categories:

- internal controls over operations,
- internal controls over financial reporting, and
- internal controls over systems.

## About the Department

### Our Mission

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

**Overview.** 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. Today, the Department supports programs that touch on every area and level of education. The Department has approximately 4,200 employees and manages a \$65 billion discretionary appropriation. The Department has [set high expectations](#) for its own employees and is continuously working to improve management practices, ensure fiscal integrity, and develop a culture of high performance.

**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. As a principal office of the Department, Federal Student Aid (FSA) provides about 14 million postsecondary students with low-interest loans, grants, and work-study funds to cover expenses, such as tuition and fees, room and board, books and supplies, and transportation. The Department's early learning, elementary, and secondary programs annually serve approximately 14,000 school districts and 55 million students attending about 99,000 public and 31,000 private schools.

**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 of 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.

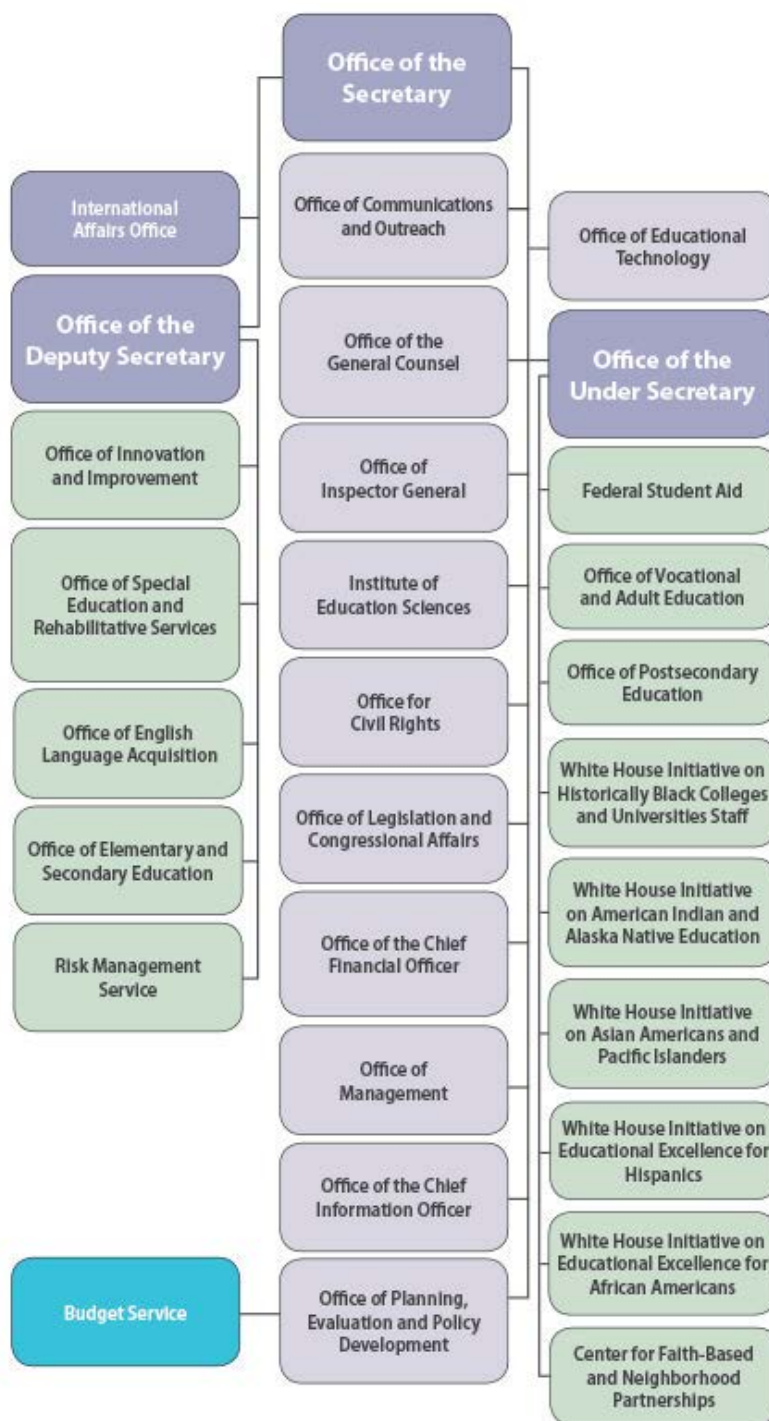
**Organizational Structure.** Our staff is organized as shown in the organizational chart. Links are provided to web pages that provide a detailed [description of the principal offices](#) and [overview of the activities of the Department](#) and [its programs](#).

**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 federal student aid services 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, Ohio.

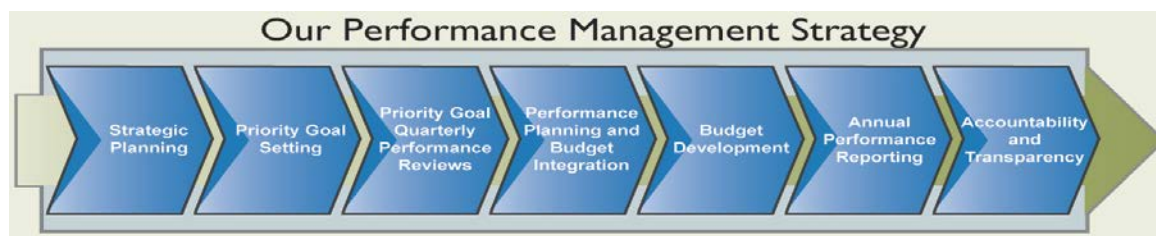
**Web Presence.** The Department maintains [a comprehensive website](#) that focuses on most popular searches, latest news and events, and links to social media.

## Our Organization in Fiscal Year 2013

An [interactive version of this chart](#) is available. Note that [Federal Student Aid](#) is the largest component of the Department. The printed version reflects the Department organization as of September 30, 2013.



## The Department's Approach to Performance Management



### Performance Management Framework

From its mission and core values, the Department is developing an *FY 2014–2018 Strategic Plan* by building upon and updating the current [FY 2011–2014 Strategic Plan](#). In accordance with the [GPRA Modernization Act of 2010](#), the Department's framework for performance management starts with the strategic plan, including its priority goals, which serve as the foundation for establishing overall long-term priorities and developing performance goals, objectives, and measures by which the Department can gauge achievement of its stated outcomes. The Department is currently tying its internal management review process, known as the Quarterly Performance Review (QPR), to its Strategic Objectives Annual Review (SOAR) to inform long-term strategy planning, budgeting practices and fiscal management, staff capacity and effectiveness, and transparency around successes and challenges.

As the Department closes out its FY 2011–2014 plan and migrates to the updated FY 2014–2018 plan, the Department's results are mixed—presenting both accomplishments and challenges moving forward. Of the 35 metrics in the FY 2011–2014 plan, 13 have shown significant progress toward established goals, including such important areas as increased state commitments to high-quality outcome metrics for pre-schools; better use of data to evaluate teachers and colleges, and to help students identify their own strengths and remediate areas where they face challenges; as well as some improvements in the number of [science, technology, engineering, and math \(STEM\)](#) degrees being earned. The nation continues to face serious challenges in promoting high standards while at the same time increasing the number of students who successfully complete their formal education and find employment. Progress towards the Department's strategic and priority goals is measured using data-driven review and analysis. This focus promotes active management engagement across the Department, which ensures alignment to the [Department's Annual Performance Plans and Annual Performance Reports](#).

The *Strategic Plan* for FY 2014–2018 is being developed in collaboration with Congress, state and local partners, and other education stakeholders. The *Strategic Plan* is comprised of six foundational strategic goals and seven priority goals (see pages 18–20). The chart below shows the goals, objectives, and priorities established in the Department's current [FY 2011–2014 Strategic Plan](#). The Department's updated Strategic Plan for FY 2014–2018 largely follows the same goals and general strategic objectives as our previous plan, with six strategic goals that will help to align the Administration's yearly budget requests and the Department's legislative agenda. The FY 2014–2018 plan will be published early in 2014.

## AGENCY MISSION

**Mission:** To promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.

## 2011–2014 STRATEGIC PLAN

### Strategic Goals

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

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

#### Goal 2: *Elementary and Secondary Education.*

Prepare all 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.

### Strategic Objectives

**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.

**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.

### Priority Goals

- Improve students' ability to afford and complete college

- Improve learning by ensuring that more students have an effective teacher
- Demonstrate progress in turning around the nation's lowest-performing schools
- Prepare all students for college and career



Strategic Goals	Strategic Objectives	Priority Goals
<p><b>Goal 3: <i>Early Learning.</i></b> 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.</p>	<p><b>Objective 3.1: <i>Access.</i></b> Increase access to high-quality early learning programs and comprehensive services, especially for children with high needs.</p> <p><b>Objective 3.2: <i>Workforce.</i></b> 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.</p> <p><b>Objective 3.3: <i>Assessment and Accountability.</i></b> Improve the capacity of states and early learning programs to develop and implement comprehensive early learning assessment systems.</p>	<ul style="list-style-type: none"> <li>• Improve outcomes for all children from birth through third grade</li> </ul>
<p><b>Goal 4: <i>Equity.</i></b> 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.</p>	<p><b>Objective 4.1: <i>Continue to Increase the Infusion of Equity Throughout the Department's Programs and Activities.</i></b> Promote and coordinate equity- focused efforts in Departmental programs.</p> <p><b>Objective 4.2: <i>Civil Rights Enforcement.</i></b> Ensure equal access to education and promote educational excellence throughout the nation through the vigorous enforcement of civil rights laws.</p>	
<p><b>Goal 5: <i>Continuous Improvement of the U.S. Education System.</i></b> Enhance the education system's ability to continuously improve through better and more widespread use of data, research and evaluation, transparency, innovation, and technology.</p>	<p><b>Objective 5.1: <i>Data Systems.</i></b> 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.</p> <p><b>Objective 5.2: <i>Research and Evaluation.</i></b> Support multiple approaches to research and evaluation to support educational improvement and Department decision-making.</p> <p><b>Objective 5.3: <i>Transparency.</i></b> Present relevant and reliable information that increases demand for educational attainment and improves educational performance, while maintaining student privacy.</p> <p><b>Objective 5.4: <i>Technology and Innovation.</i></b> Accelerate the development and broad adoption of new, effective programs, processes, and strategies, including education technology.</p>	<ul style="list-style-type: none"> <li>• Make informed decisions and improve instruction through the use of data</li> </ul>
<p><b>Goal 6: <i>U.S. Department of Education Capacity.</i></b> Improve the organizational capacities of the Department to implement this Strategic Plan.</p>	<p><b>Objective 6.1: <i>Effective Workforce.</i></b> Continue to build a high-performing, skilled workforce within the Department.</p> <p><b>Objective 6.2: <i>Programmatic Risk Management.</i></b> Improve the Department's program efficacy through comprehensive risk management and grant monitoring.</p> <p><b>Objective 6.3: <i>Implementation and Support.</i></b> Build Department capacity to support states' and other grantees' implementation of reforms that result in improved outcomes for students.</p> <p><b>Objective 6.4: <i>Productivity and Performance Management.</i></b> Improve workforce productivity through information technology and performance management systems.</p>	

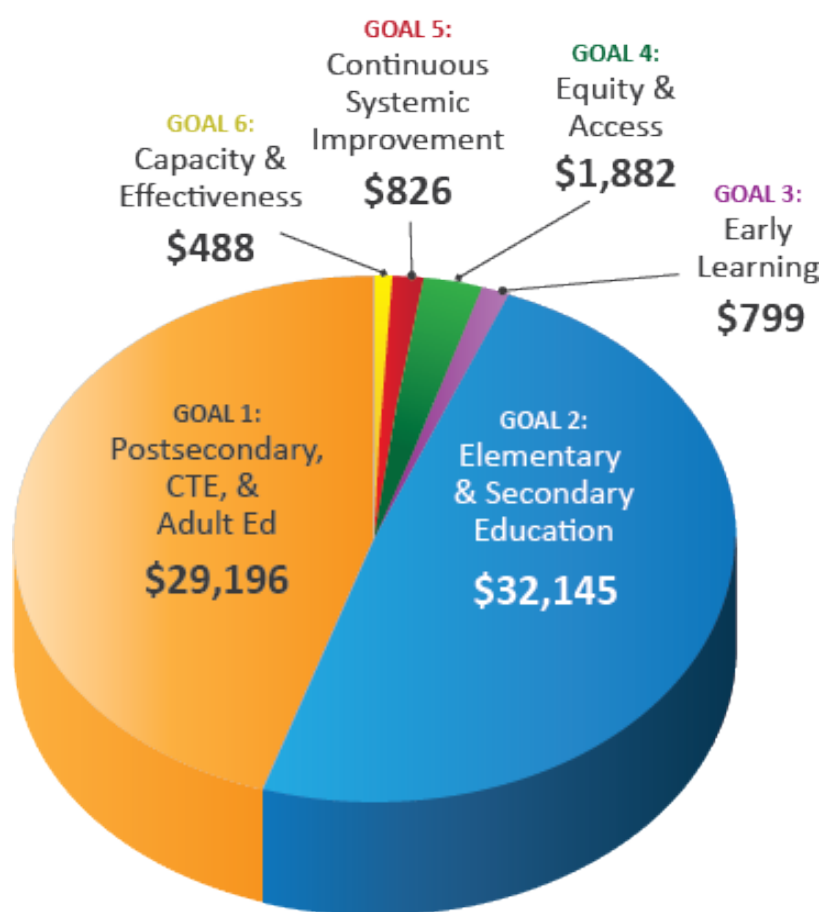
## Discretionary Funding by Goal

The Department is the smallest of the 15 cabinet level agencies in terms of government staff, yet it has the third largest grant portfolio among the 26 federal grant-making organizations, with approximately 4,200 employees and \$65 billion in discretionary appropriations. Its grant making overall represents 26.3 percent of the Department's \$311.7 billion in gross outlays for FY 2013, divided between discretionary and formula grants.

More than 90 percent of the discretionary appropriations are divided among programs and accounts that support state and local education efforts under goals 1, 2, and 3 of the Department's Strategic Plan. In addition, significant amounts are appropriated for federal support in the areas of equity and access, as well as continuous systemic improvement under goals 4 and 5 of the Strategic Plan. Appropriations allocated to goal 6 include management efforts to improve and streamline services offered by the Department and its employees.

For greater detail on the programs and accounts under each goal and other details on performance metrics, see the [Annual Performance Report for FY 2012](#). The [Annual Performance Report for FY 2013](#) will be published in February 2014.

**FY 2013 Discretionary Funding by Strategic Goal**



Notes: Dollars in millions.  
Includes only discretionary funding.

## The Department's Priority Goals

The Department has identified six Agency Priority Goals for FY 2012–13 that serve as a particular focus for its 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. In most cases, progress is reported through the third quarter of FY 2013. Quarterly updates are available on [performance.gov](http://performance.gov).

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

#### **Priority Goal: Improve students' ability to afford and complete college**

**Goal for FY 2012–2013:** 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 goals.

#### ***Supports Strategic Goal 1.***

**Overview:** As more and more jobs require postsecondary education and training, college is becoming a vital necessity for most Americans. Yet too many students fail to complete college and are burdened by high student loan debt. Institutions raise tuition and fees as states cut education funding for postsecondary institutions. Even with increased federal Pell Grant funding, many Americans remain concerned about whether they can afford the high cost of college. Many Americans do not know about or are confused by the maze of information that is available about colleges and how to pay for college. To help students and their families make decisions about college, the Department has developed a number of resources, such as [College Navigator](#), the [College Affordability and Transparency Center](#), and the [Net Price Calculator](#). In order to meet the national goal to increase the number of college graduates, the Department is committed to helping states and institutions increase the number and percentage of students who complete their postsecondary educations.

The Department will support college completion by identifying and promoting successful evidence-based practices and by highlighting noteworthy state efforts in key areas such as transfer, performance-based funding, and college-and-career readiness. The Department has achieved the goal that was set to implement the College Scorecard. The challenge that remains is that the Department must work with the federal Consumer Financial Protection Bureau to ensure that its Paying for College tool complements and aligns with the data used in the scorecard. Regarding state completion goals, the primary obstacle is that the Department has little influence over states' decisions to set goals.

**Progress:** The scorecard was released in tandem with the President's State of the Union address in February. This is a first version of the scorecard, with future versions to incorporate additional information, such as earnings data once logistical issues for obtaining such data have been addressed. The number of states with completion goals has grown from 38 to 40 since November 2012 (completion defined as either attainment, graduation, or degree production), with a variety of target dates and levels of specificity. The Department has little influence over state decisions to establish goals, although it continues to encourage goal setting and highlight states that have goals in speeches, editorials, and conversations.

## **Priority Goal: Improve learning by ensuring that more students have an effective teacher**

**Goal for FY 2012–2013:** 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.

### ***Supports Strategic Goal 2.***

**Overview:** The Priority Goal is based on the premise, supported by abundant research, that teachers are the single most critical in-school factor in improving student achievement. Principals are often cited as the second most influential in-school factor. Teacher and principal evaluation systems supported by the Department's contributing programs enable the development and identification of effective educators and provide the needed information to improve the educator workforce or provide incentives to teach in challenging schools or shortage areas.

The Department will help strengthen the profession by focusing on meaningful feedback, support, and incentives at every stage of a career, based on fair evaluation systems that look at multiple measures, including, in significant part, student growth.

The Department will support state and district efforts that provide time for teacher collaboration, on-the-job learning opportunities, and professional advancement. As states transition to new college- and career-ready standards, the Department will support opportunities for teachers to enhance their instructional expertise related to the new standards.

The Department continues to ensure adherence to timelines regarding development and adoption of state requirements for comprehensive teacher evaluation systems and for district development and implementation of comprehensive educator evaluation systems.

Current challenges center on maintaining momentum for reform, given districts' and states' current fiscal situation, potential changes in leadership, ongoing development of student growth measures in non-tested grades and subjects, and the scaling up of systems in a relatively short time frame. Another challenge relates to the coordination required of the Department's programs to ensure policy and communications consistency. With multiple programs interacting with the same grantees (e.g., states and districts), to a varying degree, it will take a significant shift in the Department's culture to break down silos to improve coordination.

**Progress:** The Department has made significant progress in leveraging its programs to support state- and district-led efforts to ensure that more students have effective teachers by better training, recruiting, identifying, and retaining 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 [Recognizing Educational Success, Professional Excellence, and Collaborative Teaching \(RESPECT\)](#) project and the [Teacher Incentive Fund \(TIF\)](#);
- encouraging school districts to leverage best practices to recruit and retain effective teachers (through TIF grants);

- encouraging the development and adoption of innovative strategies to transform the teaching profession that will ultimately impact student outcomes through TIF, Investing in Innovation (i3), and other grants; and
- creating a critical mass of states that have created the conditions for education innovation and reform through [Race to the Top](#) (RTT), *Elementary and Secondary Education Act* (ESEA) Flexibility, [School Improvement Grants](#) (SIG), and other initiatives.

As a result of these efforts:

- Twenty-five (25) states have received approval of their evaluation system guidelines through either ESEA Flexibility (21 states) and/or Race to the Top (4 additional states).
- Race to the Top states plan to have 2,012 participating local educational agencies (LEAs) with qualifying evaluation systems for teachers in the 2012–2013 school year.
- Race to the Top states plan to have 1,978 participating LEAs with qualifying evaluation systems for principals in the 2012–2013 school year.
- ESEA Flexibility States plan to have all LEAs with qualifying teacher and principal evaluation systems ready to implement in the 2014–2015 school year.
- And 213 LEAs are implementing evaluation systems under the SIG Transformation Model.
- In addition, 162 LEAs are implementing reformed educator evaluation systems as part of a TIF 3 (2010) grant. 159 LEAs plan to have reformed educator evaluation systems ready to implement in the 2013–2014 school year as part of a TIF 4 (2012) grant.

### **Priority Goal: Demonstrate progress in turning around the nation's lowest-performing schools**

**Goal for FY 2012–2013:** 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.

#### ***Supports Strategic Goal 2.***

**Overview:** The goal seeks to prepare all K-12 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.

Through RTT, the SIG program, ESEA Flexibility, and other federal programs, the Department is providing significant resources to dramatically improve the nation's lowest-achieving schools by using intensive turnaround models and identifying the low-achieving schools that are showing strong evidence of successfully turning around.

The Department is focused on supporting innovation, not just compliance monitoring, and is focused on spurring growth in achievement, not just absolute achievement measures as done in the past. Central to these efforts has been the creation of the [Office of School Turnaround](#) (OST). Through OST's monthly check-in calls with all 50 states, the School Turnaround Learning Community, and the many OST-facilitated peer-to-peer learning opportunities, states, districts, and schools are learning from each other and scaling up promising practices. In order to better provide technical assistance and support for what is working, OST has created a National Activities Plan to effectively use up to 5 percent of the more than \$500 million annual SIG program.



Key barriers and challenges include:

- sustainability of reforms in schools as SIG grants end;
- capacity challenges at state, district, and school level mean some intervention challenges persist;
- insufficient focus on comprehensive turnaround efforts at the state and district level, including alignment of SIG, Race to the Top, and ESEA Flexibility; and
- lack of quality and completeness data/knowledge allows others to define success.

Engagement with external stakeholders includes the following:

- The Department implemented a communications plan that prioritizes regional and local media outreach to share promising stories and proven practices.
- And conducted several outreach events, including SIG/turnaround forum with external stakeholders.

### **Progress:**

- The federal government has made significant investments in turning around the nation's persistently lowest-achieving schools, in large part through SIG, RTT, and the Department's work to grant states flexibility regarding specific requirements of the *No Child Left Behind Act of 2001* (NCLB).
- With more than 1,400 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.
- Thirty-four (34) states and the District of Columbia are carrying out plans to implement turnaround principles in their priority schools under their Department-approved ESEA Flexibility plan.
- Overall, from 2009–10 to 2010–11, 64 percent of SIG schools increased their student proficiency rates in reading, and 65 percent increased their student proficiency rates in math. The remaining SIG schools showed similar proficiency rates or decreases in proficiency rates over these two years. Because there are so many factors that contribute to student proficiency rates, and because these data are only based on one year of SIG implementation, it is not certain that it is attributable to the SIG program.
- Office of School Turnaround has profiled nearly 100 states, districts, and schools implementing promising school turnaround practices, and is using National Activities funds to profile 100 more to eventually share publicly.

**Priority Goal: Prepare all students for college and career**

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**Goal for FY 2012–2013:** By September 30, 2013, all states will adopt internationally-benchmarked college- and career-ready standards.

***Supports Strategic Goal 2.***

**Overview:** The adoption of internationally-benchmarked college- and career-ready standards is the foundation to improving educational outcomes for all students and a fundamental step toward meeting the goal of once again having the highest proportion of college graduates in the world by 2020. The Department is working to increase the number of states approved for ESEA Flexibility, those that have adopted college- and career-ready standards, by working with states that submitted ESEA Flexibility requests to meet the high bar for approval. The Department is developing and targeting technical assistance activities that will, in part, increase state capacity to leverage limited resources and continue to identify promising practices across multiple states.

For example, the Department will build a bank of data to assist in full and effective transition to college- and career-ready standards developed or identified by other Department offices to leverage resources across the agency. Second, the Department is working internally to coordinate the provision of technical assistance across RTT, ESEA Flexibility, and other related programs. And, in the most recent Comprehensive Centers competition, the Department created a Center on Standards and Assessments Implementation that will help build the capacity of state educational agencies to implement college- and career-ready standards. The Department has met with stakeholders to provide information on state plans, as well as to enlist external support and technical assistance for states and districts as they move forward with implementing the new standards.

**Progress:** Forty-six (46) states and the District of Columbia (47 total) have adopted college- and career-ready standards through adoption of the Common Core State Standards.

Through their [ESEA Flexibility](#) requests, 47 states, the District of Columbia, Puerto Rico, and the Bureau of Indian Education have, as of the 2nd quarter, submitted evidence of formal adoption of college- and career-ready standards and provided plans to transition to those standards by 2013–2014. In February 2013, three states (Pennsylvania, Texas, and Wyoming) submitted requests for flexibility. More states may yet request flexibility in the coming months. The total number of states that submitted and that have been approved (39 states and the District of Columbia) to date is significantly more than the Department initially anticipated as nearly all states have requested flexibility and states have been generally willing to make changes to their requests needed to meet ESEA Flexibility principles.

Because of the iterative approach to approval, and the high bar set for states, the Department has not set specific targets for approval but has worked with states individually to meet the high bar. Some states are unable to meet that bar at this time.

## Priority Goal: Improve outcomes for all children from birth through third grade

**Goal for FY 2012–2013:** 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.

### *Supports Strategic Goal 3.*

**Overview:** To enhance the quality of early learning programs and improve outcomes for children from birth through third grade, including children with disabilities and those who are English learners, the Department will promote initiatives that improve the early learning workforce, build the capacity of states and programs to develop and implement comprehensive early learning assessment systems, and improve systems for ensuring accountability of program effectiveness.

The nine Race to the Top - Early Learning Challenge (RTT-ELC) FY 2011 grantees all have high-quality plans as evidenced by their winning an RTT-ELC grant and addressing these criteria in their applications and will report disaggregated data on the status of children at kindergarten entry. With the addition of the RTT-ELC FY 2012, four states were added. RTT-ELC states are just beginning to develop or enhance these instruments and are limited to using funds other than those provided under the program. Because of sequestration and a slow economic recovery, there are few state resources to support development of appropriate instruments and the implementation of the assessments. Grantees report that they may not meet their proposed implementation date. In addition, the Department would like to have a national picture, but there are currently no organizations that collect data on state activities around Kindergarten Entry Assessment (KEA) implementation.

**Progress:** The nine FY 2011 grantees' Annual Performance Reports (APRs), Summaries, and Response Letters have been posted on the RTT-ELC program page (<http://www2.ed.gov/programs/racetothetop-earlylearningchallenge/performance.html>).

The APRs asked states if they made progress in developing a KEA that is 1) aligned with standards, 2) valid for the target population and purpose, 3) administered by the 2014–15 school year, 4) reported to the Statewide Longitudinal Data System, and 5) significantly funded outside of the RTT-ELC grant. Six states reported progress in all 5 of the progress areas, while Massachusetts reported progress in 4 of the 5, noting that they have not been able to find funding for the project outside of the grant. Three states made it clear that they would not be able to implement the KEA by the 2014–15 school year.

On April 16, 2013, the Departments of Education and Health and Human Services announced they will invest the majority of the 2013 Race to the Top funds (\$370 million) for both a new competition and to provide supplemental awards for six state grantees—California, Colorado, Illinois, New Mexico, Oregon, and Wisconsin—who had only received 50 percent of their initial request.

Final Scopes of Work and Amendment Letters for the nine FY 2011 grantees have been posted on the RTT-ELC program page (<http://www2.ed.gov/programs/racetothetop-earlylearningchallenge/awards-phase-1.html>).

**Race to the Top - Early Learning Challenge States on track to reach the goal:** California, Colorado, Delaware, Illinois, Maryland, Massachusetts, Minnesota, New Mexico, North Carolina, Ohio, Oregon, Rhode Island, and Washington.

**Race to the Top - Early Learning Challenge States not on track to reach the goal:** Wisconsin.

**Priority Goal: Make informed decisions and improve instruction through the use of data**

**Goal for FY 2012–2013:** By September 30, 2013, all states will implement comprehensive statewide longitudinal data systems (SLDS).

***Supports Strategic Goal 5.***

**Overview:** The Department will facilitate the development of interoperable state data systems from early learning through the workforce and will provide support to the education community, including teachers and administrators, on how to understand and appropriately use data to inform policies, instructional practices, and leadership decisions.

Key barriers and challenges include districts' and states' limited resources; state procurement practices; lack of engagement with needed district and state stakeholders; difficulties with cross-agency governance and data sharing; ongoing leadership changes at state educational agencies (SEAs), partner agencies, and at the state level; misconceptions about data collection and the *Family Educational Rights and Privacy Act* (FERPA); state laws, and other regulations related to privacy and confidentiality; lack of training on how to use data to make policy and instructional decisions; and concerns from stakeholders about the long-term sustainability of data systems without long-term federal funding.

Cross-sector linkages between K-12, early childhood, postsecondary, and workforce require a champion outside the SEA (e.g., a governor's office) but political support for widespread data collection and linkage varies. Additionally, state education and labor agencies are relatively new partners so they are figuring out how to work together. The Department is implementing new, [targeted technical assistance to increase states' capacity](#) to support statewide longitudinal data systems after federal funding. Additionally, the Department meets with state leadership to affirm their support for and commitment to use SLDS data to make educational improvements, but there is a need for the Department and the Department of Labor (DOL) to provide guidance and resources to states to encourage secure linking of education and workforce records.

**Progress:** [SLDS grants](#) were awarded to 14 states in November 2005 (FY 2006 grantees), 12 additional states and the District of Columbia in June 2007 (FY 2007 grantees), 27 states—including 15 new states—in March 2009 (FY 2009 grantees), 20 states in May 2010 (FY 2009 *American Recovery and Reinvestment Act* grantees), and 24 states and territories—including 6 new states and 2 new territories—in June 2012 (FY 2012 grantees). 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 DC to have a functioning K-12 SLDS, 12 states to link with early childhood systems, 21 states to link with postsecondary data from state institutions, and 10 to link with labor. Labor linkages have presented the largest challenges for states due to the lack of a common ID, multiple privacy laws, and multi-agency coordination. The Department has increased coordination with DOL and the Workforce Data Quality Initiative grants program, including joint sessions at an annual

grantee conference. Additionally, fewer states are ready to link to early childhood data, as evidenced in the low number of Priority 2 FY 2012 applications. The Department is creating a series of best practice materials in early childhood and held a privacy workshop for states on sharing early childhood data.

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

## Cross-Agency Priority Goals

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

**Broadband:** As part of expanding all [broadband](#) capabilities, ensure 4G wireless broadband coverage for 98 percent of Americans by 2016.

**Veteran Career Readiness:** Improve career readiness of veterans. By September 30, 2013, increase the percent 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.

**Job Training:** Ensure our country has one of the most skilled workforces in the world by preparing 2 million workers with skills training by 2015 and improving the coordination and delivery of job training services.

**Science, Technology, Engineering, and Math (STEM) Education:** In support of the President's goal that the U.S. have the highest proportion of college graduates in the world by 2020, the federal government will work with education partners to improve the quality of STEM education at all levels to 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.

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

## Looking Ahead and Addressing Challenges

Education is key to the nation's long-term economic prosperity and is an investment in its future. A highly educated workforce is necessary for American competitiveness in the global economy. The Department continues to maintain strong support for traditional state formula grant programs while continuing to fund competitive initiatives, including [Race to the Top](#), [Promise Neighborhoods](#), [Investing in Innovation](#) (i3) grants, and a redesigned [School Improvement Grants](#) program. Almost every state is supporting higher standards that ensure students will be college- and career-ready.

The United States is seeing the highest high school graduation rate in three decades, and over the past four years, postsecondary financial assistance available to students and families has increased significantly. Moreover, the Department has seen an increase of more than 50 percent in the number of students accessing higher education on Pell Grants.

Finally, the Department's efforts to support and strengthen the teaching profession through improved teacher evaluation and professional development are predicted to pay long-term dividends.



Going forward, the Department will build on what it has already established:

- state-driven accountability that demands progress for all children;
- high-quality early education for more low-income children;
- more flexibility for state decision-making;
- more support for principals and teachers to apply high standards to practice;
- reforming career education in high schools and community colleges; and
- reforming and simplifying the application process for student aid to help drive college affordability and completion.

The Department cannot stop here, however. It needs to continue to strengthen the support systems necessary for all students to reach the middle class and beyond. Pre-school should be accessible for all students. The Department needs to fund a set of K-12 strategic reforms, including improving teaching to improve learning and making schools safer. The Department needs to ensure that college is more affordable. Ultimately, the Department looks to creating ladders of opportunity to help students living in poverty advance beyond their means.

The Department's 2014–2018 *Strategic Plan* stands on a foundation of six strategic goals:

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

Goal 2: Elementary and Secondary Education. Improve the elementary and secondary education system's ability to consistently deliver excellent instruction aligned with rigorous academic standards while providing effective support services to close achievement and opportunity gaps, and ensure all students graduate high school college- and career-ready.

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.

Goal 4: Equity. Increase educational opportunities for and reduce discrimination against underserved students so that all students are well-positioned to succeed.

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, evidence, transparency, innovation, and technology.

Goal 6: U.S. Department of Education Capacity. Improve the organizational capacities of the Department to implement this strategic plan.

The challenges to achieving these goals lie in the Department's capacity and funding. The Department must focus on ways to thrive in a climate that is resource constrained. In addressing capacity, the Department will invest in the continuous improvement of a skilled, diverse, and engaged workforce to improve productivity and communication. Competencies will be modernized and sharpened, processes will be streamlined, and succession planning will be ongoing so that there is no break in effective leadership or direction.

The Department will employ comprehensive risk management and grant and contract monitoring to ensure prudent use of public dollars by mitigating risk through increased oversight and support of grantees and contractors.

The Department will build systems to support states' and grantees' implementation of reforms that result in improved outcomes. To this end, the Department will keep the public informed of promising practices and new reform initiatives that result from federal investment and new relationships that have been enabled by innovations afforded by grant initiatives and through use of the latest technologies.

Regarding funding, the Department, as others, faces fiscal uncertainty. Over the past few years, the Department has achieved savings through hiring more slowly and reducing lease costs, utilities, travel, printing, supplies, and some contract costs. Through careful management of funds, the Department was able to avert furloughing employees in FY 2013 so that our customers and stakeholders continued to receive the best possible service. The Department will continue to meet the financial challenge head-on, always with efficiency and responsibility in mind as it complies with the *Balanced Budget and Emergency Deficit Control Act*.

The Department continues to have concerns about interest and default rates on student loans. It will work toward more collaboration with other federal government agencies around science, technology, engineering, and mathematics (STEM) initiatives and with the Department of Health and Human Services on early learning.

The Department sees education as the foundation for a strong national economy. Working with partners and colleagues in Congress, the states, and across the education community, the Department's primary focus will be on the students, who are the reason for its existence.

