Federal Student Aid

An OFFICE of the U.S. DEPARTMENT of EDUCATION

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ANNUAL REPORT 2012

United States Department of Education
Arne Duncan
Secretary

Federal Student Aid
James W. Runcie
Chief Operating Officer

Finance Office
Jay Hurt
Chief Financial Officer

November 16, 2012

About This Report

Federal Student Aid, a principal office of the United States Department of Education, is required by legislation to produce an *Annual Report*, which details Federal Student Aid's financial and program performance. The *Federal Student Aid Annual Report* for Fiscal Year 2012 is a comprehensive document that provides an analysis of Federal Student Aid's financial and program performance results. The report enables the President, Congress, and the public to assess the organization's performance relative to its mission, and determine whether Federal Student Aid has demonstrated accountability for the resources entrusted to it.

This report presents information about Federal Student Aid's performance as a Performance-Based Organization, its accomplishments, initiatives, and challenges, as required by Office of Management and Budget Circulars A-11 and A-136. The report also satisfies the requirements included in the following federal statutes:

- *Higher Education Amendments of 1998 (Pub. L. 105-244)*
- *The Federal Managers' Financial Integrity Act of 1982*
- *The Chief Financial Officers Act of 1990*
- *The Government Management Reform Act of 1994*
- *The Federal Financial Management Improvement Act of 1996*
- *The Reports Consolidation Act of 2000*
- *The Accountability of Tax Dollars Act of 2002*
- *The Government Performance and Results Act of 1993,* as amended by the *Government Performance and Results Act Modernization Act of 2010*
- *The Improper Payments Information Act of 2002,* as amended by *the Improper Payments Elimination and Recovery Act of 2010*

Letter From the Chief Operating Officer of Federal Student Aid

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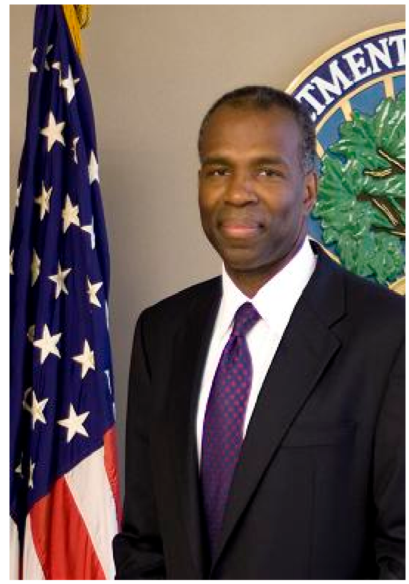
Dear Federal Student Aid Colleagues, Partners, and Customers:



James W. Runcie
Chief Operating Officer

I am pleased to present the Fiscal Year (FY) 2012 Annual Report for Federal Student Aid. This report summarizes Federal Student Aid's performance and highlights our organization's many successes during the last year. During FY 2012, Americans continued to face many challenges from a prolonged economic downturn, high unemployment rates, and tighter budgets. These factors impacted Federal Student Aid and our programs resulting in an increased number of students applying for aid and a rise in cohort default rates. As a result, we focused our resources on serving students and families throughout the student aid lifecycle—from application to repayment.

In FY 2012, Federal Student Aid took great strides in improving student access to the Free Application for Federal Student Aid℠ (FAFSA℠). We expanded the FAFSA Completion Project, which assists high school college access counselors in determining how many of their students have completed the FAFSA, from 18 sites to 92 sites. We began publishing FAFSA completion data aggregated by high school for every high school with a FAFSA filer. We also made improvements to the Internal Revenue Service (IRS) Data Retrieval Tool, which allows applicants to retrieve tax information directly from the IRS and populate it on the FAFSA.

Once students have completed their application, they may need assistance managing their federal student loan obligations while attending school. This led to the development of the Financial Aid Counseling Tool, a new online resource to help students make informed decisions about student aid in the context of other financial matters. Some of the features include information on federal student lending, repayment options, and tips for avoiding default. This tool also provides information on loan counseling, budgeting, taxes, credit, and other types of borrowing.

After graduation, students can take advantage of several resources to help them manage debt when entering into repayment. For example, Federal Student Aid launched a new online application for the Income-Based Repayment (IBR) Plan this year. This new functionality allows student loan borrowers with federally-held loans to import their IRS data directly into the IBR electronic application. This enhancement will result in an expedited and more streamlined experience for the borrower and greater accuracy in the application process. We also introduced the MyData Button on the National Student Loan Data System website. The MyData Button was developed in conjunction with the Education Data Initiative to empower students by providing them with easy access to their own data.

To improve customer experience for students and families, Federal Student Aid launched StudentAid.gov, which consolidated several websites into one comprehensive site and features financial aid information from application to repayment. We increased our social media presence by launching @FAFSA on Twitter where we have held several online town hall sessions for students and families to answer questions on financial aid.

In addition to developing new resources to improve the customer experience, Federal Student Aid delivered aid to more students than ever before. In fact, in FY 2012, we processed approximately 22 million applications and delivered $141.9 billion to 15 million students. Federal Student Aid continued to strengthen program oversight and monitoring, particularly around enforcement of the Clery Act. In accordance with provisions of the *Healthcare and Education Reconciliation Act of 2010*, we awarded 7 contracts to new non-profit loan servicers providing additional loan servicing capacity and supporting over 4 million borrowers. Additionally during the year, we successfully implemented a number of new student aid regulations that strengthened the integrity of the Title IV programs.

We were only able to realize these achievements as a direct result of the commitment of the workforce at Federal Student Aid. I want to acknowledge my colleagues for their public service and thank them for their dedication to America's students and families.

Sincerely,

James W. Runcie

James W. Runcie
Chief Operating Officer
November 16, 2012

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Federal Student Aid at a Glance

Established as a Performance-Based Organization	**1998**
Headquarters	**830 First Street, NE Washington, DC 20202**
Website	**StudentAid.gov**
FY 2012 Budget	**$1.2 billion**
Total Employees	**1,227 employees**
Regional Offices	**10**
Total Applications Processed	**21.9 million**
Total Postsecondary Students Served	**15 million**
Total Federal Student Aid Delivered	**$141.9 billion**
Mission	***Funding America's Future, One Student at a Time***

How Federal Student Aid Benefits the Public

Designated as a Performance-Based Organization in 1998, Federal Student Aid performs a vital service within the system of funding postsecondary education in the United States. As a principal office of the United States Department of Education, Federal Student Aid ensures that all eligible Americans have access to federal financial assistance for education or training beyond high school. In Fiscal Year 2012, Federal Student Aid supported the funding of billions of dollars in student financial aid, which enabled millions of students to attend college or career school. The list below details some of the ways in which the organization serves the public. Federal Student Aid ensures that students and their families benefit from its programs by:

- Informing students and families of the availability of the federal student aid programs and on the process of applying for and receiving aid from those programs;
- Developing the Free Application for Federal Student Aid℠ and processing approximately 22 million Free Application for Federal Student Aid℠ submissions each year;
- Accurately disbursing, reconciling, and accounting for all federal student aid funds that are delivered to students each year through more than 6,200 colleges and career schools;
- Managing the outstanding federal student loan portfolio and securing repayment from federal student loan borrowers;
- Offering free assistance to students, parents, and borrowers throughout the entire financial aid process; and
- Providing oversight and monitoring of all program participants—schools, financial entities, and students—to ensure compliance with the laws, regulations, and policies governing the federal student aid programs.

While Federal Student Aid employees are committed to assisting students achieve their postsecondary education goals, they also provide benefits to the community through direct service. The ideals of service are demonstrated through their participation in various government, United States Department of Education, and Federal Student Aid-sponsored community service programs. Employee efforts have positively impacted the community in following ways:

- Tutoring students at local area schools;
- Donating food to various food banks, through the Feds Feed Families program, a government-wide food drive;
- Supporting and participating in the Susan G. Komen Race for the Cure;
- Donating holiday gifts to children in local schools though the Operation Santa program; and
- Assisting in the renovation and rebuilding of affordable housing for families through the Habitat for Humanity program.

Guide to Federal Student Aid Programs

Federal Student Aid awarded $141.9 billion of federal financial student aid to approximately 15 million students in FY 2012. This aid was provided in the form of low-interest loans, grants, and work-study funds to cover expenses, such as tuition and fees, room and board, books and supplies, and transportation. The three main categories of federal student aid are:

- Loans:
  - Student aid funds that are borrowed for college or career school and must be repaid with interest;
- Grants:
  - Student aid funds that do not have to be repaid (unless other conditions apply); and
- Work-Study:
  - A part-time work program through which students earn money to help pay for school.

The information below presents a brief overview of the various aid programs included in each category.

Loans

- Direct Subsidized Loans
  - Federal loans based on financial need made to undergraduate students for which the federal government does not charge interest while the borrower is in school, in grace, or in deferment status. For Direct Subsidized Loans first disbursed between July 1, 2012, and July 1, 2014, the borrower is responsible for paying any interest that accrues during the grace period. If the interest is not paid during the grace period, the interest will be added to the loan's principal balance.

- Direct Unsubsidized Loans
  - Federal loans made to undergraduate students and graduate students for which the borrower is fully responsible for paying the interest regardless of the loan status. Interest on unsubsidized loans accrues from the date of disbursement and continues throughout the life of the loan.

- Direct PLUS Loans
  - Federal loans made to graduate or professional students and parents of dependent undergraduate students for which the borrower is fully responsible for paying the interest regardless of the loan status.

- Direct Consolidation Loans
  - Federal loans made that allow the borrower to combine one or more federal student loans into one new loan. The borrower will only have to make one monthly payment on the consolidation loan and the repayment term of the loan may be longer than the terms on the original loans.

- Federal Perkins Loans
  - Federal student loans, made by the recipient's school, to undergraduate and graduate students who demonstrate financial need. Participating schools receive a certain amount of funds each year from Federal Student Aid for distribution under this program, which supplement funds in a school's revolving fund, from which new

disbursements are made. Once the full amount of the school's funds has been awarded to students, no more loans can be made under this program for the year.

Grants

- Federal Pell Grants
    - Federal financial aid awarded to undergraduate students with demonstrated financial need. This form of aid does not require repayment.

- Federal Supplemental Educational Opportunity Grants
    - Federal grants distributed under this program are administered directly by the financial aid office at each participating school and known as "campus-based" aid. Each participating school receives a certain amount of Federal Supplemental Educational Opportunity Grant funds each year from Federal Student Aid. Once the full amount of the school's grant' funds has been awarded to students, no more awards can be made under this program for the year.

- Teacher Education Assistance for College and Higher Education Grants
    - Federal grants awarded annually to eligible undergraduate or graduate students who agree to teach mathematics, science, or other specialized subjects in high-need schools for at least four years within eight years of their graduation. Eligible students may be awarded grants totaling up to $4,000 annually. If students fail to fulfill the service requirements, the grants will convert to Direct Unsubsidized loans, with interest accrued from the time of the award.

- Iraq and Afghanistan Service Grants
    - Federal grants awarded to students who are not eligible for a Federal Pell Grant on the basis of Expected Family Contribution, but meet the remaining Federal Pell Grant eligibility requirements, and:
        - Have a parent or guardian who was a member of the United States Armed Forces and died as a result of military service performed in Iraq or Afghanistan after the 9/11 events; and
        - Were under 24 years old or enrolled in college at least part-time at the time of the parent or guardian's death.

Federal Work-Study

- Federal program that provides part-time jobs for undergraduate, graduate and professional students with financial need, allowing them to earn money to help pay education expenses. The program is available to full-time or part-time students and encourages community service work. The work is often related to the student's course of study and is administered by the schools who participate in the Federal Work-Study program.

Federal Student Aid provides several options for students to finance their education; however, to obtain federal financial aid, aid recipients must complete the financial aid process. For more information on obtaining federal student aid, go to **StudentAid.gov/financial-aid-process**.

Introduction to the Federal Student Aid Annual Report

The Fiscal Year 2012 *Federal Student Aid Annual Report* provides financial and performance information that enables the President, Congress, and the public to assess how Federal Student Aid has performed in accomplishing its mission and achieving its goals. The report is organized into the following sections:

Management's Discussion and Analysis: The **Management's Discussion and Analysis** section provides an overview of the entire *Federal Student Aid Annual Report.* It includes a synopsis of Federal Student Aid's mission and its organizational structure, as well as the organization's fiscal year financial and performance highlights, which are discussed in more detail within the subsequent sections of this report. This section also contains a discussion of Federal Student Aid's systems, controls, and compliance with laws and regulations. The section concludes with the subsection, Limitations of Financial Statements, which provides the context in which the financial statements should be reviewed.

Annual Performance Report: The ***Annual Performance Report*** presents the strategic goals included in the *Federal Student Aid: Strategic Plan, Fiscal Years 2012–16* and discusses the results of the various performance metrics as related to each strategic goal. Targets established for each performance metric are compared to Federal Student Aid's actual performance during the year. These results are presented to demonstrate Federal Student Aid's effectiveness in accomplishing its mission. The *Annual Performance Report* also presents the fiscal year accomplishments of the organization and discusses the process by which Federal Student Aid provides legislative and regulatory recommendations to the United States Department of Education on issues that affect federal student financial aid. The *Annual Performance Report* concludes with the subsections, Annual Bonus Awards, which details executive compensation at the organization, and the Report of the Federal Student Aid Ombudsman, which details its processes in assisting borrowers in obtaining a resolution to federal student aid issues.

Financial Section: The **Financial Section** provides a detailed view of Federal Student Aid's stewardship and accountability of its resources. The section includes the Message from the Chief Financial Officer, the audited financial statements, and the accompanying notes to the financial statements. It concludes with the subsections, Required Supplementary Stewardship Information and Required Supplementary Information.

Independent Auditors' Reports: The **Independent Auditors' Reports** section consists of the various reports of the auditors, including the Report of Independent Auditors, which contains the audit opinion. In addition to the Report of the Independent Auditors, the section is composed of the Office of Inspector General Audit Transmittal Letter, the Report on Internal Control, and the Report on Compliance and Other Matters. The section concludes with the Management's Response to the Audit, which is Federal Student Aid's executive management's response to the findings and recommendations contained in the various audit reports.

<u>Other Accompanying Information</u>: The **Other Accompanying Information** section includes the Schedule of Spending, which presents an overview of how and where Federal Student Aid spent its money during the fiscal year. This section also provides links to the United States Department of Education *Fiscal Year 2012 Agency Financial Report*, which includes a discussion of Federal Student Aid's improper payments in compliance with the *Improper Payment Information Act of 2002,* as amended by the *Improper Payments Elimination and Recovery Act of 2010.* The section concludes with a link to the Summary of Financial Statement Audit and Management Assurances and a link to Federal Student Aid's Management Challenges.

<u>Appendices</u>: The **Appendices** section includes the Discontinued Performance Goals from the previously issued *Federal Student Aid: Strategic Plan, Fiscal Years 2011–15*, a glossary of acronyms and terms, and details on the availability of this *Annual Report*.

Management's Discussion and Analysis

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Fiscal Year 2012 Financial and Performance Highlights of Federal Student Aid

Operational Highlights

	September 30, 2012	September 30, 2011	Percentage Change 2012 over 2011
Total Student Aid Loan Portfolio	$ 948 billion	$ 848 billion	11.8%
Total federal Student Loan borrowers outstanding	38 million	36 million	5.6
Total Number of Postsecondary Education Institutions	6,252	6,300	(0.8)
Audit Opinion	Unqualified	Unqualified	Not applicable

Financial Highlights

(Dollars in millions)

	September 30, 2012	September 30, 2011	Percentage Change 2012 over 2011
Total Assets	$ 752,738	$ 593,994	26.7%
Total Liabilities	729,965	575,691	26.8
Net Position	22,773	18,303	24.4
Net Cost	10,683	(3,373)	(416.7)
Budgetary Resources Available for Spending	56,695	54,353	4.3
Budgetary Resources Available for Spending (Non-Budgetary Credit Reform Financing Accounts)	269,586	262,293	2.8
Total Outlays, Net (Budgetary)	3,774	(6,611)	(157.1)
Total Outlays, Net (Non-Budgetary Credit Reform Financing Accounts)	159,988	168,495	(5.0)

Performance Highlights

Performance Measures	FY 2012 Target	FY 2012 Actual	Performance Results
% of first-time FAFSA filers among high school seniors	>=52%	54.0%	Met
Customer satisfaction score (ACSI)	78	78.5	Met
Percent of borrowers>90 days delinquent	<=10%	9.5%	Met
Loan servicing costs per borrower	$19.64	$18.94	Met

*The amounts provided for the Total Student Aid Portfolio includes both amounts managed by Federal Student Aid and federal loans held by lenders or schools.

Mission and Organizational Structure

Federal Student Aid (FSA), a principal office of the United States (U.S.) Department of Education (Department), seeks to ensure that all eligible individuals can benefit from federal financial assistance for education beyond high school. As the nation's largest provider of student financial aid, FSA is responsible for implementing and managing federal student financial assistance programs authorized under the *Higher Education Act of 1965,* as amended (HEA). Specifically, the federal student assistance programs for which FSA is responsible are authorized by Title IV of the HEA (Title IV). These programs provide grants, loans, and work-study funds to students attending college or career school.

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

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

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

Legislative Authority that influences the mission of FSA

FSA's mission is *"Funding America's Future, One Student at a Time."* Historically, there have been several legislative acts that have significantly impacted FSA as an organization. The *Higher Education Amendments of 1998* established FSA as a PBO, to administer the Title IV programs at the Department. Several other key pieces of legislation have influenced FSA's mission, and are detailed in the following table.

Overview of Legislative Authority

- ***Higher Education Act of 1965,* as amended**
  Created the federal student financial assistance programs known as the Title IV programs.

- ***Higher Education Amendments of 1992***
  Initially authorized William D. Ford Federal Direct Loan Program^{SM} as a demonstration pilot.

- ***Student Loan Reform Act of 1993***
  Authorized a multi-year phased implementation of the William D. Ford Federal Direct Loan Program^{SM}.

- ***Higher Education Amendments of 1998***
  Amended the HEA and authorized the designation of FSA as the first PBO in the federal government.

- ***Higher Education Reconciliation Act of 2005***
  Allowed graduate and professional students to borrow the Parent Loans for Undergraduate Student and amended the HEA to make it easier for distance education programs to qualify for federal student aid.

- ***College Cost Reduction and Access Act of 2007***
  Authorized the Teacher Education Assistance for College and Higher Education Grant Program and created the Public Service Loan Forgiveness Program.

- ***Ensuring Continued Access to Student Loans Act of 2008***
  Provided the Department with the authority to implement programs to ensure that eligible students and parents were not denied access to federal student loans during the credit market disruptions of 2008.

- ***Higher Education Opportunity Act of 2008***
  Authorized the Grants for Access and Persistence Program and assists states in establishing partnerships to provide eligible students with Leveraging Educational Assistance Partnership grants to attend postsecondary institutions.

- ***American Recovery and Reinvestment Act of 2009***
  Authorized the increase of Pell Grants to the amount of $5,550 and created the $2,500 American Opportunity Tax Credit for four years of college tuition.

- ***SAFRA Act***
  Provided that beginning July 1, 2010, no new loans were to be originated under the Federal Family Education Loan Program^{SM}.

FSA Stakeholders

The community of stakeholders in the student aid delivery system includes students and parents, lenders, guaranty agencies, postsecondary institutions, contracted servicers and collection agencies, as well as the taxpayers and other federal entities, such as Congress and the Office of Management and Budget (OMB).

Role of FSA and Participants in the Federal Student Aid System

POSTSECONDARY INSTITUTIONS
Determine students' aid packages and disburse funds.

FSA supports them by
•Monitoring compliance,
•Educating them regarding policy, and
•Assisting them in meeting requirements.

THE PRESIDENT, ED, & OTHERS IN EXECUTIVE BRANCH
Set regulatory standards and policy on student aid funding.

FSA supports it by
•Providing data and information for decision making, and
•Providing recommendations for implementation.

FFEL LENDERS
Hold and service outstanding FFELP loans to students.

FSA supports them by
•Monitoring compliance,
•Assisting them in meeting requirements,
• Paying interest and Special Allowance Payment, and
•Educating them regarding policy.

CONGRESS
Sets statutory standards on student aid funding and appropriate budgets.

FSA supports it by
•Providing data and information for decision making, and
•Providing updates on operational performance.

GUARANTY AGENCIES
Insure FFELP loans and service their defaulted loan portfolio.

FSA supports them by
•Monitoring compliance,
•Assisting them in meeting requirements,
•Educating them regarding policy, and
•Paying default claims.

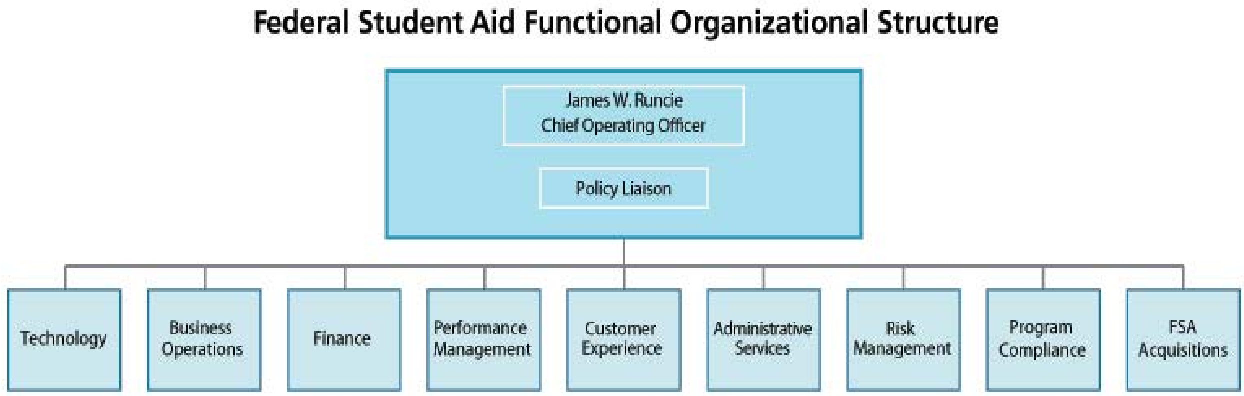
FSA-CONTRACTED SERVICERS
1. Service Direct Loan portfolio and portions of FFELP portfolio,
2. Provide systems and services to support FSA's core operations (e.g., applications, disbursement), and
3. Recover funds from defaulted loans.

FSA supports them by
•Acquiring the service,
•Setting performance standards, and
•Overseeing operations.

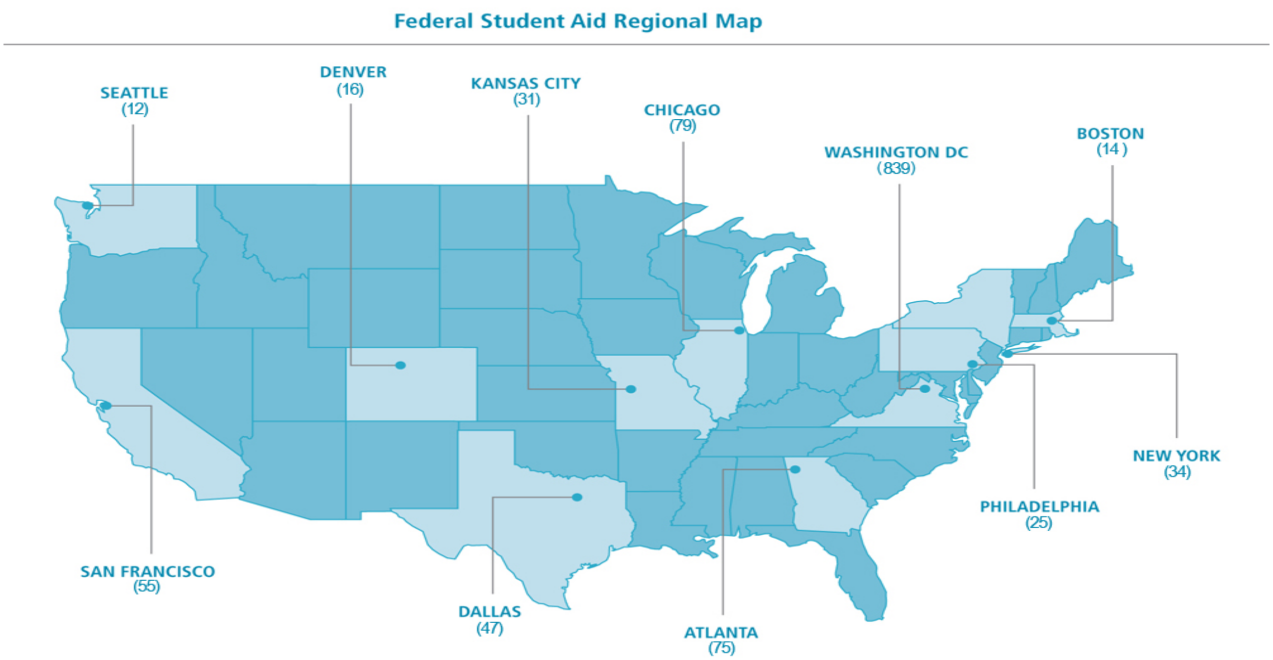
One of FSA's responsibilities is to coordinate and monitor the activity of the large number of federal, state, nonprofit, and private entities involved in federal student aid delivery, within a statutory framework established by Congress, and a regulatory framework established by the Department.

FSA Organizational Structure

FSA currently operates under a functional organizational structure that aligns the organization closely with its strategic drivers, business objectives, and mission goals. A Chief Operating Officer (COO), who is appointed to a five-year term by the Secretary of Education (Secretary), leads FSA. James W. Runcie was appointed by the Secretary as the COO on September 15, 2011. The following graphic illustrates the current functional organizational structure of FSA.



During Fiscal Year (FY) 2012, the organization operated on an annual administrative budget of approximately $1 billion. FSA is staffed by more than 1,200 full-time employees and is augmented by contractors who provide outsourced business operations. The workforce is based in Washington, D.C., with ten regional offices located throughout the country as reflected in the following graphic. The number of full-time employees at each location is shown in parentheses immediately following the location name.



Programs

The federal student financial assistance programs collectively represent the nation's largest source of federal financial aid for postsecondary students. In FY 2012, FSA processed almost 22 million Free Applications for Federal Student Aid (FAFSA^{SM}), resulting in the delivery of $141.9 billion in Title IV aid to approximately 15 million postsecondary students and their families. These students attend more than 6,200 active institutions of postsecondary education that participate in student aid programs and are accredited by dozens of agencies.

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Types of Federal Student Financial Assistance Programs

- **Loan Programs**

  Student aid funds that must be repaid with interest.

- **Grant Programs**

  Student aid funds that do not have to be repaid (other conditions apply).

- **Work-Study Program**

  A part-time employment program to earn money while in school.

Funding America's Future, One Student at a Time

FSA Fact

The Federal Pell Grant turned 40 years old this year. This grant, one of the first forms of federal student aid that did not require repayment, has enabled millions of students to go to college. For more information about obtaining a Pell Grant, go to: StudentAid.gov/types/grants-scholarships/Pell.

The following table presents a comparison of the amounts of Title IV aid disbursed to students by program in 2012 and 2011. A summary of each of the Title IV student assistance programs is presented in the paragraphs that follow the table.

