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) 2019 *Agency Financial Report* (AFR) by refining graphics and providing more useful, balanced, and easily understood information about the Department's loan programs, including additional cost and risk information. Additionally, we chose 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 2019. Since the Department has chosen to produce separate financial and performance reports, a detailed discussion of performance information for FY 2019 will be provided in the Department's *Annual Performance Report* to be released online at the same time as the President's FY 2021 Budget in February 2020. 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**.

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.

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 Federal Student Aid (FSA), Leveraging Data as a Strategic Asset, and Technology Business Management Solutions (TBMS).

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:

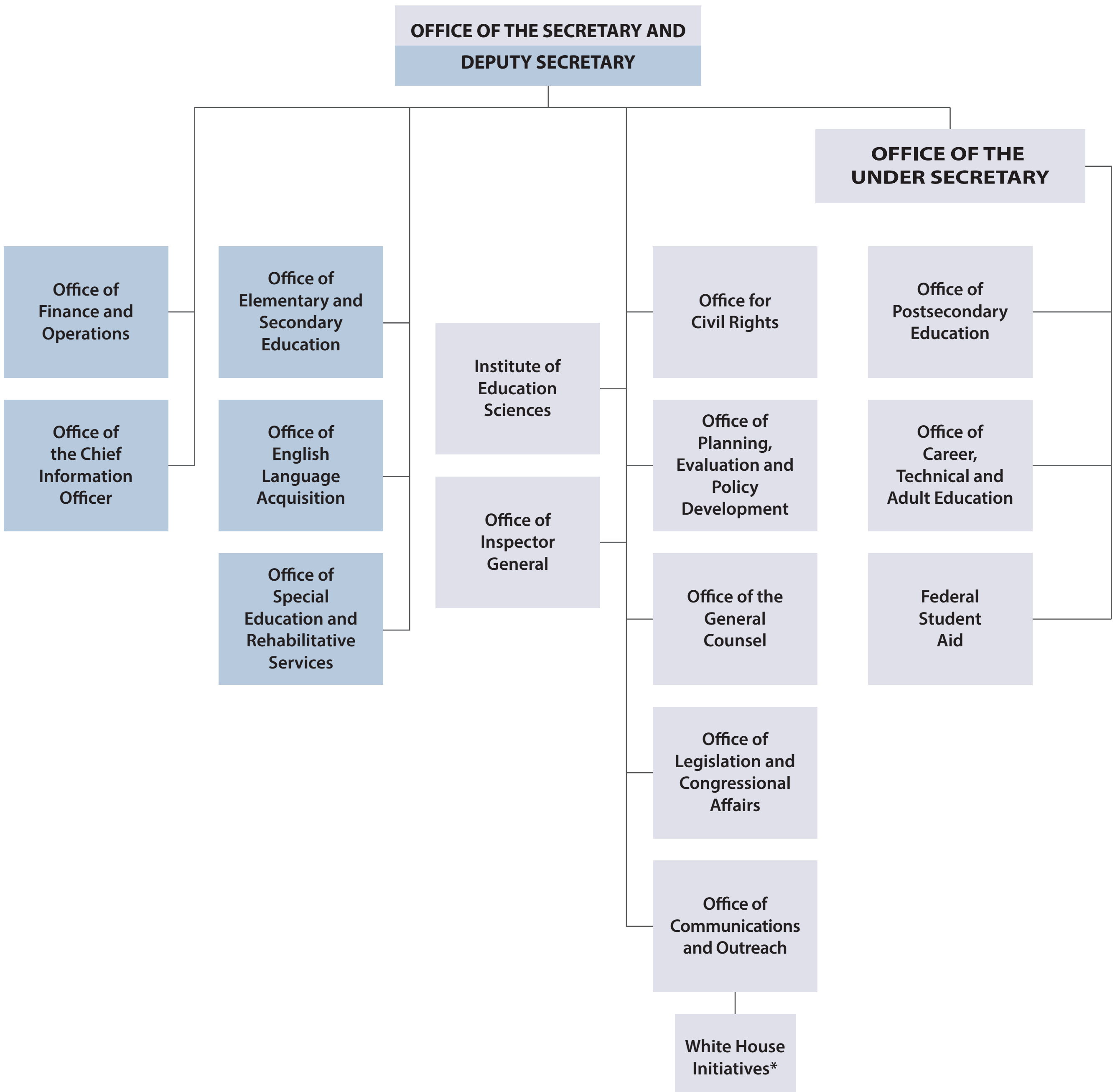
- Establishing policies related to federal education funding, including distributing funds, collecting on student loans, and using data to monitor the use of funds;
- Supporting data collection and research on America's schools;
- Identifying major issues in education and focusing national attention 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 2019

This chart reflects the coordinating structure of the U.S. Department of Education. A **text version** of the FY 2019 coordinating structure of the Department is available.



