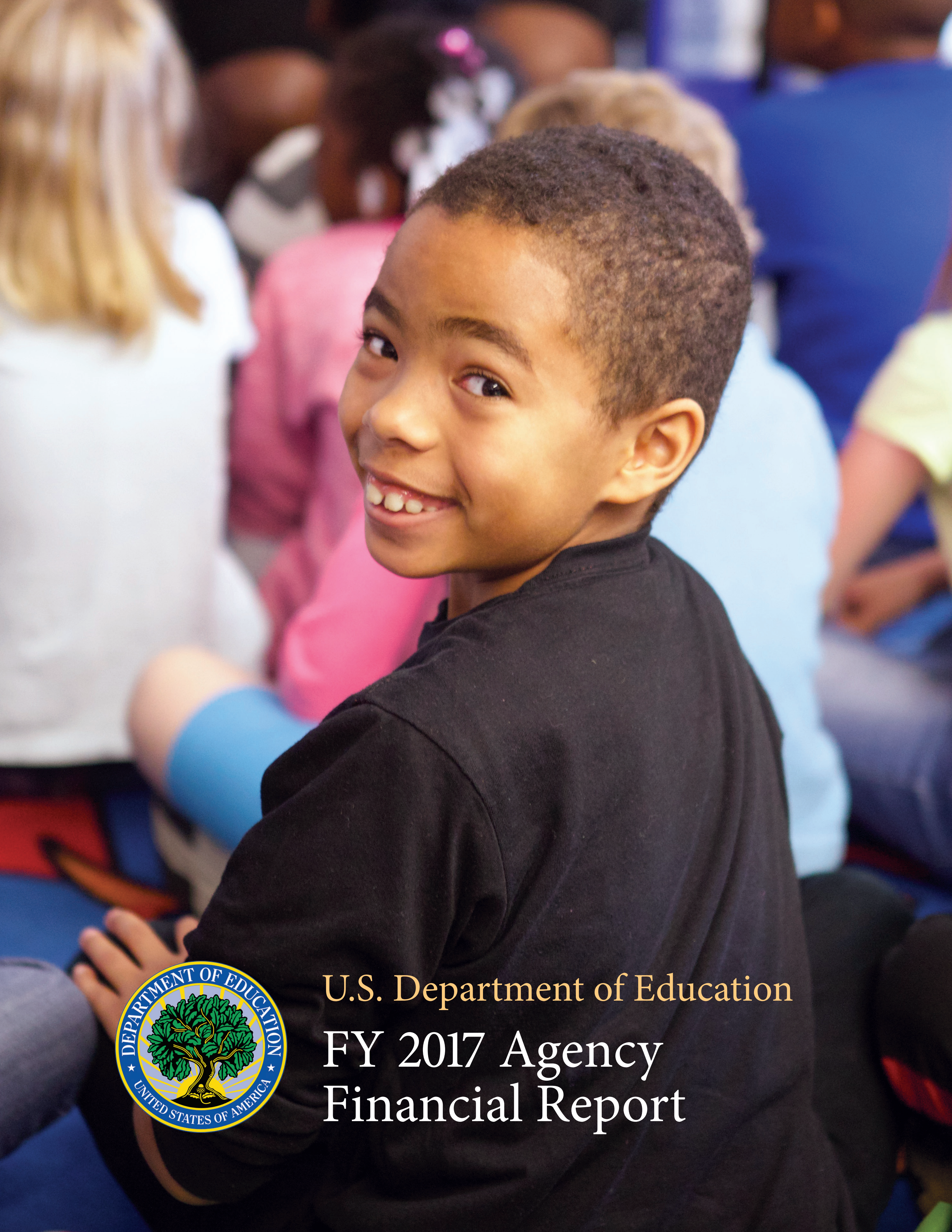

U.S. Department of Education

FY 2017 Agency Financial Report

U.S. Department of Education
Betsy DeVos
Secretary

Office of the Chief Financial Officer
Tim Soltis
Delegated the Duties of Chief Financial Officer

November 13, 2017

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NOTICE OF AVAILABILITY OF ALTERNATE FORMATS

This report is available at **http://www.ed.gov/about/reports/annual/index.html**. On request, the report also is available in alternative formats, such as Braille, large print, or compact disk. For more information, please contact our Alternate Format Center at 202-260-0852 or the 504 coordinator via e-mail at **om_eeos@ed.gov**.

To become connected to the Department through social media, please visit the Department's website at **www.ed.gov**. Our Twitter page is at **@usedgov**, and our blog is at **Homeroom**.

NOTICE TO LIMITED ENGLISH PROFICIENT PERSONS

Notice of Language Assistance: If you have difficulty understanding English, you may request language assistance services, free of charge, for this Department information by calling 1-800-USA-LEARN (1-800-872-5327) (TTY: 1-800-877-8339), or by e-mailing us at **Ed.Language.Assistance@ed.gov**.

For Fiscal Year 2017, in addition to the *Agency Financial Report* (AFR), the Department will post to its website the *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** with the FY 2019 budget.

Please submit your comments and questions regarding this report, and any suggestions to improve its usefulness to **AFRComments@ed.gov** or write to:

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

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ABOUT THIS REPORT

The purpose of the United States Department of Education's (the Department) Fiscal Year (FY) 2017 *Agency Financial Report* (AFR) is to inform Congress, the President, other external stakeholders, and the American people on how the Department used the federal resources entrusted to it to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access. The Department accomplishes its mission and the related strategic goals and objectives by administering programs that range from preschool education through postdoctoral research; enforcing civil rights laws to provide equal access and treatment; and supporting research that examines ways that states, schools, districts, and postsecondary institutions can improve America's education system. As evidenced by the information contained in this AFR, the Department has demonstrated that it is a good steward of financial resources and has put in place well-controlled and well-managed business and financial management systems and processes.

The AFR also provides high-level financial and performance highlights, assessments of controls, a summary of challenges, and a demonstration of the Department's stewardship. This 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*; A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*; and A-136, *Financial Reporting Requirements*. The report satisfies the reporting requirements contained in the following legislation:

- ***Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA)***
- ***Improper Payments Elimination and Recovery Act of 2010***
- ***Government Performance and Results Act (GPRA) Modernization Act of 2010***
- ***Federal Information Security Management Act of 2002***
- ***Reports Consolidation Act of 2000***
- ***Federal Financial Management Improvement Act of 1996***
- ***Government Management Reform Act of 1994***
- ***Chief Financial Officers Act of 1990***
- ***Federal Managers' Financial Integrity Act of 1982***
- ***General Education Provisions Act***
- ***Department of Education Organization Act of 1979***

Federal Student Aid (FSA), a principal office of the Department and a designated Performance-Based Organization, also produces a separate *Annual Report* that details their financial and program performance. Summary level information about FSA activities can be found in the applicable sections of this report. For more detail on FSA's performance and financial information, refer to **StudentAid.gov**.

CERTIFICATE OF EXCELLENCE

During FY 2016, the Department won its 13th award of the prestigious Certificate of Excellence in Accountability Reporting by the Association of Government Accountants with additional special recognition for Best-in-Class presentation of the Management's Discussion and Analysis section of the AFR.


AGA
Certificate of Excellence in Accountability Reporting®
presented to the
U.S. Department of Education
in recognition of outstanding effort in preparing the Agency Financial Report for the fiscal year ending September 30, 2016.
Diane L. Dudley, CGFM, CPA
Chair, CEAR Board
Ann M. Ebberts, MS, PMP
Chief Executive Officer, AGA


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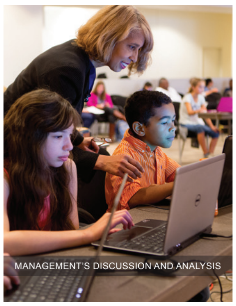
HOW THIS REPORT IS ORGANIZED

The AFR is designed to focus on use of federal resources provided to or distributed by the Department to support its mission, with a particular emphasis on the challenges ahead.



MANAGEMENT'S DISCUSSION AND ANALYSIS

This section provides information about the Department's mission and organizational structure as well as its 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 supplementary stewardship information, and the report from the independent auditors.

OTHER INFORMATION

This section provides payment integrity reporting details, a summary of financial statement audit and management assurances, and the Office of Inspector General's Management and Performance Challenges for FY 2018 Executive Summary.

APPENDICES

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

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MESSAGE FROM THE SECRETARY

November 13, 2017

Fiscal year (FY) 2017 was my first as U.S. Secretary of Education, and it has been nothing short of fulfilling. I would like to take a moment to reflect on what we have accomplished thus far and share the exciting efforts that we will pursue on behalf of America's students, parents and educators.

Our mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access. This mission drives me and all employees at the Department to work even harder than we had the day before. Our nation's students deserve nothing less than 100 percent of our efforts.

Even though our administration began in the middle of the fiscal year, we have been able to build on efforts to identify new priorities and objectives to better help America's students succeed. In FY 2017, we began work on four goals: first, to support state and local efforts to improve learning outcomes for all P–12 students in every community; second, to expand postsecondary education options and improve outcomes to foster economic opportunity and informed, thoughtful and productive citizens; third, to strengthen the quality, accessibility and use of education data through better management, increased privacy protections and transparency; and fourth, to reform the effectiveness, efficiency and accountability of the Department.

Achieving the first goal begins with acknowledging the fact that each and every child is unique, with different abilities, talents and needs. Far too many students do not have access to a learning environment that is able to maximize their abilities or meet their individual needs.

Every child deserves access to a safe and nurturing learning environment where they can grow and thrive. It is imperative they gain that access, regardless of where they live or how much money their family earns.

Our nation has taken concrete steps towards offering students that access through the implementation of the Every Student Succeeds Act (ESSA), signed into law in 2015 and currently in its first year of application.

No two states are the same—each has its own unique education challenges and opportunities. And, as in any other sector, the best solutions in education will come from the bottom up, not mandated from the top down. That is why the organizing principle of ESSA is to provide states with greater flexibility so they can best meet the needs of the students and families they serve.

But a student's education should not end upon graduating from high school. There are many pathways students can choose in their quest for lifelong learning and search for employment, and that is why we are committed to expanding the postsecondary education options available to them. Each year there are fewer "traditional" students seeking postsecondary degrees or credentials, thus our goal is to support the innovative and affordable options that meet their needs and help them succeed.

We started by making Pell Grants available year-round. This gives low-income students the flexibility to complete their education at a faster pace if they so choose, thereby potentially reducing their debt and allowing them to pursue the next chapter of their lives.

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Access to federal student aid has allowed millions of students to further their education at an institution of higher learning, yet the customer experience for acquiring and paying off these loans has been subpar at best. Complex applications, confusing notifications and multiple platforms have all led to a lack of clarity and created an onerous process for borrowers. This reality has prompted us to begin transforming Federal Student Aid's service delivery by implementing the Next Generation Processing and Servicing Environment. Our goal is to put in place a servicing system that will greatly enhance the user experience while protecting taxpayer dollars.

We are also committed to improving how Department staff access, use and share meaningful education data, while protecting the privacy of children and their families. These improvements will enable us to provide appropriate support to education stakeholders so they, too, have the information necessary to make informed decisions on behalf of their students, parents, educators, states and local districts.

Finally, it is important for the Department not only to look for avenues where we can help, but also to examine whether we are creating unnecessary burdens on educators, administrators and, most importantly, families. We want to foster a culture of innovation in education, and that begins by reviewing and removing those regulations that make it harder for educators to do what they do best: educate.

This year we paused the Borrower Defense to Repayment and Gainful Employment regulations, each well-intentioned but not implemented in the best way, so that we can revisit and rewrite them in a way that protects students, uses taxpayer dollars wisely and treats all institutions fairly. Throughout FY 2018, we will continue our review of all departmental regulations, rules and guidance to ensure that they are indeed furthering the Department's mission.

When confronted with any decision at the Department, my first question is always the same: what will most benefit students? Improving education for every student is the entirety of the Department's mission, and I remain laser-focused on keeping our orientation around what is best for them.

It is incumbent upon us to bring education up to speed to meet the ever-evolving demands of the 21st century. Thanks to the support of the President, and with the efforts of our entire staff, the Department of Education is poised to do just that.

Betsy DeVos

Betsy DeVos

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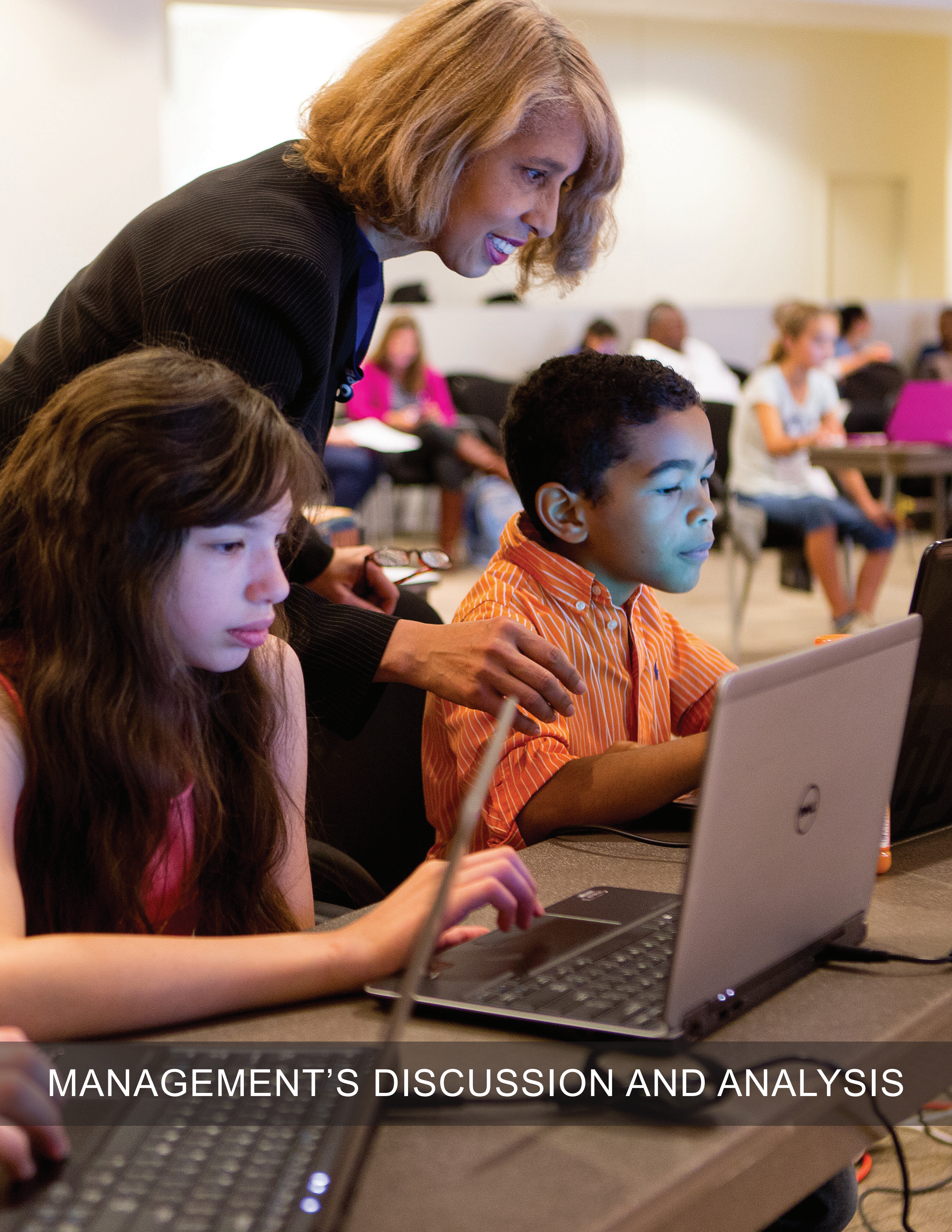

MANAGEMENT’S DISCUSSION AND ANALYSIS

ABOUT THE MANAGEMENT'S DISCUSSION AND ANALYSIS

The U.S. Department of Education (the Department) continued to enhance the content quality, report layout, and public accessibility of the Fiscal Year (FY) 2017 Agency Financial Report (AFR) by providing additional graphics and more useful, balanced, and easily understood information about the Department's grant and loan programs, including additional cost and risk information. Additionally, we augmented information provided in the body of the AFR with relevant web content to provide users with additional information about the Department's operations and performance. To take advantage of the hyperlinks embedded in the report, the Department recommends reading it **on the Internet**. To help us continue to improve the quality and usefulness of information provided in our AFR, we encourage our public and other stakeholders to provide feedback and suggestions at **AFRComments@ed.gov**.

This section highlights information on the Department's performance, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address select challenges.

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 and a link to the full list of **Department offices** with a description of selected offices by function.

DISCUSSION OF PERFORMANCE

This section includes an overview of performance reporting and a high-level discussion on the Department's focus areas for FY 2017. The results achieved from Department expenditures are discussed at a high level in the AFR. For more details about performance, please refer to the Department's budget and performance web page and **performance.gov**.

To view information on all Department programs, visit the **Department's website**.

FORWARD-LOOKING INFORMATION

The Forward-Looking Information section describes the challenges that the Department aims to address to achieve progress on Direct Loans, Shared Services, and Enterprise Risk Management (ERM).

FINANCIAL HIGHLIGHTS

The Department expends a substantial portion of its budgetary resources and cash on multiple loan and grant programs intended to support state and local efforts to improve learning outcomes for all prekindergarten through 12th grade (P–12) students in every community and to expand postsecondary education options and improve outcomes to foster economic opportunity and informed, thoughtful, and productive citizens. Accordingly, the Department included more high-level details about sources and uses of the federal funds received and net costs by program.

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

The Department's internal control framework and its assessment of controls, in accordance with Office of Management and Budget (OMB) **Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control***, provide assurance to Department leadership and external stakeholders that financial data produced by the Department's business and financial processes and systems are complete, accurate, and reliable.

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ABOUT THE DEPARTMENT

OUR MISSION

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.*

Who We Are. 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 1980. Today, the Department supports programs in every area and level of education from preschool through postdoctoral research.

The **Department** makes funds and information available to individuals pursuing education, colleges and universities, state education agencies, and school districts by engaging in four major types of activities:

- establishing policies related to federal education funding, including distributing funds, collecting on student loans, and using data to monitor the use of funds;
- supporting data collection and research on America's schools;
- identifying major issues in education and focusing national attention on them; and
- enforcing federal laws promoting equal access and prohibiting discrimination in programs that receive federal funds.

Our Public Benefit. The Department executes the laws passed by Congress to promote student academic achievement and preparation for global competitiveness. The Department works with students, parents, educational institutions, school districts, and states to foster educational excellence and to ensure equal access to a high quality education for all students. While recognizing the primary role of states and school districts in providing high quality education, the Department is committed to helping ensure students throughout the nation develop skills to succeed in school, pursue postsecondary options, and transition to the workforce. The Department's vision is to improve educational outcomes for all students.

Many of the Department's programs involve awarding grants to state and local educational agencies and providing grants and loans to postsecondary students. The Department's largest outlays are for its portfolio of student loans (see the **Financial Highlights** and **Notes** sections). Grant programs constitute the second-largest driver of outlays. The grant programs include: student aid to help pay for college through Pell Grants, Work Study, and other campus-based programs; grants awarded based on statutory formulas mostly for elementary and secondary education (see the chart on page 5); and competitive grant programs to promote innovation (see **The Department's Approach to Performance Management** section). The Department also supports research, collects education statistics, and enforces civil rights statutes. We manage and spend financial resources on programs designed to support parents, teachers, principals, school leadership, institutions, and states in the pursuit of instilling knowledge and transferring skills to students.

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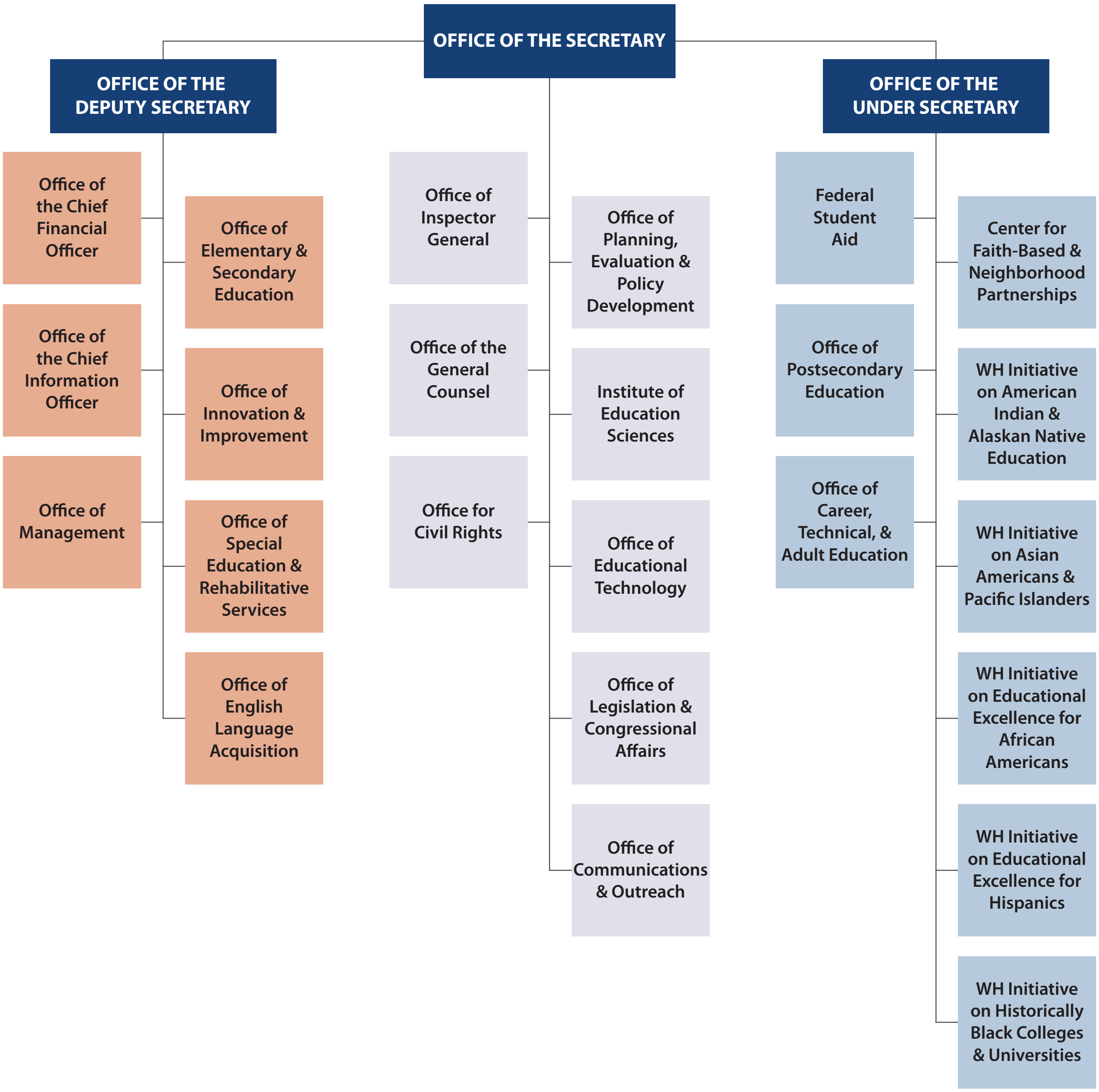
OUR ORGANIZATION IN FISCAL YEAR 2017

This chart reflects the coordinating structure of the U.S. Department of Education. **Interactive** and **text versions** of the FY 2017 coordinating structure of the Department are available.



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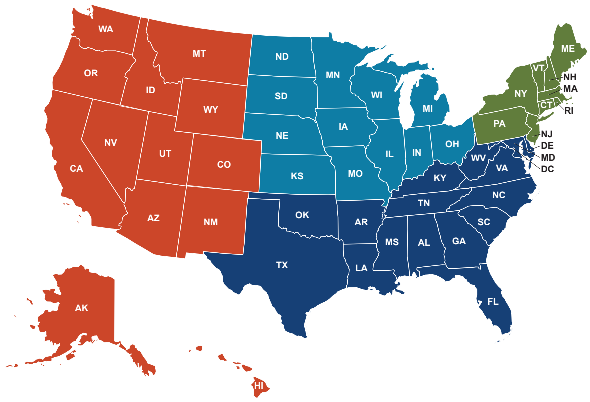
FY 2016 ACTUAL FORMULA GRANT DISTRIBUTION BY REGION AND STATE

The figures in these tables are made up of funding from multiple programs allocated to states based on statutory formulas. These do not include discretionary grants, need-based grants, or federal loans. For more details, view the **Department's State Budget Tables**.



West	Grades K–12	Postsec	All Other
Alaska	$ 258	$ 36	$ 12
Arizona	829	1,044	100
California	4,058	3,791	404
Colorado	440	418	51
Hawaii	165	75	16
Idaho	163	162	21
Montana	170	67	16
Nevada	253	133	24
New Mexico	348	181	30
Oregon	372	342	58
Utah	272	378	34
Washington	662	429	68
Wyoming	112	29	11
TOTAL	**$ 8,103**	**$ 7,086**	**$ 844**

South	Grades K–12	Postsec	All Other
Alabama	$ 538	$ 496	$ 74
Arkansas	352	268	53
Delaware	116	60	15
District of Columbia	93	132	18
Florida	1,865	1,807	227
Georgia	1,111	942	111
Kentucky	495	379	65
Louisiana	627	383	47
Maryland	535	378	53
Mississippi	401	325	52
North Carolina	986	803	129
Oklahoma	457	295	45
South Carolina	525	379	68
Tennessee	678	529	73
Texas	3,217	2,166	308
Virginia	725	668	92
West Virginia	217	206	37
TOTAL	**$ 12,936**	**$ 10,217**	**$ 1,469**

NOTES: Dollars in millions. Detail may not add to totals due to rounding. Data are current as of September 13, 2017.

Midwest	Grades K–12	Postsec	All Other
Illinois	$ 1,488	$ 1,140	$ 137
Indiana	660	724	71
Iowa	285	374	35
Kansas	332	237	28
Michigan	1,149	829	124
Minnesota	483	461	59
Missouri	620	532	78
Nebraska	212	132	24
North Dakota	120	46	12
Ohio	1,275	793	129
South Dakota	164	86	12
Wisconsin	564	390	73
TOTAL	**$ 7,352**	**$ 5,744**	**$ 782**

Northeast	Grades K–12	Postsec	All Other
Connecticut	$ 330	$ 266	$ 33
Maine	148	107	19
Massachusetts	656	518	71
New Hampshire	128	117	13
New Jersey	898	617	80
New York	2,478	1,923	204
Pennsylvania	1,280	937	166
Rhode Island	131	108	16
Vermont	95	48	14
TOTAL	**$ 6,144**	**$ 4,640**	**$ 616**

Other	Grades K–12	Postsec	All Other
American Samoa	$ 26	$ 4	$ 1
Freely Associated States	7	16	0
Guam	43	15	4
Indian set-aside	247	-	43
Northern Mariana Islands	18	4	1
Puerto Rico	682	890	69
Virgin Islands	25	5	3
All Other	329	-	2
TOTAL	**$ 1,376**	**$ 934**	**$ 123**

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THE DEPARTMENT'S APPROACH TO PERFORMANCE MANAGEMENT

PERFORMANCE MANAGEMENT FRAMEWORK

The ***Government Performance and Results Act Modernization Act of 2010*** **(GPRAMA)** requires agencies to establish a strategic plan that presents the long-term goals that the agency intends to accomplish. GPRAMA requires agencies to establish a **four-year strategic plan** at the beginning of each Administration. The Strategic Plan describes the key policy and operational priorities for the agency, detailing the Department's strategic performance goals that will guide human capital and budget planning.

Throughout Fiscal Year (FY) 2017, the Department conducted a series of strategic planning meetings to develop the *FY 2018–22 Strategic Plan*. These meetings included a focus on capturing lessons learned and developing a framework for the new Strategic Plan. The Department also consulted with Congress and the **Office of Management and Budget** (OMB). The Department plans to publish the *FY 2018–22 Strategic Plan* with the President's FY 2019 Budget in February 2018. Questions or comments about the Department's performance management framework and reporting should be e-mailed to **PIO@ed.gov**.

INFORMATION IN THE *AGENCY FINANCIAL REPORT*

The Department has elected to produce separate financial and performance reports. The *Agency Financial Report* for FY 2017 provides a high-level description of performance measures and goals based on the *FY 2014–18 Strategic Plan*. A detailed discussion of performance information for FY 2017 will be provided in the Department's *Annual Performance Report* to be released at the same time as the President's FY 2019 Budget. The Department's annual performance reports for prior years are available **online**. We also urge readers to seek programmatic data as it is reported in the **Congressional Budget Justification**, as well as on the web pages of **individual programs**.

The high-level discussion of performance information in this year's AFR includes performance matters that inform decisions of the Department and its partners. Discussions about the most serious management challenges the Department faces from the perspective of the Department's Office of Inspector General are provided in the Other Information section of the report.

AGENCY ACHIEVEMENTS AND LOOKING AHEAD

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. This mission is manifested in the Department's efforts to continually improve the educational environment for all students, and address their education needs. The Department's **National Center for Education Statistics** (NCES) estimates that 50.7 million students are attending public elementary and secondary schools in the fall of 2017, with a projected 35.6 million in prekindergarten through grade 8 and a projected 15.1 million in grades 9 through 12. An additional 5.2 million students are expected to attend private elementary and secondary schools. In fact, NCES predicts that the total P–12 enrollment will continue to grow to an all-time high of 56.8 million by 2026, indicating the increasing need for the highest quality agency performance.

Looking to the future, the Department plans to focus in the key areas of: (1) supporting state and local efforts to improve learning outcomes for all P–12 students in every community; (2) expanding postsecondary education options and improving outcomes to foster economic opportunity and informed, thoughtful, and productive citizens; (3) strengthening the quality, accessibility, and use of education data through better management, increased privacy protections, and transparency; and (4) reforming the effectiveness, efficiency, and accountability of the Department.

SUPPORTING STATE AND LOCAL EFFORTS TO IMPROVE LEARNING OUTCOMES FOR P–12 STUDENTS

In March, the Department released a revised **consolidated state plan template** to support states in meeting the requirements of the ***Elementary and Secondary Education Act of 1965*** (ESEA), as

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amended by the *Every Student Succeeds Act* (ESSA). The Department worked with state educational agencies (SEAs), and other state and local stakeholders, to develop a revised template that is structured to reduce burden and promote innovation, flexibility, transparency, and accountability, while maintaining essential protections for all students. The revised template asks states only to provide detail on their plans in areas (a) explicitly required by law and (b) deemed absolutely necessary for consideration of such a plan, consistent with ESEA section 8302(b)(3), leveraging input of states, local educators, and parents. State plans have been submitted to the Department, peer-reviewed, and approved.

Looking Ahead: Every student—regardless of background or circumstance—deserves an opportunity to fulfill his or her potential. High-quality educational opportunities are critical when it comes to achieving that goal, especially for the most vulnerable students and communities. The **President's FY 2018 Budget** is an indication of the commitment to support the most vulnerable. Level funding of the **Title I Grants program** totaling $14.9 billion would be allocated to local educational agencies' programs to support state and local efforts to ensure that more than 25 million students in high-poverty schools have access to rigorous coursework and teaching. Additionally, the federal investment in the ***Individuals with Disabilities Education Act*** formula grant programs at $12.7 billion would support services to 6.8 million children with disabilities and to states to design and implement special education program improvement efforts under the Department's **Results Driven Accountability** framework. The **English Language Acquisition program** would receive $736 million to implement effective language instruction programs designed to help English learners attain English language proficiency.

The Administration's education priority is to help ensure every student in America has an equal opportunity for a great education by giving parents more control and greater options. The proposed FY 2018 budget includes a $167 million increase for the **Charter Schools Grants program** to strengthen state efforts to start new charter schools or expand and replicate existing high-performing charter schools while providing up to $100 million to meet the demand for charter school facilities.

The Department is also focused on promoting evidence-based decision making with the intention to support states and districts in using and building evidence effectively. To this end, in FY 2017, the Department published revised evidence definitions and related selection criteria for competitive grant programs in Education Department General Administrative Regulations that align with ESSA; disseminated nonregulatory guidance on evidence in ESSA, ***Using Evidence to Strengthen Education Investments***, which contains a five-step decision-making framework that shapes evidence as a mechanism for continuous improvement and recommends criteria for each of the four evidence levels in ESSA; awarded $16 million to support rigorous evaluations and researcher-practitioner partnerships focused on state and local education priorities; and awarded 60-month contracts for nine Regional Educational Laboratories, which work in partnership with states and districts to bridge research, policy, and practice in education.

EXPANDING POSTSECONDARY EDUCATION OPTIONS AND IMPROVING OUTCOMES

With the passage of the FY 2017 spending bill, year-round Pell grants were restored, and the Department announced that these grants would become available to college students beginning July 1, 2017. The **Department recommended** that unless a student had remaining eligibility from the 2016–17 award year, institutions should award Pell Grant funds for this past summer out of the 2017–18 award year since the additional funding will be available later in the year (e.g., spring or summer of 2018). The change allows an eligible student to receive up to 150 percent of the student's scheduled Pell Grant for an award year beginning with the 2017–18 award year. This change gives hundreds of thousands of college students more resources to finish their coursework in a timeframe meeting their individual needs. Students will be able to graduate more quickly and with less debt.

The Department is transforming how **Federal Student Aid** (FSA) provides customer service to more than 42 million student loan borrowers. FSA customers will transition to a new processing and servicing environment in 2019, providing a customer support system that will give a better experience for students and benefits for taxpayers. The **FSA Next Generation Processing and Servicing Environment** will provide for a single data processing platform to house all student loan information while also allowing for customer account servicing to be performed either by a single contract servicer or by multiple contract servicers. This approach is expected to require separate acquisitions for database housing, system processing, and customer account servicing, allowing

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for maximum flexibility. These changes to the servicing and processing environment are expected to provide the opportunity for additional companies to submit proposals for contracting with FSA.

The Department **issued a reset**, or pause, regarding two postsecondary regulations—Borrower Defense to Repayment, concerning forgiveness of student loan debt, and Gainful Employment, concerning educational programs that prepare students for gainful employment in a recognized occupation. Two negotiated rulemaking committees have been established to rethink these two higher education regulations, with the intent to develop fair, effective, and improved regulations to protect individual borrowers from fraud, ensure accountability across institutions of higher education, and protect taxpayer interests. It is the Department's aim to protect students from predatory practices while also providing clear, fair, and balanced rules for colleges and universities to follow.

Looking Ahead: Year-round Pell grants were proposed in the 2018 President's Budget, which should safeguard and strengthen the Pell Grant program by level funding the discretionary appropriation and the year-round Pell grants. It is estimated that year-round Pell grants will increase aid available to eligible students by $16.3 billion over 10 years.

In an effort to address the fact that student loan financing can be confusing for millions of students and families who want to invest in postsecondary education, the 2018 budget proposal lays out changes in repayment and loan forgiveness plans for new borrowers after July 1, 2018. The changes simplify loan repayment for students by replacing five different income-driven repayment plans with a single plan aimed at prioritizing expedited loan repayment for undergraduate borrowers. These changes will save taxpayers an estimated $143 billion over the next decade while insulating current borrowers from changes to their loan programs. Proposed funding of $492 million is intended to help close gaps among racial and socioeconomic groups in college enrollment and degree attainment by improving academic programs, institutional capacity and student support services for Historically Black Colleges and Universities, Minority-Serving Institutions, and Hispanic-Serving Institutions. The proposed budget also provides $808.3 million for students from disadvantaged backgrounds, who are part of the **Federal TRIO Programs** and $219 million for those in the **Gaining Early Awareness and Readiness for Undergraduate Programs**.

STRENGTHENING THE QUALITY, ACCESSIBILITY, AND USE OF EDUCATION DATA

The Department's **College Scorecard** supports postsecondary students by providing the public with clear, easily accessible, and critical information on college performance. Feedback from the intended users—students, parents, counselors, and others—helps determine the design of the site and the information it contains. The College Scorecard integrates self-reported data from institutions of higher education collected by NCES with administrative data from FSA and U.S. Department of Treasury's tax data. The Department established a data-sharing agreement with Treasury's Statistics of Income (SOI) for five years to obtain administrative earnings data to inform the College Scorecard. The Department will continue to provide SOI with individual-level data on several cohorts of students from all Title IV institutions and receive back institution-level data on salary after attending the institution. Most recently, the Department developed a user-requested comparison tool feature for the College Scorecard to allow users to compare multiple school profiles and data points at once.

The Department's **National Assessment of Educational Progress** (NAEP), the largest nationally representative and continuing assessment of student knowledge in various subject areas, is evolving to address schools' transition to digitally based assessments. Since 1969, NAEP has provided a common measure of student achievement across the country, continuing to explore new testing methods and question types that reflect the growing use of technology in education, and continuing to work to be paperless.

The Department's InformED initiative is intended to transform how the Department makes information available—and actionable—for internal users and for the public. Through a cross-office steering committee, InformED has led in the identification and development of high-priority open data initiatives. In addition, to ensure coordination around the collection, use, and

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analysis of agency data, the Department has supported the Data Strategy Team with representatives from the Department's Office of Management, NCES, and Office of Planning, Evaluation and Policy Development.

Looking Ahead: The President's Budget includes $616.8 million for the Department's Institute of Education Sciences to continue to support state and local-based research, evaluations, and statistics that help educators, policymakers, and other stakeholders improve student outcomes. $42 million is suggested for **Supporting Effective Educator Development** grants to provide evidence-based professional development activities and prepare teachers and principals from nontraditional preparation and certification routes to serve in high-need LEAs.

$120 million is suggested for **Education Innovation and Research (EIR)** grants to develop and expand the evidence base for effective interventions and innovations responding to other education needs, including those identified by Secretarial priorities and those emerging from the field. This continued investment is particularly necessary in light of new ESEA requirements for states and school districts to support the use of evidence-based interventions in schools identified for comprehensive support and improvement or implementing targeted support and improvement plans. Robust Federal investment in identifying such interventions through the EIR program is essential to ensuring that LEAs have the tools they need to address the persistent challenges in their lowest-performing schools.

REFORMING THE EFFECTIVENESS, EFFICIENCY, AND ACCOUNTABILITY OF THE DEPARTMENT

In response to President Trump's **Executive Order 13777, *Enforcing the Regulatory Reform Agenda***, the Department established a Regulatory Reform Task Force that has catalogued over 150 regulations and more than 1,700 items of policy guidance at the Department. The task force, comprised of agency political appointees and career staff, provided recommendations on which regulations and guidance documents to repeal, modify, or keep in an effort to ensure those items that remain adequately protect students while giving states, institutions, teachers, parents, and students the flexibility to improve student achievement. Each principal office has made initial recommendations to the task force whether regulations and guidance under its purview meet the Order's criteria for repeal, replacement, or modification. As previously discussed, candidates for modification that have been identified include the Gainful Employment and Borrower Defense to Repayment, and a reset for these regulations is underway.

Also, in response to **Executive Order 13781, *Comprehensive Plan for Reorganizing the Executive Branch***, which requires development of a plan to enhance employee performance, the Department submitted an Agency Reform Plan to OMB, describing proposals the Department is considering. For the OMB submission, work groups considered the areas of: (a) reviewing potential reform areas, (b) determining if reform is needed or helpful and whether reform will benefit the agency and the public, and (c) developing proposals for implementing the reform if the work group determines it is needed or helpful. Agency staff continue to assess reform factors that include: new activities or functions the Department should initiate; ways the agency can be more efficient in meeting the needs of students, families, and education partners; activities or functions the Department should consider combining or modifying; agency activities or functions that duplicate what others are doing; and how the Department could best deliver the education services or products to students and educators.