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

Programs	2012 Aid Disbursed to Students	2011 Aid Disbursed to Students	Difference	Percent Increase/ (Decrease)
Loan Programs				
William D. Ford Federal Direct Loan Program[SM]	$ 105,810	$ 108,186	$ (2,376)	(2)%
Federal Family Education Loan Program[SM]	0	0	0	0
Federal Perkins Loan Program	945	854	91	110
Subtotal Loan Programs	**$ 106,755**	**$ 109,040**	**$ (2,285)**	**(2)%**
Grant Programs				
Federal Pell Grant Program	$ 33,299	$ 36,129	$ (2,830)	(8)%
Federal Supplemental Educational Opportunity Grant Program	715	729	(14)	(2)
Academic Competitiveness Grant Program	5	578	(573)	(99)
National Science and Mathematics Access to Retain Talent Grant Program	4	463	(459)	(99)
Leveraging Educational Assistance Partnerships Program	0	47	(47)	(100)
The Teacher Education Assistance for College and Higher Education Grant Program	120	127	(7)	(6)
Subtotal Grant Programs	**$ 34,143**	**$ 38,073**	**$ (3,930)**	**(10)%**
Work-Study Programs				
Federal Work-Study Program	$ 965	$ 989	$ (24)	(2)%
Grand Total	**$ 141,863**	**$ 148,102**	**$ (6,239)**	**(4)%**

Aid disbursed to students as cited in the table above, and in the following sections concerning the Federal Loan Programs, the Federal Grant Programs and the Federal Work Study Program in the Management's Discussion and Analysis section, excluding the Federal Perkins Loan Program amounts, are derived from amounts from FSA's and the Department's Financial Systems. All amounts are fiscal year amounts, except for the Federal Perkins Loan, which is reported as an award year amount. The number of awards or recipients reported in the Management's Discussion and Analysis section are derived from amounts used to support the President's Budget and based on award year.

The amounts found in the Summary of Federal Aid Disbursed to Students by Program Table and in the sections concerning Federal Loan Programs, Federal Grant Programs, and the Federal Work Study Program presented on page 8 in the FY 2011 FSA Annual Report Management's Discussion and Analysis section, were derived from amounts used to support the President's Budget. These amounts differ from the FY 2011 comparative amounts included in the same section of the FY 2012 FSA Annual Report.

Funding for the Academic Competitiveness Grant and National Science and Mathematics Access to Retain Talent Grant Programs expired at the end of academic year 2010–11, and the Leveraging Educational Assistance Partnerships Program is no longer funded as of the end of FY 2010.

Federal Loan Programs

In fulfilling its program responsibilities, FSA directly manages or oversees more than $948 billion in outstanding loans—representing over 163 million student loans to more than 38 million borrowers. These loans were primarily made through the first two federal student loan programs described below.

The **William D. Ford Federal Direct Loan (Direct Loan[SM]) Program**[SM] lends funds directly to students and parents through participating schools. Created in 1993, this program is funded by borrowings from the U.S. Department of the Treasury (Treasury), as well as an appropriation for subsidy costs. In FY 2012, the Department made $105.8 billion[1] in net loans to 11.1 million recipients. With the enactment of the *SAFRA Act*, as part of the *Health Care and Education Reconciliation Act of 2010* (HCERA) (Pub. L. 111-152), beginning in July 2010, no new loans were originated under the Federal Family Education Loan (FFEL[SM]) Program[SM].

During FY 2012, the Department offered a short-term initiative, Special Direct Consolidation Loans (SDCL) to assist eligible borrowers in managing their debt by making one payment to one entity. Eligible borrowers had to have at least one loan owned by the Department and one commercially-held FFEL loan in order to qualify for this consolidation opportunity. This initiative, which began in January 2012 and ended June 30, 2012, disbursed more than $13 billion.

Under the **Federal Family Education Loan Program[SM],** students and parents obtained federal loans through private lenders. Guaranty agencies insured lenders for borrower default; guaranty agencies, were, in turn, reinsured by the federal government. Federal subsidies ensured private lenders earned at least a certain yield on the loans they made. Although the passage of the *SAFRA Act* ended the origination of new FFEL Program loans as of July 1, 2010, lenders and guaranty agencies continue to service and collect outstanding FFEL Program loans. FSA, FFEL lenders, and guaranty agencies held a FFEL Program loan portfolio of approximately $451.7 billion, as of September 30, 2012. In FY 2012, FSA made gross payments of approximately $1.8 billion to lenders for interest and special allowance subsidies and $9.6 billion to guaranty agencies for reinsurance claims and fees paid to guaranty agencies for account maintenance, default aversion, and collection activities.

In addition to the above described FFEL Program, the *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) authorized the Department to implement a number of programs to ensure credit market disruptions did not deny eligible students and parents access to federal student loans for the 2008–09 and 2009–10 academic years. Under this authorization, the Department implemented the Loan Participation Purchase and Loan Purchase Commitment Programs. These programs were successfully closed-out on October 15, 2010.

A third program the Department implemented under the authority of ECASLA is the Asset-Backed Commercial Paper (ABCP) Conduit Program (Conduit). Under this program, which began operations in mid-2009, the Department entered into forward purchase commitments with a Conduit. The Conduit issues commercial paper backed by qualifying student loans made between October 1, 2003, and September 30, 2009. If no other financing is available to retire this paper as it matures, the Department commits to provide the needed funds by purchasing the underlying student loans, thereby by providing a federal subsidy that has the

[1]Excludes consolidation loans of $35.6 billion.

effect of providing low cost capital to private lenders. Lenders were able to place loans into the Conduit until June 30, 2010. By that time, a total of 25 lenders had participated, and backed by their loans, the Conduit issued a total of $41.5 billion in commercial paper. Under the Put Agreement with the Conduit, the Department purchases loans subject to certain events, for example, when a loan becomes 255 days delinquent. As of September 30, 2012, the Department has purchased $2.2 billion in delinquent loans from the Conduit. To date, the Conduit has only put defaulted loans to the Department. The option to sell loans to the Department ends in January 2014. As of September 30, 2012, the number of lenders that continue to participate in the Conduit has dropped to 22. Three lenders removed their portfolios from the Conduit during FY 2012.

The **Federal Perkins Loan Program** is one of three campus-based programs through which the Department provides funds directly to eligible institutions. Funds provided through this program enable eligible institutions to offer low-interest loans to students based on need. In FY 2012, approximately $945.0 million were disbursed through approximately 483,000 campus-based awards.

Federal Grant Programs

In its responsibility for administering Title IV aid, FSA oversaw the disbursement of $34.1 billion in grants to 11.0 million recipients via several grant programs. The following provides a summary for each grant program, including aid disbursed for FY 2012.

The **Federal Pell Grant (Pell Grant) Program** helps ensure financial access to postsecondary education by providing grant aid to low-income and middle-income undergraduate students. As the most need-based of the Department's student aid programs, Pell Grants vary according to the financial circumstances of students and their families. In FY 2012, the Department disbursed $33.3 billion in Pell Grants averaging approximately $3,653 to more than 9 million students. The maximum Pell Grant award was $5,550 for the 2011–12 award year and remained at $5,550 for the 2012–13 award year.

The **Federal Supplemental Educational Opportunity Grant Program** is one of three campus-based programs through which the Department provides funds directly to eligible institutions. Funds provided through this program enable eligible institutions to offer grants to students based on need. In FY 2012, approximately $715.1 million were disbursed through approximately 1.4 million campus-based awards.

The Teacher Education Assistance for College and Higher Education (TEACH) Grant Program, authorized by the *College Cost Reduction and Access Act of 2007* (CCRAA), provides up to $4,000 per year to students agreeing to teach mathematics, science, or other specialized subjects in a high-poverty school for at least four years within eight years of their graduation. If students fail to fulfill the service requirements, TEACH Grants convert to Direct Unsubsidized loans, with interest accrued from the time of the award. This grant program began in the 2008–09 school year, starting July 1, 2008. In FY 2012, the Department disbursed approximately 47,000 grants for $119.7 million under TEACH.

The Iraq and Afghanistan Service Grant Program, which became effective July 1, 2010, provides non-need-based grants to students whose parent or guardian was a member of the Armed Forces and died in Iraq or Afghanistan as a result of performing military service after September 11, 2001. Service Grants are equal to the maximum Pell Grant for a given award year. The Department disbursed approximately $166,200 to support an estimated maximum of 1,000 awards in FY 2012.

Federal Work-Study Program

The **Federal Work-Study (FWS) Program** is one of three campus-based programs through which the Department provides funds directly to eligible institutions. Funds provided through this program enable eligible institutions to offer employment to students based on financial need. In FY 2012, approximately $964.7 million were disbursed through approximately 683,000 campus-based awards.

FSA Fact

The first step in obtaining federal student aid is the completion of the FAFSA. This free application will provide the borrower with useful information, such as the Expected Family Contribution. To find out more about filing the FAFSA, go to: StudentAid.gov/FAFSA.

Vision, Mission, and Core Values

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

Vision

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

Mission

Funding America's Future, One Student at a Time

Core Values

- **Integrity**
- **Respect**
- **Customer Service**
- **Stewardship**
- **Excellence**
- **Teamwork**

As discussed in detail in the next section, FSA has translated this vision into a set of clearly defined strategic goals and objectives and related measurable performance metrics. The accomplishment of these will, in turn, enable the organization to successfully accomplish its mission.

Performance Management

This section of the FSA *Annual Report* provides a general overview of the performance management processes at FSA; summary of FSA's FY 2012 performance metrics, objectives, and results; discussion of FSA's High-Priority Performance Goal (Priority Goal); and discussion of FSA's efforts to validate the quality of performance data reported.

Performance Management Processes at Federal Student Aid

FSA uses three tools to establish goals, and to communicate, measure, and report performance. These tools are the following:

- *Five-Year Strategic Plan*;
- *Annual Performance Report*; and
- Annual Organizational Performance Review (OPR).

Five-Year Strategic Plan

As part of the strategic planning process, FSA continuously identifies and evaluates key drivers that significantly influence FSA's long-term goals and objectives. FSA analyzes these drivers to identify long-term core strategic goals that will serve as the foundation of FSA's long-term strategic planning. These strategic goals collectively provide the framework for continuous improvement at FSA, guiding the organization in managing its programs more effectively and providing clear strategic direction to all of FSA's internal and external constituencies. The strategic goals developed must be:

- appropriate to the mission of the organization;
- realistic and measurable;
- achievable in the time frame established and challenging in their targets; and
- understandable to the layperson (i.e., language is unambiguous and terminology is adequately defined).

Each strategic goal encompasses objectives and identifies performance metrics to measure FSA's level of success in meeting the strategic goal. For each performance metric, FSA identifies a target level of performance for each fiscal year. FSA sets the target level of performance at a challenging, but realistic level that is achievable within the time frame. Meeting or exceeding the target indicates that FSA succeeded in meeting the performance metric, while falling short of the target indicates that FSA did not meet the performance metric. The following table summarizes the key components of the *Federal Student Aid Strategic Plan FY 2012–16* (*FSA Strategic Plan: FY 2012–16).*

Key Components of *FSA Strategic Plan: FY 2012–16*

Key Component	Description
Strategic Goals	Statements of long-term purpose outlined in the *FSA Strategic Plan FY 2016–16* that define how FSA will accomplish its mission. These goals are aligned to FSA's responsibilities as a PBO.
Objectives	Statements that describe the tactical activities FSA will perform to achieve the associated strategic goal.
Performance Metrics	Levels of performance over a period of time used to gauge FSA's success in reaching its strategic goals. These metrics include targets and timeframes.
Targets	Indicators of the desired performance levels or specific desired results targeted for a given fiscal year. Targets are expressed in quantifiable terms and compared to the actual result to determine level of performance.

Throughout the fiscal year, FSA measures and analyzes performance based upon performance metric results. For any performance metrics not on track, FSA's analysis includes identifying the root cause of the unexpected result and determining the appropriate corrective actions necessary to improve performance.

Annual Performance Report

To report progress on meeting the strategic goals, FSA prepares and publishes an *Annual Performance Report.* This report is included in FSA's *Annual Report* issued in mid-November. In addition to the *Annual Performance Report*, FSA's *Annual Report* includes FSA management's discussion and analysis of financial and performance results, its audited financial statements and notes, and the report of the independent auditors.

Annual Organizational Performance Review

The Annual OPR is part of the Department-wide performance management system. It operates at the principal office level and is designed to integrate and align all of the Department's performance management elements, including the Department's *Strategic Plan*, the Secretary's annual priorities, the priorities of the principal offices, and other requirements of law and of the President. The OPR contains timelines with specific milestones. FSA tracks and reports the status of OPR metrics to the Department on a quarterly basis.

FY 2012 Strategic Goals, Objectives, and Performance Metrics

In the previous five years, FSA primarily focused on achieving operational efficiency and system integration, both of which are key to FSA's designation as a PBO. During FY 2010, FSA initiated the development of an updated five-year strategic plan. This plan, FSA's *Strategic Plan: FY 2011–15*, was implemented at the beginning of FY 2011 and sought to improve the overall system of funding for postsecondary education by (1) equipping students and their families with better information to make improved decisions about postsecondary education; and (2) actively shaping the behavior of participants in education funding, by using FSA's knowledge, data, oversight authority, and relationships to improve the coordination of all participants in the system.

During FY 2011, FSA updated its five-year strategic plan and issued the *FSA Strategic Plan: FY 2012–16.* The updated plan, issued in December 2011, continued to build upon the most recent goals established in the previous year's strategic plan, by clarifying the organization's objectives and updating performance standards to better reflect the progress made in meeting the stated objectives. As part of the process of developing this plan, FSA identified the key strategic drivers listed in the following table.

Key Strategic Driver	Relevance to FSA's Strategic Planning Process
The Higher Education Act of 1965 legislation	Prescribes Title IV program and PBO requirements (i.e., improve service, reduce costs, improve and integrate support systems, develop delivery and information systems, and enhance staff development and talent).
Student and borrower needs	Students and borrowers are key customers of FSA services and products.
Key trends and conditions for the financial aid environment	Indicates student aid environment within which FSA must operate. Key trends in FY 2012 are listed below. • Rising cost of attendance for postsecondary education. • Decline in availability of nonfederal sources of postsecondary education funding. • Anticipated increase in enrollment. • Increase in enrollment at two-year and proprietary institutions, and distance learning. • Increased role of the federal government in providing funding for postsecondary education.

Key Strategic Driver	Relevance to FSA's Strategic Planning Process
The Department's Five-Year Strategic Plan	Requires FSA's support of the Department's strategic goals related to postsecondary education.
President Obama's higher education goal that, by 2020, America will have the highest proportion of college graduates in the world	Requires the Department's and FSA's support to achieve goal.
The Office of Inspector General's (OIG's) Management Challenges	Requires the Department and FSA senior management's consideration for establishing priorities. OIG's management challenges for FY 2012 include: • Improper Payments; • Information Technology Security; • Oversight and Monitoring; and • Data Quality and Reporting.
The Office of Inspector General and Government Accountability Office (GAO) audits	Requires FSA senior management's consideration for establishing priorities to address findings and recommendations.
Federal financial management laws and regulations	Prescribes financial management requirements.
Federal performance reporting legislation and requirements	Prescribes performance and reporting requirements.
Federal budget deficits	Requires FSA to look for opportunities to reduce operating costs through improved efficiency.

FSA identified the following five Strategic Goals based upon analysis of the above key strategic drivers:

- **Strategic Goal A:** *Provide superior service and information to students and borrowers.*
- **Strategic Goal B:** *Work to ensure that all participants in the system of funding postsecondary education serve the interests of students, from policy to delivery.*
- **Strategic Goal C:** *Develop efficient processes and effective capabilities that are among the best in the public and private sectors.*
- **Strategic Goal D:** *Ensure program integrity and safeguard taxpayers' interests.*
- **Strategic Goal E:** *Strengthen FSA's performance culture and become one of the best places to work in the federal government.*

The remainder of this section provides a discussion of each strategic goal, including the associated objectives and a summary of performance metric results. For a more detailed discussion, please see the *Annual Performance Report* section of this document.

For a list of the FY 2011 performance goals that were discontinued in the FY 2012 reporting period due to the implementation of the updated *FSA Strategic Plan: FY 2012–16*, please refer to appendix A of this report.

How the remainder of this section is organized

This section is organized by the five strategic goals. For each strategic goal, this section provides an overview of the goal, lists the associated objectives that support the strategic goal, and details the performance metrics used to measure performance. Specifically, the following information is included for each strategic goal:

Strategic Goal: States the strategic goal and provides a discussion of the relevance of this goal to FSA's mission.

Objective: Includes a brief discussion of the objectives identified for the strategic goal.

Performance Metrics measured: Includes a brief summary of FSA's performance as measured by the performance metrics for the strategic goal, followed by a table that details, for each performance metric, the current reporting period target, the actual result, and the page reference to the detail contained in the *Annual Performance Report* section of this document. The following is the legend for the performance result indicator included in the table.

Performance Result Indicator Legend

Performance result met or exceeded the target.	**Met** (green)
Performance result did not meet the target.	**Not met** (red)
Performance result is not applicable because the performance metric was not developed, the performance metric was not implemented, or the required data were not available in time for inclusion.	**N/A** (yellow)

The performance metric results reported are as of fiscal year-end (i.e., September 30, 2012) unless otherwise noted. If the required data are not available as of fiscal year-end in sufficient time for inclusion, data as of the most recent period available is used. Data as of fiscal year-end may not be available in some instances, where the required data are obtained from external sources (i.e., state and private nonprofit guaranty agencies, lenders and loan servicers, grant and loan recipients, etc.).

FSA Fact

FSA was one of the first federal government offices to be designated as a Performance-Based Organization. As a PBO, FSA's focuses on providing tangible results and efficient management. For more information about FSA's performance as a PBO, go to: StudentAid.gov/strategic-planning-reporting.

Strategic Goal A: *Provide superior service and information to students and borrowers.*

A major component of FSA's mission is to ensure that all eligible individuals have access to federal student aid. In order to achieve this goal, FSA provides funding options to eligible students and their families to make well-informed decisions. As a customer-facing organization, FSA also has an obligation to uphold the highest standards of service when interacting with its customers: students and their families.

Strategic Goal A aims to actively inform all eligible individuals of their funding options, help customers make well-informed decisions, provide better services, and improve customer experience.

Objectives supported:
To support this strategic goal, FSA identified a set of objectives, which includes detailed initiatives designed to assist with meeting each objective. Meeting each objective will result in accomplishing the strategic goal. The objectives that support this strategic goal include:

- **Objective 1:** Take a data-driven approach to better understand our customers and develop insights from these customers.
- **Objective 2:** Reach out to potential students more effectively to expand access to postsecondary education.
- **Objective 3:** Aggregate and distribute information on the costs and benefits of postsecondary education programs and on funding options to improve financial literacy and support the customers' decision-making.
- **Objective 4:** Identify students for whom financial assistance can make a difference in completing a degree or credential and develop a plan to support the President's 2020 college completion goal.
- **Objective 5**: Enhance customer-facing processes to improve the customer experience.

Performance Metrics measured:
To determine the success of FSA's efforts to meet this strategic goal, FSA identified a set of performance metrics including a target level of performance. For this strategic goal, the following table lists the performance metrics, FY 2012 target and actual performance levels, result (i.e., met, not met, etc.), and reference to supporting detail in the *Annual Performance Report* section of this document. In summary, FSA met or exceeded the target for all the performance metrics presented under this strategic goal.

Strategic Goal A: *Provide superior service and information to students and borrowers.*

Performance Summary for Strategic Goal A

Performance Metrics	FY 2012 Target	FY 2012 Actual	Result	Reference Page
% of first-time FAFSA filers among high school seniors	>=52%	54.0%	Met	50
% of first-time FAFSA filers aged 19-24 among those in population that are high school graduates, no college	>=27%	28.4%	Met	51
% of first-time FAFSA filers among workforce aged 25+, high school graduates, no college	>=3.6%	3.7%	Met	52
% of first-time FAFSA filers among low-income students	>=57%	63.1%	Met	53
Customer Satisfaction Score (ACSI)	>=78	78.5	Met	54

FSA Fact

FSA has taken steps to reduce the number of questions on the FAFSA and make it more user-friendly. This effort led to an 11 minute reduction in the average completion time for the FAFSA. The average time to complete the FAFSA is now 23 minutes.

Strategic Goal B: *Work to ensure that all participants in the system of funding postsecondary education serve the interests of students, from policy to delivery.*

FSA plays a vital role within the system of postsecondary education funding in the United States. While the Office of Postsecondary Education within the Department is responsible for any matters related to policy and regulation setting regarding postsecondary education, FSA collaborates with the Department and Congress to inform policy and regulations relating to student financial assistance. Specifically, FSA provides timely and relevant information to the Department and policymakers to support their decision-making processes concerning issues related to funding postsecondary education. In addition, FSA has a leadership role in the universe of postsecondary education funding to ensure that all system participants effectively serve the interests of students.

To execute delivery of financial assistance, FSA works closely with partners: it coordinates the activities of different contractors, including servicers and private collection agencies; it works with guaranty agencies and FFEL Program lenders to administer programs; it provides oversight and support to postsecondary institutions; and it directly interacts with students and their families.

Strategic Goal B aims to increase FSA's role in working with postsecondary institutions, contractors, and other major participants in the overall aid delivery system, to fulfill the organization's mission more effectively and consistently champion the promise of postsecondary education for all Americans.

Objectives supported:
To support this strategic goal, FSA identified a set of objectives, which includes detailed initiatives designed to assist FSA with meeting each objective. Meeting each objective will result in accomplishing the strategic goal. The objectives that support this strategic goal include:

- **Objective 1:** Improve FSA's support, communications, and processes for postsecondary and financial institutions.
- **Objective 2:** Provide ideas, data, and analyses to inform policymakers about opportunities and challenges in postsecondary education funding.
- **Objective 3:** Support system participants in implementing legislative, regulatory, executive, and other requirements.

Performance Metrics measured:
To determine the success of FSA's efforts to meet this strategic goal, FSA identified a set of performance metrics including a target level of performance. For this strategic goal, the following table lists the performance metrics, FY 2012 target and actual performance levels, result (i.e., met, not met, etc.), and reference to supporting detail in the *Annual Performance Report* section of this document. In summary, FSA met or exceeded the target for both performance metrics included under this strategic goal.

Strategic Goal B: ***Work to ensure that all participants in the system of funding postsecondary education serve the interests of students, from policy to delivery.***

Performance Summary for Strategic Goal B

Performance Metrics	FY 2012 Target	FY 2012 Actual	Result	Reference Page
Ease of Doing Business school survey (1-100 Scale).	>=72	74	Met	55
Percent of borrowers > 90 days delinquent	<=10%	9.5%	Met	56

FSA Fact

Since 1972, more than $313 billion in grants have been disbursed to more than 60 million students under the Federal Pell Grant Program. The maximum Pell Grant award was $5,550 for the award year 2011–12 and remained $5,550 for the 2012–13 award year. For more information on the Federal Pell Grant Program, go to: StudentAid.gov/types/grants-scholarships/Pell.

Strategic Goal C: *Develop efficient processes and effective capabilities that are among the best in the public and private sectors.*

FSA is responsible for managing the operational functions associated with delivering Title IV grants, work-study, and loan programs, while continually improving operating efficiency. To maintain credibility and confidence in the overall student aid delivery system, it is important for FSA to anticipate and plan for changes in volume that impact capacity requirements. For example, FSA experienced a significant increase in Direct Loan originations as a result of the passage of the *SAFRA Act* during FY 2010. As part of the ability to respond to changing demands, FSA must consider budgetary resources available to support increasing capacity. Historically, FSA's budget has not grown proportionally to the increase in the volume of aid, and that is likely to remain true going forward. As a result, FSA will need to pursue further efficiencies to access additional resources in its operating budget for allocation to the initiatives outlined in its strategic plan.

FSA will also continue to improve its internal efficiency and capabilities across key functions, particularly in technology, acquisition, risk management, and business management, by comparing the current state of these functions with best practices and benchmarks across public and private sectors. The objectives under this goal will build the foundation and capability to support the first two strategic goals, providing better service and information to FSA customers and playing an integral role in the overall student aid delivery system.

Strategic Goal C aims to pursue further efficiencies to free up additional resources in the operating budget by integrating systems, improving acquisition processes, improving risk management, and improving project management.

Objectives supported:
To support this strategic goal, FSA identified a set of objectives, which includes detailed initiatives designed to assist FSA with meeting each objective. Meeting each objective will result in accomplishing the strategic goal. The objectives that support this strategic goal include:

- **Objective 1:** Deliver funds to students accurately, efficiently, and promptly, to create high levels of customer satisfaction.
- **Objective 2:** Strengthen FSA's Information Technology (IT) function to achieve systems modernization and active management of technology to ensure that FSA's delivery systems are secure and privacy of personal information is maintained.
- **Objective 3:** Continuously refine and manage FSA's acquisition strategy and contract performance to realize cost savings and operating efficiencies, and mitigate risk.
- **Objective 4:** Improve the organizational capacity to anticipate and manage external change.
- **Objective 5:** Enhance the risk management organization, systems, and processes.
- **Objective 6:** Develop a methodology to measure and track cost reductions to increase efficiency and productivity.
- **Objective 7:** Build stronger business management capabilities and increase operational transparency to improve cross-functional coordination.

Performance Metrics measured:
To determine the success of FSA's efforts to meet this strategic goal, FSA identified a set of performance metrics including a target level of performance. For this strategic goal, the following table lists the performance metrics, FY 2012 target and actual performance levels, result (i.e., met, not met, etc.), and reference to supporting detail in the *Annual Performance Report* section of this document. In summary, FSA met or exceeded the target for both performance metrics.

Strategic Goal C: ***Develop efficient processes and effective capabilities that are among the best in the public and private sectors.***

Performance Summary for Strategic Goal C

Performance Metrics	FY 2012 Target	FY 2012 Actual	Result	Reference Page
Aid delivery costs per application	$10.90	$10.85	Met	57
Loan servicing costs per borrower	$19.64	$18.94	Met	58

FSA Fact

In July 2012, FSA launched the Financial Awareness Counseling Tool (FACT) to assist student borrowers in managing their student loan debt. This interactive tool provides students with five tutorials that cover topics ranging from managing a budget to avoiding default. To get more information about FACT, go to: StudentLoans.gov.

Strategic Goal D: *Ensure program integrity and safeguard taxpayers' interests.*

As the nation's largest provider of federal student assistance, FSA's role requires the organization to provide more oversight of taxpayer dollars than most agencies, as FSA annually disburses $141.9 billion in aid and administers a loan portfolio valued at more than $948 billion. Even small variances in the financial performance of this portfolio can have a large impact on the U.S. federal budget. FSA is committed to upholding the highest standards of integrity with the Title IV Programs and continues to work with institutions on increased monitoring and oversight efforts.

FSA will strive to better manage taxpayer resources and minimize program costs. As part of this goal, FSA will concentrate its limited resources on those areas that have been identified as having the greatest potential risk for fraud and abuse. In addition, FSA will focus on data gathering and analysis to better understand and manage FSA's growing student aid portfolio. Through these efforts, FSA will be able to better identify, understand, and mitigate all enterprise risks, including the student aid portfolio risk.

Strategic Goal D aims for continuous improvement of FSA's oversight functions to maintain program integrity and safeguard taxpayers' interests by using program dollars effectively and efficiently. FSA has oversight and enforcement responsibility for more than 6,200 schools and 1,847 financial institutions. As such, FSA must leverage and focus its resources to optimize oversight and monitoring activities, and its administrative, sanction, and enforcement actions when warranted.

