Financial Section

Message From the Chief Financial Officer

On behalf of the Department of Education, it is my privilege to present to you our Fiscal Year (FY) 2016 Agency Financial Report (AFR). I thank the Department's leadership and staff for their commitment to another successful fiscal year, and I hope that you find the AFR a useful summary of the Department's financial picture, operating performance, and stewardship.

Both the short- and long-term economic impacts of the Department's mission to prepare students for college and to support attainment of college degrees by those students are immense. At the heart of U.S. global competitiveness are students whose creativity, innovative mindsets, and entrepreneurial aspirations will sustain the American economy, as well as the U.S. contribution to the challenges we face today and in the future. High quality, equitably accessible, and affordable education for our country's students is the foundation for our future prosperity.

With approximately $1.2 trillion in total assets, comprised primarily of credit program receivables that are funded by $1.1 trillion in Treasury borrowings, and $285.2 billion in total annual spending supporting programs across the full education spectrum, effective controls over financial activities are essential to responsibly delivering our mission outcomes.

Over the past eight years, the Department of Education experienced an unprecedented rate of growth in our loan portfolio, primarily due to the Department's assumption of direct student loans. For example, credit program receivables increased from $234.3 billion in FY 2009 to $1.1 trillion in FY 2016. During this time period, we also received two large supplemental appropriations; $97.4 billion under the *American Recovery and Reinvestment Act of 2009* and $10 billion under the Education Jobs Fund.

I am proud of attaining our 15th consecutive unmodified or "clean" opinion of our financial statements, the result of our dedicated cadre of financial professionals, their application of effective controls, and a continuous improvement approach to promoting responsible financial stewardship across all of the Department's mission offices. With less than 1 percent of our $285.2 billion in payments each year applied to fund the Department's payroll, the achievement of clean opinions, as well as the receipt of our 12th award of the prestigious Certificate of Excellence in Accountability Reporting by the Association of Government Accountants, reflects the efforts of the Department's highly productive team.

In addition to giving an unmodified opinion of our FY 2016 financial statements, our auditors reported that we have no material controls weaknesses, nor material instances of noncompliance with laws and regulations. As such, I can provide reasonable assurance that the financial data included in this AFR are complete and reliable in accordance with federal requirements. Although we have a strong internal control framework, we are actively working to address the management challenges and other control and compliance issues reported by our auditors and self-reported in various sections of this report.

Accountability, transparency, and stewardship are core values embraced by the Department's financial management professionals and their work underpins the mission achievements described in this report that benefit all American students and families. As we move into the future, we have four major priorities to sustain our core values—upgrading our financial management and related business systems, to include migration to a shared service solution when feasible; enhancing data quality and our capacity to support decision making through robust data analytics; incorporating enterprise risk management practices into the culture of the Office of the Chief Financial Officer; and reshaping and enhancing the competencies of our financial management workforce.

We look forward to implementing even stronger financial management practices in the coming years to provide the American taxpayer with the best possible value for the resources entrusted to us.

Tim Soltis
Delegated the Duties of Chief Financial Officer

November 14, 2016

About the Financial Section

In FY 2016, 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 Department's financial statements and additional information for FY 2016 and FY 2015 include the following. The Department welcomes comments from readers to further improve the report. Comments can be e-mailed to AFRcomments@ed.gov.

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 Department revised the presentation of its Consolidated Balance Sheet to emphasize the Department's growing loan portfolio.

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** provides 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
Note 5. Credit Programs for Higher Education: Credit Program Receivables, Net and Liabilities for Loan Guarantees
Note 6. Liabilities Not Covered by Budgetary Resources

Note 7. Debt
Note 8. Subsidy Due to Treasury General Fund
Note 9. Other Liabilities
Note 10. Intragovernmental Cost and Exchange Revenue by Program
Note 11. Credit Program Interest Expense and Interest Revenue
Note 12. Statement of Budgetary Resources
Note 13. Reconciliation of Net Cost of Operations to Budget
Note 14. Commitments and Contingencies

Required Supplementary Information

This section contains the Combining Statement of Budgetary Resources for the Periods Ended September 30, 2016, and September 30, 2015.

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. 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 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 2016 and FY 2015 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, 2016 and 2015, and for the years then ended.

United States Department of Education
Consolidated Balance Sheet
As of September 30, 2016 and 2015
(Dollars in Millions)

		FY 2016		FY 2015
Assets:				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$	96,763	$	103,619
Other Intragovernmental Assets (Note 4)		102		78
Total Intragovernmental		96,865		103,697
Credit Program Receivables, Net (Note 5)				
Direct Loan Program		958,881		880,557
FFEL Program		114,870		134,704
Other Credit Programs for Higher Education		2,828		2,472
Other Assets (Note 4)		1,363		1,689
Total Assets (Note 2)	**$**	**1,174,807**	**$**	**1,123,119**
Liabilities:				
Intragovernmental:				
Debt (Note 7)				
Direct Loan Program	$	994,285	$	909,927
FFEL Program		131,347		139,771
Other Credit Programs for Higher Education		2,191		2,078
Subsidy Due to Treasury General Fund (Note 8)		2,642		8,237
Other Intragovernmental Liabilities (Note 9)		1,822		2,060
Total Intragovernmental		1,132,287		1,062,073
Other Liabilities (Note 9)		9,683		6,243
Total Liabilities (Note 6)	**$**	**1,141,970**	**$**	**1,068,316**
Commitments and Contingencies (Note 14)				
Net Position:				
Unexpended Appropriations	$	61,052	$	62,740
Cumulative Results of Operations		(28,215)		(7,937)
Total Net Position	**$**	**32,837**	**$**	**54,803**
Total Liabilities and Net Position	**$**	**1,174,807**	**$**	**1,123,119**

The accompanying notes are an integral part of these statements.

United States Department of Education
Consolidated Statement of Net Cost
For the Years Ended September 30, 2016 and 2015
(Dollars in Millions)

	FY 2016	FY 2015
Program Costs:		
Increase College Access, Quality, and Completion		
Gross Costs	$ 97,314	$ 63,697
Earned Revenue	(34,316)	(31,600)
Net Program Costs	$ 62,998	$ 32,097
Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs		
Gross Costs	$ 22,363	$ 22,350
Earned Revenue	(16)	(20)
Net Program Costs	$ 22,347	$ 22,330
Ensure Effective Educational Opportunities for All Students		
Gross Costs	$ 16,925	$ 16,656
Earned Revenue	(11)	(11)
Net Program Costs	$ 16,914	$ 16,645
Enhance the Education System's Ability to Continuously Improve		
Gross Costs	$ 2,121	$ 2,412
Earned Revenue	(58)	(59)
Net Program Costs	$ 2,063	$ 2,353
Net Cost of Operations (Notes 10 & 13)	**$ 104,322**	**$ 73,425**

The accompanying notes are an integral part of these statements.

United States Department of Education
Consolidated Statement of Changes in Net Position
For the Years Ended September 30, 2016 and 2015
(Dollars in Millions)

	FY 2016				FY 2015			
		Cumulative Results of Operations		Unexpended Appropriations		Cumulative Results of Operations		Unexpended Appropriations
Beginning Balances:								
Beginning Balances	**$**	**(7,937)**	**$**	**62,740**	**$**	**(23,741)**	**$**	**66,447**
Budgetary Financing Sources:								
Appropriations Received	$	-	$	88,210	$	-	$	100,955
Appropriations Transferred – In/Out		-		-		-		(397)
Other Adjustments (Rescissions, etc.)		-		(821)		-		(783)
Appropriations Used		89,077		(89,077)		103,482		(103,482)
Nonexchange Revenue		9		-		8		-
Donations and Forfeitures of Cash and Cash Equivalents		1		-		2		-
Other Financing Sources:								
Imputed Financing from Costs Absorbed by Others		81		-		30		-
Negative Subsidy Transfers, Downward Subsidy Re-Estimates, and Other		(5,124)		-		(14,293)		-
Total Financing Sources	**$**	**84,044**	**$**	**(1,688)**	**$**	**89,229**	**$**	**(3,707)**
Net Cost of Operations:	**$**	**(104,322)**	**$**	**-**	**$**	**(73,425)**	**$**	**-**
Net Change:	**$**	**(20,278)**	**$**	**(1,688)**	**$**	**15,804**	**$**	**(3,707)**
Net Position	**$**	**(28,215)**	**$**	**61,052**	**$**	**(7,937)**	**$**	**62,740**

The accompanying notes are an integral part of these statements.

United States Department of Education
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2016 and 2015
(Dollars in Millions)

	FY 2016		FY 2015	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:				
Unobligated Balance, Brought Forward, October 1	$ 14,774	$ 14,437	$ 14,837	$ 10,109
Recoveries of Prior Year Unpaid Obligations	746	21,047	1,978	20,727
Other Changes in Unobligated Balance (+ or -)	(772)	(24,695)	(679)	(23,984)
Unobligated Balance from Prior Year Budget Authority, Net	$ 14,748	$ 10,789	$ 16,136	$ 6,852
Appropriations (Discretionary and Mandatory)	87,924	24	100,701	904
Borrowing Authority (Discretionary and Mandatory) (Note 12)	-	167,400	-	171,807
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	522	53,608	381	52,897
Total Budgetary Resources	**$ 103,194**	**$ 231,821**	**$ 117,218**	**$ 232,460**
Status of Budgetary Resources:				
New Obligations Incurred and Upward Adjustments (Total) (Note 12)	$ 90,802	$ 216,342	$ 102,444	$ 218,023
Unobligated Balance, End of Year:				
Apportioned, Unexpired Accounts	10,280	-	11,806	550
Unapportioned, Unexpired Accounts	1,212	15,479	1,771	13,887
Unexpired Unobligated Balance, End of year	**$ 11,492**	**$ 15,479**	**$ 13,577**	**$ 14,437**
Expired Unobligated Balance, End of Year	900	-	1,197	-
Unobligated Balance, End of Year (Total)	**$ 12,392**	**$ 15,479**	**$ 14,774**	**$ 14,437**
Total Status of Budgetary Resources	**$ 103,194**	**$ 231,821**	**$ 117,218**	**$ 232,460**
Change in Obligated Balance:				
Unpaid Obligations				
Unpaid Obligations, Brought Forward, October 1	$ 52,645	$ 78,116	$ 56,219	$ 80,316
New Obligations and Upward Adjustments	90,802	216,342	102,444	218,023
Outlays (Gross) (-)	(88,452)	(196,787)	(103,847)	(199,496)
Actual Transfers, Unpaid Obligations (Net) (+ or -)	-	-	(193)	-
Recoveries of Prior Year Unpaid Obligations (-)	(746)	(21,047)	(1,978)	(20,727)
Unpaid Obligations, End of Year	**$ 54,249**	**$ 76,624**	**$ 52,645**	**$ 78,116**
Uncollected Payments				
Uncollected Payments, Federal Sources, Brought Forward, October 1 (-)	$ (3)	$ (26)	$ (1)	$ (26)
Change in Uncollected Payments, Federal Sources (+ or -)	1	22	(2)	-
Uncollected Payments, Federal Sources, End of Year (-)	$ (2)	$ (4)	$ (3)	$ (26)
Memorandum (Non-add) Entries				
Obligated Balance, Start of Year (+ or -)	**$ 52,642**	**$ 78,090**	**$ 56,218**	**$ 80,290**
Obligated Balance, End of Year (+ or -)	**$ 54,247**	**$ 76,620**	**$ 52,642**	**$ 78,090**
Budget Authority and Outlays, Net:				
Budget Authority, Gross (Discretionary and Mandatory)	$ 88,446	$ 221,032	$ 101,082	$ 225,608
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(721)	(114,123)	(713)	(122,387)
Change in Uncollected Customer Payments from Federal Sources (Discretionary and Mandatory) (+ or -)	1	22	(2)	-
Recoveries of Prior Year Paid Obligations (Discretionary and Mandatory)	(1)	(516)	(2)	(542)
Budget Authority, Net (Discretionary and Mandatory)	**$ 87,725**	**$ 106,415**	**$ 100,365**	**$ 102,679**
Outlays, Gross (Discretionary and Mandatory)	$ 88,452	$ 196,787	$ 103,847	$ 199,496
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(721)	(114,123)	(713)	(122,387)
Outlays, Net (Discretionary and Mandatory)	87,731	82,664	103,134	77,109
Distributed Offsetting Receipts (-) (Note 12)	(10,766)	-	(13,105)	-
Agency Outlays, Net (Discretionary and Mandatory) (Note 12)	**$ 76,965**	**$ 82,664**	**$ 90,029**	**$ 77,109**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements For the Years Ended September 30, 2016 and 2015