Looking Ahead: The Department intends to continue to build on what's working well to create an agency that better serves America's students and educators. Beginning with its FY 2018 Annual Performance Report, the Department will report the appropriate performance data for performance indicators that will relate to deregulatory actions, as outlined in the **Executive Order 13777**. The results of this internal reform will better align and support the new strategic plan, which is the basis for the Department's performance management framework. The Department uses quarterly performance reviews, targeted strategic initiatives, and outreach to leaders and stakeholders to assess progress and garner engagement toward achieving strategic goals and outcomes. The *FY 2018–22 Strategic Plan* will be published with the President's FY 2019 Budget.

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FORWARD-LOOKING INFORMATION

This section summarizes information pertinent to the Department's future progress and success.

DIRECT LOAN PROGRAM

The Department's largest program, the William D. Ford Federal Direct Loan (Direct Loan) program, provides students and their families with funds to help pay for their postsecondary education costs. Easing the burden of student loan debt is a significant priority for the Department. The following is a discussion of (1) the steps the Department has taken to ensure that student debt is manageable and (2) the risks inherent in estimating the cost of the program.

Managing Student Loan Debt

Each year, federal student loans help millions of Americans obtain a college education—an investment that, on average, has high returns. While the average return to a college degree remains high, substantial inequities in outcomes exist, and some students leave school poorly equipped to manage their debt, whether due to limited labor market opportunities or high debt.

Traditionally, federal loans of this type have had flat 10-year repayment schedules, making it difficult for borrowers to pay at the start of their career when their salaries are lower. The recent expansion of income-driven repayment plans grants students the opportunity for greater financial flexibility as it pertains to their monthly payment. For more details on these plans, visit FSA's **How to Repay Your Loans Portal**.

As the labor market declined during the financial crisis of 2008, serious challenges in student debt repayment came to the forefront of conversations. The availability of income-driven repayment plans like Pay As You Earn (PAYE) and an improving labor market has led to substantial improvement, signifying Departmental progress in the focus area of higher education, namely, its efforts to innovate loan program guidelines in order to make student loan debt more manageable for borrowers across the board. Recent trends in student loan repayment data show that:

- More than 80 percent of Direct Loan recipients with loans in repayment are current on their loans.
- Growing numbers of borrowers are taking action and responsibility with regard to their student loans when they are in need of modifications and support. As of June 2017, nearly 6.3 million Direct Loan recipients were enrolled in income-driven repayment plans, representing a 19 percent increase from June 2016 and a 62 percent increase from June 2015.

The Department has made progress in this area and continues to work relentlessly to make student debt more manageable. Looking to the future, the Department will build on its recent successes by:

- Conducting significant outreach efforts to inform student loan borrowers of their repayment options, including the protections provided by income-driven repayment plans.
- Ensuring that borrowers have access to an affordable repayment plan, high-quality customer service, reliable information, and fair treatment.
- Continuing to support additional tools like the College Scorecard and Financial Aid Shopping Sheet to increase transparency around higher education costs and outcomes, in an effort to help students and families make informed decisions before college enrollment.

Managing Risks and Uncertainty Facing the Direct Loan Program's Cost Estimates

Direct Loan program costs are estimated consistent with the requirements of the *Federal Credit Reform Act of 1990*. Under the Act, the future costs and revenues associated with a loan are estimated for the entire life of the loan, up to 40 years in this case. The actual performance of a loan cohort tends to deviate from the estimated performance during that time, which is not unexpected given the inherent uncertainty involved in developing estimates. There are four types of risk that make estimating lifetime program costs a difficult task.

Legislative, Regulatory, and Policy Risk

There are inherent risks from the possibility that the cost structure of the Direct Loan program may be altered through legislative, regulatory, or administrative action. In addition, recent legislative, regulatory, and policy

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action may be difficult to interpret with regard to effects on financial modeling and estimation, given the lack of actual trend data availability. Some examples of current risks include the following:

Income-Driven Repayment Plans: Several new income-driven repayment plans have been introduced in recent years, including Income-Based Repayment, PAYE, and Revised Pay As You Earn. In general, the proliferation of plans has made income-driven repayment terms more generous (and more costly to the government) and made the plans available to a greater number of borrowers. Having more plans complicates repayment plan selection, since the tradeoffs between available plans vary by borrower and may not always be entirely clear. Selected comparisons between projected originations and borrower repayments under the different income-driven repayment plans are available on the **Department's website**. The Department has also engaged in outreach campaigns to broaden borrower awareness of these plans. However, future commitment to market and increased participation in these plans are areas of uncertainty.

Public Service Loan Forgiveness: Enacted in 2007, the Public Service Loan Forgiveness (PSLF) program allows a Direct student loan borrower to have the balance of their Direct student loans forgiven after having made 120 qualifying monthly payments under a qualifying repayment plan, while working full time for a qualifying public service employer (such as government or certain types of nonprofit organizations). In general, forgiveness provided via PSLF raises the cost of the Direct Loan program; however, there is still uncertainty as to how many borrowers will take advantage of the program. Much of this uncertainty arises because borrowers do not need to apply for the program until after having made the 120 qualifying monthly payments. While data on current applications is helpful to gauge potential forgiveness, it may not be representative of final participation figures. In addition, since the first date by which a borrower could receive forgiveness under this program is October 1, 2017, the Department does not yet have a robust set of actual forgiveness data. The available data on borrowers who have already certified their employment, nearly 740,000 borrowers as of September 2017, is less valuable than it appears since it does not track breaks in their repayment or qualifying employment. The Department continues to remain informed on, and manage the risk that may arise in relation to, the uncertainty about the effect of further borrower outreach on boosting participation in the PSLF program.

Borrower Defense: In May 2015, Corinthian Colleges, Inc. (Corinthian), a publicly traded company operating numerous postsecondary schools that enrolled over 70,000 students at more than 100 campuses nationwide, filed for bankruptcy under deteriorating financial conditions and while subject to multiple state and federal investigations. The Department received thousands of claims for student loan relief from Corinthian students under a provision in the *Higher Education Act of 1965* (HEA) referred to as "borrower defense." Valid borrower defense claims would lead to the discharge of borrower debt, thus increasing the cost of the Direct Loan program to taxpayers. However, it is unknown how many of the claims are valid. Since Corinthian, several other postsecondary schools have closed under similar circumstances, including ITT Technical Institute.

In August 2015, the Department initiated a rulemaking process to establish a more accessible and consistent borrower defense standard to clarify and streamline the borrower defense process to protect borrowers. The legality of this rule has since been challenged in court (*California Association of Private Postsecondary Schools v. DeVos*) and certain provisions of the rule have been subsequently delayed. In addition, the Department has initiated a new rulemaking process to consider potential changes to the original rule. The overall level of activity that could lead to valid borrower defense claims, particularly in the for-profit postsecondary sector, coupled with the uncertainty as to the framework of the final rule, make projections as to the financial impact exceedingly difficult. The Department continues to monitor instances of this risk factor to its programs.

Estimation Risk

Actual student loan outcomes may deviate from estimated student loan outcomes, which is not unexpected given the long projection window of up to 40 years. The Direct Loan program is subject to a large number of future borrower level events and economic factors that heavily impact the ultimate cost of issued loans. For example, estimates that need to be made for loans originating in FY 2017 include how long students will remain in school; what repayment plan will be chosen; whether the loan will be consolidated; whether the borrower will die, become disabled, bankrupt, or have another claim for discharge or forgiveness (closed school, borrower defense, etc.); if the loan will go into deferment or forbearance; if the loan will go into default and, if so, what collections will be received on the defaulted loan; and, if the loan is in income-driven repayment, what the borrower's employment (public sector or not) and income and family status will be over

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the next 25 years. These types of projections are not only extremely difficult to make but also are subject to change if future student behaviors deviate from past experience. Changes in private student loan markets, such as the recent increase in refinancing of federal student loans into private student loans, also add a layer of uncertainty to student loan estimates. Lastly, the Direct student loan portfolio has grown from around $380 billion in FY 2011 to around $1.06 trillion as of the end of FY 2017. This growth naturally results in increased re-estimates, since a re-estimate worth 1 percent of the portfolio today would be more than twice as large as a similar re-estimate in FY 2011 ($10.6 billion vs. $3.8 billion).

Macroeconomic Risk

The ultimate amount, timing and value of future borrower repayments under the Direct Loan program are heavily affected by certain economic factors, especially since the introduction of income-based repayment plans. Some examples include the following:

Interest Rates: Direct Loan subsidy estimates are very sensitive to changes in interest rates. Recent interest rate history has been atypical, as interest rates have continued to remain lower than their historical averages. Under the current program terms, the fixed borrower rates for direct loans are established in advance of the upcoming school year, while the Treasury fixed interest rate on borrowings to fund those loans is not set until after those awards are fully disbursed, which can be as much as 18 months later. Unexpected changes in interest rates during this time can significantly impact the subsidy cost of these loans.

Unemployment: The financial crisis of 2008 and ensuing spike in unemployment rates had a dramatic effect on both student loan volume and student loan performance. Student loan volume peaked along with unemployment, as many displaced workers sought higher education opportunities. Student loan performance suffered as many borrowers repaying their loans were left with much less disposable income with which to make their loan payments. For example, the default rate for students was at a high of 14.7 percent for loans entering repayment in 2010, while the most recent rate is 11.5 percent for loans entering repayment in 2014. While recessions and economic downturns are cyclical phenomena, their exact timing and impact on the cost estimates remain an area of uncertainty.

Wage Growth: The estimated costs of income-driven repayment plans are largely dependent on trends in observed wage growth. To the extent that future wage growth deviates significantly from prior wage growth, actual costs of income-driven repayment plans may deviate from projected estimated costs. The Department continues to manage risks in this area by continuing to learn about its borrower base and remain informed on such labor market statistics.

Operational Risk

Unforeseen issues in administering and servicing student loans may impact the cost estimates. For example, in March 2017, a tool used to automatically transfer a family's tax information to both student aid applications and income-driven repayment (IDR) plan applications was taken down due to security concerns. Although usage of the tool for IDR recertification has since been brought back up, it is yet uncertain what, if any, impact this outage may have had on student loan cost estimates. However, this example highlights that there is an inherent risk that future, unpredictable disruptions in the administrative status quo may impact student loan cost estimates.

CONTINUOUS IMPROVEMENT

Improving critical infrastructure, systems, and overall capacity, and ensuring sound strategic decision making regarding allocation of resources are essential to the Department's future progress and success. Exploring the expanded use of shared services and incorporating enterprise risk management into Department decision making are two of the Department's key initiatives.

Shared Services

The Department of Education uses shared services where feasible and practical, including payroll and travel. The Department will explore other options to further leverage shared services for other mission support areas in the coming years.

Enterprise Risk Management

The Department plans to implement Enterprise Risk Management (ERM) practices by integrating its existing risk management processes and governance bodies into a suitable ERM framework and including risk as a central element in all critical day-to-day and strategic decision-making activities. The Department will also develop a more risk-aware culture that facilitates increased focus on the wide range of risks the Department faces and fosters more open discussions about how those risks might impact the accomplishment of the Department's mission and whether allocation of resources is aligned to best mitigate risks to an acceptable level. The Senior Management Council will oversee the implementation of ERM in accordance with OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control.*

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FINANCIAL HIGHLIGHTS

INTRODUCTION

This section provides summarized information and analyses about the Department's assets, liabilities, net position, sources and uses of funds, program costs, and related trend data. It also provides a high-level perspective of the detailed information contained in the financial statements and related notes.

The Department consistently produces complete, accurate, and timely financial information. The Department's 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 format and content specified by OMB 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 16 consecutive years, the Department has earned an unmodified (or "clean") audit opinion. The financial statements and notes for FY 2017 are on pages 32–69 and the Independent Auditors' Report begins on page 78.

BALANCE SHEET

The consolidated balance sheet presents, as of a specific point in time (the end of the fiscal year), the Department's total assets, total liabilities, and net position.

The Department's assets totaled $1,259.2 billion as of September 30, 2017. The vast majority of the assets relate to credit program receivables, which comprised 91.1 percent of all assets. Direct loans comprise the largest share of these receivables, totaling $1,041.6 billion. All other assets totaled $112.5 billion, most of which was Fund Balance with Treasury.

The Department's liabilities totaled $1,202.1 billion as of September 30, 2017. As with assets, the vast majority of the Department's liabilities are associated with credit programs, primarily amounts borrowed from the U.S. Department of the Treasury (Treasury) to fund student loans. This debt totaled $1,180.1 billion as of September 30, 2017.

Figure 1. Assets by Type

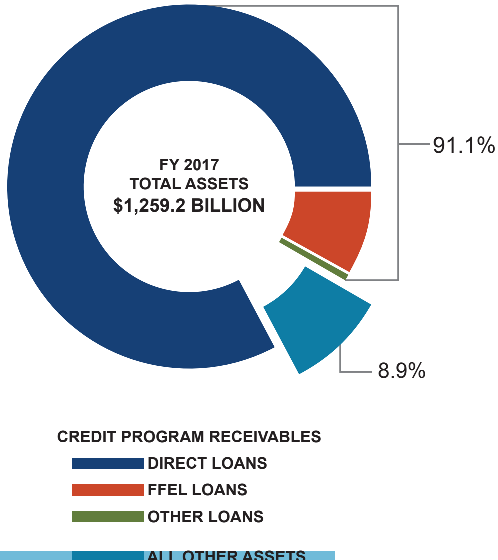

Figure 2. Liabilities by Type

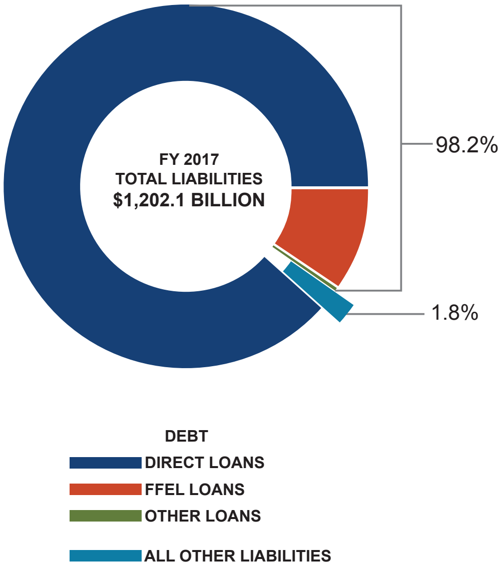

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Figure 3. Components of Direct Loan Receivables, Net
(Dollars in Billions)

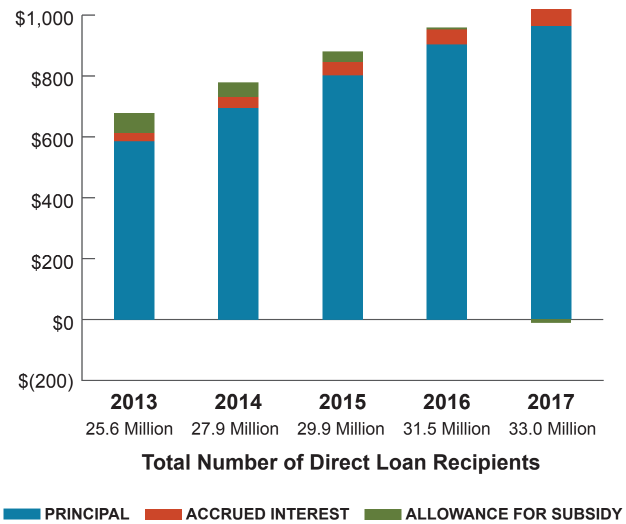

Figure 3 shows the changes in the Direct Loan receivables components over the past five years. The principal continues to grow as the Direct Loan program has originated all new federal loans since July 2010. However, the rate of increase in principal has slowed, as the Direct Loan program has originated fewer new loans each year since FY 2013 as a result of stagnant and in some cases declining enrollment, coinciding with the recovery from the 2007–09 recession. Even so, new loan disbursements continue to exceed overall loan principal repayments—student loan borrowers now have more options to stretch out their repayment terms and reduce their monthly payments.

In accordance with the *Federal Credit Reform Act of 1990* (FCRA), the Department's financial statements report the value of direct loans and loan guarantees (credit program receivables) at the net present value of their future cash flows, discounted at a fixed rate established based on Treasury securities. The difference between the recorded principal and interest balance and the net present value of the loans is referred to as the "allowance for subsidy," which can be positive or negative.

Prior years' positive allowance for subsidy balances represented estimates of funds expected to be recovered in excess of principal loaned less anticipated defaults, loan cancellations, and other adjustments. These positive allowance for subsidy balances resulted primarily from the difference between the interest rates charged by the Department to borrowers and the interest rates charged to the Department on amounts borrowed from Treasury to make the loans. The reduction in the positive allowance since FY 2013 is due primarily to higher subsidy costs to the government, the main cause being increasing participation in income-driven repayment plans discussed elsewhere in this AFR as (a) new plans have become available that are more advantageous to borrowers, (b) new plans have become available that expand the potential pool of borrowers, and (c) the Department has conducted targeted outreach to borrowers to make them aware of their potential eligibility for these plans. During FY 2017, the allowance for subsidy changed from a positive to a negative balance. In practical terms, this means that the present value of funds expected to be recovered is now less than the principal loaned, which represents an increased cost to the taxpayer.

Table 1 shows the payment status of the Direct Loan principal and interest balances outstanding over the past 5 years. The Current Repayment category consists of loans that are being paid back on time, including the current portion of loans refinanced pursuant to income-driven repayment plans.

Table 1. Payment Status of Direct Loan Principal and Interest Balances
(Dollars in Billions)

Loan Status	Fiscal Year				
	2013	2014	2015	2016	2017
Total Dollar Amount of Direct Loans Outstanding	**613.8**	**731.2**	**845.1**	**953.6**	**1,058.4**
Current Repayment	188.5	247.2	332.0	406.8	467.9
In School, Grace Period, and Education Deferments	265.5	281.8	284.3	289.6	291.7
Forbearance and Noneducation Deferments	70.5	97.8	103.0	106.5	122.5
Delinquent	47.8	54.6	65.1	71.8	79.5
Default/ Bankruptcy/Other	41.5	49.8	60.7	78.9	96.8
Total No. of Direct Loan Recipients (in Millions)	**25.6**	**27.9**	**29.9**	**31.5**	**33.0**

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Loans in the Delinquent category are considered in "repayment" status, but payments are anywhere from 31 to 360 days late. Default/Bankruptcy/Other includes loans that are over 360 days delinquent (default status); loans in a nondefaulted bankruptcy status; and loans in disability status. The percentage of loans in default continues to grow, even as delinquencies and new defaults have declined, because defaulted loans can be difficult to collect on or rehabilitate. The percentage of the portfolio in current repayment, which rose from 31 percent in FY 2013 to 44 percent in FY 2017, has eclipsed payments temporarily postponed and has grown far faster than loans in default.

The Department borrows funds from the Treasury to disburse new loans and pay credit program outlays and related costs. The Department repays Treasury after consideration of cash position and the liability for future cash outflows. Figure 4 shows the Direct Loan program cumulative borrowing and repayment activity since the inception of the program that resulted in the debt amount on the balance sheet. Figure 6 (see page 16) illustrates the Direct Loan program financing process and provides financing and disbursing trend data.

STATEMENT OF NET COST

The consolidated statement of net cost reports the Department's components of the net costs of operations for a given fiscal year. Net cost of operations consists of the gross cost incurred less any exchange (i.e., earned) revenue from activities. Gross cost is composed of the cost of credit and grant programs, and operating costs. Exchange revenues are primarily interest earned on credit program loans. Figure 5 shows the Department's gross costs and earned revenues over the past five years.

Figure 4. Direct Loan Program Cumulative Financing Activity
(Dollars in Billions)

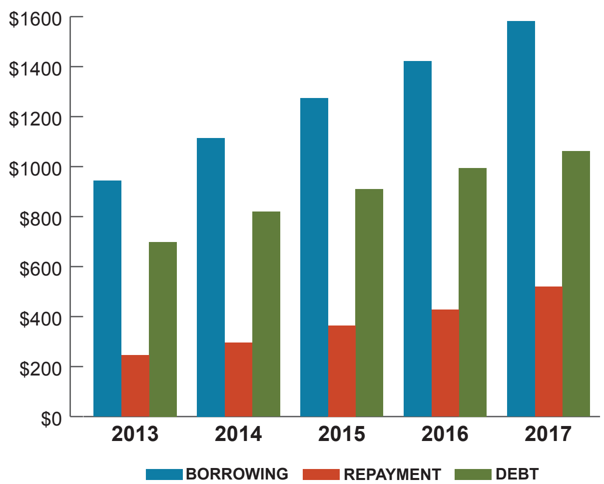

Figure 5. Gross Cost & Earned Revenue
(Dollars in Billions)

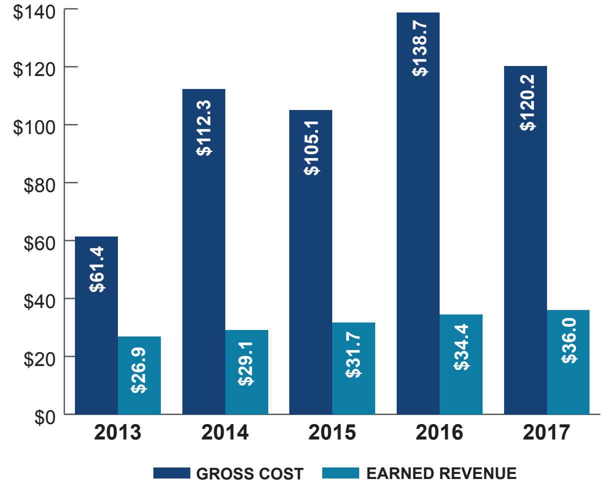

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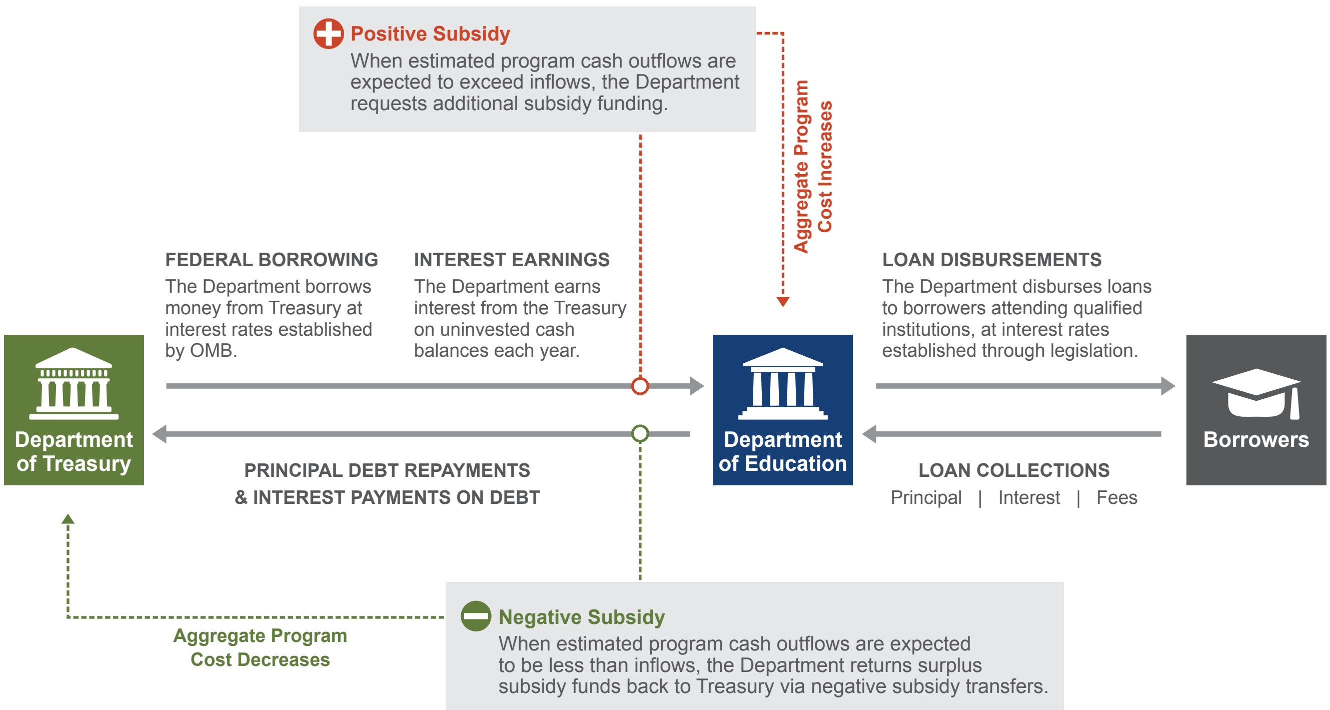
Figure 6. William D. Ford Federal Direct Loan Program: *Following the Funding*



Treasury Financing and Subsidy Cost of Direct Loans (Dollars in Billions)					
Fiscal Year	2013	2014	2015	2016	2017
Net Borrowing	**149.0**	**120.6**	**90.9**	**84.4**	**67.3**
Borrowing from Treasury	177.7	171.2	159.7	147.0	160.5
Debt Repayments to Treasury	(28.7)	(50.6)	(68.7)	(62.6)	(93.2)
Interest Expense to Treasury	(22.7)	(25.2)	(27.6)	(30.5)	(31.3)
Interest Earned from Treasury	3.4	3.7	4.2	3.9	4.3
Cumulative Taxpayer Cost / (Savings)	(65.2)	(47.4)	(35.5)	(5.3)	16.8
Current Subsidy Expense (Revenue)	(39.6)	8.1	(0.9)	16.1	5.3

Direct Loan Program Cash Transactions with Borrowers (Dollars in Billions)					
Fiscal Year	2013	2014	2015	2016	2017
Loan Disbursements	**129.5**	**134.1**	**142.2**	**140.5**	**142.5**
Stafford Subsidized	26.5	25.9	24.0	23.8	23.4
Stafford Unsubsidized	56.1	54.7	52.7	52.3	51.4
Parent PLUS	19.4	18.9	19.2	19.0	18.7
Consolidation[1]	27.5	34.5	46.4	45.5	49.0
Loan Collections	**36.2**	**48.8**	**65.1**	**73.2**	**82.0**
Principal	26.4	36.3	50.0	55.9	62.6
Interest	8.1	10.8	13.4	15.5	17.6
Fees	1.7	1.8	1.8	1.8	1.9

[1] Consolidation disbursement amounts stem from a number of loan programs, including most notably FFEL, in addition to Direct Loans. Numbers may not add up due to rounding.

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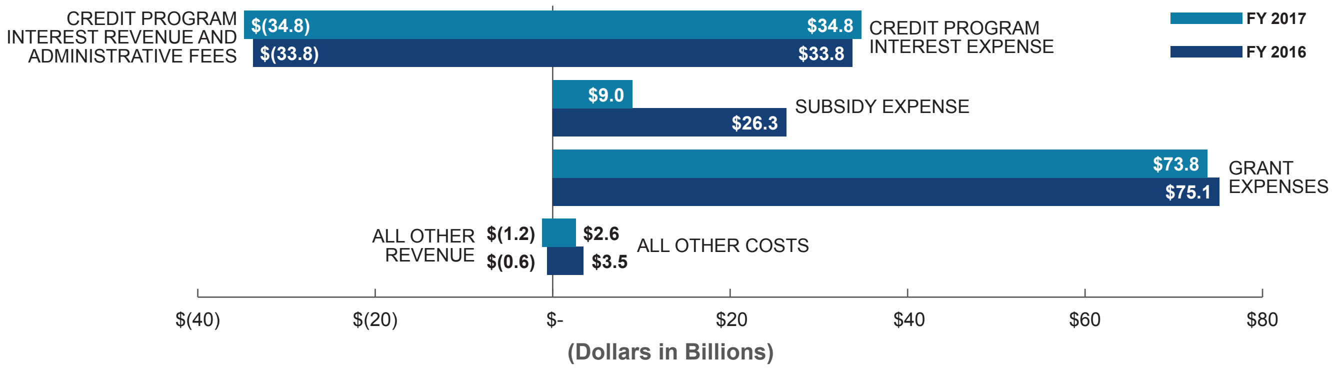
The major components of the Department's gross cost and earned revenue are shown in Figure 7 and include:

- Credit program interest expense offset by credit program interest revenue and administrative fees as the result of subsidy amortization;
- Credit program subsidy expense (see also Figure 8); and
- Grant expenses (see also Figure 9).

Figure 7. Major Components of Gross Cost and Earned Revenue

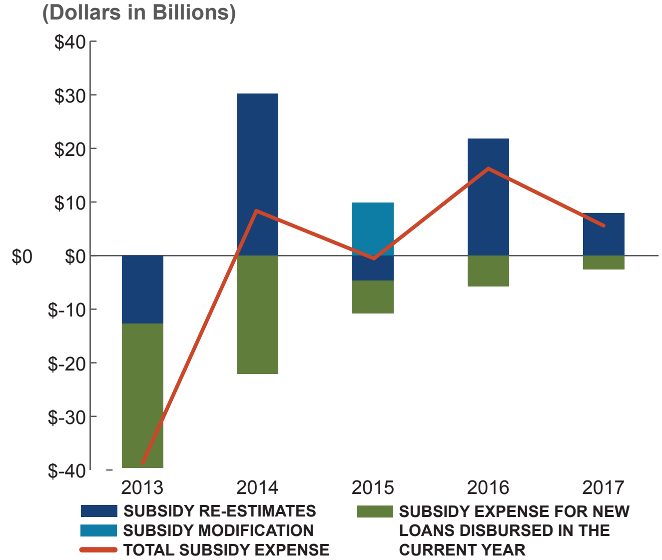


One of the components significantly impacting the Department's gross costs pertains to the estimated subsidy expense of the Direct Loan program. The Department's gross costs can fluctuate significantly each year as a result of changes in the estimated subsidy expense. Subsidy expense is an estimate of the cost of providing direct loans, but excludes the administrative costs of issuing and servicing the loans. The Department estimates subsidy expense using economic models that project cash flows on a net present value basis.

The Department estimates subsidy costs annually for new loans disbursed in the current year; updates the previous cost estimates for outstanding loans disbursed in prior years (subsidy re-estimates); and updates previous cost estimates based on changes to terms of existing loans (subsidy modifications). Figure 8 shows these three components of the Direct Loan program subsidy expense for the past five years.

Factors such as interest rates charged to the borrower, interest rates on Treasury debt, default rates, fees, and other costs impact the estimated cost calculation and determine whether the overall subsidy expense is positive or negative. Subsidy expense for new loans has been negative in recent years primarily because lending interest rates charged

Figure 8. Direct Loan Program Subsidy Expense
(Dollars in Billions)



	2013	2014	2015	2016	2017
Subsidy Expense for New Loans Disbursed in the Current Year	$(27.0)	$(22.1)	$(6.2)	$(5.7)	(2.6)
Subsidy Re-estimates	(12.6)	30.2	(4.6)	21.8	7.9
Subsidy Modification	-	-	9.9	-	-
Total Subsidy Expense—(negative) and positive	**$(39.6)**	**$8.1**	**$(0.9)**	**$16.1**	**5.3**

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to student and parent borrowers were greater than the historically low rates at which the Department borrowed from Treasury. In practical terms, a negative subsidy and/or a downward re-estimate of prior years' subsidy occurs when the interest and/or fees charged to the borrower are more than sufficient to cover the interest on Treasury borrowings and the costs of borrower default. Conversely, a positive subsidy and/or an upward re-estimate of prior years' subsidy occurs when the interest and/or fees charged to the borrower do not cover the interest on Treasury borrowings and the cost of borrower defaults.

Direct Loan program re-estimated subsidy cost was adjusted upward by $7.9 billion in FY 2017. In addition to the major assumption updates described below, the re-estimate reflects several other assumption updates, including interest rates provided by the Office of Management and Budget, volume, and enter repayment rates. Prepayment rates increased from the FY 2016 estimate, resulting in a $2.4 billion upward re-estimate. Contract collection costs were updated for new data reflecting lower overall average commission rates, resulting in a $5.1 billion downward re-estimate.

- **IDR Model Changes.** The U.S. Government Accountability Office (GAO) audit, *Federal Student Loans: Education Needs to Improve Its Income Driven Repayment Plan Budget Estimates*, identified several areas in which the Department could improve its IDR cost estimates. Largely in response to this audit, as well as concerns raised in FY 2016's Independent Auditors' Report, in FY 2017 the Department incorporated an adjustment for inflation into the Department's IDR submodel, modified the current IDR submodel to estimate IDR subsidies by loan type, and implemented methods to address concerns regarding the volatility of the submodel's income data. In addition, default; collection; death, disability, and bankruptcy; and prepayment rate assumptions used by the submodel were updated. The combined effect of these changes was a net downward re-estimate of $14.7 billion.

- **Repayment Plan Selection.** The GAO audit referred to above also recommended the Department help ensure that subsidy estimates reasonably reflect trends in IDR plan participation. In response, the Department updated its methodology for repayment plan selection, taking into account the timing of repayment plan selection as well as recent growth trends in the selection of income-driven repayment plans. The combined effect of these changes was a net upward re-estimate of $18.4 billion.

- **Death, Disability, and Bankruptcy.** The Department made major updates to the death, disability, and bankruptcy assumption in FY 2017. These updates included a revised accounting for the effect of a matching agreement with Social Security Administration, updates to closed school regulations, and revised borrower defense regulations. Updates to the data used to calculate discharges were also incorporated. The combined effect of these changes was a net upward re-estimate of $9.2 billion.

The Department has more than 100 grant and loan programs (**www.ed.gov/programs/inventory.html**). The largest grant programs are shown in Figure 9 and include:

- **Pell Grants**—provides need-based grants to low-income undergraduate and certain postbaccalaureate students to promote access to postsecondary education. Students may use their grants at any one of approximately 5,400 participating postsecondary institutions. Grant amounts are dependent on: the student's expected family contribution; the cost of attendance (as determined by the institution); the student's enrollment status (full-time or part-time); and whether the student attends for a full academic year or less.

- **Title I Grants to Local Educational Agencies**—provides financial assistance through state educational agencies to local educational agencies and public schools with high numbers or percentages of poor children to help ensure that all children meet challenging state academic content and student academic achievement standards.

- **Individuals with Disabilities Education Act Grants**—provides formula grants to states to assist them in providing a free appropriate public education in the least restrictive environment for children with disabilities ages 3 through 21 and assists states in providing early intervention services for infants and toddlers from birth through age two and their families. Also provides discretionary grants to institutions of higher education, public agencies, and nonprofit organizations to support research, demonstrations, technical assistance and dissemination, technology, personnel development and parent-training and information centers.

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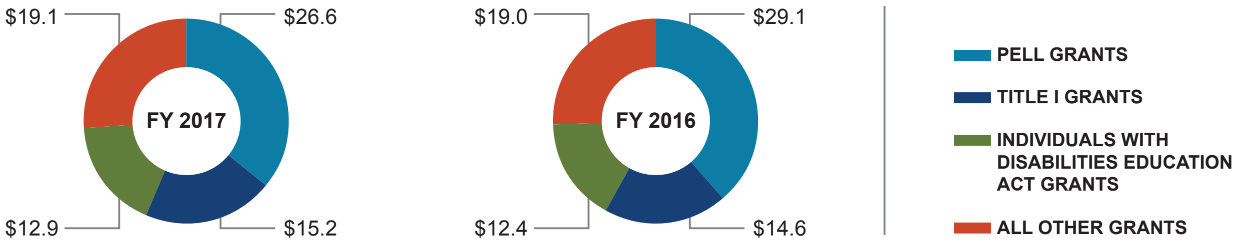
Figure 9. Grant Costs by Major Program (Dollars in Billions)



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.

STATEMENT OF CHANGES IN NET POSITION

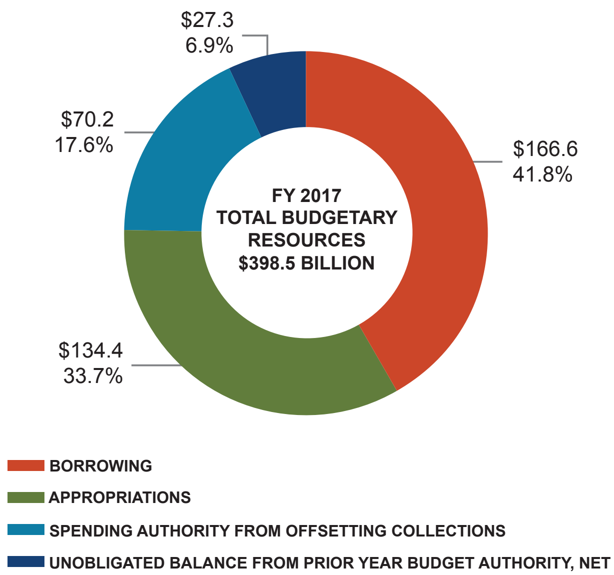
The consolidated statement of changes in net position reports the beginning net position, the summary effect of transactions that affect net position during the fiscal year, and the ending net position. Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include undelivered orders and unobligated balances for grant and administrative operations. 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 $57.2 billion as of September 30, 2017. This reflects a 74.4 percent increase over the net position of $32.8 billion from 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 the statement is based on budgetary transactions as prescribed by OMB and Treasury.

The Department's budgetary resources totaled $398.5 billion for the period ended September 30, 2017, increasing from $335.0 billion, or approximately 19.0 percent from the prior year. Budgetary resources are comprised of appropriated budgetary resources of $152.2 billion and non-budgetary credit reform resources of $246.3 billion. The non-budgetary credit reform resources are predominantly borrowing authority for the loan programs.

Figure 10. Budgetary Resources



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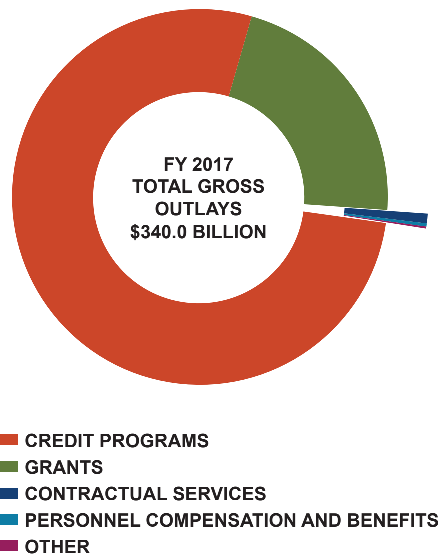
The Department's gross outlays totaled $340.0 billion for the period ended September 30, 2017. Gross outlays are primarily comprised of credit program loan disbursements and claim payments, credit program subsidy interest payments to Treasury, and grant payments. Credit program gross outlays were offset by $168.2 billion of collections—primarily principal, interest and subsidy collections.

Figure 11. Gross Outlays by Type



	Billions	%
CREDIT PROGRAMS	**$ 263.0**	**77.4%**
DIRECT LOAN PROGRAM	237.0	69.7%
FFEL PROGRAM	25.2	7.4%
OTHER CREDIT PROGRAMS FOR HIGHER EDUCATION	0.8	0.2%
GRANTS	**$ 73.5**	**21.6%**
PELL GRANTS	26.9	7.9%
TITLE I GRANTS TO LOCAL EDUCATIONAL AGENCIES	15.2	4.5%
INDIVIDUALS WITH DISABILITIES EDUCATION ACT GRANTS	12.7	3.7%
ALL OTHER GRANTS	18.7	5.5%
CONTRACTUAL SERVICES	**$ 2.8**	**0.8%**
PERSONNEL COMPENSATION AND BENEFITS	**$ 0.6**	**0.2%**
OTHER	**$ 0.1**	**0.0%**
TOTAL	**$ 340.0**	**100.0%**

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 2017 and FY 2016, 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.

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ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

MANAGEMENT ASSURANCES

The Secretary of Education's 2017 Statement of Assurance provided below is the final report produced by the Department's annual assurance process. Although the Department has not identified any material weaknesses, it acknowledges that there are significant weaknesses and management challenges to be addressed that are identified elsewhere in this report.

