MANAGEMENT'S DISCUSSION AND ANALYSIS

ABOUT THE MANAGEMENT'S DISCUSSION AND ANALYSIS

The U.S. Department of Education (the Department) continued to enhance the content quality, report layout, and public accessibility of the Fiscal Year (FY) 2018 Agency Financial Report (AFR) by improving graphics and providing more useful, balanced, and easily understood information about the Department's loan programs, including additional cost and risk information. Additionally, we augmented information provided in the body of the AFR with relevant web content to provide users with additional information about the Department's operations and performance. To take advantage of the hyperlinks embedded in the report, the Department recommends reading it **on the Internet**. To help us continue to improve the quality and usefulness of information provided in our AFR, we encourage our public and other stakeholders to provide feedback and suggestions at **AFRComments@ed.gov**.

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

MISSION AND ORGANIZATIONAL STRUCTURE

This section provides information about the Department's mission, an overview of its history, and its structure. The active links include the organization chart and principal offices and a link to the full list of **Department offices** with a description of selected offices by function.

THE DEPARTMENT'S APPROACH TO PERFORMANCE

This section provides a brief summary of the Department's performance goals and results for FY 2018. Since the Department has chosen to produce separate financial and performance reports, a detailed discussion of performance information for FY 2018 will be provided in the Department's *Annual Performance Report* to be released online at the same time as the President's FY 2020 Budget in February 2019. For more information, prior-year performance reports can be found on the Department's website. We also urge readers to seek programmatic data as it is reported in the Congressional Budget Justification, as well as on the web pages of individual programs. Any questions or comments about the Department's performance reporting should be e-mailed to **PIO@ed.gov**. For more details on performance, please refer to the Department's budget and performance web page at **www.Performance.gov**.

FORWARD-LOOKING INFORMATION

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

FINANCIAL HIGHLIGHTS

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

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

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

ABOUT THE DEPARTMENT

OUR MISSION

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

Who We Are. In 1867, the federal government recognized that furthering education was a national priority and created a federal education agency to collect and report statistical data. The Department was established as a cabinet-level agency in 1980. Today, the Department supports programs in every area and level of education from preschool through postdoctoral research.

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

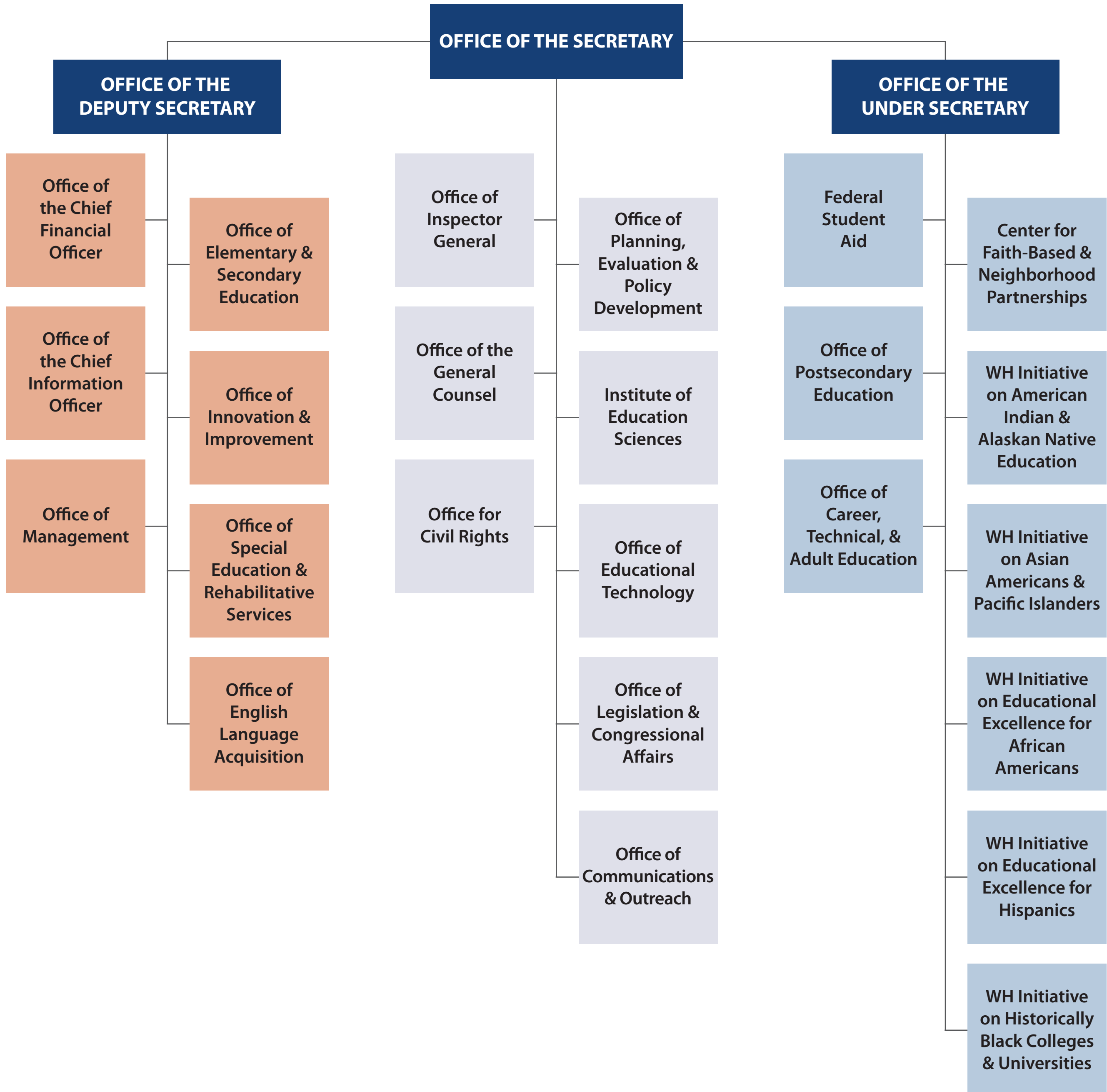
- establishing policies related to federal education funding, including distributing funds, collecting on student loans, and using data to monitor the use of funds;
- supporting data collection and research on America's schools;
- identifying major issues in education and focusing national attention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

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

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

OUR ORGANIZATION IN FISCAL YEAR 2018

This chart reflects the coordinating structure of the U.S. Department of Education. **Interactive** and **text versions** of the FY 2018 coordinating structure of the Department are available.



THE DEPARTMENT'S APPROACH TO PERFORMANCE

PERFORMANCE MANAGEMENT FRAMEWORK

In accordance with the *GPRA Modernization Act of 2010*, the Department's framework for performance management starts with the four-year *Strategic Plan*, which serves as the foundation for establishing long-term priorities. It also supports the development of performance goals, objectives, and measures by which the Department can gauge achievement of its stated outcomes. In coordination with the *Strategic Plan*, the Department established two-year Agency Priority Goals (APGs). Progress towards the Department's *Strategic Plan* and its APGs are measured using data-driven review and analysis. Additional information is available in the *Annual Performance Report and Annual Performance Plan*.

The *FY 2018–22 Strategic Plan* is comprised of four strategic goals. The Department continues to welcome input from Congress, state and local partners, and other education stakeholders about the *Strategic Plan*. Questions or comments about the *Strategic Plan* should be emailed to **PIO@ed.gov**.

FY 2018–22 Strategic Goals and Strategic Objectives[1]

Strategic Goal 1: Support state and local efforts to improve learning outcomes for all P–12 students in every community.	
Strategic Objective 1.1	Increase high-quality educational options and empower students and parents to choose an education that meets their needs.
Strategic Objective 1.2	Provide all P–12 students with equal access to high-quality educational opportunities.
Strategic Objective 1.3	Prepare all students for successful transitions to college and careers by supporting access to dual enrollment, job skills development and high-quality science, technology, engineering and mathematics (STEM).
Strategic Objective 1.4	Support agencies and institutions in the implementation of evidence-based strategies and practices that build the capacity of school staff and families to support students' academic performance.
Strategic Goal 2: Expand postsecondary educational opportunities, improve outcomes to foster economic opportunity and promote an informed, thoughtful and productive citizenry.	
Strategic Objective 2.1	Support educational institutions, students, parents and communities to increase access and completion of college, lifelong learning and career, technical and adult education.
Strategic Objective 2.2	Support agencies and educational institutions in identifying and using evidence-based strategies or other promising practices to improve educational opportunities and successfully prepare individuals to compete in the global economy.
Strategic Objective 2.3	Support agencies and educational institutions as they create or expand innovative and affordable paths to relevant careers by providing postsecondary credentials or job-ready skills.
Strategic Objective 2.4	Improve quality of service for customers across the entire student aid life cycle.
Strategic Objective 2.5	Enhance students' and parents' ability to repay their federal student loans by providing accurate and timely information, relevant tools and manageable repayment options.
Strategic Goal 3: Strengthen the quality, accessibility and use of education data through better management, increased privacy protections and transparency.	
Strategic Objective 3.1	Improve the Department's data governance, data life cycle management and the capacity to support education data.
Strategic Objective 3.2	Improve privacy protections for, and transparency of, education data both at the Department and in the education community.
Strategic Objective 3.3	Increase access to, and use of, education data to make informed decisions both at the Department and in the education community.
Strategic Goal 4: Reform the effectiveness, efficiency and accountability of the Department.	
Strategic Objective 4.1	Provide regulatory relief to educational institutions and reduce burden by identifying time-consuming regulations, processes and policies and working to improve or eliminate them, while continuing to protect taxpayers from waste and abuse.
Strategic Objective 4.2	Identify, assess, monitor and manage enterprise risks.
Strategic Objective 4.3	Strengthen the Department's cybersecurity by enhancing protections for its information technology infrastructure, systems and data.
Strategic Objective 4.4	Improve the engagement and preparation of the Department's workforce using professional development and accountability measures.