**Enhancing Education Systems and Support:** The Department strives to leverage its data, evaluation, performance, and financial systems to meet four important aspects of its mission:

- To contribute to the Department's ability to build customer relations by providing timely responses to customer inquiries.
- To empower employees to make informed decisions by increasing their access to data.
- To increase accountability through improved financial management.
- To keep Department employees informed of project status and ensure that all users receive proper training on new systems.

Finally, as the Department transitions to its new *Strategic Plan* for FY 2014–2018 during the coming year, as an organization it will have charted a roadmap for future success and will continue to evaluate how best to accomplish its strategic goals and objectives during these fiscally challenging times. The new plan is intended to help the Department refine its course and better focus performance within the framework of the *GPR Modernization Act of 2010*.

The six Department *Strategic Plan* goals guide the day-to-day work of the Department's staff. This plan will help to align the administration's yearly budget requests and the Department's legislative agenda. Continuous improvement rests on ongoing cycles of assessing performance, examining data, and improving practices. Creating a culture of continuous improvement is at the heart of the Department's efforts to work with and support elementary, secondary, and postsecondary educators and policy makers at the federal, state, and local levels.

Accomplishing all of this plan's priorities will require strong coordination and collaboration from Department staff working with Congress, partners at the state and local levels, and all other

stakeholders. This includes meeting numerous legislative challenges. In addition, state and federal fiscal constraints may impact the Department's ability to provide the necessary incentives and resources to increase quality, transparency, and accountability.

**Reporting on Progress Made on Strategic Goals and Objectives:** The Department will continue to use tools such as quarterly reviews to ensure progress toward achieving strategic goals and outcomes. The Department's strategic goals align with government-wide goals and priorities and translate to specific organizational goals. The Organizational Performance Review will continue to be a paramount process for setting goals at the principal office level. These goals will cascade down to the individual employee level through Senior Executive Service plans and through the Department's individual performance plans and metrics.

To support the tracking and reporting of progress against the goals and objectives, the Department has created and is developing its data profile on <http://www.performance.gov> for key policy and programmatic topics. It is also creating a set of information dashboards and data analysis tools to provide more relevance and context for senior leaders in gauging the impact of individual and collective performance, and in overall strategic decision making.

The effective implementation of the Department's priority and strategic goals will depend, in part, on the effective use of high-quality and timely data, including evaluations and performance measures, throughout the lifecycle of policies and programs. The Department is committed to increasing the number of programs and initiatives that are evaluated using methods that include those consistent with the What Works Clearinghouse Evidence Standards and incorporating cost-effectiveness measures into evaluations and program improvement systems.

Department of Education's FY 2014–2015 Priority Goals	
<b>Improve students' ability to complete college</b>	By September 30, 2015, increase degree attainment among 25–34-year-old age cohort to 45.6 percent.
<b>Support implementation of college- and career-ready standards and assessment</b>	By September 30, 2015, at least 50 states will have adopted college and career-ready standards.  By September 30, 2015, at least 50 states will be implementing next-generation assessments, aligned with college- and career-ready standards.
<b>Improve learning by ensuring that more students have effective teachers and leaders</b>	By September 30, 2015, at least 37 states will have fully implemented teacher and principal evaluation and support systems that consider multiple measures of effectiveness, with student growth as a significant factor.
<b>Turn around and close achievement gaps in low-performing schools</b>	By September 30, 2015, decrease the number of high schools with low graduation rates to 1,285.
<b>Support comprehensive early learning assessment systems</b>	By September 30, 2015, at least nine states will be collecting and reporting disaggregated data on the status of children at kindergarten entry using a common measure.
<b>Ensure equitable educational opportunities</b>	By September 30, 2015, increase the national high school graduation rate to 83 percent, as measured by the Adjusted Cohort Graduation Rate; decrease disparities in the national high school graduation rate among minority students, students with disabilities, English learners, and students in poverty.
<b>Enable evidence-based decision making.</b>	By September 30, 2015, at least 11 percent of select new <sup>1</sup> (non-continuation) discretionary grant dollars will reward evidence.

<sup>1</sup> A list of reform-directed grant programs will be provided. New grant dollars that "reward evidence" include all dollars awarded as a result of addressing tiered-evidence as either eligibility threshold (e.g., i3 competition), absolute priority, competitive priority (earning at least one point for it), or selection criteria (earning at least one point for it).

## Financial Highlights

### Introduction

This section provides summarized information and analyses of the Department's assets, liabilities, net position, sources and uses of funds, program costs, and related trend data. It is intended to help increase the AFR users' understanding of the Department's business processes and provide a high-level perspective of the detailed information contained in the financial statements and related notes.

The Department consistently produces accurate and timely financial information. Our financial statements and notes are prepared in accordance with accounting principles generally accepted in the United States for federal agencies issued by the Federal Accounting Standards Advisory Board (FASAB) and the Office of Management and Budget (OMB), specifically in Circular No. A-136, *Financial Reporting Requirements*. The financial statements, notes, and underlying business processes, systems, and controls are audited by an independent accounting firm with audit oversight provided by the Office of Inspector General (OIG). For twelve consecutive years, the Department has earned an unqualified (or "clean") audit opinion. The financial statements and notes for FY 2013 are on pages 45–89 and the Independent Auditors' Report begins on page 94.

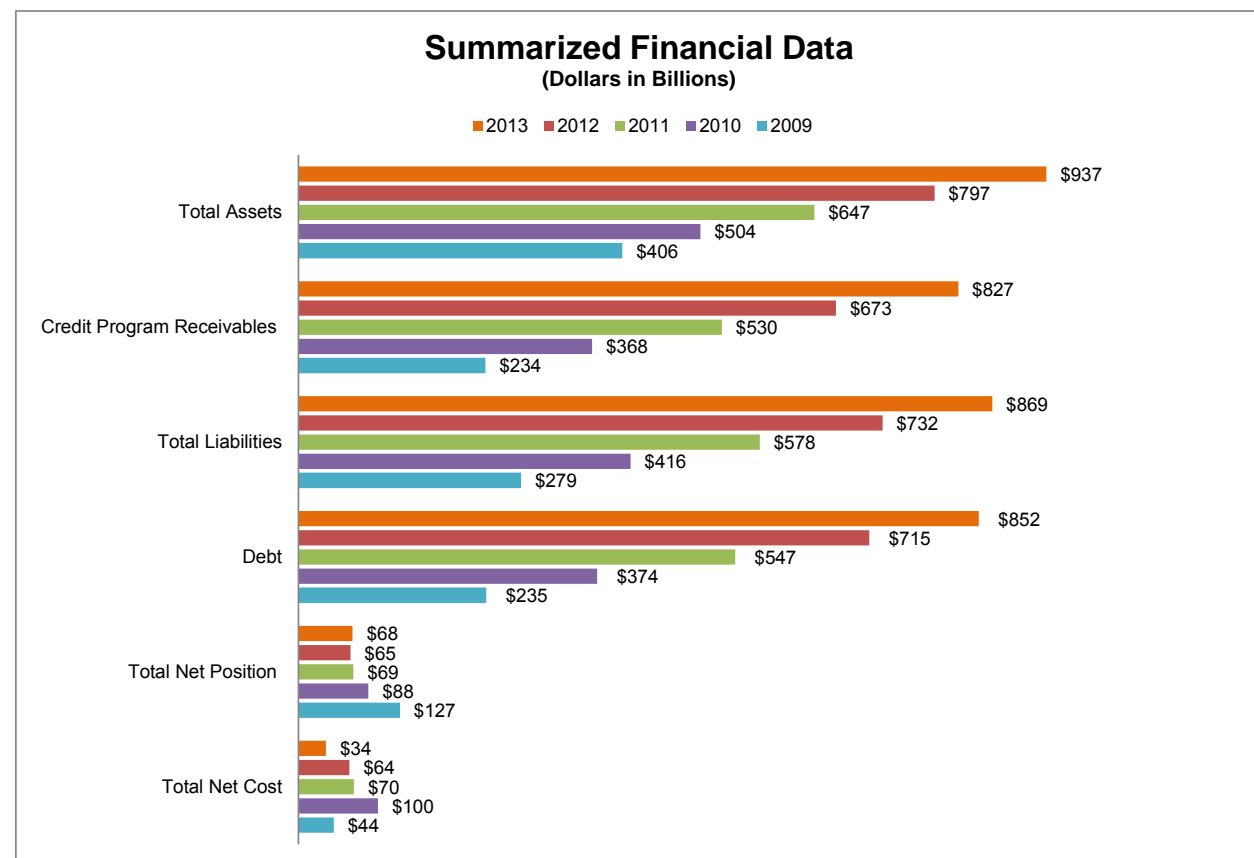
Management's assessment of internal controls in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*, provides the Department with credibility to external stakeholders and confidence that financial data produced from its underlying financial systems and business processes are complete, correct, and reliable. This ensures the financial statements conform with applicable federal reporting requirements, the Department has trustworthy financial information for good decision-making, and various reports can be produced for both internal and external stakeholders.

### Trend Analysis

The tables below summarize trend information about components of the Department's financial condition. The Table of Key Measures below summarizes trend information about components of the Department's financial condition and offers a snapshot of the Department's financial condition as of September 30, 2013, compared with the end of fiscal years 2012–2009, displaying net cost, assets, liabilities, and net position. The Summarized Financial Data graphic is a presentation of the table data, rounded to the billions, for an alternate display over the same five consecutive years.

Table of Key Measures						
As of September 2013, 2012, 2011, 2010, 2009						
(Dollars in Millions)						
	% Change FY 13/FY 12	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
<b>Costs</b>						
Gross Cost	-31%	\$ 61,353	\$ 89,263	\$ 89,910	\$ 116,953	\$ 55,412
Earned Revenue	+5%	(26,881)	(25,490)	(20,397)	(17,279)	(11,251)
<b>Total Net Cost of Operations</b>	<b>-46%</b>	<b>\$ 34,472</b>	<b>\$ 63,773</b>	<b>\$ 69,513</b>	<b>\$ 99,674</b>	<b>\$ 44,161</b>
<b>Net Position</b>						
Fund Balance with Treasury	-11%	\$ 108,732	\$ 121,993	\$ 114,085	\$ 132,259	\$ 168,032
Credit Program Receivables, Net	+23%	826,684	673,488	530,491	367,904	234,254
Other	+14%	1,642	1,446	1,966	3,501	3,659
<b>Total Assets</b>	<b>+18%</b>	<b>937,058</b>	<b>796,927</b>	<b>646,542</b>	<b>503,664</b>	<b>405,945</b>
Debt	+19%	852,432	715,303	547,108	374,335	235,385
Liabilities for Loan Guarantees*	-100%	-	1,037	10,025	14,479	20,543
Other	+9%	16,783	15,432	20,824	27,248	22,957
<b>Total Liabilities</b>	<b>+19%</b>	<b>869,215</b>	<b>731,772</b>	<b>577,957</b>	<b>416,062</b>	<b>278,885</b>
Unexpended Appropriations	-2%	71,371	72,686	71,729	94,371	127,269
Cumulative Results of Operations	+53%	(3,528)	(7,531)	(3,144)	(6,769)	(209)
<b>Total Net Position (Assets minus Liabilities)</b>	<b>+4%</b>	<b>\$ 67,843</b>	<b>\$ 65,155</b>	<b>\$ 68,585</b>	<b>\$ 87,602</b>	<b>\$ 127,060</b>

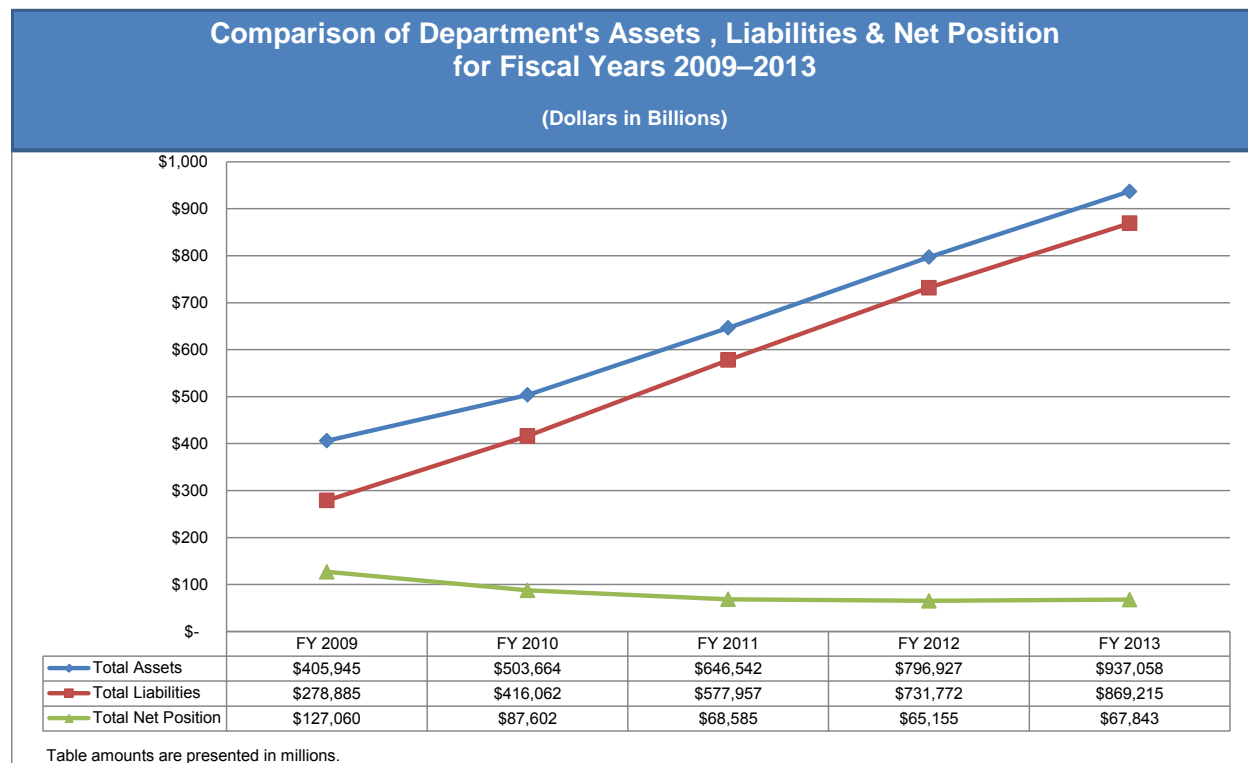
\* The presentations of the FY 2012 and earlier Liability for Loan Guarantees is in the Liability section of the Department's Balance Sheet; however, the presentation of the same F Y 2013 liability is in the Credit Program Receivables, Net Balance Sheet line item, due to its negative value.





## Balance Sheet

The Consolidated Balance Sheet is “as of a particular date” in time (the end of the fiscal year) and provides descriptions of Department “assets,” “liabilities,” and the difference, which is known as “net position.”

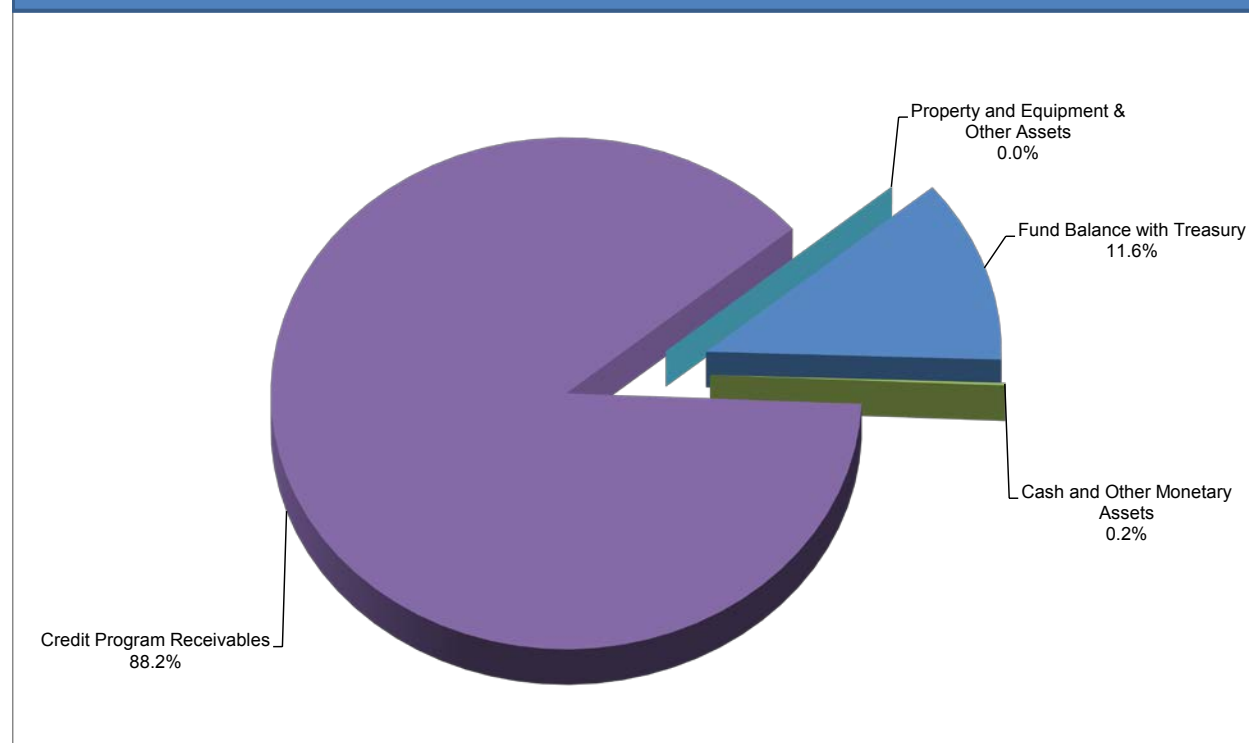


## Analysis of Assets

Assets of the Department totaled \$937.1 billion as of September 30, 2013, an increase of about 18 percent over the FY 2012 balance. The vast majority of the increase in assets relates to the Credit Program Receivables, which increased by \$153.2 billion, a 23 percent increase over FY 2012. This Credit Program Receivables increase is largely the result of Direct Loan disbursements for new loan originations and Federal Family Education Loan (FFEL) consolidations, net of borrower principal and interest collections, which increased the net portfolio for Direct Loans by \$129.5 billion (\$27.4 billion was disbursed for consolidated loans). Total Assets are primarily comprised of Credit Program Receivables.

The presentation of the FY 2012 Liability for Loan Guarantees is in the liability section of the Department's Balance Sheet, while the presentation of the FY 2013 liability is in the Credit Program Receivables, Net line item which is presented in the assets section of the Balance Sheet.

**Composition of Assets**  
As of September 30, 2013  
(\$937.1 Billion)



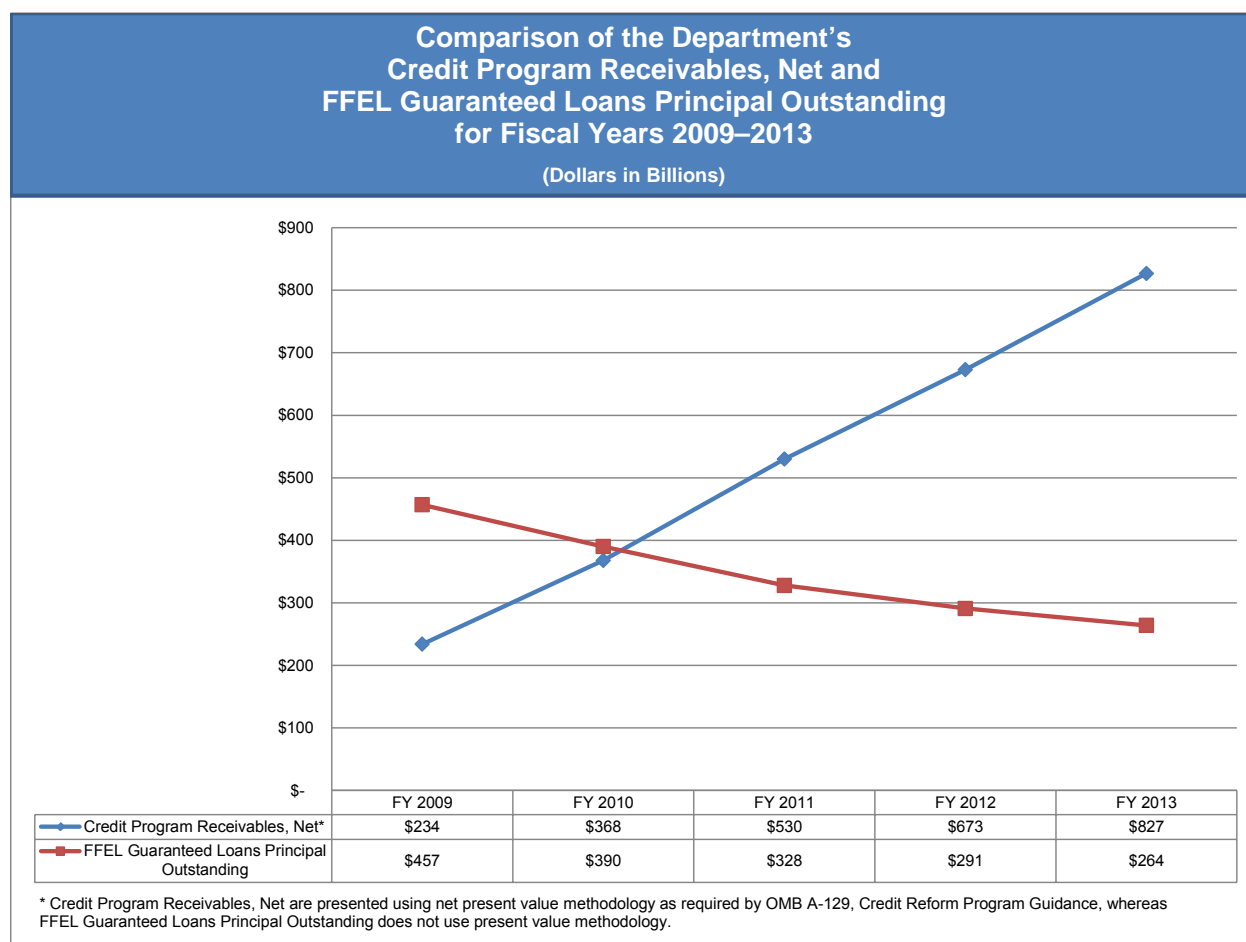
**Assets as of September 30, 2013 and 2012**

(Dollars in Millions)

		2013	2012
Fund Balance with Treasury	\$	108,732	\$ 121,993
Cash and Other Monetary Assets		1,482	1,307
Credit Program Receivables		826,684	673,488
Other Assets*		160	139
<b>Total Assets</b>	<b>\$</b>	<b>937,058</b>	<b>\$ 796,927</b>

\* The Other Assets amount includes Accounts Receivable, Property and Equipment, and Other.

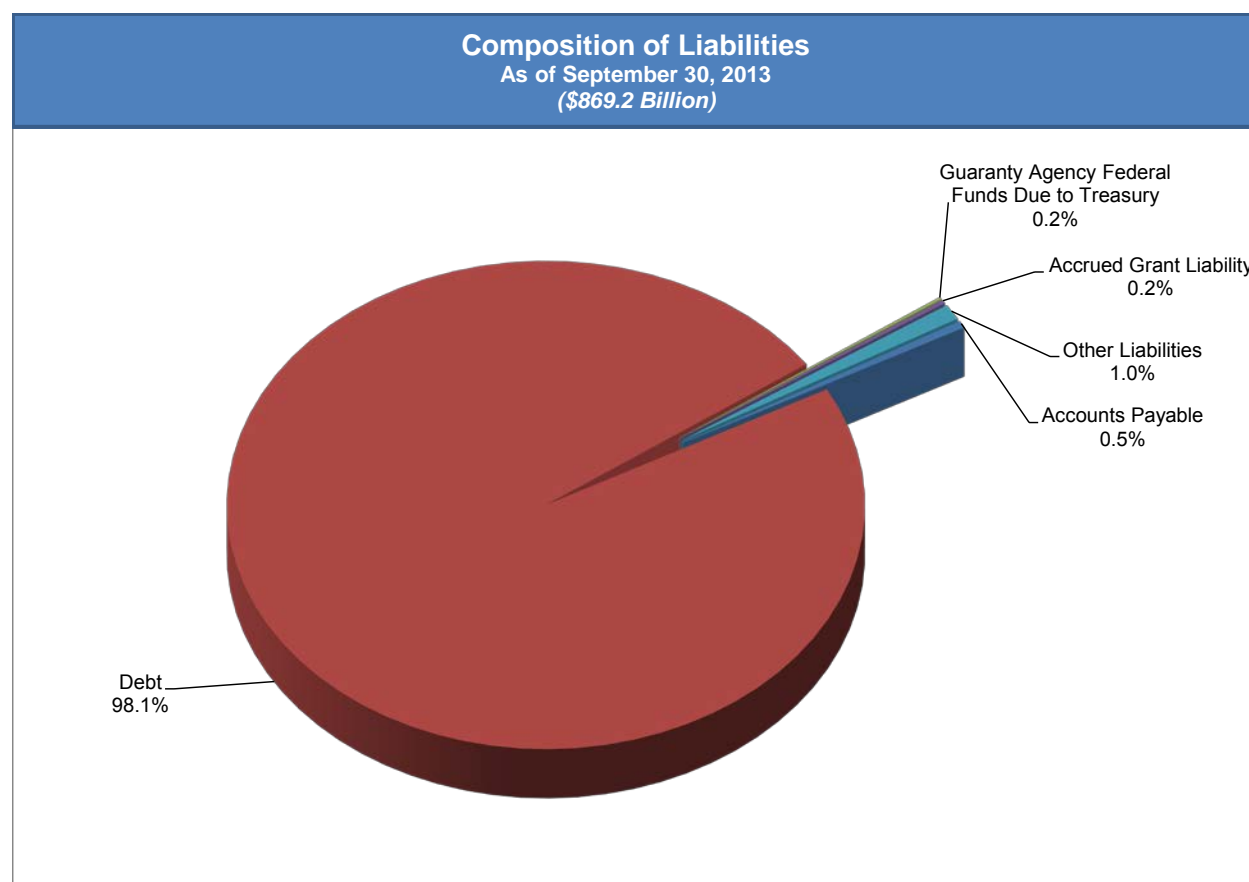
The chart below depicts the Department's shift in the composition of its student loan portfolio from guaranteed to direct loans. While there has been a pronounced increase in the Direct Loan Program, FFEL Guaranteed Loans have been shrinking because no new FFEL Loans were made after June 30, 2010. This shift is in accordance with the provisions of the *SAFRA Act*, which has required the transition for new loans to full direct lending instead of guaranteeing the loans provided by the private sector.



## Analysis of Liabilities

Liabilities of the Department totaled \$869.2 billion as of September 30, 2013, an increase of about 19 percent over the FY 2012 balance. The increase is the result of current year borrowing from Treasury (Debt) 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 \$137.1 billion increase in Debt. Total Liabilities are primarily made up of Debt resulting from Credit Program Receivable activity.

The presentation of the FY 2012 Liability for Loan Guarantees is in the liability section of the Department's Balance Sheet, while the presentation of the FY 2013 negative liability is in the Credit Program Receivables Balance Sheet line item. As mentioned above, with the *SAFRA Act* legislation, the Department ceased to guarantee loans after June 30, 2010.



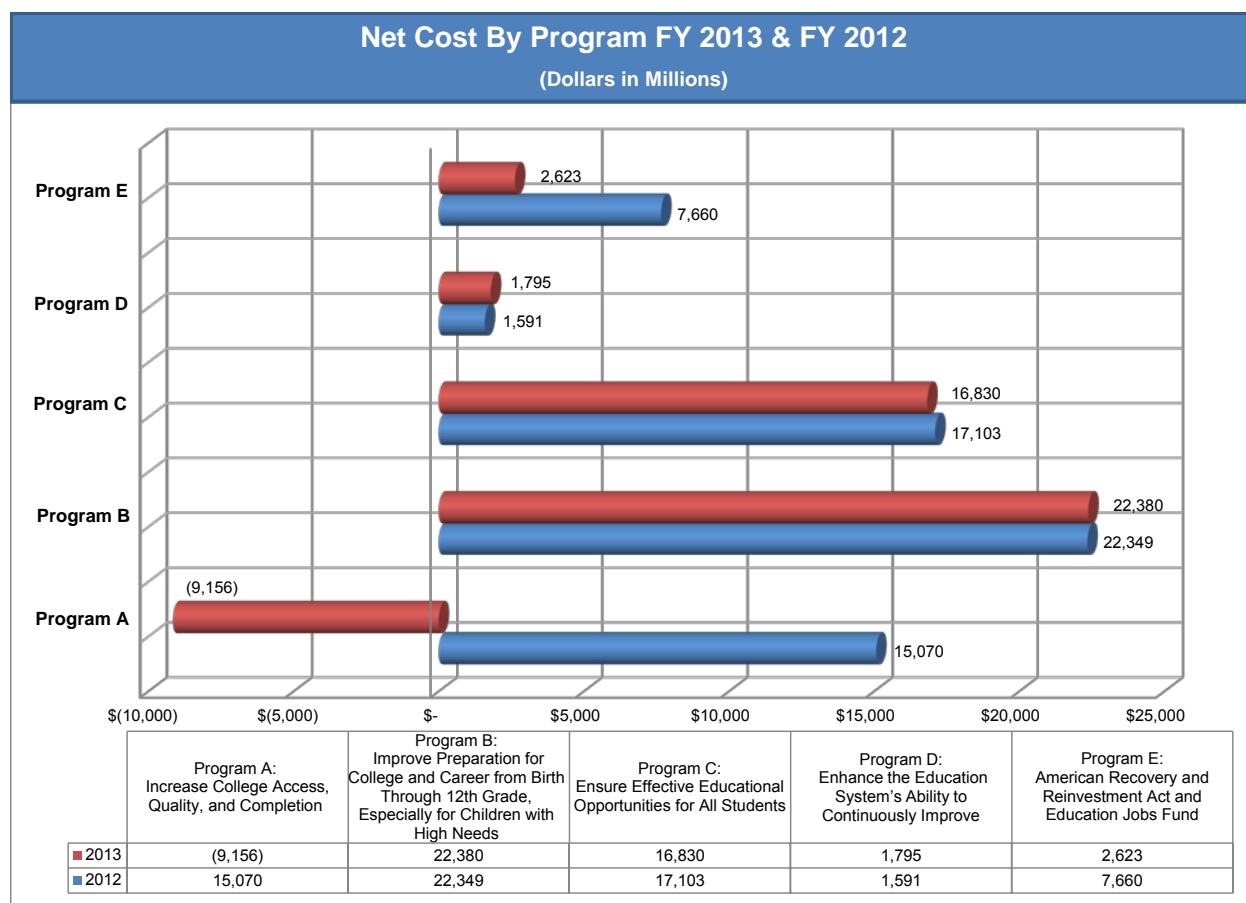
**Liabilities as of September 30, 2013 and 2012**  
(Dollars in Millions)

	<b>2013</b>		<b>2012</b>	
Accounts Payable	\$	4,129	\$	4,129
Debt		852,432		715,303
Guaranty Agency Federal Funds Due to Treasury		1,482		1,307
Accrued Grant Liability		2,170		2,901
Liabilities for Loan Guarantees		-		1,037
Other Liabilities		9,002		7,095
<b>Total Liabilities</b>	<b>\$</b>	<b>869,215</b>	<b>\$</b>	<b>731,772</b>

## Statement of Net Cost

The Consolidated Statement of Net Cost reports the components of the net costs of the Department's operations for a "particular period" of time. The net cost of operations consists of the gross cost incurred by the Department less any exchange (i.e., earned) revenue from activities.

Net Costs of the Department totaled \$34.5 billion for the year ended September 30, 2013, a 46 percent decrease compared to total program net costs for the prior year. The Department's negative net cost for Program A, as shown below, is derived using economic models that project, on a net present value basis, which results in a higher estimate of future cash inflows (net of outflows) related to the loan programs. Current year models predict the net present value of future cash flows will exceed program costs by \$27 billion and \$12.6 billion for Direct Loans issued in the current year and prior year, respectively, and are \$8.8 billion higher for prior year FFEL. These estimated cash flows are amortized, or spread out, over 30 years and are re-valued each year based on current economic conditions.



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 *FY 2011–2014 Strategic Plan*.