STATEMENT OF ASSURANCE
FISCAL YEAR 2017
November 13, 2017

The Department of Education (the Department) management is responsible for meeting the objectives of the *Federal Managers' Financial Integrity Act of 1982* (FMFIA) by establishing, maintaining, evaluating and reporting on the Department's internal control and financial systems.

In accordance with Section 2 of FMFIA and Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, management evaluated the effectiveness of the Department's internal controls to support effective and efficient operations, reliable reporting and compliance with applicable laws and regulations.

Section 4 of FMFIA and the *Federal Financial Management Improvement Act of 1996* (FFMIA) require management to ensure the Department's financial management systems provide reliable, consistent disclosure of financial data. In accordance with Appendix D of OMB Circular A-123, management evaluated whether the Department's financial management systems substantially complied with FFMIA requirements. The Department also conducted a separate assessment of the effectiveness of its internal control over financial reporting, including controls designed to prevent, detect and recover improper payments, in accordance with Appendix A of OMB Circular A-123.

The Department has not identified any material weaknesses in operations, reporting or compliance with applicable laws and regulations.

Based on the results of the Department's assessments described above, our system of internal controls provides Department management with reasonable assurance that the objectives of sections 2 and 4 of the FMFIA were achieved as of September 30, 2017.

Betsy DeVos

Betsy DeVos

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INTRODUCTION

Strong risk management practices and internal control help an entity run its operations efficiently and effectively, report reliable information about its operations and financial position, and comply with applicable laws and regulations. The **FMFIA** requires federal agencies to establish internal controls that provide reasonable assurance that agency objectives will be achieved. **OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*** implements FMFIA and defines management's responsibilities for ERM and internal control. The Circular provides guidance to federal managers to improve accountability and effectiveness of federal programs, as well as mission support operations through implementation of ERM practices and by establishing, maintaining, and assessing internal control effectiveness. The guidance requires federal agencies to provide reasonable assurance that it has met the three objectives of internal controls:

- *Operations*—Effectiveness and efficiency of operations;
- *Reporting*—Reliability of reporting for internal and external use; and
- *Compliance*—Compliance with applicable laws and regulations.

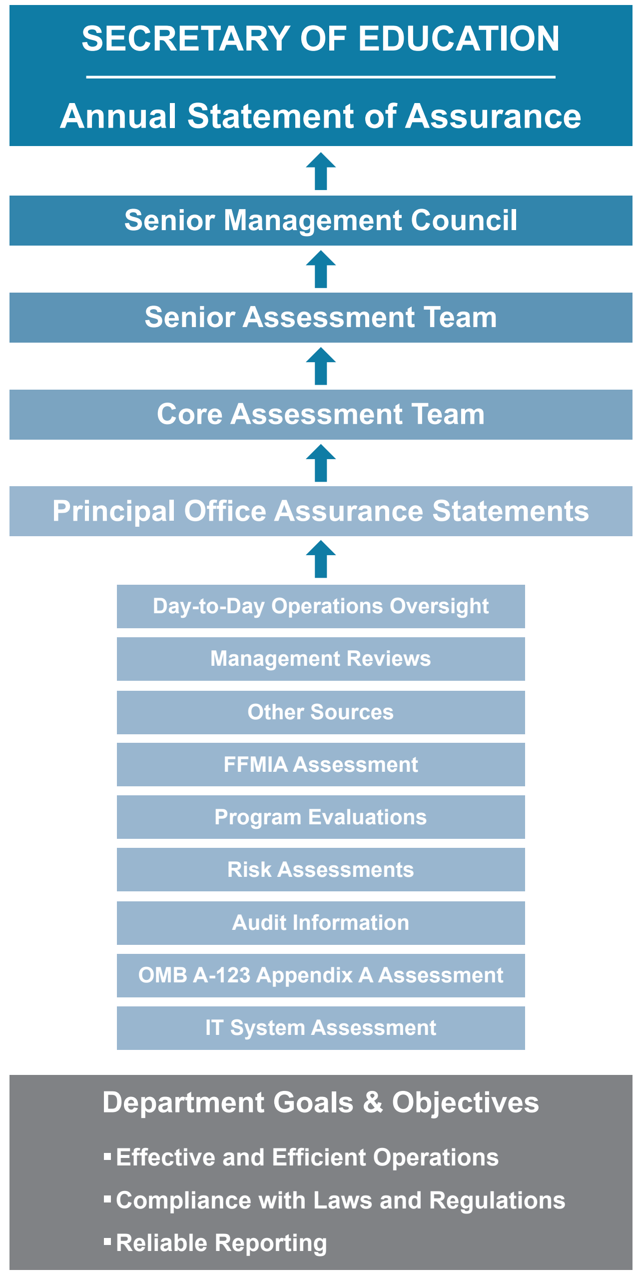
This section describes the Department's internal control framework, an analysis of the effectiveness of its internal controls, and assurances provided by the Department's leadership that internal controls were in place and working as intended during FY 2017 to meet the three objectives.

Control Framework

The Department's internal control framework helps to ensure that the Department achieves its strategic goals and objectives related to delivering education services effectively and efficiently while complying with applicable laws and regulations and preparing accurate reports. This includes providing reasonable assurance to Department leadership and external stakeholders that financial data produced by the Department's financial systems are complete, accurate, and reliable enough to support the preparation and fair presentation of financial statements that conform to federal standards, facilitate sound financial decision-making, and provide transparency about how the Department spent federal funds and maintains stewardship over its financial resources.

The Department maintains a comprehensive internal control framework and assurance process as depicted in the following diagram.

Figure 12. Internal Control Framework and Assurance Process



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The Office of the Chief Financial Officer (OCFO) manages the assurance process on behalf of Department leadership. The Department established governance over the process, consisting of a Senior Management Council, a Senior Assessment Team (SAT), and a Core Assessment Team (CAT). The Senior Management Council is comprised of senior leaders from across the Department. It is the primary governance structure for internal control and provides oversight to ensure management accountability for effective controls across the Department. The SAT and CAT include representatives from OCFO, the Office of the Chief Information Officer (OCIO), student loan and grant-making program offices, Risk Management Service, and other operational support offices (including the Office of Management). The SAT and CAT provide greater oversight and monitoring of activities related to internal control assessments.

The annual assurance process is the primary mechanism by which the Department implements FMFIA and OMB requirements pertaining to internal control. It requires the head of each principal office to evaluate its respective internal controls and to assert, in a letter to the Chief Financial Officer, that it has reasonable assurance that key internal controls are in place and working as intended or to provide a detailed description of significant deficiencies, material weaknesses, and other matters of nonconformance. In making this assessment, the head of the principal office considers information such as office managers' personal knowledge of operations, external audit results, internal assessments, and other related material.

OCFO staff work with the principal offices to help them identify potential control deficiencies and consult with the SAT to determine whether they represent significant deficiencies or potential material weaknesses. Any principal office that identifies a significant deficiency or material weakness must prepare a Corrective Action Plan to address the issue. These Corrective Action Plans, in addition to daily operational oversight and management-initiated evaluations, facilitate the correction and monitoring of controls. If potential material weaknesses are identified, they are evaluated by the Senior Management Council to determine if they should be reported on the Department's Statement of Assurance.

Analysis of Controls

Overall, the Department relies on the principal office annual assurances, supported by risk-based internal control evaluations and testing, to provide reasonable assurance that its internal controls are well designed and in place and working as intended. The Department also considers issues identified by external auditors. During FY 2016, the Department revised its annual assurance process to conform to the new requirements contained in the revised U.S. Government Accountability Office publication, *Standards for Internal Control in the Federal Government* (commonly referred to as the "Green Book"). In FY 2017, the Department further revised the process to conform to the revised OMB Circular A-123 issued on July 15, 2016.

In FY 2017, the Department identified no material control weaknesses related to effective, efficient program operations and no areas of noncompliance with laws and regulations other than those noted in the Internal Control Exceptions section below. Although no material weaknesses were identified, the Department realizes that it has areas of control that need further strengthening, such as those disclosed in this report and the major challenges identified by the Department's OIG in its **OIG FY 2018 *Management Challenges* report**. The Department continues to demonstrate its commitment to addressing, mitigating, or resolving its identified management challenges.

In accordance with OMB Circular A-123, the Department also conducted an additional assessment of the effectiveness of the Department's internal controls over financial reporting and compliance with key financial management laws and regulations as described below.

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Internal Control over Financial Reporting

The Department maintains strong internal controls to identify, document, and assess internal control over financial reporting, which includes:

- comprehensive process documentation for the Department's significant business processes' and subprocesses,
- maintenance of a control catalogue comprised of 3,631 key financial, operational, and IT controls that align to the business processes (the Department documents 312 key controls and FSA documents 3,319 key controls [1,411 Business Process and Entity-Level controls and 1,908 IT controls]),[1]
- technical assistance provided to principal offices to help them understand and assess key financial controls,
- a risk-based testing strategy, and
- a process to develop corrective action plans when control deficiencies are found and to track progress against those plans.

During FY 2017, the Department tested 84 key financial controls. Although some control deficiencies were detected in the design and effectiveness of controls, the Department did not identify any significant deficiencies or material weaknesses. Corrective actions have been initiated for the deficiencies identified.

In FY 2017, FSA tested 2,810 key controls: 1,342 Business Process and Entity-Level controls and 1,468 IT controls. FSA assessed that 96 percent of the controls tested are designed and operating effectively. The other 4 percent are immaterial deficiencies for which FSA has established or is establishing corrective actions. FSA will continue to repeat this assessment process on a regular basis, constantly looking for opportunities to improve operations.

Internal Control over Financial Management Systems

The FFMIA requires management to ensure that the Department's financial management systems consistently provide reliable data that comply with federal financial management system requirements, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction level. Appendix D to OMB Circular A-123, Compliance with the *Federal Financial Management Improvement Act* of 1996, and OMB Circular A-130, *Managing Federal Information as a Strategic Resource*, provide specific guidance to agency managers when assessing conformance to FFMIA requirements.

The Department's core financial systems are under the umbrella of the Education Central Automated Processing System (EDCAPS), serving approximately 8,800 Departmental internal users in Washington, D.C., and 10 regional offices throughout the United States, as well as 39,600 external users. EDCAPS is composed of five main linked components:

- Financial Management Support System (FMSS),
- Contracts and Purchasing Support System (CPSS),
- Grants Management System (G5),
- E2 Travel System, and
- Hyperion Budget Planning.

The Department designated the FMSS as a mission-critical system that provides core financial management services, and focused its system strategy on the following areas during FY 2017:

- Managing and implementing cross-validation rules throughout the fiscal year to prevent invalid accounting transactions from being processed,
- Transmitting the Department's spending data related to contracts, grants, loans, and other financial assistance awards for the **USASpending.gov** initiative as part of the *Federal Funding Accountability and Transparency Act of 2006*,
- Transmitting the Department's spending data related to contracts, grants, loans, and other financial assistance awards for the *Digital Accountability and Transparency Act of 2014* (DATA Act) implementation, and

[1] These figures include FSA.

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- Initiating the upgrade of the FMSS Oracle E-Business Suite application to Oracle R12, to ensure continued vendor support, improved security, improved infrastructure and enhanced functionality.

In FY 2018, EDCAPS will continue to provide customer service and improve security of its systems by completing the Department's implementation of Oracle E-Business Suite R12. In doing so, the Department will be current and ready to provide a more secure and better integrated financial management application.

The Department's financial management systems are designed to support effective internal control and produce accurate, reliable, and timely financial data and information. Based on self-assessments, system-level general controls tests, and the results of internal and external audits, the Department has not identified any material weaknesses in controls over systems. The Department has also determined that its financial management systems substantially comply with FFMIA requirements. However, as noted below in the Internal Control Exceptions section, the Department continues to address issues and improve its controls over systems.

Federal Information Security Modernization Act of 2014

The *Federal Information Security Modernization Act of 2014* (FISMA) requires federal agencies to develop, document, and implement an agency wide program to provide security for the information and information systems that support the operations and assets of the agency and ensure the confidentiality, integrity, and availability of system-related information.

The Department's and FSA's information security programs completed a number of significant activities in FY 2016 and FY 2017 to improve cybersecurity capabilities and functions, some of which included:

- In March 2017, the Office of the Chief Information Officer (OCIO) initiated an Information Technology (IT) Systems Assessment process, designed to improve management of the Department's IT systems inventory by:
    - Reexamining/revising the IT systems baseline for both FISMA reportable and non-FISMA reportable IT systems,
    - Enhancing governance and security posture of the Department's IT systems portfolio, informing strategy to address externally hosted systems,
    - Establishing long/short term corrective action plans to address findings, and
    - Rationalizing the IT systems portfolio and inventory.
- The IT Systems Assessment process began with examining the 19 High Value Asset (HVA) systems within the Department. As of September 2017, the OCIO team had completed assessments for all 19 HVA systems.
- With the issuance by OMB of the federal government's Cybersecurity Strategy and Implementation Plan (CSIP), the Department focused many of its efforts to address the recommendations and actions highlighted in the CSIP in order to resolve any cybersecurity gaps and emerging priorities that were noted across the government. The CSIP required the Department to prioritize the identification and protection of high-value information and assets. The Department completed this action and re-validated its list of HVAs in January 2017, which will enable the Department to better understand the potential impact from a cyber incident, and helps to ensure that robust physical and cybersecurity protections are in place for our high-value assets. The Department completed development of its Cybersecurity Strategy and Implementation Plan (ED-CSIP) in February 2017, which includes the cybersecurity initiatives and activities that demonstrate how the Department is implementing the Cybersecurity Framework functions of Identify, Protect, Detect, Respond, and Recover.

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- The Department continued to enhance the capabilities of the Department's Security Operations Centers (SOCs). The Department has fully deployed the Einstein capabilities in order to enhance our ability to detect cyber vulnerabilities and protect against cyber threats. The Department has also continued to strengthen its partnership with the Department of Homeland Security for the project planning that will accelerate the deployment of Continuous Diagnostics and Mitigation (CDM) capabilities. This will further enhance capabilities that the Department initiated in 2016 to implement network access control and data loss prevention (DLP) solutions. The DLP capability has been activated for the Department's primary network and is effectively detecting and preventing any inadvertent attempts by staff to send social security numbers via e-mail. The CDM solution will also enable the Department to enhance our configuration management capabilities.

- The Department continued its progress of implementing and enforcing the use of multifactor authentication for all federal employees, contractors, and other authorized users. The Department and FSA focused on increasing the issuance of Personal Identity Verification (PIV) cards to privileged users to meet OMB requirements. The Department has consistently reported each quarter achieving the Cross Agency Priority target requiring our users to be technically enforced to use their PIV cards when logging on to the network.

- The Department made significant strides in its identification, tracking, and remediation of unsupported software across the enterprise.

- 100 percent of Department users completed the annual computer security and privacy awareness training course in FY 2017. The Department strictly enforced compliance with annual security and privacy awareness training requirements, and disabled network accounts for noncompliant users.

- There has also been an increased Departmental focus on data security at institutions of higher education (IHEs). FSA issued a new "Dear Colleague Letter" to IHEs that receive financial aid stressing the need to comply with the *Gramm-Leach-Bliley-Act* standards and announcing that these standards would now be included in future reviews to be conducted by the Department. The Department recognizes that it is vital to focus on cybersecurity at these IHEs as they connect to FSA systems and access FSA data. It is noteworthy that the Department has successfully implemented two-factor authentication for all external users of the G5 system, which is a customer-facing grants management system. The Department has also engaged the General Services Administration and we have signed a memorandum of understanding to implement a pilot for the use of Login.gov for two-factor authentication to other Department citizen-facing information systems.

As a result of the Department implementing a comprehensive set of activities to strengthen the overall cybersecurity of the Department's networks, systems, and data, the Department completed actions to close 10 of the 15 recommendations to address the 11 findings made by the OIG in its FY 2016 annual FISMA audit. For the FY 2017 annual FISMA audit, the OIG is reporting 37 recommendations covering the seven FISMA metrics domains.

The OIG FISMA Audit objective was to conduct annual independent evaluations and tests to determine the effectiveness of the information security program policies, procedures, and practices of the Department and Federal Student Aid (FSA). The FY 2017 OIG FISMA reporting metrics were organized around the five security functions outlined in the National Institute of Standards and Technology's "Framework for Improving Critical Infrastructure Cybersecurity (Cybersecurity Framework): Identify, Protect, Detect, Respond, and Recover." The FY 2017 maturity model was more comprehensive and attributes were assessed differently than the previous year's maturity model indicator scoring. As a result, certain functions were assessed at a lower level, and the OIG found the Department and FSA were not effective in all five security functions.

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INTERNAL CONTROL EXCEPTIONS

The Department identified two instances of noncompliance with laws and regulations in FY 2017. Additionally, reviews and assessments conducted pursuant to information technology-related laws and regulations identified challenges still facing the Department.

IMPROPER PAYMENTS INFORMATION ACT OF 2002

The *Improper Payments Information Act of 2002* (IPIA), **Pub. L. 107-300, 116 Stat. 2350**, as amended by the *Improper Payments Elimination and Recovery Act of 2010* (IPERA), **Pub. L. 111-204, 124 Stat. 2224**, and the *Improper Payments Elimination and Recovery Improvement Act of 2012* (IPERIA), **Pub. L. 112-248, 126 Stat. 2390**, require federal agencies to annually report improper payments for programs that are deemed susceptible to significant improper payments. IPERA also requires each agency's Office of Inspector General (OIG) to review the agency's improper payment reporting in its AFR and accompanying materials, and to determine whether the agency has met six compliance requirements.

In its annual improper payment compliance audit for FY 2016, the OIG concluded that the Department was not compliant with IPERA because it did not meet two of IPERA's six compliance requirements. The Department reported improper payment rates for the Direct Loan and Pell Grant (Pell) programs that did not meet the FY 2016 reduction targets and the Department's risk assessments for its grant programs managed by offices other than Federal Student Aid (FSA) and contracting activities managed by FSA did not conform to applicable guidance.

This determination of noncompliance with IPERA does not represent a material weakness in the Department's internal controls.

DEBT COLLECTION IMPROVEMENT ACT OF 1996

The *Debt Collection Improvement Act of 1996* (DCIA), **Pub. L. 104-134, 110 Stat. 1321-358**, was enacted into law as part of the *Omnibus Consolidated Rescissions and Appropriations Act of 1996*, **Pub. L. 104-134, 110 Stat. 1321**. The primary purpose of the DCIA is to increase the collection of nontax debts owed to the federal government. Additionally, the DATA Act, **Pub. L. 113-101, 128 Stat. 1146**, amended Section 3716(c)(6) of the DCIA to require referral of delinquent debt to Treasury's Offset Program within 120 days.

Due to unique program requirements of HEA, the Department requested guidance from Treasury's Bureau of Fiscal Service, Office of General Counsel for the application of this revised DCIA requirement to Title IV debt. Treasury provided its interpretation of this requirement for Title IV debt in July 2015. As of September 30, 2017, the Department and FSA were not in compliance with the new 120-day referral requirement in 31 U.S.C. Section 3716(c)(6) because FSA had not yet revised its loan servicing systems, procedures, and internal processes in response to this interpretation. During FY 2017, FSA initiated the change management process for its default loan servicer to refer eligible debts to the Treasury Offset Program sooner, developed DCIA compliant referral exclusions, and continued to identify policy changes required to work towards achieving compliance. This area of noncompliance is noted in the independent auditors' report, exhibit B.

This determination of noncompliance with the DCIA does not represent a material weakness in the Department's internal controls.

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FINANCIAL SECTION

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

I am pleased to present the Department of Education's FY 2017 Agency Financial Report (AFR), which is intended to provide useful, easy to understand and accessible financial and performance information to our government and public stakeholders for consideration and evaluation of the Department's major accomplishments, performance, costs, risks, and the value we provide to the taxpayer.

Investment in human capital through educational attainment is a crucial element of a strong national economic and global security strategy. A well-educated citizenry enjoys numerous benefits, including greater job security, higher wages, and improved health. U.S. colleges and universities represent critical centers for research and innovation and a well-educated citizenry is better prepared to help solve the nation's most pressing domestic and international problems. While states have the greatest role to play in achieving and sustaining the provision of an excellent and equitably accessible education system for American students, the Department supports students by working with parents, students, educational institutions, school districts and states to foster educational excellence and ensure equal access to it in support of the country's global competitiveness.

As a critical mission support organization, the Office of the Chief Financial Officer (OCFO) has primary responsibility for maintaining financial integrity over the federal resources entrusted to the Department and for preparing the AFR, such that our stakeholders are empowered with reliable information about our financial stewardship and achievements relative to the costs of executing our mission. With approximately $1.3 trillion in total assets, comprised primarily of credit program receivables that were funded by $1.2 trillion in Treasury borrowings and considering the approximate $340.0 billion gross outlays made during FY 2017 to support education programs from preschool through postdoctoral research, effective internal controls over the Department's business processes and financial activities are essential to responsibly delivering our mission outcomes and the Department's strategic goals and objectives.

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On behalf of the Department of Education, I am proud to present our 16th consecutive unmodified or "clean" opinion of our financial statements. Our clean opinion, along with no material weaknesses, represents the dedicated efforts of an exemplary team of business and financial management professionals, whose commitment to promoting financial integrity and applying effective controls ensures high quality, accurate, and reliable information for all of our customers. Their work also earned the Department its 13th award of the prestigious Certificate of Excellence in Accountability Reporting by the Association of Government Accountants with additional special recognition for Best-in-Class presentation of the Management's Discussion and Analysis section of the AFR. This year, the Department accomplished several key improvements in our management and stewardship of taxpayer funding, including:

- Improved disclosures about the composition of our loan portfolio, costs, and associated credit risks.
- Development of the Continuous Controls Monitoring System, a robust automated capability to demonstrate integrity over Department payments.
- The initiation of a major upgrade to our core financial system to modernize its technical infrastructure and reduce potential cyber security risks.
- The implementation of a number of reform initiatives intended to help maximize employee and organizational efficiency.

As we continue to implement initiatives to improve OCFO operations, we are also firmly committed to supporting the Administration's focus on reforming the federal government by achieving more effective, efficient, and accountable financial management operations in the Department of Education. Planned and ongoing actions include:

- Delivering improved financial management and analysis services with reduced staff through increased staff performance, more streamlined business processes, and better use of technology.
- Obtaining and analyzing data of sufficient quality to improve the timeliness and accuracy of financial reporting and to reduce improper payment and fraud risks, including progression towards proactive, preventative control through advanced data analytics.
- Integrating enterprise risk management concepts into our internal control framework and developing a more risk aware culture in OCFO.
- Developing innovative tools and practices to expand support to mission offices' effective fiscal monitoring of grants concurrent with the realization of staff reductions across the Department.

These actions will increase our effectiveness in service delivery and enable us to make more efficient and effective use of the taxpayer resources entrusted to us. We continuously strive to improve the quality and usefulness of the information provided in the AFR and encourage feedback or suggestions to be sent to us at **AFRComments@ed.gov**.

Tim Soltis
Delegated the Duties of Chief Financial Officer

November 13, 2017

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ABOUT THE FINANCIAL SECTION

In FY 2017, the Department prepared its financial statements as a critical aspect of ensuring accountability and stewardship for the public resources entrusted to it. Preparation of these statements is an important part of the Department's financial management goal of providing accurate and reliable information for decision making.

The **Consolidated Balance Sheet** summarizes the assets, liabilities, and net position by major category as of the reporting date. Intragovernmental assets and liabilities resulting from transactions between federal agencies are presented separately from assets and liabilities from transactions with the public.

The **Consolidated Statement of Net Cost** shows, by strategic goal, the net cost of operations for the reporting period. Net cost of operations consists of full program costs incurred by the Department less exchange revenues earned by those programs.

The **Consolidated Statement of Changes in Net Position** presents the Department's beginning and ending net position by two components—Cumulative Results of Operations and Unexpended Appropriations. It summarizes the change in net position by major transaction category. The ending balances of both components of the net position are also reported on the Consolidated Balance Sheet.

The **Combined Statement of Budgetary Resources** presents the budgetary resources available to the Department, the status of these resources, and the outlays of budgetary resources.

The **Notes to the Financial Statements** provide information to explain the basis of the accounting and presentation used to prepare the statements and to explain specific items in the statements. They also provide information to support how particular accounts have been valued and computed. A list of each of the notes is presented below.

The **Combining Statement of Budgetary Resources** as Required Supplementary Information presents budgetary resources by major program.

The **Required Supplementary Stewardship Information** provides disclosure of investments in human capital and the related program outcomes resulting from stewardship expense outlays.

NOTES TO THE FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Note 2. Non-Entity Assets

Note 3. Fund Balance with Treasury

Note 4. Other Assets

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Note 8. Subsidy Due to Treasury General Fund

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Note 10. Gross Cost and Exchange Revenue by Program

Note 11. Credit Program Interest Expense and Revenues

Note 12. Statement of Budgetary Resources

Note 13. Reconciliation of Net Cost of Operations to Budget

Note 14. Commitments and Contingencies

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REQUIRED SUPPLEMENTARY INFORMATION

This section contains the Combining Statement of Budgetary Resources for the Years Ended September 30, 2017, and September 30, 2016.

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

Stewardship Expenses summarize spending and stakeholder relationships with state and local educational agencies. Stewardship resources are substantial investments by the federal government for the long-term benefit of the nation. Since costs of stewardship resources are treated as expenses in the financial statements in the year the costs are incurred, they are reported as Required Supplementary Stewardship Information to highlight the benefit nature of the costs and to demonstrate accountability.

Supplementing state and local government funding, the Department utilizes its annual appropriations and outlay authority to foster human capital improvements across the nation by supporting programs along the entire spectrum of "cradle to career" education. Increased employability makes Americans more competitive in the global labor market, yielding lower unemployment, higher economic well-being, and greater security for the nation.

REPORT OF THE INDEPENDENT AUDITORS

The results of the audit of the Department's financial statements for FY 2017 and FY 2016 to comply with the *Chief Financial Officers Act of 1990*, as amended, are presented to be read in conjunction with the Financial Section in its entirety. The Department's Office of Inspector General (OIG) contracted with the independent certified public accounting firm of CliftonLarsonAllen LLP to audit the financial statements of the Department as of September 30, 2017 and 2016, and for the years then ended.

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United States Department of Education
Consolidated Balance Sheet
As of September 30, 2017 and 2016
(Dollars in Millions)

	FY 2017	FY 2016
ASSETS		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 110,174	$ 96,763
Other Intragovernmental Assets (Note 4)	65	102
Total Intragovernmental	110,239	96,865
Public:		
Credit Program Receivables, Net (Note 5)		
Direct Loan Program	1,041,554	958,881
FFEL Program	102,410	114,870
Other Credit Programs for Higher Education	2,755	2,828
Other Assets (Note 4)	2,285	1,363
Total Public	1,149,004	1,077,942
Total Assets (Note 2)	**$ 1,259,243**	**$ 1,174,807**
LIABILITIES		
Intragovernmental:		
Debt (Note 7)		
Direct Loan Program	$ 1,061,559	$ 994,285
FFEL Program	116,290	131,347
Other Credit Programs for Higher Education	2,222	2,191
Subsidy Due to Treasury General Fund (Note 8)	7,013	2,642
Other Intragovernmental Liabilities (Note 9)	2,633	1,822
Total Intragovernmental	1,189,717	1,132,287
Public:		
Other Liabilities (Note 9)	12,366	9,683
Total Liabilities (Note 6)	**$ 1,202,083**	**$ 1,141,970**
Commitments and Contingencies (Note 14)		
NET POSITION		
Unexpended Appropriations	$ 62,399	$ 61,052
Cumulative Results of Operations	(5,239)	(28,215)
Total Net Position	**$ 57,160**	**$ 32,837**
Total Liabilities and Net Position	**$ 1,259,243**	**$ 1,174,807**

The accompanying notes are an integral part of these statements.

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United States Department of Education
Consolidated Statement of Net Cost
For the Years Ended September 30, 2017 and 2016
(Dollars in Millions)

		FY 2017		FY 2016
PROGRAM COSTS				
Increase College Access, Quality, and Completion				
Gross Costs	$	78,289	$	97,314
Earned Revenue		(35,887)		(34,316)
Net Program Costs	$	42,402	$	62,998
Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs				
Gross Costs	$	22,577	$	22,363
Earned Revenue		(10)		(16)
Net Program Costs	$	22,567	$	22,347
Ensure Effective Educational Opportunities for All Students				
Gross Costs	$	17,258	$	16,925
Earned Revenue		(11)		(11)
Net Program Costs	$	17,247	$	16,914
Enhance the Education System's Ability to Continuously Improve				
Gross Costs	$	2,122	$	2,121
Earned Revenue		(59)		(58)
Net Program Costs	$	2,063	$	2,063
Total Program Cost	**$**	**120,246**	**$**	**138,723**
Total Program Revenue	**$**	**(35,967)**	**$**	**(34,401)**
Net Cost of Operations (Notes 10 & 13)	**$**	**84,279**	**$**	**104,322**

The accompanying notes are an integral part of these statements.

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United States Department of Education
Consolidated Statement of Changes in Net Position
For the Years Ended September 30, 2017 and 2016
(Dollars in Millions)

	FY 2017		FY 2016	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	**$ (28,215)**	**$ 61,052**	**$ (7,937)**	**$ 62,740**
Budgetary Financing Sources				
Appropriations Received	$ -	$ 135,945	$ -	$ 88,210
Appropriations Transferred In/Out	-	1	-	-
Other Adjustments (Rescissions, etc.)	-	(1,910)	-	(821)
Appropriations Used	132,689	(132,689)	89,077	(89,077)
Nonexchange Revenue	-	-	9	-
Donations and Forfeitures of Cash and Cash Equivalents	-	-	1	-
Other Financing Sources				
Imputed Financing from Costs Absorbed by Others	27	-	81	-
Negative Subsidy Transfers, Downward Subsidy Re-estimates, and Other	(25,461)	-	(5,124)	-
Total Financing Sources	**$ 107,255**	**$ 1,347**	**$ 84,044**	**$ (1,688)**
NET COST OF OPERATIONS	**$ (84,279)**	**$ -**	**$ (104,322)**	**$ -**
NET CHANGE	**$ 22,976**	**$ 1,347**	**$ (20,278)**	**(1,688)**
NET POSITION	**$ (5,239)**	**$ 62,399**	**$ (28,215)**	**$ 61,052**

The accompanying notes are an integral part of these statements.

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United States Department of Education
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2017 and 2016
(Dollars in Millions)

	FY 2017		FY 2016	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
BUDGETARY RESOURCES				
Unobligated Balance, Brought Forward, October 1	$ 12,392	$ 15,479	$ 14,774	$ 14,437
Recoveries of Prior Year Unpaid Obligations	4,781	13,356	746	21,047
Other Changes in Unobligated Balance (+ or -)	(456)	(18,277)	(772)	(24,695)
Unobligated Balance from Prior Year Budget Authority, Net	$ 16,717	$ 10,558	$ 14,748	$ 10,789
Appropriations (Discretionary and Mandatory)	134,388	-	87,924	24
Borrowing Authority (Discretionary and Mandatory) (Note 12)	-	166,601	-	167,400
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	1,096	69,169	522	53,608
Total Budgetary Resources	**$ 152,201**	**$ 246,328**	**$103,194**	**$ 231,821**
STATUS OF BUDGETARY RESOURCES				
New Obligations Incurred and Upward Adjustments (Total) (Note 12)	$ 139,923	$ 223,115	$ 90,802	$ 216,342
Unobligated Balance, End of Year:				
Apportioned, Unexpired Accounts	9,012	-	10,280	-
Unapportioned, Unexpired Accounts	2,100	23,213	1,212	15,479
Unexpired Unobligated Balance, End of year	**$ 11,112**	**$ 23,213**	**$ 11,492**	**$ 15,479**
Expired Unobligated Balance, End of Year	1,166	-	900	-
Unobligated Balance, End of Year (Total)	**$ 12,278**	**$ 23,213**	**$ 12,392**	**$ 15,479**
Total Status of Budgetary Resources	**$ 152,201**	**$ 246,328**	**$103,194**	**$ 231,821**
CHANGE IN OBLIGATED BALANCE				
Unpaid Obligations				
Unpaid Obligations, Brought Forward, October 1	$ 54,249	$ 76,624	$ 52,645	$ 78,116
New Obligations Incurred and Upward Adjustments	139,923	223,115	90,802	216,342
Outlays (Gross) (-)	(132,553)	(207,402)	(88,452)	(196,787)
Recoveries of Prior Year Unpaid Obligations (-)	(4,781)	(13,356)	(746)	(21,047)
Unpaid Obligations, End of Year	$ 56,838	$ 78,981	$ 54,249	$ 76,624
Uncollected Payments				
Uncollected Payments, Federal Sources, Brought Forward, October 1 (-)	$ (2)	$ (4)	$ (3)	$ (26)
Change in Uncollected Payments, Federal Sources (+ or -)	-	(588)	1	22
Uncollected Payments, Federal Sources, End of Year (-)	$ (2)	$ (592)	$ (2)	$ (4)
Memorandum (Non-Add) Entries				
Obligated Balance, Start of Year (+ or -)	**$ 54,247**	**$ 76,620**	**$ 52,642**	**$ 78,090**
Obligated Balance, End of Year (+ or -)	**$ 56,836**	**$ 78,389**	**$ 54,247**	**$ 76,620**
BUDGET AUTHORITY AND OUTLAYS, NET				
Budget Authority, Gross (Discretionary and Mandatory)	$ 135,484	$ 235,770	$ 88,446	$ 221,032
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(1,279)	(166,942)	(721)	(114,123)
Change in Uncollected Payments from Federal Sources (Discretionary and Mandatory) (+ or -)	-	(588)	1	22
Recoveries of Prior Year Paid Obligations (Discretionary and Mandatory) (+ or -)	(1)	(439)	(1)	(516)
Budget Authority, Net (Discretionary and Mandatory)	**$ 134,204**	**$ 67,801**	**$ 87,725**	**$ 106,415**
Outlays, Gross (Discretionary and Mandatory)	$ 132,553	$ 207,402	$ 88,452	$ 196,787
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(1,279)	(166,942)	(721)	(114,123)
Outlays, Net (Discretionary and Mandatory)	131,274	40,460	87,731	82,664
Distributed Offsetting Receipts (-) (Note 12)	(19,562)	-	(10,766)	-
Agency Outlays, Net (Discretionary and Mandatory) (Note 12)	**$ 111,712**	**$ 40,460**	**$ 76,965**	**$ 82,664**

The accompanying notes are an integral part of these statements.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED SEPTEMBER 30, 2017 AND 2016

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

The Department is primarily responsible for administering federal student loan and grant programs and provides technical assistance to loan and grant recipients and other state and local partners. The largest portions of the Department's financial activities relate to the execution of loan and grant programs which are discussed below.

Federal Student Loan Programs. The Department administers direct loan, loan guarantee, and other student aid programs to help students and their families finance the cost of postsecondary education. These include the William D. Ford Federal Direct Loan (Direct Loan) program and the Federal Family Education Loan (FFEL) program.

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 through participating schools to eligible undergraduate and graduate students and their parents. The Direct Loan program offers four types of loans: Stafford, Unsubsidized Stafford, PLUS, and Consolidation. Evidence of financial need is required for an undergraduate 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.

The FFEL program, authorized by the HEA, operates through state and private nonprofit guaranty agencies that provide loan guarantees on loans made by private lenders to eligible students. The *Student Aid and Fiscal Responsibility Act* (SAFRA), which was included in the *Health Care and Education Reconciliation Act of 2010* (HCERA), stated that no new FFEL loans would be made effective July 1, 2010. FFEL program receivables include defaulted FFEL loans and acquired FFEL loans. Acquired FFEL loans include interest in student loan assets acquired using temporary authority provided in the *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA). 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 Asset-Backed Commercial Paper (ABCP) Conduit. This authority expired after September 30, 2010; as a result, loan purchase commitments and purchases of loan participation interests concluded. However, under the terms of the Put Agreement with the conduit, ABCP Conduit activity ceased operations in January 2014.

The Department also administers loans for the Federal Perkins Loan program, the Historically Black Colleges and Universities (HBCU) Capital Financing program, the Health Education Assistance Loan (HEAL) program, and the Teacher Education Assistance for College and Higher Education Grant (TEACH) program, along with low-interest loans to institutions of higher education for the building and renovating of their facilities through the Facilities Loan programs.

Grant Programs. The Department has more than 100 grant programs. The three largest grant programs are Title I of the *Elementary and Secondary Education Act* (ESEA), Federal Pell Grant (Pell Grant), and the *Individuals with Disabilities Education Act* (IDEA) grants. In addition to student loans and grants, the Department offers

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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.

PROGRAM OFFICES

The Department has three major program offices that administer most of its loan and grant programs:

- Federal Student Aid (FSA) administers need-based financial assistance programs for students pursuing postsecondary education and makes available federal grants, direct loans, and work-study funding to eligible undergraduate and graduate students.
- The Office of Elementary and Secondary Education (OESE) assists state and local educational agencies to improve the achievement of preschool, elementary, and secondary school students, helps ensure equal access to services leading to such improvement—particularly children with high needs, and provides financial assistance to local educational agencies whose local revenues are affected by federal activities.
- The Office of Special Education and Rehabilitative Services (OSERS) supports programs that help provide early intervention and special education services to children and youth with disabilities. OSERS also supports programs for the vocational rehabilitation of youth and adults with disabilities, including preemployment transition services and other transition services designed to assist students with disabilities to enter postsecondary education and achieve employment.

Other offices that administer programs and provide leadership, technical assistance, and financial support to state and local educational activities and institutions of higher education for reform, strategic investment, and innovation in education include: the Office of Career, Technical, and Adult Education (OCTAE); Office of Postsecondary Education (OPE); Institute of Education Sciences (IES); Office of English Language Acquisition (OELA); and Office of Innovation and Improvement (OII). In addition, the Office for Civil Rights (OCR) works to ensure equal access to education, promotes educational excellence throughout the nation, and serves student populations facing discrimination and the advocates and institutions promoting systemic solutions to civil rights issues. (See Note 10)

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 Generally Accepted Accounting Principles (GAAP) accepted in the U.S. for federal entities, issued by the Federal Accounting Standards Advisory Board (FASAB), and the Office of Management and Budget (OMB) Circular 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 use of budgetary resources. FSA also issues audited stand-alone financial statements which are included in their annual report.

The Department's financial statements should be read as a component of the U.S. government, a sovereign entity. One of the many implications 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.

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

ACCOUNTING FOR FEDERAL CREDIT PROGRAMS

The Department's accounting for its loan and loan guarantee programs is based on the requirements of the *Federal Credit Reform Act of 1990* (FCRA). The purpose of the FCRA is to record the lifetime subsidy cost of direct loans and loan guarantees, in present value terms, at the time the loan is disbursed (subsidy). 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).

Under the FCRA, subsidy cost is estimated using the net present value of future cash flows to and from the Department. In accordance with the FCRA, credit programs either estimate a subsidy cost to the government (a "positive" subsidy), breakeven (zero subsidy cost), or estimate a negative subsidy cost. Negative subsidy occurs when the estimated cost of providing loans to borrowers from Treasury borrowing, collection costs, and loan forgiveness is less than the value of collections from borrowers for interest and fees, in present value terms.

The subsidy costs of direct loan and loan guarantee programs are budgeted and tracked by the fiscal year in which the loan award is made or the funds committed. Such a grouping of loans or guarantees is referred to as a "cohort." A cohort is a grouping of direct loans obligated or loan guarantees committed by a program in the same year even if disbursements occur in subsequent years.

In order to account for the change in the net present value of the loan portfolio over time, the subsidy cost is "amortized" each year. Amortization accounts for the differences in interest rates, accruals, and cash flows over the life of a cohort, ensuring that cost is reflected in subsidy estimates and re-estimates. Amortization of subsidy is calculated as the difference between interest received from borrowers and Treasury (on uninvested cash) and interest paid to Treasury on borrowings.