Objectives supported:
To support this strategic goal, FSA identified a set of objectives, which includes detailed initiatives designed to assist FSA with meeting each objective. Meeting each objective will result in accomplishing the strategic goal. The objectives that support this strategic goal include:

- **Objective 1:** Improve quality control and reduce errors, waste, fraud, abuse, and mismanagement in the delivery of Title IV aid.
- **Objective 2:** Manage funds owed to the Department and provide transparency about student aid portfolio risk exposure.

Performance Metrics measured:
To determine the success of FSA's efforts to meet this strategic goal, FSA identified a set of performance metrics including a target level of performance. For this strategic goal, the following table lists the performance metrics, FY 2012 target and actual performance levels, result (i.e., met, not met, etc.), and reference to supporting detail in the *Annual Performance Report* section of this document. In summary, FSA exceeded the target for one performance metric; and set the baseline for the remaining two performance metrics, which was the target for FY 2012.

Strategic Goal D: *Ensure program integrity and safeguard taxpayers' interests.*

Performance Summary for Strategic Goal D

Performance Metrics	FY 2012 Target	FY 2012 Actual	Result	Reference Page
Improper Payment rate	Set baseline	Pell Grant 2.10% Direct Loan 0.58% FFEL 1.93%	**Met**	59
Direct Loan default rate	<=11.3%	9.6%	**Met**	60
Collection rate	Set baseline	$31.90	**Met**	61

FSA Fact

In an effort to address concerns of fraud in the Pell Grant program, FSA, working with colleagues from the Office of Postsecondary Education and the Office of General Counsel, developed enhanced verification protocols and requirements, beginning with the 2013–14 FAFSA processing year. Those enhancements include selecting a limited number of applicants for increased verification procedures and increasing scrutiny of students who appear to have unusual enrollment patterns.

Strategic Goal E: *Strengthen FSA's performance culture and become one of the best places to work in the federal government.*

FSA achieved substantial improvement in operational performance after its transformation into a PBO in 1998, successfully and reliably delivering aid under changing legislative conditions. The results of the 2011 Employee Viewpoint Survey highlight additional areas of improvement. In addition, a significant number of FSA's staff is eligible for retirement over the next several years. In order to meet the performance challenges facing FSA and to fulfill its rapidly expanding role, the organization will have to rebuild its human capital foundations.

Strategic Goal E aims to meet the performance challenges facing FSA. To do so, FSA will need to empower its employees to accept new challenges, while ensuring the knowledge accumulated by the retirement of eligible staff is not lost upon their departure.

Objectives supported:
To support this strategic goal, FSA identified a set of objectives, which includes detailed initiatives designed to assist FSA with meeting each objective. Meeting each objective will result in accomplishing the strategic goal. The objectives that support this strategic goal include:

- **Objective 1:** Improve the integrity of core human capital processes to attract, develop, and retain talented FSA employees from diverse backgrounds; help them achieve their full performance potential and recognize their contribution to FSA's mission.
- **Objective 2:** Further develop a student-centric culture among all managers and employees that will fully deliver on FSA's mission, vision, and strategy.

Performance Metric measured:
To determine the success of FSA's efforts to meet this strategic goal, FSA identified a performance metric including a target level of performance. For this strategic goal, the following table lists the performance metric, FY 2012 target and actual performance level, result (i.e., met, not met, etc.), and reference to supporting detail in the *Annual Performance Report* section of this document. This performance metric's result was not available for FY 2012 because the FY 2012 Actual performance level will not be available in time for inclusion in this *Annual Report*.

Goal E: *Strengthen FSA's performance culture and become one of the best places to work in the federal government.*

Performance Summary for Strategic Goal E

Performance Metric	FY 2012 Target	FY 2012 Actual	Result	Reference Page
FSA Morale Index (Subset of Questions from Government-wide View Point Survey) - % of positive responses to survey (does not include neutral responses)	58%	—	N/A	62

High Priority Performance Goal

A High Priority Performance Goal is a measurable commitment to a specific result the federal government will deliver for the American people. These goals represent high priorities for both the administration and the Department, have high relevance to the public or reflect the achievement of key agency missions, and will produce significant results over a 24-month period. As required by OMB’s guidance for implementing the *Government Performance and Results Act Modernization Act of 2010* (Pub. L. 111-352), the Department developed a set of Priority Goals during the FY 2010 budget, policy, and strategic planning processes.

FSA was responsible for the Departmental Priority Goal in FY 2010–11 that all participating higher education institutions that want to be operationally ready to originate Federal Direct Student Loans will be able to do so by the end of FY 2011. This Priority Goal had two aims: (1) assisting the United States in achieving the goal of having the highest proportion of college graduates in the world by 2020 and (2) saving taxpayers billions of dollars over the next 10 years by switching to the Direct Loan program, per the non-partisan Congressional Budget Office estimates.

FSA met the requirements of its FY 2010–11 Priority Goal, by ensuring that all schools that wanted to participate in the Direct Loan Program were able to originate Direct Loans.

The Department identified a limited number of new Priority Goals for FY 2012–13 during the budget, policy, and strategic planning processes. These new Priority Goals reflect the importance of teaching and learning at all levels of the education system. Because they reflect a limited number of priorities, they do not fully reflect the agency’s strategic goals nor cover the entire agency mission. As such, FSA is not responsible for one specific Priority Goal for FY 2012–13. Instead, FSA will continue to provide support as needed to the Department in accomplishing the Departmental Priority Goals. For more information on the Department’s Priority goals, see **The Department's FY 2012–13 Priority Performance Goals.**

FSA Fact

FSA disbursed over $102.7 billion in direct loans for the 2011–2012 award year. For more information on the Direct Loan Program, go to: StudentAid.gov/types/Loans.

Quality of Performance Data

Ensuring the integrity of the data required to determine performance results is a critical step in reporting performance. For this step, FSA developed and implemented a Validation and Verification Matrix. Specifically, FSA uses this matrix as a tool to validate the completeness and reliability of the underlying data gathered and used to calculate each performance metric for the reporting period, including the performance results reported in this *Annual Report*.

For each performance metric, this matrix is used to document the following: measurement definition and owner; data source, availability, security procedures, and known limitations; whether data are subject to FSA's A-123 Internal Control Review process; and procedures for accessing the data, calculating the performance metric, and validating and verifying the data gathered.

For a discussion of data quality and limitations for each performance metric, please see the section Performance Results by Strategic Goal, contained in the *Annual Performance Report* section of this *Annual Report*.

Financial Management Discussion and Analysis

The financial management discussion and analysis provides an overview of FSA's financial results for FY 2012. This section is included to assist readers in understanding FSA's financial results, position, and condition as portrayed in the principal financial statements and notes found in the Financial Section of this report. The financial analysis explains major changes in assets, liabilities, costs, and budgetary resources. It also includes comparisons of the current year to the prior year and discusses the relevance of significant balances and amounts reflected in the principal financial statements and notes.

FSA is committed to providing sound management, financial systems, and controls to ensure that students receive aid and repay loans according to applicable laws and regulations. FSA's financial statements are prepared in accordance with established federal accounting standards. The financial statements are subject to an annual independent audit to ensure that FSA's financial position has been fairly presented. In FY 2012, FSA achieved an unqualified audit opinion on its financial statements for the eleventh consecutive year.

FSA presents its financial statements and notes in the format required by the OMB Circular A-136, *Financial Reporting Requirements*. One result of FSA's compliance is that for the comparative fiscal years, FY 2012 and FY 2011, the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position were prepared on a consolidated basis, whereas the Statement of Budgetary Resources was prepared on a combined basis. The Report of Independent Auditors on these statements and accompanying Reports on Internal Control and Compliance with Laws and Other Matters are included in this report and can be found in the section, *Independent Auditors' Reports*.

Federal Student Aid is responsible for managing a net loan portfolio of approximately $672.8 billion. This portfolio has seen significant growth, increasing by 27.0 percent over the September 30, 2011 net portfolio balance. This growth is driven by the expansion of the Direct Loan program, as dictated by the *SAFRA Act* legislation. Operationally, FSA must efficiently utilize the resources it has available to ensure that this portfolio is serviced efficiently and effectively, and that quality customer service is provided to its borrowers. There are several risks that FSA must mitigate to ensure this portfolio is effectively managed. These risks are discussed at the conclusion of the analysis of the financial statements.

The FY 2012 FSA Financial Highlights tables presented below provide a condensed summary of the significant balances in FSA's financial statements for the current and prior years, as of September 30, 2012 and 2011 respectively, and the percentage change between the two years.

FY 2012 FSA Financial Highlights

Condensed Balance Sheet
(*Dollars in millions*)

	FY 2012	FY 2011	Percentage Change
Fund Balance with Treasury	$ 78,452	$ 62,214	26.1%
Credit Program Receivables, Net	672,835	529,965	27.0
Remaining Assets	1,451	1,815	(20.1)
Total Assets	$ **752,738**	$ **593,994**	**26.7%**
Debt	$ 714,324	$ 546,264	30.8%
Other Intragovernmental Liabilities	4,095	6,724	(39.1)
Remaining Liabilities	11,546	22,703	(49.1)
Total Liabilities	$ **729,965**	$ **575,691**	**26.8%**
Net Position	$ 22,773	$ 18,303	24.4%
Total Liabilities & Net Position	$ **752,738**	$ **593,994**	**26.7%**

Cost Summary
(*Dollars in millions*)

	FY 2012	FY 2011	Percentage Change
Gross Cost	$ 35,989	$ 16,839	113.7%
Less: Earned Revenue	25,306	20,212	25.2
Net Cost of Operations	$ 10,683	$ (3,373)	(416.7)%

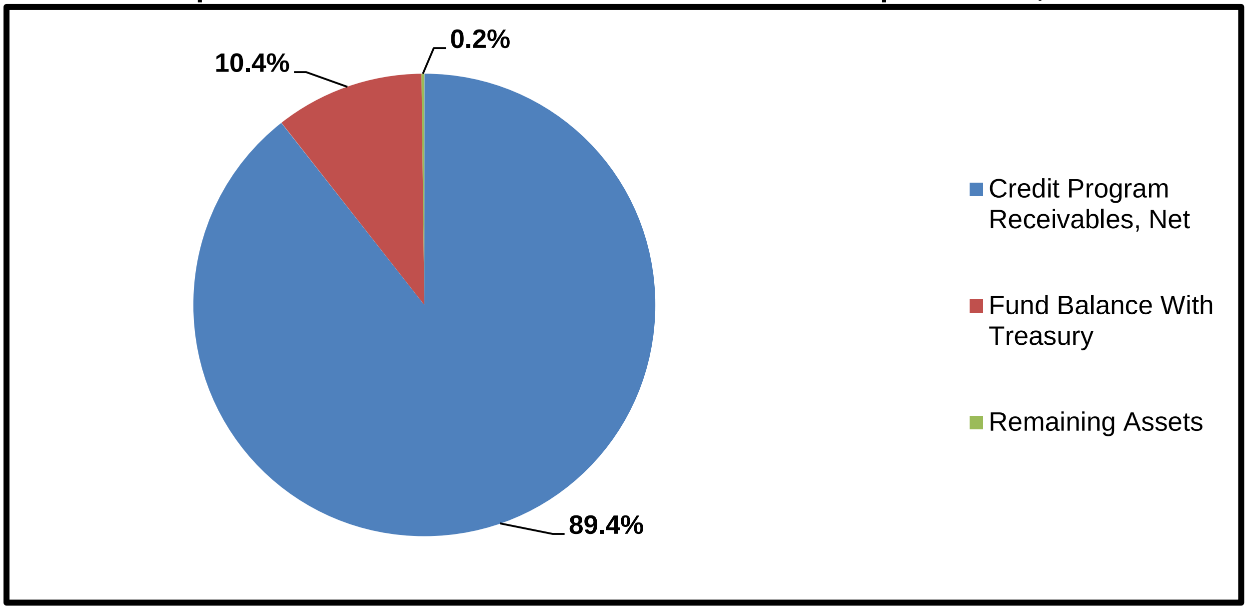
The Balance Sheet

The Balance Sheet presents the recorded value of assets and liabilities retained or managed by FSA as of a specific point in time. The assets represent resources available for use by FSA, while the liabilities represent amounts owed by FSA. The difference between the assets and the liabilities represents FSA's net position.

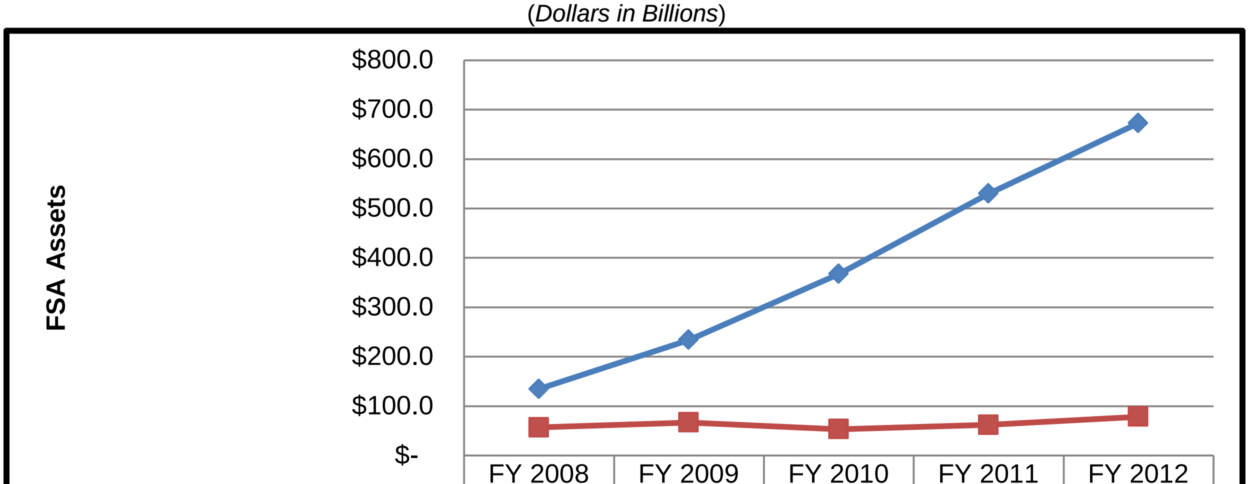
Composition of FSA Assets

FSA's assets are the resources available to pay liabilities or satisfy future service needs. The Consolidated Balance Sheet shows that FSA had total assets of $752.7 billion as of September 30, 2012, an increase of $158.7 billion, or 26.7 percent over the September 30, 2011 total assets balance of $594.0 billion. The difference resulted primarily from the continuing growth of FSA's Credit Program Receivables, $142.9 billion, along with related increases in its various programs' Fund Balances with Treasury, of $16.2 billion. Together, FSA's Fund Balance with Treasury, which is 10.4 percent of total assets, and its net Credit Program Receivables, which is 89.4 percent of total assets, accounted for over 99 percent of FSA's total assets as of September 30, 2012, as illustrated in the Composition of Assets chart provided below. Growth of these two principal balance sheet line items over the past five fiscal years is presented in the Comparison of Assets chart that follows.

Composition of Federal Student Aid's Assets as of September 30, 2012



Comparison of Federal Student Aid's Assets for Fiscal Years 2008–2012
(*Dollars in Billions*)



	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Credit Program Receivables, Net	$134.5	$234.0	$367.4	$530.0	$672.8
Fund Balance With Treasury	$56.9	$66.8	$53.5	$62.2	$78.5

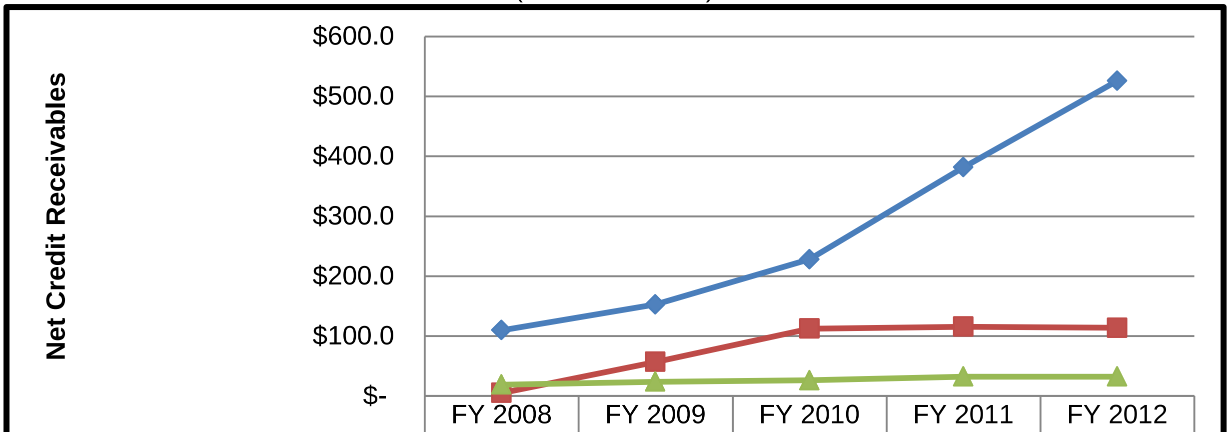
Credit Program Receivables are comprised of principal, interest, and fees owed by students for Direct Loans, TEACH Grants, Perkins loans, and FFEL loans under the Conduit, Loan Participation Purchase, Loan Purchase Commitment, and defaulted guaranteed loan programs. As described in Notes 1 and 6, FSA presents these amounts net of a subsidy cost allowance that adjusts credit receivables to their present value. As of September 30, 2012, the Credit Program Receivables' balance, net of subsidy allowance, was $672.8 billion, an increase of $142.9 billion or 27.0 percent over the September 30, 2011 total. The majority of that increase, $144.6 billion was to the Direct Loan Program, a 37.9 percent increase, driven by new originations and consolidations as described above. By comparison, the net FFEL Credit Program receivables fell slightly by $2.0 billion or 1.3 percent compared to the prior year's balance. The changes observed in both the Direct Loan and FFEL credit receivables are principally related to the impact of the *SAFRA Act* legislation, which as of June 30, 2010 eliminated all new loan disbursements under the FFEL Program in favor of direct lending, and also to the impact of the SDCL opportunity. The latter provided an opportunity from January 17 through June 30, 2012, for eligible borrowers who had at least one Direct Loan Program loan or Department-held FFEL Program loan and at least one commercially-held FFEL loan, to consolidate such loans into a SDCL.

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

The move to direct lending, required by the *SAFRA Act,* and the SDCL opportunity have also been major factors impacting FSA's Fund Balance with Treasury over the past twelve months. FSA's Fund Balance with Treasury represents the funds it has available to pay its current liabilities, make purchases and finance authorized loans to borrowers. Treasury processes cash receipts from borrowers and cash disbursements for FSA loan and grant programs. As of September 30, 2012, FSA reported a Fund Balance with Treasury in the amount of $78.5 billion, an increase of 26.1 percent over the prior year's September 30 balance.

Grant programs accounted for 41.1 percent of the Fund Balance with Treasury at the end of FY 2012, an increase of $8.1 billion or 33.3 percent over FY 2011. This increase was mainly due to the net impact of increased apportioned funding to date, decreases in grant disbursements for current and eliminated grant programs, an increase in interest revenue resulting from a reporting change, and decreased collections for defaulted Perkins loans and grant overpayments. The Direct Loan program accounted for a further 29.9 percent of the total fund balance, an increase of $5.8 billion, or 33.1 percent over September 30, 2011. The latter was principally due to an increase in the collection of principal and interest from non-defaulted origination borrowers, net new borrowings from Treasury and appropriations. The FFEL fund balance also increased by $2.2 billion, or 11.2 percent, primarily as a result of increases in new borrowings, excess interest recapture (negative special allowance payments), increased collections, and the receipt of subsidy appropriations, net of the increases in the payments for default claims, interest benefits, and loan status changes/discharges.

Total Federal Student Aid Loan Portfolio for the Fiscal Years 2008–2012
(*Dollars in Billions*)

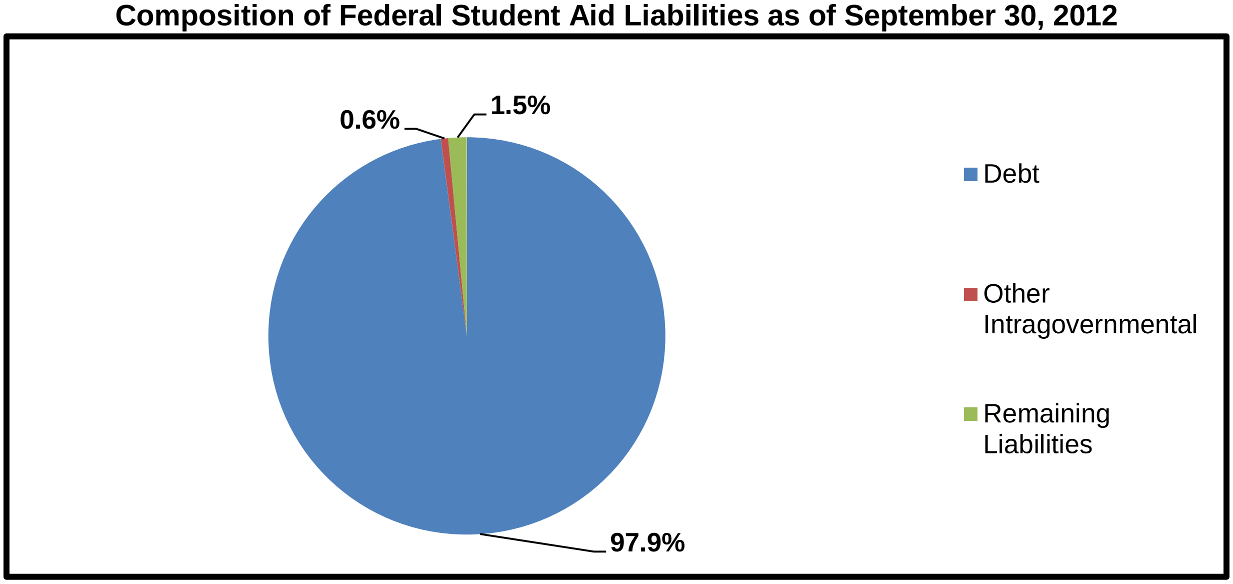


	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Direct Loans	$109.9	$152.8	$228.2	$381.5	$526.0
FFEL, ECASLA	$5.2	$57.1	$112.4	$115.7	$113.8
FFEL, Guaranteed Loans (i.e., non-ECASLA)	$19.2	$23.9	$26.4	$32.3	$32.3

Composition of FSA Liabilities

FSA's liabilities represent probable and measurable future outflows of resources arising from past transactions or events. As of September 30, 2012, FSA had total liabilities of $730.0 billion, which represents an increase of $154.3 billion or 26.8 percent over the previous year's total. The primary component of these liabilities was FSA's Debt, $714.3 billion or 97.9 percent of total liabilities, as shown in the Composition of Liabilities chart depicted below. Other Intragovernmental Liabilities, at 0.6 percent, and FSA's Remaining Liabilities, at 1.5 percent, accounted for only a relatively small portion of the total. The latter includes Liabilities for Loan Guarantees, which is $1.0 billion or 0.1 percent

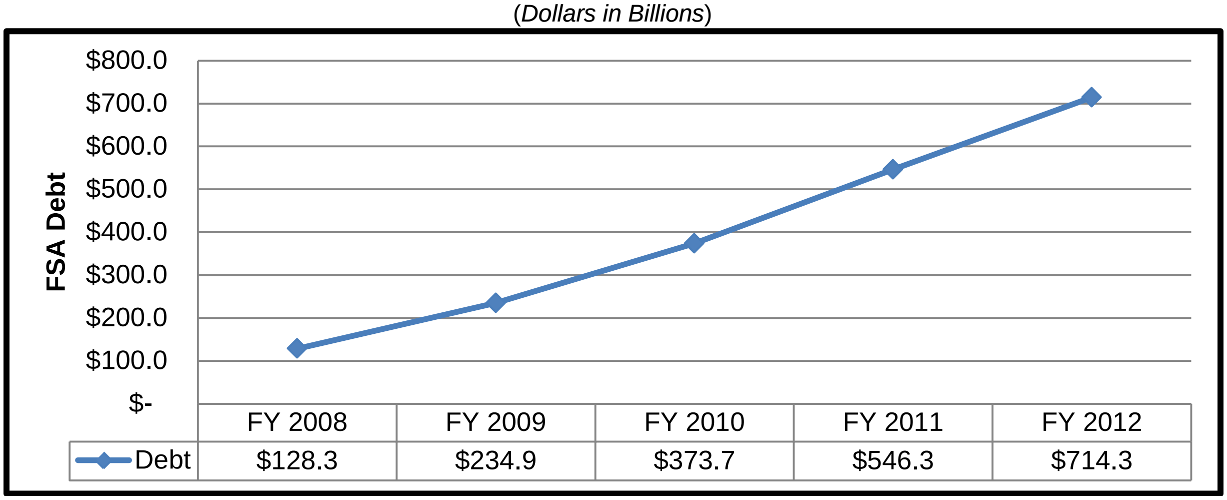
Composition of Federal Student Aid Liabilities as of September 30, 2012



FSA's Debt increased 30.8 percent to $714.3 billion during the twelve months ended September 30, 2012, primarily as a result of the new borrowings to support the growing loan volume in the Direct Loan Program. This trend has continued throughout the past 5 years, with the annual rates of the debt increase averaging 36.7 percent throughout that period, as illustrated in the chart below.

Comparison of Federal Student Aid Debt as of September 30, 2012 for Fiscal Years 2008–2012

(*Dollars in Billions*)



During the same period, Liabilities for Loan Guarantees decreased by $9.0 billion or by 89.7 percent to $1.0 billion, principally as a result of technical and default reestimates and claim payments, offset by activity associated with negative special allowance payments. See Note 6 for a more detailed reconciliation of the change. Other Intragovernmental Liabilities also decreased by a further $2.6 billion, mainly due to a net reduction in Direct Loan liabilities in miscellaneous receipt accounts, primarily consisting of downward subsidy reestimates due to updated economic assumptions, including probabilistic estimating, discount rates and interest rates. Please refer to Note 11 for further details.

Statement of Net Cost

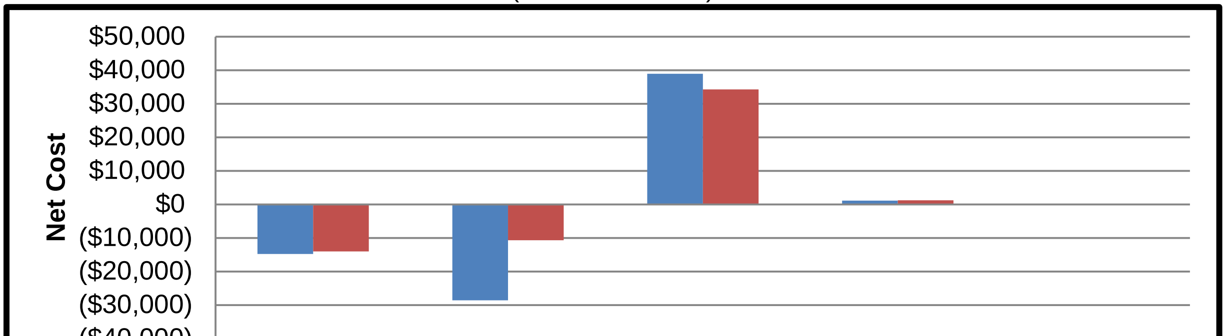
The Statement of Net Cost is the federal financial statement that presents the net cost of operations for FSA programs. FSA net cost is the gross cost incurred during its operations less any revenues earned from its activities.