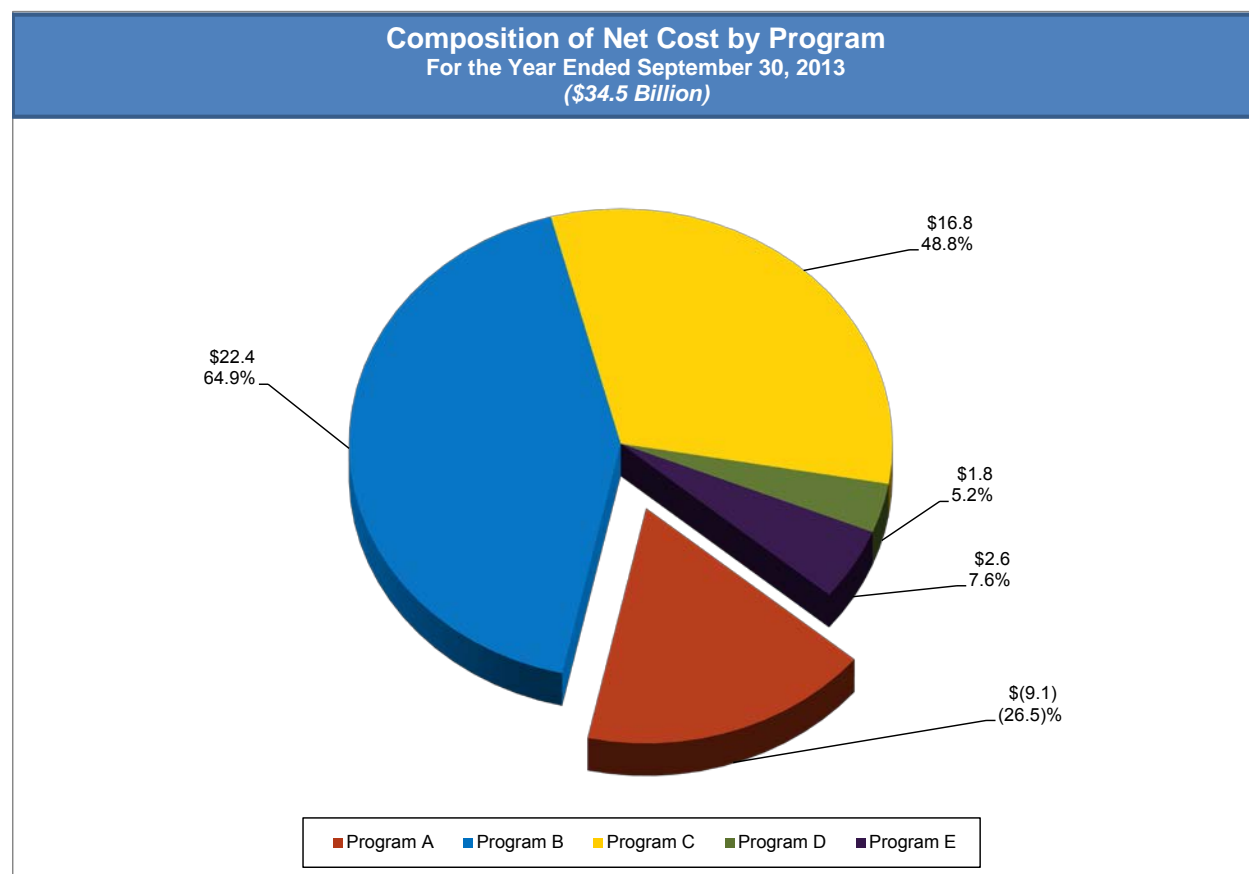
The Department has more than 100 grant and loan programs (<http://www2.ed.gov/programs/gtep/gtep.pdf>). In the Statement of Net Cost, they have been mapped to the Strategic Goals. The three largest grant programs are Title I, Pell, and the *Individuals with Disabilities Education Act* (IDEA) grants. Each of these programs' FY 2013 appropriations exceeded \$10 billion. In addition to student loans and grants, the Department offers other discretionary grants under a variety of authorizing legislation, awarded using a competitive process, and formula grants, using formulas determined by Congress with no application process. Among the largest K-12 discretionary grants are: TRIO, RTT, and the Teacher Incentive Fund. Among the largest formula grants are: Title I Grants to LEAs (Title I, *Elementary and Secondary Education Act of 1965*, as amended) and IDEA grants.



Net Cost Program	Reporting Group/ Program Office	Strategic Goal
<b>Program A:</b> Increase College Access, Quality, and Completion	Federal Student Aid  Office of Postsecondary Education  Office of Vocational and Adult Education	<b>Goal 1: Postsecondary Education, Career and Technical Education, and Adult Education.</b> Increase college access, quality, and completion by improving higher education and lifelong learning opportunities for youth and adults.
<b>Program B:</b> 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	<b>Goal 2: Elementary and Secondary Education.</b> 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. <b>Goal 3: Early Learning.</b> 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.
<b>Program C:</b> Ensure Effective Educational Opportunities for All Students	Office of English Language Acquisition  Office for Civil Rights  Office of Special Education and Rehabilitative Services	<b>Goal 4: Equity.</b> 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.
<b>Program D:</b> Enhance the Education System's Ability to Continuously Improve	Institute of Education Sciences  Office of Innovation and Improvement	<b>Goal 5: Continuous Improvement of the U.S. Education System.</b> Enhance the education system's ability to continuously improve through better and more widespread use of data, research and evaluation, transparency, innovation, and technology.
<b>Program E:</b> <i>American Recovery and Reinvestment Act</i> and Education Jobs Fund	<i>American Recovery and Reinvestment Act</i>  Education Jobs Fund	Cuts across Strategic Goals 1–5

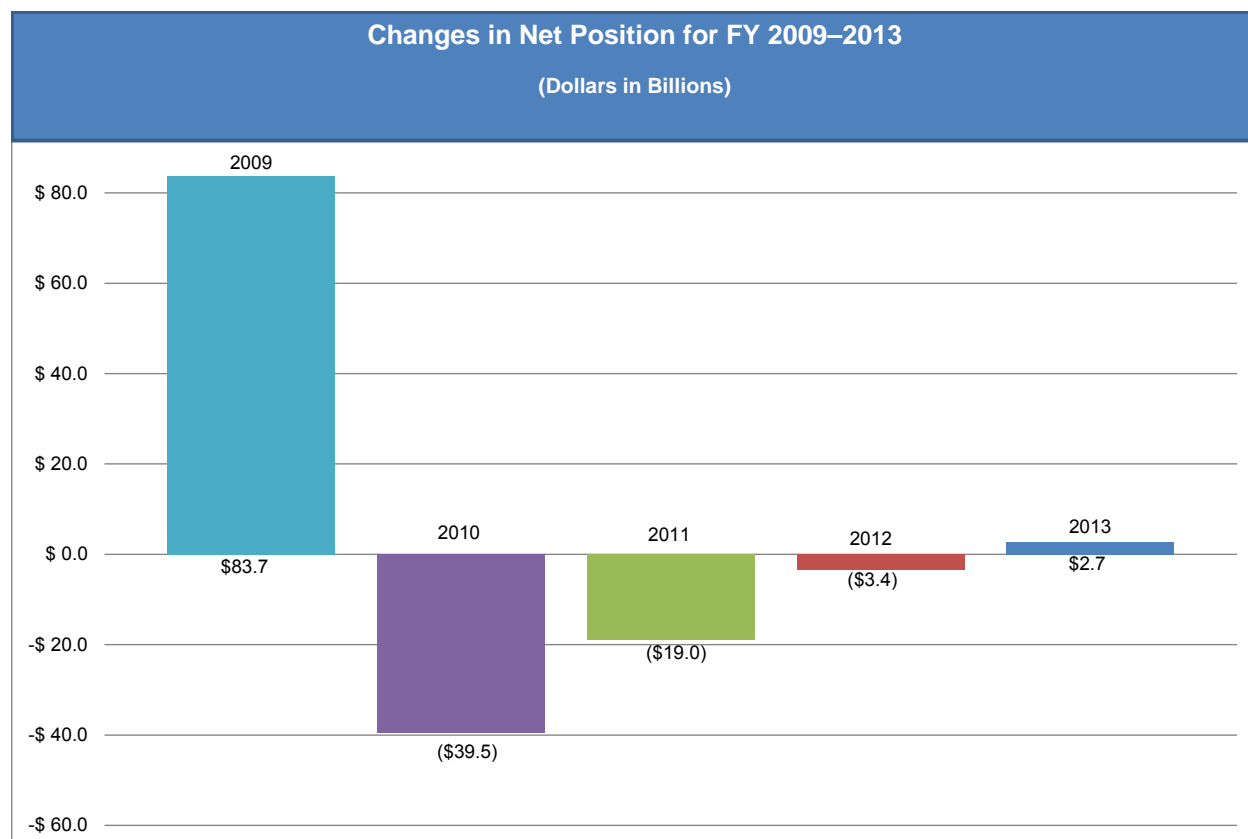
*Strategic Plan* Goals 1–5 are sharply defined directives that guide the Department's program offices to carry out the vision and programmatic mission; the net cost programs can be specifically associated with these five Strategic Goals. The Department also has a cross-cutting *Strategic Plan* Goal 6, 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.



## Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position reports the beginning net position, the transactions that affect net position presented for a “particular period” of time, and the ending 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. Net Position of the Department totaled \$67.8 billion for the period ended September 30, 2013. This reflects a 4 percent increase over the prior fiscal year.

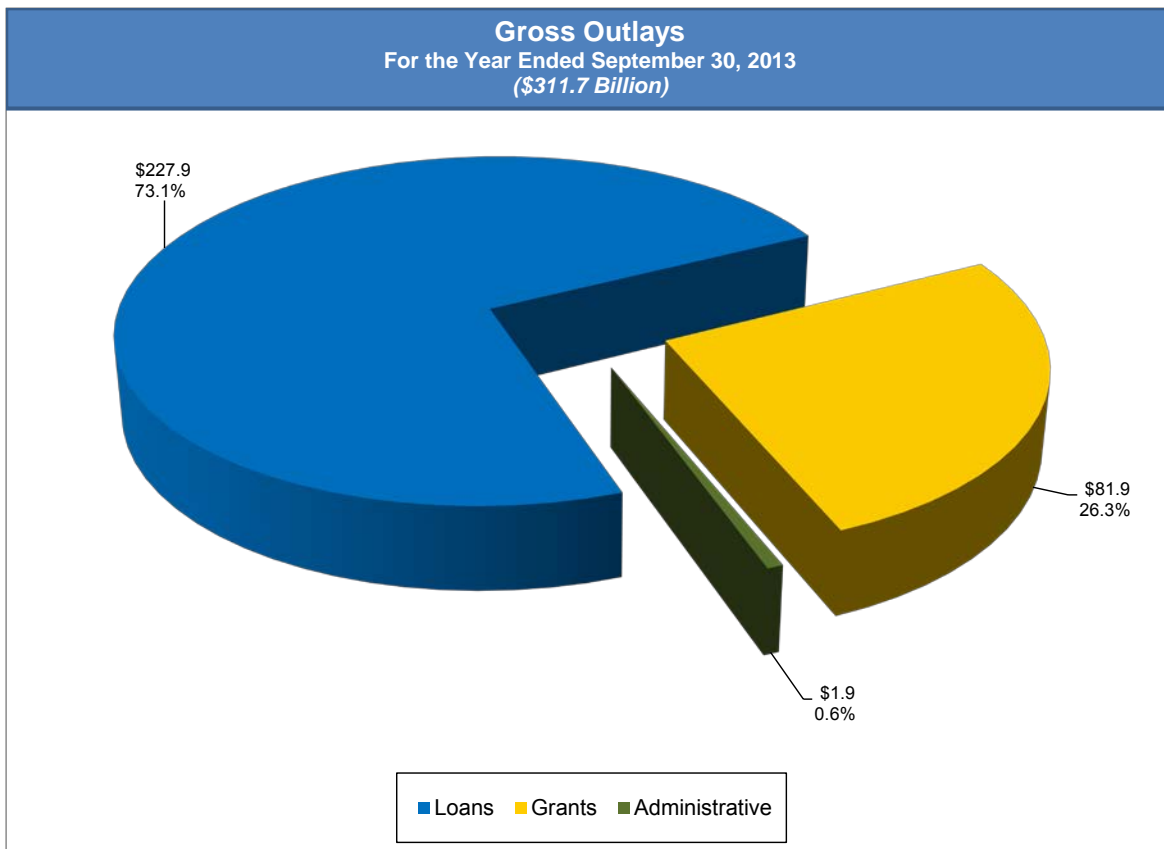
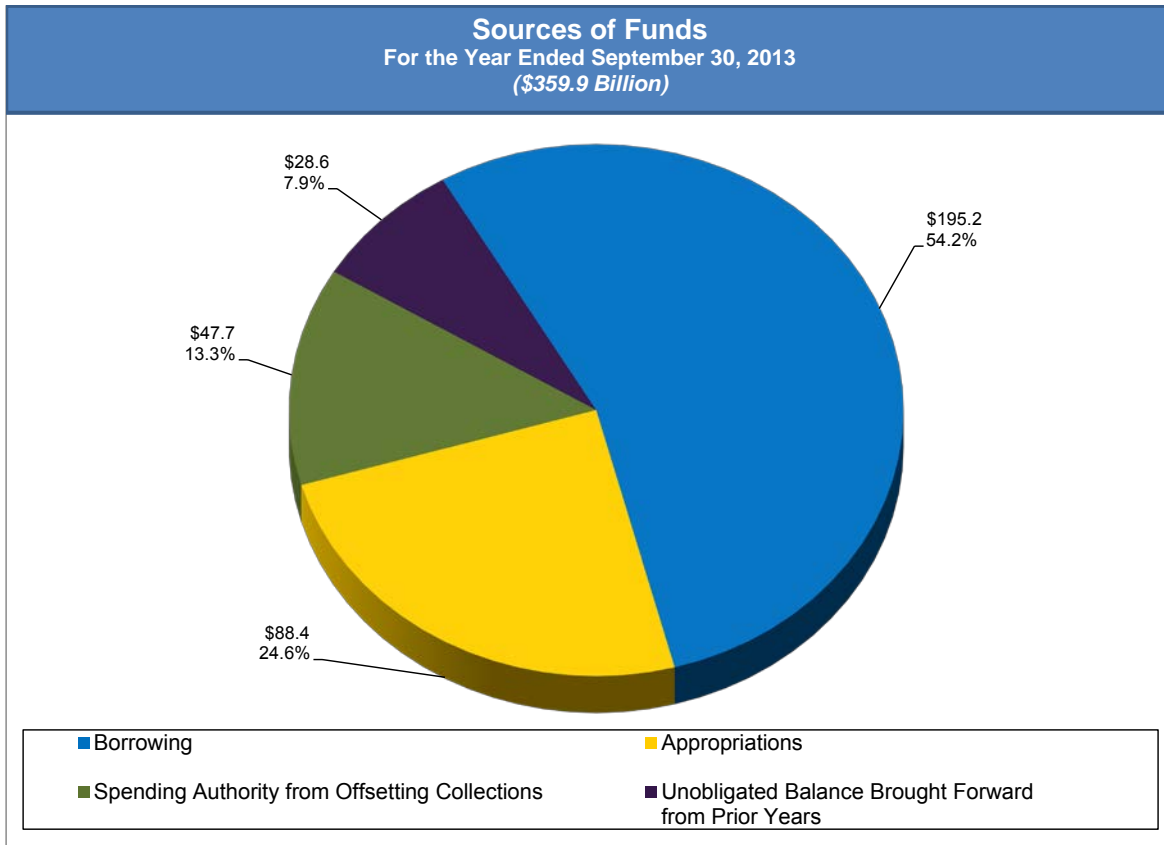


## Statement of Budgetary Resources

The Combined Statement of Budgetary Resources presents information on how budgetary resources were made available and their status at the end of the fiscal year. Information in this statement is reported on the budgetary basis of accounting.

Budgetary resources of the Department totaled \$359.9 billion for the period ended September 30, 2013, decreasing 4 percent from the prior year. Budgetary resources are comprised of appropriated budgetary resources of \$102.5 billion and non-budgetary credit reform resources of \$257.4 billion. The non-budgetary credit reform resources are predominantly borrowing authority for the loan programs.

Gross outlays of the Department totaled \$311.7 billion for the period ended September 30, 2013 and consisted of appropriated budgetary resources of \$90.6 billion and non-budgetary credit reform funding of \$221.1 billion.



Additional information on the Department's sources of funds and spending is shown in the Schedule of Spending on pages 134–135. This schedule includes sections titled, "What Money Is Available to Spend" and "How Was the Money Spent."

### **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 2013 and FY 2012, 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.



## Analysis of Controls, Systems, and Legal Compliance

This section provides management assurances regarding compliance with the [\*Federal Managers' Financial Integrity Act of 1982\*](#) (P.L. 97-255) (FMFIA) and Office of Management and Budget (OMB) [\*Circular A-123, Management's Responsibility for Internal Control\*](#). It also provides an analysis of the Department's controls, systems, and legal compliance.

The Department is the smallest of the 15 cabinet level agencies in terms of government staff, yet it has the third largest grant portfolio among the 26 federal grant-making organizations. The Department manages the second largest loan portfolio in the federal government. As such, the Department relies heavily on its internal controls and system frameworks to ensure that the Department maintains appropriate stewardship over funds entrusted to it by the American people.

### Controls Framework and Analysis

The FMFIA requires agencies to establish internal controls that provide reasonable assurance that the following objectives are achieved:

- effectiveness and efficiency of operations,
- compliance with applicable laws and regulations, and
- reliability of financial reporting.

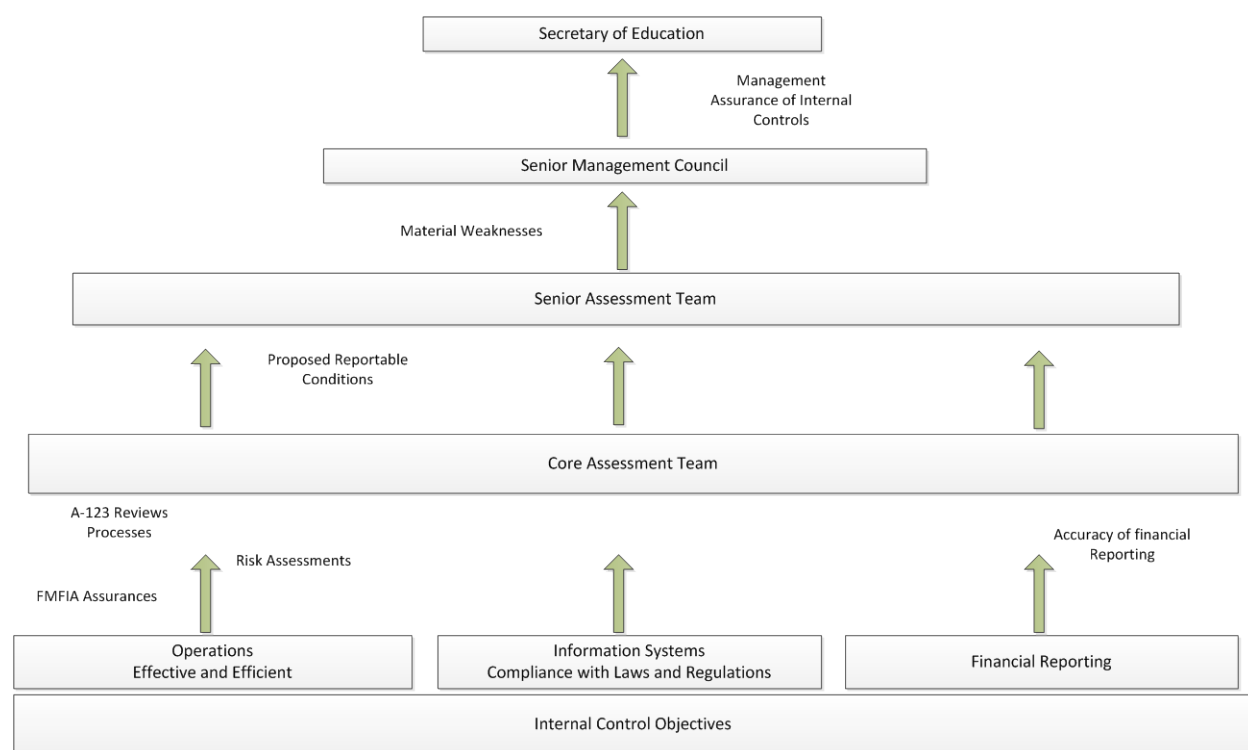
OMB Circular A-123 implements the FMFIA and defines management's responsibility for internal control in federal agencies.

The Department's internal control framework is robust. Consistent with Circular A-123, the Department established a Senior Management Council (SMC) comprised of senior leaders from across the Department to provide oversight over the internal control framework. This oversight role includes identifying focus areas, determining when internal control deficiencies are significant, setting expectations for their correction, and monitoring the implementation of corrective actions. The Department also established a Senior Assessment Team (SAT) and Core Assessment Team (CAT) to help guide the internal control process.

Each principal office within the Department implements internal controls to achieve operational goals, which include internal controls over: operations, financial reporting, and information technology systems. The process begins with risk assessments of the Department's business processes and information technology systems. The SAT considers the potential impact of risks using a multi-dimensional framework comprised of numerous risk factors. The SAT recommends higher risk processes and systems for more frequent and rigorous internal control evaluations. Through the evaluations, Department offices document key controls, evaluate and test the design and effectiveness of those controls, and communicate results to the SAT. Each office must develop and implement corrective action plans for all reported deficiencies. Throughout this process, the CAT provides technical support.

The office of Federal Student Aid (FSA) maintains a parallel governance structure that is integrated with the Department's. FSA's Chief Operating Officer both chairs the FSA SMC and participates as a member of the Department's SMC, FSA's Chief Financial Officer both chairs the FSA SAT and participates as a member of the Department's SAT, and the chair of the Federal Student Aid CAT participates as a member of the Department's CAT. Additional information on Federal Student Aid's internal control framework, assessment of controls, and

related assurances can be found in the Analysis of Systems, Controls, and Legal Compliance section of the [FY2013 Federal Student Aid Annual Report](#).



## Controls over Operations

The Department's two primary areas of operation are administering grants and loans. Other significant business activities include the management of contracts and interagency agreements, human capital, facilities, and legal enforcement activities. To ensure the efficient and effective implementation of these and other operations, including compliance with applicable laws and regulations, the Department issued a Directive, establishing in policy that all managers are responsible for ensuring the development, maintenance, documentation, evaluation, and improvement of internal control for the programs and administrative functions for which they are responsible. The Directive also designates the Chief Financial Officer (CFO) as the Senior Internal Control Official for the Department. In this role, the Office of the CFO develops and issues policies, procedures, and reporting requirements; develops and provides training and technical assistance; coordinates with the SMC, SAT, and CAT; conducts selected internal control reviews; and develops and maintains internal control and audit follow-up systems.

Each principal office assesses the design and operation of applicable key controls in their respective areas of responsibility and prepares an annual FMFIA assurance which highlights internal control processes and reports material weaknesses and significant deficiencies identified. These management assurances, along with the results of internal control reviews and external audits serve as the basis for the Secretary's assurance statement provided later in this section of the report.

In FY 2013, the Department identified no material weaknesses in internal controls over the effectiveness and efficiency of operations. The Department, however, continues to identify challenges in the administration of grants, loans, and other program operations. Additionally, the OIG has identified five FY 2014 management challenges: improper payments, information technology security, oversight and monitoring, data quality and reporting, and information technology system development and implementation. A summary of the OIG report with links to the full report are provided in the Other Information section.

## Controls over Financial Reporting

Internal Control over Financial Reporting (ICOFR) is a subset of FMFIA, Section 2. For the Department to comply with [ICOFR](#), each principal office must annually assess and report on the adequacy and effectiveness of the applicable internal controls they have in place to protect the reliability and integrity of the Department's financial reporting. The [Office of Management and Budget \(OMB\) implementation guidance](#) describes a process for accessing internal control over financial reporting. The Department's assessment of the effectiveness of control over financial reporting is performed in accordance with OMB Circular A-123, [Appendix A](#) (A-123A) and leverages the implementation guidance. A-123A requires each agency to provide an annual statement of assurance on the effectiveness of internal control over financial reporting as part of the overall FMFIA assurance statement.

Planning is a critical step in the A-123A compliance process. Key decisions that drive the assessment are made during the planning phase. Management must decide the materiality threshold, the scope of the assessments (e.g., which financial processes to review), and the test approach/methodology as well as other key decisions. Materiality levels were established for each of the four principal financial statements based on the [Government Accountability Office \(GAO\) Financial Audit Manual \(FAM\)](#) guidance and taking into consideration the Department's established materiality threshold.

Each year, as a function of the risk assessment and analysis process, management identifies areas to test. For any deficiency identified during testing, the CFO staff works with control owners to facilitate Corrective Action Plan development, approval, and implementation. The Department also considers the status of ongoing corrective actions and results of the financial statement audit.

In FY 2013, the Department focused on 10 business processes and assessed 60 key controls. The testing process was primarily focused on assessing whether key controls were operating effectively as of June 30, 2013. Additionally, follow-up testing and the results of the financial statement audit were considered to determine the effectiveness of controls as of September 30, 2013. The Department concluded that internal controls over financial reporting were in place and working.

FSA conducted its assessment of effectiveness of internal control over financial reporting and provided its assurances to the Department. Overall, the results of the FSA self-assessments revealed no material weaknesses.

In FY 2012, FSA identified and disclosed two material weaknesses related to the issues with the large-scale system conversions for the Debt Management Collection System/2 (DMCS2) and Affiliated Computer Services (ACS), Inc. Education Servicing (ACES) that occurred during that review period. Nine Corrective Action Plans (CAPs), with underlying action items, were developed to address those issues, and another CAP was added in FY 2013. At the end of FY 2013, nine of the ten CAPs have been closed and the issues remediated. The remaining

CAP continues to be worked and will be tracked and monitored through to resolution, or will be resolved through new contract actions.

In addition, throughout FY 2013, FSA has been committed to responding to external audit recommendations in its Report on Internal Controls over Financial Reporting. At the end of FY 2013, 22 CAPs have been developed to address the recommendations. Corrective actions taken in 2013 sufficiently remediated the underlying conditions such that, for the year ended September 30, 2013, these deficiencies no longer aggregate to a material weakness.

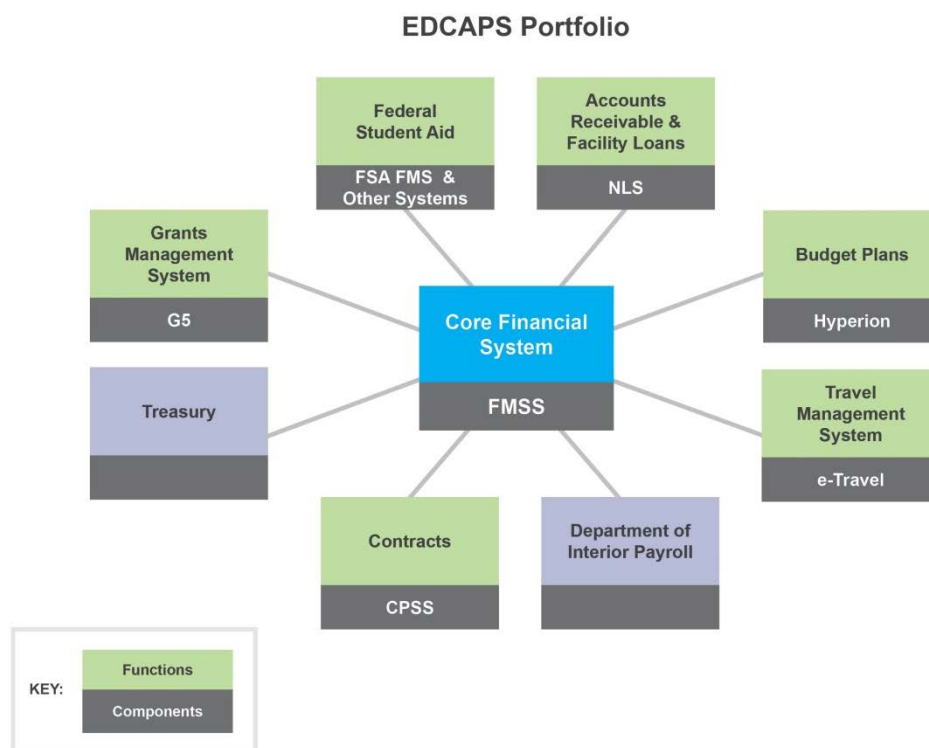
Additional information on FSA's assessment of controls and related assurances can be found in the Analysis of Systems, Controls, and Legal Compliance section of the [FY2013 Federal Student Aid Annual Report](#).

## Controls over Systems

Among the guidance applied by the Department in assessing controls over systems during FY 2013 were FMFIA (section 4) and OMB Circular A-127, *Financial Management Systems*, or Appendix D of OMB A-123, *Compliance with the Federal Financial Management Improvement Act of 1996*.

The Department's core financial applications have been brought together under the umbrella of the Education Central Automated Processing System (EDCAPS). EDCAPS is a suite of financial applications, including commercial off-the-shelf and custom code and interfaces that encompass the Department's core financial management processes.

The Department's financial management systems are designed to support effective internal controls and to produce accurate, reliable, and timely financial information. Our current financial systems (EDCAPS) portfolio is depicted in the image below:



The components of EDCAPS are linked through custom interfaces to provide the Department with real-time financial management capabilities. EDCAPS serves approximately 4,200 departmental users in Washington, DC, as well as 10 regional offices throughout the United States. EDCAPS also serves approximately 100,000 external users.

## Components of EDCAPS

**Financial Management System Software (FMSS)**—The FMSS is the Department's core financial system. It provides financial management functions for the Department, including general ledger, financial statement production, funds control and budget reporting, cost accounting, and accounts receivable/administrative accounts payable functions.

**Contracts and Purchasing Support System (CPSS)**—The CPSS provides users with a central repository to enter, retrieve, manage, and view acquisition/contract-related data. The centralized data provides enhanced information dissemination with the ability to respond to internal and external information requests. Various other systems and processes are used to augment and supplement the business process management gaps in the current environment.

**Federal Student Aid's Financial Management System (FSA's FMS)**—FSA's FMS is an integrated financial management system, utilizing Oracle Federal Financials, which incorporates full financial business functionality, including general ledger, accounts payable, and accounts receivable across multiple FSA program areas. FMS supports FSA service areas, enterprise areas, and partners and provides timely and consistent financial data for strategic decision making. The core of FMS encompasses interfaces (file transfers of data) from program applications to the Oracle Financials application and the consolidation and centralization of all accounting and financial data into one system for FSA programs. There are also customized modules or extensions that provide additional functionality to FMS allowing for the collection of data from financial partners in various FSA programs. FMS, in turn, interfaces with the Department's general ledger and with other systems to provide accounting and payment transactions. In addition, FMS provides FSA with a fully auditable accounting system incorporating appropriate security, controls, and audit trails.

**Grants Management System (G5)**—G5 manages all grant activities from initial recipient contact, through grant processing, to payments and grant closeout. This single system approach provides improved grant information management, recipient response time, and accuracy of financial management information.

**Travel Management System (TMS)**—The Department participates in e-Travel. Under e-Travel, travel system functionality is provided under contract by E2 solutions. EDCAPS interfaces with E2 in accordance with an established memorandum of understanding.

**Hyperion Budget Planning**—Hyperion Budget Planning is used by the Department for preparing annual spending plans. The Plan versus Actuals Report is generated from this system.

EDCAPS also has interfaces with the Department of Interior for payroll data, the Department of Treasury for payment data, and the Nortridge Loan System (NLS) for promissory note data.

## Self-Assessments

The Department is keenly aware of the importance of strong internal controls and adequate security controls over system access and data and continually looks for ways to strengthen



these controls. The Department's System Security Plan (SSP) identifies management, operational, and technical security controls for EDCAPS. The SSP is based upon a review of the environment, documentation, and interviews with information system personnel. While the Department has not eliminated all risks, management reviews confirm that all favorable actions are taken to diminish deficiencies and strengthen internal control overall. Risks are routinely monitored and contingency and mitigation plans are maintained.

Because EDCAPS is a moderate-impact application per [Federal Information Processing Standards \(FIPS\) 199](#), this system is subject to the moderate-impact baseline required by National Institute of Standards and Technology (NIST) Special Publication (SP) 800 53 Rev 3. Therefore, EDCAPS uses the NIST SP 800 53 Rev 3 moderate-impact baseline as its minimum security control requirements.

All internal EDCAPS user accounts are established using an EDCAPS Access Request Form. This form is used to grant initial access to EDCAPS subsystems and must be validated by the user's supervisor and the appropriate Information System Security Officer. Access is based on the user's role or job title. Principles of least privilege and segregation of incompatible duties are applied at all times. Access to all EDCAPS applications is protected by a user ID and password. Each application has a security administrator who is responsible for vetting individual EDCAPS access forms and for establishing their accounts. Access is granted based on the "need to know" and the least privilege the user requires performing his or her duties.

The [Federal Financial Management Improvement Act](#) (FFMIA) requires federal agencies to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger at the transaction level. Agencies are required to assess and report on whether these systems comply with FFMIA on an annual basis.

EDCAPS has been designed to deliver efficient and effective operations, while complying with FFMIA. In determining whether the Department's financial systems comply with system controls, management considered available information from annual audit reports and other relevant and appropriate information. The Department's determination leverages the results of related annual reviews. The Department is committed to continually improving all controls and acknowledges the ongoing efforts of security management to strengthen financial management systems.

Based on self-assessments and results of external audits, the Department has concluded that there are no material weaknesses in control over systems. However, self-assessments and external audits continue to identify significant challenges associated with maintaining highly effective controls over the multiple areas of system controls.

FSA conducted its assessment of effectiveness of internal control over financial reporting and has provided its assurances to the Department. A significant component of FSA's assessment includes Statements on Standards for Attestation Engagements (SSAE) 16 audits over its loan servicers' controls, including system controls. No material weaknesses were identified. Of the more than 3,200 controls tested, about 6 percent of them had control weaknesses. Overall, the impact of those weaknesses was immaterial to the FSA financial statements. Accordingly, FSA concluded that its systems substantially complied with the requirements of the *Federal Financial Management Improvement Act* (FFMIA). However, FSA considers the deficiencies to be significant and continues to act on them. Additional information on FSA's internal control framework, assessment of controls, and related assurances can be found in the Analysis of Systems, Controls, and Legal Compliance section of the FY 2013 Federal Student Aid Annual Report.

## Management Assurances

Based on the assurances of the Department's management, which is responsible for internal controls, and assessment of the results of external audits, the Department is able to provide reasonable assurance that the internal controls and financial management systems in effect during FY 2013 met the objectives of both sections 2 and 4 of the FMFIA.

- FMFIA section 2 explains management's responsibility for, and its role in, assessment of accounting and administrative controls.
- FMFIA section 4 relates to the Department's analysis of systems, controls, and legal compliance related to financial reporting; internal controls and system frameworks included FMFIA, FFMIA, and the [Federal Information Security Management Act](#) (FISMA), as well as OMB Circulars A-123 and A-127, as addressed in previous sections of this report.

## Statement of Assurance

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) and OMB Circular A-123, *Management's Responsibility for Internal Control*. The Department evaluated its internal controls to support (1) effective and efficient programmatic operations, (2) compliance with applicable laws and regulations, and (3) reliable financial reporting.

### Internal Control Over Operations

For all program areas, the Department provides reasonable assurance that internal controls were in place and operating to meet the objectives of section 2 of FMFIA, no material weaknesses were identified, and we were in compliance with applicable laws and regulations as of September 30, 2013.

### Internal Control Over Financial Reporting

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. The Department has reasonable assurance that internal controls over financial reporting as of September 30, 2013, were operating effectively and no material weaknesses were found in the design or operation of the controls.

### Internal Control Over Systems

The Department is required to implement and maintain financial management systems that substantially comply 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 in accordance with the requirements of section 4 of FMFIA, the Department's financial management systems substantially comply with *Federal Financial Management Improvement Act* as of September 30, 2013.

Notwithstanding the aforementioned assertions, I acknowledge that we have issues that we must remediate, including internal control and compliance issues identified by our auditors and the management challenges raised by the Office of the Inspector General in other sections of this report.