The FCRA establishes the use of financing, program, and Treasury General Fund receipt accounts for loan guarantees committed and direct loans obligated after September 30, 1991.

- Financing accounts borrow funds from Treasury, make direct loan disbursements, collect fees from lenders and borrowers, 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 General Fund receipt accounts. Financing accounts are presented separately in the combined statement of budgetary resources (SBR) as non-budgetary credit reform accounts to allow for a clear distinction from all other budgetary accounts. This facilitates reconciliation of the SBR to the *Budget of the United States Government* (President's Budget).
- Program accounts receive and obligate appropriations to cover the positive subsidy cost of a direct loan or loan guarantee when the loan is approved and disburses the subsidy cost to the financing account when the loan is issued. Program accounts also receive appropriations for administrative expenses.
- Treasury General Fund receipt accounts receive amounts paid from financing accounts when there are negative subsidies for new loan disbursements or downward re-estimates of the subsidy cost of existing loans.

The Department records an estimated obligation each year for direct loan awards to be made in a fiscal year based on estimates of schools' receipt of aid applications. The Department advances funds to schools based on these estimates. Promissory notes are signed when schools reach individual agreements with borrowers and the schools subsequently report each disbursement of advanced funds to the Department. A new promissory note is usually not required for students in the second or later year of study. Half of all loan awards are issued

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in the fourth quarter of the fiscal year. Loans awarded are typically disbursed in multiple installments over an academic period. As a result, loans may be disbursed over multiple fiscal years. Loan awards may not be fully disbursed due to students leaving or transferring to other schools. The Department's obligation estimate may also not reflect the actual amount of awards made. Based on historical averages, the Department expects approximately 7.5 percent of the amount obligated for new loan awards will not be disbursed.

When a loan is placed in deferment or forbearance, loan repayment is temporarily suspended with the length of postponement different for each lender. Interest accrues while a loan is in deferment or forbearance. Loans are cancelled if a person dies, meets disability requirements, or through the bankruptcy courts. Loans are also cancelled through the Public Service Loan Forgiveness (PSLF) Program, which forgives the remaining balance on a Direct Loan after 120 qualifying monthly payments are made. These payments must be made under a qualifying repayment plan while working full-time for a qualifying employer. In addition, the Department offers the Pay As You Earn (PAYE) program. This student loan repayment program is designed to help borrowers who struggle to make their normal student loan payments. The plan allows payments to be limited to 10 percent of discretionary income if qualifications are met. Under the PAYE program, if all requirements are met, forgiveness of the remaining balance of a student loan is possible after 20 years of consistent payments.

BUDGETARY RESOURCES

Budgetary resources are amounts available to enter into new obligations and to liquidate them. The Department's budgetary resources include unobligated balances of resources from prior years; recoveries of prior-year unpaid obligations; and new resources, which include appropriations, authority to borrow from Treasury, and spending authority from collections.

Borrowing authority is an indefinite budgetary resource authorized under the FCRA. This resource, when realized, finances the unsubsidized portion of the Direct Loan, FFEL, and other loan programs. In addition, borrowing authority is requested to cover the cost of the initial loan disbursement as well as any related negative subsidy to be transferred to Treasury General Fund receipt accounts. Treasury prescribes the terms and conditions of borrowing authority and lends to the financing account amounts as appropriate. Amounts borrowed, but not yet disbursed, are included in uninvested funds and earn interest. Treasury uses the same weighted average interest rates for both the interest charged on borrowed funds and the interest earned on uninvested funds. Treasury sets a different fixed interest rate to be used for each loan cohort once the loans are substantially disbursed. 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 1st of the current fiscal year, regardless of when the Department borrowed the funds, except for amounts borrowed to make annual interest payments.

Authority to borrow from Treasury provides most of the funding for disbursements made under the Direct Loan, FFEL, and other loan programs. Subsidy and administrative costs of the programs are funded by appropriations. Borrowings are repaid using collections from borrowers, fees, and interest on uninvested funds.

Unobligated balances represent the cumulative amount of budgetary resources that are not obligated and that remain available for obligation under law, unless otherwise restricted. Resources expiring at the end of the fiscal year remain available for five years, but only for upward adjustments of prior year obligations, after which they are cancelled and may not be used. Resources that have not expired at year-end are available for new obligations, as well as upward adjustments of prior-year obligations. Funds are appropriated on an annual, multiyear, or no-year basis. Appropriated funds shall expire on the last day of availability and are no longer available for new obligations. Amounts in expired funds are unavailable for new obligations, but may be used to adjust previously established obligations.

Permanent Indefinite Budget Authority. The Direct Loan, FFEL, and other loan programs have permanent indefinite budget authority through legislation to fund subsequent increases to the estimated future costs of the loan programs. Parts B and D of the HEA pertain to the existence, purpose, and availability of permanent indefinite budget authority for these programs.

Reauthorization of Legislation. Funds for most Department programs are authorized, by statute, to be appropriated for a specified number of years, with an

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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 in accordance with congressional budgeting rules. (See Note 12)

USE OF ESTIMATES

Department management is required to make certain estimates while preparing consolidated financial statements in conformity with GAAP. These estimates are reflected in the assets, liabilities, net cost, and net position of the financial statements and may differ from actual results. The Department's estimates are based on management's best knowledge of current events, historical experiences, and other assumptions that are believed to be reasonable under the circumstances. Significant estimates reported on the financial statements include: allocation of Department administrative overhead costs; allowance for subsidy for direct, defaulted guaranteed, and acquired loans; the liability for loan guarantees; the amount payable or receivable from annual credit program re-estimates and modifications of subsidy cost; and grant liability and advance accruals. (See Notes 4, 5, 9, and 10)

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. Non-entity assets are offset by liabilities to third parties and have no impact on net position. The Department combines its entity and non-entity assets on the balance sheet and discloses its non-entity assets in the notes. (See Note 2)

FUND BALANCE WITH TREASURY

Fund Balance with Treasury includes four types of 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: (1) general funds, which consist of expenditure accounts used to record financial transactions funded by congressional appropriations (which include amounts appropriated to fund subsidy and administrative costs of loan programs); (2) revolving funds, which manage the activity of self-funding programs whether through fees, sales, or other income (which include financing accounts for loan programs); (3) special funds, which collect funds from sources that are authorized by law for a specific purpose—these receipts are available for expenditure for special programs; and (4) other funds include trust funds, deposit funds, agency receipt funds, and clearing accounts. Treasury processes cash receipts and cash disbursements for the Department. The Department's records are reconciled with Treasury's. (See Note 3)

ACCOUNTS RECEIVABLE

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

GUARANTY AGENCIES' FEDERAL FUNDS

Guaranty Agencies' Federal Funds are primarily comprised of the federal government's interest in the program assets held by state and nonprofit FFEL program guaranty agencies. Section 422A of the HEA required FFEL guaranty agencies to establish federal student loan reserve funds (federal funds). Federal funds 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.

The balance in the Federal Fund represents consolidated reserve balances of the 26 guaranty agencies based on the Guaranty Agency financial reports that each agency submits annually to the Department. Although the Department and the guaranty agencies operate on different fiscal years, all guaranty agencies are subject to an annual audit based on form of organization. A year-end valuation adjustment is made to adjust the Department's balances in order to comply with federal accounting principles and disclose funds held outside of Treasury.

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Guaranty Agencies' Federal Funds are classified as non-entity assets with the public and are offset by a corresponding liability due to Treasury. The federal funds are held by the guaranty agencies but can only be used for certain specific purposes listed in the Department's regulations. The federal funds are the property of the U.S. and are reflected in the *Budget of the United States Government*. Payments made to the Department from guaranty agencies' federal funds through a statutory recall or agency closures represent capital transfers and are credited to the Department's Fund Balance with Treasury account. (See Notes 2, 4, and 9)

CREDIT PROGRAM RECEIVABLES, NET AND LIABILITIES FOR LOAN GUARANTEES

The financial statements reflect the Department's estimate of the long-term subsidy cost of direct and guaranteed loans in accordance with the FCRA. 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 an "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 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 liability for loan guarantees presents the net present value of all future cash flows from currently insured FFEL loans, including claim payments, interest assistance, allowance payments, and recoveries from assigned loans. Guaranteed loans that default are initially turned over to guaranty agencies for collection. Defaulted FFEL loans are accounted for as assets and reported at their net present value, similar to direct loans, although they are legally not direct student loans. Credit program receivables, net includes defaulted FFEL loans owned by the Department and held by the Department or guaranty agencies. In most cases, after approximately four years, defaulted guaranteed loans not in repayment are turned over by the guaranty agencies to the Department for collection.

FFEL program receivables include purchased loans and other interests acquired under an expired program. The cash flows related to these receivables include collections on purchased loans and other activities, including transfers of re-estimated subsidy. 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.

Capitalization of interest occurs as a result of various initiatives such as loan consolidations. As a result, interest receivable is reduced and loan principal is increased. (See Note 5)

PROPERTY AND EQUIPMENT, NET AND LEASES

The Department has very limited acquisition costs associated with buildings, furniture, and equipment as all Department and contractor staff are housed in leased buildings. The Department does not own real property for the use of its staff. 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.

The Department also leases information technology and telecommunications equipment, as part of a contractor-owned, contractor-operated services contract. Lease payments associated with this equipment have been determined to be operating leases and, as such, are expensed as incurred. The noncancellable lease term is one year, with the Department holding the right to extend the lease term by exercising additional one-year options. (See Notes 4 and 14)

LIABILITIES

Liabilities represent actual and estimated amounts to be paid as a result of transactions or events that have already occurred. However, no liabilities can be paid by the Department without budget authority. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources, and there is no certainty that an appropriation will be enacted. The government, acting in its sovereign capacity, can abrogate liabilities that arise from activities other than contracts. FFEL program and Direct Loan program liabilities are entitlements covered by permanent indefinite budget authority. (See Note 6)

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ACCOUNTS PAYABLE

Accounts payable include amounts owed by the Department for goods and services received from other entities, as well as payments not yet processed. 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. (See Note 9)

DEBT

The Department borrows from Treasury to provide funding for the Direct Loan, FFEL, and other credit programs for higher education. The liability to Treasury from borrowings represents unpaid principal at year-end. The Department repays the principal based on available fund balances. Interest rates are based on the corresponding rate for 10-year Treasury securities and are set for those borrowings supporting each cohort of loans once the loans for that cohort are substantially disbursed. Interest is paid to Treasury on September 30th. 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 debt for other credit programs for higher education includes the liability for full payment of principal and accrued interest for the FFB-financed HBCU Capital Financing program. (See Note 7)

NET COST

Net cost consists of gross costs and earned revenue. 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 nonfederal entities).

Net program costs are gross costs less revenue earned from activities. The Department determines gross cost and earned revenue by tracing amounts back to the specific program office. Administrative overhead costs of funds unassigned are allocated based on full-time employee equivalents of each program. (See Note 10)

CREDIT PROGRAM INTEREST REVENUE AND EXPENSE

The Department recognizes interest revenue from the public when interest is accrued on Direct Loan program loans, defaulted and acquired FFEL loans, and outstanding principal for other loan programs. Interest due from borrowers is accrued at least monthly and is satisfied upon collection or capitalization into the loan principal. Federal interest revenue is recognized on the unused fund balances with Treasury in the financing accounts.

Federal interest expense is recognized monthly on the outstanding borrowing from Treasury (debt) used to finance direct loan and loan guarantee programs. Accrued interest to Treasury is paid on September 30th. The interest rate for federal interest expense is the same as the rate used for federal interest revenue.

Interest expense equals interest revenue plus administrative fees accrued for all credit programs due to subsidy amortization. Subsidy amortization is required by the FCRA and accounts for the difference between interest expense and revenue cash flows. 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. (See Note 11)

NET POSITION

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

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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 nonvested 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. (See Notes 6 and 9)

RECLASSIFICATIONS

Certain reclassifications were made to the prior year notes to conform to the current year presentation. These changes had no effect on total assets, liabilities and net position, net cost of operations, or budgetary resources. Components of Fund Balance with Treasury in Note 3 were reclassified to identify the amount of borrowing authority not yet converted to Fund Balance with Treasury; the total Fund Balance with Treasury was unaffected. Components of gross cost and earned revenue in Note 10 were reclassified between intragovernmental and with the public to better reflect the underlying activities that resulted in changes in the Guaranty Agencies' Federal Funds balance; the total gross cost and the total earned revenue were unaffected. Direct Loan program revenue was reclassified in Note 5 to better reflect administrative fee revenue; total Direct Loan program revenue was unaffected. Components of Distributed Offsetting Receipts in Note 12 were reclassified to identify the amount associated with HEAL program loans; total distributed offsetting receipts was unaffected.

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NOTE 2. Non-Entity Assets

As of September 30, 2017 and 2016, non-entity assets consisted of the following:

Non-Entity Assets
(Dollars in Millions)

	2017		2016	
	Intragovernmental	With the Public	Intragovernmental	With the Public
Non-Entity Assets				
Fund Balance with Treasury	$ 260	$ -	$ 231	$ -
Credit Program Receivables, Net	-	495	-	449
Other Assets				
Guaranty Agencies' Federal Funds	-	2,077	-	1,197
Accounts Receivable, Net	-	68	-	69
Total Non-Entity Assets	**260**	**2,640**	**231**	**1,715**
Entity Assets	109,979	1,146,364	96,634	1,076,227
Total Assets	**$ 110,239**	**$ 1,149,004**	**$ 96,865**	**$ 1,077,942**

The Department's FY 2017 assets are predominantly entity assets (99.8 percent), leaving the small portion of assets remaining as non-entity assets. Non-entity intragovernmental assets primarily consist of balances in deposit and clearing accounts. Non-entity assets with the public primarily consist of guaranty agency reserves (78.7 percent), reported as Guaranty Agencies' Federal Funds, and Federal Perkins Loan program loan receivables (18.8 percent), reported as credit program receivables, net. Federal Perkins Loan program receivables are a non-entity asset because the assets are held by the Department but are not available for use by the Department. The corresponding liabilities for these non-entity assets are reflected in various accounts, including intragovernmental accounts payable, Guaranty Agencies' Federal Funds Due to Treasury, and other liabilities. (See Note 9)

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NOTE 3. Fund Balance with Treasury

Fund Balance with Treasury by status of funds and fund type, as of September 30, 2017 and 2016, consisted of the following:

Fund Balance with Treasury
(Dollars in Millions)

	General Funds	Revolving Funds	Special Funds	All Other Funds	Total
2017					
Unobligated Balance					
Available	$ 9,008	$ -	$ 3	$ 1	$ 9,012
Unavailable	1,174	23,218	10	-	24,402
Obligated Balance, not Disbursed	56,829	78,390	-	-	135,219
Authority Temporarily Precluded from Obligation	-	-	1	-	1
Borrowing Authority Not Yet Converted to Fund Balance with Treasury	-	(58,701)	-	-	(58,701)
Other	-	-	-	241	241
Total Fund Balance with Treasury	**$ 67,011**	**$ 42,907**	**$ 14**	**$ 242**	**$ 110,174**
2016					
Unobligated Balance					
Available	$ 10,280	$ -	$ -	$ -	$ 10,280
Unavailable	902	15,480	12	-	16,394
Obligated Balance, not Disbursed	54,240	76,621	1	-	130,862
Borrowing Authority Not Yet Converted to Fund Balance with Treasury	-	(60,991)	-	-	(60,991)
Other	-	-	-	218	218
Total Fund Balance with Treasury	**$ 65,422**	**$ 31,110**	**$ 13**	**$ 218**	**$ 96,763**

COMPOSITION OF FUNDS

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. Special funds include fees collected on delinquent or defaulted Perkins loans that have reverted back to the Department from the initial lenders.

STATUS OF 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. Total unavailable unobligated balance ($24,402 million) differs from unapportioned and expired amounts on the SBR ($26,479 million) due to the Guaranty Agencies' Federal Funds ($2,077 million).

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NOTE 4. Other Assets

Other assets, as of September 30, 2017 and 2016, consisted of the following:

Other Assets
(Dollars in Millions)

	2017		2016	
	Intragovernmental	With the Public	Intragovernmental	With the Public
Guaranty Agencies' Federal Funds	$ -	$ 2,077	$ -	$ 1,197
Accounts Receivable, Net	1	172	1	137
Advances	64	1	101	3
Property and Equipment, Net	-	33	-	24
Other	-	2	-	2
Total Other Assets	**$ 65**	**$ 2,285**	**$ 102**	**$ 1,363**

NOTE 5. Credit Programs for Higher Education: Credit Program Receivables, Net and Liabilities for Loan Guarantees

Credit program receivables, as of September 30, 2017 and 2016, consisted of the following:

Credit Program Receivables
(Dollars in Millions)

	Principal	Accrued Interest	Allowance for Subsidy	Net
2017				
Direct Loan Program	$ 998,825	$ 59,534	$ (16,805)	$ 1,041,554
FFEL Program	101,601	19,338	(18,529)	102,410
Other Credit Programs for Higher Education	3,157	409	(811)	2,755
Total Credit Receivables	**$ 1,103,583**	**$ 79,281**	**$ (36,145)**	**$ 1,146,719**
2016				
Direct Loan Program	$ 902,754	$ 50,835	$ 5,292	$ 958,881
FFEL Program	109,804	18,191	(13,125)	114,870
Other Credit Programs for Higher Education	2,988	389	(549)	2,828
Total Credit Receivables	**$ 1,015,546**	**$ 69,415**	**$ (8,382)**	**$ 1,076,579**

The federal student loan programs provide students and their families with the funds to help meet postsecondary education costs. Funding for these programs is provided through permanent indefinite budget authority. What follows is additional analysis of the activity, costs and adjustments for each of the loan programs.

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

Direct Loan program loan receivables include defaulted and nondefaulted loans owned and held by the Department. Of the $1,058.4 billion in gross receivables, as of September 30, 2017, $70.7 billion (6.7 percent) in loan principal was in default and had been transferred to the Department's defaulted loan servicer, compared to $57.3 billion (6.0 percent) as of September 30, 2016.

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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)

	2017	2016
Beginning Balance, Allowance for Subsidy	**$ (5,292)**	**$ (35,496)**
Activity		
Fee Collections	1,694	1,685
Loan Cancellations	(7,689)	(5,065)
Subsidy Allowance Amortization	23,276	17,815
Other	(513)	(350)
Total Activity	**16,768**	**14,085**
Components of Subsidy Expenses for 2017 and 2016 Cohorts of Loans		
Interest Rate Differential	(13,045)	(15,463)
Defaults, Net of Recoveries	(133)	(127)
Fees	(1,968)	(1,993)
Other	12,541	11,887
Negative Subsidy Expenses for 2017 and 2016 Cohorts of Loans	**(2,605)**	**(5,696)**
Components of Subsidy Re-estimates For All Prior Year Cohorts of Loans		
Interest Rate Re-estimates	(5,765)	(1,536)
Technical and Default Re-estimates	13,699	23,351
Upward Subsidy Re-estimates of Prior Year Cohorts of Loans	**7,934**	**21,815**
Ending Balance, Allowance for Subsidy	**$ 16,805**	**$ (5,292)**

The estimation process used to determine the amount of positive or negative subsidy expense each fiscal year, and subsequently the cumulative taxpayer cost of the program (allowance for subsidy), is subject to various internal and external risk factors which often show strong interdependence with one another. These risks include uncertainty about changes in the general economy, changes in the legislative and regulatory environment, and changing trends in borrower performance with regard to contractual cash flows within the loan programs.

Due to the complexity of the Direct Loan program, there is inherent projection risk in the process used for estimating long-term program costs. As stated, some uncertainty stems from potential changes in student loan legislation and regulations because these changes may fundamentally alter the cost structure of the program. Operational and policy shifts, such as growing efforts to increase borrower enrollment in income-driven repayment (IDR) plans, may also affect program costs by causing significant changes in borrower repayment timing. Actual performance may deviate from estimated performance, which is not unexpected given the long-term nature of these loans (cash flows may be estimated up to 40 years), and the multitude of projection paths and possible outcomes. The increasing enrollment of borrowers in the IDR plans has made projection of borrower incomes a key input for the estimation process. This uncertainty is directly tied to the macroeconomic climate and is another inherent program element that displays the interrelated risks facing the Direct Loan program.

Loan cancellations include write-offs of loans because the borrower died, became disabled, or declared bankruptcy. The interest rate re-estimate reflects the cost of finalizing the Treasury borrowing rate to be used for borrowings received to fund the disbursed portion of the loan awards obligated. Other components of subsidy transfers consist of contract collection costs, program review collections, fees, loan forgiveness under Pay as You Earn (PAYE) and other accruals.

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The following schedule summarizes the Direct Loan program interest expense and revenues for the years ended September 30, 2017 and 2016:

Direct Loan Program Interest Expense and Revenues
(Dollars in Millions)

	2017	2016
Interest Expense on Treasury Borrowing	$ 31,286	$ 30,503
Total Interest Expense	**$ 31,286**	**$ 30,503**
Interest Revenue from the Public	$ 50,142	$ 44,199
Interest Revenue on Uninvested Funds	4,258	3,943
Administrative Fees	162	176
Amortization of Subsidy	(23,276)	(17,815)
Total Revenues	**$ 31,286**	**$ 30,503**

The following schedule summarizes the Direct Loan subsidy expense for the years ended September 30, 2017 and 2016:

Direct Loan Program Subsidy Expense
(Dollars in Millions)

	2017	2016
Components of Subsidy Expenses for 2017 and 2016 Cohorts of Loans		
Interest Rate Differential	$ (13,045)	$ (15,463)
Defaults, Net of Recoveries	(133)	(127)
Fees	(1,968)	(1,993)
Other	12,541	11,887
Negative Subsidy Expenses For 2017 and 2016 Cohorts of Loans	**(2,605)**	**(5,696)**
Upward Subsidy Re-estimates For All Prior Loan Cohorts	7,934	21,815
Direct Loan Subsidy Expense	**$ 5,329**	**$ 16,119**

Direct Loan program re-estimated subsidy cost was adjusted upward by $7.9 billion in FY 2017. In addition to the major assumption updates described below, the re-estimate reflects several other assumption updates, including interest rates provided by OMB, volume, and enter repayment rates. Prepayment rates increased from the FY 2016 estimate, resulting in a $2.4 billion upward re-estimate. Contract collection costs were updated for new data reflecting lower overall average commission rates, resulting in a $5.1 billion downward re-estimate.

- **IDR Model Changes.** The U.S. Government Accountability Office (GAO) audit report, *Federal Student Loans: Education Needs to Improve Its Income Driven Repayment Plan Budget Estimates*, identified several areas in which the Department could improve its IDR cost estimates. Largely in response to this audit, as well as concerns raised in FY 2016's Independent Auditor's Report, in FY 2017 the Department incorporated an adjustment for inflation into the Department's IDR submodel, modified the current IDR submodel to estimate IDR subsidies by loan type, and implemented methods to address concerns regarding the volatility of the submodel's income data. In addition, default; collection; death, disability, and bankruptcy; and prepayment rate assumptions used by the submodel were updated. The combined effect of these changes was a net downward re-estimate of $14.7 billion.

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- **Repayment Plan Selection.** The GAO audit report cited above also recommended the Department help ensure that subsidy estimates reasonably reflect trends in IDR plan participation. In response, the Department updated its methodology for repayment plan selection, taking into account the timing of repayment plan selection as well as recent growth trends in the selection of income-driven repayment plans. The combined effect of these changes was a net upward re-estimate of $18.4 billion.
- **Death, Disability, and Bankruptcy.** The Department made major updates to the death, disability, and bankruptcy assumption in FY 2017. These updates included a revised accounting for the effect of a matching agreement with Social Security Administration, updates to closed school regulations, and revised borrower defense regulations. Updates to the data used to calculate discharges were also incorporated. The combined effect of these changes were a net upward re-estimate of $9.2 billion.

Subsidy rates are sensitive to the difference between the borrowers' rates and the rate the Department is charged by Treasury on the debt to fund the loans; for example, a 1 percent increase in projected borrower interest rates would reduce projected direct loan subsidy cost by $5.2 billion. Re-estimated costs only include cohorts that are 90 percent disbursed; cohort years 1994–2016. With the increase in IDR participation, the Department also conducted sensitivities on incomes for students in IDR and Public Service Loan Forgiveness (PSLF) plans. For example, a 10 percent upward increase in borrower incomes decreases costs almost $2.3 billion for cohort 2016. A 10 percent increase in PSLF plan participation would increase costs by $.6 billion for cohort 2016.

Direct Loan program re-estimated subsidy cost was adjusted upward by $21.8 billion in FY 2016. The re-estimates reflect several updated assumptions: however, in this case, the size of the net upward re-estimate was due largely to collection rates on defaulted loans and repayment plan selection. Actual collections on defaults since FY 2011 were lower than anticipated, which reduced estimated lifetime rates and increased the cost to the Department by $10.1 billion. For repayment plan selection, a greater percentage of borrowers chose costlier plans than had been estimated and increased the cost to the Department by $8.1 billion. The percentage of borrowers choosing an IDR plan was the primary cost driver for that assumption.

The subsidy rates applicable to the 2017 loan cohort year follow:

Direct Loan Subsidy Rates—Cohort 2017

	Interest Differential	Defaults	Fees	Other	Total
Stafford	4.33%	1.46%	-1.07%	7.21%	11.93%
Unsubsidized Stafford	-8.33%	0.93%	-1.07%	8.99%	0.52%
PLUS	-18.97%	0.56%	-4.30%	7.86%	-14.85%
Consolidation	4.97%	1.25%	0.00%	10.89%	17.11%
Weighted Average Total	**-6.84%**	**1.06%**	**-1.21%**	**9.15%**	**2.16%**

The subsidy rate represents the subsidy expense of the program in relation to the obligations or commitments made during the fiscal year and are weighted on gross volume. The subsidy rates shown above, which reflect aggregate positive subsidy in the FY 2017 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 Department does not re-estimate student loan cohorts until they are at least 90 percent disbursed. As a result, the financial statement re-estimate does not include a re-estimate of the current year cohort. The first re-estimate of this cohort will take place upon execution of the FY 2019 President's Budget.

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The subsidy 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.

The following schedule summarizes the Direct Loan program loan disbursements by loan type for the years ended September 30, 2017 and 2016:

Direct Loan Program Loan Disbursements by Loan Type
(Dollars in Millions)

	2017	2016
Stafford	$ 23,368	$ 23,752
Unsubsidized Stafford	51,410	52,254
PLUS	18,695	19,001
Consolidation	48,999	45,518
Total Disbursements	**$ 142,472**	**$ 140,525**

The allocation of disbursements for the first three loan types is estimated based on historical trend information.

Student and parent borrowers may prepay existing loans without penalty through a new consolidation loan. Under the FCRA and requirements provided by OMB regulations, the retirement of direct loans being consolidated is considered a collection 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 subsidy costs. The net receivables include estimates of future prepayments of existing loans through consolidations; they do not reflect subsidy costs associated with anticipated future consolidation loans.

Direct loan consolidations were $49.0 billion during FY 2017 and $45.5 billion during FY 2016. Under the FCRA, 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.

Federal Family Education Loan Program. As a result of the SAFRA Act, no new FFEL loans have been made since July 1, 2010. Federal guarantees on FFEL program loans and commitments remain in effect for loans made before July 1, 2010, unless they were sold to the Department through an ECASLA program (acquired FFEL loans), consolidated into a direct loan, or otherwise satisfied, discharged, or cancelled. As of September 30, 2017 and 2016, total principal balances outstanding of guaranteed loans held by lenders were approximately $176 billion and $197 billion, respectively. As of September 30, 2017 and 2016, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately $173 billion and $193 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the guaranty agencies. The rates range from 75 to 100 percent of the loan value depending on when the loan was made and the guaranty agency's claim experience.

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The balances of defaulted and acquired FFEL loans as of September 30, 2017 and 2016, are presented below.

FFEL Program Loan Receivables
(Dollars in Millions)

	Principal	Accrued Interest	Allowance for Subsidy	Net
2017				
DEFAULTED FFEL GURANTEED LOANS				
FFEL GSL Program (Pre-1992)	$ 3,882	$ 5,659	$ (8,019)	$ 1,522
FFEL GSL Program (Post-1991)	34,395	7,216	(13,838)	27,773
Total Defaulted FFEL Guaranteed Loans	38,277	12,875	(21,857)	29,295
ACQUIRED FFEL LOANS				
Loan Purchase Commitment	21,375	2,224	1,656	25,255
Loan Participation Purchase	40,288	3,947	2,072	46,307
ABCP Conduit	1,661	292	(400)	1,553
Total Acquired FFEL Loans	63,324	6,463	3,328	73,115
FFEL Program Loan Receivables	**$ 101,601**	**$ 19,338**	**$ (18,529)**	**$ 102,410**
2016				
DEFAULTED FFEL GURANTEED LOANS				
FFEL GSL Program (Pre-1992)	$ 4,087	$ 5,674	$ (7,622)	$ 2,139
FFEL GSL Program (Post-1991)	35,645	6,562	(12,398)	29,809
Total Defaulted FFEL Guaranteed Loans	39,732	12,236	(20,020)	31,948
ACQUIRED FFEL LOANS				
Loan Purchase Commitment	23,867	2,090	2,922	28,879
Loan Participation Purchase	44,434	3,600	4,347	52,381
ABCP Conduit	1,771	265	(374)	1,662
Total Acquired FFEL Loans	70,072	5,955	6,895	82,922
FFEL Program Loan Receivables	**$ 109,804**	**$ 18,191**	**$ (13,125)**	**$ 114,870**

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The following schedule provides a reconciliation between the beginning and ending balances of the liability for the outstanding portfolio of insured FFEL loans. This liability is included as a component of other liabilities on the balance sheet (see Note 9).

FFEL Program Reconciliation of Liabilities for Loan Guarantees
(Dollars in Millions)

	2017	2016
Beginning Balance, FFEL Financing Account Liability for Loan Guarantees	**$ 1,417**	**$ (3,398)**
Activity		
Interest Supplement Payments	(810)	(830)
Claim Payments	(5,819)	(6,678)
Fee Collections	1,633	1,731
Interest on Subsidy Amortization	(1,263)	(1,766)
Other	7,459	5,648
Total Activity	**1,200**	**(1,895)**
Components of Loan Modifications		
Loan Modification Costs	-	151
Modification Adjustment Transfers	-	24
Loan Modifications	**-**	**175**
Upward Subsidy Re-estimates	1,019	6,535
Ending Balance, FFEL Financing Account Liability for Loan Guarantees	**3,636**	**1,417**
FFEL Liquidating Account Liability for Loan Guarantees	23	12
FFEL Liabilities for Loan Guarantees	**$ 3,659**	**$ 1,429**

Other activity includes negative special allowance collections, collections on defaulted FFEL loans, guaranty agency expenses, and loan cancellations due to death, disability, or bankruptcy.

The following schedules provide reconciliations between the beginning and ending balances of the allowance for subsidy for the acquired FFEL portfolio.

Loan Purchase Commitment Reconciliation of Allowance for Subsidy
(Dollars in Millions)

	2017	2016
Beginning Balance, Allowance for Subsidy	**$ (2,922)**	**$ (4,410)**
Activity		
Subsidy Allowance Amortization	635	644
Loan Cancellations	(203)	(193)
Direct Asset Activities	(45)	(40)
Total Activity	**387**	**411**
Upward Subsidy Re-estimates	879	1,077
Ending Balance, Allowance for Subsidy	**$ (1,656)**	**$ (2,922)**

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Loan Participation Purchase Reconciliation of Allowance for Subsidy
(Dollars in Millions)

	2017	2016
Beginning Balance, Allowance for Subsidy	**$ (4,347)**	**$ (7,573)**
Activity		
Subsidy Allowance Amortization	1,219	1,208
Loan Cancellations	(390)	(355)
Direct Asset Activities	(67)	(74)
Total Activity	**762**	**779**
Upward Subsidy Re-estimates	1,513	2,447
Ending Balance, Allowance for Subsidy	**$ (2,072)**	**$ (4,347)**

The following schedule provides FFEL program subsidy expense for the years ended September 30, 2017 and 2016, respectively:

FFEL Program Subsidy Expense
(Dollars in Millions)

	2017	2016
Upward Subsidy Re-estimates		
FFEL Loan Guarantee Program	$ 1,019	$ 6,535
Loan Purchase Commitment	879	1,077
Loan Participation Purchase	1,513	2,447
Total FFEL Program Upward Subsidy Re-estimates	**3,411**	**10,059**
FFEL Guaranteed Loan Program Modification Costs	-	175
FFEL Program Subsidy Expense	**$ 3,411**	**$ 10,234**

FFEL subsidy cost was adjusted upward by $3.4 billion in FY 2017. The net upward re-estimates in these programs were due primarily to interest rates provided by OMB and updated prepayment rates. Subsidy rates are 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 subsidy costs by $15.1 billion.

FFEL re-estimated subsidy cost was adjusted upward by $10.2 billion in FY 2016. The net upward re-estimates in these programs were due primarily to collection rates on defaulted loans which were lower than anticipated.

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OTHER CREDIT PROGRAMS FOR HIGHER EDUCATION

Receivables, Net for Other Credit Programs for Higher Education
(Dollars in Millions)

	Principal	Accrued Interest	Allowance for Subsidy	Net
2017				
Federal Perkins Loans	$ 424	$ 268	$ (197)	$ 495
TEACH Program Loans	723	95	(225)	593
HEAL Program Loans	398	30	(74)	354
Facilities Loan Programs	1,612	16	(315)	1,313
Total	**$ 3,157**	**$ 409**	**$ (811)**	**$ 2,755**
2016				
Federal Perkins Loans	$ 385	$ 242	$ (178)	$ 449
TEACH Program Loans	698	101	(109)	690
HEAL Program Loans	405	31	(99)	337
Facilities Loan Programs	1,500	15	(163)	1,352
Total	**$ 2,988**	**$ 389**	**$ (549)**	**$ 2,828**

Federal Perkins Loan Program. The Federal Perkins Loan program 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. The maximum lifetime grant for students is $16,000 for undergraduate programs and $8,000 for graduate programs. For students failing to fulfill the service requirement, the grants are converted to direct unsubsidized Stafford Loans. Since grants can be converted to direct loans, for budget and accounting purposes, the program is operated as a loan program under the FCRA.

The subsidy rates applicable to the 2017 loan cohort year follow:

TEACH Subsidy Rates—Cohort 2017

	Interest Differential	Defaults	Fees	Other	Total
Subsidy Rates	8.60%	0.20%	0.00%	6.17%	14.97%

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HEAL Program. The Department assumed responsibility in FY 2014 for the HEAL program and the authority to administer, service, collect, and enforce the program. The HEAL program is structured as required by the FCRA. A liquidating account is used to record all cash flows to and from the government resulting from guaranteed HEAL loans committed prior to 1992. All loan activity for 1992 and beyond is recorded in corresponding financing accounts.

Facilities Loan Programs. The Department also administers the 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 loans to eligible institutions, charge interest, and collect principal and interest payments. In compliance with HEA, as amended, the bonding authority maintains an escrow account to pay the principal and interest on bonds for loans in default.

The total amount of support for HBCU programs, along with any accrued interest and unpaid servicing fees, will be capitalized to principal and be reamortized through the original maturity date of June 1, 2037. The Department has approximately $1.6 billion in outstanding borrowing from the FFB to support loans made to HBCU institutions and $242 million obligated to support near term lending as of September 30, 2017.

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

ADMINISTRATIVE EXPENSES

Administrative expenses, for the years ended September 30, 2017 and 2016, consisted of the following:

Administrative Expenses
(Dollars in Millions)

	2017		2016	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	$ 1,200	$ 144	$ 721	$ 465
Other Expense	19	3	50	33
Total	**$ 1,219**	**$ 147**	**$ 771**	**$ 498**

Administrative expenses are allocated between Direct Loan and FFEL programs based on estimates. The Department revised the estimation process in 2017. The revised process estimates (by program) the number of applications processed, number of loans serviced, dollar amount of loan originations, cost of school compliance actions, and the cost to collect defaulted loans. The revised process is more robust than the process used in previous years and results in a higher percentage of costs being allocated to the Direct Loan program.

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NOTE 6. 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
(Dollars in Millions)

	2017		2016	
	Intragovernmental	With the Public	Intragovernmental	With the Public
Liabilities Not Covered By Budgetary Resources				
Subsidy Due to Treasury General Fund	$ 1,784	$ -	$ 2,429	$ -
Other Liabilities				
Federal Perkins Loan Program	482	-	437	-
Accrued Unfunded Annual Leave	-	40	-	40
FECA Liabilities	3	14	8	1
Custodial Liabilities	-	-	2	-
Total Liabilities Not Covered By Budgetary Resources	**$ 2,269**	**$ 54**	**$ 2,876**	**$ 41**
Total Liabilities Covered By Budgetary Resources	1,187,448	12,312	1,129,411	9,642
Total Liabilities	**$ 1,189,717**	**$ 12,366**	**$ 1,132,287**	**$ 9,683**

NOTE 7. Debt

Debt, as of September 30, 2017 and 2016, consisted of the following:

Debt
(Dollars in Millions)

	Beginning Balance	Borrowing	Repayments	Ending Balance
2017				
Direct Loan Program	$ 994,285	$ 160,508	$ (93,234)	$ 1,061,559
FFEL Program	131,347	-	(15,057)	116,290
Other Credit Programs for Higher Education	2,191	255	(224)	2,222
Total	**$ 1,127,823**	**$ 160,763**	**$ (108,515)**	**$ 1,180,071**
2016				
Direct Loan Program	$ 909,927	$ 146,992	$ (62,634)	$ 994,285
FFEL Program	139,771	160	(8,584)	131,347
Other Credit Programs for Higher Education	2,078	224	(111)	2,191
Total	**$ 1,051,776**	**$ 147,376**	**$ (71,329)**	**$ 1,127,823**

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The Department borrows from Treasury to fund the disbursement of new loans and the payment of credit program outlays and related costs. During FY 2017, debt increased 4.6 percent from $1,127.8 billion in the prior year to $1,180.1 billion. The Department makes periodic principal payments after considering the cash position and liability for future outflows in each cohort of loans, as mandated by the FCRA.

Approximately 90.0 percent of the Department's debt, as of September 30, 2017, is attributable to the Direct Loan program. The majority of the net borrowing activity (borrowing less repayments) for the year was designated for funding new Direct Loan disbursements.

The Department also borrows from Treasury for activity in the other credit programs for higher education. During FY 2017, TEACH net borrowing of $(88.9) million was used for the advance of new grants and repayments of principal made to Treasury. In FY 2017, debt in HBCU increased by $81.5 million, or 5.7 percent. This total represents the aggregate of new bonds administered and repayments made on previously issued bonds.

NOTE 8. Subsidy Due to Treasury General Fund

Subsidy Due to Treasury General Fund

(Dollars in Millions)

	2017	2016
Credit Program Downward Subsidy Re-estimates		
Direct Loan Program	$ 5,010	$ -
FFEL Program	219	213
Total Credit Program Downward Subsidy Re-estimates	**5,229**	**213**
Future Liquidating Account Collections		
FFEL Program	1,614	2,253
Other Credit Programs for Higher Education	170	176
Total Future Liquidating Account Collections	**1,784**	**2,429**
Total Subsidy Due to Treasury General Fund	**$ 7,013**	**$ 2,642**

When downward subsidy re-estimates are executed, the amounts will be transferred to the Treasury General Fund in the following fiscal year. Future liquidating account collections represent the net present value of estimated future excess collections (estimated collections in excess of estimated outlays) for the Department's pre-1992 FFEL and HEAL loan programs.