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 engages in four major types of activities: establishing policies related to federal educational funding, including the distribution of 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 prohibiting discrimination in programs that receive federal funds.

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 significant portion of the financial activities of the Department relate to the execution of grant and loan 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 FFEL program, authorized by the HEA, operates through state and private nonprofit guaranty agencies which provided loan guarantees on loans made by private lenders to eligible students. The *SAFRA Act,* which was included in the *Health Care and Education Reconciliation Act of 2010* (HCERA), stated that no new FFEL loans would be made effective July 1, 2010.

The Department also administers loans for 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 and loan programs. The three largest grant programs are Title I, Federal Pell Grant (Pell Grant), and the *Individuals with Disabilities Education Act* (IDEA) grants. 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.

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 pre-employment 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.

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 purpose of the *Federal Credit Reform Act of 1990* (FCRA) is to record the lifetime subsidy cost of direct loans and loan guarantees at the time the loan is disbursed. 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 of subsidy is interest expense on debt with Treasury minus interest income from borrowers and interest on uninvested fund balance with Treasury. It is calculated as the difference between interest revenue and interest expense. 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.

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 existing loans.

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 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 1 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 canceled 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 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 (general program administration 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 five 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; (4) trust funds are used for the acceptance and administration of funds contributed from public and private sources and programs and are in cooperation with other federal and state agencies or private donors; and (5) other funds include 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, which consist of Cash and Other Monetary Assets, 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 27 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.

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 Department also values all pre-1992 loans, loan guarantees, and direct loans at their net present values. If the liability for loan guarantees is positive, the amount is reported as a component of credit program receivables, net.

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 and reported in the financial statements under credit reform rules, similar to direct loans, although they are legally not direct student loans. Negative balances are reported as a component of credit program receivables, net. 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 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. (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)

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 at September 30. 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 Expense and Interest Revenue

The Department accrues interest receivable and records interest revenue on performing direct loans and FFEL loans purchased by the Department. The Department recognizes interest income when interest is accrued on loans to the public for the Direct Loan, FFEL, and other loan programs. FFEL financing and liquidating accounts accrue interest as part of allowance for subsidy. 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 fund balance with Treasury for the Direct Loan, FFEL, and other loan programs.

Federal interest expense is recognized on the outstanding borrowing from Treasury (debt) used to finance loans. The interest rate for federal interest expense is the same as the rate used for federal interest revenue.

Interest expense and interest revenue are equal for all credit programs due to subsidy amortization. Subsidy amortization is required by the FCRA and accounts for the difference between interest accruals and interest 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.

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 financial statements and 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. Changes made to the balance sheet provide additional information related to credit program receivables and related liability balances, and immaterial balances were aggregated and consolidated into other lines. Components of the prior year Direct Loan subsidy transfers were reclassified in Note 5 to better reflect the fiscal year of underlying loan disbursement versus actual subsidy disbursement; the total FY 2015 Direct Loan subsidy transfers was not affected. Additionally, changes were made to the Statement of Budgetary Resources in accordance with OMB Circular A-136, *Financial Reporting Guidance,* to disaggregate end of year expired unobligated balances and recoveries of prior year unpaid obligations.

Note 2. Non-Entity Assets

As of September 30, 2016 and 2015, non-entity assets consisted of the following:

Non-Entity Assets
(Dollars in Millions)

Non-Entity Assets	2016 Intragovern-mental	2016 With the Public	2015 Intragovern-mental	2015 With the Public
Fund Balance with Treasury	$ 231	$ -	$ 69	$ -
Credit Program Receivables, Net	-	449	-	410
Other Assets				
Guaranty Agencies' Federal Funds	-	1,197	-	1,561
Accounts Receivable, Net	-	69	-	67
Total Non-Entity Assets	**231**	**1,715**	**69**	**2,038**
Entity Assets	96,634	1,076,227	103,628	1,017,384
Total Assets	**$ 96,865**	**$ 1,077,942**	**$ 103,697**	**$ 1,019,422**

The Department's FY 2016 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 non-agency receipt accounts, deposit accounts and clearing accounts. Non-entity assets with the public primarily consist of guaranty agency reserves (69.8 percent), reported as Guaranty Agencies' Federal Funds, and related Federal Perkins Loan program loan receivables (26.2 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)

Note 3. Fund Balance with Treasury

Fund Balance with Treasury by status of funds and fund type, as of September 30, 2016 and 2015, consisted of the following:

Fund Balance with Treasury
(Dollars in Millions)

	2016					
	General Funds	Revolving Funds	Special Funds	Trust Funds	All Other Funds	Total
Status of Funds						
Unobligated Balance						
Available	$ 10,280	$ -	$ -	$ -	$ -	$ 10,280
Unavailable	902	15,480	12	-	-	16,394
Obligated Balance, not Disbursed	54,240	15,630	1	-	-	69,871
Other	-	-	-	-	218	218
Total Fund Balance with Treasury	**$ 65,422**	**$ 31,110**	**$ 13**	**$ -**	**$ 218**	**$ 96,763**

	2015					
	General Funds	Revolving Funds	Special Funds	Trust Funds	All Other Funds	Total
Status of Funds						
Unobligated Balance						
Available	$ 11,805	$ 550	$ -	$ 1	$ -	$ 12,356
Unavailable	1,394	13,886	14	-	-	15,294
Obligated Balance, not Disbursed	52,638	23,260	1	1	-	75,900
Other	-	-	-	-	69	69
Total Fund Balance with Treasury	**$ 65,837**	**$ 37,696**	**$ 15**	**$ 2**	**$ 69**	**$ 103,619**

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. Trust funds generally consist of remaining undisbursed donations for the hurricane relief activities.

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 ($16,394 million) differs from unapportioned and expired amounts on the SBR ($17,591 million) due to the Guaranty Agencies' Federal Funds ($1,197 million).

Note 4. Other Assets

Other assets, as of September 30, 2016 and 2015, were comprised of the following:

Other Assets
(Dollars in Millions)

	2016		2015	
	Intragovern-mental	With the Public	Intragovern-mental	With the Public
Guaranty Agencies' Federal Funds	$ -	$ 1,197	$ -	$ 1,561
Accounts Receivable, Net	1	137	2	101
Advances	101	3	76	2
Property and Equipment, Net	-	24	-	21
Other	-	2	-	4
Total Other Assets	**$ 102**	**$ 1,363**	**$ 78**	**$ 1,689**

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

The Department currently operates two major student loan programs, Direct Loan and FFEL. 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 Department holds $1,076.6 billion in outstanding credit program net receivables. This outstanding balance is comprised primarily of direct loans, defaulted FFEL loans, and FFEL loans purchased using authority provided in the *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA). There are several other loan programs that the Department administers—including the Federal Perkins Loan program, TEACH grant program, HEAL program, and the Facilities Loan programs.

Credit program receivables, as of September 30, 2016 and 2015, consisted of the following:

Credit Program Receivables, Net
(Dollars in Millions)

	2016			
	Principal	Accrued Interest	Allowance for Subsidy	Net
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**

	2015			
	Principal	Accrued Interest	Allowance for Subsidy*	Net
Direct Loan Program	$ 800,811	$ 44,250	$ 35,496	$ 880,557
FFEL Program	114,704	17,529	2,471	134,704
Other Credit Programs for Higher Education	2,876	361	(765)	2,472
Total Credit Receivables	**$ 918,391**	**$ 62,140**	**$ 37,202**	**$ 1,017,733**

* Includes allowance for subsidy and liability for loan guarantees

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 a comprehensive description of the student loan programs at the Department, including summary financial data and subsidy rates.

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

The Department 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. Half of all loan awards are issued 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 estimate may also not reflect the actual amount of awards made. Based on historical averages, the Department expects approximately 6.2 percent of the amount obligated for new loan awards will not be disbursed.

Direct Loan program loan receivables includes defaulted and nondefaulted loans owned and held by the Department. Of the $953.6 billion in gross receivables, as of September 30, 2016, $57.3 billion (6.0 percent) in loan principal was in default and had been transferred to the Department's defaulted loan servicer, compared to $44.1 billion (5.2 percent) as of September 30, 2015.

The allowance for subsidy represents the estimated cost (to taxpayers) of financing the entire loan program for all loans outstanding. The subsidy cost figures are estimated using OMB-reviewed financial modeling methodologies which are subject to the FCRA. The allowance is the aggregate of all positive and negative subsidies as well as modification adjustments, at a point in time, for the current fiscal year and all those prior.

Positive subsidies, which are resources provided by Treasury to the Department for continuing loan origination and servicing activities, are required when estimated program cash outflows are expected to exceed inflows. Alternatively, when the estimated cash inflows are expected to exceed outflows, the Department transfers excess subsidy funds back to the Treasury (negative subsidy transfers). Positive subsidy increases aggregate program costs and negative subsidy decreases aggregate program costs to taxpayers.

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 which displays the interrelated risks facing the Direct Loan program.