/s/

Arne Duncan  
December 11, 2013

## Financial Management Systems Strategy

The Department designated FMSS as a mission-critical system that provides core financial management services. The Department expects to improve the following performance outcomes: control and accountability over financial management services, including financial management system controls and practices that include cross-validation rules to prevent erroneous accounting transactions from being processed; and financial system reporting capabilities that continue to respond quickly to internal and external financial information inquiries. Additional areas of emphasis are the continued tight integration and streamlining with the office of Federal Student Aid and business processes; reduced manual reconciliation efforts for 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). Oracle has issued version Release 12 of its software as a replacement for the 11i version. Release 12 has passed the necessary testing and is federally compliant for financial management. The Department is examining solutions for migrating to the Release 12 version. OMB has directed agencies to explore the possibility of utilizing a shared service provider (SSP) for financial management before implementing or migrating to new versions of financial applications. During FY 2014, the Department expects to begin the analysis of identifying the potential of using an SSP solution for financial management.

## Legal Compliance

**Federal Financial Management Improvement Act (FFMIA)**—requires federal agencies to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger at the transaction level. Section 803(c) (1) of the FFMIA requires the Department to make an annual determination of the agency's substantial compliance with Section 803(a) of the Act based on a review of relevant factors. In determining whether the Department's financial systems substantially comply with FFMIA, management considered available information from audit reports and other relevant and appropriate information. The Department's determination leveraged the results of related reviews such as those required by FISMA and OMB Circular A-123. Key factors used in the determination included: agency improvements and ongoing efforts to strengthen financial management systems and the impact of instances of non-compliance on overall financial management system performance.

In FY 2012, management determined that the Department's systems were not in overall compliance with FFMIA based, in part, on self-reported FFMIA material weaknesses. These issues directly impacted the reliability of borrower account information and related financial statement balances throughout FY 2012. Corrective actions taken in FY 2012 and FY 2013 sufficiently remediated the underlying conditions such that, for the year ended September 30, 2013, these deficiencies no longer aggregate to a material weakness. However, some of the remaining FY 2012 issues, including new issues of lesser significance identified in FY 2013, continued to impact the reliability of borrower account information and related financial statement balances throughout FY 2013. The auditors have provided their recommendations to address these issues and the Department plans to implement them in FY 2014. Full and complete implementation of the auditor's recommendations and corrective actions to their

findings will allow the Department to continue to strengthen and improve the internal controls of its financial management systems.

The Department places a priority on the importance of adequate security controls over system access and data and continually looks to ways to strengthen these controls. Management reviews during FY 2013 confirm that favorable actions have been taken to diminish weaknesses and strengthen internal controls overall. The Department is committed to continually improving its key controls and acknowledges the ongoing efforts of management to strengthen financial management systems. Additionally, based on the evaluation of the criteria listed in the FFMIA Indicators of Compliance and Risk Categories, the department's financial management system possesses low risk in complying with the FFMIA requirements based on the listed compliance indicators. None of the compliance indicators are rated at the high-risk level. Though the Department and its auditors have identified issues of non-compliance with some system requirements and significant internal control weaknesses exist, taken as a whole, the Department has determined that it is in substantial compliance with FFMIA in FY 2013 for its system of controls over loans, grants, contracts, payroll, and other key business activities.

**Federal Information Security Management Act (FISMA)**—requires that each agency perform an annual, independent evaluation of the information security program and practices of that agency to determine the effectiveness of such program and practices. The Department has been implementing a multiyear process to improve our reporting activities. In FY 2013, the Office of Inspector General (OIG) found that the Department has made progress in remediating issues identified in previous FISMA reviews. Specifically, they found the Department was compliant in 4 of the 11 reporting metrics. Their findings included issues related to: (1) configuration management; (2) identity and access management; (3) incident response and reporting; (4) risk management; (5) security training; (6) remote access management; and (7) contingency planning. Also, the findings in seven of the reporting metrics contained repeat or modified repeat findings from OIG reports issued from fiscal years 2010 through 2012.

In response to the reported issues, the Department established: a 24x7, on premise, Security Operations Center (EDSOC) that will operate in an integrated enterprise-wide program and respond to threats and vulnerabilities to the Department's information infrastructure and assets; a Risk Management Framework, using a suite of continuous monitoring tools; and initiatives intended to safeguard personally identifiable information. The Department has garnered significant benefits from previous years' audits and expects that the recommendations presented in FY 2013 will further improve the information security program by strengthening the associated management, technical and operational security controls. The Office of the Chief Information Officer has formulated a plan to address each of the findings and recommendations across the seven metric areas. The plan has been conveyed to and accepted by the OIG.

**Prompt Payment Act of 1982**—requires federal agencies to make timely payments to vendors. When a payment is not processed within the timeframes specified in the act, payment of interest is required. During FY 2013, the Department made timely payments for 99.77 percent of the 6,998 vendor invoices processed. Virtually all recurring payments were processed by information technology audits in accordance with the provisions of the *Prompt Payment Act*.

**Anti-Deficiency Act**—prohibits federal agencies from obligating or expending federal funds in advance or in excess of an appropriation, apportionment, or certain administrative subdivisions of those funds. The act also prohibits agencies from accepting voluntary services. For FY 2013, the Department had no *Anti-Deficiency Act* violations to report.





## Message From the Chief Financial Officer

The Department of Education is firmly committed to financial management excellence. We hope you find the *Agency Financial Report* (AFR) a useful summary of the Department's use of resources, operating performance, financial stewardship, and internal control. In compiling the AFR this year, we made a concerted effort to provide information at a high level with the support of web links for readers who want more details.

I am extremely pleased to report that we have attained our 12<sup>th</sup> consecutive unqualified or "clean" opinion on our FY 2013 financial statements. The consistency in our accounting and reporting is a tribute to the excellent work of our employees and contract partners. Operating budgets were tight in 2013, but the financial management team and the Department's employees carried out their responsibilities in an efficient and effective manner. We spent less than 1 percent of the annual appropriations on administrative costs in making almost \$200 billion in new grant and loan obligations.

Along with the unqualified opinion for 2013, our auditors reported that there were no material internal control weaknesses and no instances of noncompliance with applicable laws and regulations, except for one compliance issue with the *Federal Financial Management Improvement Act* (FFMIA). This is an improvement over 2012.

The audit and related reports help us by suggesting areas where we can improve. Last year, we reported a material weakness associated with a transition among some systems contracts that help track our student loan accounts. We took steps in 2013 to address those issues and eliminated the material weakness. Despite our significant efforts to improve our internal control over financial reporting and related information technology controls, the auditors reported the Department's financial management systems did not substantially comply with the FFMIA system requirements. In their view, certain technical and operational issues in the functionality and application control over financial systems for managing loans receivable impacted the Department's ability to maintain effective controls and the efficiency of servicing the direct loan portfolio. The auditors reported no instances of noncompliance with other applicable laws and regulations. We remain committed to addressing the reported FFMIA issue, as well as the other management challenges identified in reports by the Inspector General and the independent auditors.

We strive to monitor and improve our internal controls for all of our activities and demonstrate compliance with applicable laws and regulations. Internal controls are never perfect, and there are always areas for improvement, including those identified by our independent auditors in their report and by the Office of Inspector General in its management challenges.

/s/

Thomas P. Skelly

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

December 11, 2013



**United States Department of Education**  
**Consolidated Balance Sheet**  
**As of September 30, 2013 and 2012**  
(Dollars in Millions)

	<b>FY 2013</b>	<b>FY 2012</b>
<b>Assets:</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 108,732	\$ 121,993
Accounts Receivable (Note 4)	2	1
Other Intragovernmental Assets (Note 8)	22	18
Total Intragovernmental	108,756	122,012
Cash and Other Monetary Assets (Note 5)	1,482	1,307
Accounts Receivable, Net (Note 4)	121	92
Credit Program Receivables, Net (Note 6)	826,684	673,488
Property and Equipment, Net (Note 7)	2	7
Other Assets (Note 8)	13	21
<b>Total Assets (Note 2)</b>	<b>\$ 937,058</b>	<b>\$ 796,927</b>
<b>Liabilities:</b>		
Intragovernmental:		
Accounts Payable (Note 9)	\$ 2	\$ 31
Debt (Note 10)	852,432	715,303
Guaranty Agency Federal Funds Due to Treasury (Note 5)	1,482	1,307
Other Intragovernmental Liabilities (Note 11)	8,855	6,944
Total Intragovernmental	862,771	723,585
Accounts Payable (Note 9)	4,127	4,098
Accrued Grant Liability (Note 12)	2,170	2,901
Liabilities for Loan Guarantees (Note 6)	-	1,037
Other Liabilities (Note 11)	147	151
<b>Total Liabilities (Note 11)</b>	<b>\$ 869,215</b>	<b>\$ 731,772</b>
Commitments and Contingencies (Note 20)		
<b>Net Position:</b>		
Unexpended Appropriations (Note 13)	\$ 71,371	\$ 72,686
Cumulative Results of Operations (Note 13)	(3,528)	(7,531)
<b>Total Net Position (Note 13)</b>	<b>\$ 67,843</b>	<b>\$ 65,155</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 937,058</b>	<b>\$ 796,927</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, 2013 and 2012**  
(Dollars in Millions)

	FY 2013	FY 2012
<b>Program Costs:</b>		
<b><u>Increase College Access, Quality, and Completion</u></b>		
Gross Costs	\$ 17,588	\$ 40,410
Earned Revenue	(26,744)	(25,340)
Net Program Costs	(9,156)	15,070
<b>Total Program Costs</b>	<b>\$ (9,156)</b>	<b>\$ 15,070</b>
<b><u>Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs</u></b>		
Gross Costs	\$ 22,405	\$ 22,419
Earned Revenue	(25)	(70)
Net Program Costs	22,380	22,349
<b>Total Program Costs</b>	<b>\$ 22,380</b>	<b>\$ 22,349</b>
<b><u>Ensure Effective Educational Opportunities for All Students</u></b>		
Gross Costs	\$ 16,856	\$ 17,114
Earned Revenue	(26)	(11)
Net Program Costs	16,830	17,103
<b>Total Program Costs</b>	<b>\$ 16,830</b>	<b>\$ 17,103</b>
<b><u>Enhance the Education System's Ability to Continuously Improve</u></b>		
Gross Costs	\$ 1,881	\$ 1,660
Earned Revenue	(86)	(69)
Net Program Costs	1,795	1,591
<b>Total Program Costs</b>	<b>\$ 1,795</b>	<b>\$ 1,591</b>
<b><u>American Recovery and Reinvestment Act and Education Jobs Fund</u></b>		
Gross Costs	\$ 2,623	\$ 7,660
Earned Revenue	-	-
Net Program Costs	2,623	7,660
<b>Total Program Costs</b>	<b>\$ 2,623</b>	<b>\$ 7,660</b>
<b>Grand Total Program Costs</b>	<b>\$ 34,472</b>	<b>\$ 63,773</b>
<b>Net Cost of Operations (Notes 14 &amp; 17)</b>	<b>\$ 34,472</b>	<b>\$ 63,773</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, 2013 and 2012

(Dollars in Millions)

	FY 2013		FY 2012	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
<b>Beginning Balances:</b>				
Beginning Balances	\$ (7,531)	\$ 72,686	\$ (3,144)	\$ 71,729
<b>Budgetary Financing Sources:</b>				
Appropriations Received	\$ -	\$ 90,993	\$ -	\$ 98,372
Other Adjustments (Rescissions, etc.)	-	(2,824)	1	(493)
Appropriations Used	89,484	(89,484)	96,922	(96,922)
Nonexchange Revenue	10	-	1	-
Donations and Forfeitures of Cash and Cash Equivalents	1	-	1	-
Nonexpenditure Financing Sources Transfers-Out	-	-	(29)	-
<b>Other Financing Sources:</b>				
Imputed Financing from Costs Absorbed by Others	\$ 34	\$ -	\$ 34	\$ -
Negative Subsidy Transfers, Downward Subsidy Re-Estimates, and Other	(51,054)	-	(37,544)	-
<b>Total Financing Sources</b>	<b>\$ 38,475</b>	<b>\$ (1,315)</b>	<b>\$ 59,386</b>	<b>\$ 957</b>
<b>Net Cost of Operations:</b>	<b>\$ (34,472)</b>	<b>\$ -</b>	<b>\$ (63,773)</b>	<b>\$ -</b>
<b>Net Change:</b>	<b>\$ 4,003</b>	<b>\$ (1,315)</b>	<b>\$ (4,387)</b>	<b>\$ 957</b>
<b>Ending Balances (Note 13)</b>	<b>\$ (3,528)</b>	<b>\$ 71,371</b>	<b>\$ (7,531)</b>	<b>\$ 72,686</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, 2013 and 2012**  
(Dollars in Millions)

	FY 2013		FY 2012	
	Non-Budgetary Credit Reform Financing Accounts		Non-Budgetary Credit Reform Financing Accounts	
	Budgetary		Budgetary	
<b>Budgetary Resources:</b>				
Unobligated Balance, Brought Forward, October 1	\$ 12,622	\$ 18,993	\$ 5,434	\$ 15,402
Recoveries of Prior Year Unpaid Obligations	1,191	35,425	1,182	18,649
Other Changes in Unobligated Balance (+ or -)	(428)	(39,189)	(638)	(20,697)
Unobligated Balance from Prior Year Budget Authority, Net	\$ 13,385	\$ 15,229	\$ 5,978	\$ 13,354
Appropriations (Discretionary and Mandatory)	88,380	5	98,284	36
Borrowing Authority (Discretionary and Mandatory) (Note 16)	-	195,185	-	209,614
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	779	46,976	448	47,270
<b>Total Budgetary Resources (Note 16)</b>	<b>\$ 102,544</b>	<b>\$ 257,395</b>	<b>\$ 104,710</b>	<b>\$ 270,274</b>
<b>Status of Budgetary Resources:</b>				
Obligations Incurred (Note 16)	\$ 86,337	\$ 246,080	\$ 92,088	\$ 251,281
Unobligated Balance, End of Year:				
Apportioned	13,700	-	10,480	1
Unapportioned	2,507	11,315	2,142	18,992
Total Unobligated Balance, End of Year	16,207	11,315	12,622	18,993
<b>Total Status of Budgetary Resources (Note 16)</b>	<b>\$ 102,544</b>	<b>\$ 257,395</b>	<b>\$ 104,710</b>	<b>\$ 270,274</b>
<b>Change in Obligated Balance:</b>				
<b>Unpaid Obligations</b>				
Unpaid Obligations, Brought Forward, October 1	\$ 65,057	\$ 172,230	\$ 72,684	\$ 164,389
Obligations Incurred	86,337	246,080	92,088	251,281
Outlays (Gross) (-)	(90,573)	(221,138)	(98,533)	(224,791)
Recoveries of Prior Year Unpaid Obligations (-)	(1,191)	(35,425)	(1,182)	(18,649)
Unpaid Obligations, End of Year	<b>\$ 59,630</b>	<b>\$ 161,747</b>	<b>\$ 65,057</b>	<b>\$ 172,230</b>
<b>Uncollected Payments</b>				
Uncollected Payments, Federal Sources, Brought Forward, October 1 (-)	\$ (2)	\$ (26)	\$ (6)	\$ (27)
Change in Uncollected Payments, Federal Sources (+ or -)	(1)	1	4	1
Uncollected Payments, Federal Sources, End of Year (-)	\$ (3)	\$ (25)	\$ (2)	\$ (26)
<b>Memorandum (Non-add) Entries</b>				
Obligated Balance, Start of Year (+ or -)	<b>\$ 65,055</b>	<b>\$ 172,204</b>	<b>\$ 72,678</b>	<b>\$ 164,389</b>
Obligated Balance, End of Year (+ or -)	<b>\$ 59,627</b>	<b>\$ 161,722</b>	<b>\$ 65,055</b>	<b>\$ 172,204</b>
<b>Budget Authority and Outlays, Net:</b>				
Budget Authority, Gross (Discretionary and Mandatory)	\$ 89,159	\$ 242,166	\$ 98,732	\$ 256,920
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(935)	(72,672)	(655)	(64,687)
Change in Uncollected Customer Payments from Federal Sources (Discretionary and Mandatory) (+ or -)	(1)	1	4	1
<b>Budget Authority, Net (Discretionary and Mandatory)</b>	<b>\$ 88,223</b>	<b>\$ 169,495</b>	<b>\$ 98,081</b>	<b>\$ 192,234</b>
Outlays, Gross (Discretionary and Mandatory)	\$ 90,573	\$ 221,138	\$ 98,533	\$ 224,791
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(935)	(72,672)	(655)	(64,687)
Outlays, Net (Discretionary and Mandatory)	89,638	148,466	97,878	160,104
Distributed Offsetting Receipts (-) (Note 16)	(48,725)	-	(40,612)	-
<b>Agency Outlays, Net (Discretionary and Mandatory) (Note 16)</b>	<b>\$ 40,913</b>	<b>\$ 148,466</b>	<b>\$ 57,266</b>	<b>\$ 160,104</b>

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



## Notes to the Financial Statements For the Years Ended September 30, 2013 and 2012

### Note 1. Summary of Significant Accounting Policies

#### Reporting Entity and Programs

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, as discussed below.

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 and their parents finance the costs of postsecondary 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 eligibility criteria established by statute 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 may 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*, formerly the *Student Aid and Fiscal Responsibility Act*, which was included in the *Health Care and Education Reconciliation Act of 2010* (HCERA) 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 of Education (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.

The Teacher Education Assistance for College and Higher Education (TEACH) Grant 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.

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 to 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 their facilities.

In addition to student loans and grants, the Department supports state and local education agencies through discretionary grants under a variety of authorizing legislation, which are awarded using a competitive process, and formula (mandatory) grants. Among the largest K-12 discretionary grants are The Federal TRIO Program (TRIO), Race to the Top, and Teacher Incentive Fund. Among the largest formula grants are Title I, *Elementary and Secondary Education Act of 1965*, as amended, (Title I) Grants to Local Educational Agencies and *Individuals with Disabilities Education Act* (IDEA) grants.

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.

Public Law 111-226 (Education Jobs Fund), enacted on August 10, 2010, provided funding to the Department for saving and creating education jobs.

As of fiscal year 2013, Recovery Act and Education Jobs Fund programs are winding down and have 4 percent and less than 1 percent remaining, respectively, to be expended as of September 30, 2013.

## Reporting Groups

The Department has established five reporting groups that administer loan and grant programs. They are:

- 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.

## 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. 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.

### **Credit Reform Accounting: Federal Credit Reform**

The *Federal Credit Reform Act of 1990* (CRA) became effective on October 1, 1991. Its purpose is to measure the cost of Federal credit programs and to place the cost of each credit program on a basis equivalent with other Federal spending, i.e., calculate the cost of Direct Loan Programs evenly with the cost of Guaranteed Loan Programs. Under CRA, subsidy cost is estimated using the net present value of future cash flows to, and from, the Department.

A loan guarantee is any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender. A direct loan is any debt instrument issued to the public by the federal government. CRA establishes the use of Program, Financing, and General Fund Receipt Accounts for loan guarantees committed and direct loans obligated after September 30, 1991. It also establishes Liquidating Accounts for activity relating to any loan guarantees committed or direct loans obligated before October 1, 1991. These accounts are classified as either budgetary or non-budgetary in the Combined Statements of Budgetary Resources. The budgetary accounts include the Program and Liquidating Accounts. The non-budgetary accounts are the Financing Accounts.

The Program Account is a budget account that receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to the Financing Account. A Program Account also receives appropriations for administrative expenses. The Financing Account is a non-budgetary account that records all of the cash flows resulting from CRA direct loans or loan guarantees. It disburses loans, collects repayments and fees, pays claims, borrows from U.S. Treasury, earns and pays interest, and receives the subsidy cost payment from the Program Account. The General Fund Receipt Account is a budget account used by Treasury for the receipt of amounts paid from the Financing Account when there are negative subsidies for original cost estimates or downward re-estimates of prior subsidy costs.

### **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 cash flow projection 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. In developing assumptions for future interest rates, the Department uses a probabilistic technique that estimates future interest rates and weighs each one by the assumed probability of each scenario occurring. 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, graduate schools, proprietary (for-profit) schools, freshmen and sophomores at four-year colleges, as well as juniors and seniors at four-year colleges.

Estimates reflected in these financial statements were prepared using assumptions developed for the FY 2013 Mid-Session Review, a governmentwide 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.

## **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 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, ECASLA Programs, the TEACH Program, 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.

Non-Budgetary Financing Accounts are reported separately in the Non-Budgetary Credit Reform Financing Accounts column of the Statement of Budgetary Resources (SBR). The amounts recorded in this column are the cash flow activity resulting from Credit Reform Financing Accounts. In compliance with A-136 guidance, the activity in the Financing Accounts is reported separately in the Budget of the United States Government and is excluded from the budget surplus or deficit totals. The separate presentation in the SBR allows for a clear distinction between budgetary accounts and Non-Budgetary Credit Reform Financing Accounts.

## Entity and Non-Entity 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.

## Fund Balance with Treasury

The Fund Balance with Treasury includes general, financing, revolving, trust, special, and other funds in the Department's accounts with Treasury 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 provided in advance by multiyear appropriations for obligations anticipated during the current and future fiscal years. Revolving funds conduct continuing cycles of business-like activity and do not require annual appropriations. Their fund balance is derived from borrowings, as well as collections from the public and other federal agencies. Other funds, which are non-budgetary, primarily consist of deposit and receipt funds and clearing accounts. Non-budgetary Credit Reform Financing Accounts have many similarities to revolving funds.

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts that are not apportioned for obligation during the current fiscal year and expired appropriations no longer



available to incur new obligations. Obligated balances not yet disbursed include undelivered orders and unpaid expended authority.

### **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.

### **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 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. 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.

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. Payments made to the Department from guaranty agency federal funds through a statutory recall or agency closures represent capital transfers and are credited to the Department's Fund Balance with Treasury account.

### **Credit Program Receivables, Net 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 also values all pre-1992 loans and loan guarantees at their net present values.

Credit program receivables for activities under the temporary loan purchase authority include the present value of future cash flows related to 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 particular borrowers 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.

### Non-Budgetary Credit Reform Financing Accounts

Actual cash flows to and from the Government for direct loan and loan guarantee programs are recorded in separate Credit Reform Financing Accounts within the Treasury. These accounts borrow funds from Treasury, make direct loan disbursements, pay claims on guaranteed loans, collect principal and interest from borrowers, earn interest from Treasury on any uninvested funds, and transfer excess subsidy to Treasury's General Fund Receipt Account.

Appropriations for new subsidy and subsidy re-estimates are received in program accounts and transferred to Non-Budgetary Credit Reform Financing Accounts. The budgetary resources and activities for these accounts are presented separately in the Combined Statement of Budgetary Resources and the Budget of the United States and are excluded from the determination of the budget deficit or surplus.

### Property and Equipment, Net

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.

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

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.

## **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.

## **Accounts Payable**

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

## **Debt**

The Department borrows from Treasury 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. These are 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.

## **Accrued Grant Liability**

Disbursements of grant funds are recognized as expenses at the time of disbursement. Some grant recipients incur allowable expenditures as of the end of an accounting period but have not yet been reimbursed by the agency. The Department will accrue a liability for these allowable expenditures incurred that have not yet been reimbursed. The amount is estimated using statistical sampling as well as information on recent grant expenditures and unliquidated balances.

## **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.

## **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. Sick leave and other types of non-vested leave are expensed as taken. Annual leave earned but not taken, within established limits, is funded from future financing sources.

**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.

## 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 2012 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 the requirements contained in OMB Circular No. A-136, *Financial Reporting Requirements*, effective for FY 2013's reporting, the presentation of the SBR was changed. The statement was changed to better align the Change in Obligated Balance section of the statement. Also, during FY 2013, as required by Treasury and Departmental guidance, excess collections from pre-1992 FFEL loan guarantees, the College Housing Loan program, and the Higher Education Facilities Loan Program, which are payable to Treasury, are to be reported as non-current liabilities not covered by budgetary resources. This reclassification has resulted in a \$3 billion reduction of the FY 2012 reported balance of Intragovernmental Accounts Payable and a corresponding increase in the FY 2012 reported Other Liabilities balance. In accordance with Treasury guidance on capital transfer accounting, excess collections from pre-1992 FFEL loan guarantees, the College Housing Loan Program, and the Higher Education Facilities Loan

Program, which are payable to Treasury, but that have not yet been transferred, should be reported as Other Financing Sources on the Statement of Changes in Net Position. Transfers-Out was reduced by \$22 million while Negative Subsidy Transfers, Downward Subsidy Re-Estimates, and Other was increased by \$22 million.

### **Subsequent Events**

The financial statements, notes, and required supplementary information do not reflect the effects of the subsequent event described below.

### **ABCP Conduit**

The asset-backed commercial paper vehicle (ABCP Conduit) closes in the second quarter of 2014. Following Departmental policy, the costs of the ABCP Conduit will be re-estimated after the program closes. A recovery of prior year obligations and the cancellation of borrowing authority in the amount of approximately \$71 billion will occur after the final re-estimate is completed.

## Note 2. Non-Entity Assets

As of September 30, 2013 and 2012, non-entity assets consisted of the following:

### Non-Entity Assets

(Dollars in Millions)

	2013	2012
<b>Non-Entity Assets</b>		
Intragovernmental:		
Fund Balance with Treasury	\$ 40	\$ (39)
<b>Total Intragovernmental</b>	<b>40</b>	<b>(39)</b>
With the Public:		
Cash and Other Monetary Assets	1,482	1,307
Credit Program Receivables, Net	369	351
Accounts Receivable, Net	61	(4)
<b>Total With the Public</b>	<b>1,912</b>	<b>1,654</b>
<b>Total Non-Entity Assets</b>	<b>1,952</b>	<b>1,615</b>
Entity Assets	935,106	795,312
<b>Total Assets</b>	<b>\$ 937,058</b>	<b>\$ 796,927</b>

Entity and non-entity assets are combined on the Consolidated Balance Sheet. Non-entity assets are offset by liabilities to third parties and have no impact on net position. 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 Loan Program loan receivables. The corresponding liabilities for these non-entity assets are reflected in various accounts, including Intragovernmental Accounts Payable, Guaranty Agency Federal Funds Due to Treasury, and Other Liabilities. (See Notes 1, 3, 4, 5, and 6)

## Note 3. Fund Balance with Treasury

Fund Balance with Treasury by fund type, as of September 30, 2013 and 2012, consisted of the following:

### Fund Balances

(Dollars in Millions)

	2013	2012
General Funds	\$ 74,329	\$ 76,351
Revolving Funds	34,343	45,664
Special Funds	17	14
Trust Funds	3	3
Other Funds	40	(39)
<b>Fund Balance with Treasury</b>	<b>\$ 108,732</b>	<b>\$ 121,993</b>

A portion of the general funds is provided in advance by multiyear appropriations for obligations anticipated during the current and future fiscal years. Revolving funds are 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 primarily consist of non-entity deposit and receipt funds and clearing accounts.

The Status of Fund Balance with Treasury, as of September 30, 2013 and 2012, consisted of the following:

### Status of Fund Balance with Treasury

(Dollars in Millions)

	2013	2012
Unobligated Balance:		
Available	\$ 13,700	\$ 10,481
Unavailable	12,340	19,827
Obligated Balance, Not Yet Disbursed	82,652	91,724
Non-Budgetary Fund Balance with Treasury	40	(39)
<b>Fund Balance with Treasury</b>	<b>\$ 108,732</b>	<b>\$ 121,993</b>

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.

### Note 4. Accounts Receivable

Accounts receivable are established as claims to cash or other assets against other entities. At the Department, administrative accounts receivable arise through legal provisions or program requirements to return funds due to noncompliant program administration, regulatory requirements, or individual service obligations. As such, administrative accounts receivable consist primarily of institutional debt resulting from external audit or program review, program scholarship grant repayments, and employee debt. Accounts Receivable, as of September 30, 2013 and 2012, consisted of the following:

### Accounts Receivable

(Dollars in Millions)

	2013		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	\$ 2	\$ -	\$ 2
With the Public	306	(185)	121
<b>Total</b>	<b>\$ 308</b>	<b>\$ (185)</b>	<b>\$ 123</b>

	2012		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	\$ 1	\$ -	\$ 1
With the Public	317	(225)	92
<b>Total</b>	<b>\$ 318</b>	<b>\$ (225)</b>	<b>\$ 93</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 Funds Due to Treasury. The table below presents Cash and Other Monetary Assets for the years ended September 30, 2013 and 2012.

### Cash and Other Monetary Assets

(Dollars in Millions)

	2013	2012
<b>Beginning Balance, Cash and Other Monetary Assets</b>	<b>\$ 1,307</b>	<b>\$ 1,664</b>
Increase/(Decrease) in Guaranty Agency Federal Funds, net	175	(357)
<b>Ending Balance, Cash and Other Monetary Assets</b>	<b>\$ 1,482</b>	<b>\$ 1,307</b>

The \$175 million net increase and \$357 million net decrease in the Federal Fund in fiscal years 2013 and 2012, respectively, represent the change in the estimated value of net assets held in the FFEL guaranty agency Federal Funds. This increase reflects the impact of guaranty agencies' operations.

## Note 6. Credit Programs for Higher Education: Credit Program Receivables, Net and Liabilities for Loan Guarantees

The Federal Government currently operates two major student loan programs: the Federal Family Education Loan (FFEL) program and the William D. Ford Federal Direct Loan (Direct Loan) program. The *Health Care and Education Reconciliation Act of 2010* (HCERA) eliminated the authorization to originate new FFEL loans; as of July 1, 2010, all new loans are originated in the Direct Loan Program. The Direct Loan Program offers four types of loans: Stafford, Unsubsidized Stafford, PLUS, and Consolidation. Evidence of financial need is required for a student to receive a subsidized Stafford loan. The other three loan programs are available to borrowers at all income levels. Loans can be used only to meet qualified educational expenses.

**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. As of September 30, 2013 and 2012, total principal balances outstanding of Direct Loans were approximately \$585 billion and \$473 billion, respectively.

The Department disbursed approximately \$130 billion in Direct Loans to eligible borrowers in FY 2013 and approximately \$142 billion in FY 2012. 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 9 percent of Direct Loan obligations made in a 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 2013 cohort, an

estimated \$14.2 billion will never be disbursed. Eligible schools may originate direct loans through an advance from the Department or by advancing their own funds in anticipation of reimbursement from the Department.

Negative allowance for subsidy is a factor of interest rates, default rates, fees, and other costs. Negative subsidy is an estimate of future cash inflows exceeding future cash outflows. Subsidy, either positive or negative, provides resources for the Department to carry on its loan origination activities under the Direct Loan Program or support its past FFEL Program loan guarantees' made on or before June 30, 2010.

**Federal Family Education Loan Program.** As a result of the *SAFRA Act*, the Department and private lenders did not originate or guaranty any new loans in FY 2013 or FY 2012. 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 of September 30, 2013 and 2012, total principal balances outstanding of guaranteed loans held by lenders were approximately \$264 billion and \$291 billion, respectively. As of September 30, 2013 and 2012, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately \$258 billion and \$285 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.

ECASLA gave the Department temporary authority to purchase FFEL loans and participation interests in those loans. 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. This authority expired after September 30, 2010; as a result, loan purchase commitments and purchases of loan participation interests concluded. However, ABCP Conduit activity has continued.

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. 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, 2013. 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. 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.

The conduit, a separate legal entity, has approximately \$588 million in commercial paper outstanding. The Department's relationship with the ABCP Conduit requires it to buy delinquent loans and be available to purchase loans at the end of the program, January 2014. As of September 30, 2013, the Department has \$71 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. Any obligations not used during the shutdown of the ABCP Conduit program will be deobligated at the end of the program. Further discussion on this subsequent event is discussed in the last section of Note 1.

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 Program loan receivables.

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 Grant Program.** The Department awards annual grants of 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 (CHAFL), 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 has approximately \$5 million in outstanding borrowing from Treasury lent to eligible CHAFL institutions as of September 30, 2013.

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 *Higher Education Act of 1965* (HEA), as amended, the bonding authority maintains an escrow account to pay the principal and interest on bonds for loans in default.

On March 22, 2013, the Department and representatives from Treasury and OMB jointly offered loan modification terms and conditions to all four HBCU institutions in response to their request for forbearance considerations. In an effort to mitigate the economic effects of the hurricanes and to better serve the interests of the United States and the institutions, the Department has agreed to three components of modifications: forbearance, expense-based repayment, and debt adjustment. As part of the five-year forbearance agreement, the Department will pay on behalf of the institutions: servicing costs due to the Bank of New York Mellon Trust Company; servicing costs due to the designated bonding authority, Rice Capital (Atlanta, GA); and biannual bond principal and interest payments due to the Federal Financing Bank. The loan modification will not reduce the amount owed by the institutions and the Department will become the holder of the aforementioned bonds to the extent of its payments made on behalf of the institutions during the forbearance period. The total amount of this support and any accrued interest and unpaid servicing fees will be capitalized to principal and

be reamortized through the original maturity date on June 1, 2037. Accordingly, the structure of this modification will result in zero subsidy cost. The Department has approximately \$1.1 billion in outstanding borrowing from the Federal Finance Bank to support loans made to HBCU institutions with another \$260 million obligated to support near term lending as of September 30, 2013.

## **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 decreased from \$36 billion during FY 2012 to \$28 billion during FY 2013. The \$28 billion includes approximately \$0.6 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 had no modifications in fiscal year 2013, but modified loans in fiscal year 2012.

Two modifications were recognized in FY 2012; the first was related to the interest rates used in the calculation of special allowance payments and the second was the offering of Special Direct Consolidation Loans. Both modifications affect FFEL subsidy costs for cohort year 2010 and prior.

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 London Inter Bank Offered Rate initiative.