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NOTE 9. Other Liabilities

Other liabilities, as of September 30, 2017 and 2016, consisted of the following:

Other Liabilities
(Dollars in Millions)

	2017		2016	
	Intragovernmental	With the Public	Intragovernmental	With the Public
Accounts Payable	$ 1	$ 4,191	$ 1	$ 3,966
Accrued Grant Liability	-	3,959	-	3,760
Guaranty Agencies' Funds Due to Treasury	2,077	-	1,197	-
Loan Guarantee Liability	-	3,870	-	1,633
Federal Perkins Loan Program	482	-	437	-
Miscellaneous Receipt, Deposit Funds and Clearing Accounts	52	270	40	255
Advances from Others and Deferred Credits	10	7	11	9
Accrued Unfunded Annual Leave	-	40	-	40
FECA Liabilities	3	14	8	1
Accrued Payroll and Benefits	-	15	-	19
Employer Contributions and Payroll Taxes	8	-	126	-
Custodial Liabilities	-	-	2	-
Total Other Liabilities	**$ 2,633**	**$ 12,366**	**$ 1,822**	**$ 9,683**

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NOTE 10. Gross Cost and Exchange Revenue by Program

Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

	2017				
	FSA	OESE	OSERS	Other	Total
INCREASE COLLEGE ACCESS, QUALITY, AND COMPLETION					
Gross Cost					
Intragovernmental	$ 36,054	$ -	$ -	$ 65	$ 36,119
With the Public	37,717	-	-	4,453	42,170
Total Gross Program Costs	**73,771**	**-**	**-**	**4,518**	**78,289**
Earned Revenue					
Intragovernmental	(5,335)	-	-	(14)	(5,349)
With the Public	(30,490)	-	-	(48)	(30,538)
Total Program Earned Revenue	**(35,825)**	**-**	**-**	**(62)**	**(35,887)**
Net Program Costs	**37,946**	**-**	**-**	**4,456**	**42,402**
IMPROVE PREPARATION FOR COLLEGE AND CAREER FROM BIRTH THROUGH 12TH GRADE, ESPECIALLY FOR CHILDREN WITH HIGH NEEDS					
Gross Cost					
Intragovernmental	-	176	-	-	176
With the Public	-	22,400	-	1	22,401
Total Gross Program Costs	**-**	**22,576**	**-**	**1**	**22,577**
Earned Revenue					
With the Public	-	(10)	-	-	(10)
Total Program Earned Revenue	**-**	**(10)**	**-**	**-**	**(10)**
Net Program Costs	**-**	**22,566**	**-**	**1**	**22,567**
ENSURE EFFECTIVE EDUCATIONAL OPPORTUNITIES FOR ALL STUDENTS					
Gross Cost					
Intragovernmental	-	-	16	36	52
With the Public	-	-	16,370	836	17,206
Total Gross Program Costs	**-**	**-**	**16,386**	**872**	**17,258**
Earned Revenue					
With the Public	-	-	(10)	(1)	(11)
Total Program Earned Revenue	**-**	**-**	**(10)**	**(1)**	**(11)**
Net Program Costs	**-**	**-**	**16,376**	**871**	**17,247**
ENHANCE THE EDUCATION SYSTEM'S ABILITY TO CONTINUOUSLY IMPROVE					
Gross Cost					
Intragovernmental	-	-	-	85	85
With the Public	-	-	-	2,037	2,037
Total Gross Program Costs	**-**	**-**	**-**	**2,122**	**2,122**
Earned Revenue					
With the Public	-	-	-	(59)	(59)
Total Program Earned Revenue	**-**	**-**	**-**	**(59)**	**(59)**
Net Program Costs	**-**	**-**	**-**	**2,063**	**2,063**
Net Cost of Operations	**$ 37,946**	**$ 22,566**	**$ 16,376**	**$ 7,391**	**$ 84,279**

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Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

	2016				
	FSA	OESE	OSERS	Other	Total
INCREASE COLLEGE ACCESS, QUALITY, AND COMPLETION					
Gross Cost					
Intragovernmental	$ 35,692	$ -	$ -	$ 120	$ 35,812
With the Public	57,340	-	-	4,162	61,502
Total Gross Program Costs	**93,032**	**-**	**-**	**4,282**	**97,314**
Earned Revenue					
Intragovernmental	(4,464)	-	-	(6)	(4,470)
With the Public	(29,796)	-	-	(50)	(29,846)
Total Program Earned Revenue	**(34,260)**	**-**	**-**	**(56)**	**(34,316)**
Net Program Costs	**58,772**	**-**	**-**	**4,226**	**62,998**
IMPROVE PREPARATION FOR COLLEGE AND CAREER FROM BIRTH THROUGH 12TH GRADE, ESPECIALLY FOR CHILDREN WITH HIGH NEEDS					
Gross Cost					
Intragovernmental	-	183	-	-	183
With the Public	-	22,179	-	1	22,180
Total Gross Program Costs	**-**	**22,362**	**-**	**1**	**22,363**
Earned Revenue					
Intragovernmental	-	(5)	-	-	(5)
With the Public	-	(11)	-	-	(11)
Total Program Earned Revenue	**-**	**(16)**	**-**	**-**	**(16)**
Net Program Costs	**-**	**22,346**	**-**	**1**	**22,347**
ENSURE EFFECTIVE EDUCATIONAL OPPORTUNITIES FOR ALL STUDENTS					
Gross Cost					
Intragovernmental	-	-	105	35	140
With the Public	-	-	15,973	812	16,785
Total Gross Program Costs	**-**	**-**	**16,078**	**847**	**16,925**
Earned Revenue					
With the Public	-	-	(10)	(1)	(11)
Total Program Earned Revenue	**-**	**-**	**(10)**	**(1)**	**(11)**
Net Program Costs	**-**	**-**	**16,068**	**846**	**16,914**
ENHANCE THE EDUCATION SYSTEM'S ABILITY TO CONTINUOUSLY IMPROVE					
Gross Cost					
Intragovernmental	-	-	-	96	96
With the Public	-	-	-	2,025	2,025
Total Gross Program Costs	**-**	**-**	**-**	**2,121**	**2,121**
Earned Revenue					
With the Public	-	-	-	(58)	(58)
Total Program Earned Revenue	**-**	**-**	**-**	**(58)**	**(58)**
Net Program Costs	**-**	**-**	**-**	**2,063**	**2,063**
Net Cost of Operations	**$ 58,772**	**$ 22,346**	**$ 16,068**	**$ 7,136**	**$ 104,322**

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NOTE 11: Credit Program Interest Expense and Revenues

For the years ended September 30, 2017 and 2016, interest expense and revenues for credit programs consisted of the following:

Credit Program Interest Expense and Revenues
(Dollars in Millions)

	Gross Interest Expense	Subsidy Amortization	Net Interest Expense	Gross Interest and Administrative Fee Revenue		Subsidy Amortization	Net Revenue
	Intragovernmental	With the Public		Intragovernmental	With the Public	With the Public	
2017							
Direct Loan Program	$ 31,286	$ -	$ 31,286	$ 4,258	$ 50,304	$ (23,276)	$ 31,286
FFEL Program	4,661	(1,263)	3,398	1,071	4,234	(1,907)	3,398
Other Credit Programs for Higher Education	69	-	69	20	81	(32)	69
Total	**$ 36,016**	**$ (1,263)**	**$ 34,753**	**$ 5,349**	**$ 54,619**	**$ (25,215)**	**$ 34,753**
2016							
Direct Loan Program	$ 30,503	$ -	$ 30,503	$ 3,943	$ 44,375	$ (17,815)	$ 30,503
FFEL Program	4,980	(1,766)	3,214	516	4,600	(1,902)	3,214
Other Credit Programs for Higher Education	66	-	66	12	79	(25)	66
Total	**$ 35,549**	**$ (1,766)**	**$ 33,783**	**$ 4,471**	**$ 49,054**	**$ (19,742)**	**$ 33,783**

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NOTE 12. Statement of Budgetary Resources

The Statement of Budgetary Resources compares budgetary resources with the status of those resources. As of September 30, 2017, budgetary resources were $398.5 billion and net agency outlays were $152.2 billion. As of September 30, 2016, budgetary resources were $335.0 billion and net agency outlays were $159.6 billion.

NEW OBLIGATIONS INCURRED AND UPWARD ADJUSTMENTS BY APPORTIONMENT TYPE AND CATEGORY

New obligations incurred and upward adjustments by apportionment type and category, as of September 30, 2017 and 2016, consisted of the following:

New Obligations Incurred and Upward Adjustments by Apportionment Type and Category
(Dollars in Millions)

	2017	2016
DIRECT		
Category A	$ 2,186	$ 2,170
Category B	360,781	304,270
Exempt from Apportionment	13	638
Total Direct Apportionment	362,980	307,078
REIMBURSABLE		
Category A	3	3
Category B	55	63
New Obligations Incurred and Upward Adjustments	**$ 363,038**	**$ 307,144**

New obligations incurred and upward adjustments 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. The apportionment categories are determined in accordance with the guidance provided in OMB regulations. Category A apportionments are those resources that can be obligated in the current fiscal year 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.

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UNUSED BORROWING AUTHORITY

Unused borrowing authority and related changes in available borrowing authority, as of September 30, 2017 and 2016, consisted of the following:

Unused Borrowing Authority
(Dollars in Millions)

	2017	2016
Beginning Balance, Unused Borrowing Authority	**$ 60,991**	**$ 54,829**
Current Year Borrowing Authority	166,601	167,400
Funds Drawn from Treasury	(160,763)	(147,376)
Borrowing Authority Withdrawn	(8,128)	(13,862)
Ending Balance, Unused Borrowing Authority	**$ 58,701**	**$ 60,991**

The Department is given authority to draw funds from Treasury to finance the Direct Loan, FFEL, and other loan programs. Unused borrowing authority is a budgetary resource and is available to support obligations for these programs. The Department periodically reviews its borrowing authority balances in relation to its obligations, resulting in the withdrawal of unused amounts.

UNDELIVERED ORDERS AT THE END OF THE PERIOD

Undelivered orders, as of September 30, 2017 and 2016, consisted of the following:

Undelivered Orders
(Dollars in Millions)

	2017	2016
Budgetary	$ 52,390	$ 50,019
Non-Budgetary	75,665	73,366
Undelivered Orders (Unpaid)	**$ 128,055**	**$ 123,385**

Budgetary undelivered orders represent the amount of goods and/or services ordered which have not been actually or constructively received. This amount includes any orders which may have been prepaid or advanced but for which delivery or performance has not yet occurred. Non-budgetary undelivered orders primarily represent undisbursed loan awards and related negative subsidy.

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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 Treasury General Fund receipt accounts for downward current fiscal year executed subsidy re-estimates and negative subsidies. Distributed offsetting receipts, for the years ended September 30, 2017 and 2016, consisted of the following:

Distributed Offsetting Receipts
(Dollars in Millions)

	2017	2016
Negative Subsidies and Downward Re-estimates of Subsidies:		
Direct Loan Program	$ 18,849	$ 7,881
FFEL Program	370	2,529
Facilities Loan Programs	55	18
TEACH Program	-	5
HEAL Program	18	21
Total Negative Subsidies and Downward Re-estimates	19,292	10,454
Other	270	312
Distributed Offsetting Receipts	**$ 19,562**	**$ 10,766**

EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF BUDGETARY RESOURCES AND THE *BUDGET OF THE UNITED STATES GOVERNMENT*

The FY 2019 *Budget of the United States Government* (President's Budget), which presents the actual amounts for the year ended September 30, 2017, has not been published as of the issue date of these financial statements. The FY 2019 President's Budget is scheduled for release in February 2018. A reconciliation of the FY 2016 SBR to the FY 2018 President's Budget (FY 2016 actual amounts) for budgetary resources, obligations incurred, distributed offsetting receipts, and net outlays is presented below.

SBR to *Budget of the United States Government*
(Dollars in Millions)

	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Combined Statement of Budgetary Resources	**$ 335,015**	**$ 307,144**	**$ 10,766**	**$ 159,629**
Expired Funds	(1,339)	(433)	-	-
FFEL Guaranty Agency Amounts Included in the President's Budget	8,332	8,333	-	-
Distributed Offsetting Receipts	-	-	-	10,766
Other	8	-	(2)	(4)
Budget of the United States Government[1]	**$ 342,016**	**$ 315,044**	**$ 10,764**	**$ 170,391**

[1] Amounts obtained from the Appendix, *Budget of the United States Government*, FY 2018

Reconciling differences exist because the President's Budget excludes expired funds. Additionally, 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 fund of the guaranty agencies. Ownership by the federal government is independent of the actual control of the assets. Since the actual operation of the federal fund is independent from the Department's direct control, budgetary resources and obligations incurred are estimated and disclosed in the President's Budget to approximate the gross activities of the combined federal fund. Amounts reported on the FY 2016 SBR for the federal fund are compiled by combining all guaranty agencies' annual reports to determine a net valuation amount for the federal fund.

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NOTE 13. Reconciliation of Net Cost of Operations to Budget

The reconciliation of net cost of operations to budget reconciles the resources used to finance activities, both those received through budgetary resources and those received through other means, with the net cost of operations on the statement of net cost. This reconciliation provides an explanation of the differences between budgetary and financial (proprietary) accounting, as required by FASAB Standard No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.

Resources used to finance activities (section one) are reconciled with the net cost of operations by: (a) excluding resources used or generated for items not part of the net cost of operations (section two); and (b) including components of the net cost of operations that will not require or generate resources in the current period (section three). The primary resources used to finance activities that do not fund the net cost of operations include the acquisition of net credit program assets, the liquidation of liabilities for loan guarantees, and subsidy re-estimates accrued in the prior period. Significant components of the net cost of operations that will not generate or use resources in the current period include subsidy amortization, interest on the liability for loan guarantees, and increases in exchange revenue receivable from the public.

The reconciliation of net cost of operations to budget, as of September 30, 2017 and 2016, is presented below:

Reconciliation of Net Cost of Operations to Budget
(Dollars in Millions)

	2017	2016
RESOURCES USED TO FINANCE ACTIVITIES		
New Obligations Incurred and Upward Adjustments	$ 363,038	$ 307,144
Spending Authority from Offsetting Collections & Recoveries	(186,509)	(136,094)
Offsetting Receipts	(19,562)	(10,766)
Net Budgetary Resources Obligated	**156,967**	**160,284**
Imputed Financing From Costs Absorbed by Others	27	81
Other Financing Sources	(25,461)	(5,124)
Net Other Resources	**(25,434)**	**(5,043)**
Net Resources Used to Finance Activities	**131,533**	**155,241**
RESOURCES USED OR GENERATED FOR ITEMS NOT PART OF THE NET COST OF OPERATIONS		
(Increase)/Decrease in Budgetary Resources Obligated but Not Yet Provided	(3,777)	1,763
Resources that Fund Subsidy Re-estimates Accrued in Prior Period	(28,006)	(2,598)
Credit Program Collections	142,011	92,080
Acquisition of Fixed Assets	(10)	(11)
Acquisition of Net Credit Program Assets or Liquidation of Liabilities for Loan Guarantees	(171,770)	(161,826)
Resources from Non-Entity Activity	25,476	5,196
Net Resources That Do Not Finance the Net Cost of Operations	**(36,076)**	**(65,396)**
Net Resources Used to Finance the Net Cost of Operations	**95,457**	**89,845**
COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Change in Depreciation	1	-
Subsidy Amortization and Interest on the Liability for Loan Guarantees	23,953	17,977
Other	2	22
Total Components Not Requiring or Generating Resources	**23,956**	**17,999**
Increase/(Decrease) in Annual Leave Liability	-	2
Accrued Re-estimates of Credit Subsidy Expense	134	28,006
Increase in Exchange Revenue Receivable from the Public	(35,155)	(31,611)
Accrued Interest with Treasury	1	1
Other (+/-)	(114)	80
Total Components Requiring or Generating Resources in Future Periods	**(35,134)**	**(3,522)**
Total Components That Will Not Require or Generate Resources in the Current Period	**(11,178)**	**14,477**
Net Cost of Operations	**$ 84,279**	**$ 104,322**

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NOTE 14. Commitments and Contingencies

The Department discloses contingencies where any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred in accordance with FASAB Standard No. 5, Accounting for Liabilities of the Federal Government. The following commitments are amounts for contractual arrangements that may require future financial obligations.

FUTURE MINIMUM LEASE PAYMENTS

The Department leases all or a portion of 16 privately owned and 10 publicly owned buildings in 20 cities. Estimated future minimum lease payments for the privately and publicly owned buildings are presented below.

Future Minimum Lease Payments
(Dollars in Millions)

2017		2016	
FY	Amount	FY	Amount
2018	$ 73	2017	$ 74
2019	77	2018	78
2020	79	2019	80
2021	81	2020	83
2022	85	2021	85
After 2022	86	After 2021	86
Total	**$ 481**	**Total**	**$ 486**

GUARANTY AGENCIES

The Department may assist guaranty agencies experiencing financial difficulties. The Department has not done so in fiscal years 2017 or 2016 and does not expect to in future years. No provision has been made in the financial statements for potential liabilities.

FEDERAL PERKINS LOAN PROGRAM

The Federal Perkins Loan program provides financial assistance to eligible postsecondary school students. In FY 2017, the Department provided funding of 83.1 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 16.9 percent of program funding. For the latest academic year that ended June 30, 2017, approximately 356 thousand loans were made totaling $885.4 million at 1,266 institutions, making an average of $2,488 per loan. The Department's equity interest was approximately $6.3 billion as of June 30, 2017.

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.

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The Federal Perkins Loan program was scheduled to officially end on September 30, 2015. However, the program was extended through September 30, 2017 by the *Federal Perkins Loan Program Extension Act of 2015* (Extension Act). The Extension Act eliminated the Perkins Loan grandfathering provisions that the Department had put in place, and establishes new eligibility requirements for undergraduate and graduate students to receive Perkins Loans. As of September 30, 2017, the Department is no longer authorized to make new Perkins Loans.

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 impact on the Department's financial position.

The cost of loan forgiveness related to borrower defense claims resulting from proprietary school closures reflected in the accompanying financial statements is limited to claims received through September 30, 2017. The final disposition of claims filed and those yet to be filed from schools closed before September 30, 2017, is not expected to have a material impact on these financial statements

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.

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United States Department of Education Combining Statement of Budgetary Resources
For the Year Ended September 30, 2017
(Dollars in Millions)

	Combined	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1	$ 12,392	$ 15,479
Recoveries of Prior Year Unpaid Obligations	4,781	13,356
Other Changes in Unobligated Balance (+ or -)	(456)	(18,277)
Unobligated Balance from Prior Year Budget Authority, Net	$ 16,717	$ 10,558
Appropriations (Discretionary and Mandatory)	134,388	-
Borrowing Authority (Discretionary and Mandatory) (Note 12)	-	166,601
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	1,096	69,169
Total Budgetary Resources	**$ 152,201**	**$ 246,328**
STATUS OF BUDGETARY RESOURCES		
New Obligations Incurred and Upward Adjustments (Total) (Note 12)	$ 139,923	$ 223,115
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	9,012	-
Unapportioned, Unexpired Accounts	2,100	23,213
Unexpired Unobligated Balance, End of Year	**$ 11,112**	**$ 23,213**
Expired Unobligated Balance, End of Year	1,166	-
Unobligated Balance, End of Year (Total)	**$ 12,278**	**$ 23,213**
Total Status of Budgetary Resources	**$ 152,201**	**$ 246,328**
CHANGE IN OBLIGATED BALANCE		
Unpaid Obligations		
Unpaid Obligations, Brought Forward, October 1	$ 54,249	$ 76,624
New Obligations Incurred and Upward Adjustments	139,923	223,115
Outlays (Gross) (-)	(132,553)	(207,402)
Recoveries of Prior Year Unpaid Obligations (-)	(4,781)	(13,356)
Unpaid Obligations, End of Year	**$ 56,838**	**$ 78,981**
Uncollected Payments		
Uncollected Payments, Federal Sources, Brought Forward, October 1 (-)	$ (2)	$ (4)
Change in Uncollected Payments, Federal Sources (+ or -)	-	(588)
Uncollected Payments, Federal Sources, End of Year (-)	$ (2)	$ (592)
Memorandum (Non-Add) Entries		
Obligated Balance, Start of Year (+ or -)	**$ 54,247**	**$ 76,620**
Obligated Balance, End of Year (+ or -)	**$ 56,836**	**$ 78,389**
BUDGET AUTHORITY AND OUTLAYS, NET		
Budget Authority, Gross (Discretionary and Mandatory)	$ 135,484	$ 235,770
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(1,279)	(166,942)
Change in Uncollected Payments from Federal Sources (Discretionary and Mandatory) (+ or -)	-	(588)
Recoveries of Prior Year Paid Obligations (Discretionary and Mandatory) (+ or -)	(1)	(439)
Budget Authority, Net (Discretionary and Mandatory)	**$ 134,204**	**$ 67,801**
Outlays, Gross (Discretionary and Mandatory)	$ 132,553	$ 207,402
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(1,279)	(166,942)
Outlays, Net (Discretionary and Mandatory)	131,274	40,460
Distributed Offsetting Receipts (-) (Note 12)	(19,562)	-
Agency Outlays, Net (Discretionary and Mandatory) (Note 12)	**$ 111,712**	**$ 40,460**

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Federal Student Aid		Office of Elementary and Secondary Education	Office of Special Education and Rehabilitative Services	Other		Total
Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Budgetary	Budgetary	Non-Budgetary Credit Reform Financing Accounts	
$ 10,384	$ 15,303	$ 913	$ 161	$ 934	$ 176	$ 27,871
3,919	13,356	454	233	175	-	18,137
(239)	(18,270)	(55)	(64)	(98)	(7)	(18,733)
$ 14,064	$ 10,389	$ 1,312	$ 330	$ 1,011	$ 169	$ 27,275
88,321	-	22,197	16,582	7,288	-	134,388
-	166,426	-	-	-	175	166,601
1,037	68,906	-	-	59	263	70,265
$ 103,422	**$ 245,721**	**$ 23,509**	**$ 16,912**	**$ 8,358**	**$ 607**	**$ 398,529**
$ 92,308	$ 222,838	$ 23,304	$ 16,601	$ 7,710	$ 277	$ 363,038
8,595	-	144	2	271	-	9,012
2,093	22,883	-	-	7	330	25,313
$ 10,688	**$ 22,883**	**$ 144**	**$ 2**	**$ 278**	**$ 330**	**$ 34,325**
426	-	61	309	370	-	1,166
$ 11,114	**$ 22,883**	**$ 205**	**$ 311**	**$ 648**	**$ 330**	**$ 35,491**
$ 103,422	**$ 245,721**	**$ 23,509**	**$ 16,912**	**$ 8,358**	**$ 607**	**$ 398,529**
$ 20,216	$ 76,389	$ 15,314	$ 9,328	$ 9,391	$ 235	$ 130,873
92,308	222,838	23,304	16,601	7,710	277	363,038
(86,205)	(207,131)	(22,505)	(16,233)	(7,610)	(271)	(339,955)
(3,919)	(13,356)	(454)	(233)	(175)	-	(18,137)
$ 22,400	**$ 78,740**	**$ 15,659**	**$ 9,463**	**$ 9,316**	**$ 241**	**$ 135,819**
$ -	$ (4)	$ -	$ -	$ (2)	$ -	$ (6)
-	(588)	-	-	-	-	(588)
$ -	$ (592)	$ -	$ -	$ (2)	$ -	$ (594)
$ 20,216	**$ 76,385**	**$ 15,314**	**$ 9,328**	**$ 9,389**	**$ 235**	**$ 130,867**
$ 22,400	**$ 78,148**	**$ 15,659**	**$ 9,463**	**$ 9,314**	**$ 241**	**$ 135,225**
$ 89,358	$ 235,332	$ 22,197	$ 16,582	$ 7,347	$ 438	$ 371,254
(1,219)	(166,641)	-	-	(60)	(301)	(168,221)
-	(588)	-	-	-	-	(588)
(1)	(439)	-	-	-	-	(440)
$ 88,138	**$ 67,664**	**$ 22,197**	**$ 16,582**	**$ 7,287**	**$ 137**	**$ 202,005**
$ 86,205	$ 207,131	$ 22,505	$ 16,233	$ 7,610	$ 271	$ 339,955
(1,219)	(166,641)	-	-	(60)	(301)	(168,221)
84,986	40,490	22,505	16,233	7,550	(30)	171,734
(19,438)	-	-	-	(124)	-	(19,562)
$ 65,548	**$ 40,490**	**$ 22,505**	**$ 16,233**	**$ 7,426**	**$ (30)**	**$ 152,172**

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United States Department of Education Combining Statement of Budgetary Resources
For the Year Ended September 30, 2016
(Dollars in Millions)

	Combined	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1	$ 14,774	$ 14,437
Recoveries of Prior Year Unpaid Obligations	746	21,047
Other Changes in Unobligated Balance (+ or -)	(772)	(24,695)
Unobligated Balance from Prior Year Budget Authority, Net	$ 14,748	$ 10,789
Appropriations (Discretionary and Mandatory)	87,924	24
Borrowing Authority (Discretionary and Mandatory) (Note 12)	-	167,400
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	522	53,608
Total Budgetary Resources	**$ 103,194**	**$ 231,821**
STATUS OF BUDGETARY RESOURCES		
New Obligations Incurred and Upward Adjustments (Total) (Note 12)	$ 90,802	$ 216,342
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	10,280	-
Unapportioned, Unexpired Accounts	1,212	15,479
Unexpired Unobligated Balance, End of Year	**$ 11,492**	**$ 15,479**
Expired Unobligated Balance, End of Year	900	-
Unobligated Balance, End of Year (Total)	**$ 12,392**	**$ 15,479**
Total Status of Budgetary Resources	**$ 103,194**	**$ 231,821**
CHANGE IN OBLIGATED BALANCE		
Unpaid Obligations		
Unpaid Obligations, Brought Forward, October 1	$ 52,645	$ 78,116
New Obligations Incurred and Upward Adjustments	90,802	216,342
Outlays (Gross) (-)	(88,452)	(196,787)
Recoveries of Prior Year Unpaid Obligations (-)	(746)	(21,047)
Unpaid Obligations, End of Year	**$ 54,249**	**$ 76,624**
Uncollected Payments		
Uncollected Payments, Federal Sources, Brought Forward, October 1 (-)	$ (3)	$ (26)
Change in Uncollected Payments, Federal Sources (+ or -)	1	22
Uncollected Payments, Federal Sources, End of Year (-)	$ (2)	$ (4)
Memorandum (Non-Add) Entries		
Obligated Balance, Start of Year (+ or -)	**$ 52,642**	**$ 78,090**
Obligated Balance, End of Year (+ or -)	**$ 54,247**	**$ 76,620**
BUDGET AUTHORITY AND OUTLAYS, NET		
Budget Authority, Gross (Discretionary and Mandatory)	$ 88,446	$ 221,032
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(721)	(114,123)
Change in Uncollected Payments from Federal Sources (Discretionary and Mandatory) (+ or -)	1	22
Recoveries of Prior Year Paid Obligations (Discretionary and Mandatory) (+ or -)	(1)	(516)
Budget Authority, Net (Discretionary and Mandatory)	**$ 87,725**	**$ 106,415**
Outlays, Gross (Discretionary and Mandatory)	$ 88,452	$ 196,787
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(721)	(114,123)
Outlays, Net (Discretionary and Mandatory)	87,731	82,664
Distributed Offsetting Receipts (-) (Note 12)	(10,766)	-
Agency Outlays, Net (Discretionary and Mandatory) (Note 12)	**$ 76,965**	**$ 82,664**

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Federal Student Aid		Office of Elementary and Secondary Education	Office of Special Education and Rehabilitative Services	Other		Total
Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Budgetary	Budgetary	Non-Budgetary Credit Reform Financing Accounts	
$ 12,719	$ 14,236	$ 800	$ 273	$ 982	$ 201	$ 29,211
188	21,047	368	88	102	-	21,793
(374)	(24,687)	(87)	(153)	(158)	(8)	(25,467)
$ 12,533	$ 10,596	$ 1,081	$ 208	$ 926	$ 193	$ 25,537
41,948	24	22,145	16,493	7,338	-	87,948
-	167,272	-	-	-	128	167,400
470	53,563	3	-	49	45	54,130
$ 54,951	**$ 231,455**	**$ 23,229**	**$ 16,701**	**$ 8,313**	**$ 366**	**$ 335,015**
$ 44,567	$ 216,152	$ 22,316	$ 16,540	$ 7,379	$ 190	$ 307,144
8,782	-	846	-	652	-	10,280
1,212	15,303	-	-	-	176	16,691
$ 9,994	**$ 15,303**	**$ 846**	**$ -**	**$ 652**	**$ 176**	**$ 26,971**
390	-	67	161	282	-	900
$ 10,384	**$ 15,303**	**$ 913**	**$ 161**	**$ 934**	**$ 176**	**$ 27,871**
$ 54,951	**$ 231,455**	**$ 23,229**	**$ 16,701**	**$ 8,313**	**$ 366**	**$ 335,015**
$ 19,286	$ 77,880	$ 14,950	$ 8,835	$ 9,574	$ 236	$ 130,761
44,567	216,152	22,316	16,540	7,379	190	307,144
(43,449)	(196,596)	(21,584)	(15,959)	(7,460)	(191)	(285,239)
(188)	(21,047)	(368)	(88)	(102)	-	(21,793)
$ 20,216	**$ 76,389**	**$ 15,314**	**$ 9,328**	**$ 9,391**	**$ 235**	**$ 130,873**
$ -	$ (4)	$ -	$ -	$ (3)	$ (22)	$ (29)
-	-	-	-	1	22	23
$ -	$ (4)	$ -	$ -	$ (2)	$ -	$ (6)
$ 19,286	**$ 77,876**	**$ 14,950**	**$ 8,835**	**$ 9,571**	**$ 214**	**$ 130,732**
$ 20,216	**$ 76,385**	**$ 15,314**	**$ 9,328**	**$ 9,389**	**$ 235**	**$ 130,867**
$ 42,418	$ 220,859	$ 22,148	$ 16,493	$ 7,387	$ 173	$ 309,478
(653)	(113,986)	-	-	(68)	(137)	(114,844)
-	-	-	-	1	22	23
(1)	(516)	-	-	-	-	(517)
$ 41,764	**$ 106,357**	**$ 22,148**	**$ 16,493**	**$ 7,320**	**$ 58**	**$ 194,140**
$ 43,449	$ 196,596	$ 21,584	$ 15,959	$ 7,460	$ 191	$ 285,239
(653)	(113,986)	-	-	(68)	(137)	(114,844)
42,796	82,610	21,584	15,959	7,392	54	170,395
(10,684)	-	-	-	(82)	-	(10,766)
$ 32,112	**$ 82,610**	**$ 21,584**	**$ 15,959**	**$ 7,310**	**$ 54**	**$ 159,629**

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REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

OMB requires each federal agency to report on its stewardship over various resources entrusted to it and certain responsibilities assumed by it that cannot be measured and conveyed through traditional financial reports. These elements do not meet the criteria for assets and liabilities required in the preparation of the Department's financial statements and accompanying footnotes, but are nonetheless important to understanding the agency's financial condition, strategic goals, and related program outcomes.

STEWARDSHIP EXPENSES

Stewardship expenses are substantial investments made by the federal government for the long-term benefit of the nation. Because costs of stewardship resources are treated as expenses in the financial statements in the year the costs are incurred, they are reported as Required Supplementary Stewardship Information to highlight their benefit and to demonstrate accountability for their use.

In the United States, the structure of education finance is such that state and local governments play a much greater overall role than the federal government. Of the estimated more than $1 trillion spent nationally on all levels of education, the majority of funding comes from state, local, and private sources. In the area of elementary and secondary education, nearly 90 percent of resources come from nonfederal sources. These funds serve over 50 million students enrolled in public, private, and charter schools in the United States and its territories, according to the National Center for Education Statistics. **See the National Center for Education Statistics Condition of Education** for more information.

With its relatively small role in total education funding, the Department strives to create the greatest number of favorable program outcomes with a limited amount of taxpayer-provided resources. This is accomplished by targeting areas in which funds will go the furthest in doing the most good. Accordingly, federal funding is used to provide grant, loan, loan-forgiveness, work-study, and other assistance to more than 20 million postsecondary students. The majority of the Department's $340.0 billion in gross outlays during FY 2017 was attributable to Direct Loan disbursements administered by FSA. Grant-based activity under discretionary, formula, and need-based formats primarily accounted for the remainder of the outlays.

Discretionary grants, such as the Federal TRIO Programs and the Teacher Incentive Fund, are awarded on a competitive basis. When funds for these grants are exhausted, they cease to be funded. The Department reviews discretionary grant applications using:

- a formal review process for selection,
- both legislative and regulatory requirements, and
- published selection criteria established for individual programs.

Formula grants, such as Title I and Title III of the *Elementary and Secondary Education Act*, are not competitive. The majority go to school districts, as often as annually, on a formula basis, and they:

- provide funds as dictated by a law and
- allocate funds to districts on a per-student basis.

Need-based grants, including the Pell Grant, Federal Work Study, and the Federal Supplemental Educational Opportunity Grant, are based on family income and economic eligibility. While there are many state, institutionally (college or school), and privately sourced need-based grants, most need-based grants are funded by the federal government where the financial aid formula is determined by a combination of factors, including:

- family income and discretionary assets,
- expected family contribution, and
- dependency status of the student and other members of their family.

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Further details on financial figures and program-level goals can be viewed in the Department's ***2017 Budget Summary***.

INVESTMENT IN HUMAN CAPITAL

Human capital investments are defined similarly by OMB, in Circular A-136, and the Statement of Federal Financial Accounting Standards No. 8, *Supplementary Stewardship Reporting*. These investments are expenses included in net cost for education and training programs intended to increase or maintain national economic productive capacity and produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity.

Supplementing state and local government funding, the Department utilizes its annual appropriations and outlay authority to foster human capital improvements across the nation by supporting programs along the entire spectrum of education. Direct Loans, guaranteed loans, grants, and technical program assistance are administered and monitored by FSA and numerous other program-aimed components of the Department. The Institute of Education Sciences is the independent nonpartisan research arm of the Department that aims to present scientific evidence on which to ground education practice and policy while providing useful information to all stakeholders in the arena of American education. Further details of the major offices/programs applicable to this section are described below:

Federal Student Aid. Federal Student Aid is the part of the Department that administers need-based financial assistance programs for students pursuing postsecondary education and makes federal grants, direct loans, guaranteed loans and work-study funding available to eligible undergraduate and graduate students.

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

Direct Loan Subsidy. The William D. Ford Federal Direct Loan (Direct Loan) program is a direct-lending program in which loan capital is provided to students by the federal government through borrowings from the United States (U.S.) Department of Treasury.

Federal Family Education Loan (FFEL) Program Subsidy. The FFEL Loan program has originated no new loans since June 30, 2010; however, its permanent budget authority allows it to continue to operate with state and private nonprofit guaranty agencies to honor loan guarantees and for the Department to pay interest supplements on outstanding loans by private lenders to eligible students. The FFEL Loan program expenses include the Loan Participation Purchase, Loan Purchase Commitment, and ABCP Conduit expenses.

Perkins Loans, Pell and Other Grants. Perkins Loan and Grant programs include the Pell Grant program that awards direct grants through participating institutions to undergraduate students with financial need. Participating institutions either credit the appropriated funds to the student's school account or pay the student directly once per term.

The Teacher Education Assistance for College and Higher Education (TEACH) Grant Program. The TEACH Grant program awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students. If the students do not satisfy their agreement to serve, the grants are converted to Direct Unsubsidized Loans. The President's Budget proposes to overhaul the TEACH Grant program, and replace it with a new, targeted teacher recruitment and retention program called the Presidential Teaching Fellows. This new program would provide grants to states that meet certain conditions to supply scholarships of up to $10,000 to talented individuals attending the most effective programs in the state. These individuals would commit to teaching for at least three years in a high-need school and subject. To be eligible for funds, states would measure the effectiveness of their teacher preparation programs based on the student achievement data of their graduates among other measures; hold teacher preparation programs accountable for results; and upgrade licensure and certification standards.

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Office of Elementary and Secondary Education (OESE). OESE promotes academic excellence, enhances educational opportunities and equity for all of America's children and families, and improves quality of teaching and learning by providing leadership, technical assistance and financial support.

Office of Special Education and Rehabilitative Services (OSERS). OSERS is committed to the broad values of Inclusion, Equity and Opportunity for infants, toddlers, children, youth, and adults with disabilities to actively participate in all aspects of life. OSERS promotes inclusion, ensures equity and creates opportunity as it strives to improve results and outcomes for children and adults with disabilities. By providing funding to programs that serve infants, toddlers, children, and adults with disabilities, OSERS works to ensure that these individuals are fully included in school, in employment, and in life. OSERS also provides funds to programs that offer information and technical assistance to parents of infants, toddlers and children with disabilities, as well as members of the learning community who serve these individuals.

The following table illustrates the Department's expenses paid for bolstering the nation's human capital, broken out by the nature of the expense, for the last five years.

PROGRAM OUTCOMES

Favorable results in the various programs administered by the Department can be interpreted in many ways. Accordingly, the effectiveness of the Department's investments in human capital can be gauged by changes in the number of students who fully complete the requirements for earning a bachelor's or associate's degree. This often final stepping stone in one's educational career correlates strongly with wage and/or salary increases due to the high-level skills expected by employers of graduates entering the labor force. Attaining a degree has proven to increase an individual's job opportunity outlook for life, making them less susceptible to general economic downturns and allowing them to afford living expenses more comfortably; make debt payments, including student loans; and avoid delinquency and credit problems. Increased employability makes Americans more competitive in the global labor market, yielding lower unemployment, higher economic well-being, and greater national security.

One important method used in the area of analyzing student loan programs, borrower activity, and institution participation is the monitoring of default statistics. Each year, substantial stewardship expenses incurred

Table 2. Summary of Human Capital Expenses
(Dollars in Millions)

	2017	2016	2015	2014	2013
FEDERAL STUDENT AID EXPENSE					
Direct Loan Subsidy	$ 5,329	$ 16,119	$ (892)	$ 8,126	$ (39,557)
Federal Family Education Loan Program Subsidy	3,411	10,234	(3,856)	(6,585)	(8,753)
Perkins Loans, Pell and Other Grants	28,770	30,671	31,400	33,098	33,542
Program Operational Costs	224	308	242	206	222
Subtotal	**37,734**	**57,332**	**26,894**	**34,845**	**(14,546)**
DEPARTMENTAL PROGRAMS					
Elementary and Secondary Education	22,420	22,155	22,146	22,832	22,221
Special Education and Rehabilitative Services	16,294	15,944	15,751	15,948	15,919
American Recovery and Reinvestment Act and Education Jobs Fund	-	-	-	-	2,623
Other Departmental Programs	6,565	6,349	6,494	6,938	6,175
Program Operational Costs	419	625	511	667	703
Subtotal	**45,698**	**45,073**	**44,902**	**46,385**	**47,641**
Grand Total	**$ 83,432**	**$ 102,405**	**$ 71,796**	**$ 81,230**	**$ 33,095**

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Figure 13. Federal Student Aid Investments in Human Capital, FY 2017

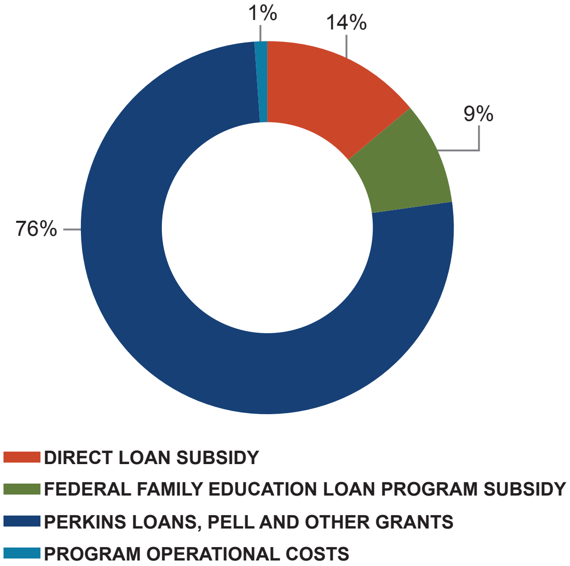
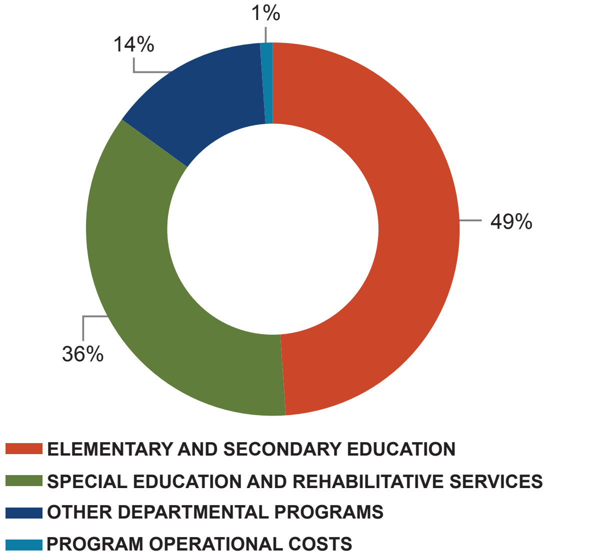


Figure 14. Departmental Program Investments in Human Capital, FY 2017



by the Department are aimed at lowering the number of defaulted loans, defaulted borrowers, and disbursed dollars going into default. This is done because every default—when a loan payment is missed for multiple months—results in loan funds that are not replenished, missed opportunities to invest in other degree-seeking human capital and additional resources used by the government in attempting to collect its money. Each aspect of a default costs American taxpayers, affects the federal budget, decreases economic well-being, and harms borrowers' credit scores.