[1] The FY 2018 Statement of Net Cost and related notes have been updated to align with the new *FY 2018–22 Strategic Plan*.

THE DEPARTMENT'S AGENCY PRIORITY GOALS (APGs)

The Department identified four APGs for FY 2018–19. Improving education starts with allowing greater decision-making authority at the state and local levels and empowering parents and students with educational options. These APGs aim to increase educational choice, improve the customer service the Department provides student aid borrowers, ensure protections of student privacy, and reduce red tape. The effective implementation of the Department's APGs will depend, in part, on the effective use of high-quality and timely data, including evaluations and performance measures. Quarterly updates for the APGs are available on **www.Performance.gov**.

APG	Related Strategic Objective
Improve the access to, and the quality and transparency of, school choice options for K–12 students. By September 30, 2019, the Charter School Program (CSP) will support the creation and expansion of 300 new charter schools nationally. The CSP will also support the enrollment of 50,000 students in new charter schools. Additionally, by September 30, 2019, the Department will disseminate eight resources, at least one per quarter, on evidence-based and promising practices related to school choice.	**Strategic Objective 1.1:** Increase high-quality educational options and empower students and parents to choose an education that meets their needs.
Improve borrowers' access to quality customer service. By September 30, 2019, Federal Student Aid will improve customers' access to and availability of quality customer service by decreasing the overall average speed of answer to 60 seconds or less, decreasing abandoned rates to three percent or less and requiring all non-default federal student loan servicers to expand and standardize call center hours.	**Strategic Objective 2.4:** Improve quality of service for customers across the entire student aid life cycle.
Improve student privacy and data security at Institutions of Higher Education (IHEs) through outreach and compliance efforts. By September 30, 2019, the Department will increase information security program outreach activities to IHEs by 40% in order to help protect IT systems and data privacy and commence audits of IHEs subject to A-133 and *Gramm-Leach-Bliley Act* (GLBA), resulting in 36 IHEs (from a baseline of zero) completing an audit of GLBA-related information security safeguards with no significant findings.	**Strategic Objective 3.2:** Improve privacy protections for, and transparency of, education data both at the Department and in the education community.
Provide regulatory relief to education stakeholders. By September 30, 2019, the Department will reduce the regulatory burden on education stakeholders by submitting to OMB no less than 25 deregulatory actions (against a baseline of zero (0) for FYs 2015 and 2016).	**Strategic Objective 4.1:** Provide regulatory relief to educational institutions and reduce burden by identifying time-consuming regulations, processes and policies and working to improve or eliminate them, while continuing to protect taxpayers from waste and abuse.

Goal 1. Support state and local efforts to improve learning outcomes for all P–12 students in every community.

Strategic Goal 1 focuses on outcomes related to the transition from the *No Child Left Behind Act* to implementation of the *Every Student Succeeds Act* (ESSA), which reauthorized the *Elementary and Secondary Education Act* in December 2015. The hallmark of the ESSA is the flexibility it provides for states to do what is best for children while preserving important protections for economically disadvantaged students, children with disabilities, English learners, and other vulnerable students. The law requires that states take steps to ensure all students have access to excellent teachers and positive, safe learning environments that equip them for college and career success.

The Agency Priority Goal associated with Strategic Goal 1 focuses on expanding educational choice options for parents and students. Specifically, the APG aims to improve the access to, and the quality and transparency of, school choice options for K–12 students.

APG for FY 2018–2019: Improve the access to, and the quality and transparency of, school choice options for K–12 students.

By September 30, 2019, the Charter School Program (CSP) will support the creation and expansion of 300 new charter schools nationally. The CSP will also support the enrollment of 50,000 students in new charter schools. Additionally, by September 30, 2019, the Department will disseminate eight resources, at least one per quarter, on evidence-based and promising practices related to school choice.

To achieve this APG, the Department focused on the implementation of its Charter School Program, including conducting new competitions and providing technical assistance to current grantees. Through CSP, the Department supported 134 new charter schools in school year 2017–18. The FY 2018 performance target for new charter schools was set at 150. Of significant note, preliminary data indicate that the total number of students enrolled in CSP-supported schools is over 1.6 million, which exceeds the FY 2018 target of 1,564,854 (Prior Year + 25,000). Additionally, the Department released five evidence-based and promising practice resources related to educational choice. The Department expects to continue to support research in this area through a National Center for Research on Education Access and Choice (REACH). In July 2018, the Department awarded a five-year grant to the REACH Center to complete two central activities: carrying out studies and developing the National Longitudinal School Choice Database (NLSCD). Through a set of 34 studies (quantitative and qualitative), the REACH Center will examine five types of state and district policies regarding school choice to identify how these policies can be structured to improve the education received by disadvantaged students. Additional information on this APG is available on **www.Performance.gov**.

Goal 2. Expand postsecondary educational opportunities, improve outcomes to foster economic opportunity and promote an informed, thoughtful and productive citizenry.

Strategic Goal 2 focuses on expanding the Department's efforts to support innovative and accessible paths to postsecondary credentials and job-ready skills training. In addition to supporting expanded postsecondary opportunities, the Department has a number of initiatives focused on affordability. These initiatives ensure borrowers have the best information available to make postsecondary program selection and associated borrowing decisions. The Department also continues to help students understand their financial aid options and repayment obligations. The Agency Priority Goal associated with Strategic Goal 2 focuses on improving borrowers' access to quality customer service.

APG for FY 2018–2019: Improve borrowers' access to quality customer service.

By September 30, 2019, Federal Student Aid will improve customers' access to and availability of quality customer service by decreasing the overall average speed of answer to 60 seconds or less, decreasing abandoned rates to three percent or less and requiring all non-default federal student loan servicers to expand and standardize call center hours.

Improving access to information and the speed of response will allow customers to have expanded access to the resources they need to manage their federal student loans successfully, which will empower students and help them to reduce the risk of delinquency and default. The office of Federal Student Aid (FSA) plans to have the Next Generation Financial Services Environment (Next Gen FSA) transform the student aid customer experience with the use of industry best-in-class financial services technologies. Due to the rapid development of Next Gen FSA, FSA reevaluated and suspended its plan for the expansion of call center hours across all servicers. Despite this change, FSA continued to communicate with servicers regarding expectations for improvements to average speed to answer (ASA) and average abandon rate (AR) metrics. For FY 2018, the overall average speed to answer was 65.97 seconds (from 76.9 seconds in FY 2017; FY 2018 performance target is less than 70 seconds) and the abandonment rate was 3.9 percent (from 3.8 percent in FY 2017; FY 2018 performance target is less than three percent). FSA delivered the first tangible result of Next Gen FSA that customers will be able to see and touch: a redesigned **fafsa.gov**. The website's pages fit the screen size and shape of any device, including desktop computers, laptop computers and mobile devices, such as smartphones or tablets. The beta mobile application, for the 2017–2018 FAFSA® form, was rolled out in August 2018. On October 1, 2018, FSA launched the fully functional myStudentAid mobile app, featuring the myFAFSA component, which allows individuals to complete and submit the 2019–20 FAFSA® form. FSA's flagship website for professionals, the Financial Aid Toolkit, received 139,168 visits in FY 2018. FSA also leveraged social media, in-person events, and the Information for Financial Aid Professionals (IFAP) website to disseminate news, information, and updates that IHEs need to participate in the Title IV programs successfully. Additional information on this APG is available on **www.Performance.gov**.

The website visits for FinancialAidToolkit.ed.gov (the website for counselors and mentors) has decreased from FY 2017 to FY 2018. In FY 2017, FSA launched the FAFSA on October 1 and required tax data from an earlier tax year than in the past. That year, we conducted a large multichannel marketing effort to ensure our customers knew of the changes. One piece of this effort was to engage our partners and direct them to the Toolkit website for resources. In FY 2018, we did not conduct a marketing campaign around the FAFSA. As a result the visits to the Toolkit website dropped. In FY 2019, we plan to once again conduct a large multichannel marketing effort around the launch of the 2019–20

FAFSA. We anticipate the number of visits to the FinanicalAidToolkit.ed.gov will increase in FY 2019.

Goal 3. Strengthen the quality, accessibility and use of education data through better management, increased privacy protections and transparency.

Strategic Goal 3 focuses on strengthening data-driven decision-making in education by focusing on the ways we manage and make available education data, while protecting student privacy. The Department is committed to improving how staff and stakeholders access, use, and share meaningful data on education while protecting privacy. These improvements enable the Department and other stakeholders in the education community to better provide the public with the information necessary to make informed decisions on behalf of their communities, states, and local districts. The Agency Priority Goal associated with Strategic Goal 3 focuses on improving student privacy and data security at IHEs through outreach and compliance efforts. Additional information on this APG is available on **www.Performance.gov**.

APG for FY 2018–2019: Improve student privacy and data security at Institutions of Higher Education (IHEs) through outreach and compliance efforts.

By September 30, 2019, the Department will increase information security program outreach activities to IHEs by 40% in order to help protect IT systems and data privacy and commence audits of IHEs subject to A-133 and the *Gramm-Leach-Bliley Act* (GLBA), resulting in 36 IHEs (from a baseline of zero) completing an audit of GLBA-related information security safeguards with no significant findings.