## Credit Program Receivables

Credit Program Receivables, as of September 30, 2013 and 2012, consisted of the following:

### Credit Program Loan Receivables, Net

(Dollars in Millions)

	2013	2012
Direct Loan Program Loan Receivables, Net	\$ 679,107	\$ 526,035
FFEL Program Loan Receivables:		
FFEL Guaranteed Loan Program, Net (Pre-1992)	2,231	2,697
FFEL Program (Post-1991):		
FFEL Guaranteed Loan Program, Net	35,144	29,644
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	38,946	41,145
Loan Participation Purchase, Net	67,546	70,888
ABCP Conduit, Net	1,864	1,731
Federal Perkins and Other Loan Program Loan Receivables, Net	369	351
TEACH Program Loan Receivables, Net	453	344
Facilities Loan Programs Loan Receivables, Net	1,024	653
<b>Total</b>	<b>\$ 826,684</b>	<b>\$ 673,488</b>

**William D. Ford Federal Direct Loan Program.** Direct Loan Program loan receivables are defaulted and non-defaulted loans owned by the Department and are held by the Department or guaranty agencies. 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)

	2013	2012
Principal Receivable	\$ 584,528	\$ 472,877
Interest Receivable	29,332	21,082
Total	613,860	493,959
Allowance for Subsidy	65,247	32,076
<b>Direct Loan Program Receivables, Net</b>	<b>\$ 679,107</b>	<b>\$ 526,035</b>

Of the \$613.9 billion in receivables, as of September 30, 2013, \$28.9 billion (4.7 percent) in loan principal was in default and had been transferred to the Department's defaulted loan servicer, compared to \$20.2 billion (4.1 percent) a year earlier. As of September 30, 2013, 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.** FFEL Program loan receivables are defaulted loans owned by the Department and are held by the Department or guaranty agencies. Guaranteed student loans that default are first placed with guarantee agencies for collection. If collection activities of guarantee agencies are not successful, the defaulted FFEL loans are assigned to the Department for collection. Defaulted FFEL loans are accounted for under credit reform rules, although they are legally not direct student loans.

The following schedule summarizes the principal and related interest receivables, net of the allowance for subsidy:

### FFEL Program Loan Receivables, Net

(Dollars in Millions)

	2013	2012
<b>FFEL Program (Pre-1992)</b>		
Principal Receivable	\$ 5,040	\$ 5,519
Interest Receivable	5,563	5,358
Total	10,603	10,877
Allowance for Subsidy	(8,356)	(8,180)
Liabilities for Loan Guarantees	(16)	-
<b>FFEL Guaranteed Loan Program, Net (Pre-1992)</b>	<b>2,231</b>	<b>2,697</b>
<b>FFEL Program (Post-1991)</b>		
FFEL Guaranteed Loan Program:		
Principal Receivable	32,649	31,549
Interest Receivable	4,849	4,541
Total	37,498	36,090
Allowance for Subsidy	(6,614)	(6,446)
Liabilities for Loan Guarantees	4,260	-
<b>FFEL Guaranteed Loan Program, Net</b>	<b>35,144</b>	<b>29,644</b>
Temporary Loan Purchase Authority:		
Loan Purchase Commitment:		
Principal Receivable	31,899	34,012
Interest Receivable	1,859	1,875
Total	33,758	35,887
Allowance for Subsidy	5,188	5,258
<b>Loan Purchase Commitment, Net</b>	<b>38,946</b>	<b>41,145</b>
Loan Participation Purchase:		
Principal Receivable	56,041	58,834
Interest Receivable	3,297	3,144
Total	59,338	61,978
Allowance for Subsidy	8,208	8,910
<b>Loan Participation Purchase, Net</b>	<b>67,546</b>	<b>70,888</b>
ABCP Conduit:		
Principal Receivable	2,208	2,038
Interest Receivable	193	133
Total	2,401	2,171
Allowance for Subsidy	(537)	(440)
<b>ABCP Conduit, Net</b>	<b>1,864</b>	<b>1,731</b>
<b>FFEL Program Loan Receivables, Net</b>	<b>\$ 145,731</b>	<b>\$ 146,105</b>

All loans purchased by the Department under the temporary loan purchase authority are defaulted and non-defaulted federal assets.

**Federal Perkins Loan Program.** As of September 30, 2013 and 2012, loan and interest receivables, net of allowance for losses, were \$358 million and \$343 million, respectively. These receivables are valued at net realizable value with estimated allowance for losses of \$154 million and \$147 million as of September 30, 2013 and 2012, respectively.



**TEACH Grant Program.** As of September 30, 2013 and 2012, loan receivables were \$453 million and \$344 million, respectively. The receivable balance is net of allowance for subsidy of \$106 million and \$93 million as of September 30, 2013 and 2012, respectively.

**Facilities Loan Programs.** The following schedule summarizes the principal and related interest receivables, net of the allowance for subsidy:

### Facilities Loan Programs Loan Receivables, Net

	(Dollars in Millions)	
	2013	2012
Principal Receivable	\$ 1,211	\$ 1,056
Interest Receivable	10	12
Receivables	1,221	1,068
Allowance for Subsidy/Loss	(197)	(415)
<b>Facilities Loan Programs Loan Receivables, Net</b>	<b>\$ 1,024</b>	<b>\$ 653</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)	
	2013	2012
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ 32,076</b>	<b>\$ 25,346</b>
<b>Activity</b>		
Fee Collections	(1,557)	(1,585)
Loan Cancellations <sup>1</sup>	1,890	1,250
Subsidy Allowance Amortization	(7,719)	(3,778)
Other	1,000	123
<b>Total Activity</b>	<b>(6,386)</b>	<b>(3,990)</b>
<b>Components of Subsidy Transfers</b>		
Interest Rate Differential	37,063	32,372
Defaults, Net of Recoveries	(1,887)	(2,356)
Fees	1,801	1,792
Other <sup>2</sup>	(9,967)	(8,901)
<b>Current Year Subsidy Transfers</b>	<b>27,010</b>	<b>22,907</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates <sup>3</sup>	11,754	(7,651)
Technical and Default Re-estimates	793	(4,536)
<b>Subsidy Re-estimates</b>	<b>12,547</b>	<b>(12,187)</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ 65,247</b>	<b>\$ 32,076</b>

<sup>1</sup> Loan cancellations include write-offs of loans because the primary borrower died, became disabled, or declared bankruptcy.

<sup>2</sup> Other consists of contract collection costs, program review collections, fee and other accruals.

<sup>3</sup> The interest rate re-estimate relates to subsidy associated with establishing a fixed rate for the Department's borrowing from Treasury.

**Federal Family Education Loan Program.** The FFEL Guaranteed Student Loan Financing Account has a negative estimated Liability for Loan Guarantees of \$4.3 billion as of September 30, 2013. This indicates expected collections on anticipated future defaulted loans will be in excess of default disbursements, calculated on a net present value basis. As of September 30, 2012, the Department's Liability for Loan Guarantees was approximately \$1 billion on anticipated loan defaults. Under Generally Accepted Accounting Principles negative estimated liability, the negative estimated liability has been classified as Credit Program Receivables on the Consolidated Balance Sheet. According to "Federal Accounting Standards Advisory Board Standard No. 2, *Accounting for Direct Loans and Loan Guarantees*," a negative liability is reasonable, as that the accounting standard was written with deference to budgetary rules as promulgated by OMB. 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)

	2013	2012
<b>Beginning Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>\$ (1,013)</b>	<b>\$ (9,984)</b>
<b>Activity</b>		
Interest Supplement Payments	1,336	1,756
Claim Payments	9,125	9,291
Fee Collections	(2,239)	(2,344)
Interest on Liability Balance	1,783	1,440
Other <sup>1</sup>	(12,564)	(12,748)
<b>Total Activity</b>	<b>(2,559)</b>	<b>(2,605)</b>
<b>Components of Loan Modifications</b>		
Loan Modification Costs	-	(153)
Modification Adjustment Transfers	-	(6)
<b>Loan Modifications</b>	<b>-</b>	<b>(159)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	-	-
Technical and Default Re-estimates	7,832	11,735
<b>Subsidy Re-estimates</b>	<b>7,832</b>	<b>11,735</b>
<b>Ending Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>4,260</b>	<b>(1,013)</b>
FFEL Liquidating Account Liability for Loan Guarantees	(16)	(24)
<b>Liabilities for Loan Guarantees</b>	<b>\$ 4,244</b>	<b>\$ (1,037)</b>

<sup>1</sup> Other activity is comprised of negative special allowance collections, collections on defaulted FFEL loans, and loan cancellations due to death, disability, or bankruptcy. In addition, other miscellaneous collections, expenditures, and accruals related to operations are recorded.

The presentation of the FY 2012 Liability for Loan Guarantees is in the liability section of the Department's Balance Sheet, while the presentation of the FY 2013 liability is in the Credit Program Receivables Balance Sheet line item. The Liability for Loan Guarantees schedule above presents both years.

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. Loans in these programs are acquired loans by the Department. 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)

	2013	2012
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ 5,258</b>	<b>\$ 4,415</b>
<b>Activity</b>		
Subsidy Allowance Amortization	(771)	(684)
Loan Cancellations	106	84
Contract Collection Cost and Other	51	37
<b>Total Activity</b>	<b>(614)</b>	<b>(563)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	-	-
Technical and Default Re-estimates	544	1,406
<b>Subsidy Re-estimates</b>	<b>544</b>	<b>1,406</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ 5,188</b>	<b>\$ 5,258</b>

### Loan Participation Purchase Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2013	2012
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ 8,910</b>	<b>\$ 8,564</b>
<b>Activity</b>		
Subsidy Allowance Amortization	(1,319)	(1,167)
Loan Cancellation	197	157
Contract Collection Cost and Other	43	(37)
<b>Total Activity</b>	<b>(1,079)</b>	<b>(1,047)</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	-	-
Technical and Default Re-estimates	377	1,393
<b>Subsidy Re-estimates</b>	<b>377</b>	<b>1,393</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ 8,208</b>	<b>\$ 8,910</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 on uninvested funds.

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. Changes in timing of interest accrual have zero effect on the financial statements. 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 monthly basis. In addition, no

budgetary resources or status of resources are affected, including expended and unexpended obligations. The amounts are affected by the timing of interest accruals; however, the amounts related to these timing differences are not material to the footnote disclosures. (See Note 15)

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, 2013 and 2012:

### Direct Loan Program

(Dollars in Millions)

	2013	2012
Interest Expense on Treasury Borrowing	\$ 22,661	\$ 20,643
<b>Total Interest Expense</b>	<b>\$ 22,661</b>	<b>\$ 20,643</b>
Interest Revenue from the Public	\$ 26,972	\$ 20,156
Amortization of Subsidy	(7,720)	(3,778)
Interest Revenue on Uninvested Funds	3,409	4,265
<b>Total Interest Revenue</b>	<b>\$ 22,661</b>	<b>\$ 20,643</b>

### Subsidy Expense

#### William D. Ford Federal Direct Loan Program

### Direct Loan Program Subsidy Expense

(Dollars in Millions)

	2013	2012
<b>Components of Current Year Subsidy Transfers</b>		
Interest Rate Differential	\$ 37,063	\$ 32,372
Defaults, Net of Recoveries	(1,887)	(2,356)
Fees	1,801	1,792
Other	(9,967)	(8,901)
<b>Current Year Subsidy Transfers</b>	<b>27,010</b>	<b>22,907</b>
Subsidy Re-estimates	12,547	(12,187)
<b>Direct Loan Subsidy Expense</b>	<b>\$ 39,557</b>	<b>\$ 10,720</b>

William D. Ford Federal Direct Loan re-estimated subsidy cost was adjusted downward by \$12.5 billion in FY 2013. Updated discount rates for the 2012 and 2011 cohorts in the credit subsidy calculator decreased cost by \$11.8 billion. Deferment and forbearance rate changes decreased cost by \$1.5 billion. Costs increased \$1.5 billion due to increases in default and disability rates. Changes in prepayment rates reflect slower than expected prepayment activity, leading to increased interest earnings resulting in \$1.1 billion in downward subsidy 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 by \$1.8 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994–2012.

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.

### Federal Family Education Loan Program

#### FFEL Program Subsidy Expense

(Dollars in Millions)

	2013	2012
FFEL Guaranteed Loan Program Subsidy Re-estimates	\$ 7,832	\$ 11,735
Loan Purchase Commitment Subsidy Re-estimates	544	1,406
Loan Participation Purchase Subsidy Re-estimates	377	1,393
<b>FFEL Program Subsidy Re-estimates</b>	<b>8,753</b>	<b>14,534</b>
FFEL Guaranteed Loan Program Modification Costs	-	153
<b>FFEL Program Subsidy Expense</b>	<b>\$ 8,753</b>	<b>\$ 14,381</b>

FFEL Guaranteed re-estimated subsidy cost was adjusted downward by \$7.8 billion in FY 2013. Costs decreased \$5.2 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 increased \$1 billion due to increases in bankruptcy and disability rates. 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 \$12.3 billion. Re-estimated costs only include those cohorts that were 90 percent disbursed; cohort years 1992–2010.

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.

## Subsidy Rates

The subsidy rates applicable to the 2013 loan cohort year follow:

### Subsidy Rates—Cohort 2013

	Interest Differential	Defaults	Fees	Other	Total
Direct Loan Program	(26.22%)	0.88%	(1.33%)	7.48%	(19.19%)
TEACH Program	3.47%	0.41%	0.00%	7.13%	11.01%

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 may include re-estimates. The subsidy rates shown above, which reflect aggregate negative subsidy in the FY 2013 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, 2013 and 2012, consisted of the following:

### Administrative Expenses

(Dollars in Millions)

	2013		2012	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	\$ 639	\$ 413	\$ 543	\$ 321
Other Expense	25	16	26	16
<b>Total</b>	<b>\$ 664</b>	<b>\$ 429</b>	<b>\$ 569</b>	<b>\$ 337</b>



**Note 7. Property and Equipment, Net**

Property and Equipment, as of September 30, 2013 and 2012, consisted of the following:

**Property and Equipment, Net**

(Dollars in Millions)

	2013		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software, and Telecommunications Equipment	\$ 177	\$ (175)	\$ 2
Furniture and Fixtures	3	(3)	-
<b>Property and Equipment, Net</b>	<b>\$ 180</b>	<b>\$ (178)</b>	<b>\$ 2</b>

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

The depreciation expense as of September 30, 2013 and 2012 is \$6 million and \$9 million, respectively.

The major drivers of fixed assets at the Department are improvements to information technology including financial management and program management systems. Specifically, recent enhancements have been made to the Department's automated grant management capability. The Department acquires more robust information technology to augment its significant capabilities to manage student loan and grant operations.

## 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 have been determined to be 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.

All Department and contractor staff are housed in leased buildings. The Department does not own real property. 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, are expensed as incurred. The Department leases 22 privately owned and 8 publicly owned buildings in 19 cities. Building lease expense as of September 30, 2013 and 2012, was \$80 million and \$65 million, respectively. Estimated future minimum lease payments for the privately and publicly owned buildings are presented below.

<b>Leases</b>	
(Dollars in Millions)	
<b>2013</b>	
<b>FY</b>	<b>Amount</b>
2014	\$ 80
2015	90
2016	93
2017	96
2018	100
After 2018	103
<b>Total</b>	<b>\$ 562</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. Under this agreement, funds are transferred from the Department to Interior to fund initiatives that include, but are not limited to: (1) Improving Basic Programs Operated by Local Education Agencies, (2) Comprehensive School Reform, (3) Teacher Quality Improvement Formula Grants, (4) Enhancing Education through Technology, and (5) 21<sup>st</sup> Century Community Learning Centers. Other Intragovernmental Assets were \$22 million and \$18 million as of September 30, 2013 and 2012, 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 \$13 million and \$21 million as of September 30, 2013 and 2012, respectively.

## Note 9. Accounts Payable

Accounts Payable, as of September 30, 2013 and 2012, consisted of the following:

<b>Accounts Payable</b> (Dollars in Millions)		
	<b>2013</b>	<b>2012</b>
Direct Loan Booking Accrual	\$ 2,923	\$ 2,984
In Process Disbursements:		
Direct Loans	573	588
Grants	366	288
FFEL Claim Payments	52	163
Contractual Services	228	-
Other	(15)	75
<b>Accounts Payable to the public</b>	<b>4,127</b>	<b>4,098</b>
Intragovernmental Accounts Payable	2	31
<b>Total Accounts Payable</b>	<b>\$ 4,129</b>	<b>\$ 4,129</b>

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. The Department pays vendor invoices according to the Prompt Payment Act rules that are built into the financial system as a control mechanism, generally within 25–30 days of receipt of goods and proper invoicing. The Department also monitors and leverages vendor discount opportunities by processing payments to coincide with discount terms when possible.

Accounts Payable Other abnormal balance of \$(15) million is primarily due to FFEL Guaranteed Loan Program collections of fees, principal, and interest on defaulted loans.

## Note 10. Debt

Debt, as of September 30, 2013 and 2012, consisted of the following:

<b>Debt</b> (Dollars in Millions)					
	<b>2013</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	\$ 549,332	\$ -	\$ 177,682	\$ (28,653)	\$ 698,361
FFEL Program					
Guaranteed Loan Program	43,254	-	-	-	43,254
Loan Purchase Commitment	42,341	-	602	(4,345)	38,598
Loan Participation Purchase	77,292	-	519	(9,794)	68,017
ABCP Conduit	1,735	-	1,000	(192)	2,543
TEACH Program	370	-	128	(13)	485
Facilities Loan Programs	45	-	-	(8)	37
<b>Total Treasury Debt</b>	<b>714,369</b>	<b>-</b>	<b>179,931</b>	<b>(43,005)</b>	<b>851,295</b>
<b>Debt to the FFB</b>					
HBCU	934	-	225	(22)	1,137
<b>Total Debt to the FFB</b>	<b>934</b>	<b>-</b>	<b>225</b>	<b>(22)</b>	<b>1,137</b>
<b>Total</b>	<b>\$ 715,303</b>	<b>\$ -</b>	<b>\$ 180,156</b>	<b>\$ (43,027)</b>	<b>\$ 852,432</b>

	2012				
	Beginning Balance	Accrued Interest	Borrowing	Repayments	Ending Balance
<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 Programs	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>

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. Borrowing from Treasury decreased by \$13.2 billion and 7 percent from FY 2012. The majority of the increase in debt resulted from the Direct Loan Program borrowing for loan origination. Additionally, the FFEL, TEACH, and HBCU programs had increased borrowings.

The maturity date for borrowing from Treasury is based on the time period used in subsidy calculation, not the contractual term of the Department's or private lender's loan to the borrower. The period of time used for subsidy calculation may exceed the contractual term of a loan to a borrower. Borrowings from Treasury mature on September 30 of the estimated final year of a cohort.

**Note 11. Other Liabilities**

Other Liabilities, as of September 30, 2013 and 2012, consisted of the following:

**Other Liabilities**

(Dollars in Millions)

	2013		2012	
	Intragovern- mental	With the Public	Intragovern- mental	With the Public
<b>Liabilities Covered by Budgetary Resources</b>				
<b>Current</b>				
Advances From Others	\$ 29	\$ -	\$ 35	\$ -
Employer Contributions and Payroll Taxes	6	-	5	-
Liability for Deposit Funds and Clearing				
Accounts	7	37	(73)	36
Accrued Payroll and Benefits	-	28	-	26
Deferred Revenue	-	31	-	36
Liabilities in Miscellaneous Receipt Accounts	6,074	-	3,716	-
<b>Total Other Liabilities Covered by Budgetary Resources</b>	<b>6,116</b>	<b>96</b>	<b>3,683</b>	<b>98</b>
<b>Liabilities Not Covered by Budgetary Resources</b>				
<b>Current</b>				
Accrued Unfunded Annual Leave	-	36	-	37
<b>Non-Current</b>				
Accrued Unfunded FECA Liability	4	-	5	-
Custodial Liability	2	-	-	-
Liabilities in Miscellaneous Receipt Accounts	358	-	342	-
Capital Transfers <sup>1</sup>	2,375	-	2,914	-
Accrued FECA Actuarial Liability	-	15	-	16
<b>Total Other Liabilities Not Covered by Budgetary Resources</b>	<b>2,739</b>	<b>51</b>	<b>3,261</b>	<b>53</b>
<b>Other Liabilities</b>	<b>\$ 8,855</b>	<b>\$ 147</b>	<b>\$ 6,944</b>	<b>\$ 151</b>

<sup>1</sup> See Reclassification in Note 1.

Other liabilities include current and non-current liabilities. The current liabilities covered by budgetary resources primarily consist of downward subsidy re-estimates (\$6.1 billion), which when executed will be paid to the General Fund of the Treasury.

The non-current liabilities not covered by budgetary resources primarily relate to capital transfers (\$2.4 billion) and the student loan receivables of the Federal Perkins Loan Program (\$0.4 billion).

**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 \$2,790 million and \$3,314 million as of September 30, 2013 and 2012, respectively.

As of September 30, 2013 and 2012, liabilities on the Balance Sheet totaled \$869.2 billion and \$731.8 billion, respectively. Of this amount, liabilities covered by budgetary resources totaled \$866.4 billion as of September 30, 2013, and \$731.4 billion as of September 30, 2012.

**Note 12. Accrued Grant Liability**

Accrued Grant Liability is an accrual made by the Department for expenditures incurred by grantees prior to their receiving grant funds to cover the expenditures. Accrued Grant Liability is estimated using statistical sampling. The Accrued Grant Liability by major reporting groups, as of September 30, 2013 and 2012, consisted of the following:

<b>Accrued Grant Liability</b>		
(Dollars in Millions)		
	<b>2013</b>	<b>2012</b>
FSA	\$ 1,727	\$ 2,269
OESE	105	211
OSERS	120	233
RA/JF	61	55
Other	157	133
<b>Accrued Grant Liability</b>	<b>\$ 2,170</b>	<b>\$ 2,901</b>

**Note 13. Net Position**

Unexpended appropriations, as of September 30, 2013 and 2012, consisted of the following:

<b>Unexpended Appropriations</b>		
(Dollars in Millions)		
	<b>2013</b>	<b>2012</b>
Unobligated Balances:		
Available	\$ 13,700	\$ 10,479
Not Available	909	632
Undelivered Orders	56,762	61,575
<b>Unexpended Appropriations</b>	<b>\$ 71,371</b>	<b>\$ 72,686</b>

The Cumulative Results of Operations of \$(3,528) million and \$(7,531) million as of September 30, 2013 and 2012, respectively, consists mostly of unfunded upward subsidy re-estimates, other unfunded expenses, and net investments of capitalized assets.



Other Financing Sources on the Statement of Changes in Net Position was primarily comprised of negative subsidy transfers, downward subsidy re-estimates, and other, as of September 30, 2013 and 2012 as presented in the following table:

### Negative Subsidy Transfers, Downward Subsidy Re-Estimates, and Other

(Dollars in Millions)

	2013			
	Negative Subsidy Transfers	Downward Subsidy Re-Estimates	Other	Ending Balance
Direct Loan	\$ (27,010)	\$ (12,603)	\$ -	\$ (39,613)
FFEL	-	(11,065)	-	(11,065)
Facilities	-	(199)	(18)	(217)
Grants	-	-	(52)	(52)
TEACH	-	(18)	-	(18)
Other	-	-	(89)	(89)
<b>Total</b>	<b>\$ (27,010)</b>	<b>\$ (23,885)</b>	<b>\$ (159)</b>	<b>\$ (51,054)</b>

	2012			
	Negative Subsidy Transfers	Downward Subsidy Re-Estimates	Other	Ending Balance
Direct Loan	\$ (22,907)	\$ 1,025	\$ -	\$ (21,882)
FFEL	-	(15,699)	131	(15,568)
Facilities	-	(20)	(14)	(34)
Grants	-	-	(35)	(35)
TEACH	-	-	-	-
Other	-	-	(25)	(25)
<b>Total</b>	<b>\$ (22,907)</b>	<b>\$ (14,694)</b>	<b>\$ 57</b>	<b>\$ (37,544)</b>

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

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	FSA OPE OVAE	<b>Goal 1: Postsecondary Education, Career and Technical Education, and Adult Education.</b> 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	<b>Goal 2: Elementary and Secondary Education.</b> 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.  <b>Goal 3: Early Learning.</b> 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	<b>Goal 4: Equity.</b> 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	<b>Goal 5: Continuous Improvement of the U.S. Education System.</b> 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 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, focusing primarily upon improving the organizational and administrative capacities of the Department to implement the *Strategic Plan* Goals 1–5. The costs associated with *Strategic Plan* Goal 6 are allocated to Goals 1–5 based on full-time employee equivalents of each program.

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. Gross Cost and Exchange Revenue is the cost incurred less any exchange revenue earned from activities. The Department determines Gross Cost and Exchange Revenue by tracing amounts back to the relevant program office. Administrative overhead costs of funds unassigned are allocated based on full-time employee equivalents of each program.

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). "Increase College Access, Quality, and Completion" program negative net cost of operations is due to negative subsidy cost transfers and the downward re-estimates of prior subsidy cost. The following tables present the gross cost and exchange revenue by program for the Department for FY 2013 and FY 2012.

### Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

	2013					
	<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	\$ 28,513	\$ -	\$ -	\$ -	\$ 85	\$ 28,598
Public Gross Cost	(15,247)	-	-	-	4,237	(11,010)
Total Gross Program Costs	13,266	-	-	-	4,322	17,588
Intragovernmental Earned Revenue	(3,685)	-	-	-	(12)	(3,697)
Public Earned Revenue	(23,003)	-	-	-	(44)	(23,047)
Total Program Earned Revenue	(26,688)	-	-	-	(56)	(26,744)
<b>Total Program Cost</b>	<b>(13,422)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>4,266</b>	<b>(9,156)</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	-	188	-	-	-	188
Public Gross Cost	-	22,210	-	-	7	22,217
Total Gross Program Costs	-	22,398	-	-	7	22,405
Intragovernmental Earned Revenue	-	(2)	-	-	-	(2)
Public Earned Revenue	-	(23)	-	-	-	(23)
Total Program Earned Revenue	-	(25)	-	-	-	(25)
<b>Total Program Cost</b>	<b>-</b>	<b>22,373</b>	<b>-</b>	<b>-</b>	<b>7</b>	<b>22,380</b>
<b><i>Ensure Effective Educational Opportunities for All Students</i></b>						
Intragovernmental Gross Cost	-	-	48	-	30	78
Public Gross Cost	-	-	16,008	-	770	16,778
Total Gross Program Costs	-	-	16,056	-	800	16,856
Intragovernmental Earned Revenue	-	-	(1)	-	-	(1)
Public Earned Revenue	-	-	(24)	-	(1)	(25)
Total Program Earned Revenue	-	-	(25)	-	(1)	(26)
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>16,031</b>	<b>-</b>	<b>799</b>	<b>16,830</b>
<b><i>Enhance the Education System's Ability to Continuously Improve</i></b>						
Intragovernmental Gross Cost	-	-	-	-	62	62
Public Gross Cost	-	-	-	-	1,819	1,819
Total Gross Program Costs	-	-	-	-	1,881	1,881
Intragovernmental Earned Revenue	-	-	-	-	(2)	(2)
Public Earned Revenue	-	-	-	-	(84)	(84)
Total Program Earned Revenue	-	-	-	-	(86)	(86)
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,795</b>	<b>1,795</b>
<b><i>American Recovery and Reinvestment Act and Education Jobs Fund</i></b>						
Intragovernmental Gross Cost	-	-	-	-	-	-
Public Gross Cost	-	-	-	2,623	-	2,623
Total Gross Program Costs	-	-	-	2,623	-	2,623
Intragovernmental Earned Revenue	-	-	-	-	-	-
Public Earned Revenue	-	-	-	-	-	-
Total Program Earned Revenue	-	-	-	-	-	-
<b>Total Program Cost</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,623</b>	<b>-</b>	<b>2,623</b>
<b>Net Cost of Operations</b>	<b>(13,422)</b>	<b>22,373</b>	<b>16,031</b>	<b>2,623</b>	<b>6,867</b>	<b>34,472</b>

**Gross Cost and Exchange Revenue by Program**

(Dollars in Millions)

	<b>2012</b>					
	<b><u>FSA</u></b>	<b><u>OESE</u></b>	<b><u>OSERS</u></b>	<b><u>RA/JF</u></b>	<b><u>Other</u></b>	<b><u>Total</u></b>
<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	(25,306)	-	-	-	(34)	(25,340)
<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	-	(70)	-	-	-	(70)
<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	-	-	(10)	-	(1)	(11)
<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	-	-	-	-	(69)	(69)
<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>

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

For FY 2013 and FY 2012, interest expense and interest revenue by program consisted of the following:

**Interest Expense and Interest Revenue**

(Dollars in Millions)

	2013					
	Expenses			Revenue		
	Federal	Non-federal	Total	Federal	Non-federal	Total
Direct Loan Program	\$ 22,661	\$ -	\$22,661	\$ 3,409	\$ 19,252	\$22,661
FFEL Program :						
Guaranteed Loan Program	2,083	(1,783)	300	300	-	300
Loan Purchase Commitment	1,244	-	1,244	79	1,165	1,244
Loan Participation Purchase	2,293	-	2,293	203	2,090	2,293
ABCP Conduit	124	-	124	44	80	124
TEACH Program	16	-	16	2	14	16
Other Programs	31	-	31	12	31	43
<b>Total</b>	<b>\$ 28,452</b>	<b>\$ (1,783)</b>	<b>\$26,669</b>	<b>\$ 4,049</b>	<b>\$ 22,632</b>	<b>\$26,681</b>

	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>

Federal interest expense is recognized on the Department's outstanding Borrowings from Treasury (Debt). The Direct Loan and FFEL Programs have \$698 billion and \$153 billion in Debt, respectively, as of September 30, 2013. Federal Interest Revenue is earned on Fund Balance with Treasury for the Direct Loan and FFEL Programs. The interest rate set by OMB is the same for interest expense and income.

Non-Federal interest revenue is interest earned from the public on Credit Program Receivables held by the Department. The Credit Program Receivable balances for the Direct Loan and FFEL Program are \$679 billion and \$146 billion, respectively, as of September 30, 2013. Non-federal interest expense results from the amortization of loan subsidy.

## 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, 2013, budgetary resources were \$359,939 million and net agency outlays were \$189,379 million. As of September 30, 2012, budgetary resources were \$374,984 million and net agency outlays were \$217,370 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, 2013 and 2012, consisted of the following:

#### Obligations Incurred by Apportionment Type and Category

(Dollars in Millions)

	2013	2012
Direct:		
Category A	\$ 1,607	\$ 1,594
Category B	330,477	341,320
Exempt from Apportionment	280	419
Total Direct Apportionment	332,364	343,333
Reimbursable:		
Exempt from Apportionment	53	36
<b>Obligations Incurred</b>	<b>\$ 332,417</b>	<b>\$ 343,369</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, 2013 and 2012, consisted of the following:

### Unused Borrowing Authority

(Dollars in Millions)

	2013	2012
<b>Beginning Balance, Unused Borrowing Authority</b>	<b>\$ 145,532</b>	<b>\$ 142,194</b>
Current Year Borrowing Authority	195,185	209,614
Funds Drawn From Treasury	(180,156)	(193,318)
Borrowing Authority Withdrawn	(21,866)	(12,958)
<b>Ending Balance, Unused Borrowing Authority</b>	<b>\$ 138,695</b>	<b>\$ 145,532</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, 2013 and 2012, consisted of the following:

### Undelivered Orders

(Dollars in Millions)

	2013	2012
Budgetary	\$ 56,901	\$ 61,713
Non-Budgetary	158,703	169,062
<b>Undelivered Orders (Unpaid)</b>	<b>\$ 215,604</b>	<b>\$ 230,775</b>

Undelivered orders at the end of the period, as presented above, will differ from the undelivered orders included in Unexpended Appropriations on the Net Position. 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, 2013 and 2012, consisted of the following:

### Distributed Offsetting Receipts

(Dollars in Millions)

	2013	2012
Negative Subsidies and Downward Re-estimates:		
FFEL Program	\$ 9,946	\$ 16,371
Direct Loan Program	38,436	24,258
Facilities Loan Programs	198	20
TEACH Program	17	-
Total Negative Subsidies and Downward Re-estimates	48,597	40,649
Other	128	(37)
<b>Distributed Offsetting Receipts</b>	<b>\$ 48,725</b>	<b>\$ 40,612</b>

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

The FY 2015 *Budget of the United States Government* (President's Budget), which presents the actual amounts for the year ended September 30, 2013, has not been published as of the issue date of these financial statements. The FY 2015 President's Budget is scheduled for release in February 2014. A reconciliation of the FY 2012 SBR to the FY 2014 President's Budget (FY 2012 actual amounts) for budgetary resources, obligations incurred, distributed offsetting receipts, and net agency 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>\$ 374,984</b>	<b>\$ 343,369</b>	<b>\$ 40,612</b>	<b>\$ 217,370</b>
Expired Funds	(1,287)	(640)	-	-
Amounts Included in the President's Budget	12,041	12,010	-	-
Amounts Excluded from President's Budget and Rounding	-	1	1	(2)
Distributed Offsetting Receipts	-	-	-	40,612
<b><i>Budget of the United States Government</i><sup>1</sup></b>	<b>\$ 385,738</b>	<b>\$ 354,740</b>	<b>\$ 40,613</b>	<b>\$ 257,980</b>

<sup>1</sup>Amounts obtained from the Appendix, Budget of the United States Government, FY 2014.

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 2012 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, 2013 and 2012, are presented below:

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

(Dollars in Millions)

	2013	2012
<b><u>Resources Used to Finance Activities:</u></b>		
Obligations Incurred	\$ 332,417	\$ 343,369
Spending Authority from Offsetting Collections and Recoveries	(110,224)	(85,170)
Offsetting Receipts	(48,725)	(40,612)
<b>Net Budgetary Resources Obligated</b>	<b>173,468</b>	<b>217,587</b>
Imputed Financing from Costs Absorbed by Others	34	34
Other Financing Sources	(51,054)	(37,522)
<b>Net Other Resources</b>	<b>(51,020)</b>	<b>(37,488)</b>
<b>Net Resources Used to Finance Activities</b>	<b>122,448</b>	<b>180,099</b>
<b><u>Resources Used or Generated for Items Not Part of the Net Cost of Operations:</u></b>		
Increase/(Decrease) in Budgetary Resources Obligated but Not Yet Provided	14,721	(997)
Resources that Fund Subsidy Re-estimates Accrued in Prior Period	(3,922)	3,329
Credit Program Collections	58,352	52,238
Acquisition of Fixed Assets	(1)	-
Acquisition of Net Credit Program Assets or Liquidation of Liabilities for Loan Guarantees	(191,789)	(198,020)
Resources from Non-Entity Activity	51,229	37,447
<b>Net Resources That Do Not Finance the Net Cost of Operations</b>	<b>(71,410)</b>	<b>(106,003)</b>
<b>Net Resources Used to Finance the Net Cost of Operations</b>	<b>51,038</b>	<b>74,096</b>
<b><u>Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:</u></b>		
Depreciation	6	9
Subsidy Amortization and Interest on the Liability for Loan Guarantees	8,109	4,259
Other	27	(17)
<b>Total Components Not Requiring or Generating Resources</b>	<b>8,142</b>	<b>4,251</b>
Increase/(Decrease) in Annual Leave Liability	(1)	(1)
Accrued Re-estimates of Credit Subsidy Expense	(2,382)	3,922
Increase in Exchange Revenue Receivable from the Public	(22,288)	(18,448)
Change in Accrued Interest with Treasury	2	1
Other	(39)	(48)
<b>Total Components Requiring or Generating Resources in Future Periods</b>	<b>(24,708)</b>	<b>(14,574)</b>
<b>Total Components That Will Not Require or Generate Resources in the Current Period</b>	<b>(16,566)</b>	<b>(10,323)</b>
<b>Net Cost of Operations</b>	<b>\$ 34,472</b>	<b>\$ 63,773</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 2013 and FY 2012, the Department collected \$0.1 million and \$1.2 million, respectively, in custodial revenues.