Although a direct and proven linkage does not exist between the two variables, the Department feels strongly about its ability to mitigate the risk of default through various efforts. Stewardship expenses for this postsecondary goal include those incurred to increase borrower awareness of repayment options, encouraging third-party loan servicers to work more effectively in helping students avoid default by devising viable repayment plans, and by working with financial aid offices around the country to help them improve the loan counseling provided to students who have yet to graduate or enter repayment.

Default statistics for the FY 2014 cohort of borrowers entering repayment were released at the end of FY 2017. Of the 5.0 million borrowers entering repayment from October 1, 2013, to September 30, 2014, 581,000 defaulted on their loan before September 30, 2016. This borrower default rate of 11.5 percent across all institution types showed an increase from the prior year rate of 11.3 percent for the 2013 cohort. It is important to note that this metric is unadjusted for loan program facets, such as consolidations and forbearance.

Trends in default rates, among other indicating metrics monitored at the Department, continue to support proof of favorable outcomes within programs at all levels.

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REPORT OF THE INDEPENDENT AUDITORS

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 13, 2017

The Honorable Betsy DeVos
Secretary of Education
Washington, D.C. 20202

Dear Secretary DeVos:

The enclosed report presents the results of the audit of the U.S. Department of Education's (Department) financial statements for fiscal years 2017 and 2016 to comply with the Chief Financial Officers Act of 1990, as amended. The report 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, 2017 and 2016, and for the years 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 years 2017 and 2016 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:
  - Controls over the Department's Modeling Activities Need Improvement, and
  - Department and Federal Student Aid Management Need to Mitigate Persistent Information Technology Control Deficiencies; and
- One instance of reportable noncompliance with Federal law related to referring delinquent student loan debts to Treasury.

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

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Page 2 – The Honorable Betsy DeVos

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.

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 comply with the Federal Financial Management Improvement Act of 1996, or on compliance with certain provisions of laws, regulations, contracts, and grant agreements.

CliftonLarsonAllen is responsible for the enclosed independent auditors' report and the conclusions expressed on internal control and compliance. 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 report, please contact me at (202) 245-6900.

Sincerely,

Kathleen S. Tighe
Inspector General

Enclosure

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CliftonLarsonAllen LLP

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INDEPENDENT AUDITORS' REPORT

Inspector General
United States Department of Education

Secretary
United States Department of Education

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the United States Department of Education (Department), which comprise the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the years then ended, and the related notes to the consolidated financial statements (financial statements).

Management's Responsibility for the Financial Statements

The Department's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America (U.S.); this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the U.S.; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 17-03*, Audit Requirements for Federal Financial Statements* (OMB Bulletin 17-03). Those standards and OMB Bulletin 17-03 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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INDEPENDENT AUDITORS' REPORT (Continued)

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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the United States Department of Education as of September 30, 2017 and 2016, and its net costs, changes in net position, and budgetary resources for the years 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 information in the Management's Discussion and Analysis (MD&A), Required Supplementary Information (RSI), and Required Supplementary Stewardship Information (RSSI), included in the U.S. Department of Education's FY 2017 Agency Financial Report, 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, 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, RSI, and RSSI 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 audits of the financial statements. We do not express an opinion or provide any assurance on this information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information
Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The Message from the Secretary, Message from the Chief Financial Officer, Other Information, and Appendices in the U.S. Department of Education FY 2017 Agency Financial Report are presented for purposes of additional analysis and are not a required part of the financial statements or RSI. In addition, management has included references to information on websites or other data outside of the Agency Financial Report. This information has not been subjected to the auditing procedures applied in the audits of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

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INDEPENDENT AUDITORS' REPORT (Continued)

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

Internal Control over Financial Reporting

In planning and performing our audit of the consolidated 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 statement of 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 more detail in Exhibit A, which we consider to be significant deficiencies.

<u>Controls over the Department's Modeling Activities Need Improvement</u>

The Department maintains various models that apply mathematical techniques or statistical methods to historical student loan event data to estimate future loan performance and calculate the cost or value of the various student loan programs on a present value basis. In FY2016, we identified deficiencies in the controls over, and documentation of, the Department's processes for model design and development, risk assessment, model operation and validation, and oversight. We also identified certain deficiencies in the Department's modeling for income-driven repayment (IDR) loans.

In FY2017, the Department implemented corrective actions to improve its controls over modeling activities, including the enhancement of the scope and responsibilities of the Credit Reform Working Group, the development of a model inventory and preliminary risk assessment. However, the Department's FY2017 model validation procedures identified potential areas for model enhancements that require additional analysis. The Department does not have a formal structure to capture and track these issues identified in their model risk assessment document.

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INDEPENDENT AUDITORS' REPORT (Continued)

The Department also made a number of technical model revisions to address findings identified by the Government Accountability Office in FY2016, but corrective actions for certain other issues, including income imputation for IDR loans, are still in process.

They also initiated other corrective actions that have not yet been completed, including the development of policies and procedures for model development, operation and validation, and performance of an independent validation of the Student Loan Model. These remaining issues could impact the reliability of the subsidy estimates used for financial reporting, budgetary formulation and management analysis.

Department and Federal Student Aid Management Need to Mitigate Persistent Information Technology Control Deficiencies

The Department oversees a large portfolio of Department-owned and contractor-owned business systems and applications that requires an effective and comprehensive information system security program. Prior audits have identified numerous control deficiencies at the Department, Federal Student Aid (FSA), and application level. This year, the Department made substantial progress in completing entity-wide information security policies and procedures and addressing general application control deficiencies for the Department's core financial management system. However, we continued to identify control deficiencies in the Department's information security program relating to personnel management and compliance monitoring. We also found configuration management weaknesses in the Department's general network and core financial management system. Furthermore, we continued to identify general control deficiencies in FSA's financial applications. These deficiencies increase the risk of unauthorized access to the Department's systems used to capture, process, and report financial transactions and balances, affecting the reliability and security of its data and information.

Compliance

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, regulations, contracts, and grant agreements consistent with our professional responsibilities discussed below.

The results of our tests, exclusive of those discussed in the second paragraph below, disclosed one instance of noncompliance, described below and in Exhibit B, which is required to be reported in accordance with *Government Auditing Standards* and OMB Bulletin 17-03.

As of September 30, 2017, FSA is not in compliance with the legal requirement for referring 120 day delinquent student loan debts to Treasury. In 2014, Federal law[1] was amended[2] to require agencies to notify the Secretary of the Treasury of valid, delinquent nontax debts that are over 120 days delinquent – 60 days earlier than

[1] 31 U.S. Code Section 3716(c)(6)
[2] Public Law 113-101 (DATA Act) Section 5

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INDEPENDENT AUDITORS' REPORT (Continued)

the previous 180 days requirement – for the purpose of administrative offset (i.e. collection through the reduction of future Federal payments). Due to the number of entities and systems involved in handling student loan debts, FSA is not yet capable of meeting this accelerated timeline.

We also performed tests of compliance with certain provisions of the Federal Financial Management Improvement Act (FFMIA). However, providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of these provisions disclosed no instances in which the Department's financial management systems did not substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, or (3) the USSGL at the transaction level.

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) complying with other applicable laws, regulations, contracts, and grant agreements.

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, and (3) testing compliance with certain provisions of laws, regulations, contracts and grant agreements.

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.

We did not test compliance with all laws, regulations, contracts and grant agreements applicable to the Department. We limited our tests to certain provisions of laws, regulations, contracts and grant agreements noncompliance with which could have a direct effect on the determination of material financial statement amounts and disclosures. 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. We caution that noncompliance 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.

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INDEPENDENT AUDITORS' REPORT (Continued)

Management's Response to Findings

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

Status of Prior Year's Control Deficiency and Noncompliance Issue

We have reviewed the status of the Department's corrective actions with respect to the findings included in the prior year's Independent Auditors' Report, dated November 14, 2016. The status of prior year findings is presented in Exhibit D.

Purpose of the Report on Internal Control over Financial Reporting and on Compliance

The purpose of the Report on Internal Control over Financial Reporting and on Compliance 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

CliftonLarsonAllen LLP

Arlington, Virginia
November 13, 2017

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

Controls over the Department's Modeling Activities Need Improvement

The Department does not have a fully developed framework for model risk management and governance, or fully developed internal controls over its critical modeling activities, including model development, risk assessment, operation, and validation.

The Cost Estimation and Analysis Division (CEAD), a component of the Department's Office of Planning, Evaluation and Policy Development, is responsible for developing estimates of the subsidy cost of the Department's direct and guaranteed loan programs. These estimates are used to support budget estimates, policy decisions and financial reporting. CEAD has developed a set of complex financial and economic models that apply mathematical techniques and statistical methods to historical loan level data to develop student loan program performance assumptions and estimate the value and cost of the Department's various loan programs. These models also support management's estimate of the net present value of cash flows related to nearly $1.4 trillion in direct, defaulted, and guaranteed student loans as of September 30, 2017.

An effective control structure is generally defined through appropriately documented, approved, and implemented policies and procedures that outline requirements for ensuring all modeling and related control activities are performed and documented in accordance with the intent of management. A proper governance structure involves input from program management and multiple layers of review, approval, and oversight from CEAD management, the Department and FSA Offices of the Chief Financial Officer, and senior agency management over modeling activities. Our audit identified the following:

Model development
The Department does not have a formalized process for managing critical model development and configuration management activities, which should include authorization; defining the objectives, applicable program attributes, and requirements affecting the planned model; evaluation of available data; proposed design and potential design alternatives; and model testing, approval, and implementation.

Our FY2016 audit found the Department maintained limited documentation supporting the initial design, evaluation, justification and testing of the models for:

- selecting a sample of borrowers from the National Student Loan Data System (NSLDS) used for calculating program performance assumptions
- estimating future incomes for borrowers under income-dependent repayment plans
- projecting future cash flows for borrowers under income-dependent repayment plans
- calculating specific performance assumptions
- projecting overall program level cash flows (Student Loan Model)

During FY2016, CEAD updated its model for recoveries on defaulted loans and enhanced documentation related to the NSLDS sampling process. In FY2017, CEAD updated their model for prepayments and loan forgiveness due to death, disability, and bankruptcy, and have begun efforts to update their model for defaults. CEAD also implemented a number of enhancements to their income-driven repayment (IDR) model in response to deficiencies identified in a FY2016 GAO report. These included incorporating inflation factors to income forecasts, adjusting grouping factors for imputed borrower incomes to reduce income volatility, and modifying the IDR participation allocation rates related to parent PLUS loans, which are not eligible for IDR. Their

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

documentation for these modifications represented a significant improvement in discussing the methodology and their basis. However, the documentation was not sufficiently detailed to serve as a fully effective guide for an independent reviewer to follow the procedures performed.

The Department performs data quality reviews of its primary data source used in its modeling activities (the National Student Loan Data System or NSLDS). However, the Department does not have a structured process to document its evaluation of whether the reviews sufficiently address the specific data used within its models, or independently determine the appropriateness or reliability of the data used by their models. The Department also does not have a structured process for implementing, controlling and securing the various versions of the models maintained.

CEAD has begun discussing these actions with the Department's reconstituted modeling oversight group, the Credit Reform Working Group (CRWG), in its monthly meetings, but does not document their model development plan, testing plans and approval of testing results before changes are implemented.

CEAD is comprised of a small team of experienced economists and analysts responsible for performing its modeling activities, and thoroughly documenting such design requirements, development processes, and testing evaluation is onerous for the current team. The Department has obtained additional contract support to assist with these efforts, but did not approve an additional specialist position for CEAD. Given the size, growth and changes of the Direct Loan Program in recent years, ineffective controls over the design of new models can significantly impact the reliability of their estimates.

Model risk assessment
CEAD maintains over 18 different economic and financial modeled assumptions used within the calculation of the Allowance for Subsidy for the Direct Loan Program and various other model assumptions for the FFEL and other Department programs. Some of the assumptions are updated annually, while others are updated biannually. The Department does not have a formalized process for maintaining the Department's model inventory, accumulating, assessing and documenting modeling risks, and monitoring the modification or development of its models. This risk assessment process should be independent of the agency-level risk assessment process performed in connection with the agency level management controls review process required by OMB Circular A-123, and should assist the CRWG in supporting the prioritization of model development activities within the normal CEAD workload. In FY2017, the Department has initiated an independent, external validation review of its models.

Model operation
The Department's documentation of the control activities performed for operating approved models is not formalized. We identified deficiencies in the documentation of control activities over the Department's model operations relating to data accumulation and validation, assumption development, and model execution. As a result, we could not verify the operating effectiveness of certain control activities, including various reviews and approvals. Although the Department completed technical documentation of the Student Loan Model (SLM) in FY2017, their documentation of policies and procedures remains incomplete.

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

Model validation
Model validation refers to the initial and ongoing review and approval of the design of the model and its ability to properly correlate historical data into estimated future program performance. The Department performs a number of critical procedures to monitor the performance of its models and validate the overall reasonableness of its outputs, including backcasts, cash flow analyses, and sensitivity analyses. However, these procedures are performed at the aggregate level and the Department does not evaluate the performance of specific cash flows, assumptions or individual models against established benchmarks using sound approaches and statistical measures of performance. We identified opportunities to enhance the usefulness of various monthly accounting reports that are reviewed by the CRWG and could serve to identify unusual program activity or other potential modeling issues.

The Department also does not have a process to comprehensively evaluate the results of these procedures and document their conclusion as to whether the models, in aggregate, continue to be adequate for forecasting the future performance of the student loan programs.

Governance
In FY2017, the Department formalized the roles and responsibilities of the CRWG, which includes various members of Department and FSA management, and serves as the first level monitoring structure over the Department's modeling activities. Due to the current status of the Department's enterprise risk management program, the CRWG has been unable to initiate efforts to integrate model risk issues with Department's risk management program.

Summary
Without a fully effective risk management and control structure over its modeling activities, estimation errors or modeling risks may go undetected, increasing the potential for improper reporting and program decisions.

GAO's *Standards for Internal Controls in the Federal Government* requires that agencies:

- design controls activities in response to objectives and risks
- define and delegate responsibilities
- document internal controls and "all transactions and other significant events"
- evaluate and document the results of ongoing monitoring evaluations to identify internal control issues

OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, updated in July 2016, requires agencies to take steps to integrate risk management into the internal controls over their business operations.

Industry specific guidance from federal regulators regarding model risk management, model governance and related controls is also provided by the Federal Reserve and the Office of the Comptroller of the Currency in Supervision and Regulation (SR) 11-7, *Supervisory Guidance on Model Risk Management*, and by the Federal Housing Finance Agency in their AB 2013-07 *Model Risk Management Guidance*.

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

Recommendations:

We recommend the Director, Budget Service:

1a. Develop and document the Department's process, policies and procedures for the authorization, design, development, testing, approval and implementation of new models and model enhancements.
1b. Document the Department's process, policies, procedures and related controls for managing the operation and use of approved models.
1c. Enhance the process to capture model risks, update the assessment of risks related to each model, and document how that assessment impacts the Department's prioritization of corrective actions, and requisite level of controls, validation and monitoring over each model.
1d. Document and enhance the Department's processes, policies, procedures and related controls for the periodic review, validation and approval of the Department's models at the assumption, model and program level.
1e. Document the overall review and conclusions drawn related to the evaluation of the results of model performance reviews and validation procedures performed.
1f. Ensure modeling risks are considered in connection with the Department's enterprise risk management program.

Department and Federal Student Aid Management Need to Mitigate Persistent Information Technology Control Deficiencies

The Department oversees a large portfolio of Department-owned and contractor-owned business systems and applications that requires an effective and comprehensive information system security and privacy program. According to OMB Circular A-130, *Managing Information as a Strategic Resource*, key elements of an effective security program include 1) agency-wide and system-level policies and procedures; 2) properly designed, implemented and monitored information system controls to protect Department information and information systems from unauthorized access, use, disclosure, disruption, modification or destruction; and 3) cost effective risk management.

Prior audits have identified numerous control deficiencies at the Department and application level. While the Department has made gradual progress to address these issues in recent years, we continued to identify certain control deficiencies in the Department's information security program relating to compliance monitoring, personnel management, and management of various application level security, configuration management, and access controls. In addition, we continued to identify general application control deficiencies in FSA's financially relevant applications.

Effective system security starts with strong governance, including agency level oversight, policies and procedures, entity-wide controls, and controls monitoring. We have reported for several years that the Department's agency level information technology policies were outdated or did not fully address specific controls required by National Institute of Standards and Technology (NIST) guidance. Designing and implementing effective agency level policies is the responsibility of the Department's Chief Information Officer (CIO). This year the CIO substantially completed the guidance associated with the Department's Information Assurance/Cybersecurity Policy.

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

Managing the information and system security program across the Department is primarily the responsibility of the Department's Chief Information Security Officer (CISO), in conjunction with FSA's CISO. The Department and FSA CISOs have enhanced their efforts to monitor the system security control activities over their agency systems in recent years and have initiated several multi-year corrective actions that should aid in addressing many of the long standing weaknesses that affect the Department and FSA systems. For example, the FSA CISO has implemented a security program based on continuous monitoring that includes regular updates to security documentation, routine security control assessments and vulnerability assessments, and risk analysis. The outcomes of these system security activities are reviewed and evaluated by the CISO in support of an ongoing authorization to operate. Monitoring of remediation activities associated with identified control deficiencies in FSA's systems is fostered by regular update meetings held with management within the Technology Office and Business Operations, the Office of Inspector General (OIG) and the financial statement auditors.

However, agency-level security controls also require the efforts of other offices across the Department, including the Office of Security, Facilities and Logistics Services. We continue to find a large number of Department employees and contractors with overdue reinvestigations, incorrect levels of background investigations for privileged users, and lack of investigation information. In addition, although the Department provided training for completing position designations using the Office of Personnel Management's Position Designation Tool, the Department's Office of Management has not ensured Department system owners completed position designations in order to determine and document suitability and investigation requirements for each system's roles/responsibilities. Furthermore, the Department CISO has been working with Contracting on language for service level agreements (SLAs) for contractor employee clearance monitoring as recommended in FY 2015, however the SLAs have not yet been implemented.

The Department's agency-level information security controls are required to be evaluated annually by the OIG, in accordance with the Federal Information Security Modernization Act (FISMA). The FY 2016 OIG review involved testing financial and non-financial systems' controls and identified control deficiencies in five of eight reporting areas related to configuration management, information security continuous monitoring, incident response, identity and access management, and security and privacy training.

Although FSA implemented a governance structure for managing agency-level system security risk, the tactical execution of remediating system level control weaknesses and ensuring compliance with information security requirements still needs improvement.

Managing system security controls at the application or system level is the responsibility of the system owners, in conjunction with system level information system security officers (ISSOs). Since last year, FSA added additional ISSOs and an ISSO supervisor; however, our audit continued to identify application, or system, specific control deficiencies in the areas of security management, access controls, configuration management, and contingency planning in one or more of the five financial systems we tested this year. We continued to identify configuration management issues with the Department's general support system, but noted substantial improvement in the remediation of information security control weaknesses for the Department's core financial management system.

At FSA, we tested four systems and our audit continued to identify control deficiencies in security management, access controls, configuration management, and contingency planning across

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

these systems. The agency expected to implement a new system for user access management to address various access control deficiencies this year, but this system was not completed.

Specifically, we identified system specific issues in the following areas:

Security management

- Plans of Action and Milestones (POA&Ms) were not updated with the results from security control assessments or vulnerability assessments for two FSA systems, and POA&Ms were not updated on a quarterly basis for four FSA systems
- Role based security training for users with significant system security responsibilities was not always completed for one FSA system tested
- Interconnection agreements were not detailed in System Security Plans and/or were not current for one FSA system
- Background reinvestigations were not tracked adequately or completed timely; and inappropriate levels of investigations were completed for numerous Department and FSA employees and contractor users
- Position designations were not finalized for Department employees and contractors
- Evidence to validate Department assets were returned for separated Department employees was not always provided

Access controls

- User access for one FSA system was not always approved for all roles granted
- Termination of system access for separated employees and contractors was not always completed timely for three FSA systems
- Inactive accounts were not always disabled for one FSA system
- User access for three FSA systems was not always recertified and some user accounts that were recertified had either never used the system, or had not logged in for an extended period of time

Configuration management

- System configuration settings were not always compliant with Department policy for one FSA system
- Computer security configurations were inadequate and software was not patched or was unsupported for two Department systems

Contingency Planning

- Contingency plan tests were not conducted annually for one FSA system

The combination of agency-level and system specific deficiencies can increase the risk of unauthorized access to the Department and FSA's systems used to capture, process, and report financial transactions and balances, affecting the reliability and security of the data and information. These findings are discussed in further detail below, and in a Limited Distribution Report to be provided to the Department and FSA management.

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

Security management
An organization–wide information security program sets the framework for addressing risk through developing and implementing effective information security procedures, monitoring the effectiveness of those procedures, providing appropriate security training and remediating control weaknesses through the POA&M process. Security policies and procedures also include employee hiring, transfer and termination practices.

Overall, we found improvement in the level of compliance with security awareness training requirements this year. For one FSA system, we found system users with significant system security responsibilities had not always completed role based training.

In addition, documentation was not provided to validate that Department assets were returned and access was disabled timely for one of 25 separated employees tested. In addition evidence was not provided to validate that Personal Identity Verification cards were returned for the entire population of 25 separated employees tested. Furthermore, we noted issues with regard to background investigations, including numerous individuals with overdue investigations, privileged users with an incorrect level of investigation based on their system access and job function, and privileged users without documented background investigation status.

Access Controls
Access controls limit or detect inappropriate access to systems, protecting the data within them from unauthorized modification, loss or disclosure. Standards require that entities use a properly executed Memorandum of Understanding (MOU) to document 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. Consistent with previous years, for one system, we identified expired MOUs, and instances in which interconnections were not detailed in the corresponding System Security Plan.

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. Based on our work, we found:

- Accounts for terminated FSA, and loan servicer employees were not disabled for three of the four FSA systems tested
- Inactive accounts were not disabled for one FSA system
- For one FSA system, one from a sample of 25 new users did not have evidence that all user roles were approved
- User access for three systems was not always recertified, and some user accounts that were recertified for one system had either never used the system, or had not logged in for an extended period of time

Configuration Management
Configuration management ensures changes to systems are tested and approved, and systems are configured securely in accordance with policy. In our audit, we found one FSA system with configuration settings that did not adhere to Department policy. Furthermore, our testing identified insecure configurations, as well as unpatched and unsupported software for two systems.

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

Contingency Planning
Contingency plan tests were not conducted annually for one FSA system.

Information Security Program
The OIG performs an independent evaluation of the Department's information technology security program and practices, as required by the Federal Information Security Modernization Act of 2014 (FISMA). The 2017 FISMA evaluation identified findings in all seven areas reviewed: (1) Risk Management, (2) Configuration Management, (3) Identity and Access Management (4) Security Training, (5) Information Security Continuous Monitoring, (6) Incident Response, and (7) Contingency Planning. The report made 37 recommendations (4 of which were repeat recommendations) to assist the Department and FSA with increasing the effectiveness of their information security program.

According to NIST SP 800-39, *Managing Information Security Risk - Organization, Mission, and Information System View*, the information system owner, in coordination with the information system security officer, is responsible for ensuring compliance with information security requirements.

The information system security officer is an individual responsible for ensuring that the appropriate operational security posture is maintained for an information system and as such, works in close collaboration with the information system owner. The information system security officer also serves as a principal advisor on all matters, technical and otherwise, involving the security of an information system. The information system security officer has the detailed knowledge and expertise required to manage the security aspects of an information system and, in many organizations, is assigned responsibility for the day-to-day security operations of a system.

OMB Circular A-130, *Managing Information as a Strategic Resource*, July 28, 2016, Appendix 1 states agencies are to:

- Implement policies and procedures to ensure that all personnel are held accountable for complying with agency-wide information security and privacy requirements and policies.

- Implement security and privacy controls, and verify that they are operating as intended, and continuously monitored and assessed; put procedures in place so that security and privacy controls remain effective over time, and that steps are taken to maintain risk at an acceptable level within organizational risk tolerance.

- Correct deficiencies that are identified through information security and privacy assessments, information system continuous monitoring and privacy continuous monitoring programs, or internal or external audits and reviews, to include OMB reviews.

In order to appropriately manage risk from an organization-wide structure, the Department and FSA CISOs need to hold accountable those individuals responsible for ensuring that persistent IT control deficiencies are remediated and the appropriate security posture is maintained for Department and FSA information systems.

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

Recommendations:

We recommend the Principal Deputy Assistant Secretary, Office of Management:

2a. Implement a monitoring process over the personnel security activities to ensure investigations and reinvestigations are prioritized for personnel with sensitive system access within the Department.

We recommend the Department CISO work with the FSA CISO to:

2b. Strengthen and refine the process for holding system owners and information system security officers accountable for remediation of control deficiencies and ensuring that the appropriate security posture is maintained for Department and FSA information systems.

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT B
Instance of Noncompliance

Requirement for Referring Delinquent Student Loan Debts to Treasury

In 2014, Federal law[3] was amended[4] to require agencies to notify the Secretary of the Treasury of valid, delinquent nontax debts that are over 120 days delinquent – 60 days earlier than the previous 180 days requirement – for the purpose of administrative offset (i.e. collection through the reduction of future Federal payments). Due to the number of entities and systems involved in handling student loan debts, FSA is not yet capable of meeting this accelerated timeline. Accordingly, as of September 30, 2017, the Department and FSA are not in compliance with the legal requirement for referring 120 day delinquent student loan debts to Treasury.

To meet this requirement, the Department obtained legal clarification of how certain specific requirements of the amended law apply to the Direct Loan Program and other Department programs, improve delinquent debt reporting procedures, increase the frequency of some debt referrals and modify its defaulted loan management system to accommodate this change. The Department is also evaluating the impact of defining defaulted loans earlier on schools' performance reporting and has developed a long-term project plan to incorporate the new referral requirements into various servicer contracts and guaranty agency agreements, so they can initiate the required system programming changes. FSA is also working with the Department in evaluating certain options for other requirements needed to achieve compliance.

Recommendation:

We recommend that the Secretary of Education work with the Federal Student Aid Chief Operating Officer to:

3. Continue to execute the corrective actions as outlined in FSA's project plan to comply with the timing requirement for the referral of delinquent non-tax debts.

[3] 31 U.S. Code Section 3716(c)(6)
[4] Public Law 113-101 (DATA Act) Section 5

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT C
Management's Response

UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, DC 20202

NOV 0 9 2017

MEMORANDUM

TO: Kathleen S. Tighe
Inspector General

FROM: Tim Soltis
Delegated the Duties of Chief Financial Officer

Jason Gray
Chief Information Officer

SUBJECT: DRAFT INDEPENDENT AUDITORS' REPORT
Fiscal Years 2017 and 2016 Financial Statements
U.S. Department of Education
ED-OIG/A17R0001

Please convey the Department's sincere thanks to everyone on your staff who worked diligently on this financial statement audit. We extend our appreciation for the professionalism and commitment by all parties, including the Office of the Inspector General and CliftonLarsonAllen, throughout the audit process.

We have reviewed, and concur and agree with, the draft Independent Auditors' Report. We are pleased to have received an unmodified "clean" audit opinion with no material weaknesses. The Department takes the two significant deficiencies reported, in the areas of controls over modeling activities and information technology controls, very seriously and we are dedicated to resolving the issues identified. We will share the final audit results with responsible senior officials, other interested program managers, and staff who will begin preparing 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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The Department of Education's mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT D
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:

Fiscal Year 2016 Recommendations	Fiscal Year 2017 Status
CLA Recommended that the Deputy Secretary:	
1a. Perform a comprehensive evaluation of the impact of the Department's modeling on the Department's mission in connection with the development of its enterprise risk management program.	Modified Repeat, see Significant Deficiency
CLA Recommended the Department Chief Financial Officer, in conjunction with the Director, Budget Service:	
1b. Document the Department's process, policies and procedures for the design, development, testing and authorization of new models.	Modified Repeat, see Significant Deficiency
1c. Compile an inventory of the Department's models, and regularly document management's assessment of risks related to each model and how that assessment impacts the Department's level of controls, validation and monitoring over each model.	Modified Repeat, see Significant Deficiency
1d. Document the Department's process, policies, procedures and related controls for the periodic review, validation and approval of the Department's models at the model and program level.	Modified Repeat, see Significant Deficiency
1e. Document the overall review and conclusions drawn related to the evaluation of the results of model performance reviews and validation procedures performed.	Modified Repeat, see Significant Deficiency
CLA Recommended the Director, Budget Service and the Department and FSA Chief Financial Officers:	
1f. Document the Department's process, policies, procedures and related controls for managing the operation and use of approved models.	Modified Repeat, see Significant Deficiency
1g. Design, document and implement a modeling governance structure that specifically and separately addresses the roles and responsibilities for the oversight of critical modeling activities, including model risk assessment, model development, model operation, and model validation activities, as well as defining standards for policies, procedures and internal controls for these activities.	Modified Repeat, see Significant Deficiency
CLA Recommended the Department Chief Financial Officer:	
1h. Ensure the agency's management controls program fully evaluates the Department's modeling activities commensurate with the materiality of the impact of the process to the agency's reporting activities.	Modified Repeat, see Significant Deficiency

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INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT D
Status of Prior Year Recommendations

CLA Recommended the Department CIO:	
2a. Ensure the update, review, approval and dissemination of the Information Assurance/ Cybersecurity Policy and associated guidance is completed in order to comply with NIST standards and OMB guidance.	Closed
2b. Design and implement controls over the handling of Department security and privacy incidents to ensure their resolution is properly documented.	Modified Repeat, see Significant Deficiency
CLA Recommended the Principal Deputy Assistant Secretary, Office of Management:	
2c. Implement a monitoring process over the personnel security activities to ensure investigations and reinvestigations are prioritized for personnel with sensitive system access within the Department.	Modified Repeat, see Significant Deficiency
CLA Recommended the Department CISO work with the FSA CISO to:	
2d. Strengthen and refine the process for holding system owners and information system security officers accountable for remediation of control deficiencies and ensuring that the appropriate security posture is maintained for Department and FSA information systems.	Modified Repeat, see Significant Deficiency
Noncompliance with Laws and Regulations	
3. CLA recommended that the Secretary of Education work with the Federal Student Aid Chief Operating Officer to continue to execute the corrective actions as outlined in FSA's project plan to comply with the timing requirement for the referral of delinquent non-tax debts.	Repeat

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OTHER INFORMATION

ABOUT THE OTHER INFORMATION SECTION

The Other Information section includes:

- a summary of the Office of Inspector General's (OIG's) view on the Department's management and performance challenges for fiscal year (FY) 2018,
- a summary of assurances,
- payment integrity,
- fraud reduction efforts,
- reduce the footprint information,
- civil monetary penalty inflation adjustment information, and
- Grants Oversight and New Efficiency (GONE) Act of 2016 information.

OFFICE OF INSPECTOR GENERAL'S MANAGEMENT AND PERFORMANCE CHALLENGES

The OIG's Management and Performance Challenges Report provides a summary of what the OIG believes are the Department's biggest challenges for FY 2018. The OIG identified the following four challenges: (1) Improper Payments, (2) Information Technology Security, (3) Oversight and Monitoring, and (4) Data Quality and Reporting. The full report is available at the **OIG website**.

SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

The Summary of Financial Statement Audit and Management Assurances provides information about the material weaknesses reported by the agency or through the audit process. The Department reported no material weaknesses in FY 2017.

PAYMENT INTEGRITY

This section summarizes the Department's efforts to maintain payment integrity and to develop effective controls designed to prevent, detect, and recover improper payments. It also includes information regarding the Department's high-risk programs.

REDUCE THE FOOTPRINT

This section summarizes the Department's efforts to comply with Office of Management and Budget (OMB) Management Procedures Memorandum 2013-02, the *Freeze the Footprint policy* implementing guidance. That guidance directs agencies to not increase the total square footage of their domestic office and warehouse inventory compared to an FY 2012 baseline.

GONE ACT OF 2016

The GONE Act summarizes the Department's efforts to track the number and status of grant closeouts and extensions.

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

November 6, 2017

TO: The Honorable Betsy DeVos
Secretary of Education

FROM: Kathleen S. Tighe
Inspector General

SUBJECT: Management Challenges for Fiscal Year 2018

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 post significant challenges because of their breadth and complexity.

Last year, we presented five management challenges: improper payments, information technology security, oversight and monitoring, data quality and reporting, and information technology system development and implementation. Although the Department made some progress in addressing these areas, four of the five remain as a management challenge for fiscal year (FY) 2018. We removed information technology system development and implementation because our current body of work does not support its continued reporting as a challenge to the Department. Our planned work for FY 2018 includes audits of the Department's implementation of the Federal Information Technology Acquisition Reform Act and the Department's implementation of the Portfolio of Integrated Value-Oriented Technologies Contracts. Our conclusions from this and other work could result in this area returning as a management challenge in future years.

The FY 2018 management challenges are:

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

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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 2018 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.

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OFFICE OF INSPECTOR GENERAL'S (OIG) MANAGEMENT AND PERFORMANCE CHALLENGES FOR FISCAL YEAR 2018 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 five management challenges: improper payments, information technology security, oversight and monitoring, data quality and reporting, and information technology system development and implementation. Although the Department made some progress in addressing these areas, four of the five remain as a management challenge for fiscal year (FY) 2018. We removed information technology system development and implementation because our current body of work does not support its continued reporting as a challenge to the Department. Our planned work for FY 2018 includes audits of the Department's implementation of the Federal Information Technology Acquisition Reform Act and the Department's implementation of the Portfolio of Integrated Value-Oriented Technologies Contracts. Our conclusions from this and other work could result in this area returning as a management challenge in future years.

The FY 2018 management challenges are:

(1) Improper Payments,

(2) Information Technology Security,

(3) Oversight and Monitoring, and

(4) Data Quality and Reporting.

These challenges reflect continuing vulnerabilities and emerging issues faced by the Department as identified through recent OIG audit, inspection, and investigative work. A summary of each management challenge area follows. This FY 2018 Management Challenges Report is available at **http://www2.ed.gov/about/offices/list/oig/managementchallenges.html**.

MANAGEMENT CHALLENGE 1—IMPROPER PAYMENTS

Why This Is a Challenge

The Department must be able to ensure that the billions of dollars entrusted to it are reaching the intended recipients. The Department identified the Federal Pell Grant (Pell) and the William D. Ford Federal Direct Loan (Direct Loan) programs as susceptible to significant improper payments. In addition, the Office of Management and Budget (OMB) has designated these programs as high-priority programs, which are subject to greater levels of oversight.

Our recent work has demonstrated that the Department remains challenged to meet required improper payment reduction targets and to intensify its efforts to successfully prevent and identify improper payments. In May 2017, we reported that the Department's improper payment reporting, estimates, and methodologies were generally accurate and complete; however, we identified opportunities for the Department to improve (1) its policies and procedures over the Direct Loan and Pell program's improper payment calculations, (2) the completeness of its improper payment corrective action reporting, and (3) the evidence or support for its Agency Financial Report reporting. We also concluded that the Department did not comply with the Improper Payments Elimination and Recovery Act of 2010 (IPERA) because it (1) did not meet the reduction targets it established for the Direct Loan and Pell programs, (2) did not comply with applicable guidance regarding its risk assessment for the Vocational Rehabilitation State Grants program, and (3) did not consider all required risk factors in completing its risk assessments for certain grant programs and contracting activities.

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Overall, our semiannual reports to Congress from April 1, 2014, through March 31, 2017, included more than $2.3 million in questioned or unsupported costs from audit reports and more than $44 million in restitution payments from our investigative activity. We also recently issued a report on Western Governors University that identified over $700 million in questioned costs.

Progress in Meeting the Challenge

The Department stated that it places a high value on maintaining payment integrity to ensure that Federal funds reach intended recipients in the right amount and for the right purpose. The Department stated that its work to sustain payment integrity in response to this challenge includes establishing policies, business processes, and controls over key payment activities that are intended to prevent, detect, and recover improper payments. The Department added that its efforts intend to achieve the appropriate balance between making timely and accurate payments to recipients, while at the same time ensuring the controls are not too costly or overly burdensome.

The Department reported that it had developed and implemented corrective actions in response to OIG recommendations to improve the accuracy and completeness of its 2017 improper payment estimates for the Direct Loan and Pell Grant programs. The Department added that it developed and implemented corrective actions to improve its improper payment risk assessment process for non-Federal Student Aid (FSA) grant programs and contracts.

The Department stated that it continues to assess and enhance its controls over payments. According to the Department, this includes routinely analyzing application and payment data and considering other factors, such as program reviews and audit reports, to help identify ways to further reduce risks and enhance its controls. The Department also stated that its payment integrity internal control framework includes more than 500 controls designed to help prevent and detect improper payments. According to the Department, those controls are included in the universe of internal controls that are tested annually to assess their design and operating effectiveness. When control deficiencies are detected, the Department works to identify the root causes, develops corrective action plans, and tracks the plans through resolution.

Finally, the Department stated that it has increased its efforts to enhance payment integrity through three new or ongoing initiatives. These included (1) establishing a payment integrity workgroup, (2) developing a continuous control monitoring system, and (3) developing policies and new business processes to more accurately report the number and amount of improper payments detected and collected.

What Needs to Be Done

The Department needs to continue to take action to improve its ability to reduce improper payments. The Department should continue its work to complete planned corrective actions to bring programs into compliance with IPERA and improve its quality control processes, process documents, and policies and procedures. While the Department continues to review its controls, it should continue to explore additional opportunities for preventing improper payments. Although the Department has added controls and seeks to strike a balance between burden and controls, it needs to consider options to strengthen existing internal controls and to develop new and cost-effective controls to reduce the level of risk.

The Department needs to develop and implement processes to more effectively and efficiently monitor Student Financial Assistance (SFA) program recipients, State educational agencies (SEA), and local educational agencies (LEA) to ensure they properly spend and account for Federal education funds. This area will remain a management challenge until the Department fully meets the expectations of IPERA and its monitoring systems provide greater assurance that Federal funds are both properly distributed and appropriately used by recipients.