The Department plans to achieve this APG through collaborative efforts involving training, outreach, monitoring, and reporting. In FY 2018, FSA and the Department's Privacy Technical Assistance Center (PTAC) collaborated to conduct 63 outreach activities targeting data privacy and IT security requirements of IHE. Many of the outreach activities performed were sessions at large conferences (e.g., the sessions at the FSA training conference that PTAC gave with 400+ attendees per session) and 97% of attendees at two PTAC sessions in California and Arkansas agreed or strongly agreed that it was helpful. The Office of Management and Budget did not include the new audit standards for GLBA-related information security safeguards in the audit compliance supplement this year. As such, the Department cannot yet report on the number of IHEs passing an audit of GLBA-related information security safeguards. Additional information on this APG is available on **www.Performance.gov**.

Goal 4. Reform the effectiveness, efficiency and accountability of the Department.

The Department's organizational capacity relies not only on our human capital but also on other resources, including physical, material, financial, and informational resources. Strategic Goal 4 focuses on improving the Department's processes, such as reviewing regulations, and where appropriate, on repealing, replacing or modifying regulations. The APG associated with Strategic Goal 4 aims to provide regulatory relief to education stakeholders.

APG for FY 2018–2019: Provide regulatory relief to education stakeholders.

By September 30, 2019, the Department will reduce the regulatory burden on education stakeholders by submitting to OMB no less than 25 deregulatory actions (against a baseline of zero (0) for FYs 2015 and 2016).

The Department intends to reduce the regulatory burden on stakeholders through review, rescission, and modification of outdated, burdensome regulations and guidance. The goal will be achieved through a comprehensive review of the Department's regulations and guidance to identify those that are overly burdensome, inconsistent with Administration priorities, unnecessary, outdated, or ineffective. Based on that review, the Department will determine whether such regulations or guidance need to be modified or rescinded and will then take appropriate action consistent with applicable law. For FY 2018, the Department submitted a total of 24 deregulatory actions, including four significant deregulatory actions reflected on reginfo.gov and 20 requests for significance determination of deregulatory actions submitted to OMB via e-mail (FY 2018 performance targets are two and 13, respectively). The Department published two key deregulatory actions: the Significant Disproportionality Delay Rule and the State Authorization Distance Education Delay Rule. These actions provide an estimated $13.1 million in cost savings for the regulated communities over the next two years. This number includes $7.5 million in cost savings for the Significant Disproportionality Delay Rule and $5.6 million for the State Authorization Distance Education Delay Rule.

FINANCIAL HIGHLIGHTS

INTRODUCTION

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

The Department consistently produces complete, accurate, and timely financial information. The Department's financial statements and notes are prepared in accordance with accounting principles generally accepted in the United States for federal agencies issued by the Federal Accounting Standards Advisory Board and the format and content specified by OMB Circular No. A-136, Financial Reporting Requirements. The financial statements, notes, and underlying business processes, systems, and controls are audited by an independent accounting firm with audit oversight provided by the Office of Inspector General (OIG). For 17 consecutive years, the Department has earned an unmodified (or "clean") audit opinion. The financial statements and notes for FY 2018 are on pages 28–67 and the Independent Auditors' Report begins on page 76.

BALANCE SHEETS

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

The Department's assets totaled $1,328.0 billion as of September 30, 2018. The vast majority of the assets relate to credit program receivables, which comprised 91.2 percent of all assets. Direct Loans comprise the largest share of these receivables, totaling $1,115.1 billion. All other assets totaled $117.1 billion, most of which was Fund Balance with Treasury.

The Department's liabilities totaled $1,279.2 billion as of September 30, 2018. As with assets, the vast majority of the Department's liabilities are associated with credit programs, primarily amounts borrowed from the U.S. Department of the Treasury (Treasury) to fund student loans. Debt associated with Direct Loans totaled $1,150.6 billion as of September 30, 2018.

Figure 1. Assets by Type

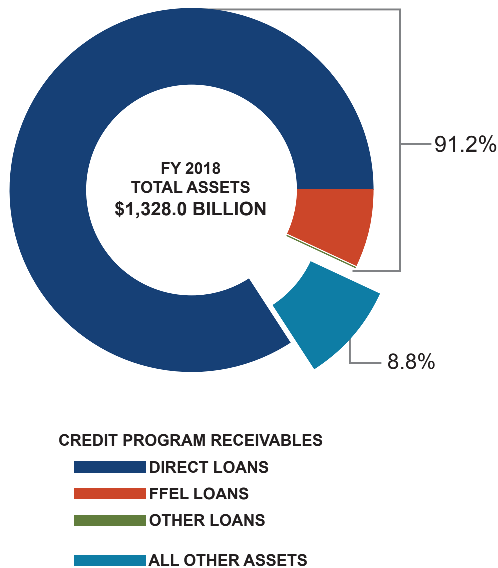


Figure 2. Liabilities by Type

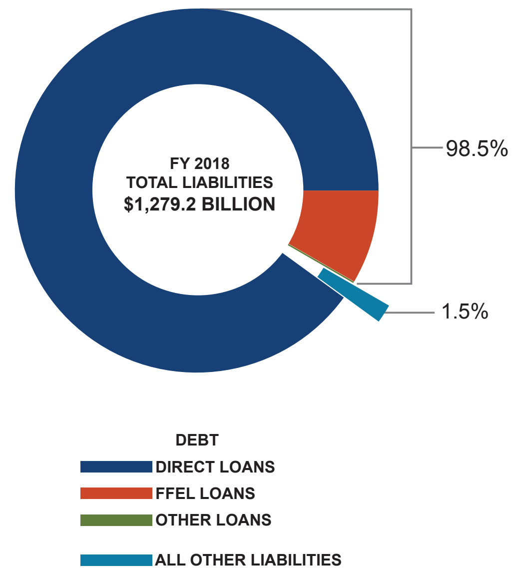
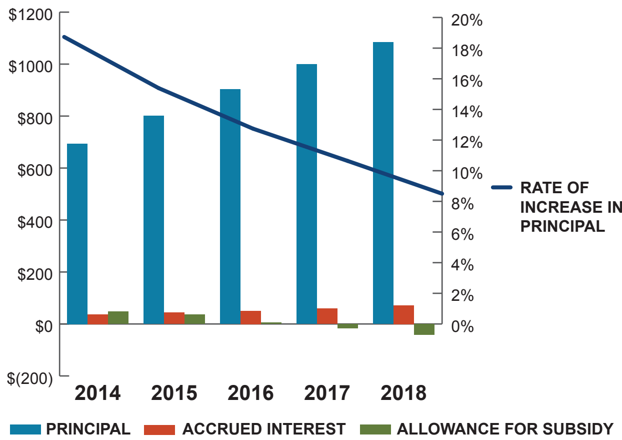


Figure 3. Components of Direct Loan Receivables, Net
(Dollars in Billions)



Direct Loan Component (Dollars in Billions)	Fiscal Year				
	2014	2015	2016	2017	2018
Principal	**$ 694.0**	**$ 800.8**	**$ 902.8**	**$ 998.8**	**$1,083.7**
Rate of Increase in Principal	18.7%	15.4%	12.7%	10.6%	8.5%
Accrued Interest	$ 37.1	$ 44.3	$ 50.8	$ 59.5	$ 72.0
Allowance for Subsidy	$ 47.4	$ 35.5	$ 5.3	$ (16.8)	$ (40.7)
Total No. of Direct Loan Recipients (in Millions)	**27.9**	**29.9**	**31.5**	**33.0**	**34.2**

Figure 3 shows the changes in the Direct Loan receivables components over the past five years. The principal continues to grow as the Direct Loan program has originated all new federal loans since July 2010. However, the rate of increase in principal has slowed, as the Direct Loan program has originated fewer new loans each year since FY 2014 as a result of stagnant and in some cases declining enrollment, coinciding with the recovery from the 2007–09 recession. Even so, new loan disbursements continue to exceed overall loan principal repayments—student loan borrowers now have more options to stretch out their repayment terms and reduce their monthly payments.

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

Prior years' positive allowance for subsidy balances represented estimates of funds expected to be recovered in excess of principal loaned less anticipated defaults, loan cancellations, and other adjustments. These positive allowance for subsidy balances resulted primarily from the difference between the interest rates charged by the Department to borrowers and the interest rates charged to the Department on amounts borrowed from Treasury to make the loans. The reduction in the positive allowance since FY 2014 is due primarily to higher subsidy costs, the main cause being high participation in income-driven repayment plans. As of FY 2017, the allowance for subsidy changed to a negative balance. In practical terms, this means that the present value of funds expected to be recovered is now less than the principal outstanding.

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

Loan Status	Fiscal Year				
	2014	2015	2016	2017	2018
Total No. of Direct Loan Recipients (in Millions)	**27.9**	**29.9**	**31.5**	**33.0**	**34.2**
Total Dollar Amount of Direct Loans Outstanding	**$ 731.2**	**$ 845.1**	**$ 953.6**	**$1,058.4**	**$1,155.7**
Current Repayment[1]	247.2	332.0	406.8	467.9	531.4
In School, Grace Period, and Education Deferments	281.8	284.3	289.6	291.7	291.7
Forbearance and Noneducation Deferments	97.8	103.0	106.5	122.5	121.9
Delinquent (Past Due 31–360 Days)	54.6	65.1	71.8	79.5	92.2
Default/ Bankruptcy/ Other	49.8	60.7	78.9	96.8	118.5

[1] Loans in Current Repayment status include loans that are being repaid on-time. However, these on-time loans can include loans for which the amount of interest accruing is higher than payments that are being made, which can occur in the case of loans on income-driven repayment plans.