Through September 30, 2012, FSA's net costs in FY 2012 increased $14.1 billion or (416.7) percent to $10.7 billion compared to a negative net cost of $(3.4) billion for FY 2011.

Most of this net change, $17.9 billion was attributable to the Direct Loan Program, where negative net costs were reduced (i.e. net costs increased) from $(28.6) billion to $(10.7) billion, due to an increase in Direct Loan program subsidy expense of the same amount. There was a $12.2 billion upward adjustment of re-estimated subsidy cost compared to an $11.6 billion downward adjustment the prior year, representing an overall increase in Direct Loan Program subsidy cost of $23.8 billion. This cost increase was offset by a $5.9 billion increase in negative costs (i.e. net cost reduction) due to current year subsidy transfers, mainly attributable to interest rate differential. Subsidy expenses are the estimated costs of funding Direct Loans (and the loan guarantees for FFEL loans). The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows. Please refer to Note 6 for further details on subsidy related expenses.

The other significant reduction in net costs occurred in the grants program, where net costs decreased by $4.7 billion compared to FY 2011. This reduction was principally attributable to decreases in grant disbursements for current and eliminated grant programs including Academic Competitiveness Grant and National Science and Mathematics Access to Retain Talent Grant Programs, which were both eliminated at the end of FY 2011.

Composition of FSA Net Cost
For the years ended September 30, 2012 and 2011
(*Dollars in Millions*)



	FFEL	Direct Loans	Grant Programs	Other Programs	Recovery Act
FY 2011	$(14,825)	$(28,631)	$38,947	$1,109	$27
FY 2012	$(14,018)	$(10,720)	$34,224	$1,174	$23

Statement of Changes in Net Position

The Statement of Changes in Net Position presents those amounts that caused the net position section of the balance sheet to change from the beginning to the end of the reporting period.

FSA's net position as of September 30, 2012, was $22.8 billion, an increase of $4.5 billion, or 24.4 percent over the previous year-end net position of $18.3 billion. The difference reflects an increase in unexpended appropriations of $8.9 billion that mainly related to grant programs, together with an offsetting increase in negative cumulative results of operations in the amount of $(4.4) billion relating to unfunded upward subsidy re-estimates, other unfunded expenses and net investments of capitalized assets, that relate principally to the Direct Loan Program.

Statement of Budgetary Resources

The Statement of Budgetary Resources compares the budgetary resources provided with the status or execution of those resources. It also details the composition of the resources and shows the amount of net outlays. This statement shows that as of September 30, 2012, FSA had $326.3 billion in combined budgetary resources, of which $20.4 billion remained unobligated and unapportioned. This represented a 3.0 percent increase over combined budgetary resources twelve months earlier of $316.6 billion, of which $16.7 billion were unobligated and unapportioned.

Appropriations are available to cover the subsidy cost of each loan program and administrative expenses. Subsidy expense represents the difference between the net present value of expected future cash flows and the face value of each loan portfolio. Appropriation authority is available as needed on a permanent basis to finance costs resulting from loans guaranteed in the years before FY 1992. The Pell Grant Program receives appropriations to cover actual grant disbursements. FSA had total net outlays as of September 30, 2012 of $163.8 billion, a marginal increase of 1.2 percent, over the prior year total of $161.9 billion.

Financial Management Risks

As mentioned previously, there are several financial management risks that FSA must mitigate to protect borrower and taxpayer interests. While not directly reflected on the financial statements as detailed, they are overarching risks going forward that cannot be ignored. These risks include:

System/Service Implementations: Over the next few years, FSA will be re-competing contracts associated with many of its major business processes, including processing financial aid applications, originating and disbursing financial aid, consolidating loans, collecting defaulted debt, as well as major infrastructure functions. Some recent implementation efforts have been very successful, including the new ECASLA loan participation and purchasing processes, additional Not-For-Profit (NFP) Servicers and Title IV Additional Servicers (TIVAS) servicing capacity, and the Total and Permanent Disability (TPD) transition to Nelnet. However, as further detailed in Analysis of Systems, Controls, and Legal Compliance section, FSA has experienced significant deficiencies in the conversion to a new debt management and collection system and a new direct loan servicing system (i.e., Debt Management and Collection System (DMCS2) and ACS Education Servicing System (ACES)). These deficiencies serve as a reminder to FSA of the significant financial management risks associated with the conversion to new systems. Exacerbating this risk associated with contract re-competes are the numerous program changes that FSA has been asked to implement in recent years, and which will continue to be required of FSA into the foreseeable future.

FSA has established organization management functions that address this risk. Specifically, FSA has established an Enterprise Strategic Acquisition Planning governance structure to oversee the planning and management of the sizable re-compete efforts. In addition, FSA continues to refine its investment management processes, specifically the project and portfolio management processes in order to better control system/service implementations.

Administrative Budget: With the passage of the *SAFRA Act* in FY 2010, the Congressional Budget Office estimated that the federal government will save approximately $68 billion through FY 2020. The Congressional Budget Office also estimated that the federal government will need to spend $6 billion over that same time period to cover the increased Direct Loan program administration cost resulting from increased Direct Loan volume. Prior to the *SAFRA Act*, the program administration costs associated with this savings were paid for through mandatory FFEL funding. Meanwhile, the federal government is under significant pressure to reduce discretionary spending. If FSA does not receive the necessary funding in the Student Aid Administration appropriation to cover this increase in administrative costs, then FSA will be at risk of not being able to maintain ongoing operations.

An immediate threat to maintaining ongoing operations is the across-the-board reduction in budgetary resources, known as a sequestration of funding, which could go into effect on January 2, 2013. In addition to reducing the administrative budget for FSA, and impacting servicing operations, the sequestration could also reduce the funding available to pay collection agency contracts, leading to a potential reduction in the amount of defaulted loans collected on in the future. Finally, the sequestration could also lead to an increase in the origination fees on Direct Loans, which would negatively impact student borrowers.

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

Improper Payments: Based on OMB criteria, risk susceptible programs administered by FSA include Direct Loan Program, FFEL Program, and Pell Grant Program. FY 2012 outlays for these programs were as follows:

- Direct Loan – $105.8 billion
- FFEL Guaranteed - $11.4 billion (interest and special allowance subsidies to Lenders and reinsurance claims and fees to Guaranty Agencies)
- Pell Grant - $33.3 billion

Risks include undetected fraud, waste, and abuse. For more information regarding FSA's assessment of improper payment risk and planned strategies to mitigate this risk, please refer to the Improper Payments Reporting Details narrative in the Other Accompanying Information section in the Department's *Agency Financial Report (AFR)* located at **http://www.ed.gov/about/reports/annual/index.html**.

Debt Collection: As of September 30, 2012, the Department managed a Net Credit Program Receivable portfolio of approximately $672.8 billion. This portfolio includes FSA's Direct Loan Program, FFEL Program (guaranteed loans held by guaranty agencies or FSA), FFEL loans acquired via authorization of the ECASLA, Federal Perkins Loans Program, and TEACH Program receivables. FSA realizes that as the size of the loan portfolio significantly grows from year to year, so does the level of financial risk associated with the collections on these loans.

Generally, a debt is considered delinquent when payment is past due 30 to 270 days. Over 270 days, the debt is considered to be in default. FSA monitors the aging of its portfolio debt, takes action to rehabilitate defaulted borrowers, and provides incentives to its partners (i.e., schools and servicers) to reduce the number of defaulted borrowers. In addition, FSA transitioned to a new defaulted loan servicer. This was a necessary move for FSA, as the previous system would not have had the capacity to handle the growth in the defaulted portfolio expected due to the increase in FSA's loan portfolio.

In the *FSA Strategic Plan: FY 2012–16*, FSA included a new metric, the overall Collection Rate, to better analyze all collections for the loan portfolio, including receivables that are defaulted and delinquent, as well as those that are in repayment. This new metric will provide a broader measurement of the status of FSA's collection activities and the supporting breakout of that Collection Rate will ensure the comprehensive management of all debt collection activities. For more information about this metric, please see performance metric D.3 on page 61 of this report.

Guaranteed Loan Portfolio: As of September 30, 2012, the guaranteed loan portfolio (non-ECASLA FFEL) consisted of $290.7 billion owned by private lenders and $32.3 billion held by FSA (unassigned serviced by guaranty agencies or assigned serviced by FSA). As of September 30, 2012, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately $284.6 billion. In addition to the exposure of the guarantee, FSA makes special allowance payments to private lenders and reinsurance claims and fees to guaranty agencies. The *SAFRA Act* eliminated the origination of guaranteed FFEL loans as of July 1, 2010 and required a transition to 100 percent Direct Loans. Although the origination of guaranteed FFEL loans has ceased, FSA needs to ensure that the infrastructure (i.e., participating organizations, processes, internal controls, and systems) remains fully operational through the remaining life of the existing guaranteed FFEL loan portfolio. Failure to maintain adequate infrastructure may prevent appropriate management of guarantees and loan portfolio, resulting in loss of government assets and income.

Analysis of Systems, Controls, and Legal Compliance

FSA management adheres to the Government Accountability Office (GAO) published guidance on internal control and recognizes that internal control is an integral part of managing an organization. Internal control includes the plans, methods, and procedures that are used to meet the organization's missions, goals, and objectives. In carrying out these components of internal control, FSA supports an environment for performance-based management. Internal control also serves as the first line of defense in safeguarding assets, and preventing and detecting errors and fraud. In short, internal control, which is synonymous with management control, helps government program managers achieve desired results through effective stewardship of public resources. GAO standards state that internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

- Effectiveness and efficiency of operations, including the use of the entity's resources;
- Reliability of financial reporting, including reports on budget execution, financial statements, and other reports for internal and external use; and
- Compliance with applicable laws and regulations.[2]

FSA management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*. FSA conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of its operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this assessment, FSA reported to the Department's management that its internal control over the effectiveness and efficiency of its operations and compliance with applicable laws and regulations, as of September 30, 2012, except for the material weaknesses identified, were operating effectively.

These material weaknesses relate to the ACES and DMCS2 system conversion and/or functionality issues that impact Direct Loan and FFEL servicing and default systems and processes operated under the Common Services for Borrowers agreement with Xerox Education Solutions, Limited Liability Corporation (Xerox, LLC), which was formerly ACS Education Solutions, LLC. These issues include inflated loan balances, fund balance with Treasury and suspense account balances, transfers, portfolio and cash reconciliations, and qualified Service Organization Control 1 reports performed by Xerox, LLC's independent public accountant. The large-scale system conversions for both ACES and DMCS2 occurred in October 2011.

FSA management actively monitored and tracked system functionality issues that resulted from these implementations from the beginning, and worked closely with

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

Xerox, LLC to understand the impact and effected processes. Corrective action plans, with underlying action items, were requested from Xerox, LLC to address these issues. These corrective action plans are facilitated through FSA Acquisitions, for which progress is monitored on an on-going basis. These corrective actions are summarized in the Department's AFR. While Xerox, LLC has made significant progress in completing the corrective action plans, for the year ended September 30, 2012, the issues noted above are significant enough to warrant disclosure with respect to controls over the effectiveness and efficiency of operations and compliance with laws and regulations.

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

- Direct Loan Consolidations.
- SDCL.
- Debt Collection.
- Financial Partners Invoicing.
- School Eligibility Services Group.
- Financial Institution Oversight Service.
- Student Eligibility.
- Grant Program Operations (Pell and TEACH).
- Financial Reporting.
- Funds Control Management.
- Procurement Management.
- Servicing of Direct Loans and ECASLA-acquired FFEL Program Loans by TIVAS, NFPs, and ACES.
- TPD.
- Servicer Oversight.
- IT/General Computer Controls over: Financial Management System, Direct Loan Consolidation System, DMCS2, National Student Loan Data System, Central Processing System (CPS), ACES, Financial Partner Data Mart, Great Lakes Commercial System, Nelnet Commercial System, Pennsylvania Higher Education Assistance Agency Commercial System, Sallie Mae Commercial System, MOHELA Servicing System, ESA/EdFinancial Servicing System, CornerStone Servicing System, and Virtual Data Center.

Based on the results of this evaluation, FSA provided reasonable assurance to the Department's management that, except for the material weaknesses identified, which are the same issues disclosed for FMFIA reporting purposes, its internal control over financial reporting as of June 30, 2012 was operating effectively

As noted above, corrective action plans for these issues have been established and are underway to address and remediate these issues. Completion of these corrective actions is monitored closely by FSA management on an on-going basis. Substantial progress has been demonstrated on the issues related to DMCS2 conversion after

June 30, 2012, such that, as of September 30, 2012, management assesses that this reportable condition is no longer a material weakness in the effectiveness of internal control over financial reporting.

FSA's participation in the Department's implementation of the requirements of OMB Circular A-123, including Appendix A, enables it to continue to build upon its internal control framework. This framework will be used in continuing efforts to monitor and improve internal control. Please refer to the Department's *AFR* for additional information related to management's assurances and disclosures.

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

FSA's financial management systems strategy is formulated and managed as part of the Department's strategy. For details on FSA's financial management systems strategy, please refer to the Financial Management Systems Strategy narrative found in the Management's Discussion and Analysis section of the Department's *AFR* located at **http://www2.ed.gov/about/reports/annual/index.html**.

Limitations of Financial Statements

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

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

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

Annual Performance Report

Federal Student Aid
An OFFICE of the U.S. DEPARTMENT of EDUCATION
PROUD SPONSOR of the AMERICAN MIND™

FY 2012 Performance Highlights of Federal Student Aid

Performance Metrics	FY 2012 Target	FY 2012 Actual	Result	Reference Page
Strategic Goal A: ***Provide superior service and information to students and borrowers.***				
% of first-time FAFSA filers among high school seniors	>=52%	54.0%	Met	50
% of first-time FAFSA filers aged 19-24 among those in population that are high school graduates, no college	>=27%	28.4%	Met	51
% of first-time FAFSA filers among workforce aged 25+, high school graduates, no college	>=3.6%	3.7%	Met	52
% of first-time FAFSA filers among low-income students	>=57%	63.1%	Met	53
Customer satisfaction score (ACSI)	78	78.5%	Met	54
Strategic Goal B: ***Work to ensure that all participants in the system of funding postsecondary education serve the interests of students, from policy to delivery.***				
Ease of doing business school survey (1-100 Scale)	>=72	74	Met	55
Percent of borrowers>90 days delinquent	<=10%	9.5%	Met	56
Strategic Goal C: ***Develop efficient processes and effective capabilities that are among the best in the public and private sectors.***				
Aid delivery costs per application	$10.90	$10.85	Met	57
Loan servicing costs per borrower	$19.64	$18.94	Met	58
Strategic Goal D: ***Ensure program integrity and safeguard taxpayers' interests.***				
Improper Payment rate	Set baseline	Pell Grant 2.10% Direct Loan 0.58% FFEL 1.93%	Met	59
Direct Loan default rate	<=11.3%	9.6%	Met	60
Collection rate	Set baseline	$31.90	Met	61

Performance Metrics	FY 2012 Target	FY 2012 Actual	Result	Reference Page
Strategic Goal E: ***Strengthen FSA's performance culture and become one of the best places to work in the federal government.***				
FSA Morale Index (Subset of questions from government-wide view point survey) – % of positive responses to survey (does not include neutral responses)	58%	—	N/A	62

FSA Fact

The Direct PLUS Loan Program is for undergraduate, graduate, and professional students. For more information on the Direct PLUS Loan program, go to: StudentAid.gov/types/loans/PLUS.

Introduction to the *Annual Performance Report*

To guide FSA towards achieving its vision "To be the most trusted and reliable source of student financial aid, information, and services in the nation", FSA updated its Five-Year Strategic Plan to document the strategic goals, objectives, and performance metrics of the organization. FSA is required by the PBO-enabling legislation to report annually its level of performance. This section, the *Annual Performance Report*, satisfies this annual reporting requirement.

In addition to this section, see the following portions of this document for additional performance related information:

- Management's Discussion and Analysis: See the Management's Discussion and Analysis section of this document for a more complete discussion of FSA's mission, organization, and performance management, including performance management processes and summary of results.

- Appendix A: See Appendix A of this document for the performance goals that were in effect for the FY 2011 reporting period, but have been discontinued for the FY 2012 reporting period due to the implementation of the *FSA Strategic Plan FY 2012–16*.

The *FSA Strategic Plan FY 2012–16* was implemented at the beginning of FY 2012. The updated *Strategic Plan* builds on the prior year's plan by clarifying FSA's objectives and updating organizational performance standards to better reflect its progress in meeting the stated objectives. The strategic goals are unchanged from their initial publication in the *FSA FY 2011–15 Strategic Plan* and are as follows:

- **Strategic Goal A:** *Provide superior service and information to students and borrowers.*
- **Strategic Goal B:** *Work to ensure that all participants in the system of funding postsecondary education serve the interests of students, from policy to delivery.*
- **Strategic Goal C:** *Develop efficient processes and effective capabilities that are among the best in the public and private sectors.*
- **Strategic Goal D:** *Ensure program integrity and safeguard taxpayers' interests.*
- **Strategic Goal E:** *Strengthen FSA's performance culture and become one of the best places to work in the federal government.*

To gauge its success in meeting these strategic goals, FSA identified and included 13 performance metrics in its *Strategic Plan.* For more information on FSA's strategic goals and its performance metrics, click on the following link to go directly to the *FSA Strategic Plan FY 2012–16*.

StudentAid.gov/strategic-planning-reporting

The following table provides a summary of results, by Strategic Goal, as measured by the FY 2012 13 performance metrics.

Summary of Performance Results by Strategic Goal

Strategic Goal	Met	Not met	No target	N/A	Total
Goal A: *Provide superior service and information to students and borrowers.*	5	—	—	—	**5**
Goal B: *Work to ensure that all participants in the system of funding postsecondary education serve the interests of students, from policy to delivery.*	2	—	—	—	**2**
Goal C: *Develop efficient processes and effective capabilities that are among the best in the public and private sectors.*	2	—	—	—	**2**
Goal D: *Ensure program integrity and safeguard taxpayers' interests.*	3	—	—	—	**3**
Goal E: *Strengthen FSA's performance culture and become one of the best places to work in the federal government*.	—	—	—	1	**1**
Total	**12**	**—**	**—**	**1**	**13**

FSA Fact

One of the requirements of the Government Performance and Results Modernization Act of 2010 is that agencies update their strategic plans frequently. As part of its compliance with this Act, FSA revised its strategic plan during FY 2012. To read more about the *FSA Strategic Plan FY 2012–16*, go to: StudentAid.gov/strategic-planning-reporting.

Performance Results by Strategic Goal

This section presents detailed performance results including a discussion of progress made to date in achieving the strategic goal and the data used to assess performance.

How this section is organized
This section is organized by the five strategic goals and the associated performance metric(s). The section contains the following information for each performance metric:

Table: Identifies the performance metric associated with the strategic goal and provides the historical actual results for the four previous fiscal years (if available), the target and actual result for the current fiscal year, and an indicator as to whether FSA met the performance metric for each fiscal year reported. The following is the legend for the performance result indicator included in the table.

Performance Result Indicator Legend

Performance result met or exceeded the target.	**Met**
Performance result did not meet the target.	**Not met**
Performance result is not applicable because the performance metric was not developed, the performance metric was not implemented, or the required data were not available in time for inclusion.	**N/A**

Historical actual results are not available for the performance metrics newly developed and implemented for FY 2012 (i.e., performance metrics not carried forward from the prior five-year strategic plan).

The performance metric results reported are as of fiscal year-end (i.e., September 30, 2012) unless otherwise noted. If the required data are not available as of fiscal year-end in sufficient time for inclusion, data as of the most recent reporting period available are presented. Fiscal year-end data may not be available in instances where the required data are obtained from external sources (i.e., state and private nonprofit guaranty agencies, lenders and loan servicers, grant and loan recipients, etc.).

Target Context: Explains the parameters or rationale for targets, especially where anomalies exist.

Analysis of Progress: Provides a discussion of FSA's progress in meeting its targets and includes explanations for unmet targets and actions being taken or planned.

Data Quality and Limitations: Describes the source of data required to calculate the actual result for the performance metric, any calculation required to determine the actual result, and any known data quality issues or limitations. For an overview of FSA's business process to confirm the quality of performance data, please see Quality of Performance Data in the Management's Discussion and Analysis section of this *Annual Report*.

Strategic Goal A: *Provide superior service and information to students and borrowers.*

Performance Metric A.1: % of first-time FAFSA filers among high school seniors

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			52.0%	>=52%	54%
Performance Result				Met	Met	

Target Context:
A major component of FSA's mission is to ensure that all eligible individuals have access to federal student aid. In order to achieve this goal, FSA works diligently to increase awareness about the availability of student financial assistance. To better assess its customers and their needs and to better support college access and completion among its customer base, FSA is developing a system of customer segmentation that identifies student/family/influencer profiles and needs through the analysis of customer geographic, demographic, and behavioral data. This performance metric measures the percentage of FAFSA applications for one customer segment, high school seniors.

Analysis of Progress:
FSA exceeded this performance metric with approximately 54 percent of high school seniors from June 2011 submitting a FAFSA during the 2011–2012 application cycle. In FY 2011, FSA launched an innovative pilot project at 18 sites across the country to increase the number of students completing the FAFSA. FSA expanded this project in FY 2012 to include 92 additional sites for the 2013–14 school year. This expansion will consist of 80 multi-high-school Local Educational Agencies (LEAs) and 12 single-high-school LEAs. This project is designed to assist college access counselors in determining how many of their students have completed the FAFSA for the upcoming school year so that each site can focus its resources on students who have not completed the FAFSA and make FAFSA completion a component of a comprehensive college-and career-ready strategy.

Data Quality and Limitations:
Data for this metric are derived from FSA's CPS to identify FAFSA filers ages 18 and under submitting an original application for an award year (not a renewal application) and who indicate they never attended college, divided by the total number of high school graduates from the most recent high school academic year reported by the National Center for Education Statistics (NCES).

FSA Fact

FSA's website can help students evaluate potential colleges, determine career pursuits, or research the average earnings potential of different careers. For more assistance in researching colleges or careers, go to: StudentAid.gov/Prepare-for-college/careers.

Performance Metric A.2: % of first-time FAFSA filers aged 19-24 among those in population that are high school graduates, no college

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	New performance measure (Prior-year data not available)				>=27%	28.4%
Performance Result					Met	

Target Context:
The economy and job market require that more workers develop skills and master knowledge beyond the high school level. Although progress has been made over the years to increase college attendance and graduation levels for all individuals, work is still needed to address the gap for nontraditional students. Increasing college completion rates and the number of graduates is a priority of this administration, as evidenced by the President's 2020 goal for America to have the highest proportion of college graduates in the world. This performance metric measures the percentage of FAFSA applications for another customer segment, individuals ages 19-24. It was added to the *FSA Strategic Plan: FY 2012–16* to include the universe of first-time FAFSA filers. The baseline was set in FY 2011 and the target is to maintain or increase these percentages each year.

Analysis of Progress:
FSA exceeded this performance metric, with approximately 28.4 percent of individuals between the ages of 19-24, who have never attended college before, submitting a FAFSA during the 2011-2012 application cycle. In FY 2012, FSA expanded the FAFSA Completion Project to additional cities. As part of this project, FSA solicited the support of high school counselors, the college access community, community-based organizations, governmental agencies, faith-based organizations, and others to extend its reach to the expanded target audiences, which included individuals between the ages of 19-24 years. FSA engaged these audiences via financial aid presentations, conferences, college fairs, town halls, Train the Trainer sessions, webinars, and hands-on support in completing the FAFSA.

Data Quality and Limitations:
Data for this metric are derived from FSA's CPS to identify FAFSA filers ages 19-24 submitting an original application for an award year (not a renewal application) and who indicate they have never attended college, divided by the number of 19-24 year olds in the population that have completed high school, have not attended college and are not currently enrolled in a postsecondary education program reported in the Census Bureau's Current Population Survey, Fall Enrollment.

Performance Metric A.3: % of first-time FAFSA filers among workforce aged 25+, high school graduates, no college

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			3.8%	>=3.6%	3.7%
Performance Result				Not met	Met	

Target Context:
Increasing college completion rates and the number of graduates is a priority of this administration, as evidenced by the President's 2020 goal for America to have the highest proportion of college graduates in the world. Although progress has been made over the years to increase participation and graduation levels for all individuals, work needs to continue to drive enrollment among non-traditional aged students. This performance metric measures the penetration of FAFSA applications for a third customer segment, individuals 25 years and older.

Analysis of Progress:
FSA met this metric by achieving an actual result of 3.7 percent. As a result of various new media, FSA has been able to sharpen strategies to reach both traditional and non-traditional borrowers using the vehicles they frequent and prefer. Through new customer listening, reach, and engagement efforts, FSA has been leveraging social media tools to drive awareness, uncover insights, digitally engage, and interact with students and borrowers. FSA will continue its efforts to understand its customers and their needs to better support college access and completion.

Data Quality and Limitations:
Data for this metric are derived from FSA's CPS to identify FAFSA filers aged 25 and over submitting an original application for an award year (not a renewal application) and who indicate they have never attended college divided by the total number of people in the workforce aged 25 and older who are high school graduates that have never attended college. Workforce data reported by the Bureau of Labor Statistics

FSA Fact

The median earnings annually for high school graduates were approximately $41,000, while the median earnings for college graduates were approximately $71,000. For more information on the benefits of college, go to: StudentAid.gov/Prepare-for-College/accessible.

Performance Metric A.4: % of first-time FAFSA filers among low-income students

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			57.0%	>=57%	63.1%
Performance Result				Baseline	Met	

Target Context:
Focusing on the neediest and least-served students, FSA measures the percentage of original FAFSA filers who come from low-income households. Although progress has been made over the years to increase the participation and graduation levels for all individuals, work needs to continue to address the gap for low-income students. This measure looks at the effectiveness of FSA's outreach in getting low-income students to file a FAFSA application for the first time. The baseline was set in FY 2011 and FSA's target is to maintain or increase these percentages each year.

Analysis of Progress:
FSA created a new tool to accelerate the delivery of data to all high schools that is independent of the planned FAFSA Completion Project. This innovative tool was developed using improved data analytics capacity within FSA's Customer Experience Office. Although not a planned activity, the new tool, called the FAFSA Completion Tool, allows FSA to publish FAFSA completion data aggregated by high school for the first time ever. Prior to publishing this data, the only source of data on FAFSA completions that high schools had were from self-reported student surveys. As a result of posting this data, which FSA updates every two weeks, any high school in the country with more than five FAFSAs completed can see their completion totals. This includes a total of nearly 24,000 high schools in all 50 states, D.C. and all U.S. Territories. This tool supports the effort to increase college access for students from chronically underrepresented populations and for low-income students.

Data Quality and Limitations:
Data for the numerator of this measure, FAFSA first-time filers who are age 18 or younger and who are from households with incomes that are 150 percent or less of the poverty level, comes from CPS. This numerator is divided by the number of high school graduates from households with incomes that are 150 percent or less of the poverty level as estimated based on data extracted from NCES and the most recent School Enrollment Supplement, Current Population Survey.