The following schedule provides a reconciliation between the beginning and ending balances of the allowance for subsidy for the Direct Loan program:

Direct Loan Program Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2016	2015
Beginning Balance, Allowance for Subsidy	**$ (35,496)**	**$ (47,358)**
Activity		
Fee Collections	1,685	1,618
Loan Cancellations	(5,065)	(4,777)
Subsidy Allowance Amortization	17,815	16,373
Other	(350)	(460)
Total Activity	**14,085**	**12,754**
Subsidy Expense for Direct Loans Disbursed in the Current Year by Component		
Interest Rate Differential	(15,463)	(15,555)
Defaults, Net of Recoveries	(127)	217
Fees	(1,993)	(1,678)
Other	11,887	10,830
Total of the Above Subsidy Expense Components	**(5,696)**	**(6,186)**
Loan Modification	**-**	**9,936**
Components of Subsidy Re-estimates		
Interest Rate Re-estimates	(1,536)	1,506
Technical and Default Re-estimates	23,351	(6,148)
Upward/(Downward) Subsidy Re-estimates	**21,815**	**(4,642)**
Ending Balance, Allowance for Subsidy	**$ (5,292)**	**$ (35,496)**

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. The remaining components of subsidy expense for direct loans disbursed in the current year consist of contract collection costs, program review collections, fees, loan forgiveness under PAYE and other accruals. Components of the FY 2015 subsidy expense for direct loans disbursed in the current year were reclassified to better reflect the fiscal year of underlying loan disbursement versus actual subsidy disbursement. Due to the interaction of the timing of disbursements by loan type and other underlying subsidy rates, the bulk of these expenses for both the 2015 cohort and 2016 cohort were recorded in FY 2016.

The following schedule summarizes the Direct Loan interest expense and interest revenue for the years ended September 30, 2016 and 2015:

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

	2016	2015
Interest Expense on Treasury Borrowing	$ 30,503	$ 27,593
Total Interest Expense	**$ 30,503**	**$ 27,593**
Interest Revenue from the Public	$ 44,375	$ 39,760
Amortization of Subsidy	(17,815)	(16,373)
Interest Revenue on Uninvested Funds	3,943	4,206
Total Interest Revenue	**$ 30,503**	**$ 27,593**

The following schedule summarizes the Direct Loan subsidy expense for the years ended September 30, 2016 and 2015:

Direct Loan Program Subsidy Expense
(Dollars in Millions)

	2016	2015
Subsidy Expense for New Direct Loans Disbursed		
Interest Rate Differential	$ (15,463)	$ (15,555)
Defaults, Net of Recoveries	(127)	217
Fees	(1,993)	(1,678)
Other	11,887	10,830
Total Subsidy Expense for New Direct Loans Disbursed	**(5,696)**	**(6,186)**
Loan Modification	-	9,936
Upward/(Downward) Subsidy Re-estimates	21,815	(4,642)
Direct Loan Subsidy Expense	**$ 16,119**	**$ (892)**

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 income-driven repayment plan was the primary cost driver for that assumption.

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 $4.8 billion. Re-estimated costs only include cohorts that are 90 percent disbursed; cohort years 1994–2015. With the increase in income-driven repayment participation, the Department also conducted sensitivities on incomes for students in IDR and Public Service Loan Forgiveness (PSLF) plans. A 10 percent upward increase in borrower incomes decreases costs almost $8.7 billion for cohorts 1994–2015. A 10 percent increase in PSLF plan participation would increase costs $6.3 billion for cohorts 1994–2015.

Direct Loan program re-estimated subsidy cost was adjusted downward by $4.6 billion in FY 2015. Updated discount rates for the 2014 and 2013 cohorts decreased cost by $6.2 billion. Higher participation in income-dependent repayment plans increased cost by $15 billion. The introduction of a new model for estimating income-driven repayment plan costs resulted in a decrease in subsidy costs by $5.8 billion. Costs increased $1.8 billion due to increases in default rates. Changes in prepayment rates reflect larger than expected prepayment activity, leading to decreased interest earnings, resulting in $3.5 billion in upward subsidy cost. Costs decreased $5.7 billion due to higher forbearance rates. Interest accrues during forbearance and that interest is eventually paid to the Department. Other assumption updates produced offsetting costs, with the remainder attributable to interest on the re-estimate.

FY 2015 Modification. Recorded subsidy cost of a loan is based on a set of assumed future cash flows. Government actions that change these assumed future cash flows change subsidy cost and are recorded as loan modifications. Loan modifications are recognized under the same accounting principle as subsidy re-estimates. Modification adjustment transfers are required to adjust for the difference between the discount rate used to calculate the cost of the modification and the interest rate at which the cohort pays or earns interest.

The Department modified direct loans in FY 2015. Borrowers formerly ineligible for a more generous PAYE repayment plan became eligible for a modified version of PAYE leading to increased costs, resulting in a $9.3 billion upward modification of subsidy cost and a $629 million net upward modification adjustment transfer. In FY 2015, the Department forgave $2.1 billion in interest for borrowers participating in the PAYE/income-based repayment (IBR) plans, which provide that, if the borrower's monthly payment amount is not sufficient to pay the accrued interest on the borrower's direct subsidized loan or the subsidized portion of a direct consolidation loan, the Secretary does not charge the borrower the remaining accrued interest for a period not to exceed three consecutive years from the established repayment period start date on that loan under the PAYE/IBR plan.

The subsidy rates applicable to the 2016 loan cohort year follow:

Direct Loan Subsidy Rates—Cohort 2016

	Interest Differential	Defaults	Fees	Other	Total
Stafford	6.82%	1.56%	(1.68)%	4.98%	11.68%
Unsubsidized Stafford	(8.34)%	1.06%	(1.68)%	6.24%	(2.72)%
PLUS	(22.04)%	0.78%	(4.27)%	5.38%	(20.15)%
Consolidation	3.32%	(0.50)%	0.00%	10.68%	13.50%
Total	(4.40)%	0.65%	(1.58)%	7.18%	1.85%

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 expense for new direct loans reported in the current year relates to disbursements of loans from both current and prior years' cohorts. Subsidy expense is recognized when the Department disburses direct loans. The subsidy expense reported in the current year may include re-estimates. The subsidy rates shown above, which reflect aggregate positive subsidy in the FY 2016 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 2018 President's Budget.

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, 2016 and 2015:

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

	2016	2015
Stafford	$ (23,752)	$ (23,953)
Unsubsidized Stafford	(52,254)	(52,698)
PLUS	(19,001)	(19,163)
Consolidation	(45,518)	(46,434)
Total Expenditures	**$ (140,525)**	**$ (142,248)**

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 $46 billion during both FY 2016 and FY 2015. 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, consolidated into a direct loan, or otherwise satisfied, discharged, or cancelled. As of September 30, 2016 and 2015, total principal balances outstanding of guaranteed loans held by lenders were approximately $197 billion and $220 billion, respectively. As of September 30, 2016 and 2015, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately $193 billion and $215 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.

FFEL Program Loan Receivables

(Dollars in Millions)

	2016				
	Principal	**Accrued Interest**	**Allowance for Subsidy**	**Loan Guarantee Liability**	**Net**
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
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
FFEL Program Loan Receivables	**$ 109,804**	**$ 18,191**	**$ (13,125)**	**$ -**	**$ 114,870**

	2015				
	Principal	**Accrued Interest**	**Allowance for Subsidy**	**Loan Guarantee Liability**	**Net**
FFEL GSL Program (Pre-1992)	$ 4,388	$ 6,149	$ (8,162)	$ (10)	$ 2,365
FFEL GSL Program (Post-1991)	33,415	5,756	(4,389)	3,398	38,180
Loan Purchase Commitment	26,474	1,981	4,410	-	32,865
Loan Participation Purchase	48,540	3,403	7,573	-	59,516
ABCP Conduit	1,887	240	(349)	-	1,778
FFEL Program Loan Receivables	**$ 114,704**	**$ 17,529**	**$ (917)**	**$ 3,388**	**$ 134,704**

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 FFEL guaranteed student loan financing account had a negative estimated liability for loan guarantees of $3.4 billion as of September 30, 2015. This indicated that expected collections on anticipated future defaulted loans was in excess of default disbursements, calculated on a net present value basis. Under GAAP, the negative estimated liability as of September 30, 2015, was classified as a component of credit program receivables on the consolidated balance sheet.

The following schedule provides a reconciliation between the beginning and ending balances of the liability for loan guarantees for the insurance portion of the FFEL program:

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

	2016	2015
Beginning Balance, FFEL Financing Account Liability for Loan Guarantees	**$ (3,398)**	**$ (4,218)**
Activity		
Interest Supplement Payments	(830)	(896)
Claim Payments	(6,678)	(6,917)
Fee Collections	1,731	1,926
Interest on Liability Balance	(1,766)	(1,826)
Other	5,648	12,797
Total Activity	**(1,895)**	**5,084**
Components of Loan Modification		
Loan Modification Costs	151	-
Modification Adjustment Transfers	24	-
Loan Modification	**175**	**-**
Upward/(Downward) Subsidy Re-estimates	**6,535**	**(4,264)**
Ending Balance, FFEL Financing Account Liability for Loan Guarantees	**1,417**	**(3,398)**
FFEL Liquidating Account Liability for Loan Guarantees	12	10
FFEL Liabilities for Loan Guarantees	**$ 1,429**	**$ (3,388)**

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 loan purchase commitment component and the loan participation purchase component of the FFEL program. Loans in these programs are loans acquired by the Department. Acquired loans are reported at their net present value of future cash flows.

Loan Purchase Commitment Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2016	2015
Beginning Balance, Allowance for Subsidy	**$ (4,410)**	**$ (5,228)**
Activity		
Subsidy Allowance Amortization	644	724
Loan Cancellations	(193)	(274)
Contract Collection Cost and Other	(40)	(40)
Total Activity	**411**	**410**
Upward/(Downward) Subsidy Re-estimates	1,077	408
Ending Balance, Allowance for Subsidy	**$ (2,922)**	**$ (4,410)**

Loan Participation Purchase Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2016	2015
Beginning Balance, Allowance for Subsidy	**$ (7,573)**	**$ (8,373)**
Activity		
Subsidy Allowance Amortization	1,208	1,362
Loan Cancellations	(355)	(518)
Direct Asset Activities	(74)	(44)
Total Activity	**779**	**800**
Upward/(Downward) Subsidy Re-estimates	2,447	-
Ending Balance, Allowance for Subsidy	**$ (4,347)**	**$ (7,573)**

The following schedule provides FFEL program subsidy expense for the years ended September 30, 2016 and 2015, respectively:

FFEL Program Subsidy Expense

(Dollars in Millions)

	2016	2015
FFEL Loan Guarantee Program Subsidy Re-estimates	$ 6,535	$ (4,264)
Loan Purchase Commitment Subsidy Re-estimates	1,077	408
Loan Participation Purchase Subsidy Re-estimates	2,447	-
FFEL Program Upward/(Downward) Subsidy Re-estimates	**10,059**	**(3,856)**
FFEL Guaranteed Loan Program Modification Costs	175	-
FFEL Program Subsidy Expense	**$ 10,234**	**$ (3,856)**

FFEL guaranteed 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.

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 $16.6 billion.