Participation in income-driven repayment plans has increased as (a) plans have become available that are more advantageous to borrowers, (b) plans have become available that expand the potential pool of borrowers, and (c) the Department has conducted targeted outreach to borrowers to make them aware of their potential eligibility for these plans. The percentage of borrowers in income-driven repayment plans has grown from 10.6 percent in FY 2013 to 30.0 percent in FY 2018.

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

Loans in the Delinquent category are past due anywhere from 31 to 360 days late. Default/Bankruptcy/Other includes loans that are over 360 days delinquent (default status); loans in a nondefaulted bankruptcy status; and loans in disability status. While technical default is 271 days delinquent, default is defined as 361 days delinquent for reporting purposes. The percentage of loans in default continues to grow, even as delinquencies and new defaults have declined, because defaulted loans can be difficult to collect or rehabilitate. The percentage of the portfolio in current repayment, which rose from 34 percent in FY 2014 to 46 percent in FY 2018, has eclipsed payments temporarily postponed and has grown far faster than loans in default.

The Department borrows funds to disburse new loans and pay credit program outlays and related costs. The Department repays Treasury after consideration of cash position and the liability for future cash outflows. Figure 4 shows the Direct Loan program cumulative borrowing and repayment activity that resulted in the debt amount on the balance sheet. Figure 6 (see page 12) illustrates the Direct Loan program financing process and provides financing and disbursing trend data.

STATEMENTS OF NET COST

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

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

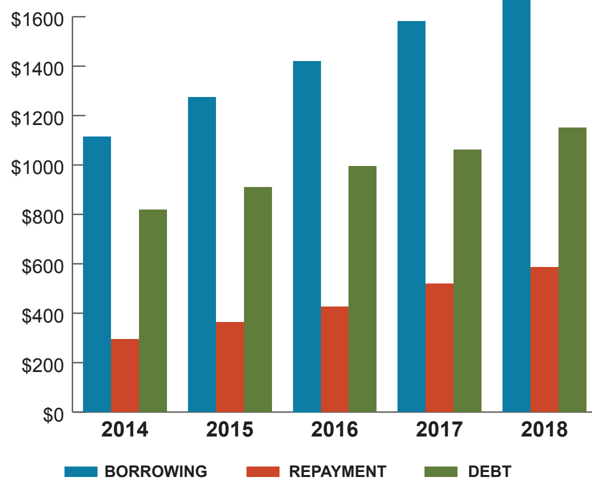


Figure 5. Gross Costs & Earned Revenue
(Dollars in Billions)

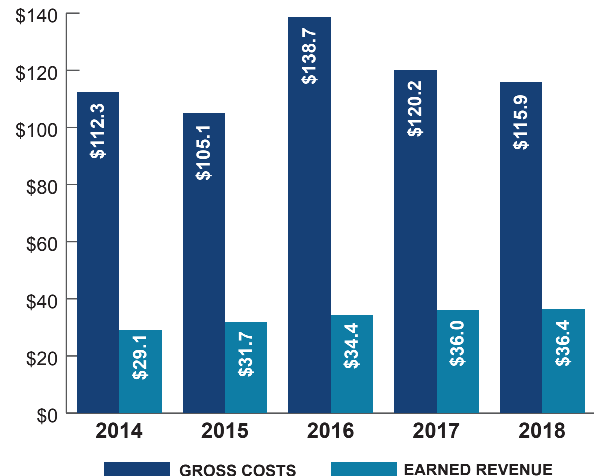
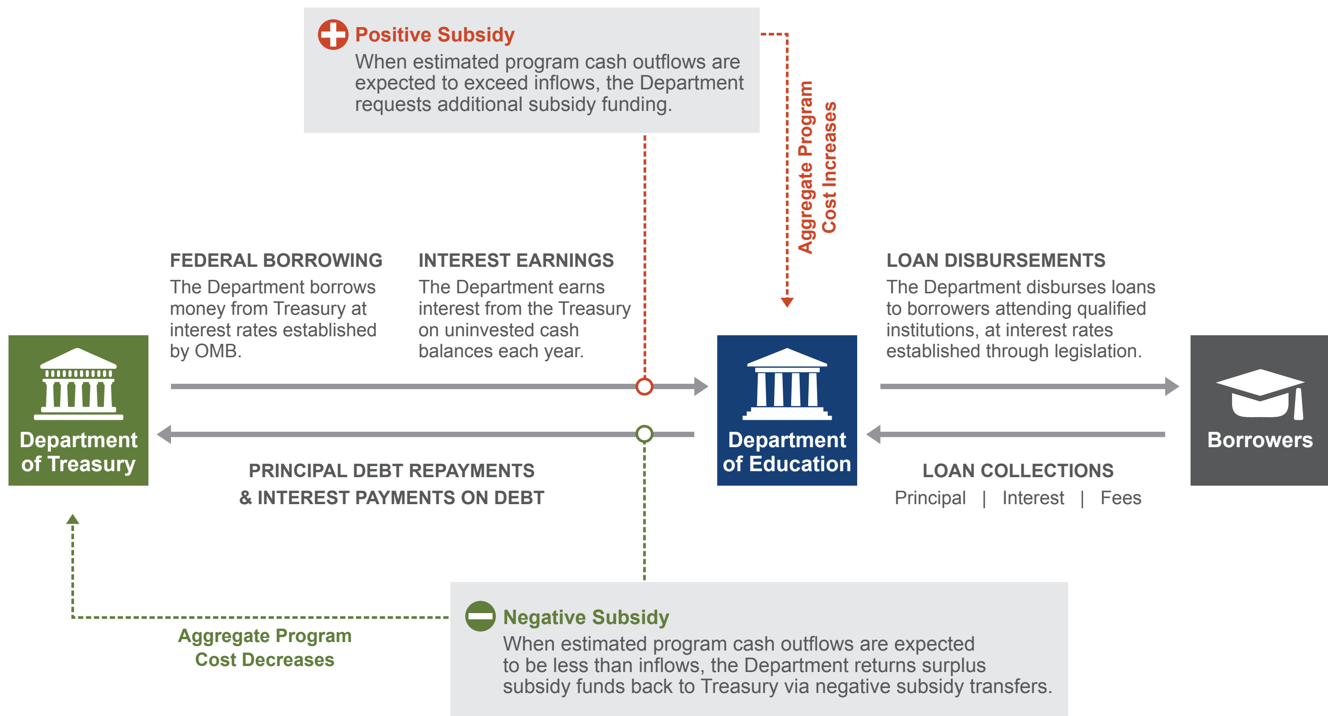


Figure 6. William D. Ford Federal Direct Loan Program: *Following the Funding*



Treasury Financing and Subsidy Cost of Direct Loans (Dollars in Billions)					
Fiscal Year	2014	2015	2016	2017	2018
Net Borrowing	**120.6**	**90.9**	**84.4**	**67.3**	**89.1**
Borrowing from Treasury	171.2	159.7	147.0	160.5	155.3
Debt Repayments to Treasury	(50.6)	(68.7)	(62.6)	(93.2)	(66.2)
Interest Expense to Treasury	(25.2)	(27.6)	(30.5)	(31.3)	(32.3)
Interest Earned from Treasury	3.7	4.2	3.9	4.3	3.9
Cumulative Taxpayer Cost / (Savings)	(47.4)	(35.5)	(5.3)	16.8	40.7
Current Subsidy Expense (Revenue)	8.1	(0.9)	16.1	5.3	7.4

Direct Loan Program Cash Transactions with Borrowers (Dollars in Billions)					
Fiscal Year	2014	2015	2016	2017	2018
Loan Disbursements	**134.1**	**142.2**	**140.5**	**142.5**	**134.1**
Stafford Subsidized	25.9	24.0	23.8	23.4	20.3
Stafford Unsubsidized	54.7	52.7	52.3	51.4	49.0
PLUS	18.9	19.2	19.0	18.7	23.1
Consolidation[1]	34.5	46.4	45.5	49.0	41.6
Loan Collections[2]	**48.8**	**65.1**	**73.2**	**82.0**	**84.9**
Principal	36.3	50.0	55.9	62.6	63.5
Interest	10.8	13.4	15.5	17.6	19.5
Fees	1.8	1.8	1.8	1.9	1.9

* Numbers may not add up due to rounding.

[1] Consolidation amounts stem from a number of loan programs, including most notably the Federal Family Education Loan (FFEL) program, in addition to Direct Loans.

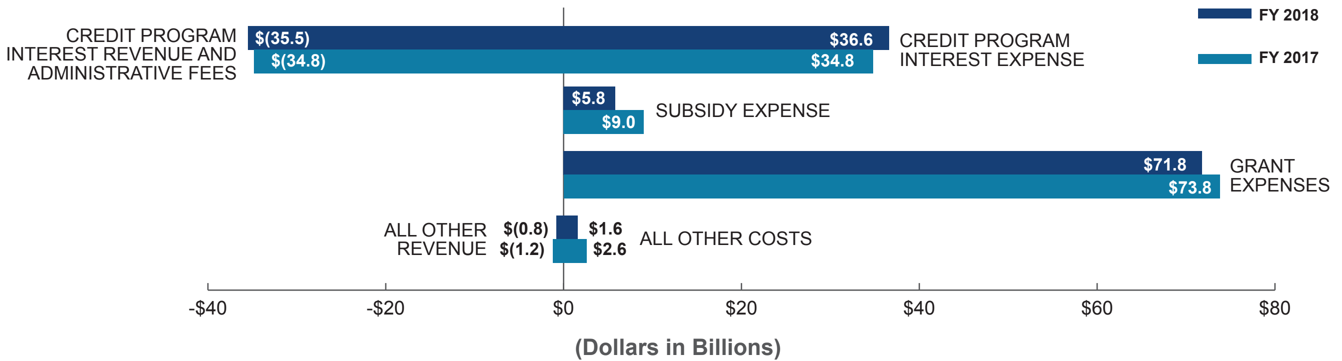
[2] Loan collections include prepayments, including prepayments in full due to consolidation of underlying loans.