**Note 19. American Recovery and Reinvestment Act of 2009 and Education Jobs Fund**

The Recovery Act provided \$97,407 million to the Department in supplemental appropriations for job preservation as well as 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. As of September 30, 2013, \$93,884 million has been expended and \$3,439 million is remaining available for future expenditure. As of September 30, 2012, \$91,491 million had been expended and \$5,886 million remained available for future expenditure.

Public Law 111-226, enacted on August 10, 2010, created an Education Jobs Fund, which allows the Department to provide \$10,000 million for assistance in saving and creating education jobs. As of September 30, 2013, \$9,990 million has been expended and \$10 million is remaining for future expenditure. As of September 30, 2012, \$9,771 million had been expended and \$229 million remained available for future expenditure.

**Note 20. Contingencies****Guaranty Agencies**

The Department may assist guaranty agencies experiencing financial difficulties. No provision has been made in the financial statements for potential liabilities. The Department has not done so in fiscal years 2013 or 2012 and does not expect to in future years.

**Federal Perkins Loan Program**

The Federal Perkins Loan Program is a campus-based program that provides financial assistance to eligible postsecondary school students. In FY 2013, the Department provided funding of 82.8 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 17.2 percent of program funding. For the latest academic year ended June 30, 2013, approximately 499 thousand loans were made totaling \$1 billion at 1,492 institutions, averaging \$2,021 per loan. The Department's equity interest was approximately \$6.7 billion as of September 30, 2013.

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.

**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, 2013

(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	Budgetary	Budgetary	Budgetary	Non-Budgetary Credit Reform Financing Accounts
<b>Budgetary Resources:</b>									
Unobligated Balance, Brought Forward, October 1	\$ 12,622	\$ 18,993	\$ 10,366	\$ 18,579	\$ 802	\$ 314	\$ 30	\$ 1,110	\$ 414
Recoveries of Prior Year Unpaid Obligations	1,191	35,425	358	35,425	556	110	56	111	-
Other Changes in Unobligated Balance (+ or -)	(428)	(39,189)	(266)	(39,189)	(72)	(33)	-	(57)	-
Unobligated Balance from Prior Year Budget Authority (Net)	\$ 13,385	\$ 15,229	\$ 10,458	\$ 14,815	\$ 1,286	\$ 391	\$ 86	\$ 1,164	\$ 414
Appropriations (Discretionary and Mandatory)	88,380	5	44,578	-	20,819	15,622	-	7,361	5
Borrowing Authority (Discretionary and Mandatory) (Note 16)	-	195,185	-	194,970	-	-	-	-	215
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	779	46,976	711	46,926	-	2	-	66	50
<b>Total Budgetary Resources (Note 16)</b>	<b>\$ 102,544</b>	<b>\$ 257,395</b>	<b>\$ 55,747</b>	<b>\$ 256,711</b>	<b>\$ 22,105</b>	<b>\$ 16,015</b>	<b>\$ 86</b>	<b>\$ 8,591</b>	<b>\$ 684</b>
<b>Status of Budgetary Resources:</b>									
Obligations Incurred (Note 16)	\$ 86,337	\$ 246,080	\$ 41,797	\$ 245,639	\$ 21,314	\$ 15,730	\$ 2	\$ 7,494	\$ 441
Unobligated Balance, End of Year:									
Apportioned	13,700	-	11,952	-	665	154	-	929	-
Unapportioned	2,507	11,315	1,998	11,072	126	131	84	168	243
Total Unobligated Balance, End of Year	\$ 16,207	\$ 11,315	\$ 13,950	\$ 11,072	\$ 791	\$ 285	\$ 84	\$ 1,097	\$ 243
<b>Total Status of Budgetary Resources (Note 16)</b>	<b>\$ 102,544</b>	<b>\$ 257,395</b>	<b>\$ 55,747</b>	<b>\$ 256,711</b>	<b>\$ 22,105</b>	<b>\$ 16,015</b>	<b>\$ 86</b>	<b>\$ 8,591</b>	<b>\$ 684</b>
<b>Change in Obligated Balance:</b>									
<b>Unpaid Obligations:</b>									
Unpaid Obligations, Brought Forward, October 1	\$ 65,057	\$ 172,230	\$ 24,093	\$ 171,959	\$ 15,902	\$ 9,248	\$ 6,115	\$ 9,699	\$ 271
Obligation Incurred	86,337	246,080	41,797	245,639	21,314	15,730	2	7,494	441
Outlays (Gross) (-)	(90,573)	(221,138)	(42,153)	(220,685)	(22,389)	(16,032)	(2,612)	(7,387)	(453)
Recoveries of Prior Year Unpaid Obligations (-)	(1,191)	(35,425)	(358)	(35,425)	(556)	(110)	(56)	(111)	-
Unpaid Obligations, End of Year	\$ 59,630	\$ 161,747	\$ 23,379	\$ 161,488	\$ 14,271	\$ 8,836	\$ 3,449	\$ 9,695	\$ 259
<b>Uncollected Payments:</b>									
Uncollected Payments, Federal Sources, Brought Forward, October 1 (-)	\$ (2)	\$ (26)	\$ -	\$ (4)	\$ -	\$ -	\$ -	\$ (2)	\$ (22)
Change in Uncollected Payments, Federal Sources (+ or -)	(1)	1	-	1	-	-	-	(1)	-
Uncollected Payments, Federal Sources, End of Year (-)	\$ (3)	\$ (25)	\$ -	\$ (3)	\$ -	\$ -	\$ -	\$ (3)	\$ (22)
<b>Memorandum (Non-add) Entries:</b>									
Obligated Balance, Start of Year (+ or -)	\$ 65,055	\$ 172,204	\$ 24,093	\$ 171,955	\$ 15,902	\$ 9,248	\$ 6,115	\$ 9,697	\$ 249
Obligated Balance, End of Year (+ or -)	\$ 59,627	\$ 161,722	\$ 23,379	\$ 161,485	\$ 14,271	\$ 8,836	\$ 3,449	\$ 9,692	\$ 237
<b>Budget Authority and Outlays, Net:</b>									
Budget Authority, Gross (Discretionary and Mandatory)	\$ 89,159	\$ 242,166	\$ 45,289	\$ 241,896	\$ 20,819	\$ 15,624	\$ -	\$ 7,427	\$ 270
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(935)	(72,672)	(844)	(72,601)	-	(2)	-	(89)	(71)
Change in Uncollected Customer Payments from Federal Sources (Discretionary and Mandatory) (+ or -)	(1)	1	-	1	-	-	-	(1)	-
<b>Budget Authority, Net (Discretionary and Mandatory)</b>	<b>\$ 88,223</b>	<b>\$ 169,495</b>	<b>\$ 44,445</b>	<b>\$ 169,296</b>	<b>\$ 20,819</b>	<b>\$ 15,622</b>	<b>\$ -</b>	<b>\$ 7,337</b>	<b>\$ 199</b>
Outlays, Gross (Discretionary and Mandatory)	\$ 90,573	\$ 221,138	\$ 42,153	\$ 220,685	\$ 22,389	\$ 16,032	\$ 2,612	\$ 7,387	\$ 453
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(935)	(72,672)	(844)	(72,601)	-	(2)	-	(89)	(71)
Outlays, Net (Discretionary and Mandatory)	89,638	148,466	41,309	148,084	22,389	16,030	2,612	7,298	382
Distributed Offsetting Receipts (-) (Note 16)	(48,725)	-	(48,445)	-	-	-	-	(280)	-
<b>Agency Outlays, Net (Discretionary and Mandatory) (Note 16)</b>	<b>\$ 40,913</b>	<b>\$ 148,466</b>	<b>\$ (7,136)</b>	<b>\$ 148,084</b>	<b>\$ 22,389</b>	<b>\$ 16,030</b>	<b>\$ 2,612</b>	<b>\$ 7,018</b>	<b>\$ 382</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's annual appropriations and outlays augments the state and local government funding and helps to build human capital in the nation by supporting cradle- to-career education programs. The Department invests in human capital through its grant and loan programs, research, leadership, and technical assistance. These activities are supported across the Department, primarily through expenditures to assist students who attend institutions of higher education, grants, and support for state and local educational agencies.

Human capital investments are expenses included in net cost for education and training programs intended to: (1) increase or maintain national economic productive capacity, and that (2) produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity.

Primary support is offered by the Office of Federal Student Aid, which 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.

The offices of Elementary and Secondary Education, Special Education and Rehabilitative Services, Innovation and Improvement, English Language Acquisition, Vocational and Adult Education, and Postsecondary Education provide leadership, technical assistance, and financial support to state and local educational agencies and institutions of higher education for reform, strategic investment, and innovation in education.

Institute of Education Sciences is the research arm of the Department. 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.

An interactive version of the Department's organizational chart is available at: <http://www2.ed.gov/about/offices/or/index.html?src=ln>.

The table presents the net cost to the Department for its investments in human capital. In summary, human capital expenses include the cost of grants, loans, and salaries and administrative expenses. These costs are offset by the estimated negative subsidy, which is explained in more detail in Note 6: Credit Programs for Higher Education, in the footnotes to the financial statements.

Summary of Human Capital Expenses					
(Dollars in Millions)	2013	2012	2011	2010	2009
<b>Federal Student Aid Expense</b>					
Direct Loan Subsidy	\$ (39,557)	\$ (10,720)	\$ (28,630)	\$ (1,567)	\$ (9,603)
Federal Family Education Loan Program Subsidy	(8,753)	(14,381)	(16,126)	(14,344)	(29,940)
Perkins Loans, Pell and Other Grants	33,542	34,310	39,008	26,799	17,302
Salaries and Administrative	222	192	193	208	186
<b>Subtotal</b>	<b>(14,546)</b>	<b>9,401</b>	<b>(5,555)</b>	<b>11,096</b>	<b>(22,055)</b>
<b>Other Departmental</b>					
Elementary and Secondary Education	22,221	22,137	21,195	21,608	21,443
Special Education and Rehabilitative Services	15,919	16,139	15,357	15,227	15,075
American Recovery and Reinvestment Act and Education Jobs Fund	2,623	7,651	27,945	44,019	21,616
Other Departmental Programs	6,175	6,211	7,341	7,067	7,150
Salaries and Administrative	703	481	504	502	472
<b>Subtotal</b>	<b>47,641</b>	<b>52,619</b>	<b>72,342</b>	<b>88,423</b>	<b>65,756</b>
<b>Grand Total</b>	<b>\$ 33,095</b>	<b>\$ 62,020</b>	<b>\$ 66,787</b>	<b>\$ 99,519</b>	<b>\$ 43,701</b>

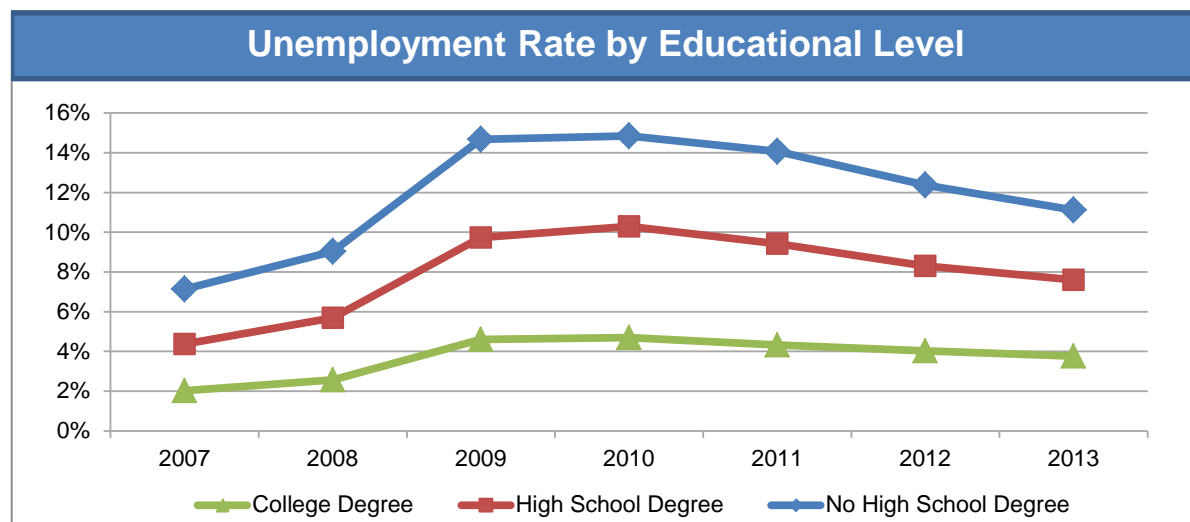
## Program Outcomes

Dramatically boosting completion rates for bachelor's and associate degrees is essential for Americans to compete in a global economy. The President thus set a goal in 2009—that, by 2020, the U.S. will have the highest proportion of college graduates in the world. Education is the stepping stone to higher living standards for American citizens, and it is vital to national economic growth. Not only does education increase the average lifetime salary of the more educated, it also reduces the risk of unemployment.

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 seek employees with the highest level of skills. For prospective employees, the focus on higher-level skills means investing in learning or developing skills through education. Like all investments, developing higher-level skills involves costs and benefits.

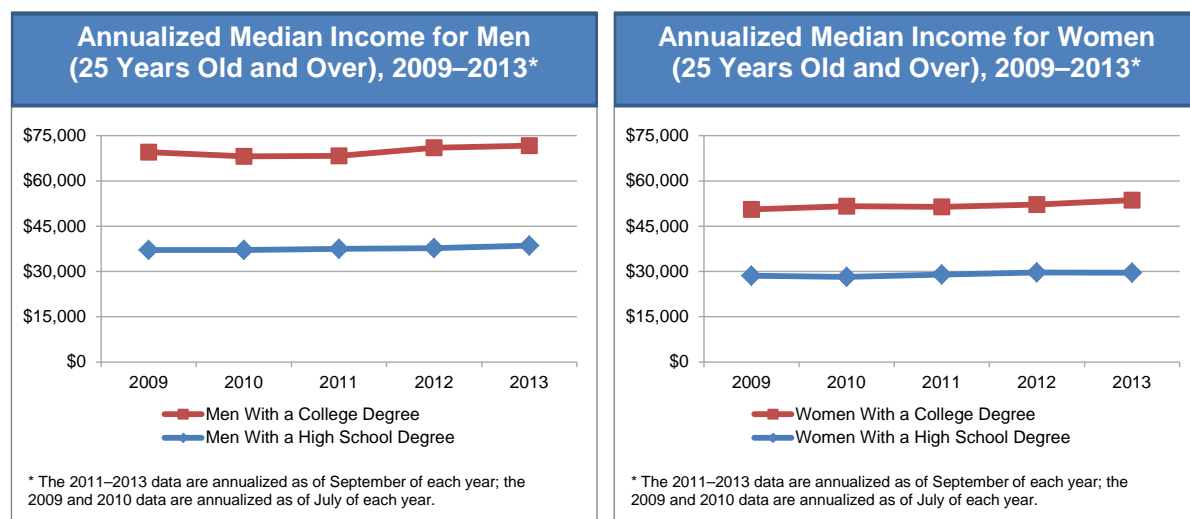
Returns related to the individual include higher earnings, better job opportunities, and jobs that are less sensitive to general economic conditions. These refer not just to salary levels over the lifetime of an individual, but include the employability of a person over one's lifetime as well. These individual benefits also support the economic well-being of the nation through reduced reliance on welfare subsidies, increased participation in civic activities, and greater productivity.

**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 2013 unemployment rate for adults (25 years old and over) who had not completed high school was 10.3 percent, compared with 7.6 percent for those with four years of high school and 3.7 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.



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

**Annual Income.** As of September 2013, the annualized median income for adults (25 years old and over) varied considerably by education level. Men with a high school diploma earned \$38,584, compared with \$71,656 for men with a college degree. Women with a high school diploma earned \$29,588, compared with \$53,612 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.





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

THE INSPECTOR GENERAL

December 11, 2013

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

Dear Secretary Duncan:

The enclosed reports present the results of the audit of the U.S. Department of Education's (Department) financial statements for fiscal year 2013 to comply with the Chief Financial Officers Act of 1990, as amended. 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 CliftonLarsonAllen, LLP (CliftonLarsonAllen) to audit the financial statements of the Department as of September 30, 2013, and for the year then ended. The contract requires that the audit be performed in accordance with U.S. generally accepted government auditing standards and Office of Management and Budget bulletin, *Audit Requirements for Federal Financial Statements*.

**Results of the Independent Audit**

CliftonLarsonAllen found:

- The fiscal year 2013 financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America;
- Two significant deficiencies in internal control over financial reporting;
- No instances of reportable noncompliance with certain provisions of laws and regulations tested or other matters, except for noncompliance with the Federal financial management systems requirement of the Federal Financial Management Improvement Act of 1996.

**Evaluation and Monitoring of Audit Performance**

The Inspector General Act of 1978 requires that the Inspector General take appropriate steps to assure that any work performed by non-Federal auditors complies with the audit standards established by the Comptroller General. In that regard, we evaluated the independence, objectivity, and qualifications of the auditors and specialists; reviewed the plan and approach of the audit; monitored the performance of the audit; reviewed CliftonLarsonAllen's reports and related audit documentation; and inquired of its representatives.

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

Page 2 – The Honorable Arne Duncan

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 or other matters.

CliftonLarsonAllen 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 or other matters. Our review disclosed no instances where CliftonLarsonAllen did not comply, in all material respects, with U.S. generally accepted government auditing standards.

We appreciate the cooperation given CliftonLarsonAllen and my office during the audit. If you have any questions or would like to discuss the reports, please contact me at (202) 245-6900.

Sincerely,



Kathleen S. Tighe  
Inspector General

Enclosure

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





CliftonLarsonAllen LLP

www.cliftonlarsonallen.com

## INDEPENDENT AUDITORS' REPORT

Inspector General  
United States Department of Education

Secretary  
United States Department of Education

In our audit of the fiscal year (FY) 2013 financial statements of the U.S. Department of Education (the Department), we found:

- The financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America (U.S.);
- Two significant deficiencies in internal control over financial reporting;
- No instances of reportable noncompliance with certain provisions of laws and regulations tested or other matters, except for noncompliance with the Federal financial management systems requirement of the Federal Financial Management Improvement Act of 1996 (FFMIA).

The following sections and Exhibits discuss in more detail: (1) these conclusions, (2) Management's Discussion and Analysis (MD&A), other required supplementary information (RSI), and other information included with the financial statements, (3) management's responsibilities, (4) our responsibilities, (5) management's response to findings and (6) the current status of prior year findings.

### Report on the Financial Statements

We have audited the accompanying financial statements of the Department, which comprise the consolidated balance sheet as of September 30, 2013, and the related consolidated statements of net cost and changes in net position, the combined statement of budgetary resources for the year then ended, and the related notes to the financial statements. The objective of our audit was to express an opinion on the fairness of these financial statements.

### Management's Responsibilities

Department management is responsible for the (1) preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the U.S., (2) preparation, measurement, and presentation of the RSI in accordance with the prescribed accounting principles generally accepted in the U.S., (3) preparation and presentation of other information in documents containing the audited financial statements and auditors' report, and consistency of that information with the audited financial statements and the RSI; and (4) design, implementation, and maintenance of internal control relevant to the preparation and fair



## INDEPENDENT AUDITORS' REPORT (Continued)

presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibilities***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the U.S. and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. We also conducted our audit in accordance with Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 14-02).

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion on the Financial Statements***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Education as of September 30, 2013, and its net costs, changes in net position, and budgetary resources for the year then ended, in accordance with accounting principles generally accepted in the U.S.

### ***Other Matters***

#### **Required Supplementary Information**

Accounting principles generally accepted in the U.S. require that the Department's MD&A and other RSI illustrated on pages 2 through 42 and 90 through 93, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board (FASAB), who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the MD&A and other RSI in accordance with auditing standards generally accepted in the U.S., 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the MD&A or other RSI

**INDEPENDENT AUDITORS' REPORT (Continued)**

because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Information**

The Message from the Secretary and the Other Information on pages ii through iv and 122 through 145 contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or RSI. The Message from the Secretary and the Other Information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

**Prior Year Financial Statements**

The FY2012 financial statements of the Department were audited by other auditors whose report, dated November 16, 2012, expressed an unmodified opinion on those statements.

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

In planning and performing our audit of the financial statements, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 or on management's assertion on internal control included in the MD&A. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control or on management's assertion on internal control included in the MD&A.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Department's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we identified certain deficiencies in internal control, described below and in Exhibit A, that we consider to be significant deficiencies.



## INDEPENDENT AUDITORS' REPORT (Continued)

### Functionality and internal controls over some loan servicing systems need improvement

The Department's Federal Student Aid (FSA) office experienced significant issues with the initial functionality of two new loan servicing systems implemented at the beginning of FY2012. These issues directly impacted the reliability of borrower account information and the related financial statement balances throughout FY2012. Management identified, and the implemented corrective actions addressed, a number of the underlying system issues in FY2012. However, some of the remaining FY2012 issues, including new issues of lesser significance identified in FY2013, continued to impact the reliability of borrower account information and related financial statement balances throughout FY2013. The primary issues affecting the reliability of the Department's financial reporting during FY2013 included:

- Defaulted student loans, valued at \$1.1 billion, had not yet been transferred to the new defaulted loan servicing system due to system functionality and new servicer set up issues at September 30, 2013.
- The defaulted loan servicing system was unable to report transfer transactions to the general ledger reliably during the year, resulting in large transfer differences with both the general ledger and with the non-defaulted loan servicers.
- Additional errors affecting the interest rate and calculation of interest on defaulted loans were identified, affecting six million borrowers for an estimated \$79 million at September 30, 2013.
- Both new systems continued to experience financial reporting errors and delays in recording cash receipts during the year, resulting in ongoing differences with the U.S. Treasury reported balances.
- Both new systems continued to experience errors and delays in the reporting of the application of loan payments to the general ledger, resulting in aged unapplied cash balances.
- Unrecorded and erroneously recorded transactions in both new systems continued to affect the Department's ability to complete timely and accurate account reconciliations.
- Systemic issues in the non-defaulted loan servicing system affected the accuracy of borrower accounts and the general ledger.
- Programming errors related to the truncation of accrued interest on large non-defaulted loan balances were identified in FY2013, affecting 54 loans for an estimated \$9 million in unrecorded interest.

Correcting the impact of these issues on individual borrower accounts has been an intensive process, requiring the Department to 1) identify the cause for the error, 2) establish controls for preventing proliferation of the issues, 3) identify affected borrowers, 4) correct the system functionality for key business processes, 5) where applicable, correct the underlying data, and 6) recalculate the correct borrower loan balances. The affected borrowers, who represent a small portion of the Department's loan portfolio, will be (or have been) notified of adjustments to their balances as a result of this process. Corrective actions are further complicated by the Department transferring many of the affected accounts from the new systems to other loan servicers in FY2013. As of September 30,

## INDEPENDENT AUDITORS' REPORT (Continued)

2013, the portfolio of the new non-defaulted loan system was transferred out to other servicers, effectively mitigating the risk of proliferation of issues.

Ensuring the effect of these system functionality issues is properly accounted for in the Department's internal and external financial reports has also required extensive resources dedicated to managing the complex reconciliation processes and the resolution of improperly posted transactions.

### The Department and FSA management need to mitigate persistent Information Technology (IT) control deficiencies

Due to the unique requirements of the Department's grant, loan and administrative business activities, the Department oversees a large portfolio of government-owned/government operated, government-owned/contractor-operated, and contractor-owned/contractor-operated information systems. Five FSA systems and one Department system comprise the key financial systems. The third party servicers who manage the Department and FSA's general support systems are monitored by management through the use of Service Level Agreements and independent reviews. For several years, financial and other audits have identified numerous system deficiencies that affect the security and reliability of the information within these systems. Our audit continued to identify similar control deficiencies in the following areas:

#### *Security management*

- The Department's IT policies were outdated or did not fully address specific controls required by the National Institute of Standards and Technology (NIST)
- Incomplete System Security Plans
- Annual security control assessments not completed
- System risk assessments not kept up-to-date
- Lack of tracking and passed deadlines for corrective actions related to IT control weaknesses
- Security awareness training for new personnel not completed
- Role based security awareness training for personnel with significant system security responsibilities not completed

#### *Personnel security*

- Background reinvestigations not being tracked effectively

#### *Access controls*

- Lack of documented approval for system access
- Untimely termination of system access for separated employees and contractors
- Inactive accounts not disabled
- Inappropriate authorization for users with access to both development and production environments, resulting in a segregation of duties issue
- Duplicate user accounts
- Incomplete user recertification
- Expired or undocumented external interconnection security agreements

## INDEPENDENT AUDITORS' REPORT (Continued)

### *Incident response*

- Inaccurate tracking of security incidents

### *Configuration management*

- System configuration settings not in compliance with Department policy

### *Contingency planning*

- Contingency plan not kept up-to-date

Additionally, four of seven independent reviews of Federal Student Aid's (FSA) third party servicers identified the following IT control issues:

- Developer access to the production environment for one system
- Improper restriction and monitoring of privileged access
- Lack of adherence to configuration management plans
- Lack of contingency procedures, back up procedures, inadequate disaster recovery testing, and failure to maintain adequate offsite data backups
- Lack of an adequate organization-level risk assessment process
- Data management strategies not formally identified, documented, and authorized

These deficiencies can increase the risk of unauthorized access to the Department's systems used to capture, process, and report financial transactions and balances.

### ***Report on Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the Department's financial statements are free from 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. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests, exclusive of those required by FFMIA as discussed below, disclosed no instances of noncompliance or other matters that are required to be reported in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States or OMB Bulletin 14-02.

### ***Systems Compliance with FFMIA Requirements***

Under FFMIA, we are required to report whether the financial management systems used by the Department substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. However, providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. As discussed below, the results of our tests disclosed the Department's financial management systems did not substantially comply with Federal financial management systems requirements. The results of our tests disclosed no instances where the Department's financial management systems did not substantially comply with applicable Federal accounting standards or the USSGL at the transaction level.



## INDEPENDENT AUDITORS' REPORT (Continued)

### The Department's financial management systems do not meet Federal financial management systems requirements

As noted in the two significant deficiencies summarized above, several of the Department's financial systems for managing the Department's portfolio of loans receivable possessed technical and operational deficiencies in their functionality and general and application controls that impacted the Department's ability to maintain effective internal control over operations and reliable financial reporting, and to produce reliable and timely information for managing the day-to-day operations of the Department throughout FY2013. These deficiencies also impacted the efficiency of the Department's operation for servicing the direct loan portfolio.

FSA's Office of Business Operations is responsible for ensuring the overall compliance of these systems with FFMIA requirements.

Additional detail on the nature of these deficiencies, their causes and our specific recommendations are presented in Exhibit A. Additional detail on this noncompliance is presented in Exhibit B.

### ***Management's Responsibility for Internal Control and Compliance***

Management is responsible for (1) evaluating the effectiveness of internal control over financial reporting based on criteria established under the Federal Managers Financial Integrity Act (FMFIA), (2) providing a statement of assurance on the overall effectiveness on internal control over financial reporting, (3) ensuring the Department's financial management systems are in substantial compliance with FFMIA requirements, and (4) ensuring compliance with other applicable laws and regulations.

### ***Auditors' Responsibilities***

We are responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting to plan the audit, (2) testing whether the Department's financial management systems substantially comply with the FFMIA requirements referred to above, (3) testing compliance with certain provisions of laws and regulations that have a direct and material effect on the financial statements and applicable laws for which OMB Bulletin 14-02 requires testing, and (4) applying certain limited procedures with respect to the RSI and all other information included with the financial statements.

We did not evaluate all internal controls relevant to operating objectives as broadly established by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our audit results to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

## INDEPENDENT AUDITORS' REPORT (Continued)

We did not test compliance with all laws and regulations applicable to the Department. We limited our tests of compliance to certain provisions of laws and regulations that have a direct and material effect on the financial statements and those required by OMB Bulletin 14-02 that we deemed applicable to the Department's financial statements for the fiscal year ended September 30, 2013. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes. Also, our work on FFMIA would not necessarily disclose all instances of noncompliance with FFMIA requirements.

### ***Management's Response to Findings***

Management's response to the findings identified in our report is presented in Exhibit D. We did not audit the Department's response and, accordingly, we express no opinion on it.

### ***Status of Prior Year's Control Deficiencies***

We have reviewed the status of the Department's corrective actions with respect to the findings included in the prior year's *Report on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*, dated November 16, 2012. The status of prior year findings is presented in Exhibit C.

### ***Purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance and Other Matters***

The purpose of the Report on Internal Control over Financial Reporting and the Report on Compliance and Other Matters sections of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or on compliance. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control and compliance. Accordingly, these reports are not suitable for any other purpose.



CliftonLarsonAllen LLP  
Arlington, Virginia  
December 11, 2013



**INDEPENDENT AUDITORS' REPORT**  
**Exhibit A**  
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**Functionality and Internal Controls Over Some Loan Servicing Systems Need Improvement**

In order to process the millions of transactions resulting from the rapidly growing portfolio of direct student loans, the Department has contracted with various loan servicers who record loan transactions, process collections, manage borrower accounts and borrower communications, report transactions to the Department's general ledger, and assist the Department in reconciling the general ledger to the various proprietary loan origination and servicing systems and platforms. In early FY2012, two new loan servicing systems, one exclusively dedicated to servicing defaulted student loans, were brought into production. Both systems contained various functionality issues, resulting in improper loan servicing, errors in account balances, and untimely financial reporting and account reconciliations. Although the most significant functionality issues were identified and addressed in FY2012, the Department continued to experience difficulties in resolving their effects throughout FY2013. In their efforts to implement corrective actions, the Department identified additional programming errors affecting borrower balances. The primary issues affecting the reliability of the Department's financial reporting during FY2013 included:

- Defaulted student loans, valued at \$1.1 billion, had not yet been transferred to the new defaulted loan servicing system due to system functionality and new servicer set up issues at September 30, 2013.
- The defaulted loan servicing system was unable to report transfer transactions to the general ledger reliably during the year, resulting in large transfer differences with both the general ledger and with the non-defaulted loan servicers.
- Additional errors affecting the interest rate and calculation of interest on defaulted loans were identified, affecting six million borrowers for an estimated \$79 million at September 30, 2013.
- Both new systems continued to experience financial reporting errors and delays in recording cash receipts during the year, resulting in ongoing differences with the U.S. Treasury reported balances.
- Both new systems continued to experience errors and delays in the recording of the application of loan payments to the general ledger, resulting in aged unapplied cash balances.
- Unrecorded and erroneously recorded transactions in both new systems continued to affect the Department's ability to complete timely and accurate account reconciliations.
- Systemic issues in the non-defaulted loan servicing system affected the accuracy of borrower accounts and the general ledger.
- Programming errors related to the truncation of accrued interest on large non-defaulted loan balances were identified in FY2013, affecting 54 loans for an estimated \$9 million in unrecorded interest.

These issues are discussed in detail on the following pages.

Transfer of defaulted loans to the new defaulted loan servicing system

Defaulted student loans were not transferred timely to the new defaulted loan servicing system, the Debt Management and Collection System (DMCS), due to system functionality and new servicer set up issues. DMCS continued to experience difficulty in processing redefaulted loans

**INDEPENDENT AUDITORS' REPORT**  
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where the initial default was processed in the legacy system, since the legacy data on the initial default was not transferred over from the legacy system into DMCS. Late in FY2013, the major functionality issues preventing the transfer of redefaulted loans to DMCS were resolved. This allowed redefaulted loans for 54,000 borrowers, valued at \$752 million, to be successfully transferred to DMCS during FY2013. However, there remained a redefaulted loan backlog at September 30, 2013 consisting of 66,824 borrowers with loan balances of \$941 million. Working with the defaulted loan servicer, management has developed a plan that is expected to complete the transfer and clear the backlog of redefaulted loans by the end of May 2014. Further, new not-for-profit loan servicers established in FY2013 were not immediately set up to transfer defaulted loans to the new defaulted loan servicing system.

As a result of the system functionality and the new servicer set up issues, loans beyond 365 days of delinquency, valued at \$1.1 billion, have not yet been transferred to DMCS at September 30, 2013.

While the balance of these defaulted loans was properly reported in the accompanying financial statements, the servicers holding these loans did not initiate defaulted loan servicing activities during this time. It is not clear what impact, if any, this delay will have on the collectability of these loans.

Timely recording of the defaulted loan transfer transactions to the general ledger

The defaulted loan servicing system was unable to record transfer transactions to the general ledger timely during the year, resulting in large differences in the net balance of transfers with the general ledger and the non-defaulted loan servicers. In reviewing the portfolio reconciliations between DMCS and the general ledger for direct loans, we noted differences greater than \$2.5 billion in principal and \$300 million in interest throughout the first quarter arising from the system's failure to report changes in DMCS to the monthly financial activity transactions file transmitted to the general ledger. This system functionality issue was largely corrected in March 2013, at which time the difference decreased to \$72 million in principal and \$108 million in interest. At June 30 and September 30, 2013, these differences amounted to \$25 million in principal and \$15 million in interest.