Performance Metric A.5: Customer Satisfaction Score (ACSI)

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			78	78	78.5
Performance Result				Met	Met	

Target Context:
To measure overall customer satisfaction level throughout the student aid lifecycle, FSA calculates a weighted score for the American Customer Satisfaction Index (ACSI) surveys for applicants, students in school, and borrowers in repayment. This performance metric measures how FSA is improving in terms of streamlined processes for customer interaction and the accessibility of information FSA provides to its customers on its websites.

Analysis of Progress:
FSA exceeded the target for this metric. FSA's FAFSA simplification efforts have improved an applicant's ability to successfully navigate and complete the application. A customized experience reduces the number of questions applicants and their parents must answer. The availability and increased use of the Internal Revenue Service (IRS) Data Retrieval Tool make it easier for applicants and their parents to provide financial information and increases the accuracy of the information provided.

Some users of the IRS Data Retrieval Tool were unable to retrieve their tax return information due to operational constraints caused by tax processing timeframes, authentication rules intended to protect taxpayers' privacy, and very sensitive system issues identified by the IRS as "Business Reasons". Nevertheless, the number of successful authentications for 2012/2013 has increased dramatically compared to 2011/2012, FSA continues to work closely with the IRS to improve the IRS authentication process where possible.

Data Quality and Limitations:
The ACSI survey is conducted annually on FSA's major programs. The index provides a national, cross-industry, cross-public and cross-private sector economic indicator, using widely accepted methodologies to obtain standardized customer satisfaction information. Survey scores are indexed on a 100-point scale. The ACSI scores for application, in school experience, and servicing are weighted by the utilization of each process/service and the intensity of the service provided.

FSA Fact

At the FSA Annual Conference held in FY 2012, almost 7,000 attendees, many of whom were financial aid administrators, were able to obtain the latest information related to FSA policies and procedures.

Strategic Goal B: ***Work to ensure that all participants in the system of postsecondary education funding serve the interests of students, from policy to delivery.***

Performance Metric B.1: Ease of doing business school survey (1-100 scale)

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			Survey launched	>=72%	74%
Performance Result				Met	Met	

Target Context:
FSA works closely with postsecondary institutions to provide millions of students with federal student aid. Successfully delivering aid through a complex system depends on FSA's ability to work well with its institutional, financial, and state partners to support them with technical assistance that will help them improve their performance and to provide adequate oversight to ensure that participants are complying with program requirements. To ensure that all participants in the postsecondary education funding system can easily access the information they need to perform their important functions and serve the interests of students, FSA conducts a survey with postsecondary institutions and partners every quarter to gauge the "ease of doing business with FSA." The first year for the survey was FY 2011; FSA set a target for this metric, of launching the survey and establishing the baseline. The survey was launched in FY 2011 as planned and the established baseline was 72. FSA's goal is to maintain or improve survey results each year.

Analysis of Progress:
FSA achieved a performance result of 74, exceeding the established target. This is an improvement over last year's result of 72. This survey goes out to financial aid administrators at colleges and universities and improvement on this score is significant because it happened during a great time of transition as the Direct Loan portfolio continues to grow and schools increasingly look to FSA as the source of information on student loans. FSA's score also reflects a greater focus on the schools as its customers and an increased capacity to hear and respond to their requests as they work to provide quality information about federal aid to their students.

Data Quality and Limitations:
A 10-12 question survey regarding the ease of doing business with FSA is sent to schools quarterly. The same exact survey has been sent to the schools quarterly since its initial launching in FY 2011. The questions focus on how easy it is to interact with major delivery and information systems. The 1 to 10 score is indexed to a scale of 1 to 100 for consistency with other customer satisfaction metrics and to allow greater accuracy in significance testing.

Performance Metric B.2: Percent of borrowers>90 days delinquent

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			9.9%	<=10%	9.5%
Performance Result				Baseline	Met	

Target Context:
For FY 2012, FSA studied other possible ways to measure the extent to which postsecondary institutions and partners are actively supporting the interest of students and borrowers. The current focus on default rates does not fully capture the extent of borrowers' difficulties in repaying student loans. Focusing on reducing the number of borrowers who are more than 90 days delinquent will provide FSA additional insight on how to communicate information about repayment options in a more targeted and timely way. FSA developed a new delinquency metric as performance metric B.2, which is the percentage of borrowers serviced by the TIVAS and NFP servicers who are more than 90 days delinquent. The baseline was set in FY 2011 at 9.9 percent and FSA's goal is to maintain a rate of less than or equal to 10 percent.

Analysis of Progress:
FSA was successful in FY 2012 and achieved a performance result of 9.5 percent for this metric. TIVAS service approximately 21 million borrower accounts, and the NFPs now service over 4 million borrower accounts, including Direct Loans and Department-held FFEL loans. TIVAS and NFPs can best serve the interest of borrowers by helping them cure delinquencies, especially the severely delinquent loans that have a greater likelihood of going into default and tarnishing borrowers' credit. By providing data on delinquencies to servicers, FSA will strengthen relationships and ensure its partners are functioning at their best in the service of FSA's customers.

Data Quality and Limitations:
FSA calculates the average number of borrowers serviced by TIVAS and NFPs who are between 91 and 270 days delinquent in the year ending June 30 each year and divides this number by the average number of borrowers in repayment for the year. Borrower-based data are collected from TIVAS and NFP invoices.

FSA Fact

Borrowers who work full-time in a public service job and have a Direct Loan or a Direct Consolidation Loan may qualify for the Public Service Loan Forgiveness Program. To find more about the Public Service Loan Forgiveness Program, go to: StudentAid.gov/repay-loans/forgiveness-cancellation/charts/public-service.

Strategic Goal C: *Develop efficient processes and effective capabilities that are among the best in the public and private sectors.*

Performance Metric C.1: Aid delivery costs per application

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			$9.89	$10.90	$10.85
Performance Result				Baseline	Met	

Target Context:
FSA developed two measures to gauge the efficiency and effectiveness of aid delivery. The first unit cost measure is the aid delivery cost per application. This unit cost tracks the direct cost to process FAFSAs and originate aid in the 12-month period, divided by the number of original FAFSAs processed in the period. The fiscal time period measured is July through June. The FY 2011 baseline was $9.89.

Analysis of Progress:
The unit cost for Aid delivery is $10.85. This unit cost reflects data for the four quarters ending June 30, 2012 (FY 2011/Quarter 4 through FY 2012/Quarter 3) because the full FY 2012 unit costs are not available until the December-January timeframe. The unit cost for FAFSAs is expected to increase in the near future as FSA refines specific cost assignment methodologies. Origination costs are expected to decrease overall, but anticipated greater capacity gaps in the tier pricing are expected to increase the origination unit cost.

Data Quality and Limitations:
The cost data for this metric is derived from general ledger data uploaded to FSA's Activity-Based Costing model, which is updated on a quarterly basis and reconciled to FSA's Statement of Net Cost, ensuring all costs assigned to FSA are included in the cost model. The FAFSA volumes are derived from the CPS.

Performance Metric C.2: Loan servicing costs per borrower

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			$18.15	$19.64	$18.94
Performance Result				Baseline	Met	

Target Context:
The second measure developed to gauge the efficiency and effectiveness of aid delivery is the loan servicing-related cost per borrower. This unit cost tracks the overall costs of loan servicing operations and maintenance, including labor, nonlabor, and contracts. The FY 2011 baseline was $18.15.

Analysis of Progress:
The unit cost for loan servicing in FY 2012 is $18.94. The loan servicing unit cost reflects a rolling four quarters (FY 2011/Quarter 4 through FY 2012/Quarter 3) time period because the full FY 2012 unit costs are not available until the December to January timeframe. While the loan-servicing unit cost has generally been trending downward in recent years, FSA expects loan-servicing costs to increase over the next several years due to the inclusion of new NFP servicers, which have higher cost structures. Also, FSA expects the maturation of its loan portfolio to increase loan-servicing cost. Specifically, FSA expects the proportion of borrowers that enter repayment to increase over the next few years. Based upon the fee structure of FSA's contracts with loan servicers, fees for servicing loans in repayment, as opposed to loans for borrowers in-school, are greater. Therefore, this expected increase in loans in repayment will increase FSA's servicing costs.

Data Quality and Limitations:
Data for this measure are derived from FSA's Activity-Based Costing model, which is updated on a quarterly basis and reconciled to FSA's Statement of Net Cost, ensuring all costs assigned to FSA are included in the cost model. Specifically, the measure is defined as the total direct costs for servicing in the year ending June 30, divided by the average number of borrowers in servicing for the year.

FSA Fact

FSA launched a new online application process for the Income-Based Repayment Plan. This new application will enable borrowers with eligible loans to apply for repayment options under the Income-Based Repayment Plan with greater ease and greater accuracy. For more information, go to: StudentAid.gov/repay-loans/understand/plans/income-based.

Strategic Goal D: *Ensure program integrity and safeguard taxpayers' interests.*

Performance Metric D.1: Improper Payment rate

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	**New performance measure (Prior-year data not available)**				Set baseline	Pell Grant 2.10% Direct Loan 0.58% FFEL 1.93%
Performance Result					**Met**	

Target Context:
Because FSA has a wide array of programs, each with unique objectives, eligibility requirements, and payment methods, it is critically important to continue to improve quality control and reduce improper payments. The FY 2012 draft baseline improper payment rate for Pell Grants is 2.10 percent, down from 2.72 percent last year. The Direct Loan improper payment rate estimate is 0.58 percent, up from 0.22 percent last year. The FFEL improper payment rate estimate is 1.93 percent. No rate was reported for FFEL last year. FSA anticipates both the Direct Loan and FFEL estimates will result in amounts below the OMB threshold.

Analysis of Progress:
This new methodology represents significant improvement over prior year approaches. It offers a consistent approach across programs to develop statistically valid estimates that consider all relevant risk factors. The prior year methodology for Pell Grants focused solely on one risk: the risk related to inaccurate applicant self-reporting of financial data on their FAFSA. FSA anticipates that the Pell Grant Program may fall below the current $750 million OMB threshold for high-priority programs. The Pell Grant Program is currently classified as a high-priority program based on prior year estimates. This year's Direct Loan estimation methodology evaluated program review test data for originations/disbursements at sample schools; last year FSA relied on a survey of school audit data and associated audit liabilities in the Postsecondary Education Participants System.

Data Quality and Limitations:
FSA implemented a new methodology to estimate improper payments for risk-susceptible programs for FY 2012 *AFR* reporting. These programs include Pell Grant, Direct Loan, and FFEL. Execution of this new methodology resulted in a new baseline for each program and FSA will continue to coordinate with OMB to obtain approval on the final approach, results, and new out-year targets consistent with the new baseline. These approvals will be in place prior to issuance of the Department's *AFR* on November 16, 2012.

Performance Metric D.2: Direct Loan default rate

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	Recent performance measure (Prior-year data not available)			11.3%	<=11.3%	9.6%
Performance Result				Met	Met	

Target Context:
FSA is responsible for overseeing approximately $141.9 billion in annually disbursed aid and overseeing a loan portfolio valued at more than $948 billion. Safeguarding taxpayer resources requires accurate oversight and management. One indication of FSA's performance is the rate at which borrowers default on their loans.

Analysis of Progress:
For the second year in a row, FSA exceeded the Direct Loan default rate performance metric. In efforts to help borrowers avoid default, FSA provides borrowers the early awareness and assistance they need in the form of financial literacy so that they can avoid defaulting on their student loans. This year, FSA implemented a web-based set of 5 interactive counseling modules available to all students through StudentLoans.gov, an FSA site that currently has over 39 million visits per year. These modules will improve a borrower's understanding of loan obligations and help reduce the risks of delinquency and default.

In addition, the performance-based servicing contracts for the TIVAS require vendors to compete for additional loan volume. This allocation is partially based on the vendor's success in avoiding defaults. Finally, FSA pays the TIVAS a higher borrower servicing fee for those borrowers who are not in a delinquent status.

Data Quality and Limitations:
The default rate for this metric is defined as the average balance of loans that are 270 days or more past due serviced by FSA or its debt collection servicer in the year ending June 30 each year, divided by the average balance of loans serviced by FSA at the end of the year.

FSA Fact

Over 584,000 borrowers applied for the Special Direct Consolidation Loan opportunity. This short-term initiative provided an opportunity for borrowers to reduce their interest rates and have all of their Departmental held loans serviced by one servicer. The initiative ended on June 30, 2012.

Performance Metric D.3: Collection rate

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	New performance measure (Prior-year data not available)				Set baseline	$31.90
Performance Result					N/A	

Target Context:
The Collection Rate metric as defined in the *FSA Strategic Plan: FY 2012–16* only identified the amount of money being collected for the year compared to the total average outstanding portfolio amount for the year (excluding loans in certain non-repayment statuses). This measurement did not provide FSA with actionable results. FSA is always looking for ways to improve on how performance is measured, and aims to measure only what matters and what the organization can effect, regardless of the timing of the Performance Planning cycle. A small working group (including some FSA Operating Committee members) continued to meet on measures after the *FSA Strategic Plan: FY 2012–16* was final. It was during this continuous improvement process that it was determined that a better collection rate methodology was one that reflected the cost of FSA's efforts spent to collect, against what was collected. This new methodology measures FSA's efficiencies—something that the organization can influence and effect.

Analysis of Progress:
The baseline for this new metric is $31.90. The FY 2011 collection rate was also calculated this year and it was $29.97. The $29.97 is provided as a point of comparison and to illustrate improvement year-over-year.

Data Quality and Limitations:
This metric measures the amount of dollars collected from borrowers in the fiscal year per dollar spent to collect. Collections are defined as the total amount of principal collected on both current and defaulted debt during the 12-month period ending June 30 of each year. Costs include the total direct costs calculated for loan servicing plus debt collections for the same period using FSA's Activity-Based Costing process.

Strategic Goal E: *Strengthen FSA's performance culture and become one of the best places to work in the federal government.*

Performance Metric E.1: FSA Morale Index (Subset of questions from government-wide View Point Survey) – % of positive responses to survey (does not include neutral responses)

Fiscal Year	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	
	Actual	Actual	Actual	Actual	Target	Actual
Performance	New performance measure (Prior-year data not available)				58%	—
Performance Result					N/A	

Target Context:
During its updating of the *FSA Strategic Plan: FY 2012–16*, FSA changed the metric for Strategic Goal E: *Strengthen FSA's performance culture and become one of the best places to work in the federal government*. Rather than focus on its rank in government, FSA now uses an FSA Morale Index, which was developed from a subset of questions from the government-wide View Point Survey. This new Index is a better indicator of employee engagement.

Analysis of Progress:
The FY 2012 Actual Performance level was not available for inclusion in this *Annual Report*. The actual result will not be available until after the due date (November 16, 2012) of this Annual Report. Therefore, the actual performance level will be reported in the *FY 2013 Annual Report*.

FSA evaluated and analyzed the seven questions that make up the FSA Morale Index. Those questions range from "I like the kind of work I do" to "Considering everything, how satisfied are you with your job?" The FY 2010 score on the FSA Morale Index was 56.2 percent. The FY 2011 score on the Morale Index of 58 percent was set as the FY 2012 target. These scores are presented as a point of comparison and to illustrate the improvement made each year. Six of the seven morale index numbers increased year over year.

Data Quality and Limitations:
The Morale Index is made up of seven questions from the government-wide View Point Survey. The results measure the percentage of positive responses to those questions, and do not include neutral responses.

FSA Fact

FSA recently launched its new website, StudentAid.gov, which consolidated five websites into one. This new website is the result of several months of collaboration between FSA employees across the organization and is a part of FSA's customer service improvements. To view the new website and all of the improvements, go to: StudentAid.gov.

FY 2012 Accomplishments of Federal Student Aid

During FY 2012, FSA realized additional accomplishments that were not specifically measured by the performance metrics implemented to measure performance against FSA's Strategic Plan. Although not measured by FSA performance metrics, these additional accomplishments were the result of initiatives FSA undertook to support the implementation of this Strategic Plan or legislative changes. This section describes FSA's additional accomplishments.

FSA realized the following additional accomplishments in support of Strategic Goal A: *Provide superior service and information to students and borrowers.*

- In FY 2012, FSA undertook an effort to re-evaluate its current brand and external messaging to ensure alignment with the organization's customer-centric focus and mission, values, and vision. Based on a series of research activities (interviews, focus groups and message testing) with key target audiences, including employees, high school students, their parents, traditional and non-traditional college students, borrowers, high school counselors, financial aid administrators and college access professionals, FSA developed and launched new branding in Summer 2012 that resonates with internal and external customers. FSA's new tagline, "*Proud Sponsor of the American Mind*" emphasizes the important role that the organization plays in supporting America's students while also clearly communicating that money is available for all levels of education.

- FSA launched the Integrated Student Experience (ISE) initiative to establish an integrated, customer-focused web experience for students, parents, and borrowers to facilitate decision-making about funding a postsecondary education. The ISE initiative will provide students and parents with an enhanced customer experience across the student aid lifecycle, with the goal of increasing financial aid awareness and college attendance, while simplifying the application and servicing processes. ISE will simplify and streamline FSA's web presence by consolidating content from 13 sites into StudentAid.gov and by standardizing web content to a single, plain-speaking voice. In FY 2012, FSA:

    - developed web designs and tested the designs with focus groups; and
    - installed a content management system that will serve as a repository for information to be used on its websites, publications, and in new media, etc., to facilitate seamless updates to these forums for FSA business owners.

- In January 2012, FSA released @FAFSA on Twitter at the inaugural monthly "*Office Hours"* event. Based on the success of that event, FSA held monthly issue-specific Twitter town hall events such as the one featuring an online conversation about Financial Literacy to commemorate National Financial Literacy Awareness Month. FSA has leveraged the @FAFSA Twitter feed to build awareness of and promote Department events such as the Vice President's Twitter town hall forum around college affordability.

FSA realized the following additional accomplishments in support of Strategic Goal B: *Work to ensure that all participants in the system of funding postsecondary education serve the interests of students, from policy to delivery.*

- The *SAFRA Act* required the Department to enter into agreements with eligible and qualified NFP loan servicers to service government-held student loans. In FY 2012, the Department entered into contracts with 7 firms representing 27 NFPs to service loans. These new NFPs now service more than 4 million borrower accounts. All implementations occurred on schedule. To implement the *SAFRA Act* legislation, FSA worked closely with each new NFP to ensure a successful launch and the smooth transition of borrower accounts from the Common Services Borrower contractor. FSA employed a variety of communication resources to fully inform and engage FSA's partners and stakeholders in this effort.

- In FY 2012, FSA implemented a web-based set of five interactive entrance and exit counseling modules. These modules are available to all students through StudentLoans.gov, an FSA site that currently has more than 39 million visits per year. Student loan borrowers are required by statute to take entrance and exit counseling that detail their rights and responsibilities as borrowers. Some schools supplement these mandatory counseling sessions with additional student loan and financial literacy information at their own expense, but these efforts vary in quality and are not available to all students. Full implementation of these modules represents a major improvement in FSA's capacity building, as this initiative addresses a critical need for thousands of schools and millions of borrowers that was previously addressed in an ad-hoc manner.

FSA realized the following additional accomplishments in support of Strategic Goal C: *Develop efficient processes and effective capabilities that are among the best in the public and private sectors.*

- FSA worked with the IRS to find ways to increase usage of the FAFSA-IRS Data Retrieval process to further simplify the aid application process, to improve the accuracy of aid awards, and to reduce administrative burden on families and institutions. Changes to the FAFSA-IRS Data Retrieval process and the enhancements to the verification process improve the administration and integrity of the Federal Pell Grant Program by ensuring that applicants receive the correct amount of a Pell Grant for which they are eligible and that Pell Grants go to the neediest applicants, as required by the law. In addition, these changes will further reduce the complexity and burden on applicants and on institutions as compared to the current manual and paper-based verification process, both well-documented barriers to accessing student aid and ultimately postsecondary opportunities. For the 2012–13 academic year, if applicants have not filed tax returns at the time the FAFSA is completed, FSA will remind applicants using emails and other communications that once they have filed their income tax return they should use the FAFSA corrections process to update their FAFSA using the FAFSA-IRS Data Retrieval process.

- In FY 2012, FSA established a Cost-Benefit methodology and template to provide structure to measuring the cost impact of initiatives. Prior to these accomplishments, the measurement of cost savings and avoidances were vague and lacked transparency. Cost-benefit justifications lacked details supporting costs and benefits and there was no connection between the project cost savings and budget line items in order to track the financial progress of the initiative. This process is helpful to drive the required resource conversations and agreements between involved stakeholders. In the past, such agreements for resources were not clearly stated and resources were not secured.

FSA realized the following additional accomplishments in support of Strategic Goal D: *Ensure program integrity and safeguard taxpayers' interests.*

- In FY 2012, FSA enhanced the Guaranty Agency (GA) Forms 2000 from legacy Oracle forms to web-based pages. This change makes user-based customization possible, and reduces the costs of future upgrades to FSA's financial management system, FMS, by using open standard formats. This initiative was the first time FSA's webinar capability was utilized, and it successfully demonstrated the new functionality to more than 40 members of the guarantor community. For testing, Finance had more than 30 members of the industry participate in the FSA software-testing environment. The guarantors' high satisfaction with the new forms is due to their involvement in all phases of the development effort.

- FSA successfully implemented Pay.gov functionality to allow GAs to initiate payments online. Pay.gov, a Treasury application, is a secure and efficient collection portal. This was accomplished by leveraging current lender functionality to create two new payment forms and subsequently provided the GAs with a live demonstration during the January webinar. FSA has collected approximately $346 million from GAs through Pay.gov during FY 2012.

FSA realized the following additional accomplishments in support of Strategic Goal E: *Develop FSA's performance culture and become one of the best places to work in the federal government.*

- FSA First Class is the principal vehicle that FSA uses to engage its employees in meaningful programming and dialogue about improving both FSA's culture and the overall employee experience. FSA Cares, the community involvement component of First Class, partnered with other federal agencies and community service organizations to provide events in which its employees could interact with other FSA employees outside of the office, while participating in volunteer activities within the local community. FSA volunteers participated in several events, which included running in the Susan G. Komen Race for the Cure, assisting in the building of a playground for underprivileged children in Washington, DC; and working with the DC Habitat for Humanity to renovate two houses.

  FSA, in conjunction with the Partnership for Public Service, continues to enhance leadership development opportunities for its employees who aspire to greater managerial roles, under its FSA First Class Managers program. The inaugural FSA's First Class Managers cadre sponsored the first FSA-wide employee engagement event called "FSA Day." "FSA Day" focused on educating employees about the work FSA performs that benefits students and schools, and offered employees the opportunity to network with colleagues whom they had not previously met, and discuss ideas and innovative ways to spur better performance and more streamlined processes and efficiencies. This program fulfills one of FSA's major human capital goals of strengthening fundamental management and leveraging those resources throughout the organization.

- During FY 2012, FSA evaluated and analyzed more than 20 sets of data derived from the 2011 Employee Viewpoint Survey. Among the many results, FSA noted three to five basis point increases in its Morale Index. Six of the seven index questions saw increases, with only one category declining over the previous year's survey results. Similarly, FSA saw a record increase in survey participation levels (ten basis points over the previous year), and continued, incremental progress overall (3.8 point increase among all federal sub-component agencies).

- In its continuing effort to improve communications at FSA, FSA established an Employee Communications Council in FY 2012. The purpose of this group is to provide a forum where employees can make suggestions and provide feedback to FSA Communications on a variety of internal communications efforts. The brainchild of last year's Foundations of Leadership Program, the Employee Communications Council is comprised of mid-level employee volunteers from across the organization. The team convenes monthly to discuss topics of interest within their business unit as well as internal communications initiatives within FSA. Suggestions and feedback provided by this Council have helped drive more useful communications across the organization and created a more informed and engaged workforce.

- In FY 2012, FSA also developed and implemented a comprehensive communications plan to launch the new FSA branding to employees. This effort included the development of an employee video that showcased the work of FSA employees and their impact on society as *Proud Sponsors of the American Mind* and a poster campaign featuring employees to encourage excitement about the new brand and encourage participation at the all-employee meeting.

FSA Fact

FSA uses social media tools to share information about its programs. To ensure access to the latest information updates, follow FSA on Twitter @*FAFSA* or like FSA on Facebook.

Legislative and Regulatory Recommendations

One of FSA's mission responsibilities is to provide input on legislative proposals (both from the Congress and from the administration) and to support the Department's regulatory activity. FSA also may suggest legislative changes for consideration by the Department's senior policy officials. These recommendations customarily center on improving and simplifying the Title IV programs, minimizing administrative costs, and improving program integrity. FSA's recommendations inform the Department's policymaking process, including its activities and decisions related to each year's budget process. These activities are usually accomplished by direct contact with colleagues within various offices of the Department, such as the Office of Postsecondary Education and the Office of the Under Secretary, at both the senior policy level and at a staff level. While a portion of this policy advising is accomplished on an ongoing, informal daily basis, during the past year, FSA provided specific recommendations to policy officials on the following issues: (1) enhancing and improving the FAFSA – IRS Data Exchange, (2) implementation of an IRS data exchange for borrowers applying for Income Based Repayment, (3) creation and implementation of seven experiments under the HEA Experimental Sites Initiative, and (4) various budget and legislative initiatives. In addition, FSA's staff also contributed to the Department's Rulemaking process, including changes to the TPD process, implementation of the Pay As You Earn repayment plan, and revisions to the process by which reasonable and affordable payments are determined for borrowers who are attempting to rehabilitate their defaulted loans. FSA staff also supported colleagues in the Office of Postsecondary Education with fulfilling the statutory requirements to develop a model financial aid award letter.

FSA Fact

In December 2011, President Obama signed the Consolidated Appropriations Act, 2012, which made several important changes to FSA's Title IV programs. To find more about those changes, go to: StudentAid.gov/about/announcements/recent-changes.

Annual Bonus Awards

As of the end of FY 2012, there were 51 FSA senior managers. In addition, there were nine Senior Executive Service staff members. Eight of the 51 senior managers and 3 of the 9 Senior Executive Service staff served on the FSA Operating Committee, and reported directly to the COO. The remaining 43 senior managers and 6 Senior Executive Service staff served in a variety of senior positions and capacities within FSA.

FY 2012 performance ratings and related awards for FSA senior managers and Senior Executive Service staff were not finalized at the time this report was prepared.

At the end of FY 2011, there were 75 FSA senior managers. There were also eight Senior Executive Service members. Seven of the 75 senior managers and 3 of the 8 Senior Executive Service staff served on the FSA Operating Committee and reported directly to the COO. The remaining 68 senior managers and 5 Senior Executive Service staff served in a variety of senior positions and capacities within FSA.

For FY 2011, the composition of ratings for the 68 senior managers who did not serve on the Operating Committee last year were as follows: 20 achieved a performance rating of Outstanding, 23 achieved a performance rating of High Results and 25 achieved a performance rating of Results Achieved.

Award amounts for those senior managers achieving an Exceptional rating ranged from a low of $6,647 to a high of $14,000 with a median award of $9,702. Award amounts for those achieving a High Results rating ranged from a low of $1,518 to a high of $13,594 with a median award of $4,958.

In FY 2011, the COO received a performance bonus of $38,350 for his work at FSA. There were also FY 2011 ratings and awards for seven senior manager members and three Senior Executive Service members of the Operating Committee. The composition of those rated includes: five achieved a performance rating of Exceptional; five achieved a performance rating of High Results, and none who received a performance rating of Results Achieved. Of the five remaining Senior Executive Service members who were not on the Operating Committee, none achieved a performance rating of Exceptional, one achieved a performance rating of High Results, three achieved a performance rating of Results Achieved, and one was not rated.