GROSS COSTS AND EXCHANGE REVENUE BY TYPE

The major components of the Department's gross costs and earned revenue include three primary components:

- Credit program interest expense offset by credit program interest revenue and administrative fees as the result of subsidy amortization;
- Credit program subsidy expense (see Analysis of Direct Loan Program Subsidy Expense below); and
- Grant expenses (see Figure 9).

Figure 7. Major Components of Gross Cost and Earned Revenue



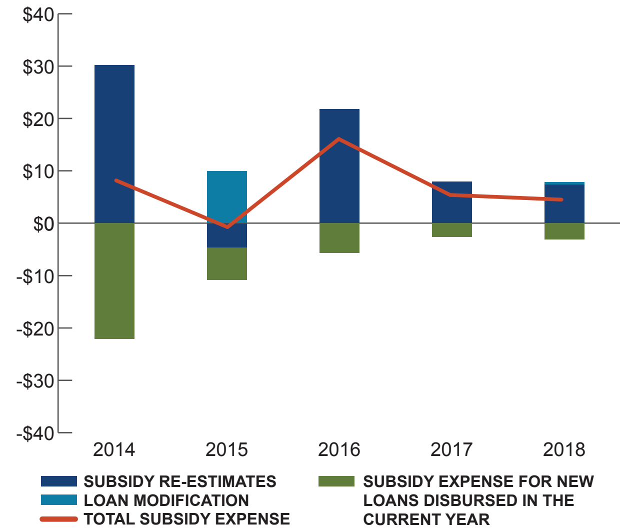
ANALYSIS OF DIRECT LOAN PROGRAM SUBSIDY EXPENSE

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

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

Factors, such as interest rates charged to the borrower, interest rates on Treasury debt, default rates, fees and other costs, and assumptions concerning borrowers' selection of repayment plans, impact the estimated cost calculation and determine whether the overall subsidy expense is positive or negative. Subsidy expense for new

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



	2014	2015	2016	2017	2018
Subsidy Expense for New Loans Disbursed in the Current Year	$(22.1)	$ (6.2)	$ (5.7)	$ (2.6)	$ (3.1)
Subsidy Re-estimates	30.2	(4.6)	21.8	7.9	7.4
Loan Modification	-	9.9	-	-	0.1
Total Subsidy Expense	**$ 8.1**	**$ (0.9)**	**$16.1**	**$ 5.3**	**$ 4.4**

loans disbursed in the current year has been negative in recent years primarily because lending interest rates charged were greater than the historically low rates at which the Department borrowed from Treasury. In practical terms, a negative subsidy occurs when the interest and/or fees charged to the borrower are more than sufficient to cover the interest on Treasury borrowings and the costs of borrower default.

Direct Loan program re-estimated subsidy cost was adjusted upward by $7.4 billion in FY 2018. Re-estimated costs only include cohorts that are 90 percent disbursed; cohort years 1994–2017. In addition to the major assumption updates described below, the re-estimate reflects several other assumption updates, including interest rates provided by OMB, volume, and enter repayment rates.

- **Income-Driven Repayment (IDR) Model Changes—** In 2018, the Department updated several assumptions within its IDR submodel and refined the logic for borrowers switching between IDR plans. These updates led to a net downward re-estimate of $4.1 billion.

- **Repayment Plan Selection—**The Department incorporated new repayment plan data that showed a continuing increase in IDR plan usage. The update also reflects changes in interpretation of repayment plan codes for Direct Loan consolidations. Much of the consolidation loan volume that was previously classified as standard (ten-year fixed) is now classified as extended. Also, the Department changed the methodology for assigning and forecasting plans from an origination cohort basis to an enter repayment cohort basis. Lastly, the Department placed limits on forecasted growth of IDR participation to reflect an anticipated saturation point. The combined effect of these changes was a net upward re-estimate of $2.1 billion.

- **Default Rates—**The Department made updates to the default rate model in FY 2018, primarily reflecting updates in the data, which led to a net upward re-estimate of $14.8 billion.

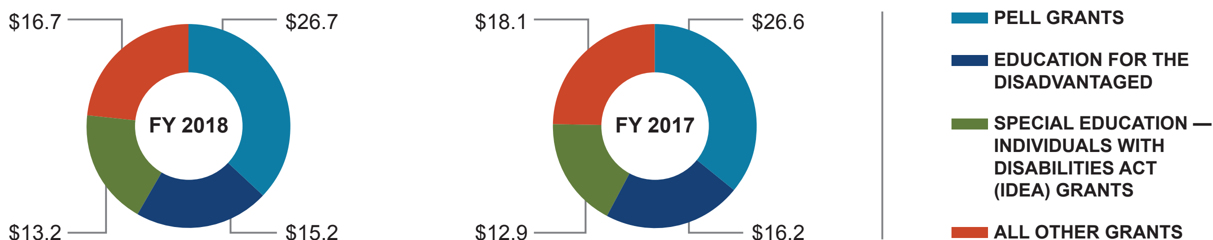
The Department has more than 100 grant and loan programs (www.ed.gov/programs/inventory.html). The Department's FY 2018 expenses for grant programs totaled $71.8 billion. The three largest grant programs are:

- **Pell Grants—**provides need-based grants to students to promote access to postsecondary education. Grant amounts are dependent on: the student's expected family contribution; the cost of attendance (as determined by the institution); the student's enrollment status (full-time or part-time); and whether the student attends for a full academic year or less. Pell grants are the single largest source of grant aid for postsecondary education.

- **Education for the Disadvantaged—**primarily consists of Title I grants that provide financial assistance through state educational agencies to local educational agencies and public schools with high numbers or percentages of poor children to help ensure that all children meet challenging state academic content and student academic achievement standards. Also provides funds to states to support educational services to children of migratory farmworkers and fishers, and to neglected or delinquent children and youth in State-run institutions, attending community day programs, and correctional facilities.

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

Figure 9. Grant Costs by Appropriation (Dollars in Billions)



In addition to student loans and grants, the Department offers other discretionary grants under a variety of authorizing legislation, awarded using a competitive process and formula grants, using formulas determined by Congress with no application process.

STATEMENTS OF CHANGES IN NET POSITION

The consolidated statements of changes in net position report the beginning net position, the summary effect of transactions that affect net position during the fiscal year, and the ending net position. Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include undelivered orders and unobligated balances for grant and administrative operations. Cumulative results of operations represent the net difference since inception between (1) expenses and (2) revenues and financing sources.

STATEMENTS OF BUDGETARY RESOURCES

The combined statements of budgetary resources present information on how budgetary resources were made available and their status at the end of the fiscal year. Information in the statements is based on budgetary transactions as prescribed by OMB and Treasury.

The Department's budgetary resources totaled $358.5 billion for the period ended September 30, 2018, decreasing from $398.5 billion, or approximately 10.0 percent from the prior year. Budgetary resources are comprised of appropriated budgetary resources of $113.1 billion and non-budgetary credit reform resources of $245.4 billion. The non-budgetary credit reform resources are predominantly borrowing authority for the loan programs.

The Department's gross outlays totaled $298.6 billion for the period ended September 30, 2018. Gross outlays are primarily comprised of credit program loan disbursements and claim payments, credit program subsidy interest payments to Treasury, and grant payments. Credit program gross outlays were offset by $124.4 billion of collections—primarily principal, interest, and subsidy collections.

LIMITATIONS OF THE FINANCIAL STATEMENTS

The principal financial statements are prepared to report the financial position and results of operations of the reporting entity, pursuant to the requirements of 31 U.S.C. § 3515(b). The statements are prepared from the Department's books and records in accordance with generally accepted accounting principles for federal entities and the formats prescribed by OMB. Reports used to monitor and control budgetary resources are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. Government.