FFEL guaranteed re-estimated subsidy cost was adjusted downward by $3.9 billion in FY 2015. Subsidy costs decreased $2.1 billion due to updated economic assumptions, including probabilistic deterministic rates, which reflected historically low commercial paper rates, resulting in substantially higher negative special allowance payments. Subsidy costs decreased $706 million due to lower deferment rates on consolidated loans that have subsidized components of outstanding debt. The Department pays interest benefits when loans are in deferment, so lower deferment rates mean less interest benefits when loans are in deferment and thus, less interest benefit payments to lenders. Other assumption updates produced offsetting subsidy costs, with the remainder attributable to interest on the re-estimate.

FY 2016 Modification. In the FFEL program, private lenders provided loan capital, backed by a federal guarantee on the loans. The federal government provided interest subsidies to lenders and reimbursement to guaranty agencies for most of the costs associated with loan defaults and other loan cancellations. The *Consolidated Appropriations Act, 2016*, increased the guaranty agencies' maximum reinsurance percentage on default claims from 95 percent to 100 percent. State and private nonprofit guaranty agencies provide services that include: insurance payments to lenders for defaults, collection of some defaulted loans, default avoidance activities, and counseling to schools, students, and lenders.

Other Credit Programs for Higher Education

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

	2016				
	Principal	**Accrued Interest**	**Allowance for Subsidy**	**Loan Guarantee Liability**	**Net**
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**

	2015				
	Principal	**Accrued Interest**	**Allowance for Subsidy**	**Loan Guarantee Liability**	**Net**
Federal Perkins Loans	$ 356	$ 222	$ (168)	$ -	$ 410
TEACH Program Loans	642	97	(108)	-	631
HEAL Program Loans	415	28	(127)	(193)	123
Facilities Loan Programs	1,463	14	(169)	-	1,308
Total	**$ 2,876**	**$ 361**	**$ (572)**	**$ (193)**	**$ 2,472**

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 2016 loan cohort year follow:

TEACH Subsidy Rates—Cohort 2016

	Interest Differential	Defaults	Fees	Other	Total
Subsidy Rates	6.23%	0.21%	0.00%	6.61%	13.05%

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 $1.5 billion in outstanding borrowing from the FFB to support loans made to HBCU institutions and $235 million obligated to support near term lending as of September 30, 2016.

The Department administers the College Housing and Academic Facilities Loan (CHAFL) 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, 2016 and 2015, consisted of the following:

Administrative Expenses
(Dollars in Millions)

	2016		2015	
	Direct Loan Program	**FFEL Program**	**Direct Loan Program**	**FFEL Program**
Operating Expense	$ 721	$ 465	$ 653	$ 442
Other Expense	50	33	28	18
Total	**$ 771**	**$ 498**	**$ 681**	**$ 460**

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)

	2016		2015	
	Intragovern-mental	**With the Public**	**Intragovern-mental**	**With the Public**
Liabilities Not Covered by Budgetary Resources				
Subsidy Due to Treasury General Fund	$ 2,429	$ -	$ 2,786	$ -
Other Liabilities				
Federal Perkins Loan Program	437	-	395	-
Accrued Unfunded Annual leave	-	40	-	38
FECA Liabilities	8	1	3	16
Custodial Liabilities	2	-	-	-
Total Liabilities Not Covered by Budgetary Resources	**$ 2,876**	**$ 41**	**$ 3,184**	**$ 54**
Total Liabilities Covered by Budgetary Resources	1,129,411	9,642	1,058,889	6,189
Total Liabilities	**$ 1,132,287**	**$ 9,683**	**$ 1,062,073**	**$ 6,243**

Note 7. Debt

Debt, as of September 30, 2016 and 2015, consisted of the following:

Debt
(Dollars in Millions)

	2016			
	Beginning Balance	**Borrowing**	**Repayments**	**Ending Balance**
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**

	2015			
	Beginning Balance	**Borrowing**	**Repayments**	**Ending Balance**
Direct Loan Program	$ 819,007	$ 159,667	$ (68,747)	$ 909,927
FFEL Program	145,800	2,557	(8,586)	139,771
Other Credit Programs for Higher Education	1,864	268	(54)	2,078
Total	**$ 966,671**	**$ 162,492**	**$ (77,387)**	**$ 1,051,776**

The Department borrows from Treasury to fund the disbursement of new loans and the payment of credit program outlays and related costs. During FY 2016, debt increased 7 percent from $1,052 billion in the prior year to $1,128 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 88.2 percent of the Department's debt, as of September 30, 2016, 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 2016, TEACH net borrowing of $67 million was used for the advance of new grants and repayments of principal made to Treasury. In FY 2016, debt in HBCU increased by $63 million, or 4.52 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)

	2016	2015
Credit Program Downward Subsidy Re-estimates		
Direct Loan Program	$ -	$ 1,474
FFEL Program	213	3,977
Total Credit Program Downward Subsidy Re-estimates	**213**	**5,451**
Future Liquidating Account Collections		
FFEL Program	2,253	2,603
Other Credit Programs for Higher Education	176	183
Total Future Liquidating Account Collections	**2,429**	**2,786**
Total Subsidy Due to Treasury General Fund	**$ 2,642**	**$ 8,237**

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. When collected, these liquidating account excess collections will also be returned to the Treasury General Fund.

Note 9. Other Liabilities

Other liabilities, as of September 30, 2016 and 2015, consisted of the following:

Other Liabilities
(Dollars in Millions)

	2016		2015	
	Intragovern-mental	**With the Public**	**Intragovern-mental**	**With the Public**
Accounts Payable	$ 1	$ 3,966	$ 1	$ 3,695
Accrued Grant Liability	-	3,760	-	2,377
Guaranty Agencies' Funds Due to Treasury	1,197	-	1,561	-
Loan Guarantee Liability	-	1,633	-	-
Federal Perkins Loan Program	437	-	395	-
Miscellaneous Receipt, Deposit Funds and Clearing Accounts	40	255	83	84
Advances from Others and Deferred Credits	11	9	14	18
Accrued Unfunded Annual Leave	-	40	-	38
FECA Liabilities	8	1	3	16
Accrued Payroll and Benefits	-	19	-	15
Employer Contributions and Payroll Taxes	126	-	3	-
Custodial Liability	2	-	-	-
Total Other Liabilities	**$ 1,822**	**$ 9,683**	**$ 2,060**	**$ 6,243**

Note 10. Intragovernmental Cost and Exchange Revenue by Program

As required by the *GPRA Modernization Act of 2010,* each of the Department's major program offices has been aligned with the goals presented in the Department's *Strategic Plan 2014–2018. Strategic Plan* Goals 1–5 guide the Department's program offices to carry out the vision and programmatic mission, and the net cost programs can be specifically associated with these five strategic goals. The Department also has a cross-cutting *Strategic Plan* Goal 6, U.S. Department of Education Capacity, focusing primarily upon improving the organizational capacities of the Department to implement the *Strategic Plan* Goals 1–5. The costs associated with *Strategic Plan* Goal 6 are allocated to Goals 1–5 based on the number of full-time employee equivalents of each program. Some principal offices support more than one Departmental strategic goal, but have been assigned to a single net cost program for the purposes of this table based on their primary area of support.

Net Cost Program	Program Office	Strategic Goal
Increase College Access, Quality, and Completion	FSA OPE OCTAE	**Goal 1: Postsecondary Education, Career and Technical Education, and Adult Education.** Increase college access, affordability, quality, and completion by improving postsecondary education and lifelong learning opportunities for youths and adults.
Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs	OESE	**Goal 2: Elementary and Secondary Education.** Improve the elementary and secondary education system's ability to consistently deliver excellent instruction aligned with rigorous academic standards while providing effective support services to close achievement and opportunity gaps, and ensure all students graduate high school college- and career-ready. **Goal 3: Early Learning.** Improve the health, social-emotional, and cognitive outcomes for all children from birth through 3rd grade, so that all children, particularly those with high needs, are on track for graduating from high school college- and career-ready.
Ensure Effective Educational Opportunities for All Students	OELA OCR OSERS	**Goal 4: Equity.** Increase educational opportunities for underserved students and reduce discrimination so that all students are well-positioned to succeed.
Enhance the Education System's Ability to Continuously Improve	IES OII	**Goal 5: Continuous Improvement of the U.S. Education System.** Enhance the education system's ability to continuously improve through better and more widespread use of data, research and evaluation, evidence, transparency, innovation, and technology.

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	$ 36,325	$ -	$ -	$ 120	$ 36,445
With the Public	56,707	-	-	4,162	60,869
Total Gross Program Costs	**93,032**	**-**	**-**	**4,282**	**97,314**
Earned Revenue					
Intragovernmental	(4,744)	-	-	(6)	(4,750)
With the Public	(29,516)	-	-	(50)	(29,566)
Total Program Earned Revenue	**(34,260)**	**-**	**-**	**(56)**	**(34,316)**
Total 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)**
Total 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)**
Total 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)**
Total Program Costs	**-**	**-**	**-**	**2,063**	**2,063**
Net Cost of Operations	**$ 58,772**	**$ 22,346**	**$ 16,068**	**$ 7,136**	**$ 104,322**

Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

2015

	FSA	OESE	OSERS	Other	Total
Increase College Access, Quality, and Completion					
Gross Cost					
Intragovernmental	$ 33,873	$ -	$ -	$ 80	$ 33,953
With the Public	25,627	-	-	4,117	29,744
Total Gross Program Costs	**59,500**	**-**	**-**	**4,197**	**63,697**
Earned Revenue					
Intragovernmental	(5,134)	-	-	(11)	(5,145)
With the Public	(26,413)	-	-	(42)	(26,455)
Total Program Earned Revenue	**(31,547)**	**-**	**-**	**(53)**	**(31,600)**
Total Program Costs	**27,953**	**-**	**-**	**4,144**	**32,097**
Improve Preparation for College and Career from Birth Through 12th Grade, Especially for Children with High Needs					
Gross Cost					
Intragovernmental	-	179	-	-	179
With the Public	-	22,169	-	2	22,171
Total Gross Program Costs	**-**	**22,348**	**-**	**2**	**22,350**
Earned Revenue					
Intragovernmental	-	(12)	-	-	(12)
With the Public	-	(8)	-	-	(8)
Total Program Earned Revenue	**-**	**(20)**	**-**	**-**	**(20)**
Total Program Costs	**-**	**22,328**	**-**	**2**	**22,330**
Ensure Effective Educational Opportunities for All Students					
Gross Cost					
Intragovernmental	-	-	91	33	124
With the Public	-	-	15,776	756	16,532
Total Gross Program Costs	**-**	**-**	**15,867**	**789**	**16,656**
Earned Revenue					
Intragovernmental	-	-	(2)	-	(2)
With the Public	-	-	(8)	(1)	(9)
Total Program Earned Revenue	**-**	**-**	**(10)**	**(1)**	**(11)**
Total Program Costs	**-**	**-**	**15,857**	**788**	**16,645**
Enhance the Education System's Ability to Continuously Improve					
Gross Cost					
Intragovernmental	-	-	-	100	100
With the Public	-	-	-	2,312	2,312
Total Gross Program Costs	**-**	**-**	**-**	**2,412**	**2,412**
Earned Revenue					
Intragovernmental	-	-	-	(4)	(4)
With the Public	-	-	-	(55)	(55)
Total Program Earned Revenue	**-**	**-**	**-**	**(59)**	**(59)**
Total Program Costs	**-**	**-**	**-**	**2,353**	**2,353**
Net Cost of Operations	**$ 27,953**	**$ 22,328**	**$ 15,857**	**$ 7,287**	**$ 73,425**