We also noted large variances in the portfolio reconciliations between DMCS and the general ledger for defaulted and acquired FFEL loans, which were reduced to much smaller differences at September 30, 2013.

The Department's reconciliation procedures identified approximately \$69 million in transfer-out related transaction correction entries that were incorrectly coded as write-offs in DMCS. These were subsequently recoded as transfers in DMCS. Approximately \$712 million of transfer out transactions did not pass the general ledger system edit check process. A multi-step correction process was then performed for these transactions to be correctly processed in the general ledger as transfers out of DMCS.

Despite the progressive reduction of the overall difference between the DMCS transactions reported in the monthly financial activity files that were transmitted to the general ledger, loan transfers in and out of DMCS continue to not be recorded timely. At September 30, 2013, management reported that there was a difference of \$137 million between the defaulted loan transfers to DMCS reported by other servicers and the amounts reported by DMCS to the general ledger. Further, at September 30, 2013, DMCS had transferred \$296 million in



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rehabilitated loans to other servicers for which the receiving servicer had not recorded the transfer-in entry to the general ledger. These differences represent servicer level differences and do not impact the accuracy of the loan receivable balances reported in the accompanying financial statements.

**Errors affecting the interest rate and calculation of interest on defaulted loans**

During their efforts to correct the DMCS system functionality issues, the Department and its defaulted loan servicer identified additional interest rate conversion and coding errors in FY2013 that affected six million borrower accounts with an estimated gross adjustment to the loan principal and the related accrued interest balance of \$79 million. The corrective actions related to this issue are complicated by rehabilitated defaulted loans that have since been transferred to other servicers and defaulted loans that have since been discharged, paid-in-full or compromised. While several interest rate corrections have been completed in FY2013, the execution of the remaining corrections is expected to take place in FY2014.

**Errors and delays in recording cash receipts during the year resulted in differences with the U.S. Treasury reporting for both new systems**

Borrower payments are sent to a Federal lockbox, where data on batches of deposits and other cash transactions, referred to as "schedules", are transmitted to both the servicers' systems and the U.S. Treasury's Collections Information Repository (CIR). The Department requires servicers to record the schedules in the servicing system within one to two business days and then transmit the information electronically to the Department's general ledger. Due to functionality issues with the two new systems, a large number of schedules were rejected from recording in the general ledger upon initial transmittal. Every time a transaction transmission was rejected from posting, the servicers had to correct and resubmit the erroneous transactions. However, the delay in recording transactions gave rise to differences between the Department's general ledger balances and the balances reported by the U.S. Treasury. The transactions recorded in the U.S. Treasury's CIR but not recorded in the Department's general ledger totaled approximately \$164 million, \$231 million, \$138 million, and \$6 million at December 30, 2012, March 31, 2013, August 31, 2013 and September 30, 2013, respectively. The decrease in reporting differences at the end of the fiscal year reflects the significant completion of the corrective actions implemented during the year, which were closely monitored by Department management.

**Errors and delays during the year resulted in aged balances of unapplied loan payments for both new systems**

Schedules of cash transactions received from the Federal lockbox are initially recorded in a suspense fund. The Department's loan servicers also receive electronic data on all borrower collections that comprise the cash transaction schedule. Payments should be applied to the borrower's account within 24 hours of receipt. When loan servicers apply payments to borrowers' accounts, the corresponding amount is removed from the suspense fund and transferred to the appropriate fund (e.g., direct loan, FFEL, etc.). The payment application transactions recorded in the servicer system are sent electronically for recording in the Department's general ledger. Both new servicing systems continued to experience financial reporting errors and delays during the year, resulting in aged suspense fund balances older and larger than Department targets. As a result of close monitoring action, much of the suspense account issues identified during the year were addressed at year end. The balance of transactions in suspense at September 30, 2013 for both new systems was a negative \$62 million, with approximately \$44 million or 71% of the balance greater than 60 days old. The

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negative suspense account balance was caused by recorded cash applications greater than recorded deposits. As discussed in the preceding paragraph, some initial suspense deposit transactions failed posting edits, whereas the subsequent cash application transactions to the borrowers' accounts were posted timely.

Unrecorded and erroneously recorded transactions in both new systems continued to affect the Department's ability to complete timely and accurate account reconciliations

Each loan servicer is required to submit daily files of summarized activity to the general ledger. Throughout the year, management reported that both servicer systems had a large number of other transactions that had failed the general ledger edits and posted to an error file. Management reported that, at June 30, the defaulted loan management system had 485,000 transactions on the general ledger error file. At August 31 and September 30, 2013, 253,000 and 66,000 transactions, respectively, were in the error file. Given the large number of transactions not properly posted, there were numerous reconciling items between the loans receivable and accrued interest balances in the general ledger and the balances in the new systems. This impacted the servicer's ability to prepare, review and submit monthly reconciliations to the Department timely through all of FY2013. In addition, many reconciliations also contained reconciling differences that were outstanding over 30 days. Reconciling differences at September 30, 2013 for the two new systems totaled approximately \$142 million.

Systemic issues in the non-defaulted loan servicing system affected the accuracy of borrower accounts and the general ledger

During their monitoring of the new non-defaulted loan servicing system, ACS, Inc. Education Servicing System (ACES), Department management continued to identify systemic issues related to transaction processing. For example, the Department's reconciliation procedures identified approximately \$31 million of transactions, primarily transfer transactions, that were incorrectly recorded in the general ledger as write offs, although they were not processed in ACES as write-offs.

Our sample testing revealed multiple processing actions applied in the servicing system to write-off transactions, increasing the risk of misstatement. Further, during our testing of the loan portfolio, we identified some loans that were affected by the prior year system configuration issues that failed to capitalize interest accrued over certain deferment and forbearance periods. Management estimates this issue resulted in lost interest of approximately \$55 million since July 2012.

As part of its corrective action plans, management processed a significant number of corrections in the current year, amounting to more than \$110 million. However, management identified additional adjustments in the amount of \$157 million that continued to affect the loan portfolio at September 30, which are expected to be corrected in the following fiscal year.

All of the issues discussed above can be directly related to the effect of not properly testing a new information system before putting the system into production. In order to mitigate risks going forward, management has elected to let the contract for ACES expire and has transferred the ACES loan portfolio to other servicers, which have been tasked with correcting the misstated loan balances. Management has also awarded a new contract for the management of the DMCS system application in future years. Management and its contractors have dedicated significant resources to identify, track, and correct the system functionality and the



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corresponding data; quantify the impact of the errors; and ensure that the financial statements properly reflect the effect of these issues. Other servicer issues noted during our audit included:

Programming errors related to the truncation of accrued interest on large non-defaulted loan balances were identified

Some non-defaulted loan servicing systems were affected by programming errors that caused them to truncate any daily interest amounts in excess of \$99.99, resulting in the underaccrual of interest on very large loan balances. Management estimates this issue only affects 54 loans, with an estimated effect of \$9 million of unrecorded interest. While the additional interest accrual will be significant for the affected borrowers, we determined that the amount was not material to the financial statements.

Recommendations:

We recommend the Chief Operating Officer of FSA:

- 1a. Ensure all servicing application functionality is corrected to meet the Department's requirements for servicing loans and reporting financial activity and balances timely and accurately.
- 1b. Continue to monitor the scheduled transfers of defaulted loans to DMCS and ensure that all new loan servicers are fully set up to transfer defaulted loans to the defaulted loan servicer.
- 1c. Continue to correct loan balances affected by the functionality issues and properly inform the impacted borrowers of the corrected account balances.
- 1d. Continue to monitor servicers' efforts to reduce the balance of unposted cash transactions, unrecorded borrower transactions, and general ledger posting differences, including the posting of transfer transactions in and out of DMCS.
- 1e. Establish protocols for management approval for write-offs and manual adjustments of unresolved differences once corrective actions are no longer cost effective.
- 1f. Continue to monitor the timeliness and accuracy of account reconciliations prepared by the servicers.

**2. Department and FSA Management Need to Mitigate Persistent Information Technology (IT) Control Deficiencies**

Due to the unique requirements of the Department's grant, loan and administrative business activities, the Department oversees a large portfolio of government-owned/government operated, government-owned/ contractor-operated, and contractor-owned/contractor-operated information systems. Five FSA systems and one Department system comprise the key systems critical to the Department's financial statement reporting.

The third party service providers who manage the Department and FSA's general support systems and applications are monitored by management through the use of Service Level

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Agreements and independent reviews. Managing the information and system security across the Department is the responsibility of the Department's Chief Information Security Officer (CISO), in conjunction with FSA's CISO. For several years, financial and other audits have identified numerous system deficiencies that affect the security and reliability of the information within these systems. Our audit continued to identify similar control deficiencies in the following areas:

*Security management*

- The Department's IT policies were outdated or did not fully address specific controls required by the National Institute of Standards and Technology (NIST)
- Incomplete System Security Plans
- Annual security control assessments not completed
- System risk assessments not kept up-to-date
- Lack of tracking and passed deadlines for corrective actions related to IT control weaknesses
- Security awareness training for new personnel not completed
- Role based security awareness training for personnel with significant system security responsibilities not completed

*Personnel Security*

- Background reinvestigations not being tracked effectively

*Access Controls*

- Lack of documented approval for system access
- Untimely termination of system access for separated employees and contractors
- Inactive accounts not disabled
- Inappropriate authorization for users with access to both development and production environments, resulting in a segregation of duties issue
- Duplicate user accounts
- Incomplete user recertification
- Expired or undocumented external interconnection security agreements

*Incident Response*

- Inaccurate tracking of security incidents

*Configuration management*

- System configuration settings not in compliance with Department policy

*Contingency Planning*

- Contingency plan not kept up-to-date

Additionally, four of the seven independent reviews of FSA third party service providers identified the following IT control issues:

- Developer access to the production environment of one system
- Improper restriction and monitoring of privileged access
- Lack of adherence to configuration management plans

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- Lack of contingency procedures, back up procedures, inadequate disaster recovery testing, and failure to maintain adequate offsite data backups
- Lack of an adequate organizational-level risk assessment process
- Data management strategies not formally identified, documented, and authorized

These deficiencies can increase the risk of unauthorized access to the Department's systems used to capture, process, and report financial transactions and balances. These findings are discussed in further detail below and in a Limited Distribution Report provided to the Department and FSA management.

Security management

An effective information security management program should have a framework and process for assessing risk, effective security procedures, and processes for monitoring and reporting the effectiveness of these procedures.

We found the Department's IT policies were outdated or did not fully address specific controls required by NIST Special Publication (SP) 800-53 (revision 3), *Recommended Security Controls for Federal Information Systems and Organizations*.<sup>1</sup> Additionally we found deficiencies in the system security plans (SSP) for three systems.

Furthermore, an annual self assessment was not performed for three of the six systems tested. Since a self assessment was not performed for these systems the risk assessments were not updated resulting in an increased risk that the CISO, ISSO, and system owners were not informed of the ongoing security state and risks to these systems. Upon notification of this issue to management, the self assessments were performed; however, the assessments included only a test of the design of controls, not testing to validate controls were operating effectively. In addition, although a controls assessment was performed for the other three systems tested, we noted several control tests were incomplete for one of three systems.

With regard to corrective action of IT control weaknesses, we noted there were 325 individual Plans of Action and Milestones (POA&M) that had passed their 2013 scheduled dates of completion for one system without documented justification for missed completion dates or adjusted expected completion dates. We also noted that corrective action of certain control weaknesses for another system was not formally tracked. Without formally documenting the weaknesses, along with the mitigation plans, estimated dates of completion and status of

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<sup>1</sup> NIST SP 800-53 revision 4 was issued in April 2013. According to the Office of Management and Budget (OMB) memorandum M-10-15, *FY 2010 Reporting Instructions for the Federal Information Security Management Act and Agency Privacy Management* requires that for non-national security programs and information systems, agencies must follow NIST standards and guidelines. For legacy information systems, agencies are expected to be in compliance with NIST standards and guidelines within one year of the publication date unless otherwise directed by OMB. The one year compliance date for revisions to NIST publications applies only to the new and/or updated material in the publications.



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corrective actions, there is no formal process in place to track and ensure the weaknesses are remediated.

Finally, we noted three sampled new system users did not complete the required security awareness training for two of the systems tested. Also, individuals with significant system security responsibilities had not completed role based training in the past two years for one system tested.

*Personnel Security*

Personnel security involves screening individuals before granting them access to computer resources commensurate with the risk and magnitude of the harm the individual could cause. We found background reinvestigations not being tracked effectively, as a sampled individual with significant system security responsibilities had an overdue reinvestigation. Management initiated this investigation upon our notification.

*Access Controls*

Access controls limit or detect inappropriate access to systems, protecting the data within them from unauthorized modification, loss or disclosure. Agencies should have formal policies and procedures and related control activities should be properly implemented and monitored. One key element of access control is *boundary protection*. Properly managed interfaces between the Department and FSA systems and external parties help reduce the risk of unauthorized access. NIST SP 800-47, *Security Guide for Interconnecting Information Technology Systems*, specifies that an agreement should be documented for the interconnection between organizations. A Memorandum of Understanding (MOU) documents the terms and conditions for sharing data and information resources in a secure method. An Interconnection Security Agreement (ISA) identifies the technical and security requirements for establishing, operating, and maintaining the interconnection and supports the MOU. We found expired MOUs and instances in which no documented MOU or ISA existed for external interconnections for four of the six systems tested.

*User authorization* refers to the documentation of the granting of user access to only the elements of a system the user needs to perform his or her duties. To be an effective control, user access should be documented, approved and periodically reviewed. Accounts for users should be terminated when the user no longer needs access to the system. We found:

- Access approval for system users was not documented for two of the systems tested
- Accounts for terminated employees and contractors were not disabled for two of the systems tested
- Inactive accounts were not disabled for one system
- One system had duplicate accounts
- User access recertification was incomplete for three of the systems tested
- Users with access to both the development and production environments for one system tested, resulting in a segregation of duties issue

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*Incident Response*

Incident response includes the identification and tracking of system events, analysis, and investigation of the events and implementation of corrective action. We noted inaccurate tracking of incidents by the Department.

*Configuration Management*

Configuration management ensures changes to systems are approved and systems are configured securely in accordance with policy. In our audit, we found four systems with configuration settings that were not in compliance with Department policy. For a fifth system, although management communicated a business need for non compliance with policy, a Risk Acceptance Form was not documented as required by Department policy.

*Contingency Planning*

Contingency planning is key to ensuring continuity of operations should system disruption occur. Of the six systems tested, we found one of the contingency plans was not up-to-date.

We noted the FY 2013 FSA FMFIA Assurance Letter reported similar IT control deficiencies. Additionally, the FY 2013 Federal Information Security Management Act (FISMA) review identified the following issues in seven of the eleven reporting metrics: configuration management, identity and access management, incident response and reporting, risk management, security training, remote access management, and contingency planning. The findings in the seven reporting metrics included repeat or modified repeat findings from audit reports issued over the last three years.

These deficiencies can increase the risk of unauthorized access to the Department's systems used to capture, process, and report financial transactions and balances.

NIST Special Publication 800-39, *Managing Information Security Risk - Organization, Mission, and Information System View*, states:

*The complex relationships among missions, mission/business processes, and the information systems supporting those missions/processes require an integrated, organization-wide view for managing risk. Unless otherwise stated, references to risk in this publication refer to information security risk from the operation and use of organizational information systems including the processes, procedures, and structures within organizations that influence or affect the design, development, implementation, and ongoing operation of those systems. The role of information security in managing risk from the operation and use of information systems is also critical to the success of organizations in achieving their strategic goals and objectives. Historically, senior leaders/executives have had a very narrow view of information security either as a technical matter or in a stovepipe that was independent of organizational risk and the traditional management and life cycle processes. This extremely limited perspective often resulted in inadequate consideration of how information security risk, like other organizational risks, affects the likelihood of organizations successfully carrying out their missions and business functions. This publication places information security into the*



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*broader organizational context of achieving mission/business success. The objective is to:*

- Ensure that senior leaders/executives recognize the importance of managing information security risk and establish appropriate governance structures for managing such risk;*
- Ensure that the organization's risk management process is being effectively conducted across the three tiers of organization, mission/business processes, and information systems;*
- Foster an organizational climate where information security risk is considered within the context of the design of mission/business processes, the definition of an overarching enterprise architecture, and system development life cycle processes; and*
- Help individuals with responsibilities for information system implementation or operation better understand how information security risk associated with their systems translates into organization-wide risk that may ultimately affect the mission/business success.*

*To successfully execute organizational missions and business functions with information system-dependent processes, senior leaders/executives must be committed to making risk management a fundamental mission/business requirement. This top-level, executive commitment ensures that sufficient resources are available to develop and implement effective, organization-wide risk management programs. Understanding and addressing risk is a strategic capability and an enabler of missions and business functions across organizations. Effectively managing information security risk organization-wide requires the following key elements:*

- Assignment of risk management responsibilities to senior leaders/executives;*
- Ongoing recognition and understanding by senior leaders/executives of the information security risks to organizational operations and assets, individuals, other organizations, and the Nation arising from the operation and use of information systems;*
- Establishing the organizational tolerance for risk and communicating the risk tolerance throughout the organization including guidance on how risk tolerance impacts ongoing decision-making activities; and*
- Accountability by senior leaders/executives for their risk management decisions and for the implementation of effective, organization-wide risk management programs.*

The ineffective and untimely remediation of application control weaknesses and repeat deficiencies identified across multiple applications indicates the need for improved strategic IT management.

In recognition of the need to improve internal control related to information security, in the latter part of FY2012, the Department and FSA senior management brought on board CISOs at the Senior Executive level with the skill set, broad government experience and leadership qualities to transform the information security program into a more robust, risk management program. During the past year, the Department and FSA Chief Information Security Officers have worked together to put a framework in place for more effectively managing risk by reviewing control weaknesses across the organization, determining root cause, and tracking remediation

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activities. The security posture of the systems is reviewed on a monthly basis by reviewing control weaknesses noted from audits, self assessments, vulnerability scans, and associated POA&Ms. As part of this initiative, monthly meetings are conducted with the Information System Security Officers in which training related to remediation of controls issues is provided. In addition, the Department documented, and is in the process of implementing, a risk management framework for applying continuous monitoring based on NIST SP 800-37, *Guide for Applying the Risk Management Framework to Federal Information Systems*. Furthermore, FSA has funded a security operations center for centralizing the management of security issues. These activities show progress and commitment from the Department and FSA's senior managers to strengthening internal controls. The risk management improvement process initiated by the Department and FSA's CISOs has the potential to provide such strategic IT management.

Recommendations:

We recommend the Department and FSA CISOs:

- 2a. Refine and fully implement the program to monitor compliance with the Department's organization-wide information security program and NIST requirements at the Department and system level.
- 2b. Implement a process ensuring accountability for individuals responsible for remediating the identified control deficiencies in the Department and FSA's systems, including cooperation between the Technology Office and Business Operations.
- 2c. Implement a process for holding contractors accountable for remediation of control deficiencies in the Department and FSA systems.
- 2d. Implement a process for holding third party service providers accountable for the remediation of control deficiencies associated with their information systems.

**INDEPENDENT AUDITORS' REPORT**  
**Exhibit B**  
**Noncompliance with Laws and Regulations**

**1. The Department's Financial Management Systems Do Not Meet Federal Financial Management System Requirements**

OMB Circular No. A-123, *Management's Responsibility for Internal Control*, states "*internal control needs to be in place over information systems – general and application control. General control applies to all information systems such as the mainframe, network and end-user environments, and included agency-wide security program planning, management, control over data center operations, system software acquisition and maintenance.*"

OMB Circular No. A-127, *Financial Management Systems*, defines a financial system as "*an information system that may perform all financial functions including general ledger management, funds management, payment management, receivable management, and cost management.*" OMB Circular No. A-127 also notes a financial management system "*includes the core financial management systems and the financial portions of mixed systems necessary to support financial management, including automated and manual processes, procedures, and controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions.*"

OMB Circular No. A-127 continues, "*Substantial compliance is achieved when an agency's financial management systems routinely provide reliable and timely financial information for managing day-to-day operations as well as to produce reliable financial statements, maintain effective internal control, and comply with legal and regulatory requirements.*"

As noted in the two significant deficiencies in Exhibit A, several of the Department's financial systems and their general and application controls for managing the Department's portfolio of loans receivable possessed technical and operational deficiencies that impacted the Department's ability to maintain effective internal control over operations and financial reporting, and routinely produce reliable, timely and accurate information for managing the day-to-day operations of the Department throughout FY2013. These deficiencies also impacted the effectiveness and efficiency of the Department's operation for servicing the direct loan portfolio. Additional detail on the nature of these deficiencies, their causes and our specific recommendations are presented in Exhibit A.



**INDEPENDENT AUDITORS' REPORT**  
**Exhibit C**  
**Status of Prior Year Recommendations**

Our assessment of the current status of the recommendations related to findings identified in the prior year audit is presented below:

<i><b>FY 2012 Recommendation</b></i>	<i><b>Fiscal Year 2013 Status</b></i>
<b>Material Weakness 1 – Controls Surrounding the Department's Debt Management Collection System and ACS, Inc. Education Servicing System Need Improvement</b>	
1. Ensure that the DMCS servicer resolves and completes the remaining requirements in order to bring DMCS to a fully operational status. In the interim, establish temporary work-around solution for the remaining requirements, where applicable.	In process; see Significant Deficiency 1
2. Complete system fixes to resolve the issues surrounding interest accruals (DMCS) 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.	In process; see Significant Deficiency 1
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.	Closed
4. Require conformance and effectiveness of the previously noted controls and coordinate closely with the servicer to closely manage progress, status and corrective actions.	In process, see Significant Deficiency 1
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.	In process; see Significant Deficiency 2
<b>Significant Deficiency 1 – Continued Focus on Credit Reform Estimates and Financial Reporting Processes is Warranted</b>	
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.	In process; management letter comment
2. Increase the frequency of the Credit Reform Working Group meetings and take full advantage of their analytical reports to have robust discussions about loan activity and the impact of estimates with different area managers.	In process; management letter comment
3. Implement formal detail review procedures over the input of variables into the Student Loan Model, input of cash flows into the OMB calculator and other calculations surrounding the process to avoid potential errors that may negatively affect the	In process; management letter comment

**INDEPENDENT AUDITORS' REPORT**  
**Exhibit C**  
**Status of Prior Year Recommendations**

<i><b>FY 2012 Recommendation</b></i>	<i><b>Fiscal Year 2013 Status</b></i>
reestimates. 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. 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. Consider developing calibrating processes to ensure data quality and model accuracy.	In process; management letter comment
5. Consider the impact of changes in general economic conditions when developing assumptions. Evaluate the selection of time periods used for weighting average calculations on a periodic basis as economic conditions change.	In process; management letter comment
6. Consider ways to better leverage management's efforts under OMB Circular A-123, Appendix A as a way to provide additional focus and attention to the controls surrounding the credit reform estimation process.	In process; management letter comment
<b>Significant Deficiency 2 – Controls Surrounding Information Systems Need Enhancement</b>	
1. Strengthen access controls to protect mission critical systems.	In process; see Significant Deficiency 2
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.	In process; see Significant Deficiency 2
3. Enhance its security training and awareness program.	In process; see Significant Deficiency 2
4. Revise current methods of identifying and logging suspicious activity as it relates to unauthorized accounts and data.	In process; see Significant Deficiency 2



**INDEPENDENT AUDITORS' REPORT**  
**Exhibit C**  
**Status of Prior Year Recommendations**

<i><b>FY 2012 Recommendation</b></i>	<i><b>Fiscal Year 2013 Status</b></i>
5. Improve incidence response and reporting procedures.	In process; see Significant Deficiency 2
6. Improve contract management and oversight of contractors on mission critical systems.	In process; see Significant Deficiency 2
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 PO&AM system and reports.	In process; see Significant Deficiency 2

**INDEPENDENT AUDITORS' REPORT**  
**Exhibit D**  
**Management's Response to Findings**



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

THE CHIEF FINANCIAL OFFICER

DEC - 3 2013

MEMORANDUM

TO: Kathleen S. Tighe  
Inspector General

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

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

SUBJECT: DRAFT AUDIT REPORTS  
Financial Statement Audits for Fiscal Year 2013  
U.S. Department of Education  
ED-OIG/A17N0001

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 Year 2013 Financial Statement Audit Report. Without exception, we concur and agree with the Independent Auditors' Report.

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

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

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

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www.ed.gov

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# Other Information

## About the Other Information Section

This section includes improper payments reporting details, the schedule of spending, and views of the Office of Inspector General about the Department's management and performance challenges for FY 2014.

### Improper Payments Reporting Details

This revised section has been reorganized and streamlined to make it more readable. Links have been added to provide context and increase the amount of information available in fewer pages.

*The Improper Payments Information Act of 2002* (IPIA; Public Law 107-300), as amended by the *Improper Payments Elimination and Recovery Act of 2010* (IPERA; Public Law 111-204), and the *Improper Payments Elimination and Recovery Improvement Act of 2012* (IPERIA; Public Law 112-248), requires agencies to annually report information on improper payments to the President and Congress, focusing on risk assessments, statistical sampling, and corrective actions.

### Schedule of Spending

The Schedule of Spending (SOS) presents an overview of how and where agencies are spending (i.e., obligating) money for the reporting period. This schedule is prepared based on the same underlying data used to populate the Statement of Budgetary Resources (SBR). The SOS presents total budgetary resources and fiscal year-to-date total obligations for the reporting entity.

### Summary of Financial Statement Audit and Management Assurances

All agencies are required to provide a summary table of Financial Statement Audit and Management Assurances for any material weaknesses reported by the agency or through the audit process.

### Office of Inspector General's Management and Performance Challenges

The Office of Inspector General's Management and Performance Challenges for Fiscal Year 2014 report is summarized in this section. The FY 2014 management challenges are:

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

These challenges reflect continuing vulnerabilities and emerging issues faced by the Department as identified through OIG's recent audit, inspection, and investigative work. A summary of each management challenge area follows. [For the full report](#), including the Department's response, visit [the OIG web site](#).

## Improper Payments Reporting Details

The Department is committed to preventing improper payments with front end controls, and detecting and recovering them if they occur. In FY 2013, the Department strengthened efforts to: 1) assess the risk of improper payments, 2) estimate improper payments, 3) address root causes of improper payments, and 4) recover improper payments. These four efforts are described in more detail below.

The Department implemented actions that meet the requirements of the *Improper Payments Elimination and Recovery Improvement Act of 2012* (IPERIA) (Public Law 112-248) and the *Improper Payments Elimination and Recovery Act of 2010* (IPERA) (Public Law 111-204), both of which amend the *Improper Payments Information Act of 2002* (IPIA) (Public Law 107-300), as well as the Office of Management and Budget's (OMB) Circular A-123, Appendix C, [Requirements for Effective Measurement and Remediation of Improper Payments](#). 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 OMB guidance defines significant improper payments as those in any particular program that exceed both 2.5 percent of program payments and \$10 million annually or that exceed \$100 million.

## Internal Controls and Accountability

The Department 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. As detailed in the *Analysis of Controls, Systems, and Legal Compliance* portion of this AFR, the Department's internal control framework is robust. It includes important controls at many levels of the payment process that are designed to help prevent and detect improper payments. These controls are periodically assessed for design and operating effectiveness as part of Department self-assessments of internal controls. For example:

- Schools are responsible and held accountable for recipient verification for need-based aid. FSA 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. In addition, FSA 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. FSA contractors are held accountable through various contract management and oversight activities and functions, control assessments, and audits.
- Department program staff work with the Department's Risk Management Service (RMS) to use the Decision Support System (DSS) Entity Risk Reviews (ERR) to assess



grantee risk and assist in the determination of special conditions for grant awards. In FY 2013, for 7 of 8 requesting Principal Offices, RMS produced 77 reports assessing risk for 1,768 applicants, including 91 competitions for new competitive grant awards, or 85 percent of all awards.

- The Department leverages continuous controls monitoring software to help detect anomalies and potential issues in agency payment-related data, including Department and FSA payments made through the core financial system.

## Risk Assessments

As required by the OMB Circular A-123, Appendix C, the Department conducts an assessment of the risk of improper payments in each program at least once every three years. Below is a summary of these assessments.

Risk Assessment Results		
Program	Last Risk Assessment	Risk-Susceptible?
<b>FSA Managed Programs</b>		
Federal Pell Grants	FY 2011	Yes
Academic Competitiveness Grants	FY 2011	No
National Science and Mathematics Access to Retain Talent Grant	FY 2011	No
The Teacher Education Assistance for College and Higher Education Grant	FY 2011	No
Federal Supplemental Educational Opportunity Grant	FY 2011	No
Leveraging Educational Assistance Partnership/Special Leveraging Educational Assistance Partnership	FY 2011	No
Iraq and Afghanistan Service Grant	FY 2011	No
Federal Perkins Loan Program	FY 2011	No
Federal Direct Loan Program	FY 2011	Yes
Federal Family Education Loan Program	FY 2011	Yes
Federal Work-Study Program	FY 2011	No
<b>Other Department Programs</b>		
Other Grant Programs	FY 2013	No
Contract Payments	FY 2013	No

## FSA-Managed Programs

The Department performed a risk assessment for all FSA-managed programs during FY 2011 and determined that the Direct Loan (DL), Federal Family Education Loan (FFEL), and Pell Grant programs were susceptible to risk of significant improper payments. The methodology and results can be found in the [FY 2011 AFR](#). For each program, risk assessment meetings were held with program owners, key personnel, and other designees to discuss the following ten risk factors:

- Volume of Payments;
- Prior Improper Payments Reporting Results;
- Newness of Program or Transactions;
- Complexity of Program or Transactions;
- Level of Manual Intervention;
- Changes in Program Funding Authorities, Practices, and Procedures;
- History of Audit Issues;
- Human Capital Management;
- Nature of Program Recipients; and
- Management Oversight.

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

### Other Department Programs

The Department performed a risk assessment for all non-FSA grant programs during FY 2013 using the methodology described in the [FY 2011 AFR](#). This methodology relies on an examination of the total questioned costs for each program that result from required OMB Circular A-133 [Single Audits](#). The Department's FY 2013 assessment determined that none of these non-FSA grant programs were susceptible to significant improper payments. The specific grant programs reviewed are provided on our [website](#).

During FY 2013, the Department also performed a risk assessment of all contract payments, including those for FSA. The risk assessment was based on the results of an ongoing FY 2013 contingency-based contract to review FY 2007 through FY 2012 contract payments as well as cyclical A-123 risk assessments. Based on an evaluation of the risk assessments and results of the recapture audit, we determined that contract payments are not susceptible to significant improper payments.

The Department intends to expand its risk assessment to other administrative payments in FY 2014, to include salary, benefits and travel payments.

## Improper Payment Estimate Methodologies

### FSA-Managed Programs

The Department continues to work with OMB to seek a mutually agreeable strategy for estimating improper payments in the FSA programs. While this work continues, OMB has agreed to the Department's use of proposed methodologies to estimate DL and FFEL program improper payments only for FY 2013 AFR reporting. The Department previously developed an estimation methodology for the Pell program that compares student-reported

data on FAFSA with IRS data on income levels. This methodology and its limitations are described in the [FY 2012 AFR](#). In an effort to address the limitations, FSA developed an alternate methodology for use in the DL, FFEL, and Pell programs that leverages data collected through FSA program reviews, which may include verifying student-reported income levels, student academic performance, and eligibility on the disbursed funds for a sample of students in each review. OMB has tentatively approved the reporting of provisional improper payment rates in the FY 2013 AFR derived from the alternative methodology for the DL and FFEL programs pending an overall agreement on a revised strategy for estimating improper payments across the FSA portfolio. OMB did not approve use of the alternative methodology for the Pell program, but instead, agreed that FSA use its previously approved methodology to estimate the improper payments for the Pell program using the IRS data. The methodologies for all three programs are described on the Department's [improper payment website](#). The Department and OMB continue to work collaboratively on suitable estimation methodologies for all three programs.

The Department believes improper payment estimates from these new methodologies yield the most accurate estimates using available program data. The approach is cost effective and it maximizes integration of existing program reviews. However, the Department acknowledges that its approach is not designed to use strict random sampling techniques intended solely to estimate improper payment rates. Accordingly, the Department considers its approach to use alternative sampling methodologies. The Department will continue working with OMB to examine our current methodologies versus other approaches with a goal of agreement in FY 2014 on the most cost effective long-term methodologies for the Pell, DL, and FFEL programs.

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

The Department estimates improper payments for this program using questioned cost data in audit reports. This methodology is described in the [FY 2012 AFR](#). No reduction targets are proposed since the Department's risk assessments have not identified Title I as a program susceptible to significant improper payments; Title I is included in the table because it is a [Section 57 program](#).

## Improper Payment Estimates

Improper Payment Reduction Outlook (\$ in millions)															
Program or Activity	FY 2012			FY 2013			FY 2014			FY 2015			FY 2016		
	Outlays \$ <sup>(2)</sup>	IP %	IP \$	Outlays \$ <sup>(3)</sup>	IP %	IP \$	Outlays \$ <sup>(4)</sup>	IP %	IP \$	Outlays \$ <sup>(4)</sup>	IP %	IP \$	Outlays \$ <sup>(4)</sup>	IP %	IP \$
Pell Grants <sup>(1)</sup>	33,299	2.49	829	32,338	2.26	731	34,149	2.26	772	37,245	2.26	842	33,776	2.26	763
Direct Loan	N/A	N/A	N/A	102,497	1.03	1,056	174,708	1.03	1,799	181,173	1.03	1,866	186,639	1.03	1,922
FFEL	N/A	N/A	N/A	10,817	0.00	0	8,438	0.00	0	7,594	0.00	0	7,173	0.00	0
Title I	15,208	.186	28.3	14,724	.385	56.7	14,003	.385	53.9	11,862	.385	45.7	13,327	.385	51.3

<sup>(1)</sup> Pell estimates are reported using the previously developed methodology that relies on a comparison of student data with IRS data. As a point of comparison, the FY 2013 estimate for Pell using the alternate methodology that relies on data from FSA program reviews is 2.22 percent or \$718 million.

<sup>(2)</sup> The source of FY 2012 outlays for Pell is FMS as presented in the FY 2012 AFR.

<sup>(3)</sup> The source of FY 2013 outlays for all program amounts is FMS.