Figure 10. Budgetary Resources

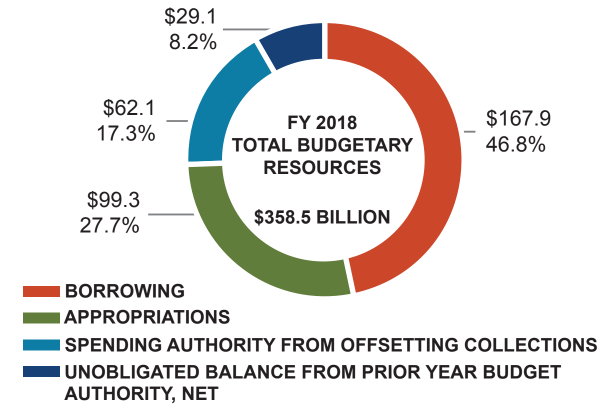
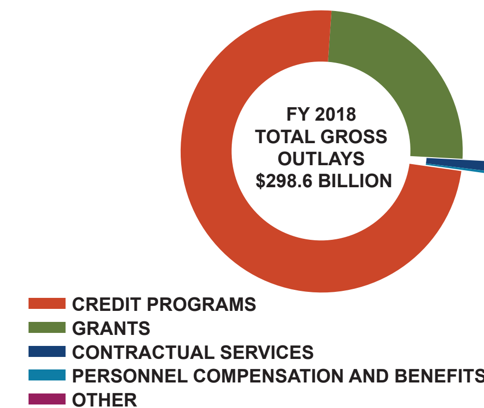


Figure 11. Gross Outlays by Type



	Billions	%
CREDIT PROGRAMS	**$ 221.3**	**74.3%**
DIRECT LOAN PROGRAM	205.0	68.9%
FFEL PROGRAM	15.6	5.2%
OTHER CREDIT PROGRAMS FOR HIGHER EDUCATION	0.7	0.2%
GRANTS	**$ 73.8**	**24.6%**
PELL GRANTS	28.2	9.4%
EDUCATION FOR THE DISADVANTAGED	15.3	5.1%
SPECIAL EDUCATION - INDIVIDUALS WITH DISABILITIES ACT (IDEA) GRANTS	12.9	4.3%
ALL OTHER GRANTS	17.4	5.8%
CONTRACTUAL SERVICES	**$ 2.8**	**0.9%**
PERSONNEL COMPENSATION AND BENEFITS	**$ 0.6**	**0.2%**
OTHER	**$ 0.1**	**0.0%**
TOTAL	**$ 298.6**	**100.0%**

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

MANAGEMENT ASSURANCES

The Secretary of Education's 2018 Statement of Assurance provided below is the final report produced by the Department's annual assurance process. Although the Department has not identified any material weaknesses, it acknowledges that there are significant weaknesses and management challenges to be addressed that are identified elsewhere in this report.

STATEMENT OF ASSURANCE
FISCAL YEAR 2018
November 14, 2018

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

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

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

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

Based on the results of the Department's assessments described above, our system of internal controls provides Department management with reasonable assurance that the objectives of sections 2 and 4 of the FMFIA were achieved as of September 30, 2018.

Betsy DeVos

INTRODUCTION

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

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

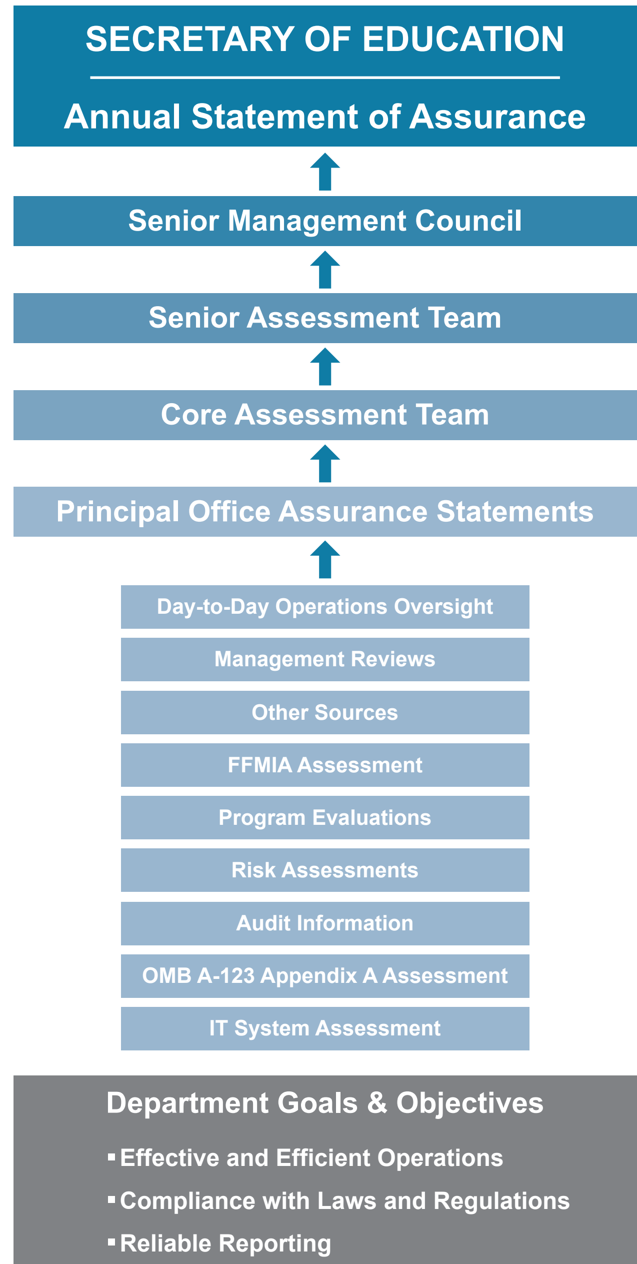
This section describes the Department's internal control framework, an analysis of the effectiveness of its internal controls, and assurances provided by the Department's leadership that internal controls were in place and working as intended during FY 2018 to meet the three objectives.

Control Framework

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

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

Figure 12. Internal Control Framework and Assurance Process



The Office of the Chief Financial Officer (OCFO) manages the assurance process on behalf of Department leadership. The Department established governance over the process, consisting of a Senior Management Council, a Senior Assessment Team (SAT), and a Core Assessment Team (CAT). The Senior Management Council is comprised of senior leaders from across the Department. It is the primary governance structure for ensuring overall management and efficiency of Department activities, especially with respect to process, procedures, and administrative structures, including providing strategic direction for the implementation of the internal control program. The SAT and CAT include representatives from OCFO, the Office of the Chief Information Officer (OCIO), student loan and grant-making program offices, Risk Management Service, and other operational support offices (including the Office of Management). The SAT and CAT provide greater oversight and monitoring of activities related to internal control assessments.

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

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

ANALYSIS OF CONTROLS

Overall, the Department relies on the principal office annual assurances, supported by risk-based internal control evaluations and testing, to provide reasonable assurance that its internal controls are well designed and in place and working as intended. The Department also considers issues identified by external auditors. During FY 2016, the Department revised its annual assurance process to conform to the new requirements contained in the revised U.S. Government Accountability Office publication, *Standards for Internal Control in the Federal Government* (commonly referred to as the "Green Book"). In FY 2018, the Department further revised the process to conform to the revised OMB Circular A-123 issued on July 15, 2016.

In FY 2018, the Department identified no material control weaknesses related to effective, efficient program operations and no areas of noncompliance with laws and regulations other than those noted in the Internal Control Exceptions section below. Although no material weaknesses were identified, the Department realizes that it has areas of control that need further strengthening, such as those disclosed in this report, the Independent Auditors' Report, and the major challenges identified by the Department's OIG in its OIG FY 2019 Management Challenges report. The Department continues to demonstrate its commitment to addressing, mitigating, or resolving its identified management challenges.

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

Internal Control over Financial Reporting

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

- comprehensive process documentation for the Department's significant business processes and subprocesses,
- maintenance of a control catalogue comprised of 3,934 key financial, operational, and Information Technology (IT) controls that align to the business processes (the Department documented 398 key controls and FSA documented 3,536 key controls [1,541 Business Process and Entity-Level controls and 1,995 IT controls]),

- technical assistance provided to principal offices to help them understand and assess key financial controls,
- a risk-based testing strategy, and
- a process to develop corrective action plans when control deficiencies are found and to track progress against those plans.

During FY 2018, the Department assessed the design and operating effectiveness of 2,767 key financial, operational, and IT process controls (the Department assessed 119 key controls and FSA assessed 2,648 key controls [1,287 Business Process and Entity-Level controls and 1,361 IT controls]).

Although some control deficiencies were detected, the Department did not identify any significant deficiencies or material weaknesses. Corrective actions have been initiated for the deficiencies identified. As a function of this assessment, the Department tested the key financial controls over the *Digital Accountability and Transparency Act of 2014* (DATA Act) reporting and concluded that the controls are designed and operating effectively.

INTERNAL CONTROL OVER FINANCIAL MANAGEMENT SYSTEMS

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

The Department's core financial systems are under the umbrella of the Education Central Automated Processing System (EDCAPS), serving approximately 8,500 Departmental internal users in Washington, D.C., and 10 regional offices throughout the United States, as well as 39,600 external users. In FY 2018, the Department conducted an annual risk assessment of EDCAPS and tested 92 IT security controls, out of a baseline of 630 IT security controls. EDCAPS is composed of five main linked components:

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

The Department designated the FMSS as a mission-critical system that provides core financial management services, and focused its system strategy on the following areas during FY 2018:

- Managing and implementing cross-validation rules throughout the fiscal year to prevent invalid accounting transactions from being processed,
- Transmitting the Department's spending data related to contracts, grants, loans, and other financial assistance awards for the USASpending.gov initiative as part of the *Federal Funding Accountability and Transparency Act of 2006*,
- Transmitting the entire Department's payments through the Department of Treasury Secure Payment System,
- Transmitting the Department's spending data related to contracts, grants, loans, and other financial assistance awards for the DATA Act implementation, and
- Initiating the upgrade of the FMSS Oracle E-Business Suite application to Oracle R12, to ensure continued vendor support, improved security, improved infrastructure, and enhanced functionality.

In FY 2019, EDCAPS will continue to provide customer service and improve security of its systems by completing the Department's implementation of Oracle E-Business Suite R12. In doing so, the Department will be current and ready to provide a more secure and better integrated financial management application.