MANAGEMENT CHALLENGE 2—INFORMATION TECHNOLOGY SECURITY

Why This Is a Challenge

Department systems contain or protect an enormous amount of sensitive information, such as personal records, financial information, and other personally identifiable information. Without adequate management, operational, and technical security controls, 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.

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The OIG's work related to information technology continues to identify control weaknesses and ineffective security management programs that the Department needs to address to adequately protect its systems and data. For example, our most recent report on the Department's compliance with the Federal Information Security Modernization Act of 2014 (FISMA) concluded that the Department's and FSA's overall information security programs were generally not effective. We found the Department and FSA were generally effective in two of the five security functions reviewed—identify and recover. However, they were not generally effective in the three remaining security functions—protect, detect, and respond.

Our report included specific findings in the areas of configuration management, identity and access management, security and privacy training, information security continuous monitoring, and incident response. We made recommendations to assist the Department and FSA with increasing the effectiveness of their information security program so that they fully comply with all applicable requirements.

Progress in Meeting the Challenge

The Department reported that it continued to make progress in implementing actions to mitigate risks associated with information technology security during FY 2017. The Department stated that it completed a cybersecurity workforce capability assessment to identify current gaps in the Department's cybersecurity workforce skills and certifications and developed several new cybersecurity guidance documents. The Department also noted that the Chief Information Security Officer (CISO) is leading coordination efforts to meet deadlines for assigning new cybersecurity codes to positions with information technology, cybersecurity, and cyber-related functions.

The Department further responded that beginning in December 2016, the CISO formally established and led a Cybersecurity Steering Committee to improve the Department's cybersecurity posture and communicate critical information. The Department stated that the committee also coordinated and resolved issues that impacted the quality and timely reporting of performance measures; coordinated reporting for the Department's high-value assets; ensured timely completion of high visibility, government-wide security operations directives; and completed risk assessment actions required by the President's Executive Order, Strengthening the Cybersecurity of Federal Networks and Critical Infrastructure, and OMB M-17-25.

The Department reported that the CISO led a number of cybersecurity policy updates that include improving the Department's overarching cybersecurity policy guidance, revising its Handbook for Cybersecurity Incident Response and Reporting, and developing a Cybersecurity Strategy and Implementation Plan. According to the Department, its plan highlights Departmental cybersecurity initiatives, strategies, and action items that are directly mapped to the Cybersecurity Framework categories. Finally, the Department stated that it completed numerous other actions that included the completion of risk assessments for all systems in the FISMA inventory and the formal designation of a Senior Accountable Official for cybersecurity risk.

What Needs to Be Done

The Department is reporting significant progress towards addressing longstanding information technology security weaknesses. However, we continue to identify significant weaknesses in our annual FISMA audits—despite the Department's reported corrective actions to address our prior recommendations.

While we commend the Department for placing a priority on addressing these weaknesses, it needs to continue its efforts to develop and implement an effective system of information technology security controls, particularly in the areas of configuration management and identity and access management. Within configuration management, we identified weaknesses that include the Department using unsupported operating systems, databases, and applications in its production environment and not adequately protecting personally identifiable information. Within identity and access management, we identified weaknesses where the Department has not fully implemented its network access control solution or two-factor authentication and where the Department and FSA did not adhere to the required Federal background investigation process for granting and monitoring access to its external users.

Our FISMA audits will continue to assess the Department's efforts and this will remain a management challenge until our work corroborates that the Department's system of controls achieves expected outcomes. To that end, the Department needs to effectively address IT security deficiencies, continue to provide mitigating controls for vulnerabilities, and implement planned actions to correct system weaknesses.

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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 and programs are achieving goals and objectives. 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. Two subareas are included in this management challenge—SFA program participants and grantees.

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. The Department's FY 2018 budget request includes $134.2 billion in new grants, loans, and work-study assistance to help an estimated 12.2 million students and their families pay for college.

The growth of distance education has added to the complexity of the Department's oversight of SFA program participants. The management of distance education programs presents challenges to the Department and school officials because little or no in-person interaction between the school officials and the student presents difficulties in verifying the student's identity and academic attendance. The overall growth and oversight challenges associated with distance learning increases the risk of school noncompliance with the Federal student aid laws and regulations and creates new opportunities for fraud, abuse, and waste in the SFA programs. Our investigative work has identified numerous instances of fraud involving the exploitation of vulnerabilities in distance education programs to obtain Federal student aid.

Our audits and work conducted by the Government Accountability Office continue to identify weaknesses in FSA's oversight and monitoring of SFA program participants.

Progress in Meeting the Challenge

The Department reported that it employs several oversight tools in its work to ensure program participants' compliance with statutes and regulations and to mitigate the inherent risks associated with the administration of financial assistance programs. These include (1) program reviews, (2) review and resolution of program participant's annual compliance audits and financial statements to ensure administrative capability and financial responsibility, and (3) certification activities to ensure continued eligibility for participation in the Federal student aid programs.

The Department stated that during FY 2017, FSA implemented actions to improve its oversight and monitoring process for schools, lenders, servicers, and guaranty agencies. In August 2017, the Department announced that FSA was adding several key senior executives to help lead and implement a more comprehensive, broader approach to its oversight function. The Department also reported that FSA had begun establishing an integrated system of oversight functions that were intended to better ensure compliance by all participating parties. The Department intends for this approach to oversight to begin with proactive risk management that identifies and mitigates risks before they pose a threat.

The Department stated that is has also taken steps to strengthen its accreditation oversight. According to the Department, this includes improving data sharing, enhancing its processes to determine agency effectiveness, and improving its processes to assess whether agencies evaluate institutions in a manner consistent with the Secretary's Criteria for Recognition.

The Department stated that this management challenge reflects the inherent risks associated with Federal student aid and the ongoing challenge to mitigate these risks through oversight and monitoring.

What Needs to Be Done

The Department continues to identify important accomplishments that are intended to improve its ability to provide effective oversight. We recognize the progress the Department is making and the need to balance controls with both cost and the ability to effectively provide necessary services. However, our audits and

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investigations involving SFA programs continue to identify instances of noncompliance and fraud, as well as opportunities for FSA to improve it processes.

The financial responsibility provisions that were planned to go into effect in July 2017 as part of the borrower defense regulation changes would have included tools to improve the Department's oversight of schools. Enforcement of such regulations could have improved FSA's processes for mitigating potential harm to students and taxpayers by giving FSA the ability to obtain financial protection from schools based on information that is broader and more current than information schools provide in their annual audited financial statements. The Department needs to implement provisions that will allow it to receive important, timely information from publicly traded, private for-profit, and private nonprofit schools that experience triggering events or conditions. Collecting and analyzing this information could improve FSA's processes for identifying Title IV schools at risk of unexpected or abrupt closure.

Overall, the Department needs to ensure that the activities of its new efforts to better coordinate oversight result in effective processes to monitor SFA program participants and reduce risk. It should work to ensure that its program review processes are designed and implemented to effectively verify that high-risk schools meet requirements for institutional eligibility, financial responsibility, and administrative capability. The Department further needs to ensure its oversight functions work together to effectively provide the intended additional protections to students and taxpayers. Finally, the Department could enhance its oversight of SFA programs by developing and implementing improved methods to prevent and detect fraud. This includes methods to limit the effectiveness of organized activities involving distance fraud rings.

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 18,200 public school districts and 50 million students attending more than 98,000 public schools and 32,000 private schools. Key programs administered by the Department include Title I of the Elementary and Secondary Education Act, which under the President's 2018 request would deliver $15.9 billion for local programs that provide extra academic support to help nearly 25 million students in high-poverty schools meet challenging State academic standards. Another key program is the Individuals with Disabilities Education Act, Part B Grants to States, which would provide about $11.9 billion to help States and school districts meet the special educational needs of 6.8 million students with disabilities.

OIG work has identified a number of weaknesses in grantee oversight and monitoring. These involve LEA and SEA control issues; fraud relating to education programs; fraud perpetrated by SEA, LEA, and charter school officials; and internal control weaknesses in the Department's oversight processes.

Progress in Meeting the Challenge

The Department noted that mitigating the risks associated with grants awarded to States, school districts, institutions of higher education, and other entities remains a significant challenge given the Department's relatively limited resources for oversight and monitoring. The Department stated that in response to this challenge, it initiated an enterprise-approach to risk management in FY 2017 and implemented targeted actions to improve support for grant recipients. The Department added that these actions focused on increasing staff expertise and leveraging risk-based tools and approaches to provide improved technical assistance and oversight.

The Department also reported that it completed several activities that were intended to improve its monitoring skills and capacity across offices through a variety of collaborative training and development efforts. Examples included developing training related to distance monitoring and providing technical assistance.

The Department added that it has implemented a number of new risk-based monitoring tools and approaches. The Department stated that its Risk Management Service provided analysis of complex monitoring issues that are intended to support well-informed, timely decision-making and preparation for site monitoring visits. The Department further

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reported that it deployed two monitoring tools that were intended to (1) assist in analyzing risk and create risk-based monitoring plans and (2) centralize and automate key monitoring data while expanding the monitoring information into new areas.

The Department also noted that its grant offices had implemented a number of new risk-based approaches to better target limited resources on those educational agencies and entities in need of the most assistance. This included the expansion of the Office of Elementary and Secondary Education's (OESE) fiscal monitoring pilot that leverages joint reviews across its programs. The Department reported that this approach has better positioned it to work more proactively with SEAs and LEAs, identify issues of concern, and share best practices and lessons learned.

The Department further reported other improvements that included the Office of Career, Technical, and Adult Education's enhancements to its comprehensive monitoring web portal, the Office of Postsecondary Education's collaboration with other offices in developing and implementing a standard discretionary grant site visit monitoring tool, and the Institute of Education Sciences' efforts to improve the oversight of privacy and information security.

What Needs to Be Done

The Department acknowledges that this area is a major risk and points out actions it has taken to address this challenge. In particular, its efforts to pilot joint program fiscal monitoring reviews appear to leverage its limited resources to focus on areas of risk. The Department should closely review the results of this pilot and look for ways to improve it and expand it into other areas. Also, the Department should continue to make use of risk-based information, develop common training and procedures, and take steps to ensure that its program offices are consistently providing effective risk-based oversight of grant recipients across applicable Federal education programs.

As various offices implement improvements to monitoring, such as those cited above, the Department should review their effectiveness and replicate effective practices to other program areas. Given the Department's generally limited staffing in relation to the amount of Federal funding it oversees, it is important for the Department to continue to explore ways to more effectively leverage the resources of other entities that have roles in grantee oversight. Another area where there is the potential to make use of limited resources to improve oversight is to review the results of single audits and program monitoring efforts in order to revise the single audit process and updates to the 2 C.F.R. 200, Subpart F—Compliance Supplement to improve program compliance and help mitigate fraud and abuse.

MANAGEMENT CHALLENGE 4—DATA QUALITY AND REPORTING

Why This Is a Challenge

The Department, its grantees, and its subrecipients must have effective controls to ensure that reported data are accurate and reliable. The Department relies on program data to evaluate program performance and inform management decisions. Our work has identified a variety of weaknesses in the quality of reported data and recommended improvements at the Department, SEA, and LEA level. This included weaknesses in controls over the accuracy and reliability of program performance and graduation rate information provided to the Department.

Progress in Meeting the Challenge

The Department reported that it made progress in FY 2017 to implement actions that are intended to mitigate the inherent risks associated with data quality. The Department stated that it continued to build standardized procedures to evaluate the quality of SEA-submitted data. As an example, the Department noted that two of its offices used a new tool to identify, follow-up, and track individual State data quality concerns after the submission of School Year 2015–16 Consolidated State Performance Reports.

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The Department stated that it developed a policy that promotes a comprehensive approach to active and strategic data management with clearly identified roles and responsibilities for data management work. The Department added that the EDFacts Data Governance Board continues to promote and support program offices' stewardship of data through a unified Information Collection package, standardized technical reporting instructions, centralized data submission systems, and increasingly standardized post-submission data quality procedures. The Department also reported that it implemented a new certification for Consolidated State Performance Reports. The certification served as reminder that the person certifying the data was providing assurance, on behalf of the State, of the accuracy of the data submission to the Department.

The Department stated that the EDFacts Data Governance Board routinely meets to exchange best practices. For example, board members shared strategies used with State grantees to document data review procedures, build replicable processes, and generate meaningful and timely messages back to the grantees post-data submission. The Department further stated that the National Center for Education Statistics developed a basic Data Quality Summary Form that will be shared with the Department principal offices for use in their reviews of submitted data files.

The Department also reported that OESE initiated work to develop a plan to address issues of data quality, data security, data reporting, and overall data management. As part of the effort, OESE is using prior OIG data quality recommendations as areas for possible improvement. Finally, the Department stated that the Office of Career, Technical, and Adult Education continues to offer several ongoing initiatives to help States develop and implement accountability systems that yield valid, reliable, and complete data on the progress of career and technical education students. The Department reported that these efforts included annual conferences to improve the quality and consistency of the definitions and measurement approaches that States use to report performance data, conference calls to discuss emerging issues in accountability, and customized technical assistance to States to improve the validity, reliability, and completeness of their data.

What Needs to Be Done

The Department continues to complete significant work that is intended to improve the overall quality of data that it collects and reports. This effort remains important, as data quality contributes to effective program management and helps ensure the credibility of information published by the Department. Although the Department has made progress in strengthening both grantees' data quality processes and its own internal reviews of grantee data, this area is an ongoing challenge. Our recent audits continue to find weaknesses in grantees' internal controls over the accuracy and reliability of program performance and graduation rate information.

The Department's efforts by the EDFacts Data Governance Board to promote common strong practices across its program offices is an important step to improving the quality of data the Department relies on. In addition, efforts to strengthen data certification statements and reach out to States and other entities that report data to the Department are important steps to reinforce the importance of good data quality practices. The Department should continue to monitor the quality of the data it receives, work to implement effective controls to address known weaknesses, and take steps to ensure that strong data management practices are implemented across the Department as well as by entities that submit data to the Department. The Department should also make use of its current oversight mechanisms, such as single audits and program monitoring protocols, to ensure that program participants have strong controls to ensure the quality of data submitted to the Department and to ensure that they have good practices to support the data certifications they sign.

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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 auditors' report can be found beginning on page 78 and the Department's management assurances on page 21.

SUMMARY OF FINANCIAL STATEMENT AUDIT

Audit Opinion: Unmodified
Restatement: No

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

SUMMARY OF MANAGEMENT ASSURANCES

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

Statement of Assurance: Unmodified

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

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

Effectiveness of Internal Control over Operations—FMFIA 2

Statement of Assurance: Unmodified

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

Conformance with Financial Management System Requirements—FMFIA 4

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

Nonconformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Nonconformances	**0**	**0**	**0**	**0**	**0**	**0**

Compliance with Federal Financial Management Improvement Act (FFMIA)

	Agency	Auditor
1. System Requirements	**No lack of compliance noted**	**No lack of compliance noted**
2. Federal Accounting Standards	**No lack of compliance noted**	**No lack of compliance noted**
3. United States Standard General Ledger at Transaction Level	**No lack of compliance noted**	**No lack of compliance noted**

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PAYMENT INTEGRITY

I. PAYMENT REPORTING

Office of Management and Budget (OMB) Memorandum M-15-02 defines an improper payment as any payment that should not have been made or that was supposed to be made, but was made in an incorrect amount under legally applicable requirements. Incorrect amounts include both overpayments and underpayments made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for an incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment even though the payment may be determined to be proper at a later date.

The Department places a high value on maintaining the integrity of all types of payments made to ensure that the billions of dollars in federal funds it disburses annually reach intended recipients in the right amount and for the right purpose. The Department ensures payment integrity by establishing effective policies, business processes, systems, and controls over key payment activities, including those pertaining to: payment data quality, cash management, banking information, third party oversight, assessments of audit reports, and financial reporting. The number and dollar value of improper payments are key indicators of payment integrity. Accordingly, the Department created a robust internal control framework that includes over 500 controls designed to help prevent, detect, and recover improper payments. In designing controls, the Department attempts to strike the right balance between making timely and accurate payments and ensuring that controls put in place are not too costly or overly burdensome and thereby deter intended beneficiaries from obtaining funds they are entitled to receive. Additionally, the Department must rely heavily on controls established by external entities that receive Department payments, including federal, state, and private organizations and institutions, because they further distribute the funds they receive from the Department to subordinate organizations and individuals. Because these "third-party" controls are outside of the Department's operational control, they present a higher risk to the Department, as evidenced by the work of the Department's Office of Inspector General (OIG) and our root cause analysis. When control deficiencies are detected, either within the Department or at external entities, the Department seeks to identify their root causes, develop corrective action plans, and track corrective actions through to completion.

Readers can obtain more detailed information on improper payments at **https://paymentaccuracy.gov/**.

RISK ASSESSMENTS

As required by OMB Circular A-123, Appendix C, the Department assesses the risk of improper payments at least once every three years for each program that is not reporting an improper payments estimate. When the Department conducts a program risk assessment, it considers the nine risk factors mandated by the OMB guidance. In FY 2017, the Department assessed the risk of improper payments for administrative payments, contract payments, the Title I program, the Vocational Rehabilitation State Grant program, and the following FSA programs: Federal Perkins Loan; Health Education Assistance Loan; Federal Family Education Loan; Federal Supplemental Educational Opportunity Grant; Federal Work-Study; Iraq and Afghanistan Service Grant; and Teacher Education Assistance for College and Higher Education Grant. Risk assessments for contracts and the Vocational Rehabilitation State Grant program had been conducted in FY 2016, but were repeated in FY 2017 because of concerns raised by the OIG in its FY 2016 IPERA audit. Based on the results of the FY 2017 risk assessments, the Department concluded that none of the programs reviewed were susceptible to risk of significant improper payments.

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DESCRIPTION OF RISK-SUSCEPTIBLE AND HIGH-PRIORITY PROGRAMS

In FY 2017, the Pell Grant and Direct Loan programs continued to be susceptible to significant improper payments and remained OMB-designated high priority programs. The Department continues to place additional emphasis to ensure payment integrity and minimize improper payments in these two important programs as required by OMB guidance. Please refer to the **Internal Controls** Section of this AFR for more information. Details on improper payment estimates for both programs are included within the **Payment Reporting Root Cause Categories**, Corrective Actions, and **Section VII** below.

PELL GRANT

The Pell Grant program, authorized under Title IV of the *Higher Education Act of 1965* (HEA), provides need based grants to low-income undergraduate and certain post baccalaureate students to promote access to postsecondary education.

DIRECT LOAN

The Direct Loan program, added to HEA in 1993 by the *Student Loan Reform Act of 1993*, authorizes the Department to make loans through participating schools to eligible undergraduate and graduate students and their parents.

IMPROPER PAYMENT ESTIMATES

The Department used a non-statistical alternative sampling and estimation methodology to estimate the improper payment rate for the Pell Grant and Direct Loan programs in FY 2017. Please refer to Section VII, Sampling and Estimation Methodology, for additional details about the methodology and its statistical limitations.

The Department's alternative methodology lacks the precision that a statistical methodology would provide, but is less costly and more efficient. Although the methodology was revised in FY 2017 to address some of the volatility issues, as described further below in Section VII, Sampling and Estimation Methodology, there continues to be both imprecision and volatility in the improper payments estimates that limit our capacity to establish accurate out-year reduction targets. Accordingly, reduction targets were set to the current year improper payment percentages. We will continue to work with relevant stakeholders to consider ways to increase precision and decrease volatility in future year methodologies and estimates.

Readers can obtain more detailed information on improper payments and all of the information reported in the past agency financial reports (AFR) at **https://paymentaccuracy.gov/**.

Figure 15. FY 2017 Pell Grant Estimates
(Dollars in Millions)

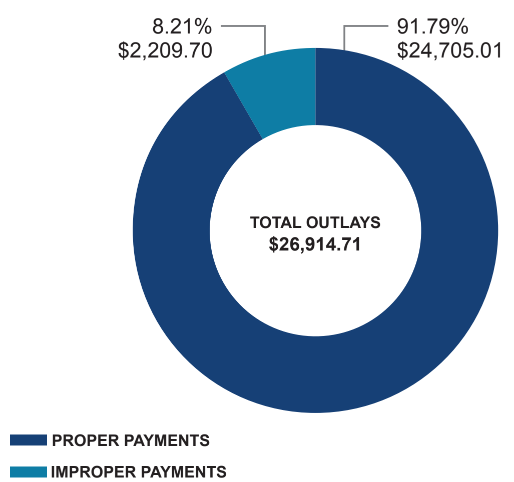
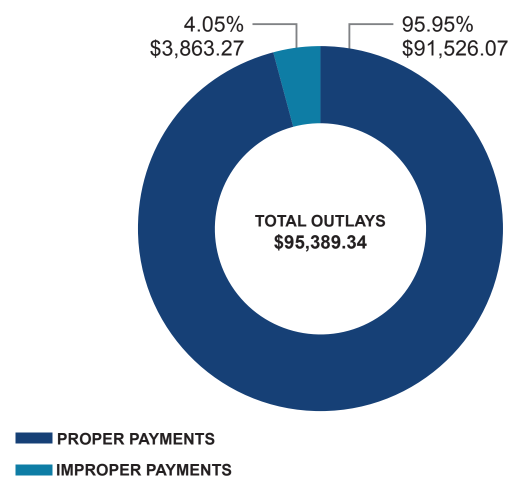


Figure 16. FY 2017 Direct Loan Estimates
(Dollars in Millions)



The source of the FY 2017 Pell Grant and Direct Loan outlay amounts is Federal Student Aid (FSA)'s Financial Management System (FMS).

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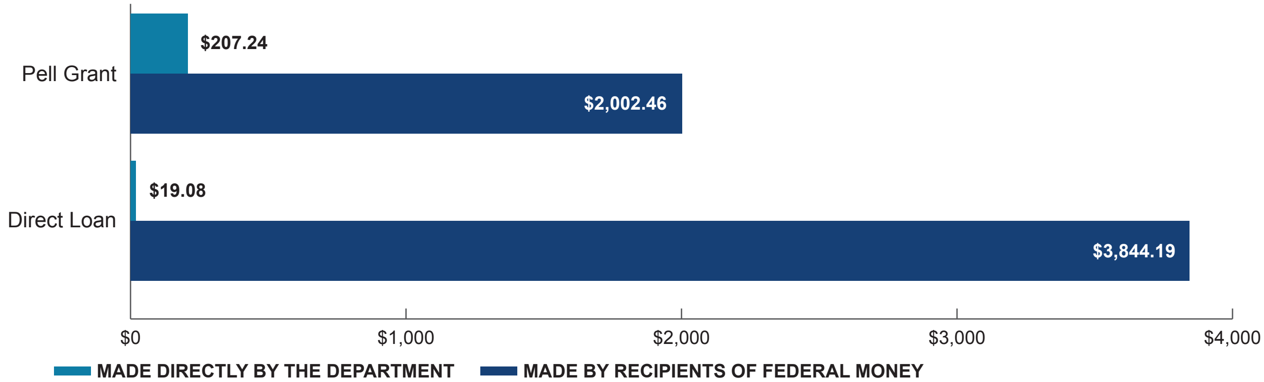
Table 3. FY 2017 Improper Payments for Risk-Susceptible Programs

Program	Overpayments (Dollars in Millions)	Overpayments (%)	Underpayments (Dollars in Millions)	Underpayments (%)
Pell Grants	$ 2,116.58	95.79%	$ 93.12	4.21%
Direct Loans	$ 3,329.62	86.19%	$ 533.65	13.81%
Total	**$ 5,446.20**	**89.68%**	**$ 626.77**	**10.32%**

Figure 17, FY 2017 Source of Improper Payments, summarizes the estimated amount of improper payments made directly by the Department and the amount of improper payments made by recipients of Federal money in FY 2017 for the Pell Grant and Direct Loan programs. Improper payments attributed to the Department include, for Pell, estimates of misreported income for students not selected for verification and who did not use the IRS Data Retrieval Tool (DRT) and, for Direct Loan, Consolidation and Refund improper payments related to the Department's loan servicing operations. Improper payments attributed to recipients of Federal money include improper disbursements of Title IV funds by schools.

Figure 17. FY 2017 Source of Improper Payments
(Dollars in Millions)



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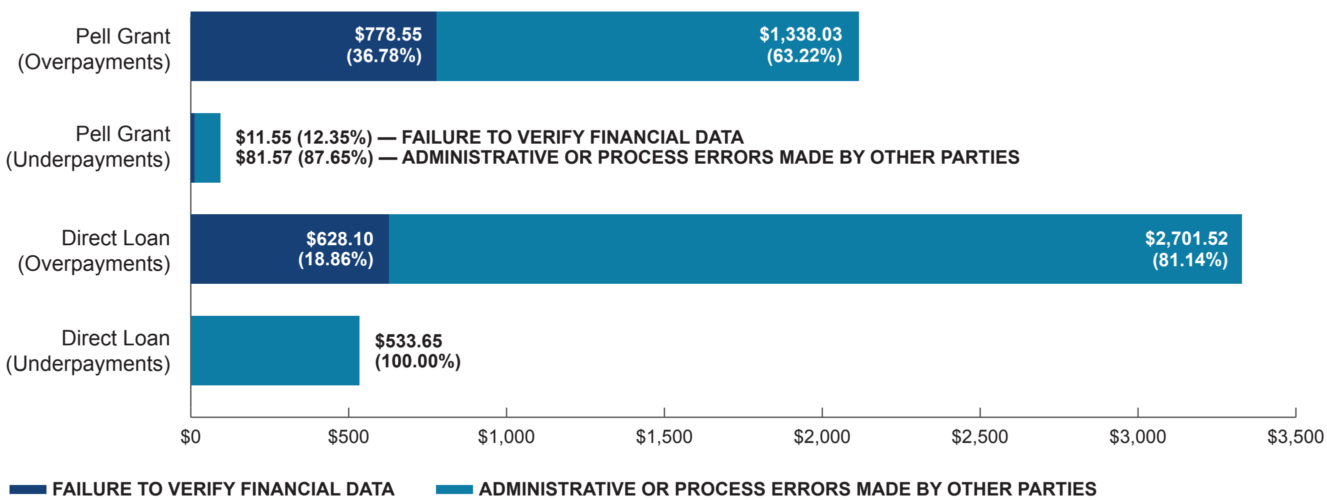
PAYMENT REPORTING ROOT CAUSE CATEGORIES

Our analysis indicated that the underlying root causes of improper payments for the Pell Grant and Direct Loan programs in FY 2017 were "Failure to Verify—Financial Data" and "Administrative or Process Errors Made by—Other Party." The root causes were identified through improper payment fieldwork and categorized using categories of error as defined in the October 2014 update to OMB Circular A-123, Appendix C (OMB Memorandum M-15-02). Specific root causes associated with the "Failure to Verify—Financial Data" category include, but are not limited to, ineligibility for a Pell Grant or Direct Loan and incorrect self-reporting of an applicant's income that leads to incorrect awards based on Expected Family Contribution. Specific root causes associated with the "Administrative or Process Errors Made by—Other Party" category include, but are not limited to, incorrect processing of student data by institutions during normal operations; student account data changes not applied or processed correctly; satisfactory academic progress not achieved; incorrectly calculated return records by institutions returning Title IV student aid funds; and processing errors at the servicer level.

Figure 18. FY 2017 Root Causes of Improper Payments
(Dollars in Millions)



IMPROPER PAYMENT CORRECTIVE ACTIONS

This section presents the corrective actions for the Pell Grant and Direct Loan programs.

The Department has established an integrated system of complementary oversight functions to help prevent, detect, and recover improper payments, and ensure compliance by all participating parties. These oversight functions include FSA's Enforcement Unit and Program Compliance, among others. FSA's Enforcement Unit is focused on identifying, investigating and adjudicating statutory and regulatory violations of the federal student aid programs and on resolving borrower defense claims. The Unit plays a central role in coordinating efforts to prevent third-party companies associated with student aid programs from harming students, parents and borrowers. Program Compliance likewise plays a central role in monitoring and oversight of the institutions (i.e., schools, guaranty agencies, lenders, and servicers) participating in the Department's federal student aid programs. The office establishes and maintains systems and procedures to support the eligibility, certification, and oversight of program participants. Program Compliance annually conducts approximately 150–300 Program Reviews of the approximately 6,000 eligible schools to assess institutions' compliance with Title IV regulations. Program Compliance evaluates a school's compliance with federal requirements, assesses liabilities for errors in performance, and identifies actions the school must take to make the Title IV, HEA programs, or the recipients, whole for any funds that were improperly managed and to prevent the same problems from recurring. A school with serious violations may be placed on heightened cash monitoring (HCM) for disbursements, lose funding for specific programs, or be terminated from participation in all Title IV programs for non-compliance. As of June 1, 2017, 558 schools were on HCM, and in FY 2017, 424 schools closed due to non-compliance and other reasons.

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The corrective actions listed below are specific to the root causes of improper payments identified from FY 2017 improper payment fieldwork.

Table 4. Corrective Actions—Root Cause Category

IPIA ERROR CAUSE	ROOT CAUSE CATEGORY	CORRECTIVE ACTIONS	COMPLETION TIMELINE
Failure to Verify Financial Data (Identified from Program Reviews)	Incorrect awards based on Expected Family Contribution (EFC)	EFC is a number that determines students' eligibility for federal student aid. The EFC formulas use the financial information students provide on their Free Application for Federal Student Aid (FAFSA) to calculate the EFC. Financial aid administrators (FAAs) subtract the EFC from students' cost of attendance (COA) to determine their need for federal student financial assistance offered by the Department. On July 10, 2017, FSA published the 2018–2019 EFC Formula Guide. The Guide includes EFC worksheets and tables for the 2018–2019 processing cycle which can help calculate an estimated EFC for students. The Guide provides information about the EFC formula worksheets, and direction about when to use the respective worksheets. FSA will publish the 2019–2020 Guide with updates to address any changes to the formulas and to clarify existing guidance. In FY 2017, the FSA Training Conference for Financial Aid Professionals was held from November 29 to December 2, 2016. The FSA Training Conference is a series of training and technical assistance programs provided by the Department for financial aid professionals charged with administering the Title IV student financial assistance programs on their campuses. In FY 2017, FSA addressed topics related to incorrect awards based on EFC. Over 2,000 unique schools registered for the FY 2017 conference. All 50 states were represented as well as the U.S. territories. More than 120 Foreign School officials attended from countries all over the world. The session recordings are publicly available. In FY 2018, FSA will again hold the FSA Training Conference. FSA will promote the training to financial aid professionals. The Training Conference will provide guidance about preventing incorrect awards based on EFC. FSA annually publishes the FSA Handbook. This publication is intended to provide guidance to college financial aid administrators and counselors about the administration of Title IV aid. The 2017–2018 Handbook includes volumes about Student Eligibility and Calculating Awards & Packaging. These volumes provide examples and guidance about using EFC to determine and calculate eligibility. FSA will publish an updated volume for 2018–2019, including content which addresses incorrect awards based on EFC. FSA has also designed, in collaboration with financial aid professionals, the FSA Assessments to help schools with compliance and improvement activities. The Assessments contain links to applicable laws and regulations related to administering Title IV funds. The Assessments address topics related to incorrect awards based on EFC such as student eligibility and financial need and packaging. FSA updated the Assessments in May 2017. In FY 2018, FSA will again update the FSA Assessments to help address incorrect awards based on EFC. FSA also offers a free training program: FSA Coach. The FSA Coach training suite provides training in the fundamentals of federal student aid program administration, focused training in specific topics of interest such as those related to correctly awarding funds based on EFC such as Beyond the Basics of Packaging. The Basic Training Course for 2016–2017 included 38 lessons in the fundamentals of federal student aid program administration and over 45 hours of instruction. For FY 2018, FSA will publish updated training content that addresses annual updates for the new award year, and interactive exercises and self-assessments to help users assess their mastery of the knowledge and skills needed to correctly award based on EFC. The Department maintains a blog to provide insights on the activities of schools, programs, grantees, and other education stakeholders to promote continuing discussion of educational innovation and reform. For example, on September 12, 2017, the Department published an article about common FAFSA mistakes including not reading definitions clearly and inputting incorrect information which may impact EFC. The Department will continue to update the blog to address incorrect awards based on EFC.	In FY 2018, FSA will publish an updated EFC Formula Guide for award year 2019–2020. FSA will hold the FY 2018 FSA Training Conference for Financial Aid Professionals from November 28 to December 1, 2017. In FY 2018, FSA will publish the 2018–2019 FSA Handbook, including updated content which addresses incorrect awards based on EFC. In FY 2018, FSA will update the FSA Assessments to help address incorrect awards based on EFC. In FY 2018, the Department will maintain its blog, publishing additional articles which address incorrect awards based on EFC. In FY 2018, FSA will publish updated free training content via FSA Coach.

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Failure to Verify Financial Data (Identified from Program Reviews)	Verification deficiencies	Verification is the process where schools, in partnership with FSA, confirm the accuracy of select data reported by students on their FAFSA. FSA's Central Processing System selects which applications are to be verified. Schools also have the authority to verify additional students. Students selected for verification are placed in one of several verification tracking groups to determine which FAFSA information must be verified. Items verified include Adjusted Gross Income (AGI), taxes paid, and other tax data. Income verification helps detect and prevent misreported income. FSA will complete an analysis of the verification data to inform the upcoming award year cycle before launch (to allow for system changes) using the most recently available data at that time. As with prior years' verification selection, data-based statistical analysis will continue to be used by the Department to select for verification of the 2018–2019 FAFSA applicants with the highest statistical probability of error and the impact of such error on award amounts. FSA will also continue to enhance verification procedures, requiring selected schools to verify specific information reported on the FAFSA by student aid applicants. FSA will publish an updated notice in the Federal Register announcing the FAFSA information schools and financial aid applicants may be required to verify, as well as the acceptable documentation for verifying FAFSA information. For FY 2017, this notice was published in the Federal Register on May 5, 2017. From November 29 to December 2, 2016, FSA held its annual FSA Training Conference for Financial Aid Professionals to provide training and technical assistance to financial aid professionals charged with administering the Title IV student financial assistance programs. FSA addressed topics related to verification, including a session on verification requirements for the 2017–18 FAFSA cycle and details on the institutional resolution of conflicting information between the 2016–2017 and 2017–2018 FAFSAs. The session recordings are publicly available. In FY 2018, FSA will again hold the FSA Training Conference. FSA will promote the training to financial aid professionals. The Training Conference will provide updated guidance to help prevent verification deficiencies. FSA annually publishes the FSA Handbook. This publication is intended for college financial aid administrators and counselors. In FY 2017, FSA published a 2017–2018 Verification Guide as part of the 2017–2018 FSA Handbook. The Guide was updated as of May 2017. The updates for 2017–2018 include updates to address changing requirements, clarify existing requirements, and provide links to new resources including a new online Q and A. For 2018–2019, FSA will publish an updated Verification Guide to address any new requirements and to provide additional clarification about existing requirements. FSA also publishes questions and answers about verification on its website. Additional questions and answers were added in FY 2017. FSA added questions and answers to help clarify verification requirements if additional questions are identified. FSA designed, in collaboration with financial aid professionals, a Verification Assessment, part of the FSA Assessments which help schools with compliance and improvement activities. The Verification Assessment, updated in March 2017, contains a consolidated set of links to applicable laws and regulations to assist schools with understanding the verification requirements, and guidance and examples of verification issues, such as conflicting information. FSA also offers free verification related training via FSA Coach, a suite of interactive courses for new and experienced financial aid administrators in the essential knowledge and skills needed to successfully administer the federal student aid programs. For FY 2018, FSA will publish updated training content that addresses annual updates for the new award year, and interactive exercises and self-assessments to help users assess their mastery of the knowledge and skills needed to properly perform verification.	In FY 2018, FSA will complete an analysis of the verification data to inform the upcoming award year cycle approximately nine months before launch (to allow for system changes) using the most recently available data at that time. FSA will publish an updated listing of FAFSA information schools and applicants may be required to verify for the 2019–2020 award year in the Spring 2018. FSA will hold the FY 2018 FSA Training Conference for Financial Aid Professionals from November 28 to December 1, 2017. In FY 2018, FSA will publish the 2018–2019 Verification Guide, including updated content which addresses verification deficiencies. In FY 2018, FSA will publish additional questions and answers about verification requirements to its website, if identified. In FY 2018, FSA will update the Verification Assessment to help address verification deficiencies. In FY 2018, FSA will publish updated free training content related to verification via FSA Coach.

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Failure to Verify Financial Data (Identified from Program Reviews)	Verification deficiencies	Beginning with the 2017–2018 award year, applicants are able to complete their FAFSA using "prior-prior year" tax data. The use of prior-prior tax data on the FAFSA (as opposed to one-year prior information) allows students and families to file the FAFSA earlier. Historically, the FAFSA was made available January 1st of each calendar year, yet it was uncommon for a family or individual to be prepared to file an income tax return in the month of January. Under the prior-prior system change, the FAFSA is available on October 1st, rather than January 1st, and students are able to use the prior-prior year's completed income tax return. The IRS DRT which allows for automated population of a student's FAFSA with tax return data, reducing opportunity for misreported income, can now be used by more students and families, since tax data from two-years prior is readily available upon access to the application. The impact of prior-prior is assessed through annual reporting of IRS DRT usage as part of the Pell Grant and Direct Loan supplemental measures available via **paymentaccuracy.gov**.	Prior-prior was implemented on October 1, 2016. In FY 2018, FSA will expand the population available to use the IRS DRT to include amended tax returns, and tax data transferred using the IRS DRT will be masked to protect applicant and parent privacy.
Failure to Verify Financial Data (Identified from Program Reviews)	Verification deficiencies	FSA continues to utilize and promote the IRS DRT, which enables Title IV student aid applicants and, as needed, parents of applicants, to transfer certain tax return information from an IRS website directly to their online FAFSA. To increase IRS DRT usage, and thereby reduce improper payments associated with misreported income, FSA has taken action to vigorously increase access to and promote the tool. For the 2018–2019 application cycle, FSA will be expanding the population available to use the tool to include amended tax returns. Additionally, the data transferred from the IRS will be masked to improve the privacy of applicant and parent tax information. As part of the ongoing effort to expand usage of the IRS DRT by applicants and parents, FSA publishes information about the benefits and use of the IRS DRT, including on its blog, and sends electronic announcements via Information for Financial Aid Professionals urging institutions to promote the use of the IRS DRT. The IRS disabled the IRS DRT in March 2017 for the 2017–18 FAFSA following concerns that data from the tool could be used by identity thieves to file fraudulent tax returns. Additional security and privacy protections have been added to address concerns that data from the tool could be used by identity thieves to file fraudulent tax returns. The IRS DRT is available to use with the 2018–19 FAFSA form. The IRS DRT remains the fastest, most accurate way to input tax return information into the FAFSA form. The latest information about the status of the IRS DRT is published on **studentaid.ed.gov**. FSA actively monitors the impact of its promotion of the IRS DRT. For example, FSA reports IRS DRT usage figures, disaggregated by dependency status and tax filing status on a quarterly basis. FSA also conducts an annual FAFSA/IRS Data Statistical Study (Study). This Study includes an analysis of Pell applicants based on IRS DRT usage. Additionally, FSA monitors anecdotal reports from schools and IRS DRT users via annual surveys, usability studies, and the FSA Feedback System, among other mechanisms.	Given the importance of IRS DRT usage in preventing misreported income, IRS DRT usage is reported on an annual basis on **paymentaccuracy.gov** as supplemental measures for the Pell Grant and Direct Loan programs. The supplemental measure results will be posted by the end of November, 2017.