Award amounts for those Operating Committee members achieving an Exceptional rating ranged from a low of $16,392 to a high of $32,037, with a median award of $20,607. Award amounts for those achieving a High Results rating ranged from a low of $13,594 to a high of $29,920, with a median award of $25,007. The Senior Executive Service member who was not on the Operating Committee achieved a High Results rating at both a high and median award of $11,482. The remaining three Senior Executive Service members' received a rating of Results Achieved and were not eligible for a performance-based award. One Senior Executive Service member was not rated and was also not eligible for a performance-based award.

For additional information, please refer to:
Higher_Education_Amendments_1998/sec101D.html

Report of the Federal Student Aid Ombudsman

The FSA Ombudsman Group entered its 13th year of service to federal student aid recipients in FY 2012. Established by the 1998 amendments to the HEA, the Ombudsman began operations on September 30, 1999, and assisted its 250,000th customer during FY 2012.

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

Since 1999, the Ombudsman has received 260,362 assistance requests, including 34,909 in FY 2012. The Ombudsman has generally received more customer contacts in each succeeding year of operation. The annual increase is, in part, attributable to growing awareness of the Ombudsman and the increase in the number of individuals receiving federal student aid. As the table below indicates, the number of customer contacts to the Ombudsman increased at a rate higher than historical experience for several years before tapering off recently.

FY	New Customer Contracts	Percentage Change from Previous FY
2009	23,765	+25.0%
2010	30,346	+27.7%
2011	32,922	+8.5%
2012	34,909	+6.0%

The Ombudsman classifies customer contacts as one of two types: General Assist, which are typically resolved almost immediately through the provision of information or referral to the appropriate entity with the student loan community; and Research, which present a more complex problem, are assigned to a research specialist to address and may take several months to close. As the table below demonstrates, the number of Research cases received by the Ombudsman has been increasing and accounts for a greater percentage of total customer contacts.

FY	Research Cases	Percentage Change in Research Cases from Previous FY	Research Cases as Percentage of Total Customer Contacts
2009	5,262	+ 6.5%	+22.1%
2010	6,828	+ 29.8%	+22.5%
2011	8,208	+ 20.2%	+24.9%
2012	11,570	+ 41.0%	+33.1%

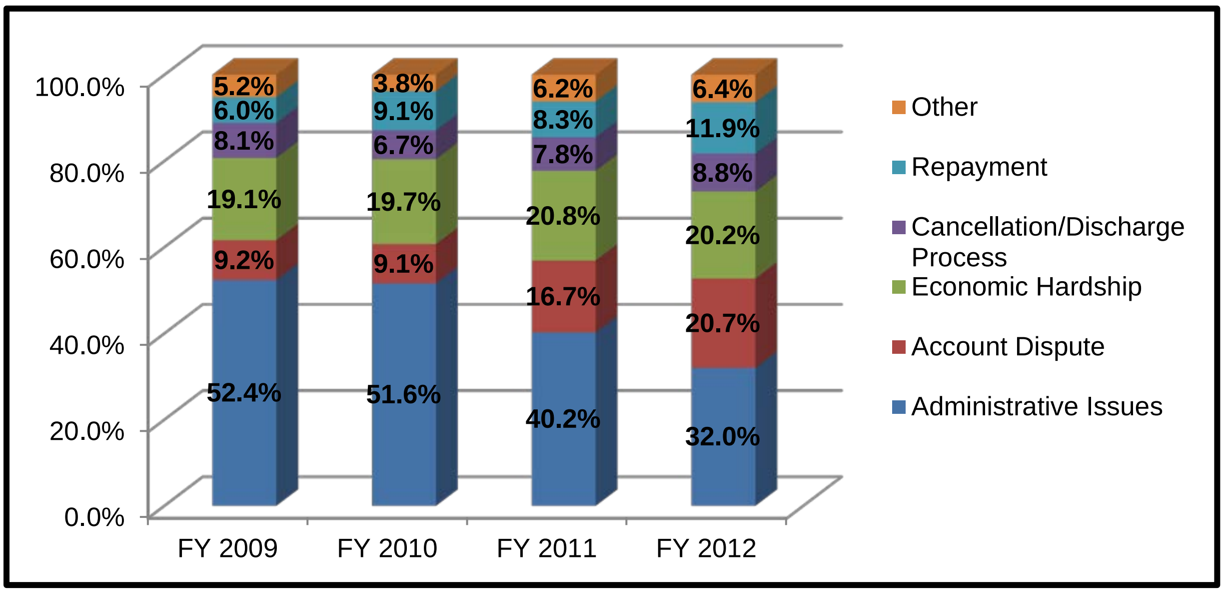
Factors Contributing to the Increase in Research Cases

The number of Research cases is driven by the complexity of the problems customers bring to the Ombudsman, and the actions required to resolve them. Several factors are believed to be contributing to the feeling on the part of student loan borrowers that they cannot manage the issues confronting them without the assistance of a third party such as the Ombudsman.

Economic Hardship

The economic downturn that began in 2008 is a major factor driving the increase in customers contacting the Ombudsman and shaping the nature of the problems for which they seek assistance. Borrowers experiencing difficulty meeting their monthly loan payments frequently report job loss, reduced earnings, or the inability to find work upon completion of their educational program.

To develop a better understanding of this phenomenon, the Ombudsman Group analyzed case data beginning with FY 2008 by grouping customer issue categories and sub-categories under a set of broad thematic headings, e.g., administrative issues (requests for general help or information), economic hardship (default, unemployment, or repayment plans), and account dispute (questions concerning account balance, interest accrual, or fees). The chart below demonstrates a steady increase in cases grouped under the thematic heading of economic hardship since 2009.



A difference that first appeared in FY 2011 data was the increase in customer issues grouped under the broad theme of account dispute, i.e., borrowers challenging the balance on their student loan accounts. Borrowers faced with difficulty repaying their student loans appear to be choosing to dispute the amount owed – the way interest was calculated or the addition of collection costs and other fees – as an initial step in managing the debt.

Changes in the Federal Student Loan Portfolio

FY 2012 was a year of significant operational changes in the servicing of the Department-held student loan portfolio. The combined impact of the operational changes and the continuing growth in the Department-held portfolio showed itself as a significant source of growth in the Ombudsman Group volume. The volume of requests for assistance coming to the Ombudsman Group from borrowers in the Department-held portfolio increased by 38.2 percent in FY 2012 over FY 2011, and 91.0 percent over FY 2010.

- **Loan Transfers:** In FY 2012, 7 new servicers began Direct Loan servicing operations, and FSA transferred over 4 million borrowers to these new servicers. As a result of the transfer to a new servicer, some borrowers reported their confusion and dismay over the transfer action to the Ombudsman Group, claiming to have received no notice of the transfer until advised via a letter from their new servicer. Some of these borrowers believed their loans had been sold. Others reported disruptions in existing repayment plans and payment submission arrangements. For some, a loan account transfer compounded payment application problems initiated by a servicing system change.

- **Servicing System Change:** The Department-held portfolio went through two major system conversions early in FY 2012. At the beginning of the fiscal year, the majority of Direct Loan accounts still resided with a single loan servicer; that servicer moved its accounts to a new servicing platform at the beginning of October. Borrowers reported a disruption in online account access to the Ombudsman Group, specifically, being unable to see records of past payments made; delays in payment and paperwork processing; and changes to auto-debit payment arrangements.

  The portfolio of defaulted loans was moved to a new servicing system beginning at the end of FY 2011 and continuing into the early months of FY 2012. The Ombudsman Group's typical annual increase in volume in the second quarter surged in FY 2012 above previous years as borrowers who had defaulted student loans contacted us seeking assistance in securing federal tax refunds that had been offset. Despite having made satisfactory arrangements to repay, including the completion of loan rehabilitation plans, tax refunds were taken, and FSA experienced significant delays in reviewing and approving the transmission of overpayments. The impact of the defaulted loan portfolio servicing system change was felt well in into the third quarter of FY 2012, beginning to abate only as the end of the fiscal year approached.

Launch of the Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau (CFPB) was created by the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*. The statute also provided for the creation of the CFPB Private Education Loan Ombudsman. The FSA Ombudsman worked closely with CFPB through the developmental phases leading to the launch of its Private Education Loan Ombudsman, and the Department collaborated in the development of the Student Debt Repayment Assistant, a web-based interactive tool to assist individuals in managing their student loan debt.

The CFPB Private Education Loan Ombudsman established a website to provide information and assistance to borrowers experiencing problems with student loans. Because its mission is focused on private education loans, visitors to the site with federal student loans were directed to the FSA Ombudsman website where they were able to submit an online request for assistance.

Through the first months of FY 2012, customer contacts to the FSA Ombudsman submitted online represented roughly seven to eight percent of the total number of requests for assistance received each month. After the CFPB Private Education Loan Ombudsman website became active in March 2012, customer requests for assistance through the Ombudsman Group website increased to 22.9 percent in June and 11.7 percent in July. The percentage of Ombudsman customer contacts submitted online returned to historic levels in August and September. It is believed that referrals from the CFPB website were a major part of the increase, and that the peaks were associated with times when CFPB activities received greater media attention.

Total and Permanent Disability

The process for discharging federal student loans for borrowers who become totally and permanently disabled has historically been a major reason for contacts to the FSA Ombudsman, and this issue has been addressed in previous annual performance reports. In April 2011, FSA assigned processing of TPD applications to a new contractor, Nelnet/TPD.

Since the change of contractors, the Ombudsman has observed improvements in the process. Processing times for applications have been shortened. In addition, there has been a noticeable focus on customer service. Borrowers seeking disability discharges have access to a toll free telephone number staffed by customer service representatives trained in the TPD process. The new TPD contractor has also increased outreach to TPD applicants to reduce the number of borrowers who are denied a discharge for failure to comply with procedural requirements. The contractor has also created a liaison with the Ombudsman Group to both facilitate resolution of problems borrowers bring to the Ombudsman and to identify potential systemic problems to be addressed.

Current regulations require the TPD applicant to submit a discharge application to each discrete loan holder. This has resulted in situation where a borrower has some loans in TPD discharge and others in collection because of the failure to submit an application to all loan holders. The Department has promulgated new regulations, which will be published shortly, that will allow the borrower to submit a single TPD application directly to the Department. The Ombudsman applauds this change and believes it will eliminate a significant source of difficulty for borrowers seeking TPD discharge.

Ombudsman Group Initiatives

Consistent with a long focus on data-driven decision-making, during FY 2012, the Ombudsman took steps to improve the quality of information captured about the nature of requests for assistance it receives. Case classification categories were revised, and new case closing categories were added to better reflect outcomes and allow tracking of the extent to which Ombudsman staff has been able to satisfy customer concerns.

On May 8 and 9, 2012, the Ombudsman hosted the annual meeting of the Federal Student Loan Ombudsman Caucus at FSA headquarters in Washington. Approximately 40 ombudsman colleagues from lenders, loan servicers, and guaranty agencies convened to discuss common issues, hear updates on developments in the student loan field, and hear a presentation from the leadership of the CFPB Private Education Loan Ombudsman.

Ombudsman Group Effectiveness

Customer satisfaction with the Ombudsman is measured, in part, through independently conducted telephone surveys. Closed cases are chosen at random and customers are asked to rate service accessibility, Ombudsman representative's knowledge, timeliness of case resolution, level of satisfaction with the resolution, and overall service. On a scale of 1 to 5, with 5 the highest rating, survey results are calculated weekly and cumulatively for the fiscal year. Only ratings of 4.0 or higher meet the Ombudsman customer satisfaction performance goal. The average FY 2012 customer satisfaction for Research cases was 4.48 on a 5.00 scale. Customers also write or call independently to express appreciation for assistance from the Ombudsman.

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Financial Section

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Message From the Chief Financial Officer

Federal Student Aid
An OFFICE of the U.S. DEPARTMENT of EDUCATION
PROUD SPONSOR of the AMERICAN MIND™


John W. Hurt, III
Chief Financial Officer

During FY 2012, FSA delivered $141.9 billion of federal aid to 15 million postsecondary students and their families. In addition, the loan portfolio overseen by FSA grew by 11.8 percent, from $848 billion to $948 billion. This is an enormous financial responsibility to students seeking student financial assistance, borrowers who are paying off their student loans, and taxpayers who expect fiscal prudence and stewardship. Thanks to the dedicated and talented staff at the Department, we met the unprecedented challenges presented by this financial responsibility and continued to maintain our high standards of financial management and fiscal reporting. As a result of these efforts, FSA achieved an unqualified audit opinion on its financial statements for the eleventh consecutive year.

Examples of FSA's successful financial management include the following:

- FSA established a more comprehensive methodology for estimating improper payments for its three largest programs (i.e., Direct Loans, Pell Grants, and FFEL loan guaranty). This new methodology represents significant improvement over prior year approaches as it offers a consistent approach across programs to develop statistically valid range estimates that consider relevant risk factors. The prior year methodology for Pell Grants focused solely on one risk: the risk related to inaccurate applicant self-reporting of financial data on their FAFSA. During FY 2012, FSA continued to make progress reducing improper payments associated with inaccurate self-reporting of financial data on the FAFSA. As a result of our efforts in FY 2012, we anticipate that the Pell Grant Program may fall below the current $750 million OMB threshold for high-priority programs. In addition, this new methodology also allows FSA to broaden the measurement to include more improper payment risks and to identify additional root causes to better inform decisions on comprehensive corrective actions. The methodology will also facilitate efforts over time to assess the impact of specific oversight and monitoring efforts on rate reduction. For more information regarding FSA's assessment of improper payment risk and planned strategies to mitigate this risk, please refer to the Improper Payments Reporting Details narrative in the Other Accompanying Information section in the Department's *AFR* located at **http://www.ed.gov/about/reports/annual/index.html**.

- As taxpayers require greater scrutiny on government expenditures and administrative budgets throughout the government are drastically reduced, FSA continues to fulfill its strategic objective to reduce administrative costs. FSA tracks all cost savings, cost avoidances, and productivity gains from the point they are conceived in FSA's business cases, all the way to actual realization. The cost savings and cost avoidance amounts calculated include all current year and future year cost impacts. This year, FSA implemented actions that will realize $75.4 million in cost savings and cost avoidances through FY 2020.

- The loan portfolio that FSA oversees is fast approaching one trillion dollars. To better track and analyze the risks associated with collecting on this debt, FSA has documented our debt collection operating model and begun to develop associated metrics. This model provides an overview of the loan portfolio, broken out by asset ownership and collection activities. In the context of this model, FSA has developed and continues to refine metrics for different levels of collection activities. In the coming year, FSA intends to further refine debt collection metrics and analyze these metrics for collection improvement opportunities.

During the current fiscal year, FSA self-identified issues that aggregated to two material weaknesses in internal controls over operations. These two material weaknesses related to the ACES and DMCS2 system conversions and/or functionality that impact the loan servicing and the default collection systems operated by Xerox, LLC. FSA management actively monitored and tracked system functionality issues that resulted from these implementations from the beginning and worked closely with Xerox, LLC to understand the impact and affected processes. Nine corrective action plans, with underlying action items, were requested from and are being implemented by Xerox, LLC to address these issues, for which progress is monitored on an on-going basis. Substantial progress has been demonstrated on the issues related to DMCS2 conversion after June 30, 2012, such that, as of September 30, 2012, management assesses that this reportable condition is no longer a material weakness in the effectiveness of internal control over financial reporting. The results of this assessment effort are described further in the Analysis of Systems, Controls, and Legal Compliance section of this report.

Also, through cooperative efforts between FSA and the Department‘s Office of the Chief Financial Officer, Office of Chief Information Officer, and Budget Service, the Department continued to correct two significant deficiencies in credit reform estimation and information systems controls that were identified in previous internal control reports. The complexity of these issues has required an ongoing multi-year effort. As a result of these concerted efforts, in the FY 2012 Report on Internal Control, the auditors recognized improvements in both areas.

I am proud to be working with a group of professionals throughout the Department who so enthusiastically meet our financial management challenges and achieve such distinguished results.

Sincerely,

John W. Hurt III

John W. Hurt, III
Chief Financial Officer
November 16, 2012

Principal Financial Statements

United States Department of Education
Federal Student Aid
Consolidated Balance Sheet
As of September 30, 2012 and 2011

(Dollars in Millions)

	Fiscal Year 2012	Fiscal Year 2011
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 78,452	$ 62,214
Accounts Receivable (Note 4)		
Total Intragovernmental	78,452	62,214
Cash and Other Monetary Assets (Note 5)	1,307	1,664
Accounts Receivable, Net (Note 4)	123	110
Credit Program Receivables, Net (Note 6)	672,835	529,965
General Property, Plant and Equipment, Net (Note 7)	6	14
Other Assets (Note 8)	15	27
Total Assets (Note 2)	**$ 752,738**	**$ 593,994**
Liabilities:		
Intragovernmental:		
Accounts Payable (Note 9)	$ 1	$ 1
Debt (Note 10)	714,324	546,264
Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5)	1,307	1,664
Payable to Treasury (Note 6)	2,914	3,886
Other Intragovernmental Liabilities (Note 11)	4,095	6,724
Total Intragovernmental	722,641	558,539
Accounts Payable (Note 9)	3,958	4,006
Accrued Grant Liability (Note 12)	2,269	3,036
Liabilities for Loan Guarantees (Note 6)	1,037	10,025
Other Liabilities (Note 11)	60	85
Total Liabilities	**$ 729,965**	**$ 575,691**
Commitments and Contingencies (Note 19)		
Net Position:		
Unexpended Appropriations	$ 30,361	$ 21,441
Cumulative Results of Operations	(7,588)	(3,138)
Total Net Position (Note 13)	**$ 22,773**	**$ 18,303**
Total Liabilities and Net Position	**$ 752,738**	**$ 593,994**

The accompanying notes are an integral part of these statements.

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

(Dollars in Millions)

	Fiscal Year 2012	Fiscal Year 2011
Program Costs		
Increase College Access, Quality, and Completion		
Gross Costs	$ 35,966	$ 16,812
Less: Earned Revenue	25,306	20,212
Net Program Costs	10,660	(3,400)
Total Program Costs	**$ 10,660**	**$ (3,400)**
American Recovery and Reinvestment Act		
Gross Costs	$ 23	$ 27
Less: Earned Revenue		
Net Program Costs	23	27
Total Program Costs	**$ 23**	**$ 27**
Grand Total Program Costs	**$ 10,683**	**$ (3,373)**
Net Cost of Operations (Notes 14 & 17)	**$ 10,683**	**$ (3,373)**

The accompanying notes are an integral part of these statements.

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

(Dollars in Millions)

	Fiscal Year 2012		Fiscal Year 2011	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances				
Beginning Balances	$ (3,138)	$ 21,441	$ (6,812)	$ 17,259
Budgetary Financing Sources:				
Appropriations Received		$ 52,927		$ 47,961
Other Adjustments (rescissions, etc)	$ (1)	(271)		(723)
Appropriations Used	43,736	(43,736)	$ 43,056	(43,056)
Nonexchange Revenue	1		3	
Nonexpenditure Financing Sources - Transfers-Out	(37)		(6)	
Other Financing Sources:				
Imputed Financing from Costs Absorbed by Others	$ 11		$ 12	
Others	(37,477)		(42,764)	
Total Financing Sources				
Total Financing Sources	$ 6,233	$ 8,920	$ 301	$ 4,182
Net Cost of Operations				
Net Cost of Operations	$ (10,683)		$ 3,373	
Net Change				
Net Change	$ (4,450)	$ 8,920	$ 3,674	$ 4,182
Ending Balances (Note 13)	**$ (7,588)**	**$ 30,361**	**$** (3,138)	**$** 21,441

The accompanying notes are an integral part of these statements.

United States Department of Education

Federal Student Aid

Combined Statement of Budgetary Resources

For the Years Ended September 30, 2012 and 2011

(Dollars in Millions)

	Fiscal Year 2012		Fiscal Year 2011	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources:				
Unobligated balance, brought forward, October 1:	$ 3,415	$ 15,004	$ 4,174	$ 15,409
Recoveries of prior year Unpaid Obligations	488	18,649	985	12,192
Other changes in unobligated balance	(499)	(20,691)	(117)	(17,495)
Unobligated balance from prior year budget authority, net	3,404	12,962	5,042	10,106
Appropriations (discretionary and mandatory)	52,919	35	47,859	0
Borrowing Authority (discretionary and mandatory) (Note 16)	0	209,379	0	211,802
Spending Authority from offsetting collections	372	47,210	1,452	40,385
Total Budgetary Resources (Note 16)	**$ 56,695**	**$ 269,586**	**$ 54,353**	**$ 262,293**
Status of Budgetary Resources:				
Obligations incurred: (Note 16)	$ 46,329	$ 251,007	$ 50,938	$ 247,289
Unobligated balance, end of year:				
Apportioned	8,562	(0)	1,214	512
Unapportioned	1,804	18,579	2,201	14,492
Total unobligated balance, end of year	10,366	18,579	3,415	15,004
Total Budgetary Resources	**$ 56,695**	**$ 269,586**	**$ 54,353**	**$ 262,293**
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1	$ 23,240	$ 164,196	$ 18,592	$ 150,605
Uncollected customer payments from Federal Sources,	(0)	(5)	(0)	(4)
Obligated balance start of year (net), before adjustments (+ or -)	23,240	164,191	18,592	150,601
Adjustment to obligated balance, start of year (+ or -)	(0)	(0)		
Obligated balance, start of year (net), as adjusted	23,240	164,191	18,592	150,601
Obligations Incurred	46,329	251,007	50,938	247,289
Outlays (gross) (-)	(44,987)	(224,595)	(45,305)	(221,506)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory) (+ or -)		1	(0)	(1)
Recoveries of prior year unpaid obligations	(488)	(18,649)	(985)	(12,192)
Obligated Balance, end of year (net)	(0)	(0)		
Unpaid Obligations, end of year (gross)	24,094	171,959	23,240	164,196
Uncollected customer payments from Federal Sources, end of year	(0)	(4)	(0)	(5)
Obligated balance, end of year	**$ 24,094**	**$ 171,955**	**$ 23,240**	**$ 164,191**
Budget Authority and Outlays, Net				
Budget authority, gross (discretionary and mandatory)	$ 53,291	$ 256,624	$ 49,311	$ 252,187
Actual offsetting collections (discretionary and mandatory)	(559)	(64,607)	(1,719)	(53,011)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory) (+ or -)	(0)	1	(0)	(1)
Anticipated offsetting collections (discretionary and mandatory) (+ or -)	(0)	(0)	(0)	(0)
Budget Authority, net (discretionary and mandatory)	**$ 52,732**	**$ 192,018**	**$ 47,592**	**$ 199,175**
Outlays, gross (discretionary and mandatory)	$ 44,987	$ 224,595	$ 45,305	$ 221,506
Actual offsetting collections (discretionary and mandatory)	(559)	(64,607)	(1,719)	(53,011)
Outlays, net (discretionary and mandatory)	44,428	159,988	43,586	168,495
Distributed offsetting receipts (Note 16)	(40,654)	(0)	(50,197)	0
Agency Outlays, net (discretionary and mandatory) (Note 16)	**$ 3,774**	**$ 159,988**	**$ (6,611)**	**$ 168,495**

The accompanying notes are an integral part of these statements.

Notes to the Principal Financial Statements for the Years Ended September 30, 2012 And 2011

Note 1. Summary of Significant Accounting Policies

Reporting Entity

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

The Direct Loan Program, added to the HEA by the *Student Loan Reform Act of 1993*, authorizes FSA to make loans directly to eligible undergraduate and graduate students and their parents through participating schools. FSA borrows money from the Treasury to fund the loans. The program does not charge interest to eligible borrowers while they are in school or in qualified deferment periods. Under the Direct Loan Program, loans are made to individuals who meet statutorily set eligibility criteria and attend eligible institutions of higher education—public or private two- and four-year institutions, graduate schools, and vocational training schools. Student borrowers who demonstrate financial need also receive federal interest subsidies while the students are in school or in a deferment period.

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

ECASLA authorized the Secretary to purchase or enter into forward commitments to purchase FFEL loans. The Department implemented three activities under this temporary loan purchase authority. These activities are: (1) loan purchase commitments; (2) loan participation purchases; and (3) an ABCP Conduit.

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

Loan Programs. Campus-based programs are not material to these statements and have been included with other programs reported under grant programs.

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

The Recovery Act, enacted on February 17, 2009 as Public Law 111-5, provided funding for improving schools, raising students' achievement, driving reform and producing better results for children and young people for the long-term health of the nation. The Recovery Act funds provided to the Department include additional funding for student aid administration and student financial assistance grant programs managed and administered by FSA. These activities are accounted for separately from non-Recovery Act funds. (See Note 18)

Basis of Accounting and Presentation

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

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

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

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

Use of Estimates

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

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

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

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

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

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

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

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

Budget Authority

Budget authority is the authorization provided by law for the Department and FSA to incur financial obligations that will result in outlays. FSA's budgetary resources include 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.

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

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

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

Assets

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

Fund Balance with Treasury

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

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

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

Accounts Receivable

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

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

Cash and Other Monetary Assets

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

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

FSA and the Department disburse funds to a guaranty agency. A guaranty agency, through its Federal Fund, pays lender claims and pays default aversion fees into its own Operating Fund. The Operating Fund is the property of the guaranty agency and is used by the guaranty agency to fulfill responsibilities that include repaying money borrowed from the Federal Fund and performing default aversion and collection activities.

Credit Program Receivables and Liabilities for Loan Guarantees

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

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

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

General Property, Plant and Equipment

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

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

Depreciable Property and Equipment

(In Years)

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

Other Assets

Other assets include assets not reported separately on the balance sheet. FSA's other assets (with the public) consist of payments made to grant recipients in advance of their expenditures and in-process disbursements of interest benefits and special allowance payments for the FFEL Program. (See Note 8)

Liabilities

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

Accounts Payable

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

Debt

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

Accrued Grant Liability

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

Net Position

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

Personnel Compensation and Other Employee Benefits

Annual, Sick, and Other Leave. The liability for annual leave, compensatory time off, and other vested leave is accrued when earned and reduced when taken. Each year, the accrued annual leave account balance is adjusted to reflect current pay rates. Annual leave earned but not taken, within established limits, is funded from future financing sources. (See Note 11) Sick leave and other types of non-vested leave are expensed as taken**.**

Retirement Plans and Other Retirement Benefits. Employees participate either in 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 DOL, which pays valid claims and subsequently seeks reimbursement from the Department for these paid claims.

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

Intragovernmental Transactions

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

Reclassifications

Certain reclassifications were made to the FY 2011 financial statements and notes to conform to the current year presentation. These changes had no effect on total assets, liabilities, net position, net cost of operations, or budgetary resources. In accordance with requirements contained in OMB Circular A-136, *Financial Reporting Requirements*, and effective for FY 2012 reporting, the presentation of the Statement of Budgetary Resources was changed to better align with the new format of the SF-133 Report on Budget Execution and Budgetary Resources. Additional reclassifications were made within the Loan Purchase Commitment and Loan Participation Purchase Reconciliation of Allowance for Subsidy sections of Note 6, Credit Programs for Higher Education, and within Note 14, Intragovernmental Cost and Exchange Revenue by Program.