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

Federal Information Security Modernization Act of 2014

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

The Department's and FSA's information security programs completed a number of significant activities in FY 2017 and FY 2018 to improve cybersecurity capabilities and functions, some of which included:

- In August of 2017, OCIO began publishing monthly ED Cyber Security Framework (CSF) Risk Scorecards. The CSF Risk Scorecard is published as part of ED's Information Security Continuous Monitoring (ISCM) efforts to identify cybersecurity risks, issues, and opportunities for improvements in our cybersecurity protections. The ED CSF Risk Scorecard is a detailed analysis tool for Authorizing Officials, Information System Owners, and Information System Security Officers to:
    - Describe the current cybersecurity posture;
    - Describe a target state for cybersecurity;
    - Identify and prioritize opportunities for improvement within the context of a continuous and repeatable process;
    - Assess progress toward the target state; and
    - Communicate among internal and external stakeholders about cybersecurity opportunities and risks.
    - The Department has also continued to strengthen its partnership with the Department of Homeland Security to deploy Continuous Diagnostics and Mitigation capabilities and strengthen the Department's ISCM program.
- 100 percent of Department users completed the annual computer security and privacy awareness training course in FY 2018. The Department strictly enforced compliance with annual security and privacy awareness training requirements, and disabled network accounts for noncompliant users. In addition, the Department won the Security Awareness Training Scenario category in the Federal Information Systems Security Educators Association's Annual Security Awareness, Training, and Education Contest.
- In January of 2018, OCIO undertook an effort to reshape the Department's cybersecurity policy and guidance. A new information security instruction and standards framework was developed to allow for the following:
    - Flexibility
    - Alignment with the Framework for Improving Critical Infrastructure Cybersecurity in coordination with M-17-25
    - Alignment with the current budgeting and risk reporting structures
    - Support for outcomes sensitive to the OCIO objectives
    - Responsiveness to the risk environment
    - Reduction in review and approval timelines
    - Workflow automation

ANALYSIS OF LEGAL COMPLIANCE

The Department identified two instances of noncompliance with laws and regulations in FY 2018. Additionally, reviews and assessments conducted pursuant to information technology-related laws and regulations identified challenges still facing the Department.

Improper Payments Information Act of 2002

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

In its annual improper payment compliance audit for FY 2017, the OIG concluded that the Department was not compliant with IPERA because it did not meet one of IPERA's six compliance requirements for the Pell Grant (Pell) program. The Department reported an improper payment rate for the Pell program that did not meet the prior year published reduction target. The Department met all six IPERA compliance requirements for the Direct Loan program. For FY 2018, the improper payment rates for the Pell and Direct Loan programs met the prior-year published reduction targets.

This determination of noncompliance with IPERA does not represent a material weakness in the Department's internal controls. The Department's current nonstatistical estimation methodology limits the ability to establish accurate out-year reduction targets. To address this issue, the Department coordinated with OMB and other stakeholders in 2018 to develop a statistically-valid methodology that will be implemented in 2019 to estimate improper payments for the Pell Grant and Direct Loan programs. This new methodology will improve the accuracy of the Department's improper payment estimates and the Department's ability to set and meet reduction targets.

Debt Collection Improvement Act of 1996

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

Due to unique program requirements of the Higher Education Act of 1965 (HEA), the Department requested guidance from Treasury's Bureau of Fiscal Service, Office of General Counsel for the application of this revised DCIA requirement to Title IV debt. Treasury provided its interpretation of this requirement for Title IV debt in July 2015. Per Treasury's interpretation, compliance for Title IV debt requires that the Title IV debt be: 1) in technical default (i.e., 271 days delinquent per Title IV aging) and 2) a receivable of the federal government. Therefore, the DCIA Treasury Offset Program referral requirement for Title IV debt owned by FSA at the time of delinquency is 271 days delinquent and for debt acquired via a FFEL guarantee default claim or default Perkins Loan assignment is 120 days delinquent (per DCIA aging which begins upon acceptance of a defaulted debt). As of September 30, 2018, the Department and FSA were not in compliance with the DCIA Treasury Offset Program referral requirement for Title IV debt as interpreted by Treasury because FSA had not yet revised its loan servicing systems, procedures, and internal processes in response to this interpretation. During FY 2018, FSA continued to implement changes to its default loan servicing system and business process for referring eligible debts to the Treasury Offset Program sooner. In addition, FSA provided guidance to the Guaranty Agencies that will facilitate sending debts to Treasury sooner. FSA anticipates this first round of changes will be implemented during FY 2019. Afterwards, FSA will a) revise its compliance reporting procedures to enable FSA to establish a new DCIA compliance baseline and b) analyze the remaining compliance gap to determine next steps. This area of noncompliance is noted in the independent auditors' report, exhibit C.

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

FORWARD-LOOKING INFORMATION

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

Enterprise Risk Management

The Department is focused on improving enterprise risk management (ERM) to maximize the Department's value to students and taxpayers through achievement of the Department's strategic goals and objectives. The Department's implementation of ERM includes three critical strategies that are more fully described under Strategic Objective 4.2, *Identify, assess, monitor and manage enterprise risks*:

1. Creating a risk-aware culture that includes transparent discussions of risks.
2. Implementing an ERM framework and capability that leverages existing risk management activities and governance bodies.
3. Managing risks in a more coordinated and strategic manner.

Beginning in FY 2019, when the ERM framework is fully implemented, the Department plans to include risk information as a central consideration in all critical day-to-day and strategic decision-making activities, including resource allocations. In FY 2018, the Department established a new governance structure for ERM and focused on building a top-down understanding of and commitment to managing risk more effectively across the organization. Under the new governance structure, senior leaders from all offices will participate in establishing and implementing enterprise-wide risk management strategies to promote strategic risk-taking and coordinated approaches to managing cross-cutting management challenges.

While the Department continues working to mature its ERM capability and develop a more complete portfolio of risks to inform decision-making at all levels of the organization, the Senior Management Council has focused on providing strategic direction to effectively manage its most significant risks. The risks summarized below are several of the most significant challenges and opportunities facing the Department that will continue to receive management priority in FY 2019 and beyond.

DIRECT LOAN PROGRAM

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

Managing Student Loan Debt

Each year, federal student loans help millions of Americans obtain a college education—an investment that, on average, has high returns. While the average return to a college degree remains high, some students leave school poorly equipped to manage their debt.

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

Recent trends in student loan repayment data show that:

- More than 80 percent of Direct Loan recipients with loans actively in repayment are current on their loans.
- As of June 2018, nearly 7.1 million Direct Loan recipients were enrolled in income-driven repayment plans, representing a 13 percent increase from June 2017 and a 34 percent increase from June 2016.

The Department continues to work relentlessly to make student debt more manageable. Looking to the future, the Department will:

- Continue conducting outreach efforts to inform student loan borrowers of their repayment options.
- Work to improve customer service and student aid systems and processes by implementing FSA's Next Generation Financial Services Environment (Next Gen FSA).

- Continue to support additional tools like the College Scorecard and Financial Aid Shopping Sheet to increase transparency around higher education costs and outcomes, in an effort to help students and families make informed decisions before college enrollment.

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

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

Legislative, Regulatory, and Policy Risk

There are inherent risks from the possibility that the cost structure of the Direct Loan program may be altered through legislative, regulatory, or administrative action. In addition, recent legislative, regulatory, and policy action may be difficult to interpret with regard to effects on financial modeling and estimation, given the lack of actual trend data availability. Some examples of current risks include the following:

Income-Driven Repayment Plans: Several new income-driven repayment (IDR) plans have been introduced in recent years, including Income-Based Repayment, Pay as You Earn (PAYE), and Revised Pay As You Earn. IDR plans tend to be more costly to the government than non-IDR plans; for the 2018 loan cohort, it is estimated that the government will recover 29 percent less for loans in income-driven repayment plans as compared to loans in standard plans. It is important to be careful in making such comparisons, however, as the underlying characteristics of borrowers selecting plans (and the corresponding dynamics of behavior driving selection in plans) also plays a role in driving the cost of loans enrolled in specific plans. In general, the proliferation of IDR plans has made income-driven repayment terms more generous (and more costly to the government) and made the plans available to a greater number of borrowers. Having more plans complicates repayment plan selection, since the tradeoffs between available plans vary by borrower and may not always be entirely clear. Selected comparisons between projected originations and borrower repayments under the different income-driven repayment plans are available on the **Department's website**. Future commitment to market and increased participation in these plans are areas of uncertainty.

Public Service Loan Forgiveness: Enacted in 2007, the Public Service Loan Forgiveness (PSLF) program allows a Direct student loan borrower to have the balance of their Direct student loans forgiven after having made 120 qualifying monthly payments under a qualifying repayment plan, while working full time for a qualifying public service employer (such as government or certain types of nonprofit organizations). In general, forgiveness provided via PSLF raises the cost of the Direct Loan program; however, there is still uncertainty as to how many borrowers will take advantage of the program. Much of this uncertainty arises because borrowers do not need to apply for the program until after having made the 120 qualifying monthly payments.

Data on approved PSLF applications first became available in FY 2018, since borrowers first became eligible for PSLF starting October 1, 2017. As of September 30, 2018, the total number of borrowers who received forgiveness totaled 206. The value of this forgiveness totaled $12.32 million. Despite the relatively modest figures of approved applications to date, the number of borrowers who have certified their employment in a public service organization continues to increase. As of September 30, 2018, the number of borrowers with certified employment totaled 936,029. The low number of approved PSLF applications in relation to employment certifications may be partially due to the complicated nature of the program, in particular the determination of what constitutes a qualifying payment. Many borrowers who file employment certification forms early in their careers may also move into private sector employment before reaching the 10 years and thus may (a) never apply for forgiveness or (b) apply for forgiveness much later, after returning to public service work. In the *Consolidated Appropriations Act*, FY 2018, Congress provided $350 million in funding to forgive up to $500 million in loan balances which were ineligible for immediate PSLF solely due to having made a payment under a nonqualifying repayment plan. Future congressional action that may affect eligibility for PSLF will continue to be an area of uncertainty. Lastly, the Department continues to remain informed on, and manage the risk that may arise in relation to, the uncertainty about the effect of further borrower outreach on boosting participation in the PSLF program.