Note 11. Credit Program Interest Expense and Interest Revenue

For FY 2016 and FY 2015, interest expense and interest revenue for credit programs consisted of the following:

Credit Program Interest Expense and Interest Revenue
(Dollars in Millions)

	2016						
	Interest Expense	**Subsidy Amortization**	**Net Expense**	**Gross Interest Revenue**		**Subsidy Amortization**	**Net Revenue**
	Federal	**Non-federal**		**Federal**	**Non-federal**	**Non-federal**	
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**

	2015						
	Interest Expense	**Subsidy Amortization**	**Net Expense**	**Gross Interest Revenue**		**Subsidy Amortization**	**Net Revenue**
	Federal	**Non-federal**		**Federal**	**Non-federal**	**Non-federal**	
Direct Loan Program	$ 27,593	$ -	$ 27,593	$ 4,206	$ 39,760	$ (16,373)	$ 27,593
FFEL Program	5,252	(1,826)	3,426	454	5,110	(2,138)	3,426
Other Credit Programs for Higher Education	60	-	60	13	72	(25)	60
Total	**$ 32,905**	**$ (1,826)**	**$ 31,079**	**$ 4,673**	**$ 44,942**	**$ (18,536)**	**$ 31,079**

Note 12. Statement of Budgetary Resources

The SBR compares budgetary resources with the status of those resources. As of September 30, 2016, budgetary resources were $335 billion and net agency outlays were $160 billion. As of September 30, 2015, budgetary resources were $350 billion and net agency outlays were $167 billion.

New Obligations and Upward Adjustments by Apportionment Type and Category

New obligations and upward adjustments by apportionment type and category, as of September 30, 2016 and 2015, consisted of the following:

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

	2016	2015
Direct:		
Category A	$ 2,170	$ 2,083
Category B	304,270	318,212
Exempt from Apportionment	638	104
Total Direct Apportionment	307,078	320,399
Reimbursable:		
Category A	3	4
Category B	63	64
New Obligations and Upward Adjustments	**$ 307,144**	**$ 320,467**

New obligations 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.

Unused Borrowing Authority

Unused borrowing authority and related changes in available borrowing authority, as of September 30, 2016 and 2015, consisted of the following:

Unused Borrowing Authority
(Dollars in Millions)

	2016	2015
Beginning Balance, Unused Borrowing Authority	**$ 54,829**	**$ 61,327**
Current Year Borrowing Authority	167,400	171,807
Funds Drawn from Treasury	(147,376)	(162,492)
Borrowing Authority Withdrawn	(13,862)	(15,813)
Ending Balance, Unused Borrowing Authority	**$ 60,991**	**$ 54,829**

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, 2016 and 2015, consisted of the following:

Undelivered Orders
(Dollars in Millions)

		2016		2015
Budgetary	$	50,019	$	49,838
Non-Budgetary		73,366		75,064
Undelivered Orders (Unpaid)	**$**	**123,385**	**$**	**124,902**

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.

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, 2016 and 2015, consisted of the following:

Distributed Offsetting Receipts
(Dollars in Millions)

		2016		2015
Negative Subsidies and Downward Re-estimates of Subsidies:				
FFEL Program	$	2,550	$	4,658
Direct Loan Program		7,881		8,211
Facilities Loan Programs		18		83
TEACH Program		5		31
HEAL Program		-		19
Total Negative Subsidies and Downward Re-estimates		10,454		13,002
Other		312		103
Distributed Offsetting Receipts	**$**	**10,766**	**$**	**13,105**

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

The *FY 2018 Budget of the United States Government* (President's Budget), which presents the actual amounts for the year ended September 30, 2016, has not been published as of the issue date of these financial statements. The FY 2018 President's Budget is scheduled for release in February 2017.

A reconciliation of the FY 2015 SBR to the FY 2017 President's Budget (FY 2015 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 Incurrred	Distributed Offsetting Receipts	Net Outlays
Combined Statement of Budgetary Resources	**$ 349,678**	**$ 320,467**	**$ 13,105**	**$ 167,138**
Expired Funds	(2,195)	(997)		
FFEL Guaranty Agency Amounts Included in the President's Budget	9,239	9,240		
Distributed Offsetting Receipts				13,105
Other	(10)	(3)	1	3
***Budget of the United States Government*[1]**	**$ 356,712**	**$ 328,707**	**$ 13,106**	**$ 180,246**

[1] Amounts obtained from the Appendix, *Budget of the United States Government,* FY 2017

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 2015 SBR for the federal fund are compiled by combining all guaranty agencies' annual reports to determine a net valuation amount for the federal fund.

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, 2016 and 2015, are presented below:

Reconciliation of Net Cost of Operations to Budget

(Dollars in Millions)

	2016	2015
Resources Used to Finance Activities:		
New Obligations and Upward Adjustments	$ 307,144	$ 320,467
Spending Authority from Offsetting Collections and Recoveries	(136,094)	(145,810)
Offsetting Receipts	(10,766)	(13,105)
Net Budgetary Resources Obligated	**160,284**	**161,552**
Imputed Financing from Costs Absorbed by Others	81	30
Other Financing Sources	(5,124)	(14,293)
Net Other Resources	**(5,043)**	**(14,263)**
Net Resources Used to Finance Activities	**155,241**	**147,289**
Resources Used or Generated for Items Not Part of the Net Cost of Operations:		
(Increase)/Decrease in Budgetary Resources Obligated but Not Yet Provided	1,763	5,177
Resources that Fund Subsidy Re-estimates Accrued in Prior Period	(2,598)	(20,131)
Credit Program Collections	92,080	102,183
Acquisition of Fixed Assets	(11)	(15)
Acquisition of Net Credit Program Assets or Liquidation of Liabilities for Loan Guarantees	(161,826)	(165,850)
Resources from Non-Entity Activity	5,196	14,948
Net Resources that Do Not Finance the Net Cost of Operations	**(65,396)**	**(63,688)**
Net Resources Used to Finance the Net Cost of Operations	**89,845**	**83,601**
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	17,977	16,710
Other	22	(1)
Total Components Not Requiring or Generating Resources	**17,999**	**16,710**
Increase/(Decrease) in Annual Leave Liability	2	1
Accrued Re-estimates of Credit Subsidy Expense	28,006	2,598
Increase in Exchange Revenue Receivable from the Public	(31,611)	(29,486)
Accrued Interest with Treasury	1	1
Other (+/-)	80	-
Total Components Requiring or Generating Resources in Future Periods	**(3,522)**	**(26,886)**
Total Components that Will Not Require or Generate Resources in the Current Period	**14,477**	**(10,176)**
Net Cost of Operations	**$ 104,322**	**$ 73,425**

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 17 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)

2016		2015	
FY	**Amount**	**FY**	**Amount**
2017	$ 74	2016	$ 83
2018	78	2017	76
2019	80	2018	81
2020	83	2019	79
2021	85	2020	82
After 2021	86	After 2020	84
Total	**$ 486**	**Total**	**$ 485**

Guaranty Agencies

The Department may assist guaranty agencies experiencing financial difficulties. The Department has not done so in fiscal years 2016 or 2015 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 2016, the Department provided funding of 83.0 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 17.0 percent of program funding. For the latest academic year that ended June 30, 2016, approximately 421 thousand loans were made totaling $1.0 billion at 1,378 institutions, making an average of $2,480 per loan. The Department's equity interest was approximately $6.5 billion as of June 30, 2016.

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.

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.

Litigation and Other Claims

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

The cost of loan forgiveness related to the recent proprietary school closures reflected in the accompanying financial statements is limited to claims received through September 30. On November 1, 2016, the Department issued certain regulations that may affect the amount to ultimately be paid related to these claims. The final disposition of claims filed and those yet to be filed from schools closed before September 30 is not expected to have a material impact to 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.

United States Department of Education
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2016

(Dollars in Millions)