<sup>(4)</sup> The source of FY 2014–2016 Pell outlay amounts is the supporting documentation for the FY 2014 President's Budget request. The source of FY 2014–2016 Direct Loan and FFEL outlay amounts is the supporting documentation for the FY 2014 President's Budget request at the Mid-Session Review.

NOTE: The FY 2013 Pell overaward improper payment rate estimate is 1.56 percent or \$505 million and the underaward improper payment rate estimate is 0.70 percent or \$226 million. The FY 2013 Direct Loan overaward improper payment rate estimate is 0.95 percent or \$974 million and the underaward improper payment rate estimate is 0.08 percent or \$82 million. The FY 2013 FFEL overaward and underaward improper payment rate estimates round down to 0.000 percent or \$0 million.

## Root Causes and Corrective Actions

General program information, charts summarizing the root causes of improper payments by program and the corrective actions in progress or planned are presented in this section.

FSA 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 Free Application for Federal Student Aid (FAFSA). In addition, FSA continues to enhance verification procedures and require selected schools to verify specific information reported on the FAFSA by student aid applicants. These and other ongoing corrective actions, such as system edits, program reviews, and compliance audits, are described in the [FY 2012 AFR](#).

In the charts that follow for each risk-susceptible program, the root causes presented were identified through improper payment testing and categorized by the [Improper Payments Information Act of 2002](#) Error Category. The corrective actions presented are recommendations to the schools (for Pell Grants and Direct Loans) and financial institutions (for FFEL) for findings that resulted from FSA program reviews.

**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.

### Root Causes and Corrective Actions for the Pell Grant and Direct Loan Programs

IPIA Error Category	Root Cause	Corrective Actions
<b>Documentation and Administrative Errors</b>	Incorrect Awards based on Expected Family Contribution (EFC)	<ul style="list-style-type: none"> <li>Institutions with this finding are required to improve policies and procedures to ensure that discrepancies between student's application and Institution Student Information Report (ISIR) have been resolved prior to disbursement of funds and EFC calculations are properly calculated and verified.</li> <li>Institutions with this finding are required to improve written procedures to properly complete and retain EFC Verification Worksheets.</li> <li>Institutions with this finding are required to improve written procedures to properly calculate Pell Grant and/or Direct Loan disbursement amounts.</li> </ul>



IPIA Error Category	Root Cause	Corrective Actions
	Incorrect Processing of Student Data During Normal Operations	<ul style="list-style-type: none"> <li>Institutions with this finding are required to improve policies and procedures to ensure timely updates of student data are made.</li> <li>Institutions with this finding are required to improve written procedures to track and monitor the completion of clock hours and to determine whether the student is adequately progressing towards the completion of the program within the maximum timeframe.</li> </ul>
	Student Account Data Changes Not Applied or Processed Correctly	<ul style="list-style-type: none"> <li>Institutions with this finding are required to regularly conduct staff training courses (semi-annually) designed to ensure proper and timely processing of student data.</li> <li>Institutions with this finding are required to improve policies and procedures to ensure timely updates of student data are made.</li> </ul>
<b>Verification Errors</b>	Ineligibility for a Pell Grant/Direct Loan (e.g., validity of high school attended, history of degrees obtained)	<ul style="list-style-type: none"> <li>Institutions with this finding are required to regularly conduct staff training courses (semi-annually) designed to prevent ineligible students from receiving Pell Grants and/or Direct Loans.</li> <li>Institutions with this finding are required to implement standards of care and diligence in administering and accounting for Pell Grants and Direct Loans. Institutions are required to constantly remind Financial Aid Administrators that their fiduciary responsibilities obligate them to the highest level of due care.</li> <li>Institutions with this finding are required to develop a systematic process of oversight and internal tracking to ensure correct student files are obtained and retained.</li> </ul>
	Satisfactory Academic Progress (SAP) Not Achieved	<ul style="list-style-type: none"> <li>Institutions with this finding are required to administer semi-annual audits of student's academic transcripts. Institutions are required to calculate Grade Point Averages (GPA), course completion, and maximum timeframes to establish conformity with Title IV policies.</li> <li>Institutions with this finding are required to improve procedures and control mechanisms that will ensure that students receiving Pell Grants and/or Direct Loans are eligible in accordance with policies.</li> </ul>
	Incorrectly Calculated Return Period	<ul style="list-style-type: none"> <li>Institutions with this finding are required to improve written procedures to properly perform Return to Title IV calculations and return applicable funds to the correct party.</li> </ul>

## Root Causes and Corrective Actions for the Direct Loan Consolidation Program

IPIA Error Category	Root Cause	Corrective Actions
<b>Documentation and Administrative Errors</b>	Incorrect Processing of Loan Verification Certificate (LVC)	<ul style="list-style-type: none"> <li>The underlying root causes of improper payments identified were due to processing errors at the servicer level; however, the legacy servicer's contract is ending and the day-to-day servicing of newly made traditional Direct Loan Consolidations will be transferred to three of the Title IV Additional Servicers (TIVAS) platforms for FY 2014. FSA will continue to monitor the transition of the consolidation function to these servicers.</li> <li>Improper payments identified through the Direct Loan Consolidation testing for FY 2013 were remediated or are in the process of being remediated.</li> </ul>
	Processing of Duplicate LVCs	
	Loan Not Intended for Consolidation was Processed	

**FFEL Program.** During FY 2013, the FFEL Program made no new loan originations. FY 2013 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.

## Root Causes and Corrective Actions for the FFEL Program

Most of the reporting errors observed during FY 2013 were the result of smaller lenders using software systems that were not updated or were processed on bank systems not designed for processing the reporting of FFEL Program loans.

IPIA Error Category	Root Cause	Corrective Actions
<b>Documentation and Administrative Errors</b>	Manual Entries Processed Erroneously (e.g., using only one payment code during the billing quarter when an activity occurred that required the use of two billing codes)	<ul style="list-style-type: none"> <li>Lenders with this finding are required to regularly conduct staff training courses designed to prevent incorrect usage of payment codes, including SAP codes, and incorrect calculation of average daily balances.</li> <li>Lenders with this finding are required to establish procedures that eliminate reporting errors related to manual entries processed erroneously.</li> <li>Lenders with this finding are required to hire sufficient staff/employees that are knowledgeable of the FFEL program.</li> <li>If unable to perform servicing requirements, lenders are required to seek the services of other individuals or firms to reduce and eliminate reporting errors due to manual processing.</li> </ul>

IPIA Error Category	Root Cause	Corrective Actions
	Incorrect Calculation of the Average Daily Balance due to Software Formula Errors	<ul style="list-style-type: none"> <li>Lenders are required to obtain and install any necessary updates to their systems to certify software formulas are accurate.</li> </ul>

## Root Cause Summary

Consistent with FY 2012, the results of the root cause analysis of improper payments across all risk-susceptible programs from FY 2013 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 of error 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 of error in the sample reviewed), as follows:

IPIA Error Category	Pell Grants	Direct Loans	Direct Loan Consolidations	FFEL
<b>Documentation and Administrative Errors</b>	27%	31%	100%	100%
<b>Verification Errors</b>	73%	69%	0%	0%

## Recovery Auditing

Agencies are required to conduct recovery audits for contract payments and programs that expend one million dollars or more annually if conducting such audits would be cost effective. The following table presents a summary of the Department's cost-benefit analysis.

Additional Recovery Auditing Cost Effectiveness	
Recovery Audit Program Area	Cost Effective
Non-FSA Grant Programs	No
FSA Programs	No
Contracts	No

A comprehensive report on the cost effectiveness of the various recapture audit programs can be found in the Department's [FY 2012 Report on the Department of Education's Payment Recapture Audits](#).

**Contract Payment Recapture Audits.** Although the Department has not found prior contract recovery audits to be cost effective, the Department issued a contingency-based contract during FY 2013 to audit all FY 2007 through FY 2012 contract payments for possible errors and recapture. This contract was awarded with the expectation that advances in data mining techniques might be able to detect payment errors that were previously undetected. Although the audit is ongoing, as in prior years, the results indicate a minimal level of improper payments.

The following chart presents the results of previous recapture efforts:

Contract Payment Recapture Audit Reporting (\$ in millions)	
Amount Subject to Review for Current Year (2013) Reporting*	\$10,027
Actual Amount Reviewed and Reported (2013)*	\$10,027
Amounts Identified for Recovery (2013)	\$0
Amounts Recovered (2013)	\$0
% of Amount Recovered out of Amount Identified (2013)	NA
Amount Outstanding (2013)	\$0
% Amount Outstanding out of Amount Identified (2013)	NA
Amount Determined Not to be Collectable (2013)	\$0
% Amount Determined Not to be Collectable out of Amount Identified (2013)	NA
Amounts Identified for Recovery Prior Years (2005–13)	\$0
Amounts Recovered (2005–13)	\$0
Cumulative Amounts Identified for Recovery (2005–13)	\$0
Cumulative Amounts Recovered (2005–13)	\$0
Cumulative Amounts Outstanding (2005–13)	\$0
Cumulative Amounts Determined Not to be Collectable (2005–13)	\$0

\*Includes FY 2007 through FY 2012 contract payments subject to the FY 2013 recapture audit contract.

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.

**Recoveries of Improper Payments.** The Department works with grantees and Title IV (FSA) program participants to resolve and recover amounts identified in Compliance Audits, OIG Audits, and Department-conducted program reviews as potential improper payments. Accounts receivable are established for amounts determined to be due to the Department and collection actions are pursued. Recipients of Department funds can appeal the management decisions regarding funds to be returned to the Department, thereby delaying or decreasing the amounts the Department is able to collect. The following chart provides estimates of the amounts identified and recovered through all Compliance Audits, OIG Audits, and program reviews for FY 2011 through FY 2013. The Department anticipates recovering similar amounts in FY 2014.

Overpayments Recaptured Outside of Payment Recapture Audits (\$ in millions)						
Agency Source	Amount Identified (FY 2013)	Amount Recovered (FY 2013)*	Amount Identified (FY 2012)	Amount Recovered (FY 2012)*	Cumulative Amount Identified (FY 2011–13)	Cumulative Amount Recovered (FY 2011–13)
Compliance Audit Reports	19.8	7.7	21.7	4.3	70.2	16.2
OIG Audit Reports	22.1	5.2	2.7	.2	38.3	8.8
Program Reviews	38.9	8.0	30.7	6.7	107.9	24.5

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

In addition to the amounts above, 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 \$13.0 million in FY 2013, \$6.2 million in FY 2012, and \$100.0 million cumulative from FY 2013 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.

## 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.



## Schedule of Spending

The Schedule of Spending (SOS) presents the total amounts agreed to be spent by the Department broken out by (a) what money was available to spend and (b) how the money was spent. The total amounts agreed to be spent on the SOS are the same as the obligations incurred amounts reported on the Statement of Budgetary Resources (SBR). The SBR provides useful information on the budgetary resources provided to a federal agency as well as the status of those resources at the end of a fiscal year. [USASpending.gov](http://USASpending.gov) is a searchable website provided by the Office of Management and Budget (OMB) that provides information on federal awards and is accessible to the public at no cost.

### Department of Education Schedule of Spending For the Years Ended September 30, 2013 and 2012 (Dollars in Millions)

	FY 2013		FY 2012	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
<b>Section I: What Money Is Available to Spend?</b>				
<i>This section presents resources that were available to spend by the Department.</i>				
Total Resources	\$ 102,544	\$ 257,395	\$ 104,710	\$ 270,274
Amount Available but Not Agreed to be Spent	(13,700)	-	(10,480)	(1)
Amount Not Available to be Spent	(2,507)	(11,315)	(2,142)	(18,992)
<b>Total Amounts Agreed to be Spent</b>	<b>\$ 86,337</b>	<b>\$ 246,080</b>	<b>\$ 92,088</b>	<b>\$ 251,281</b>

### Section II: How Was the Money Spent?

*This section presents services and items purchased, is grouped by major program, and is based on outlays.*

#### Increase College Access, Quality, and Completion

Credit Program Loan Disbursements and Claim Payments	\$ 79	\$ 141,724	\$ 56	\$ 154,449
Credit Program Subsidy Transfers	6,405	48,598	8,337	40,650
Federal Interest Payments	-	28,453	-	26,629
Other Credit Program Payments	3	1,692	4	2,581
Federal Student Loan Reserve Fund Valuation	279	-	419	-
Grants	38,344	-	39,364	-
Personnel Compensation and Benefits	258	-	258	-
Contractual Services	1,216	671	1,073	475
Rent, Utilities, and Communication	31	-	25	-
Land, Structures, and Equipment	4	-	4	-
Travel and Transportation	3	-	5	7
Other <sup>1/</sup>	2	-	3	-
	<b>46,624</b>	<b>221,138</b>	<b>49,548</b>	<b>224,791</b>

#### Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs

Grants	22,334	-	22,154	-
Personnel Compensation and Benefits	72	-	74	-
Contractual Services	86	-	114	-
Rent, Utilities, and Communication	12	-	11	-
Land, Structures, and Equipment	1	-	2	-
Travel and Transportation	1	-	1	-
	<b>22,506</b>	<b>-</b>	<b>22,356</b>	<b>-</b>

Department of Education  
Schedule of Spending  
For the Years Ended September 30, 2013 and 2012  
(Dollars in Millions)

	FY 2013		FY 2012	
	Non-Budgetary Credit Reform Financing Accounts		Non-Budgetary Credit Reform Financing Accounts	
	Budgetary		Budgetary	
<b><u>Ensure Effective Educational Opportunities for All Students</u></b>				
Grants	16,713	-	16,889	-
Personnel Compensation and Benefits	160	-	168	-
Contractual Services	57	-	64	-
Rent, Utilities, and Communication	21	-	20	-
Land, Structures, and Equipment	1	-	2	-
Travel and Transportation	2	-	3	-
	<b>16,954</b>	-	<b>17,146</b>	-
<b><u>Enhance the Education System's Ability to Continuously Improve</u></b>				
Grants	1,330	-	1,179	-
Personnel Compensation and Benefits	82	-	88	-
Contractual Services	433	-	399	-
Rent, Utilities, and Communication	13	-	11	-
Land, Structures, and Equipment	1	-	2	-
Travel and Transportation	1	-	2	-
Other <sup>1/</sup>	16	-	1	-
	<b>1,876</b>	-	<b>1,682</b>	-
<b><u>American Recovery and Reinvestment Act and Education Jobs Fund</u></b>				
Other Credit Program Payments	-	-	4	-
Grants	2,598	-	7,787	-
Personnel Compensation and Benefits	-	-	10	-
Contractual Services	15	-	-	-
	<b>2,613</b>	-	<b>7,801</b>	-
<b>Total Spending</b>	<b>\$ 90,573</b>	<b>\$ 221,138</b>	<b>\$ 98,533</b>	<b>\$ 224,791</b>
Amounts Remaining to be Spent <sup>2/</sup>	(4,236)	24,942	(6,445)	26,490
<b>Total Amounts Agreed to be Spent</b>	<b>\$ 86,337</b>	<b>\$ 246,080</b>	<b>\$ 92,088</b>	<b>\$ 251,281</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 fiscal year presented. 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.

## 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 beginning on page 94 and the Department's management assurances on pages 33–42.

### 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>1</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</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>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

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

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

Statement of Assurance: Unqualified

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

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

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

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

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

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



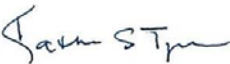
**UNITED STATES DEPARTMENT OF EDUCATION**  
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

October 30, 2013

**MEMORANDUM**

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

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

**SUBJECT:** Management Challenges for Fiscal Year 2014

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 the Department remains committed to addressing these areas and has taken or plans action to correct many of their underlying causes, each remains as a management challenge for fiscal year (FY) 2014. We also added a new challenge related to the Department's information technology system development and implementation.

The FY 2014 management challenges are:

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

We provided our draft challenges report to Department officials and considered all comments received. We look forward to working with the Department to address the FY 2014 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.

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

## Office of Inspector General's (OIG) Management and Performance Challenges for Fiscal Year 2014

### 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) 2014. We also added a new challenge related to the Department's information technology system development and implementation.

The FY 2014 management challenges are:

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

These challenges reflect continuing vulnerabilities and emerging issues faced by the Department as identified through OIG's recent audit, inspection, and investigative work. A summary of each management challenge area follows.<sup>1</sup>

### Management Challenge 1—Improper Payments

#### Why This Is a Challenge

The Federal Pell Grant (Pell) program is 1 of 13 programs the Office of Management and Budget (OMB) designated as "high-priority." In addition to the Pell program, the Department identified the William D. Ford Federal Direct Loan (Direct Loan) and Federal Family Education Loan (FFEL) programs as susceptible to significant improper payments. The Department must be able to ensure that the billions of dollars entrusted to it are reaching the intended recipients.

Our recent work has demonstrated that the Department remains challenged to meet new requirements and to intensify its efforts to successfully prevent, identify, and recapture improper payments. We have identified concerns in numerous areas relating to improper

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<sup>1</sup> The FY 2014 management challenges report will be available at <http://www2.ed.gov/about/offices/list/oig/managementchallenges.html>.



payments to include calculation of the estimated improper payment rate for the Pell, FFEL, and Direct Loan programs, and improper payments involving grantees and contractors. Our Semiannual Reports to Congress from April 1, 2010, through March 31, 2013, included audit reports with findings involving more than \$88 million in questioned or unsupported costs.

### **Progress in Meeting the Challenge**

The Department has revised its estimation methodologies for each of its risk-susceptible programs (Pell, Direct Loan, and FFEL); however, the Department was working to obtain OMB approval of the new methodologies as of September 2013.

The Department has identified root causes for improper payments in its risk-susceptible programs that included documentation, administrative, and verification errors. In response, the Department identified numerous corrective actions that were planned or completed. This included a voluntary data exchange program with the Internal Revenue Service that is intended to improve the accuracy of financial aid applicant's income data reported on the online Free Application for Federal Student Aid (FAFSA), enhanced system edits within the National Student Loan Data System to flag students with unusual enrollment history to assist in identifying applications for verification, and various internal controls to prevent and detect errors integrated into its Direct Loan systems and activities.

### **What Needs to Be Done**

The Department needs to continue to explore additional opportunities for preventing, identifying, and recapturing improper payments. The Department should continue to work with OMB to ensure its improper payment estimation methodologies and reporting are reasonable.

## **Management Challenge 2—Information Technology Security**

### **Why This Is a Challenge**

Department systems contain or protect an enormous amount of confidential information such as personal records, financial information, and other personally identifiable information. Without adequate management, operational, and technical security controls in place, the Department's systems and information are vulnerable to attacks. Unauthorized access could result in losing data confidentiality and integrity, limiting system availability, and reducing system reliability.

OIG has identified repeated problems in information technology (IT) security and noted increasing threats and vulnerabilities to Department systems and data. Over the last several years, IT security audits have identified controls that need improvement to adequately protect the Department's systems and data. This included weaknesses in 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, investigative work performed by the OIG has identified IT security control concerns in areas such as the FSA PIN system, mobile IT devices, malware, incident response, email spear phishing, and the Department's external email interface.

## Progress in Meeting the Challenge

The Department provided corrective action plans to address the recommendations in our audits and has procured services to provide additional intrusion detection capabilities for its primary enterprise environment and related data center. The Department also awarded a contract for a continuous monitoring program of its enterprise infrastructure. It has nearly completed the requirement of implementing two-factor authentication for Government and contractor employees, and is well into the process of supplying and implementing multifactor authentication for its external business partners.

The Department also stated that it is laying a foundation for increased security oversight and efficiency with an in-house Cyber Security Operations Center, with initial operating capability planned for late FY 2013 and full capacity planned by mid FY 2014.

## What Needs to Be Done

The Department needs to continue its efforts to develop more effective capabilities to respond to potential IT security incidents. It also should continue its progress towards fully implementing and enforcing the use of two-factor authentication when accessing its system. The Department should strive towards a robust capability to identify and respond to malware installations.

## Management Challenge 3—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 subareas are included in this management challenge—Student Financial Assistance (SFA) program participants, distance education, grantees, and contractors.

### Oversight and Monitoring—SFA Program Participants

#### Why This Is a Challenge

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, and abuse. In FY 2013, the Federal Government planned to provide \$170.3 billion in grants, loans, and work-study assistance to help students pay for postsecondary education. The Department's FY 2014 budget request outlines \$182.9 billion to Federal student aid, including \$35.3 billion in Pell Grants and over \$145 billion in student loans. Nearly 14.7 million students would be assisted in paying the cost of their postsecondary education at this level of available aid.

Our audits and inspections and work conducted by the Government Accountability Office continue to identify weaknesses in Federal Student Aid's (FSA's) oversight and monitoring of SFA program participants. In addition, our external audits of individual SFA program

participants frequently identified noncompliance, waste, and abuse of SFA program funds. OIG investigations have also identified various schemes by SFA program participants to fraudulently obtain Federal funds.

### **Progress in Meeting the Challenge**

FSA identified numerous initiatives that were completed, in progress, or under consideration to assist in ensuring that SFA funds are delivered accurately and efficiently. For example, FSA provides training opportunities to financial aid professionals that are intended to enhance their ability to effectively implement the Department's student aid programs. Other planned actions include the use of automation to improve various aspects of operations. This includes projects such as an enhanced online origination tool to improve the application process; an expanded Common Origination and Disbursement system to improve funds control; and the Integrated Partner Management initiative to improve management of partner entities, ranging from schools to third party servicers, as they administer Title IV Financial Aid for Students.

### **What Needs to Be Done**

Overall, FSA needs to continue to assess and improve its oversight and monitoring of postsecondary institutions; FFEL program guaranty agencies, lenders, and servicers; and other SFA program participants. It further needs to act effectively when issues are identified in its oversight and monitoring processes. FSA also needs to evaluate the risks within its programs and develop strategies to address risks identified to ensure effective operations. It further needs to assess its control environment, using information from OIG reviews, and other sources as appropriate, and implement actions for improvement.

## **Oversight and Monitoring—Distance Education**

### **Why This Is a Challenge**

Distance education refers to courses or programs offered through a technology, such as the Internet, that supports regular and substantive interaction between postsecondary students and instructors, either synchronously or asynchronously. The flexibility offered is popular with students pursuing education on a nontraditional 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. In addition, laws and regulations are generally modeled after the traditional classroom environment which does not always fit delivering education through distance education. Our investigative work has noted an increasing threat to fraudulently obtain Federal student aid from distance education programs. Our audits have identified noncompliance by distance education program participants that could be reduced through more effective oversight and monitoring.

### **Progress in Meeting the Challenge**

The Department has taken or plans to take numerous actions in response to our work in this challenge area. For example, starting in the January 2013 FAFSA cycle (for the 2013–14 award year), applicants selected for verification that are in a distance education

program must provide a notarized copy of a government-issued identification to the school. For the same FAFSA cycle, the Department began screening applicants for unusual attendance, such as a pattern of enrolling at several schools, receiving aid, and then withdrawing. In these instances, schools will need to follow up with the applicant to assure their educational purpose to attend school, or aid cannot be disbursed. The Department has also begun tracking applicants using the same email and IP address and will consider implementing new controls for the January 2014 FAFSA cycle (for the 2014–2015 school year).

### **What Needs to Be Done**

FSA needs to increase its monitoring and oversight of schools providing distance education. The Department should also gather information to identify students who are receiving SFA program funds to attend distance education programs—and gather other information as needed—in order to analyze the differences between traditional education and distance education. Based on this analysis, the Department should develop and implement requirements to specifically address potential problems inherent in distance education.

### **Oversight and Monitoring—Grantees**

#### **Why This Is a Challenge**

Effective monitoring and oversight are essential for ensuring that grantees meet grant requirements and achieve program goals and objectives. The Department's early learning, elementary, and secondary education programs annually serve nearly 16,000 public school districts and 49 million students attending more than 98,000 public schools and 28,000 private schools. Key programs administered by the Department include Title I of the *Elementary and Secondary Education Act* (ESEA), which under the President's 2014 request would deliver \$14.5 billion to help 23 million students in high poverty schools make progress toward State academic standards and the *Individuals with Disabilities Education Act*, Part B Grants to States, which would provide \$11.6 billion to help States and school districts meet the special educational needs of 6.5 million students with disabilities.

OIG work has identified a number of weaknesses in grantee oversight and monitoring. These involve Local Educational Agency (LEA) fiscal control issues, State Educational Agency (SEA) control issues, fraud perpetrated by LEA and charter school officials, and internal control weaknesses in the Department's oversight processes.

#### **Progress in Meeting the Challenge**

The Department has planned or completed numerous corrective actions in response to our audits. This includes enhancing guidance to applicants and reviewers, updating and clarifying internal guidance and policy, developing formal monitoring plans, and developing training to grantees and Department staff. The Department has also developed and implemented a software analysis tool that is intended to assist in identifying areas of potential risk in the Department's grant portfolio and developing appropriate monitoring, technical assistance, and oversight plans as a part of grants management.

**What Needs to Be Done**

The Department should continue to improve its monitoring efforts for recipients of formula and discretionary grant funds. This includes pursuing efforts to enhance risk management, increase financial expertise among its grants monitoring staff, and develop mechanisms to share information regarding risks and monitoring results. The Department also should consider adding language to its regulations so that prime recipients are fully cognizant of their responsibilities related to minimum requirements for monitoring subrecipients. The Department should include a reporting requirement for fraud and criminal misconduct in connection with all ESEA-authorized programs when the Education Department General Administrative Regulations are revised.

**Oversight and Monitoring—Contractors****Why This Is a Challenge**

Contract monitoring is an integral part of the Federal acquisition life cycle. Proper oversight is necessary to ensure that contractors meet the terms and conditions of each contract; fulfill agreed-upon obligations pertaining to quality, quantity, and level of service; and comply with all applicable regulations. The Department contracts for many services that are critical to its operations. These services include systems development, operation, and maintenance; loan servicing and debt collection; technical assistance for grantees; administrative and logistical support; and education research and program evaluations. As of May 2013, the value of the Department's active contracts exceeded \$5.5 billion.

Once a contract is awarded, the Department must effectively monitor performance to ensure that it receives the quality and quantity of products or services for which it is paying. OIG audits have identified issues relating to the lack of effective oversight and monitoring of contracts and contractor performance. This is primarily related to the appropriateness of contract payments and the effectiveness of contract management. In addition, OIG investigations have noted contractor activities, such as false claims, that resulted in improper billings and payments.

**Progress in Meeting the Challenge**

The Department has provided corrective action plans to address the issues noted in our audit work. It has also developed and implemented several training programs and procedures within this area.

**What Needs to Be Done**

The Department needs to ensure that it has an appropriately qualified staff in place and in sufficient numbers to provide effective oversight of its contracts.

**Management Challenge 4—Data Quality and Reporting****Why This Is a Challenge**

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. The Department, its



grantees, and its subrecipients must have effective controls to ensure that reported data is accurate and reliable.

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. This includes weaknesses in controls over the accuracy and reliability of program performance, academic assessments, and *American Recovery and Reinvestment Act of 2009* recipient data.

### **Progress in Meeting the Challenge**

To address concerns related to one program's performance data the Department plans to provide training to staff around assessing the SEA's efforts to sufficiently test performance data and provide reasonable assurance of its validity and completeness. It also plans to revise its site visit monitoring instrument to ensure staff sufficiently evaluate SEA monitoring activities related to the reliability of program performance data.

The Department requires management certifications regarding the accuracy of some SEA-submitted data. The Department also conducts an ongoing peer review process to evaluate State assessment systems, and it currently includes a review of test security practices during its scheduled program monitoring visits. In June 2011, the Secretary sent a letter to Chief State School Officers suggesting steps that could be taken to help ensure the integrity of the data used to measure student achievement. The Department also has a contract to provide technical assistance to improve the quality and reporting of outcomes and impact data from Department grant programs that runs through 2015.

### **What Needs to Be Done**

While the Department identified its commitment to work to improve staff and internal system capabilities for analyzing data and using it to improve programs, it must continue to work to ensure that effective controls are in place at all applicable levels of the data collection, aggregation, and analysis processes to ensure that accurate and reliable data is reported.

## **Management Challenge 5—Information Technology System Development and Implementation**

### **Why This Is a Challenge**

The Department faces an ongoing challenge of efficiently providing services to growing numbers of program participants and managing additional administrative requirements with consistent staffing levels. The Department reported that its inflation adjusted administrative budget is about the same as it was 10 years ago while its FTE has declined by 6 percent. This makes effective information systems development and implementation, and the greater efficiencies such investments can provide, critical to the success of its activities and the achievement of its mission.

Data from the Federal IT Dashboard reported the Department's total IT spending for FY 2013 as \$622.5 million. The Department identified 30 major IT investments accounting for \$506.5 million of its total IT spending. Our recent work has identified weaknesses in the Department's processes to oversee and monitor systems development that have negatively

impacted operations and may have resulted in improper payments. In addition, the Department self-reported two material weaknesses relating to financial reporting of federal student aid data and operations of the Direct Loan and FFEL programs that resulted from system functionality issues occurring after large-scale system conversions in October 2011.

**Progress in Meeting the Challenge**

The Department reported it has taken action to correct the financial reporting deficiencies associated with the system conversions. It also reported that FSA implemented other internal control improvements that resulted in system fixes and restored system functionality.

The Department further reported that actions to correct the root causes of the internal control deficiencies impacting operation of Direct Loan and FFEL programs are ongoing. Actions include research into borrower balances and root cause analysis of system limitations to inform recommendations on system and process fixes.

**What Needs to Be Done**

The Department needs to continue to monitor contractor performance to ensure that system deficiencies are corrected and that system performance fully supports the Department's financial reporting and operations. Further actions needed to address this challenge include improving management and oversight of system development and life cycle management (to include system modifications and enhancements) and ensuring that appropriate expertise to managing system contracts (to include acceptance of deliverables) is obtained.

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# Appendices

## Appendix A: Selected Department Web Links and Education Resources

### 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 Navigator

The Department provides a multi-dimensional review of higher education options for students and provides links to other sites. <http://nces.ed.gov/collegenavigator/>

### College Scorecards

College Scorecards in the Department's College Affordability and Transparency Center make it easier to find out more about a college's affordability and value.

<http://www.whitehouse.gov/issues/education/higher-education/college-score-card>

### One-Stop Shopping for Student Loans

The Department provides a site from which students can manage their loans.

<http://studentloans.gov/>

### 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. <http://studentaid.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 Adult and 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)

## Program Inventory

The *GPRA Modernization Act of 2010*, P.L. 111-352, requires that OMB establish a single website with a central inventory of all federal programs, including the purpose of each program and its contribution to the mission and goals of the Department. In 2013, the Department describes each program within 27 budgetary accounts, as well as how the programs support the Department's broader Strategic Goals and Objectives. <http://www2.ed.gov/programs/inventory.pdf>

## Grants Information and Resources

In addition to student loans and grants, the Department offers other discretionary grants, which are awarded using a competitive process, and formula grants, which use formulas determined by Congress with no application process. This site lists Department discretionary 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://www2.ed.gov/fund/grant/find/edlite-forecast.html>

For more information on the Department's programs, see <http://www2.ed.gov/programs/gtep/gtep.pdf>

## Federal Registry for Educational Excellence

Federal Registry 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. FREE is built on the Learning Registry, an open database for sharing educational resources. 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 library of digital resources for educators to help them enrich 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/publications\\_reviews.aspx](http://ies.ed.gov/ncee/wwc/publications_reviews.aspx)

## Performance Data

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

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

## Condition of Education and Digest of Education Statistics

The Condition of Education is a congressionally mandated annual report that summarizes developments and trends in education using the latest available statistics. The report presents statistical indicators containing text, figures, and data from early 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 2021

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 2021. 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=2013008>

## 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>

## National Assessment of Educational Progress

The National Assessment of Educational Progress (NAEP) 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 conducts independent and objective audits, investigations, inspections, and other activities to promote the efficiency, effectiveness, and integrity of the Department's programs and operations. <http://www.ed.gov/about/offices/list/oig/index.html>

For a list of recent reports, go to: <http://www2.ed.gov/about/offices/list/oig/reports.html>

## Appendix B: Glossary of Acronyms and Abbreviations

ABCP	Asset-Backed Commercial Paper
ACG	Academic Competitiveness Grant
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>
CAP	Corrective Action Plan
CAT	Core Assessment Team
CCRAA	<i>College Cost Reduction and Access Act of 2007</i>
CFO	Chief Financial Officer
CPSS	Contract and Purchasing Support System
CRA	<i>Civil Rights Act of 1964</i>
CSPR	<i>Consolidated State Performance Report</i>
CSRS	Civil Service Retirement System
CTEA	<i>Carl D. Perkins Career and Technical Education Act of 2006</i>
DD&B	Death, Disability and Bankruptcy
DOL	U.S. Department of Labor
DSS	Decision Support System
DST	Data Strategy Team
ECASLA	<i>Ensuring Continued Access to Student Loans Act of 2008</i>
EDCAPS	Education's Central Automated Processing System
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>GPRA 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 of 2010</i>

IPERIA	<i>Improper Payments Elimination and Recovery Improvement Act of 2012</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
KEA	Kindergarten Entry Assessment
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
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



OST	Office of School Turnaround
OVAE	Office of Vocational and Adult Education
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
RA/JF	<i>American Recovery and Reinvestment Act of 2009</i> (Recovery Act)/Education Jobs Fund
RCA	<i>Reports Consolidation Act of 2000</i>
REAP	Rural Education Achievement Program
RESPECT	Recognizing Educational Success, Professional Excellence, and Collaborative Teaching
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
SAT	Senior Assessment Team
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

SOAR	Strategic Objectives Annual Report
SOS	Schedule of Spending
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

## Acknowledgments

*This Agency Financial Report (AFR) was produced with the energies and talents of our employees and contract partners.*

*Within the Office of the Chief Financial Officer, the office of Financial Management Operations (FMO) is responsible for certifying, processing, reconciling, evaluating, and reporting all agency financial transactions; preparing annual financial statements and related notes and schedules; and coordinating the external audit of the agency's financial statements.*

*Financial Improvement and Post Audit Operations (FIPAO) provides leadership and direction in the areas of internal control assessment, financial management training, post audit activities, and indirect cost determination.*

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*We offer our sincerest thanks and acknowledgment to staff of all participating principal offices. In particular, we recognize the following organizations for their contribution:*

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The following companies were contracted to assist in the preparation of the U.S. Department of Education *FY 2013 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

*The FY 2013 Agency Financial Report*

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

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U.S. Department of Education, December 2013



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