Total and Permanent Disability: The *Tax Cut and Jobs Act of 2017*, signed into law on December 22, 2017, exempted the discharge of student loans due to total and permanent disability (TPD) from taxable income. TPD discharges had previously been considered taxable income. However, loan amounts discharged due to TPD may continue to be considered taxable income for state tax purposes. On April 16, 2018, the Department of Education announced that it would start matching records from the Department's National Student Loan Data System with Department of Veterans Affairs systems, in order to expedite the processing of total and permanent disability discharges. Borrowers matched through this process will be mailed a customized letter that will explain eligibility for loan discharge and include a TPD application. The borrower can sign and return the application to complete the process of applying for a TPD discharge. The individual effects of each of these changes, as well as the potential interaction between them, will remain an area of uncertainty until enough actual data can be observed to analyze their impact.

Estimation Risk

Actual student loan outcomes may deviate from estimated student loan outcomes, which is not unexpected given the long projection window of up to 40 years. The Direct Loan program is subject to a large number of future borrower-level events and economic factors that heavily impact the ultimate cost of issued loans. For example, estimates that need to be made for loans originating in FY 2017 include how long students will remain in school; what repayment plan will be chosen; whether the loan will be consolidated; whether the borrower will die, become disabled, bankrupt, or have another claim for discharge or forgiveness (closed school, borrower defense, etc.); if the loan will go into deferment or forbearance; if the loan will go into default and, if so, what collections will be received on the defaulted loan; and, if the loan is in income-driven repayment, what the borrower's employment (public sector or not) and income and family status will be over the next 25 years. These types of projections are not only extremely difficult to make but also are subject to change if future student behaviors deviate from past experience. Changes in private student loan markets, such as the recent increase in refinancing of federal student loans into private student loans, also add a layer of uncertainty to student loan estimates. Lastly, the Direct student loan portfolio has grown from approximately $382 billion in FY 2011 to around $1.2 trillion as of the end of FY 2018. This growth naturally results in larger re-estimates, since a re-estimate worth 1 percent of the portfolio today would be more than three times as large as a similar re-estimate in FY 2011 ($11.2 billion vs. $3.8 billion).

Macroeconomic Risk

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

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

Unemployment: The financial crisis of 2008 and ensuing spike in unemployment rates had a dramatic effect on both student loan volume and student loan performance. Student loan volume peaked along with unemployment, as many displaced workers sought higher education opportunities. Student loan performance suffered as many borrowers repaying their loans were left with much less disposable income with which to make their loan payments. For example, the cohort default rate for students was at a high of 14.7 percent for loans entering repayment in 2010, while the most recent rate is 10.8 percent for loans entering repayment in 2015. While recessions and economic downturns are cyclical phenomena, their exact timing and impact on the cost estimates remain an area of uncertainty.

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

Operational Risk

Unforeseen issues in administering and servicing student loans may impact the cost estimates. For example, in March 2017, a tool used to transfer automatically a family's tax information to both student aid applications and IDR plan applications was taken down due to

security concerns. Although usage of the tool for IDR recertification has since been brought back up, it is yet uncertain what, if any, impact this outage may have had on student loan cost estimates. However, this example highlights that there is an inherent risk that future, unpredictable disruptions in the administrative status quo may impact student loan cost estimates.

NEXT GEN FSA

About FSA

As the nation's largest provider of financial aid for education beyond high school, FSA delivers more than $120 billion in aid each year to students and their families. Through programs authorized under the *Higher Education Act of 1965*, as amended, FSA provides grants, loans, and work-study funds for college or career school. FSA also oversees the approximately 6,000 postsecondary institutions that participate in the federal student aid programs. In every interaction with students and their families, FSA strives to be the most trusted and reliable source of student financial aid information and services in the nation.

The Vision

FSA has one of the largest consumer loan portfolios in the country at $1.4 trillion.[1] It is critical that we provide a customer experience that is on par with world-class financial services firms and to establish our organization as one of the most trusted brands in the student aid industry. The Next Generation Financial Services Environment (Next Gen FSA) will enable FSA to realize this vision by modernizing the way we connect with our customers, while streamlining our student aid systems and processes. This broad effort will deliver an exceptional customer experience for millions of Americans across the entire student aid life cycle, from fostering greater awareness about the availability of financial aid, to applying for aid, to repaying loans.

Today's Environment

In the current federal financial aid process, students and families must negotiate a complex and fragmented landscape, interacting with multiple systems, vendors, processes, and interfaces across a multitude of brands and user experiences. Too often, this poor customer experience creates confusion, resulting in borrowers failing to understand their repayment options and the financial implications of their student debt, borrower indifference, and, ultimately, higher loan delinquency and default rates. Additionally, operational complexities and inefficiencies result in higher administrative costs and hinder effective oversight.

Next Gen FSA Environment

Multiple websites, mobile applications, contact centers, and other customer interfaces will be combined into a simplified, consistent, and engaging experience, which will be enhanced by standardized training and tools across vendors and partners. With a focus on mobile engagement, Next Gen FSA will meet customers where they are, letting them connect with FSA on the device of their choice. Customers will access a modernized, online portal with personalized information that helps them quickly understand their options and make informed decisions throughout the financial aid life cycle, including borrowing and loan repayment. While Next Gen FSA will cut through the information clutter and provide robust self-service, it also will seamlessly connect customers with additional support when needed.

In addition to an improved customer experience, Next Gen FSA will completely modernize FSA's back-end systems and infrastructure. This transformation will pave the way for improved processing and customer management at lower costs. Vendor and partner performance standards and accountability measures will be built into Next Gen FSA to ensure customers receive world-class service while protecting taxpayer dollars. Next Gen FSA will integrate state-of-the-art cybersecurity protections across every aspect of the student aid experience. Enterprise-wide data analytics will drive improved customer service, particularly for at-risk students and borrowers, while also enhancing our oversight of participating postsecondary schools and supporting vendors.

Solicitation and Procurement Process

The Next Gen FSA implementation plan was based, in part, on extensive market research with more than 60 industry leaders. This research-based approach enabled FSA to identify best-in-industry standards and technical benchmarks that continue to inform the procurement process. On February 20, 2018, FSA initiated a multistage procurement process designed to identify the vendors most capable of supporting the implementation of Next Gen FSA; FSA intends to select a pool of vendors to deliver the Next Gen FSA environment. The Department anticipates awards will be made with the goal of new systems and processes coming online beginning in FY 2019. The current Title IV Additional Servicing (TIVAS) and Not-for-Profit (NFP) indefinite-

[1] This includes FFEL Lender held loans.

delivery, indefinite-quantity (IDIQ) contracts are set to expire in June and September 2019, respectively. Should FSA require continued servicing support beyond these dates, there are multiple options it can pursue. For example, one option would be to issue a new task order prior to the expiration of the underlying IDIQ contract to one or more of the current servicers. Another option would be to extend the underlying IDIQ contract up to 6 months in accordance with FAR 52.217-8, then issue new task orders. The appropriate contractual actions will be taken to ensure continued servicing capabilities until this portion of the Next Gen FSA vision is implemented.

CONTINUOUS IMPROVEMENT

Improving critical infrastructure, systems, and overall capacity, and ensuring sound strategic decision making regarding allocation of resources are essential to the Department's future progress and success. Implementing Technology Business Management Solutions and exploring the expanded use of Shared Services are two of the Department's key initiatives.

Technology Business Management Solutions (TBMS)

The purpose of the TBMS project is to provide an integrated solution that will support the Office of the Chief Information Officer (OCIO)'s role in implementing an Information Technology (IT) cost transparency capability. The TBMS project will also allow OCIO to communicate IT value with senior leadership, improve the efficiency and predictability of capital planning, and optimize IT costs. In the FY 2019 IT Budget-Capital Planning Guidance, the Office of Management and Budget requires agencies to begin reporting IT spending in alignment with the TBM Framework. The new requirements include using Cost Pools and IT Towers to classify IT spending. The project consists of two phases. The first phase will include OCIO's operating budget of approximately $120 million into the TBM Cost Transparency tool provided by the Department's TBM Vendor, Apptio. The second phase will incorporate the Department's entire IT budget of approximately $750 million, as well as the ability to use the Apptio Benchmarking, Business Insights, and Bill of IT modules. These modules will allow the Department to benchmark costs between the different program offices at ED, as well as between different federal agencies. The Business Insights and Bill of IT modules will offer additional details regarding total costs for IT projects at the Department as well as allow more analysis of our vendors and business practices when it comes to IT.

The objective is to implement an integrated solution that will allow OCIO to:

- Accurately account for and categorize IT spending in IT Cost Towers and Pools.
- Evaluate IT spending using a method that helps identify redundant IT assets (e.g. systems, applications, and licenses).
- Extract cost elements from disparate sources, analyze these elements, and report cost stressors and trends to stakeholders.
- Report IT spending in IT Towers and Cost Pools to OMB for capital planning. Prepare accurate pricing to client offices for the services provided.

Shared Services

The Department of Education uses shared services where feasible and practical, including payroll services with Department of the Interior and travel services with Carlson Wagonlit. The Department is exploring shared service and commercial off-the-shelf offerings to replace its G5, and its contracts and purchasing system (Comprizon). Additionally, the Department will explore migrating its financial management system to a shared service once the current upgrade from Oracle Enterprise Business Suite R11i to R12 is completed and stabilized. We will continue to explore other options to further leverage shared services for other mission support areas in the coming years.