	Combined		Federal Student Aid		Office of Elementary and Secondary Education	Office of Special Education and Rehabilitative Services	Other	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Budgetary	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:								
Unobligated Balance, Brought Forward, October 1	$ 14,774	$ 14,437	$ 12,719	$ 14,236	$ 800	$ 273	$ 982	$ 201
Recoveries of Prior Year Unpaid Obligations	746	21,047	188	21,047	368	88	102	-
Other Changes in Unobligated Balance (+ or -)	(772)	(24,695)	(374)	(24,687)	(87)	(153)	(158)	(8)
Unobligated Balance from Prior Year Budget Authority, Net	$ 14,748	$ 10,789	$ 12,533	$ 10,596	$ 1,081	$ 208	$ 926	$ 193
Appropriations (Discretionary and Mandatory)	87,924	24	41,948	24	22,145	16,493	7,338	-
Borrowing Authority (Discretionary and Mandatory) (Note 12)	-	167,400	-	167,272	-	-	-	128
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	522	53,608	470	53,563	3	-	49	45
Total Budgetary Resources	**$ 103,194**	**$ 231,821**	**$ 54,951**	**$ 231,455**	**$ 23,229**	**$ 16,701**	**$ 8,313**	**$ 366**
Status of Budgetary Resources:								
New Obligations Incurred and Upward Adjustments (Total) (Note 12)	$ 90,802	$ 216,342	$ 44,567	$ 216,152	$ 22,316	$ 16,540	$ 7,379	$ 190
Unobligated Balance, End of Year:								
Apportioned, Unexpired Accounts	10,280	-	8,782	-	846	-	652	-
Unapportioned, Unexpired Accounts	1,212	15,479	1,212	15,303	-	-	-	176
Unexpired Unobligated Balance, End of year	**$ 11,492**	**$ 15,479**	**$ 9,994**	**$ 15,303**	**$ 846**	**$ -**	**$ 652**	**$ 176**
Expired Unobligated Balance, End of Year	900	-	390	-	67	161	282	-
Unobligated Balance, End of Year (Total)	**$ 12,392**	**$ 15,479**	**$ 10,384**	**$ 15,303**	**$ 913**	**$ 161**	**$ 934**	**$ 176**
Total Status of Budgetary Resources	**$ 103,194**	**$ 231,821**	**$ 54,951**	**$ 231,455**	**$ 23,229**	**$ 16,701**	**$ 8,313**	**$ 366**
Change in Obligated Balance:								
Unpaid Obligations								
Unpaid Obligations, Brought Forward, October	$ 52,645	$ 78,116	$ 19,286	$ 77,880	$ 14,950	$ 8,835	$ 9,574	$ 236
1 New Obligations and Upward Adjustments	90,802	216,342	44,567	216,152	22,316	16,540	7,379	190
Outlays (Gross) (-)	(88,452)	(196,787)	(43,449)	(196,596)	(21,584)	(15,959)	(7,460)	(191)
Recoveries of Prior Year Unpaid Obligations (-)	(746)	(21,047)	(188)	(21,047)	(368)	(88)	(102)	-
Unpaid Obligations, End of Year	**$ 54,249**	**$ 76,624**	**$ 20,216**	**$ 76,389**	**$ 15,314**	**$ 9,328**	**$ 9,391**	**$ 235**
Uncollected Payments								
Uncollected Payments, Federal Sources, Brought Forward, October 1 (-)	$ (3)	$ (26)	$ -	$ (4)	$ -	$ -	$ (3)	$ (22)
Change in Uncollected Payments, Federal Sources (+ or -)	1	22	-	-	-	-	1	22
Uncollected Payments, Federal Sources, End of Year (-)	$ (2)	$ (4)	$ -	$ (4)	$ -	$ -	$ (2)	$ -
Memorandum (Non-add) Entries								
Obligated Balance, Start of Year (+ or -)	**$ 52,642**	**$ 78,090**	**$ 19,286**	**$ 77,876**	**$ 14,950**	**$ 8,835**	**$ 9,571**	**$ 214**
Obligated Balance, End of Year (+ or -)	**$ 54,247**	**$ 76,620**	**$ 20,216**	**$ 76,385**	**$ 15,314**	**$ 9,328**	**$ 9,389**	**$ 235**
Budget Authority and Outlays, Net:								
Budget Authority, Gross (Discretionary and Mandatory)	$ 88,446	$ 221,032	$ 42,418	$ 220,859	$ 22,148	$ 16,493	$ 7,387	$ 173
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(721)	(114,123)	(653)	(113,986)	-	-	(68)	(137)
Change in Uncollected Customer Payments from Federal Sources (Discretionary and Mandatory) (+ or -)	1	22	-	-	-	-	1	22
Recoveries of Prior Year Paid Obligations (Discretionary and Mandatory) (+ or -)	(1)	(516)	(1)	(516)	-	-	-	-
Budget Authority, Net (Discretionary and Mandatory)	**$ 87,725**	**$ 106,415**	**$ 41,764**	**$ 106,357**	**$ 22,148**	**$ 16,493**	**$ 7,320**	**$ 58**
Outlays, Gross (Discretionary and Mandatory)	$ 88,452	$ 196,787	$ 43,449	$ 196,596	$ 21,584	$ 15,959	$ 7,460	$ 191
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(721)	(114,123)	(653)	(113,986)	-	-	(68)	(137)
Outlays, Net (Discretionary and Mandatory)	87,731	82,664	42,796	82,610	21,584	15,959	7,392	54
Distributed Offsetting Receipts (-) (Note 12)	(10,766)	-	(10,684)	-	-	-	(82)	-
Agency Outlays, Net (Discretionary and Mandatory) (Note 12)	**$ 76,965**	**$ 82,664**	**$ 32,112**	**$ 82,610**	**$ 21,584**	**$ 15,959**	**$ 7,310**	**$ 54**

United States Department of Education
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2015

(Dollars in Millions)

	Combined		Federal Student Aid		Office of Elementary and Secondary Education	Office of Special Education and Rehabilitative Services	Other	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Budgetary	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resource:								
Unobligated Balance, Brought Forward, October 1	$ 14,837	$ 10,109	$ 12,642	$ 9,857	$ 836	$ 309	$ 1,050	$ 252
Recoveries of Prior Year Unpaid Obligations	1,978	20,727	921	20,727	643	271	143	-
Other Changes in Unobligated Balance (+ or -)	(679)	(23,984)	(194)	(23,978)	(210)	(140)	(135)	(6)
Unobligated Balance from Prior Year Budget Authority, Net	$ 16,136	$ 6,852	$ 13,369	$ 6,606	$ 1,269	$ 440	$ 1,058	$ 246
Appropriations (Discretionary and Mandatory)	100,701	904	55,798	904	21,575	16,201	7,127	-
Borrowing Authority (Discretionary and Mandatory) (Note 12)	-	171,807	-	171,624	-	-	-	183
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	381	52,897	502	52,823	3	(184)	60	74
Total Budgetary Resources	**$ 117,218**	**$ 232,460**	**$ 69,669**	**$ 231,957**	**$ 22,847**	**$ 16,457**	**$ 8,245**	**$ 503**
Status of Budgetary Resources:								
New Obligations Incurred and Upward Ajdustments (Total) (Note 12)	$ 102,444	$ 218,023	$ 56,950	$ 217,721	$ 22,047	$ 16,184	$ 7,263	$ 302
Unobligated Balance, End of Year:								
Apportioned, Unexpired Accounts	11,806	550	10,473	550	677	33	623	-
Unapportioned, Unexpired Accounts	1,771	13,887	1,771	13,686	-	-	-	201
Unexpired Unobligated Balance, End of year	**$ 13,577**	**$ 14,437**	**$ 12,244**	**$ 14,236**	**$ 677**	**$ 33**	**$ 623**	**$ 201**
Expired Unobligated Balance, End of Year	1,197	-	475	-	123	240	359	-
Unobligated Balance, End of Year (Total)	**$ 14,774**	**$ 14,437**	**$ 12,719**	**$ 14,236**	**$ 800**	**$ 273**	**$ 982**	**$ 201**
Total Status of Budgetary Resources	**$ 117,218**	**$ 232,460**	**$ 69,669**	**$ 231,957**	**$ 22,847**	**$ 16,457**	**$ 8,245**	**$ 503**
Change in Obligated Balance:								
Unpaid Obligations								
Unpaid Obligations, Brought Forward, October 1	$ 56,219	$ 80,316	$ 21,466	$ 80,104	$ 15,948	$ 8,921	$ 9,884	$ 212
New Obligations and Upward Adjustments	102,444	218,023	56,950	217,721	22,047	16,184	7,263	302
Outlays (Gross) (-)	(103,847)	(199,496)	(58,209)	(199,218)	(22,402)	(15,806)	(7,430)	(278)
Actual Transfers, Unpaid Obligations (Net) (+ o -)	(193)	-	-	-	-	(193)	-	-
Recoveries of Prior Year Unpaid Obligations (-)	(1,978)	(20,727)	(921)	(20,727)	(643)	(271)	(143)	-
Unpaid Obligations, End of Year	**$ 52,645**	**$ 78,116**	**$ 19,286**	**$ 77,880**	**$ 14,950**	**$ 8,835**	**$ 9,574**	**$ 236**
Uncollected Payments								
Uncollected Payments, Federal Sources, Brought Forward, October 1 (-)	$ (1)	$ (26)	$ -	$ (4)	$ -	$ -	$ (1)	$ (22)
Change in Uncollected Payments, Federal Sources (+ or -)	(2)	-	-	-	-	-	(2)	-
Uncollected Payments, Federal Sources, End of Year (-)	$ (3)	$ (26)	$ -	$ (4)	$ -	$ -	$ (3)	$ (22)
Memorandum (Non-add) Entries								
Obligated Balance, Start of Year (+ or -)	**$ 56,218**	**$ 80,290**	**$ 21,466**	**$ 80,100**	**$ 15,948**	**$ 8,921**	**$ 9,883**	**$ 190**
Obligated Balance, End of Year (+ or -)	**$ 52,642**	**$ 78,090**	**$ 19,286**	**$ 77,876**	**$ 14,950**	**$ 8,835**	**$ 9,571**	**$ 214**
Budget Authority and Outlays, Net:								
Budget Authority, Gross (Discretionary and Mandatory)	$ 101,082	$ 225,608	$ 56,300	$ 225,351	$ 21,578	$ 16,017	$ 7,187	$ 257
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(713)	(122,387)	(647)	(122,283)	-	-	(66)	(104)
Change in Uncollected Customer Payments from Federal Sources (Discretionary and Mandatory) (+ or -)	(2)	-	-	-	-	-	(2)	-
Recoveries of Prior Year Unpaid Obligations (Discretionary and Mandatory) (+ or -)	(2)	(542)	(2)	(542)	-	-	-	-
Budget Authority, Net (Discretionary and Mandatory)	**$ 100,365**	**$ 102,679**	**$ 55,651**	**$ 102,526**	**$ 21,578**	**$ 16,017**	**$ 7,119**	**$ 153**
Outlays, Gross (Discretionary and Mandatory)	$ 103,847	$ 199,496	$ 58,209	$ 199,218	$ 22,402	$ 15,806	$ 7,430	$ 278
Actual Offsetting Collections (Discretionary and Mandatory) (-)	(713)	(122,387)	(647)	(122,283)	-	-	(66)	(104)
Outlays, Net (Discretionary and Mandatory)	103,134	77,109	57,562	76,935	22,402	15,806	7,364	174
Distributed Offsetting Receipts (-) (Note 12)	(13,105)	-	(12,957)	-	-	-	(148)	-
Agency Outlays, Net (Discretionary and Mandatory) (Note 12)	**$ 90,029**	**$ 77,109**	**$ 44,605**	**$ 76,935**	**$ 22,402**	**$ 15,806**	**$ 7,216**	**$ 174**

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. Namely, 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 $285 billion in gross outlays during FY 2016 were 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 Federal 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, institution (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.

Further details on financial figures and program-level goals can be viewed in the Department's *2016 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.

Departmentwide strategic goals are formed around the agency mission of promoting student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access. The Department drives toward accomplishing this mission by establishing priority areas. For 2016, the following six elements of focus were enumerated in the Department's Budget Request:

- increasing equity and opportunity for all students,
- strengthening support for teachers and school leaders,
- expanding high-quality preschool programs,
- augmenting affordability and quality in postsecondary education,
- promoting educational innovation and improvement, and
- improving school safety and climate.

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. 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 each office and their work can be viewed on the Department's Coordinating Structure website.

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.

Summary of Human Capital Expenses
(Dollars in Millions)

	2016	2015	2014	2013	2012
Federal Student Aid Expense					
Direct Loan Subsidy	$ 16,119	$ (892)	$ 8,126	$ (39,557)	$ (10,720)
Federal Family Education Loan Program Subsidy	10,234	(3,856)	(6,585)	(8,753)	(14,381)
Perkins Loans, Pell and Other Grants	30,671	31,400	33,098	33,542	34,310
Program Operational Costs	308	242	206	222	192
Subtotal	**57,332**	**26,894**	**34,845**	**(14,546)**	**9,401**
Departmental Programs					
Elementary and Secondary Education	22,155	22,146	22,832	22,221	22,137
Special Education and Rehabilitative Services	15,944	15,751	15,948	15,919	16,139
American Recovery and Reinvestment Act and Education Jobs Fund	-	-	-	2,623	7,651
Other Departmental Programs	6,349	6,494	6,938	6,175	6,211
Program Operational Costs	625	511	667	703	481
Subtotal	**45,073**	**44,902**	**46,385**	**47,641**	**52,619**
Grand Total	**$ 102,405**	**$ 71,796**	**$ 81,230**	**$ 33,095**	**$ 62,020**

Further detail regarding the nature of expenses and the recipient(s) of payments can be seen in the Department's financial statement footnotes (starting on page 50) and at the Department's *USA Spending Agency Profile Page*.