Additional Comparative Information

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

Note 2. Non-Entity Assets

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

Non-Entity Assets

(Dollars in Millions)

	2012	2011
Non-Entity Assets		
With the Public:		
Cash and Other Monetary Assets	$ 1,307	$ 1,664
Accounts Receivable, Net	28	7
Credit Program Receivables, Net	351	215
Total Non-Entity Assets	**1,686**	**1,886**
Entity Assets	751,052	592,108
Total Assets	$ 752,738	$ 593,994

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

Note 3. Fund Balance with Treasury

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

Fund Balances

(Dollars in Millions)

	2012	2011
General Funds	$ 33,139	$ 24,976
Revolving Funds	45,299	37,221
Special Funds	14	17
Fund Balance with Treasury	**$ 78,452**	**$ 62,214**

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

Status of Fund Balance with Treasury

(Dollars in Millions)

	2012	2011
Unobligated Balance:		
Available	$ 8,562	$ 1,726
Unavailable	19,076	15,029
Obligated Balance, Not Yet Disbursed	50,814	45,459
Fund Balance with Treasury	**$ 78,452**	**$ 62,214**

Note 4. Accounts Receivable

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

Accounts Receivable

(Dollars in Millions)

	2012		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ -	$ -	$ -
With the Public	123	-	123
Accounts Receivable	**$ 123**	**$ -**	**$ 123**

	2011		
	Gross Receivables	Allowance	Net Receivables
Intragovernmental	$ -	$ -	$ -
With the Public	136	(26)	110
Accounts Receivable	**$ 136**	**$ (26)**	**$ 110**

Note 5. Cash and Other Monetary Assets

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

Cash and Other Monetary Assets

(Dollars in Millions)

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

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

Note 6. Credit Programs for Higher Education

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

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

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

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

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

During FY 2009, the Department, Treasury, and OMB established the terms on which the Department would support an ABCP Conduit to provide liquidity to the student loan market. An ABCP Conduit issues short-term commercial paper to investors; this paper is backed by student loans pledged to the conduit. The conduit used the proceeds of sales of its commercial paper to acquire from lenders interests in student loans. Lenders must have used a portion of conduit payments to make new loans or acquire FFEL loans. Though the intent is for the conduit to meet demands on maturing paper by reissuing commercial paper, the Department, using its ECASLA authority, will purchase loans from the conduit as needed to ensure the conduit will be able to meet the demands on its paper if it is unable to refinance maturing commercial paper. The Department purchases certain pledged loans that become more than 210 days delinquent. The conduit has sold to the Department approximately $2.2 billion of these delinquent loans as of September 30, 2012. Under the terms of the Put Agreement with the conduit, the Department may purchase pledged loans 45 days prior to the Put Agreement expiration on January 19, 2014. As required by the Credit Reform Act, all cash flows to and from the Government resulting from its transactions with the ABCP Conduit are recorded in a non-budgetary credit financing account. Amounts in this account are a means of financing and are not included in budget totals. Loans originated in academic years 2004-05 through 2007-08, and pledged to the conduit prior to July 1, 2010, are eligible to be purchased through the ABCP Conduit.

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

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

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

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

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

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

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

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

Loan Consolidations

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

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

Modifications of Subsidy Cost

The recorded subsidy cost of a loan is based on a set of assumed future cash flows. Government actions that change these assumed future cash flows change subsidy cost and are recorded as loan modifications. Loan modifications are recognized under the same accounting principle as subsidy re-estimates. Modification adjustment transfers are required to adjust for the difference between current discount rates used to calculate modification costs and the discount rates used to calculate cohort interest expense and revenue. Separate amounts are calculated for modification costs and modification adjustment transfers. The Department modified loans in fiscal year 2012, while no modifications occurred in fiscal year 2011. Two modifications were implemented in FY 2012; the first is related to the interest rates used in the calculation of special allowance payments and the second is the offering of Special Direct Consolidation Loans. Both modifications affect FFEL subsidy costs for cohort year 2010 and prior.

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

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

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

Credit Program Receivables

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

Credit Program Receivables, Net

(Dollars in Millions)

	2012	2011
Direct Loan Program Loan Receivables, Net	$ 526,035	$ 381,454
FFEL Program		
Guaranteed Loan Program, Net (Pre-1992)	2,697	3,675
FFEL Program (Post-1991):		
FFEL Guaranteed Loan Program, Net	29,644	28,627
Temporary Loan Purchase Authority:		
Loan Purchase Commitment, Net	41,145	42,116
Loan Participation Purchase, Net	70,888	72,682
ABCP Conduit, Net	1,731	943
Federal Perkins Program Loan Receivables, Net	351	215
TEACH Program Receivables, Net	344	253
Credit Program Receivables, Net	**$ 672,835**	**$ 529,965**

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

Direct Loan Program Loan Receivables, Net

(Dollars in Millions)

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

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

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

FFEL Program Receivables, Net

(Dollars in Millions)

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

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

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

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

Reconciliation of Allowance for Subsidy and Liability for Loan Guarantees

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

Direct Loan Program Reconciliation of Allowance for Subsidy

(Dollars in Millions)

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

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

[2] Loan cancellations include write-offs of loans because the primary borrower died, became disabled, or declared bankruptcy.

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

FFEL Program Reconciliation of Liabilities for Loan Guarantees

(Dollars in Millions)

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

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

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

Loan Purchase Commitment Reconciliation of Allowance for Subsidy

(Dollars in Millions)

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

Loan Participation Purchase Reconciliation of Allowance for Subsidy

(Dollars in Millions)

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

Financing Account Interest Expense and Interest Revenue

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

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

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

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

Direct Loan Program

(Dollars in Millions)

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

Payable to Treasury

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

Payable to Treasury

(Dollars in Millions)

	2012	2011
Future Liquidating Account Collections, Beginning Balance	**$ 3,886**	**$ 2,424**
Valuation of Pre-1992 Loan Liability and Allowance	(548)	1,787
Capital Transfers to Treasury	(424)	(325)
Future Liquidating Account Collections, Ending Balance	**2,914**	**3,886**
Payable to Treasury	**$ 2,914**	**$ 3,886**

Subsidy Expense

William D. Ford Federal Direct Loan Program

Direct Loan Program Subsidy Expense

(Dollars in Millions)

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

William D. Ford Federal Direct Loan re-estimated subsidy cost was adjusted upward by $12.2 billion in FY 2012. Costs increased $10.3 billion due to updated economic assumptions, including probabilistic estimating, discount rates, and weighted consolidation loan interest rates. Direct Loan death, disability, and bankruptcy rates increased cost by $478 million due to increased disability claims. Costs increased $538 million due to slight decreases in loan volume, concentrated in negative subsidy loan types and default rates increased resulting in $604 million in cost. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan subsidy cost $2.0 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994-2011.

William D. Ford Federal Direct Loan re-estimated subsidy cost was adjusted downward by $11.6 billion in FY 2011. Costs decreased $5.7 billion due to updated economic assumptions, including probabilistic estimating, discount rates, and weighted consolidation loan interest rates. The availability of new information allowed Direct Loan death, disability, and bankruptcy rates to be estimated directly rather than having to use the FFEL rates, reducing cost by $1.5 billion. The decrease in costs is due to lower bankruptcy rates used in formulating the estimate for Direct Loans. Court action usually prevents discharges of Direct student loans. Costs decreased by $1.0 billion due to updated actual activity indicating slightly lower rates of prepayments, resulting in higher interest earnings from borrowers. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan subsidy cost $1.1 billion. Re-estimated costs only include those cohorts that are 90 percent disbursed; cohort years 1994-2010.

Federal Family Education Loan Program

FFEL Program Subsidy Expense

(Dollars in Millions)

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

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

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

Subsidy Rates

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

Subsidy Rates—Cohort 2012

	Interest Differential/ Supplements	Defaults	Fees	Other	Total
Direct Loan Program	(21.92%)	1.59%	(1.21%)	6.33%	(15.21%)
TEACH Program	1.55%	0.56%	0.00%	8.14%	10.25%

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

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

Administrative Expenses

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

Administrative Expenses
(Dollars in Millions)

	2012		2011	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	$ 543	$ 321	$ 661	$ 388
Other Expense	26	16	30	18
Administrative Expenses	**$ 569**	**$ 337**	**$ 691**	**$ 406**

Note 7. General Property, Plant, and Equipment

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

General Property, Plant, and Equipment
(Dollars in Millions)

	2012		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software, and Telecommunications Equipment	$ 125	$ (119)	$ 6
Furniture and Fixtures	2	(2)	-
General Property, Plant, and Equipment	**$ 127**	**$ (121)**	**$ 6**

	2011		
	Cost	Accumulated Depreciation	Net Asset Value
Information Technology, Internal Use Software, and Telecommunications Equipment	$ 125	$ (111)	$ 14
Furniture and Fixtures	2	(2)	-
General Property, Plant, and Equipment	**$ 127**	**$ (113)**	**$ 14**

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

Leases

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

Note 8. Other Assets

Other Assets (with the public) consist of payments made to grant recipients in advance of their expenditures and in-process invoices for interest benefits and special allowances for the FFEL Program. Other Assets (with the public) were $15 million and $27 million as of September 30, 2012 and 2011, respectively.

Note 9. Accounts Payable

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

Accounts Payable

(Dollars in Millions)

	2012	2011
Direct Loan Booking Accrual	$ 2,984	$ 3,044
In Process Disbursements:		
Direct Loans	588	417
Grants	200	128
FFEL Claim Payments	163	271
Other	23	146
Accounts Payable to the public	**3,958**	**4,006**
Intragovernmental Accounts Payable	**1**	**1**
Total Accounts Payable	$ 3,959	$ 4,007

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

Note 10. Debt

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

Debt

(Dollars in Millions)

	2012			
	Beginning Balance	**Borrowing**	**Repayments**	**Ending Balance**
Treasury Debt				
Direct Loan Program	$ 392,374	$ 175,881	$ (18,923)	$ 549,332
FFEL Program				
Guaranteed Loan Program	29,484	13,770	-	43,254
Loan Purchase Commitment	43,859	719	(2,237)	42,341
Loan Participation Purchase	79,302	1,621	(3,631)	77,292
ABCP Conduit	964	1,050	(279)	1,735
TEACH Program	281	119	(30)	370
Total	**$ 546,264**	**$ 193,160**	**$ (25,100)**	**$ 714,324**

	2011			
	Beginning Balance	**Borrowing**	**Repayments**	**Ending Balance**
Treasury Debt				
Direct Loan Program	$ 237,190	$ 167,071	$ (11,887)	$ 392,374
FFEL Program				
Guaranteed Loan Program	10,730	18,754	-	29,484
Loan Purchase Commitment	45,205	1,394	(2,740)	43,859
Loan Participation Purchase	79,577	5,352	(5,627)	79,302
ABCP Conduit	804	250	(90)	964
TEACH Program	150	133	(2)	281
Total	**$ 373,656**	**$ 192,954**	**$ (20,346)**	**$ 546,264**

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

Note 11. Other Liabilities

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

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

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

Other Liabilities
(Dollars in Millions)

	2012		2011	
	Intragovern-mental	**With the Public**	**Intragovern-mental**	**With the Public**
Liabilities Covered by Budgetary Resources				
Current				
Employer Contributions and Payroll Taxes	$ 2	$ -	$ 2	$ -
Accrued Payroll and Benefits	-	9	-	8
Deferred Revenue	-	36	-	62
Liabilities in Miscellaneous Receipt Accounts	3,749	-	6,506	-
Total Other Liabilities Covered by Budgetary Resources	**3,751**	**45**	**6,508**	**70**
Liabilities Not Covered by Budgetary Resources				
Current				
Accrued Unfunded Annual Leave	-	10	-	10
Non-Current				
Accrued Unfunded FECA Liability	2	-	1	-
Liabilities in Miscellaneous Receipt Accounts	342	-	215	-
Accrued FECA Actuarial Liability	-	5	-	5
Total Other Liabilities Not Covered by Budgetary Resources	**344**	**15**	**216**	**15**
Other Liabilities	**$ 4,095**	**$ 60**	**$ 6,724**	**$ 85**

Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary resources include liabilities for which congressional action is needed before budgetary resources can be provided. Although future appropriations to fund these liabilities are likely, it is not certain that appropriations will be enacted to fund these liabilities. Liabilities not covered by budgetary resources totaled $359 million and $231 million as of September 30, 2012 and 2011, respectively.

As of September 30, 2012 and 2011, liabilities on the Balance Sheet totaled $730.0 billion and $575.7 billion, respectively. Of this amount, liabilities covered by budgetary resources totaled $729.6 billion as of September 30, 2012, and $575.5 billion as of September 30, 2011.

Note 12. Accrued Grant Liability

FSA's accrued grant liability was $2,269 million and $3,036 million as of September 30, 2012 and 2011, respectively.

Note 13. Net Position

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

Unexpended Appropriations
(Dollars in Millions)

	2012	2011
Unobligated Balances		
Available	$ 8,562	$ 1,117
Not Available	294	398
Undelivered Orders	21,505	19,926
Unexpended Appropriations	**$ 30,361**	**$ 21,441**

FSA had Cumulative Results of Operations of $(7,588) million as of September 30, 2012, and $(3,138) million as of September 30, 2011. Cumulative Results of Operations consists mostly of unfunded upward subsidy re-estimates, other unfunded expenses, and net investments of capitalized assets.

Note 14. Intragovernmental Cost and Exchange Revenue by Program

As required by the *GPRA Modernization Act of 2010*, FSA's reporting organization has been aligned with Strategic Goal 1 presented in the U.S. Department of Education's *Strategic Plan 2011—2014*. Strategic Goal 1, Increase college access, quality, and completion by improving higher education and lifelong learning opportunities for youth and adults, is a sharply defined directive that guides divisions to carry out the vision and programmatic mission of FSA.

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

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

Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

	2012	2011
Increase College Access, Quality, and Completion		
Intragovernmental Gross Cost	$ 26,750	$ 20,247
Public Gross Cost	9,216	(3,435)
Total Gross Program Costs	35,966	16,812
Intragovernmental Earned Revenue	5,343	5,304
Public Earned Revenue	19,963	14,908
Total Program Earned Revenue	25,306	20,212
Total Program Cost	**10,660**	**(3,400)**
American Recovery and Reinvestment Act		
Intragovernmental Gross Cost	-	-
Public Gross Cost	23	27
Total Gross Program Costs	23	27
Intragovernmental Earned Revenue	-	-
Public Earned Revenue	-	-
Total Program Earned Revenue	-	-
Total Program Cost	**23**	**27**
Net Cost of Operations	**$ 10,683**	**$ (3,373)**

Note 15. Interest Expense and Interest Revenue

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

Interest Expense and Interest Revenue
(Dollars in Millions)

2012	Expenses Federal	Expenses Non-federal	Expenses Total	Revenue Federal	Revenue Non-federal	Revenue Total
Direct Loan Program	$ 20,643	$ -	$ 20,643	$ 4,265	$ 16,378	$ 20,643
FFEL Program						
Guaranteed Loan Program	2,083	(1,440)	643	643	-	643
Loan Purchase Commitment	1,318	-	1,318	73	1,245	1,318
Loan Participation Purchase	2,471	-	2,471	237	2,234	2,471
ABCP Conduit	90	-	90	32	58	90
TEACH Program	15	-	15	4	11	15
Total	**$ 26,620**	**$ (1,440)**	**$ 25,180**	**$ 5,254**	**$ 19,926**	**$ 25,180**

2011	Expenses Federal	Expenses Non-federal	Expenses Total	Revenue Federal	Revenue Non-federal	Revenue Total
Direct Loan Program	$ 14,321	$ -	$ 14,321	$ 3,493	$ 10,828	$ 14,321
FFEL Program						
Guaranteed Loan Program	1,331	(867)	464	464	-	464
Loan Purchase Commitment	1,552	-	1,552	77	1,475	1,552
Loan Participation Purchase	2,916	-	2,916	385	2,531	2,916
ABCP Conduit	48	-	48	18	30	48
TEACH Program	9	-	9	3	6	9
Total	**$ 20,177**	**$ (867)**	**$ 19,310**	**$ 4,440**	**$ 14,870**	**$ 19,310**

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

Note 16. Statement of Budgetary Resources

The Statement of Budgetary Resources compares budgetary resources with the status of those resources. As of September 30, 2012, budgetary resources were $326,281 million and net outlays were $163,762 million. As of September 30, 2011, budgetary resources were $316,646 million and net outlays were $161,884 million.

Permanent Indefinite Budget Authority

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

Reauthorization of Legislation

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

Obligations Incurred by Apportionment Category

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

Obligations Incurred by Apportionment Category

(Dollars in Millions)

	2012	2011
Direct		
Category A	$ 980	$ 5
Category B	295,938	296,056
Exempt from Apportionment	418	2,166
Obligations Incurred	**$ 297,336**	**$ 298,227**

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

Unused Borrowing Authority

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

Unused Borrowing Authority

(Dollars in Millions)

	2012	2011
Beginning Balance, Unused Borrowing Authority	**$ 141,977**	**$ 132,905**
Current Year Borrowing Authority	209,379	211,802
Funds Drawn From Treasury	(193,160)	(192,954)
Borrowing Authority Withdrawn	(12,958)	(9,776)
Ending Balance, Unused Borrowing Authority	**$ 145,238**	**$ 141,977**

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

Undelivered Orders at the End of the Period

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

Undelivered Orders

(Dollars in Millions)

	2012	2011
Budgetary	$ 21,573	$ 19,968
Non-Budgetary	168,791	160,824
Undelivered Orders (Unpaid)	**$ 190,364**	**$ 180,792**

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

Distributed Offsetting Receipts

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

Distributed Offsetting Receipts

(Dollars in Millions)

	2012	2011
Negative Subsidies and Downward Re-estimates:		
FFEL Program	$ 16,371	$ 24,670
Direct Loan Program	24,258	25,502
TEACH Program	-	6
Subtotal	40,629	50,178
Other	25	19
Undelivered Orders (Unpaid)	**$ 40,654**	**$ 50,197**

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

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

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

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

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

Reconciliation of Budgetary Obligations to Net Cost of Operations

(Dollars in Millions)

	2012	2011
Resources Used to Finance Activities:		
Obligations Incurred	$ 297,336	$ 298,227
Spending Authority from Offsetting Collections and Recoveries	(84,302)	(67,908)
Offsetting Receipts	(40,654)	(50,197)
Net Budgetary Resources Obligated	**172,380**	**180,122**
Imputed Financing from Costs Absorbed by Others	11	12
Other Financing Sources	(37,477)	(42,764)
Net Other Resources	**(37,466)**	**(42,752)**
Net Resources Used to Finance Activities	**134,914**	**137,370**
Less: Resources Used or Generated for Items Not Part of the Net Cost of Operations:		
Increase/(Decrease) in Budgetary Resources Obligated but Not Yet Provided	9,073	17,611
Resources that Fund Subsidy Re-estimates Accrued in Prior Period	(3,329)	(5,785)
Credit Program Collections	(52,178)	(43,314)
Acquisition of Fixed Assets	-	3
Acquisition of Net Credit Program Assets or Liquidation of Liabilities for Loan Guarantees	197,846	201,458
Resources from Non-Entity Activity	(37,512)	(42,764)
Net Resources That Do Not Finance the Net Cost of Operations	**113,900**	**127,209**
Net Resources Used to Finance the Net Cost of Operations	**21,014**	**10,161**
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Depreciation	8	14
Subsidy Amortization and Interest on the Liability for Loan Guarantees	4,239	1,806
Other	(16)	1
Total Components Not Requiring or Generating Resources	**4,231**	**1,821**
Increase in Annual Leave Liability	-	1
Accrued Re-estimates of Credit Subsidy Expense	3,922	(3,329)
Increase in Exchange Revenue Receivable from the Public	(18,441)	(12,010)
Other	(43)	(17)
Total Components Requiring or Generating Resources in Future Periods	**(14,562)**	**(15,355)**
Total Components That Will Not Require or Generate Resources in the Current Period	**(10,331)**	**(13,534)**
Net Cost of Operations	**$ 10,683**	**$ (3,373)**

Note 18. American Recovery and Reinvestment Act of 2009

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

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

American Recovery and Reinvestment Act of 2009

(Dollars in Millions)

	Cumulative Totals as of September 30, 2012		
	Appropriations	Obligations	Outlays
Student Financial Assistance:			
Federal Pell Grants	$ 15,640	$ 15,640	$ 15,639
Mandatory Add-on Pell Grants	643	643	643
Federal Work Study Grants	200	200	200
Total Student Financial Assistance	**16,483**	**16,483**	**16,482**
Student Aid Administration	60	60	60
Total	**$ 16,543**	**$ 16,543**	**$ 16,542**

American Recovery and Reinvestment Act of 2009

(Dollars in Millions)

	Cumulative Totals as of September 30, 2011		
	Appropriations	Obligations	Outlays
Student Financial Assistance:			
Federal Pell Grants	$ 15,640	$ 15,640	$ 15,618
Mandatory Add-on Pell Grants*	643	643	643
Federal Work Study Grants	200	200	200
Total Student Financial Assistance	**16,483**	**16,483**	**16,461**
Student Aid Administration	60	60	60
Total	**$ 16,543**	**$ 16,543**	**$ 16,521**

Note 19. Contingencies

Guaranty Agencies

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

Federal Perkins Loan Program Reserve

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

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

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

Litigation and Other Claims

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

Other Matters

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

Required Supplementary Stewardship Information

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

Year to date expenses incurred for human capital investments consisted of the following as of September 30, 2012 and the preceding four fiscal year ends:

Summary of Human Capital Expenses
(Dollars in Millions)

	2012	2011	2010	2009	2008
Federal Student Aid Expense					
Direct Loan Subsidy	$ (10,720)	$ (28,630)	$ (1,567)	$ (9,603)	$ 5,236
FFEL Program Subsidy	(14,381)	(16,126)	(14,344)	(29,940)	(2,852)
Recovery Act	23	18	8,869	7,571	
Grant Programs	34,310	39,008	26,799	17,302	17,464
Salaries and Administrative	192	193	208	186	189
Total	**$ 9,424**	**$ (5,537)**	**$ 19,965**	**$ (14,484)**	**$ 20,037**

The Direct Loan Program is a direct-lending program in which loan capital is provided to students by the federal government through borrowings from the U.S. Treasury. This program has expanded dramatically since the passage of the *SAFRA Act*, under which no new loan originations were permitted to be made from the FFEL program after June 30, 2010, so that loans that would have previously been made through the FFEL program are now made through the Direct Loan Program. In addition, the SDCL initiative allowed borrowers who had at least one Direct Loan Program loan or Department-held FFEL Program loan and at least one commercially-held FFEL Program loan to consolidate their eligible commercially-held FFEL Program loans into a SDCL during a limited window of time from January 17 through June 30, 2012.

The FFEL Loan Program has originated no new loans since June 30, 2010, but its permanent budget authority allows it to continue to operate with state and private nonprofit guaranty agencies to honor loan guarantees and for the Department to pay interest supplements on outstanding loans by private lenders to eligible students. The FFEL Loan Program expenses include the Loan Participation Purchase and Loan Purchase Commitment expenses of $(1,393) million and $(1,406) million respectively.

The TEACH Grant program, authorized by the CCRAA, awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students. If the students do not satisfy their agreement to serve, the grants are converted to Direct Unsubsidized Loans. The President's 2013 Budget proposes to overhaul the TEACH Grant program as of the end of the 2012–2013 academic year, and replace it with a new, targeted teacher recruitment and retention program called the Presidential Teaching Fellows. This new program would provide grants to states that meet certain conditions to supply scholarships of up to $10,000 to talented individuals attending the most effective programs in the state. These individuals would commit to teaching for at least three years in a high need school and subject. To be eligible for funds, states would measure the effectiveness of their teacher preparation programs based on student achievement data of their graduates, among other measures, hold teacher preparation programs accountable for results, and upgrade licensure and certification standards.

Grant programs include the Pell Grant Program that awards direct grants through participating institutions to undergraduate students with financial need. Participating institutions either credit the appropriated funds to the student's school account or pay the student directly once per term. Signed into law in 2006, the Academic Competitiveness Grant and the National Science and Mathematics Access to Retain Talent Grant Programs were still available in FY 2011 to encourage eligible students to take more challenging courses in high school and to pursue college majors in high demand in the global economy. These programs sunset at the conclusion of the 2010–2011 award year and were therefore not available during FY 2012.