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Administrative or Process Errors by Other Party (Identified from Program Reviews)	Incorrect processing of funds during normal operations	Incorrect processing of funds during normal operations include failure to properly pay credit balances, ineligible use of Title IV funds, incorrect disbursement periods, inaccurate application of credit balance to charges for program overages, incorrect calculation of lifetime eligibility used (LEU) and Direct Loan annual loan limits, and incorrect calculation of Cost of Attendance (COA). From November 29 to December 2, 2016, FSA held its annual FSA Training Conference for Financial Aid Professionals to provide training and technical assistance to financial aid professionals charged with administering the Title IV student financial assistance programs. The FY 2017 Training Conference included several sessions related to processing of funds during normal operations including: 150% Direct Subsidized Loan Limit; How Modules Can Affect Title IV; and Foreign Schools: Cost of Attendance. The session recordings are publicly available. In FY 2018, FSA will again hold the FSA Training Conference. FSA will promote the training to financial aid professionals. The Training Conference will provide updated guidance related to process of funds during normal operations. FSA annually publishes the FSA Handbook for college financial aid administrators and counselors. The 2017–2018 Handbook includes volumes about Calculating Awards & Packaging, and Processing Aid and Managing FSA Funds, updated in September 2017 and August 2017, respectively. These volumes provide examples and guidance about processing of funds during normal operations. FSA will publish updated volumes for 2018–2019. FSA designed, in collaboration with financial aid professionals, a Fiscal Management and Student Eligibility Assessment, part of the FSA Assessments which help schools with compliance and improvement activities. The Fiscal Management Assessment and Student Eligibility Assessment, both updated in May 2017, contain a consolidated set of links to applicable laws and regulations related to processing of funds during normal operations, and related guidance, worksheets, and checklists to help schools comply with these requirements. FSA also offers free training related to processing of funds during normal operations via FSA Coach, a suite of interactive courses for new and experienced financial aid administrators in the essential knowledge and skills needed to successfully administer the federal student aid programs. For example, FSA offered a Limits to Direct Subsidized Loan Interest Benefits, and a Monitoring for Pell Grant LEU and Resolving Unusual Enrollment History Flags training course for 2016–2017 via FSA Coach. FSA also added a new course related to processing of funds during normal operations for 2016–2017: Administering Federal Student Aid Programs in Nonstandard Terms. For FY 2018, FSA will publish updated training content that addresses annual updates for the new award year, and interactive exercises and self-assessments to help users assess their mastery of the knowledge and skills needed to process funds during normal operations.	FSA will hold the FY 2018 FSA Training Conference for Financial Aid Professionals from November 28 to December 1, 2017. In FY 2018, FSA will publish the 2018–2019 FSA Handbook, including updated content which addresses processing of funds during normal operations. In FY 2018, FSA will update the Fiscal Management and Student Eligibility Assessments. In FY 2018, FSA will publish updated free training content related to processing of funds during normal operations via FSA Coach.

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Administrative or Process Errors by Other Party (Identified from Program Reviews)	Incorrect processing of student data during normal operations	Incorrect processing of student data during normal operations includes inaccurate or inadequate tracking of clock hours, credit hours, and other documentation of attendance. From November 29 to December 2, 2016, FSA held its annual FSA Training Conference for Financial Aid Professionals to provide training and technical assistance to financial aid professionals charged with administering the Title IV student financial assistance programs. The FY 2017 Training Conference included several related sessions: Administering Adds, Drops, and Withdrawals; Basics of Determining Academic Calendars (Standard, Non-Standard, and Non-Term); and Administering Title IV Aid for Transfer Students. The session recordings are publicly available. In FY 2018, FSA will again hold the FSA Training Conference. FSA will promote the training to financial aid professionals. The Training Conference will provide updated guidance about processing of student data during normal operations. FSA annually publishes the FSA Handbook for college financial aid administrators and counselors. The 2017–2018 Handbook includes a Student Eligibility volume, updated in May 2017, which includes a section devoted to enrollment status. This volume provides examples and guidance about processing of student data during normal operations. FSA will publish an updated volume for 2018–2019. FSA designed, in collaboration with financial aid professionals, a Fiscal Management and Student Eligibility Assessment, part of the FSA Assessments which help schools with compliance and improvement activities. The Fiscal Management Assessment and Student Eligibility Assessment, both updated in May 2017, contain links to applicable laws and regulations about disbursing funds to regular students enrolled in eligible programs and enrollment record retention. The Assessments also include related guidance, worksheets, and checklists to help schools comply with these requirements. FSA also offers free training related to processing of student data during normal operations via FSA Coach, a suite of interactive courses for new and experienced financial aid administrators in the essential knowledge and skills needed to successfully administer the federal student aid programs. For FY 2018, FSA will publish updated training content that addresses annual updates for the new award year, and interactive exercises and self-assessments to help users assess their mastery of the knowledge and skills needed to process student data during normal operations.	FSA will hold the FY 2018 FSA Training Conference for Financial Aid Professionals from November 28 to December 1, 2017. In FY 2018, FSA will publish the 2018–2019 FSA Handbook, including updated content which addresses processing of student data during normal operations. In FY 2018, FSA will update the Fiscal Management and Student Eligibility Assessments. In FY 2018, FSA will publish updated free training content related to processing of funds during normal operations via FSA Coach.
Administrative or Process Errors by Other Party (Identified from Program Reviews)	Incorrect awards based on eligibility	Schools that disburse Title IV funds must demonstrate that they are eligible to participate in these programs before they can be certified for participation and must maintain eligibility. Further, student and parent borrowers must satisfy eligibility requirements for the Title IV funds. From November 29 to December 2, 2016, FSA held its annual FSA Training Conference for Financial Aid Professionals to provide training and technical assistance to financial aid professionals charged with administering the Title IV student financial assistance programs. The FY 2017 Training Conference included several sessions related to student and institutional eligibility: Maintaining Your Institutional Eligibility; Resolving Citizen and Eligible Noncitizen Issues; and Foreign Schools: Student Eligibility, SAP, and R2T4. The session recordings are publicly available. In FY 2018, FSA will again hold the FSA Training Conference. FSA will promote the training to financial aid professionals. The Training Conference will provide updated guidance about confirming student and institutional eligibility. FSA annually publishes the FSA Handbook for college financial aid administrators and counselors. The 2017–2018 Handbook includes volumes for Student Eligibility and School Eligibility and Operations, updated in March and June 2017, respectively. This volume provides examples and guidance about student and school eligibility. FSA will publish an updated volume for 2018–2019. FSA designed, in collaboration with financial aid professionals, Student Eligibility and Institutional Eligibility Assessments, part of the FSA Assessments which help schools with compliance and improvement activities. The Student Eligibility Assessment and Institutional Eligibility Assessment, both updated in May 2017, contain a consolidated set of links to applicable laws and regulations related to eligibility, and corresponding guidance, worksheets, and checklists. FSA also offers free training related to maintaining and confirming student and institutional eligibility via FSA Coach, a suite of interactive courses for new and experienced financial aid administrators in the essential knowledge and skills needed to successfully administer the federal student aid programs. For FY 2018, FSA will publish updated training content that addresses annual updates for the new award year, and interactive exercises and self-assessments to help users assess their mastery of the knowledge and skills needed to award funds to eligible students attending eligible programs and institutions.	FSA will hold the FY 2018 FSA Training Conference for Financial Aid Professionals from November 28 to December 1, 2017. In FY 2018, FSA will publish the 2018–2019 FSA Handbook, including the Student Eligibility and School Eligibility and Operations volumes. In FY 2018, FSA will update the Student Eligibility and Institutional Eligibility Assessments. In FY 2018, FSA will publish updated free training content related to awarding funds to eligible students attending eligible programs and institutions.

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Administrative or Process Errors by Other Party (Identified from Program Reviews)	Satisfactory Academic Progress (SAP) deficiencies	According to federal regulations, all schools participating in Title IV programs must establish satisfactory academic progress (SAP) standards. SAP is a student-eligibility requirement and schools are responsible for making sure that students who are not making SAP do not receive student financial aid funds. From November 29 to December 2, 2016, FSA held its annual FSA Training Conference for Financial Aid Professionals to provide training and technical assistance to financial aid professionals charged with administering the Title IV student financial assistance programs. The FY 2017 Training Conference included two sessions related to SAP: Satisfactory Academic Progress (SAP); and Foreign Schools: Student Eligibility, SAP, and R2T4. The session recordings are publicly available. In FY 2018, FSA will again hold the FSA Training Conference. FSA will promote the training to financial aid professionals. The Training Conference will provide updated SAP guidance. FSA annually publishes the FSA Handbook for college financial aid administrators and counselors. The 2017–2018 Handbook includes a Student Eligibility volume, updated in May 2017, which includes a section devoted to SAP. This volume provides examples and guidance about SAP-related issues. FSA will publish an updated volume for 2018–2019. FSA designed, in collaboration with financial aid professionals, a Satisfactory Academic Progress Assessment, part of the FSA Assessments which help schools with compliance and improvement activities. The Satisfactory Academic Progress Assessment, updated in May 2017, contains a consolidated set of links to applicable SAP laws and regulations, and related guidance and worksheets. FSA also offers free training related to SAP via FSA Coach, a suite of interactive courses for new and experienced financial aid administrators in the essential knowledge and skills needed to successfully administer the federal student aid programs. For FY 2018, FSA will publish updated training content that addresses annual updates for the new award year, and interactive exercises and self-assessments to help users assess their mastery of the knowledge and skills needed to monitor SAP.	FSA will hold the FY 2018 FSA Training Conference for Financial Aid Professionals from November 28 to December 1, 2017. In FY 2018, FSA will publish the 2018–2019 FSA Handbook, including updated SAP-related guidance. In FY 2018, FSA will update the Satisfactory Academic Progress Assessment. In FY 2018, FSA will publish updated free training content related to SAP via FSA Coach.
Administrative or Process Errors by Other Party (Identified from Program Reviews)	Incorrectly calculated return records	When a recipient of Title IV funds ceases to be enrolled prior to the end of a payment period or period of enrollment, schools are required to determine the earned and unearned Title IV aid a student has earned as of the date the student ceased attendance based on the amount of time the student spent in attendance or, in the case of a clock-hour program, was scheduled to be in attendance. From November 29 to December 2, 2016, FSA held its annual FSA Training Conference for Financial Aid Professionals to provide training and technical assistance to financial aid professionals charged with administering the Title IV student financial assistance programs. The FY 2017 Training Conference included five sessions devoted to incorrectly calculated return records: Return to Title IV Funds (R2T4): Basic Principles; R2T4 Funds: Advanced Concepts; R2T4 and Credit-Hour Programs; R2T4 and Clock-Hour Programs; and Student Eligibility, SAP, and R2T4. The session recordings are publicly available. In FY 2018, FSA will again hold the FSA Training Conference. FSA will promote the training to financial aid professionals. The Training Conference will provide updated guidance for correctly calculating return records. FSA annually publishes the FSA Handbook for college financial aid administrators and counselors. The 2017–2018 Handbook includes a volume dedicated to Withdrawals and the Return of Title IV Funds, updated in June 2017. This volume provides examples and guidance about the actions a school is required to take when a student withdraws. FSA will publish an updated volume for 2018–2019. FSA designed, in collaboration with financial aid professionals, a Return of Title IV Funds Assessment, part of the FSA Assessments which help schools with compliance and improvement activities. The Return of Title IV Funds Assessment, updated in May 2017, contains a consolidated set of links to applicable laws and regulations for the treatment of Title IV funds when a student withdraws, and related guidance, worksheets, and checklists to help schools comply with these requirements. FSA also offers free training related to correctly calculating return records via FSA Coach, a suite of interactive courses for new and experienced financial aid administrators in the essential knowledge and skills needed to successfully administer the federal student aid programs. For example, the FSA Coach offered a Beyond the Basics of R2T4, Including R2T4 Modules intermediate training course for 2016–2017. For FY 2018, FSA will publish updated training content that addresses annual updates for the new award year, and interactive exercises and self-assessments to help users assess their mastery of the knowledge and skills needed to correctly calculate return records.	FSA will hold the FY 2018 FSA Training Conference for Financial Aid Professionals from November 28 to December 1, 2017. In FY 2018, FSA will publish the 2018–2019 FSA Handbook, including updated content which addresses withdrawals and the return of Title IV funds. In FY 2018, FSA will update the Return of Title IV Funds Assessment. In FY 2018, FSA will publish updated free training content related to return of Title IV funds via FSA Coach.

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Administrative or Process Errors by Other Party (Identified from FFEL to Direct Loan Consolidations)	Incorrect processing of Loan Verification Certificate (LVC)	In FY 2017, of the 120 Direct Loan Consolidation payments sampled, 17 improper payments were identified due to incorrect processing of LVCs. There was a 5.20% FFEL to Direct Loan Consolidation error rate due to incorrect processing of LVCs. These improper payments represent 0.02% of the Direct Loan improper payment estimate. In FY 2018, FSA will meet with the TIVAS to discuss incorrect processing of LVCs, determine whether additional training may be beneficial to help ensure the correct account, lender, and loan information is processed, and whether the TIVAS' procedures for processing LVCs should be updated to mitigate the risk of improper payments. FSA will initiate an assessment of the feasibility and effectiveness of the TIVAS implementing additional levels of QA/QC over processing of LVCs.	FSA will meet with the TIVAS in FY 2018. In FY 2019, FSA will initiate an assessment of the feasibility and effectiveness of servicers implementing additional levels of QA/QC over processing of LVCs.
Administrative or Process Errors by Other Party (Identified from FFEL to Direct Loan Consolidations)	Documentation provided by servicer	In FY 2016, FSA developed and shared with the TIVAS a Direct Loan Consolidation improper payment fieldwork checklist. This checklist provides the TIVAS guidance on the documentation that should be maintained to demonstrate that FFEL to Direct Loan Consolidations were made to eligible borrowers, for eligible purposes, and for the correct amount. In FY 2016, of the 120 Direct Loan Consolidation payments sampled, 36 payments were identified as improper payments due to lack of sufficient supporting documentation provided by the TIVAS. In FY 2017, of the 120 Direct Loan Consolidation payments sampled, two improper payments were identified due to lack of sufficient supporting documentation. There was a 0.01% FFEL to Direct Loan Consolidation error rate due to lack of sufficient documentation provided by the servicers. These improper payments represent 0.00% of the Direct Loan improper payment estimate. In FY 2018, FSA will reiterate the requirement to maintain sufficient documentation to support FFEL to Direct Loan Consolidations were made properly.	In FY 2018, FSA will provide the Direct Loan Consolidation improper payment fieldwork checklist along with other guidance regarding documentation that must be maintained to the TIVAS. In FY 2018, FSA will also send a communication to the TIVAS reiterating the need to maintain sufficient documentation to support FFEL to Direct Loan Consolidations were made properly.
Administrative or Process Errors by Other Party (Identified from Direct Loan Refunds)	Not applicable; no Direct Loan Refund improper payments were identified in FY 2017.	In FY 2017, FSA developed and shared with the TIVAS a Direct Loan Refund improper payment fieldwork checklist. This checklist provides the TIVAS guidance on the documentation that should be maintained to demonstrate that refunds were made to eligible lenders and borrowers, for eligible purposes, and for the correct amount. In FY 2016, of the 120 Direct Loan Refund payments sampled, 10 payments were identified as improper payments due to lack of sufficient supporting documentation provided by the TIVAS. In FY 2017, of the 120 Direct Loan Refund payments sampled, no improper payments were identified. The Direct Loan Refund improper payment fieldwork checklist supported the collection of documentation from the servicers evidencing that all sampled Direct Loan Refunds were proper. No additional corrective actions are identified for FY 2018 as no Direct Loan Refund improper payments were identified in FY 2017.	In FY 2018, FSA will provide the Direct Loan Refund improper payment fieldwork checklist along with other guidance regarding documentation that must be maintained to the TIVAS.

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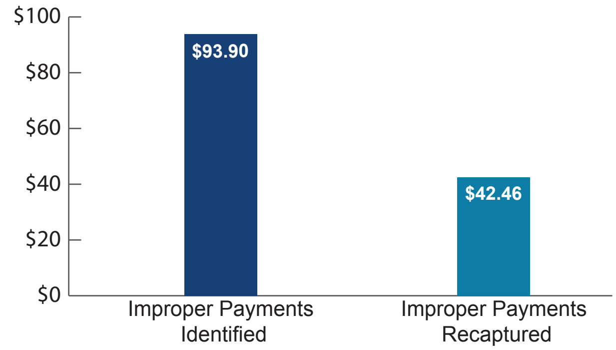
II. RECAPTURE OF IMPROPER PAYMENTS REPORTING

Agencies are required to conduct recovery audits for contract payments and programs that expend $1 million or more annually if conducting such audits would be cost effective. The Department determined that payment recapture audits would not be cost effective for any of its loan and grant programs or for contracts. 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**.

The Department identifies and recovers improper payments through sources other than payment recapture audits. 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. The Department also analyzes the return of grant funds from recipients to determine if they are due to improper payments. When an improper payment is detected and deemed collectable, the Department establishes an account receivable and pursues collections. Recoveries are also made through grant program, payroll, and other offsets. Recipients of Department funds can appeal management's decisions regarding funds to be returned to the Department or they may go bankrupt before the Department can collect, thereby delaying or decreasing the amounts the Department is able to collect. Additionally, the Department has wide discretion to make a determination to not collect improper payments from grantees in cases where it determines that pursuing collections would cause more harm to the federal interest. For these and other reasons, not all identified improper payments will ultimately be collected and collections will not necessarily be made in the same year as when the improper payments were identified.

Improper payments recovered outside of formal recapture programs, depicted in the graph below, shows that $93.90 million of improper payments were identified and $42.46 million were recovered. For detailed information on identified and collected improper payments, readers can visit **https://paymentaccuracy.gov/**. The Department continues to work to improve its methods to identify, collect, and report on improper payment collections.

Figure 19. Improper Payments Identified and Captured
(Dollars in Millions)



III. AGENCY IMPROVEMENT OF PAYMENT ACCURACY WITH THE DO NOT PAY (DNP) INITIATIVE

The Department continues its efforts to prevent and detect improper payments via the DNP Business Center Portal as required by the *Improper Payments Elimination and Recovery Improvement Act of 2012* (IPERIA). During FY 2017, 1,477,930 payments, totaling $163.2 billion, were reviewed for possible improper payments through the DNP Portal screening including the Death Master File and the System for Award Management File. The Department validated all potential improper payments identified through this screening process were properly adjudicated and reported to Treasury timely.

Treasury DNP Analytics—Agency Insights Report

The Department worked with Treasury Department's DNP Data Analytics team to assess approximately 2.85 million Education payments (totaling about $388.6 billion) disbursed through the Payment Automation Manager system from November 1, 2014 to November 30, 2016. Treasury's analysis on the Department's data quality was released in a June 2017 *Agency Insight Report* (AIR), which included a high-level overview of key findings and insights derived from the Treasury analysis.

The AIR report indicated that the Department's payment data is of high quality, to include having over 99.9% of the payment records containing legitimate Tax Identification Number data. Additionally, very few of the Department's payment patterns and trends indicated that there was a high risk of being improper. The Department intends to continue working with Treasury to conduct

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further analysis of our payment data to ensure it remains at the highest quality possible.

IV. BARRIERS

The Department must rely on controls established by fund recipients who make payments on behalf of the Department. These controls are outside of the Department's operational authority. In designing controls, the Department strives to strike the right balance between providing timely and accurate payments to grant recipients and students, while at the same time ensuring that the controls are not too costly and burdensome to fund recipients. Additionally, there are limitations to the availability of data necessary to verify FAFSA information without increasing the burden on schools and students. For example, the Internal Revenue Code does not currently permit a database match with the IRS which would eliminate the need to rely on tax transcripts submitted by the applicant (and the applicant's parent, if the applicant is a dependent) to verify income data in cases where the IRS DRT is not used to transfer tax information directly into the FAFSA.

A detailed discussion of program-specific barriers can be found in the **FY 2012 Report on the Department of Education's Payment Recapture Audits**.

V. ACCOUNTABILITY

The Department offices, managers, and staff are held accountable for promoting payment integrity by being held accountable for maintaining effective controls in their day-to-day jobs and key management officials have specific expectations related to payment integrity included in their annual performance plans. Additionally, Accountable Officials are identified for the Department and FSA.

VI. AGENCY INFORMATION SYSTEMS AND OTHER INFRASTRUCTURE

Audit Follow-up

The Department gathers and manages thousands of audits of grantees related to our loan and grant programs. Audit records are managed, maintained, and analyzed in the Department's automated audit tracking systems. Audits are a key source of identifying risks and in identifying potential improper payments made by outside entities. The Department has demonstrated tremendous success in working with grant recipients to resolve audit findings timely. The Department is continuously looking for options to gain further insight from audit reports and is partnering with OMB and others to do so.

VII. SAMPLING AND ESTIMATION METHODOLOGY

For 2014 AFR reporting, the Department obtained approval from OMB to use an alternative methodology for estimating improper payments for the Pell Grant and Direct Loan programs. The methodology is an alternative estimation methodology as it has statistical limitations, including reliance on non-random sampling and limited sample size. The methodology leverages data collected through FSA Program Reviews, which include procedures such as determining whether schools properly performed verification of students' self-reported income, identifying conflicting applicant data, student academic performance, and eligibility on the disbursed funds for a sample of students in each review. The alternative methodology provides for a more efficient use of resources by integrating the estimation methodology into core FSA monitoring functions. The Department also determined that it would be too costly and inefficient, and potentially increase the burden on schools and students to an unacceptable level, to increase the reviews that make up its alternative methodology to a level that would meet the precision rate prescribed by OMB.

On April 30, 2017, the Department submitted to OMB for approval updates to the alternative sampling plan and estimation methodology. These updates to the methodology incorporate changes in response to findings from the OIG's FY 2016 IPERA *Compliance Audit Report, U.S. Department of Education's Compliance with Improper Payment Reporting Requirements for Fiscal Year 2016*. The updates include grouping Program Reviews into two rather than three strata to help address the volatility of the improper payment estimates, which had been noted in the past by the Department and OIG. OMB approved the Department's updates to the alternative sampling plan and estimation methodology on September 28, 2017. The methodology is described in detail on the Department's **improper payments website**.

The Department recognizes that its alternative estimation methodology can lead to volatile improper payment estimates. This is largely due to fewer program reviews conducted at lower-risk schools even though the lower-risk schools often account for a much larger portion of the dollars disbursed and likely have lower rates of improper payment. As a result, the potential exists for

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student-level improper payment fieldwork results of a single observation (such as a single student or school) at lower-risk schools to significantly influence the improper payment estimates, resulting in volatility of the model.

ADDITIONAL COMMENTS

The Department recently stepped up efforts to enhance payment integrity through two new initiatives: 1) establishment of a Payment Integrity Workgroup (PIWG) and 2) continued refinements to its Continuous Controls Monitoring System (CCMS).

PIWG

The Department formed the PIWG to create the framework and governance structure to assess the various types of payments made by the Department—including Contracts, Payroll, Interagency Agreements (IAAs), Government Purchase Cards (P-Cards), Travel, and Transit Benefits.[2] The PIWG is working to fully document and assess end-to-end business processes and existing controls by payment type to be sure that we understand the unique risks and other relevant characteristics so the Department can design more effective business processes and controls. The methodology for the PIWG work is based on information contained in OMB Circular A-123, Appendices A and C.

The standup of the PIWG and leadership involvement reflects the recognition by the Department of the critical importance that payment integrity plays in demonstrating financial stewardship to the American taxpayer, considering that the Department's gross outlays totaled over $300 billion in FY 2017.

CCMS

The Department developed CCMS to integrate payment analysis, case management, and reporting functions to automate and streamline the detection, referral for recovery, and prevention of improper payments. The Department intends to continue to expand the CCMS capacities and to integrate it with the Department's existing business processes and systems to provide additional assurance regarding payment integrity that is supported by data-driven evidence.

[2] The review of IAAs and Contracts did not include FSA policies and procedures.

Risk Management

The Department took measures to prevent improper payments through the use of the Decision Support System to run Entity Risk Review reports for non-FSA grant awards. Using data drawn from the Department's grants business system, the Federal Audit Clearinghouse, the Institutes of Higher Education accreditation reporting, and Dun & Bradstreet, this report identifies financial, programmatic, and controls risks posed by award to the prospective grantee. Grant officers and awarding officials use the Entity Risk Review reports in the pre-award stage of the grant process to assess grantees' risk and assist in the determination of special conditions for grant awards. They also apply these reports in devising monitoring plans for the life of the grant, strengthening them as the Department's first line of defense against improper payments by grantees.

In FY 2017, the Department's discretionary grant awards were assessed for risk prior to award in the areas of: financial stability; adequacy of management systems to meet applicable standards; performance history; and compliance with applicable laws and regulations, including those related to Suspension and Debarment. This work successfully demonstrated the Department's early compliance with 2 C.F.R. Section 205, *Federal Awarding Agency Review of Risk Posed by Applicants*.

Enterprise Risk Management (ERM)

As required by OMB Circular A-123, the Department is developing a strategic objective to identify, assess, monitor, and manage enterprise risks. An important first step in that process was the establishment of a governance structure that included bringing together senior leadership from across the Department to begin to discuss and debate the most important risks to mission accomplishment. The implementation strategy for ERM will include actions intended to:

- Evaluate and improve the ERM framework, to include finalizing a risk profile, assigning risk owners, and identifying risk mitigation plans;
- Create a risk-aware culture where risk appetite and risk tolerance are openly discussed;
- Integrate the ERM concepts within the Department's existing internal control and governance frameworks; and
- Manage enterprise risks in a coordinated and integrated manner aligned with achievement of the Department's Strategic Plan, which would include considering risks in resource allocation decisions.

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FRAUD REDUCTION EFFORTS

The Department actively participated with OMB and other agencies to develop the implementation plan for the *Fraud Reduction and Data Analytics Act* (FRDAA) of 2016. On May 12, 2017, OMB sent a FRDAA implementation plan to Congress. Since then, OMB has been working with federal agencies to issue additional guidelines and to share best practices. The Department will continue to work with OMB to implement the FRDAA. Although controls related to the prevention and detection of improper payments are often the same for fraud detection, reporting on fraud presents unique challenges for agencies, including:

- Establishing a common definition for fraud that is relevant to the specific agency programs and activities;
- Developing a fraud taxonomy to accurately address areas of fraud risk; and
- Accurately estimating and reporting the rate of fraud, considering that due-process, intent, and legal factors are involved with fraud, which are not present in improper payments.

Despite these challenges, the Department will continue to refine its business processes to be in a better position to define, deter, detect, and take action on fraud. In July 2015, GAO published its Fraud Risk Management Framework and Selected Leading Practices and the Department has implemented a number of leading practices consistent with that framework. For example, FSA continues to make expanded use of data analytics to identify anomalies, trends, and patterns in application and disbursement data to help identify potential fraud. FSA also continues to collaborate with OIG to receive and analyze fraud referrals to help identify potential fraud indicators for suspicious student activity. FSA established a fraud unit and recently appointed a Senior Advisor on Fraud to support OIG fraud referral analysis and disposition. FSA will use their analysis and the work of the fraud unit to strengthen its internal controls. FSA also conducts internal training on fraud prevention and detection as well as listening sessions with the school community on fraud trends and good practices in prevention and detection. Additionally, the Department has catalogued internal controls related to fraud prevention and detection, to include 52 detective and 109 preventive controls related to its grant programs and administrative payments.

To combat improper use of federal funding under the *Every Student Succeeds Act*, the Department requires that each recipient and sub-recipient publically display the contact information of the Department's OIG hotline to facilitate the reporting of suspected improper use of ESSA funding and that each recipient and sub-recipient provides assurance of truthfulness and accuracy of the information they provide in applications and in response to monitoring and compliance reviews.

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REDUCE THE FOOTPRINT

This effort strives to bring a new approach to the workplace at the Department, by building greater employee performance and productivity through innovative space designs and technology enhancements, while reducing the agency's space footprint and associated out-year costs. The project will also allow the agency to meet the new federal space guidelines (150–180 usable square footage/person vs. the current usable square footage of 338).

THE DEPARTMENT CHALLENGES ARE:

- Limited IT tools to support new mobile workforce,
- IT infrastructure is outdated,
- In some cases, telework expansion has outpaced space designs, and
- Agency employee recruitment efforts restricted to a limited number of states, limiting the size of the mobile workforce.

THE DEPARTMENT STRATEGY IS TO:

- Upgrade the IT infrastructure,
- Provide mobile workers with 21st century tools,
- Strengthen the Performance Management Program,
- Promote cultural acceptance of a mobile workforce,
- Design innovative work spaces,
- Implement an Electronic Records Management System, and
- Reduce the space footprint.

The square footage totals are for the office and warehouse domestic assets, which are assets located in the 50 states, Washington, D.C., and United States territories. The square footage total includes owned and leased assets. Updated square footage information is posted on the **performance.gov** website.

Table 5. Reduce the Footprint Baseline Comparison

	FY 2015 Baseline	2016	Change (FY 2015 Baseline–2016)
Square Footage	1,548,425	1,381,775	(166,650)

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CIVIL MONETARY PENALTY ADJUSTMENT FOR INFLATION

The *Federal Civil Penalties Inflation Adjustment Act of 1990*, as amended, requires agencies to make regular and consistent inflationary adjustments of civil monetary penalties to maintain their deterrent effect. To improve compliance with the act, and in response to multiple audits and recommendations, agencies should report annually in the Other Information section the most recent inflationary adjustments to civil monetary penalties to ensure penalty adjustments are both timely and accurate.

Location for Penalty Update Details:

https://www.federalregister.gov/documents/2017/04/20/2017-08034/adjustment-of-civil-monetary-penalties-for-inflation

Table 6.

Penalty	Authority	Date of Previous Adjustment	Date of Current Adjustment	Current Penalty Level
Failure to provide information for cost of higher education	20 USC 1015(c)(5)	1-Aug-16	20-Apr-17	$36,849
Failure to provide information regarding teacher-preparation programs	20 USC 1022d(a)(3)	1-Aug-16	20-Apr-17	$30,694
Violation of Title IV of the HEA	20 USC 1082(g)	1-Aug-16	20-Apr-17	$54,789
Violation of Title IV of the HEA	20 USC 1094(c)(3)(B)	1-Aug-16	20-Apr-17	$54,789
Failure to disclose information to minor children and parents	20 USC 1228c(c)(2)(E)	1-Aug-16	20-Apr-17	$1,617
Improper lobbying for government grants and contracts	31 USC 1352(c)(1)	1-Aug-16	20-Apr-17	$19,246 to $192,459
False claims and statements	31 USC 3802(a)(1)	1-Aug-16	20-Apr-17	$10,957

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THE GRANTS OVERSIGHT AND NEW EFFICIENCY (GONE) ACT OF 2016

The goal of the *Grants Oversight and New Efficiency (GONE) Act of 2016* (Pub. L. No. 114-117) is to close out grants and cooperative agreements that are in manual closeout with zero dollars and undisbursed balances and whose period of performance has exceeded two years.

Starting with an October 3, 2016, baseline of 8,948 grants and cooperative agreements totaling approximately $2 billion in various statuses of the closeout process, the Department achieved tremendous success as shown below.

While the Department succeeded in closing out over 99 percent of the required grants and cooperative agreements during FY 2017, this was not accomplished without challenges. The Department's most pressing challenges in the closeout process were: devotion of the time and resources of limited program office staff to the closeout process, while awarding grants and performing monitoring functions; delays in obtaining required final performance and financial reports and missing final reports; unresolved audit findings; and recording extensions in the Department's grants management system.

The Department's planned corrective actions to address these challenges include integrating a financial monitoring curriculum into the Department's grants training and updating our grants management system.

Table 7.

Category	2–3 Years	>3–5 Years	> 5 Years
Number of Grants/Cooperative Agreements with Zero Dollar Balances	3	-	-
Number of Grants/Cooperative Agreements with Undisbursed Dollar Balances	7	-	-
Total Amount of Undisbursed Balances	$7,488,316	-	-

Source: G5, grants management system linked to the Department's general ledger system.

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APPENDICES

APPENDIX A: SELECTED DEPARTMENT WEB LINKS AND EDUCATION RESOURCES

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**

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

College Navigator consists of the latest data from the Integrated Postsecondary Education Data System, the core postsecondary education data collection program for the National Center for Education Statistics, as well as data from Federal Student Aid on cohort default rates, the Office of Postsecondary Education on campus safety and accreditation, and information on veterans from the Veterans Benefits Administration. **http://nces.ed.gov/collegenavigator/**

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.

https://studentaid.ed.gov/sa/prepare-for-college/checklists

https://studentaid.ed.gov/sa/types/grants-scholarships/finding-scholarships

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. The College Scorecard has been redesigned as a tool that incorporates direct input from students, families, and their advisers to provide the clearest, most accessible, and most reliable national data on college cost, graduation, debt, and postcollege earnings. The old way of assessing college choices relied on static ratings lists compiled by someone who was deciding what value to place on different factors. The new way of assessing college choices, with the help of technology and open data, makes it possible for anyone—a student, a school, a policymaker, or a researcher—to decide which factors to evaluate. **https://collegescorecard.ed.gov/**

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, as well as labor force outcomes and international comparisons. **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 prekindergarten 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/**

FINANCIAL AID SHOPPING SHEET

The Financial Aid Shopping Sheet is a consumer tool that participating institutions use to notify students about their financial aid package. It is a standardized form that is designed to simplify the information that prospective students receive about costs and financial aid so that they can easily compare institutions and make informed

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decisions about where to attend school. **https://www2.ed.gov/policy/highered/guid/aid-offer/index.html**

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**

GRANTS INFORMATION AND RESOURCES

In addition to student loans and grants, the Department offers other discretionary grants. These are awarded using a competitive process, and formula grants 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**.

NATIONAL ASSESSMENT OF EDUCATIONAL PROGRESS

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

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**.

ONE-STOP SHOPPING FOR STUDENT LOANS

The Department provides a site from which students can manage their loans. **http://studentloans.gov/**

PERFORMANCE DATA

ED*Facts* is a Department initiative to put performance data at the center of policy, management, and budget decisions for all K–12 educational programs. ED*Facts* centralizes performance data supplied by K–12 state educational agencies with other data assets, such as financial grant information, within the Department to enable better analysis and use in policy development, planning, and management. **http://www.ed.gov/about/inits/ed/edfacts/index.html**

PRACTICE GUIDES FOR EDUCATORS

The Department offers guides that help educators address everyday challenges faced in 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. **https://ies.ed.gov/ncee/wwc/PracticeGuides**

PROGRAM INVENTORY

The *GPRA Modernization Act of 2010*, P.L. 111-352, requires that the Office of Management and Budget (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. The initial Federal Program Inventory was published in May 2013. The Department described each program within 27 budgetary accounts, as well as how the programs support the Department's broader strategic goals and objectives.

Since that time, Congress passed the *Digital Accountability and Transparency Act* (DATA Act) requiring new public reporting requirements, which impact the definition of programs used in this guidance. OMB is currently working with agencies to merge the implementation of the DATA Act and the Federal Program Inventory requirements to the extent possible to avoid duplicative efforts. While OMB and agencies determine the right implementation strategy, the initial Federal Program Inventory remains available on **performance.gov** or at **http://www2.ed.gov/programs/inventory.pdf**.

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PROJECTIONS OF EDUCATION STATISTICS TO 2024

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 2024. The report includes a methodology section that describes the models and assumptions used to develop national and state-level projections. **https://nces.ed.gov/pubs2016/2016013.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**

To support the Workforce Innovation and Opportunity Act (WIOA), the Department offers professional development resources through the Literacy Information and Communication System (LINCS). This initiative seeks to expand evidence-based practice in the field of adult education and literacy. LINCS serves as OCTAE's primary outreach and dissemination mechanism to adult educators and provides high-quality, on-demand educational opportunities to practitioners of adult education. LINCS is comprised of: the LINCS Resource Collection, which provides online access to high-quality, evidence-based materials and instructional resources; the LINCS Community, a virtual professional learning space where adult educators can engage in discussions focused on critical topics to the field of adult education; a Learning Portal that offers anytime, anywhere professional development courses; a Professional Development Center that provides technical assistance to states in meeting the state leadership requirements set forth in WIOA; and the Learner Center, which provides access to federally developed or federally reviewed resources to assist adult learners in reaching their learning goals. Through these efforts, LINCS demonstrates OCTAE's commitment to delivering high-quality, on-demand educational opportunities to practitioners of adult education and literacy, so those practitioners can help adult learners successfully transition to postsecondary education and 21st century jobs. **http://lincs.ed.gov/**

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APPENDIX B: GLOSSARY OF ACRONYMS AND ABBREVIATIONS

ABCP	Asset-Backed Commercial Paper
AFR	*Agency Financial Report*
APG	Agency Priority Goals
APR	*Annual Performance Report*
CAT	Core Assessment Team
CCMS	Continuous Controls Monitoring System
CPSS	Contracts and Purchasing Support System
CSIP	Cybersecurity Strategy and Implementation Plan
DATA	*Digital Accountability and Transparency Act of 2014*
DCIA	*Debt Collection Improvement Act of 1996*
DNP	Do Not Pay
DOL	U.S. Department of Labor
DRT	Data Retrieval Tool
ECASLA	*Ensuring Continued Access to Student Loans Act of 2008*
EDCAPS	Education Central Automated Processing System
EFC	Expected Family Contribution
ERM	Enterprise Risk Management
ESSA	*Every Student Succeeds Act*
FAFSA	Free Application for Federal Student Aid
FASAB	Federal Accounting Standards Advisory Board
FAQ	Frequently Asked Questions
FCRA	*Federal Credit Reform Act of 1990*
FECA	*Federal Employees' Compensation Act*
FERS	Federal Employees Retirement System
FFB	Federal Financing Bank
FFEL	Federal Family Education Loan
FFMIA	*Federal Financial Management Improvement Act of 1996*
FISMA	*Federal Information Security Modernization Act of 2014*
FMFIA	*Federal Managers' Financial Integrity Act of 1982*
FMSS	Financial Management Support System
FPRD	Final Program Review Determination
FSA	Federal Student Aid
FY	Fiscal Year
G5	Grants Management System
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GONE	*The Grants Oversight and New Efficiency Act of 2016*
GPRA	*Government Performance and Results Act of 1993*
GSA	General Services Administration
HBCUs	Historically Black Colleges and Universities

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HCERA *Health Care and Education Reconciliation Act of 2010*

HEA *Higher Education Act of 1965*

HEAL Health Education Assistance Loans

IDEA *Individuals with Disabilities Education Act*

IDR Income-Driven Repayment

IES Institute of Education Sciences

IHE Institutions of Higher Education

IPERA *Improper Payments Elimination and Recovery Act of 2010*

IPERIA *Improper Payments Elimination and Recovery Improvement Act of 2012*

IPIA *Improper Payments Information Act of 2002*

IRS Internal Revenue Service

IRS DRT IRS Data Retrieval Tool

IT Information Technology

LEA Local Educational Agency

LINCS Literacy Information and Communication System

NCES National Center for Education Statistics

OCFO Office of the Chief Financial Officer

OCIO Office of the Chief Information Officer

OCR Office for Civil Rights

OCTAE Office of Career, Technical, and Adult Education

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

OPM Office of Personnel Management

OSERS Office of Special Education and Rehabilitative Services

PAYE Pay as You Earn

PEPS Postsecondary Education Participants System

PIV Personal Identity Verification

PIWG Payment Integrity Workgroup

PSLF Public Service Loan Forgiveness

SAFRA *Student Aid and Fiscal Responsibility Act (SAFRA Act)*

SAT Senior Assessment Team

SBR Statement of Budgetary Resources

SEA State Educational Agency

TEACH Teacher Education Assistance for College and Higher Education Grant

TIVAS Title IV Additional Servicers

Treasury U.S. Department of Treasury

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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 Operations (FIO) provides leadership and direction in the areas of internal control assessment, financial management training, post audit activities, and indirect cost determination.

Contracts and Acquisitions Management (CAM) is responsible for the solicitation, award, administration, and closeout of all contracts and other acquisition instruments for the Department.

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