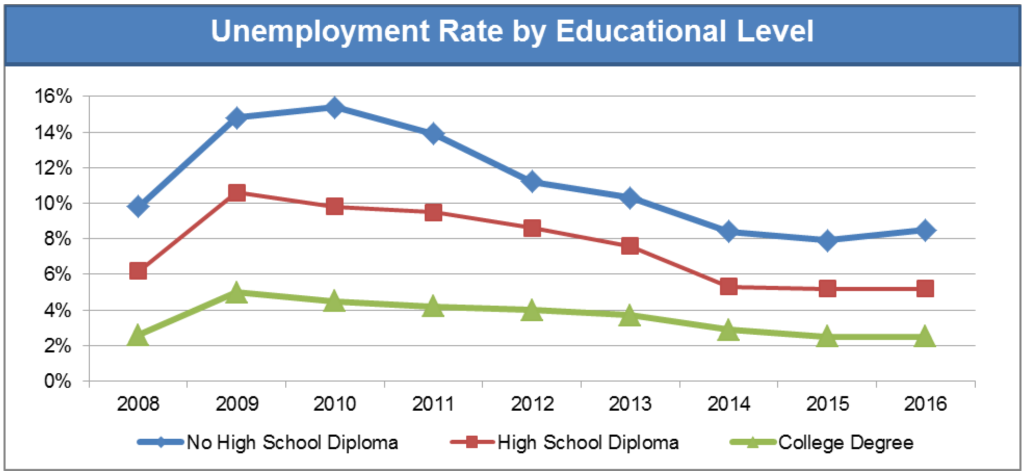
Program Outcomes

Favorable results in the various programs administered by the Department can be interpreted in many ways. The "cradle to career" analogy in education culminates with the successful completion of academic programs and the receipt of a degree. 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 degree. This often final stepping stone in one's educational career correlates strongly with wage and/or salary increases for a person, 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.

Interesting data regarding U.S. unemployment rates and average incomes published by the Department of Labor in September 2016 are illustrated in the graphs below.

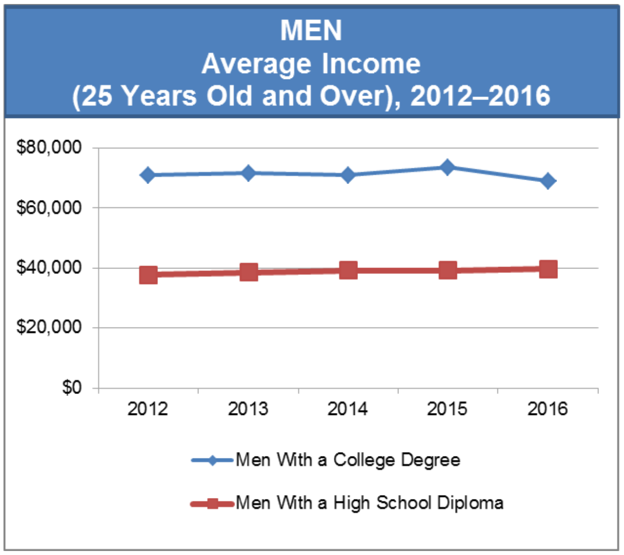
An inverse relationship is evident where persons who completed lower levels of education experienced higher rates of unemployment. For example, as of September 2016, men and women together had the following unemployment rates:

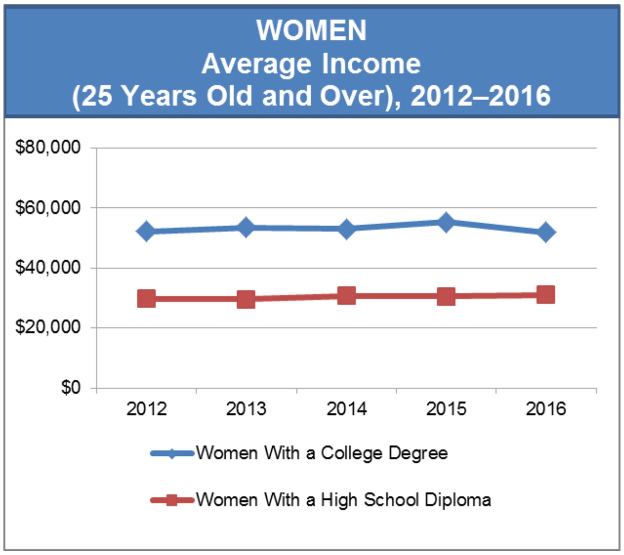
- 8.5 percent for those who had not completed high school,
- 5.2 percent for those who had completed high school, and
- 2.5 percent for those who had completed a bachelor's degree or higher.



Another relationship clearly exists for the effect on income based on whether an individual has a high school education or a college education. For example, as of September 2016, men and women had the following average incomes:

- $40,000 annually for men with a high school diploma,
- $69,000 annually for men with a college degree,
- $31,000 annually for women with a high school diploma, and
- $52,000 annually for women with a college degree.





For further details on this data, please visit the U.S. Department of Labor's Bureau of Labor Statistics, Table A-4 for employment status or Table 5 for median income.
Nationally, progress is being made from early education, expanding through the time college graduates enter the workforce, as well as later in life when they are repaying student loan debt incurred for postsecondary education. Broad improvements to the system increase equitable opportunities for every child to have the privilege to learn, develop life skills, and succeed over the course of their adult life. These improvements certainly accelerate the attainment of national educational goals.

Successful outcomes like these in early-focus areas lead to elementary school students who continue to outperform their predecessor classes. This is shown in the fact that 4th and 8th grade metrics for aptitude tests in math and reading, presented by the National Assessment of Educational Progress, are at their highest ever.

At the secondary level, the number of students graduating or completely fulfilling general education requirements continues to rise each year. Increases are also taking place for all levels of postsecondary degrees. Recent data shows that 91 percent of young adults aged 25–29 have a high school diploma or equivalent, 45 percent have an associate degree, and 34 percent have a bachelor's degree or higher. For the same age range, expanded to include those up to 34 years old, earnings were higher and unemployment was generally lower for each increased level of education.

With increased completion of high school diplomas, participation in some form of postsecondary education has also risen. In the 2013 cohort of students graduating from high school, for example, 66 percent enrolled in college the following fall. Participation in postsecondary programs is particularly higher for Black and Hispanic students, who have shown a combined increase of 1.1 million students since 2008.

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 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 2013 cohort of borrowers entering repayment were released at the end of FY 2016. Of the 5.2 million borrowers entering repayment from October 1, 2012, to September 30, 2013, 593,000 defaulted on their loan before September 30, 2015. This borrower default rate of 11.3 percent across all institution types showed a decline from the prior year rate of 11.8 percent for the 2012 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. The figures also effectively convey the synergetic nature of the Department's mission for improving one of the most important building blocks of the nation's infrastructure. Individual achievements fostered by the Department's investments in human capital and supporting stewardship expenses as far back as "the cradle" continue to build a powerful foundation for career success and advancement of the nation, in and of itself, and against global competitors.

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 14, 2016

The Honorable John B. King, Jr.
Secretary of Education
Washington, D.C. 20202

Dear Secretary King:

The enclosed report presents the results of the audit of the U.S. Department of Education's (Department) financial statements for fiscal years 2016 and 2015 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, 2016 and 2015, 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 2016 and 2015 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

400 MARYLAND AVENUE, S.W., WASHINGTON, DC 20202-1510

Promoting the efficiency, effectiveness, and integrity of the Department's programs and operations.

Page 2 – The Honorable John B. King, Jr.

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

Kathleen S. Tighe
Inspector General

Enclosure

CliftonLarsonAllen

CliftonLarsonAllen LLP

www.cliftonlarsonallen.com

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, 2016 and 2015, and the related consolidated statements of net cost and changes in net position, and the combined statements 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. 15-02*, Audit Requirements for Federal Financial Statements* (OMB Bulletin 15-02). Those standards and OMB Bulletin 15-02 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 of accounting policies used and the reasonableness of

Nexia International

INDEPENDENT AUDITORS' REPORT (Continued)

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, 2016 and 2015, 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 Department's Management Discussion and Analysis (MD&A), other Required Supplementary Information (RSI), and Required Supplementary Stewardship Information (RSSI) included in the U.S. Department of Education FY 2016 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, other 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, and the Other Information in the U. S. Department of Education FY2016 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.

INDEPENDENT AUDITORS' REPORT (Continued)

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

Report on Internal Control over Financial Reporting

In planning and performing our audit of the 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 did identify certain deficiencies in internal control, described below and in more detail in Exhibit A, which we consider to be significant deficiencies.

Controls over the Department's Modeling Activities Need Improvement

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. We identified deficiencies in the controls over the Department's processes for model design and development, risk assessment, model operation and validation, and oversight. The Department does not have a comprehensive framework for risk management and fully developed internal controls for its modeling activities, which could impact the reliability of its estimates used for financial reporting, budgetary formulation and management analysis.

INDEPENDENT AUDITORS' REPORT (Continued)

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

The Department oversees a large portfolio of Department 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. While the Department has made progress in some areas to address these issues in recent years, we continued to identify control deficiencies in the Department's information security program relating to policies and procedures, compliance monitoring, personnel management, and security incident response as well as the management of various application level security, configuration and access controls. 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.

Report on 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 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 No. 15-02.

As of September 30, 2016, 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 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.

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

INDEPENDENT AUDITORS' REPORT (Continued)

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.

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 13, 2015. The status of prior year findings is presented in Exhibit D.

INDEPENDENT AUDITORS' REPORT (Continued)

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

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

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Arlington, Virginia
November 14, 2016

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

Controls over the Department's Modeling Activities Need Improvement

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

The Cost Estimation and Analysis Division (CEAD) within the Office of Planning, Evaluation and Policy Development's Budget Service 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 $1.3 trillion in direct, defaulted, and guaranteed student loans as of September 30, 2016.

An effective controls 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 activities, which should include documenting the objectives of the model, applicable program attributes and requirements affecting the planned model, evaluation of available data, proposed design, potential design alternatives, and model testing and approval.

Our audit found the Department maintained limited documentation supporting the initial design, evaluation, justification and testing of the model 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, the Department made concerted efforts to enhance the documentation of two models updated during the year, including the modeling of recoveries on defaulted loans and documentation related to the NSLDS sampling process. The revised documentation represented a substantial improvement in explaining the methodology and its basis but was not sufficiently detailed to be fully effective guide for an independent reviewer to follow the procedures performed.