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

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

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

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

Required Supplementary Information

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

(Dollars in Millions)

	Combined		American Recovery and Reinvestment Act	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 3,415	$ 15,004		
Recoveries of prior year Unpaid Obligations	488	18,649	$ 23	
Other changes in unobligated balance	(499)	(20,691)		
Unobligated balance from prior year budget authority, net	3,404	12,962	23	
Appropriations (discretionary and mandatory)	52,919	35		
Borrowing Authority (discretionary and mandatory)		209,379		
Spending Authority from offsetting collections	372	47,210		
Total Budgetary Resources	**$ 56,695**	**$ 269,586**	**$ 23**	**$ 0**
Status of Budgetary Resources				
Obligations incurred: Direct	$ 46,329	$ 251,007	$ 23	
Unobligated balance, end of year :				
Apportioned	8,562			
Unapportioned	1,804	18,579		
Total unobligated balance, end of year	10,366	18,579		
Total Budgetary Resources	**$ 56,695**	**$ 269,586**	**$ 23**	**$ 0**
Change in Obligated Balance				
Unpaid obligations, brought forward, October 1	$ 23,240	$ 164,196	$ 22	
Uncollected customer payments from Federal Sources,		(5)		
Obligated balance start of the year (net), before adjustments (+/-)	$ 23,240	$ 164,191	$ 22	
Obligated balance, start of year (net), as adjusted	23,240	164,191	22	
Obligations Incurred	46,329	251,007	23	
Outlays (gross) (-)	(44,987)	(224,595)	(21)	
Change in uncollected customer payments from Federal Sources (+/-)		1		
Recoveries of prior year unpaid obligations	(488)	(18,649)	(23)	
Obligated Balance, end of year (net)				
Unpaid Obligations, end of year (gross)	$ 24,094	$ 171,959	$ 1	
Uncollected customer payments from Federal Sources, end of year		(4)		
Obligated balance, end of year	**$ 24,094**	**$ 171,955**	**$ 1**	**$ 0**
Budget Authority and Outlays, Net				
Budget authority, gross (discretionary and mandatory)	$ 53,291	$ 256,624		
Actual offsetting collections (discretionary and mandatory)	(559)	(64,607)		
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)		1		
Anticipated offsetting collections (discretionary and mandatory) (+/-)				
Budget Authority, net (discretionary and mandatory)	**$ 52,732**	**$ 192,018**	**$ 0**	**$ 0**
Outlays, gross (discretionary and mandatory)	$ 44,987	$ 224,595	$ 21	
Actual offsetting collections (discretionary and mandatory) (+/-)	(559)	(64,607)		
Outlays, net (discretionary and mandatory)	44,428	159,988	21	
Distributed offsetting receipts	(40,654)			
Agency Outlays, net (discretionary and mandatory)	**$ 3,774**	**$ 159,988**	**$ 21**	**$ 0**

United States Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2012
(Dollars in Millions)

	Non ARRA Combined		Direct Student Loan Program	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 3,415	$ 15,004		$ 1,817
Recoveries of prior year Unpaid Obligations	465	18,649		17,772
Other changes in unobligated balance	(499)	(20,691)		(19,319)
Unobligated balance from prior year budget authority, net	3,381	12,962		270
Appropriations (discretionary and mandatory)	52,919	35	$ 6,917	
Borrowing Authority (discretionary and mandatory)		209,379		193,140
Spending Authority from offsetting collections	372	47,210		23,887
Total Budgetary Resources	**$ 56,672**	**$ 269,586**	**$ 6,917**	**$ 217,297**
Status of Budgetary Resources				
Obligations incurred: Direct	$ 46,306	$ 251,007	$ 6,917	$ 214,281
Unobligated balance, end of year :				
Apportioned	8,562		3	
Unapportioned	1,804	18,579	(3)	3,016
Total unobligated balance, end of year	10,366	18,579		3,016
Total Budgetary Resources	**$ 56,672**	**$ 269,586**	**$ 6,917**	**$ 217,297**
Change in Obligated Balance				
Unpaid obligations, brought forward, October 1	$ 23,218	$ 164,196		$ 77,058
Uncollected customer payments from Federal Sources,		(5)		
Obligated balance start of the year (net), before adjustments (+/-)	$ 23,218	$ 164,191		$ 77,058
Obligated balance, start of year (net), as adjusted	23,218	164,191		77,508
Obligations Incurred	46,306	251,007	$ 6,917	214,281
Outlays (gross) (-)	(44,966)	(224,595)	(6,917)	(187,556)
Change in uncollected customer payments from Federal Sources (+/-)		1		
Recoveries of prior year unpaid obligations	(465)	(18,649)		(17,772)
Obligated Balance, end of year (net)				
Unpaid Obligations, end of year (gross)	$ 24,093	$ 171,959		$ 86,011
Uncollected customer payments from Federal Sources, end of year		(4)		
Obligated balance, end of year	**$ 24,093**	**$ 171,955**	**$ 0**	**$ 86,011**
Budget Authority and Outlays, Net				
Budget authority, gross (discretionary and mandatory)	$ 53,291	$ 256,624	$ 6,917	$ 217,027
Actual offsetting collections (discretionary and mandatory)	(559)	(64,607)		(36,434)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)		1		
Anticipated offsetting collections (discretionary and mandatory) (+/-)				
Budget Authority, net (discretionary and mandatory)	**$ 52,732**	**$ 192,018**	**$ 6,917**	**$ 180,593**
Outlays, gross (discretionary and mandatory)	$ 44,966	$ 224,595	$ 6,917	$ 187,556
Actual offsetting collections (discretionary and mandatory) (+/-)	(559)	(64,607)		(36,434)
Outlays, net (discretionary and mandatory)	44,407	159,988	6,917	151,122
Distributed offsetting receipts	(40,654)		(24,258)	
Agency Outlays, net (discretionary and mandatory)	**$ 3,753**	**$ 159,988**	**$ (17,341)**	**$ 151,122**

United States Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2012
(Dollars in Millions)

	Teach Grant Program		Federal Family Education Loan Program	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 7		$ 1,901	$ 13,187
Recoveries of prior year Unpaid Obligations	2	$ 24	1	853
Other changes in unobligated balance		(24)	(236)	(1,348)
Unobligated balance from prior year budget authority, net	9		1,666	12,692
Appropriations (discretionary and mandatory)	34		1,360	35
Borrowing Authority (discretionary and mandatory)		130		16,109
Spending Authority from offsetting collections		23	369	23,300
Total Budgetary Resources	**$ 43**	**$ 153**	**$ 3,395**	**$ 52,136**
Status of Budgetary Resources				
Obligations incurred: Direct	$ 34	$ 153	$ 1,884	$ 36,573
Unobligated balance, end of year :				
Apportioned				
Unapportioned	9		1,511	15,563
Total unobligated balance, end of year	9		1,511	15,563
Total Budgetary Resources	**$ 43**	**$ 153**	**$ 3,395**	**$ 52,136**
Change in Obligated Balance				
Unpaid obligations, brought forward, October 1	$ 8	$ 88	$ 20	$ 87,050
Uncollected customer payments from Federal Sources,		(5)		
Obligated balance start of the year (net), before adjustments (+/-)	$ 8	$ 83	$ 20	$ 87,050
Obligated balance, start of year (net), as adjusted	8	83	20	87,050
Obligations Incurred	34	153	1,884	36,573
Outlays (gross) (-)	(35)	(135)	(1,867)	(36,904)
Change in uncollected customer payments from Federal Sources (+/-)		1		
Recoveries of prior year unpaid obligations	(2)	(24)	(1)	(853)
Obligated Balance, end of year (net)				
Unpaid Obligations, end of year (gross)	$ 5	$ 82	$ 36	$ 85,866
Uncollected customer payments from Federal Sources, end of year		(4)		
Obligated balance, end of year	**$ 5**	**$ 78**	**$ 36**	**$ 85,866**
Budget Authority and Outlays, Net				
Budget authority, gross (discretionary and mandatory)	$ 34	$ 153	$ 1,729	$ 39,444
Actual offsetting collections (discretionary and mandatory)		(45)	(556)	(28,128)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)		1		
Anticipated offsetting collections (discretionary and mandatory) (+/-)				
Budget Authority, net (discretionary and mandatory)	**$ 34**	**$ 109**	**$ 1,173**	**$ 11,316**
Outlays, gross (discretionary and mandatory)	$ 35	$ 135	$ 1,867	$ 36,904
Actual offsetting collections (discretionary and mandatory) (+/-)		(45)	(556)	(28,128)
Outlays, net (discretionary and mandatory)	35	90	1,311	8,776
Distributed offsetting receipts			(16,371)	
Agency Outlays, net (discretionary and mandatory)	**$ 35**	**$ 90**	**$ (15,060)**	**$ 8,776**

United States Department of Education
Federal Student Aid
Combining Statement of Budgetary Resources
For the Year Ended September 30, 2012
(Dollars in Millions)

	Grant Programs		Administrative Funds	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 1,499		$ 8	
Recoveries of prior year Unpaid Obligations	435		27	
Other changes in unobligated balance	(263)			
Unobligated balance from prior year budget authority, net	1,671		35	
Appropriations (discretionary and mandatory)	43,288		1,320	
Borrowing Authority (discretionary and mandatory)				
Spending Authority from offsetting collections			3	
Total Budgetary Resources	**$ 44,959**	**$ 0**	**$ 1,358**	**$ 0**
Status of Budgetary Resources				
Obligations incurred: Direct	$ 36,218		$ 1,253	
Unobligated balance, end of year :				
Apportioned	8,467		92	
Unapportioned	274		13	
Total unobligated balance, end of year	8,741		105	
Total Budgetary Resources	**$ 44,959**	**$ 0**	**$ 1,358**	**$ 0**
Change in Obligated Balance				
Unpaid obligations, brought forward, October 1	$ 22,656		$ 534	
Uncollected customer payments from Federal Sources,				
Obligated balance start of the year (net), before adjustments (+/-)	$ 22,656		$ 534	
Obligated balance, start of year (net), as adjusted	22,656		534	
Obligations Incurred	36,218		1,253	
Outlays (gross) (-)	(34,968)		(1,179)	
Change in uncollected customer payments from Federal Sources (+/-)				
Recoveries of prior year unpaid obligations	(435)		(27)	
Obligated Balance, end of year (net)				
Unpaid Obligations, end of year (gross)	$ 23,471		$ 581	
Uncollected customer payments from Federal Sources, end of year				
Obligated balance, end of year	**$ 23,471**	**$ 0**	**$ 581**	**$ 0**
Budget Authority and Outlays, Net				
Budget authority, gross (discretionary and mandatory)	$ 43,288		$ 1,323	
Actual offsetting collections (discretionary and mandatory)			(3)	
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)				
Anticipated offsetting collections (discretionary and mandatory) (+/-)				
Budget Authority, net (discretionary and mandatory)	**$ 43,288**	**$ 0**	**$ 1,320**	**$ 0**
Outlays, gross (discretionary and mandatory)	$ 34,968		$ 1,179	
Actual offsetting collections (discretionary and mandatory) (+/-)			(3)	
Outlays, net (discretionary and mandatory)	34,968		1,176	
Distributed offsetting receipts	(25)			
Agency Outlays, net (discretionary and mandatory)	**$ 34,943**	**$ 0**	**$ 1,176**	**$ 0**

Independent Auditors' Report

Federal Student Aid
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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

NOV 16 2012

James Runcie
Chief Operating Officer
Federal Student Aid
Washington, D.C. 20202

Dear Mr. Runcie:

The enclosed reports present the results of the annual audits of the Federal Student Aid's (FSA) financial statements for fiscal years 2012 and 2011 to comply with the Higher Education Act amendments of 1998. The reports should be read in conjunction with the FSA's financial statements and notes to fully understand the context of the information contained therein.

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

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

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

Sincerely,

Kathleen S. Tighe
Inspector General

Enclosures

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

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Report of Independent Auditors

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheets of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2012 and 2011, and the related consolidated statements of net cost, and changes in net position, and the combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of FSA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FSA as of September 30, 2012 and 2011, and its net cost, changes in net position, and budgetary resources, for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 16, 2012, on our consideration of FSA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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Report of Independent Auditors
Page 2

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

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

Ernst + Young LLP

November 16, 2012

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

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2012, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 16, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

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

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the first deficiency described below to be a material weakness.

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

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

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

MATERIAL WEAKNESS

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

DMCS2

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

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

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

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

not take these defaulted direct loans receivable into account when preparing its draft financial statement note disclosure regarding the amount of defaulted direct loans receivable, which resulted in an understatement of the amount of defaulted direct loans in the note disclosure. Management subsequently corrected the note disclosure.

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

Loan portfolio reconciliations were not completed timely

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

Fund Balance with Treasury

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

Untimely interest accruals

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

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

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

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

ERNST & YOUNG

Report on Internal Control
Page 6

ACS, Inc. Education Servicing System (ACES)

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

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

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

<u>Recommendations:</u>

We recommend that Federal Student Aid perform the following:

1. Ensure that the DMCS2 servicer resolves and completes the remaining system requirements in order to bring DMCS2 to a fully operational status. In the interim, establish temporary work-around solutions for the remaining requirements, where applicable.
2. Complete system fixes to resolve the issues surrounding interest accruals (DMCS2) and incorrect loan balances (ACES). If necessary, establish temporary work-around solutions to ensure that interest will be appropriately recorded on the Department's interim and year-end financial statements.
3. Review controls and operating procedures related to the Service Organization and understand the demarcation of the control environment between the servicer and the Department.

4. Require conformance and effectiveness of the previously noted controls and coordinate closely with the servicer to closely manage progress, status and corrective actions.
5. Improve contract management and oversight of contractors on mission critical systems especially as it relates to servicers and providers that provide the Department or FSA with a Service Organization Control (SOC 1) report.

SIGNIFICANT DEFICIENCIES

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

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

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

OMB A-11, *Preparation, Submission, and Execution of the Budget*, the Credit Reform Act and other accounting guidance strongly recommend that agencies be able to analyze loan portfolios at the cohort level. The Department's financial systems are not configured to account for cash flows on a precise cohort level; consequently, over the last several years the Department developed and refined a methodology to analyze and maintain student loan activity at the

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origination cohort level. The result of this analysis, the cohort analysis tool, is currently the Department's primary repository of cohort-level data. Another tool, the forecast, consists of expected cash flows, that, when discounted, can be used to compare to the recorded activity in the general ledger and point out variances. Using the cohort analysis tool, the Department has been able to research any variances and demonstrate that balances in the Department's financial records are supported by its estimates.

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

- The long-term cost for the credit programs is reflected in the financial statements through periodic charges for subsidy costs, adjustments or re-estimates to those subsidy costs, and loan activity, which is all recognized in the allowance for the receivables related to the direct loan program and the temporary loan purchase authority, and in the liability for the guaranteed loan (FFEL) program. The loan activity that flows through this allowance and liability is determined by the accounting standards and it is accounted and reported by the Department using business object classes. Recent programs changes have required the Department to reorganize many of these object classes to better account for the new conditions. During our review of the allowance and liability activity for the last several years, we have identified large and unusual fluctuations that the Department didn't note in their review and was unable to explain. Our inquiries caused the Department to initiate their analysis which eventually found misclassifications that required re-classes to the notes of the financial statements. The Department prepares monthly analytical reports that, among other things, presents and analyzes changes in the object class activities related to these loan programs. Additionally, the Department occasionally conducts Credit Reform Work Group (CRWG) meetings where different area managers get together to discuss the reasonableness of the credit reform estimates based on their experiences with the actual program activity. Holding more frequent CRWG meetings which focus on these analytical reports to have robust discussions about loan activity and the impact on the estimates can serve as a strong internal control.
- The Department uses a computer-based cash flow projection model (i.e., Student Loan Model or SLM) and OMB calculator to calculate subsidy estimates related to the loan programs that are then recorded in the allowance for subsidy or liability accounts. The model uses multiple sources of loan data and hundreds of complex assumptions. In order to perform a check of estimates resulting from the SLM and OMB calculator, the Department prepares a backcast, which compares the model's estimates to actual activity for the current and prior fiscal years. The SLM also produces a forecast of the expected cash flows in the current year for the outstanding loans which, when discounted, can be used to compare to the recorded activity in the general ledger. Comparisons using the backcast and forecast tools, and to the extent practical, recomputation of expected amounts based on loan volumes, interest rates, and simplified cash flow assumptions, can

serve as key detect controls for potential undetected errors that may exist in the development of the assumption data and credit reform estimates. During our testing, we noted that management has no formal detailed review procedures surrounding the input of the many variables into the SLM, the input of cash flows into the OMB calculator or the process surrounding the analytical tools. Management does perform a high-level review of such data; however, this review is not sufficient to identify errors that may occur at a detailed level. For example, after the current year's financial statements were prepared, management noted an inconsistency in the re-estimate between interest rate and technical and default that resulted in a reclassification on the notes to the financial statements. Additionally, we noted calculation errors in certain of the analytical tools used by the Department, including the back of the envelope reasonableness analytical tool. While these calculation errors in certain analytical tools did not directly impact amounts in the financial statements, the analytical tools should contain accurate information if they are to serve their purpose as a detect internal control. Implementing a detailed review process may reduce the potential for errors occurring in all aspects of this complex re-estimate and also in the analytical tools.

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

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

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

Recommendations:

We recommend that Federal Student Aid perform the following:

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

    - Critically assess death, disability and bankruptcy rates and other assumptions by cohort in light of recent changes in the economic environment to determine the extent to which there may be differences in performance across cohorts.

- For a subset of borrowers, obtain credit rating data and track the borrower's ability to pay over time. Utilize the results for further analysis.

2. Increase the frequency of the CRWG meetings and take full advantage of their analytical reports to have robust discussions about loan activity and the impact on the estimates with different area managers.

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

4. Strengthen the documentation related to assumption development, including documentation, discussion and rationale of changes in the methodologies. Furthermore, improve documentation detail by including a description of the purpose of worksheets, description of formulas used, and how each work step corresponds to the methodology. Additionally, consider developing calibrating processes to ensure data quality and model accuracy.

5. Consider the impact of changes in general economic conditions when developing assumptions. Evaluate the selection of time periods used for weighted average calculations on a periodic basis as economic conditions change.

6. Consider ways to better leverage management's efforts under Appendix A of OMB Circular A-123 as a way to provide additional focus and attention to the controls surrounding the credit reform estimation process.

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

In connection with the annual audit of FSA's FY 2012 financial statements, we conducted a controls review of the information technology processes related to the significant accounting and financial reporting systems. OMB Circular A-130 Revised, *Management of Federal Information Resources*, requires: (1) standard documentation and procedures for certification and accreditation of systems; (2) records management programs that provide adequate and proper documentation of agency activities; (3) agencies to develop uniform and consistent internal information resource management policies and procedures and oversee the development and promote the use of information management principles, standards, and guidelines, evaluate agency information resources management practices in order to determine their adequacy and efficiency; and (4) determine compliance of such practices with the policies, principles, standards, and guidelines.

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

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

While the Department and FSA have worked toward strengthening and improving controls over information technology processes during FY 2012, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of IT general controls at the Department and FSA, we identified deficiencies in the following areas: (1) access for terminated users was not removed in a timely manner or not removed at all; (2) revalidation of users' rights is not consistently performed for all applications and users, and for those revalidations that are performed, we noted instances in which there was no validation of the appropriateness of user access or users were not revalidated by the appropriate members of management; (3) documentation and related approvals required to provision user access are not consistently maintained; (4) accounts with elevated administrative access being shared without appropriate monitoring or review procedures; (5) IT General Control issues indicated in Service Organization Control (SOC-1)[1] reports for key applications across change management, user access and privileged user access.

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

1. Risk management framework is not sufficiently designed or implemented to address risk from an organizational perspective and reflect change within the system in a timely manner.

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[1] Please refer to the Material Weakness related to Debt Management and Collection including the DMCS2 application.

2. Monitoring and oversight controls were not sufficiently implemented to address patch management control deficiencies.
3. Security controls weaknesses existed for hardware and software configurations.
4. Monitoring controls are not sufficiently designed to ensure that corrective actions for incidents are taken in a timely manner and properly documented.
5. Configuration Management Database was not adequately maintained and updated to track EDCAPS hardware changes.
6. Security configuration baselines have not been established for operating systems, databases, and network infrastructure devices used for EDCAPS.
7. Business application control procedures are not sufficient to ensure ongoing monitoring of information system connection.

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

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

Recommendations:

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

We recommend that the Department and FSA continue their efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness uniformly across the organization, which should decrease the likelihood of similar weaknesses being identified in future audit assessments and internal self-assessments. Examples of addressing root causes may include, but are not limited to, additional training for the information technology professionals within the organization, allocating appropriate resources and subject matter resources to information technology process areas, maintaining updated procedures to ensure proper configuration of servers against documented standards at the time of changes in the environment, and monitoring of contract performance of vendors providing system support services to the Department. As the Department and FSA migrate existing IT systems to vendors, additional focus in contracts the Department executes with service providers is required to monitor and achieve compliance with Departmental and Federal guidelines.

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

STATUS OF PRIOR YEAR FINDINGS

In the reports on the results of the FY 2011 audit of Federal Student Aid's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

Summary of FY 2011 Significant Deficiencies

Issue Area	Summary Control Issue	FY 2012 Status
Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Significant Deficiency)	Management controls and analysis need to be strengthened over credit reform estimation and financial reporting processes.	Modified Repeat Condition classified as a Significant Deficiency
Controls Surrounding Information Systems Need Enhancement (Significant Deficiency)	Improvements are needed in overall information technology security and systems.	Modified Repeat Condition classified as a Significant Deficiency

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

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

Ernst + Young LLP

November 16, 2012

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

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2012, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 16, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

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

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

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

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

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

Our Report on Internal Control dated November 16, 2012, includes additional information related to the financial management systems that were found not to comply with the requirements of FFMIA relating to information technology security and internal controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance

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

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

Ernst + Young LLP

November 16, 2012

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November 14, 2012

MEMORANDUM

TO: Kathleen Tighe
Inspector General

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

SUBJECT: DRAFT AUDIT REPORTS
Financial Statement Audit Fiscal Years 2012 and 2011
Federal Student Aid
ED-OIG/A17M0002

Please convey our sincere thanks to everyone on your staff and the Ernst & Young, LLP, team who supported the successful completion of the Financial Statement Audit Fiscal Years 2012 and 2011. Federal Student Aid reviewed the draft audit reports provided on November 8, 2012. We concur with the findings and recommendations as identified in the Report on Compliance and Other Matters and Report on Internal Control Over Financial Reporting.

Federal Student Aid will continue our extraordinary efforts to remediate the deficiencies associated with the Debt Management and Collection System (DMCS2) and ACS, Inc. Education Servicing System (ACES). In addition, we will continue to support the Department of Education's (Department) efforts to address the significant control deficiencies related to the credit reform estimation and financial reporting processes. Although we continued to make progress during fiscal year 2012, we acknowledge there are opportunities to modify existing practices to accommodate changes in credit reform programs and address noted deficiencies. Finally, we will continue to work with the Federal Student Aid and Department staff to further strengthen controls over information systems.

We are committed to maintaining an unqualified opinion and will develop and implement appropriate corrective action plans to address the significant control deficiencies cited in these reports.

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

Other Accompanying Information

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OTHER ACCOMPANYING INFORMATION

Federal Student Aid
Schedule of Spending
For the Years Ended September 30, 2012 and 2011
(Dollars in Millions)

	FY 2012		FY 2011	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
What Money is Available to Spend?				
Total Resources	$ 56,695	$ 269,586	$ 54,353	$ 262,293
Less Amount Available but Not Agreed to be Spent	8,562		1,214	512
Less Amount Not Available to be Spent	1,804	18,579	2,201	14,492
Total Amounts Agreed to be Spent	**$ 46,329**	**$ 251,007**	**$ 50,938**	**$ 247,289**
How was the Money Spent?				
Increase College Access, Quality, and Completion				
Credit Program Loan Disbursements and Claim Payments	$ 55	$ 154,291	$ 99	$ 146,511
Credit Program Subsidy Transfers	8,312	40,629	2,977	50,179
Federal Interest Payments		26,620		20,176
Other Credit Program Payments	4	2,581	4	4,297
Federal Student Loan Reserve Fund Valuation	419		2,166	
Grants	34,963		38,288	
Personnel Compensation and Benefits	177		172	
Contractual Services	1,016	474	898	343
Other [1/]	20		24	
	44,966	**224,595**	**44,628**	**221,506**
American Recovery and Reinvestment Act				
Grants	21		677	
	21		**677**	
Total Spending	**44,987**	**224,595**	**45,305**	**221,506**
Amounts Remaining to be Spent[2/]	1,342	26,412	5,633	25,783
Total Amount Agreed to be Spent	**$ 46,329**	**$ 251,007**	**$ 50,938**	**$ 247,289**

[1/] Other primarily consists of building rental payments, equipment purchases and transportation.

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

Improper Payment Information Act Reporting Details

For improper payments information, FSA's activities are part of an overall Departmental integrated reporting effort. Please refer to the Improper Payments Reporting Details narrative in the Other Accompanying Information section in the Department's *AFR* located at **http://www2.ed.gov/about/reports/annual/index.html**.

Summary of Financial Statement Audit and Management Assurances

For details on FSA programs, please refer to the Analysis of Systems, Controls, and Legal Compliance discussion found in the Management's Discussion and Analysis section of this document as well as the Summary of Financial Statement Audit and Management Assurances narrative located in the Other Accompanying Information section of the Department's *AFR* located at **http://www2.ed.gov/about/reports/annual/index.html**.

Management Challenges

For details on FSA Management Challenges, please refer to relevant items included in the OIG's Management Challenges for FY 2013 Executive Summary found in the Other Accompanying Information section within the Department's *AFR* located at **http://www2.ed.gov/about/reports/annual/index.html**.

Appendices

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Appendix A: Discontinued Strategic Goals and Performance Goals

Discontinued Strategic Goals and Performance Goals
FSA Strategic Plan FY 2011–2015

During FY 2011, FSA reviewed its strategic plan to identify revisions that would enable FSA to better address the challenges of the economic environment and improve the delivery of its mission–"Funding America's Future, One Student at a Time". As a result of this review, FSA implemented a new Strategic Plan, which contained the same strategic goals, with slightly revised performance metrics. Several of the performance metrics remained largely unchanged, but a few new or revised metrics were incorporated to better reflect the organization's performance. The strategic goals and performance metrics for FY 2012 are presented in the *FSA Strategic Plan FY 2012–16*. Implementation of this new strategic plan in FY 2012 resulted in the discontinuation of certain FY 2011 performance goals, which are listed in the following table.

Strategic Goal/Performance Goal	Description
Strategic Goal A	**Provide superior service and information to students and borrowers.**
Performance Goal 1	Percentage of students who dropped out due to financial reasons
Strategic Goal C	**Develop efficient processes and effective capabilities that are among the best in the public and private sector.**
Performance Goal 3	Additional metric to measure improvement in cost structures under development (to be established in FY 2011)
Strategic Goal D	**Ensure program integrity and safeguard taxpayers' interests.**
Performance Goal 1	Delinquency rate
Strategic Objective E	**Strengthen FSA's performance culture and become one of the best places to work in the federal government.**
Performance Goal 1	Best Places to Work in the Federal Government ranking

Appendix B: Glossary Of Acronyms and Terms

Acronym	Description
A	
ABCP Conduit	Asset-Backed Commercial Paper Conduit
ACES	ACS Education Servicing System
ACSI	American Customer Satisfaction Index
AFR	*Agency Financial Report*
C	
CCRAA	*College Cost Reduction and Access Act of 2007*
CFPB	Consumer Financial Protection Bureau
Conduit	Asset-Backed Commercial Paper Conduit
COO	Chief Operating Officer
CPS	Central Processing System
Credit Reform Act	*Federal Credit Reform Act of 1990*
CSRS	Civil Service Retirement System
D	
Department	U.S. Department of Education
Direct Loan	William D. Ford Federal Direct Loan
DMCS2	Debt Management and Collection System
DOL	U.S. Department of Labor
E	
ECASLA	*Ensuring Continued Access to Student Loans Act of 2008*
ED	U.S. Department of Education

Acronym	Description
F	
FACT	Financial Awareness Counseling Tool
FAFSA	Free Application for Federal Student Aid
FECA	*Federal Employees' Compensation Act*
Federal Fund	Federal Student Loan Reserve Fund
FERS	Federal Employees Retirement System
FFEL	Federal Family Education Loan
FFELP	Federal Family Education Loan Program
FFMIA	*Federal Managers' Financial Integrity Act of 1982*
FSA	Federal Student Aid
FSA Strategic Plan FY 2011–15	*Federal Student Aid: Strategic Plan, Fiscal Years 2011–15*
FSA Strategic Plan FY 2012–16	*Federal Student Aid: Strategic Plan, Fiscal Years 2012–16*
FWS	Federal Work-Study
FY	Fiscal Year
G	
GA	Guaranty Agency
GAO	Government Accountability Office
H	
HCERA	*Health Care and Education Reconciliation Act of 2010*
HEA	*Higher Education Act of 1965,* as amended
I	
IRS	Internal Revenue Service
ISE	Integrated Student Experience
IT	Information Technology

Acronym	Description
L	
LEA	Local Educational Agency
LLC	Limited Liability Corporation
M	
Met	Performance result met or exceeded target
N	
N/A	Performance result is not applicable because the performance metric was not developed, the performance metric was not implemented, or the required data were not available in time for inclusion.
NCES	National Center for Education Statistics
NFP	Not-For-Profit
Not met	Performance result did not meet target
O	
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
OPR	Organizational Performance Review
P	
PBO	Performance-Based Organization
Pell Grant	Federal Pell Grant Program
Priority Goal	High Priority Performance Goal
R	
Recovery Act	*American Recovery and Reinvestment Act of 2009*

Acronym	Description
S	
Secretary	Secretary of Education
SDCL	Special Direct Consolidation Loan
T	
TEACH	Teacher Education Assistance for College and Higher Education Grant
Title IV	Title IV of *the Higher Education Act of 1965*, as amended
TIVAS	Title IV Additional Servicers
TPD	Total and Permanent Disability
Treasury	United States Department of the Treasury
U	
U.S.	United States
X	
Xerox, LLC	Xerox Education Solutions, Limited Liability Corporation

Appendix C: Availability of the Federal Student Aid Annual Report

FSA's publicly available *FY 2012 Annual Report* is accessible on FSA's and the Department's websites at:

StudentAid.gov/strategic-planning-reporting

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

The *Federal Student Aid: Strategic Plan, Fiscal Years 2012–16* and previous years' *Annual Reports* are also available on the websites listed above.

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