CEAD is comprised of a small team of experienced economists and analysts responsible for performing its modeling activities, but thoroughly documenting such design requirements may

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

be onerous for the current team. Given the size, growth and changes of the Direct Loan Program in recent years, ineffective controls over the design of new models can impact the reliability of their estimates, as noted in our review of the Department's modeling for income driven repayment (IDR) plans.

IDR modeling: The Department's model for estimating future cash flows from student loan borrowers with IDR plans was updated in 2015, following the announcement of the new income-dependent Pay As You Earn program. The previous update to the Department's IDR model was in 2004. Due to recent growth in the number of borrowers using IDR plans, this model now supports a significant portion of the Direct Loan Program's subsidy cash flow estimates.

The process used to estimate these cash flows is performed outside the Student Loan Model and requires the Department to estimate borrowers' future incomes in order to estimate the amount and timing of the principal the borrower will repay. The Department obtained "synthetic" income data from the Department of the Treasury's Office of Technical Assistance (OTA), which CEAD used to estimate future incomes and project the corresponding future income-based loan repayments. CEAD found the format and nature of the data provided by OTA was not well suited for their purposes, but was nevertheless used due to time limitations to complete the forecasts.

We found the methodology used for imputing borrower incomes was also not well suited based on the nature of the OTA data, and could result in unreliable or inappropriate income forecasts. The Department did not have a process to document and communicate their concerns and the risks to their estimates as a result of these limitations.

The Department did not have formalized documentation for their justification of the overall IDR modeling approach selected, potential alternatives and their evaluation, testing plans, and formal approval for the implementation of the new model. Further, the Department did not have formalized documentation describing the process for imputing borrowers incomes and calculating other IDR related assumptions.

We also found the current methodology did not take into account inflation or forecasted macroeconomic data such as found in the President's Economic Assumptions. We also found deficiencies in the methodology for forecasting defaults from IDR borrowers. Although management indicated it plans to enhance the model, the Department has not documented the basis for its conclusion to not update this model immediately once the risk to the estimates were identified.

The Department is also currently developing a new model to be used for estimating the subsidy cost for the Direct Loan Program; however, there is limited documentation regarding the specifications, requirements, evaluation, or testing plan relating to the development of the model.

Model risk assessment
CEAD maintains over 18 different economic and financial modeled assumptions used within the calculation of the Allowance for Subsidy for the just the Direct Loan Program. Some of the assumptions are updated annually, while others are updated biannually. The Department does not have a formalized process for compiling and maintaining the Department's model inventory, assessing and documenting modeling risks, and monitoring the implementation of corrective

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

actions. 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. The Department also does not have a documented risk-based process for obtaining 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 were unable to ensure certain control activities were performed. The Department has initiated the development of a number of policy manuals and desk guides to support the proper operation of current models but these manuals are incomplete and not readily used.

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, actuals to estimates review, cohort analysis, and sensitivity analysis. However, the Department 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. Further, the Department's sensitivity analysis did not address key components of the program known to have a significant impact on its cost, including IDR plan participation rates, borrower incomes, or Public Service Loan Forgiveness participation rates.

Governance and guidance
The Department does not have a formalized process for engaging and involving senior leadership from FSA and the Department in their governance capacity over critical decisions relating to various modeling activities, including model development, risk assessment, assumption development and review and model validation. Given the pervasive impact of the credit activities on the Department budget estimates, policy decisions, and financial reporting, estimation (or model) risk should be one of the key enterprise risks to be managed by the Department and its components, with a fully developed governance framework and control structure.

The Department does maintain a Credit Reform Working Group that brings together members of FSA and Department management periodically with CEAD staff to discuss estimation and modeling issues; however, the Department has not formally defined the roles and responsibilities of the members of this group within a comprehensive model risk management framework.

The Department has also not established a formalized structure or process for other critical model risk management activities, including maintaining the inventory of models with a corresponding assessment of risks, known deficiencies, and planned corrective actions, and performing or overseeing independent validations of the Department's models.

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

<u>*Summary*</u>
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 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*.

Recommendations:

We recommend 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.

We recommend 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.
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 impact's the Department's level of controls, validation and monitoring over each model.
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.
1e. Document the overall review and conclusions drawn related to the evaluation of the results of model performance reviews and validation procedures performed.

We recommend 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.

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

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.

We recommend 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.

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

The Department oversees a large portfolio of Department 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 progress in some areas to address these issues in recent years, we continued to identify control deficiencies in the Department's information security program relating to policies and procedures, compliance monitoring, personnel management, security incident response and management of various application level security, configuration management, and access controls.

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 are outdated or did not fully address specific controls required by NIST Special Publication (SP) 800-53, revision 4, *Recommended Security and Privacy Controls for Federal Information Systems and Organizations*. Designing and implementing effective agency level policies is the responsibility of the Department's Chief Information Officer (CIO). While the CIO has revised the Department's Information Assurance/Cybersecurity Policy, it has not been approved by the Office of Management. In addition, the associated guidance has not been completed, according to management, due to limited resources.

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

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

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, the CIO has not ensured Department system owners adopt the Office of Personnel Management Position Designation Tool in order to determine and document suitability and investigation requirements for each system's roles/responsibilities. Furthermore, the Office of the Chief Financial Officer has not implemented service level agreements for contractor employee clearance monitoring, as recommended last year.

We also found the CIO's centralized controls for responding to security incidents were not always in accordance with agency policy. The entire population of sixteen sampled security and privacy incidents did not have documentation of the remediation actions and closure date of the incidents.

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 FY2015 OIG review involved testing financial and non-financial systems' controls and identified control deficiencies in four of ten reporting areas related to configuration management, continuous monitoring, incident response and reporting, and remote access management. The review also determined that the Department's Identity and Access Management programs and practices would be generally effective if implemented properly.

Although FSA had 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 the system security controls at the application or system level is the responsibility of the system owners, in conjunction with system level information security officers. Our audit identified application, or system, specific control deficiencies in the areas of security management, access controls, and configuration management 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 and configuration management across these systems. The agency is developing a new system for user access management to address various access control deficiencies, but this system will not be fully implemented until FY2017.

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

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

Security management

- One system security plan was incomplete
- Plans of Action and Milestones (POA&Ms) missed estimated completion dates and were not always updated for three systems
- Security awareness training for new system users was not always completed
- Role based security awareness training for users with significant system security responsibilities was not always completed
- Authorization decision documents were not signed by the new Authorizing Official (AO)
- Interconnection agreements were not in place or current
- Evidence to validate Department assets were returned for separated employees was not always provided

Access controls

- User access was not always approved for all users or for all roles granted
- Termination of system access for separated employees and contractors was not always completed timely
- Inactive accounts were not always disabled
- Certain users had access to directly implement system changes to the production environment
- User access 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
- Computer security configurations were inadequate and software was not patched or was unsupported
- System security impact assessment was not always conducted

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.

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 Plan of Action and Milestones (POA&M) process. Security policies and procedures also include employee hiring, transfer and termination practices. We

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

noted that the POA&Ms for three FSA systems had passed their scheduled dates of completion without updated milestone information.

Overall, we found improvement in the level of compliance with security awareness training requirements this year. For three of the four systems tested, we found system users did not always complete the required security awareness training. Also, contractors with significant system security responsibilities had not always completed role based training for two of the four FSA systems tested.

When the AO changed in FY2015 for all 4 systems tested, the new AO did not sign the new authorization decision documents to explicitly accept the risk and formally transfer responsibility and accountability for the information systems. Upon notification of this issue to management, the new AO signed new authorization decision documents in September 2016 to explicitly accept the risk and formally transfer responsible and accountability for the information systems.

In addition, a *Clearance of Personnel for Separation or Transfer Form* was not provided to validate that Department assets were returned for ten from a sample of twenty-one Department terminated employees. For one of five FSA terminated employees we tested, the form did not contain all required signatures validating that Department assets were returned.

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, we identified expired MOUs, one MOU that was not reviewed in accordance with the requirements of the ISA, 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 Department, FSA, and/or loan servicer employees, were not disabled for the Department's general ledger system and three of the four FSA systems tested
- Inactive accounts were not disabled for one FSA system
- For one FSA system, eighteen from a sample of 25 new users did not have evidence that their access was approved and one individual was granted a role that was not approved
- For another FSA system, five from a sample of 25 new users had user roles that were modified from the original access level with no evidence that the modified role was approved

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

- User access 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
- One user had inappropriate access to directly implement changes to the production environment

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. Additionally, we found security impact assessments were not conducted for one FSA system. Furthermore, our testing identified insecure configurations as well as unpatched and unsupported software in both the Department and FSA systems.

The 2015 FISMA review determined that the Department's and FSA's information technology security programs were generally effective in key aspects of three metric areas—Risk Management, Security Training, Contingency Planning—but further improvements were needed. For the Department and FSA's corrective action process, the review determined that, if implemented as intended, it should be effective. The review also found that the Department's controls over access to FSA's mainframe environment need improvement. Overall, eight of the ten reporting metrics contained repeat or modified repeat findings identified from 2011 through 2014.

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.

INDEPENDENT AUDITORS' REPORT (Continued)
EXHIBIT A
Significant Deficiencies

- 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, individuals with responsibility for information system security need clear expectations in the form of agency level information security policies and procedures that address all NIST and OMB requirements. Therefore, it is essential that the Department complete, approve and disseminate the Information Assurance/Cybersecurity Policy and associated guidance. In addition, due to the continuance of persistent IT control deficiencies across multiple systems, the 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.

Recommendations:

We recommend 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.
2b. Design and implement controls over the handling of Department security and privacy incidents to ensure their resolution is properly documented.

We recommend 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.

We recommend 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.

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, 2016, the Department and FSA are not in compliance with the new timing requirement for referring delinquent student loan debts to Treasury.

To meet this requirement, the Department has been able to obtain 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

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

UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202-_____

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 2016 and 2015 Financial Statements
U.S. Department of Education
ED-OIG/A17Q0001

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.

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.

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 2015 Recommendation	Fiscal Year 2016 Status
CLA recommended the Department CISO work with the FSA CISO to:	
1a. Refine and fully implement FSA's system security program to monitor compliance with NIST requirements, in coordination with the Department's organization wide information security program, at both the agency and system level.	Repeat finding; see Significant Deficiency
1b. Strengthen and refine the process to ensure accountability for individuals responsible for remediating the identified control deficiencies in the Department and FSA's systems, including cooperation between the Technology Office and Business Operations.	Modified Repeat finding; see Significant Deficiency
1c. Strengthen and refine the process for holding contractors accountable for remediation of control deficiencies in the Department and FSA's systems.	Repeat finding; see Significant Deficiency
Noncompliance with Laws and Regulations	
CLA recommended that the Secretary of Education and FSA Chief Operating Officer:	
2. Modify their loan servicing systems, procedures and internal processes to comply with the legal timing requirement for referring delinquent non-tax debts to Treasury.	Repeat finding; see Instance of Noncompliance