* The White House Initiatives are Center for Faith and Opportunity Initiatives, White House Initiative on American Indian and Alaska Native Education, White House Initiative on Educational Excellence for Hispanics, and White House Initiative on Educational Excellence for African Americans.

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*, including its two-year Agency Priority Goals (APGs), which serve as the foundation for establishing and implementing long-term priorities and performance goals, objectives, and measures by which the Department can gauge achievement of its stated outcomes. Progress towards the Department's strategic goals and its APGs is measured using data-driven review and analysis. Additional information on performance management is available in the *Annual Performance Plans and Annual Performance Reports*.

The *FY 2018–22 Strategic Plan* is comprised of four strategic goals and four FY 2018-19 APGs. The *Strategic Plan* aims to align the Administration's yearly budget requests and the Department's legislative agenda, supported by the considerable experience and resources available from its internal staff. 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 prekindergarten–grade 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 prekindergarten - grade 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 2019 Statement of Net Cost and related notes align with the *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 aimed to increase educational choice, improve the customer service the Department provides student aid borrowers, ensure protections of student privacy, and reduce red tape. The Department will identify APGs for FY 2020–21 in the *FY 2021 Annual Performance Plan*. 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. The *Annual Performance Plan* and quarterly updates for the APGs are available on **www.Performance.gov/education/education.html**.

APG	Related Strategic Objective
Improve the access to, and the quality and transparency of, school choice options for kindergarten - grade 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, the Office of Federal Student Aid (FSA) will advance the adoption of the Next Generation Financial Services Environment, enabling over 1.8 million customers to submit their Free Application for Federal Student Aid through the FSA mobile platform and 30,000 customers to use the mobile platform to check on their loan balances.	**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 the Single Audit 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 FY 2018–19 APG associated with Strategic Goal 1 focused 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 kindergarten–grade 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.

In FY 2019, the Department focused on the implementation of the CSP, including conducting new competitions and providing technical assistance to current grantees. Through CSP, the Department supported seven charter school grant programs through monitoring calls and site visits. In FY 2019, the Department released three evidence-based and promising practices resources related to educational choice. The Department met the target of disseminating eight resources during the FY 2018–19 APG reporting period.

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 FY 2018–19 APG associated with Strategic Goal 2 focused on improving borrowers' access to quality customer service.

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

By September 30, 2019, the Office of Federal Student Aid (FSA) will advance the adoption of the Next Generation Financial Services Environment, enabling over 1.8 million customers to submit their Free Application for Federal Student Aid (FAFSA) through the FSA mobile platform and 30,000 customers to use the mobile platform to check on their loan balances.

In FY 2019, the Department focused on this APG to improve customers' experience throughout the entire student aid life cycle by first modernizing capabilities related to the FAFSA and the servicing and repayment of customer loans. With the Department's transition in FY 2018 to a new paradigm of student loan processing, Next Generation Financial Services Environment (Next Gen FSA), FSA is providing a new experience for borrowers, and FSA customers in general, as they seek to make informed decisions about applying for aid, attending school, and repaying their student loans. From October 2018 – February 2019, FSA made changes to improve the security, usability, and experience of *myStudentAid* app for customers based on customer feedback to enhance the student and parent experience. Through FY 2019, nearly 66,000 customers used the *myStudentAid* app to check loan balances, resulting in goal achievement for this fiscal year. In addition, the **fafsa.gov** site was redesigned to accommodate the screen size and shape of any device, including desktop or laptop computers and mobile devices such as smartphones or tablets.

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 the Department manages and makes 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 FY 2018–19 APG associated with Strategic Goal 3 focused on improving student privacy and data security at Institutions of Higher Education (IHEs) through outreach and compliance efforts.

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 the Single Audit 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.

In FY 2019, the Department focused on this APG through collaborative efforts involving training, outreach, monitoring, and reporting. New audit standards for GLBA-related information security safeguards were published in the June 2019 2 C.F.R. Part 200 Appendix IX Compliance Supplement and impact the requirement of IHEs to conduct and submit an audited assessment of data security programs. IHEs subject to the Single Audit have nine months from their fiscal year end to submit the audits to the Department; IHEs will not include the newly required standards in time to meet the Department's FY 2019 APG target. In Quarter 3 through Quarter 4, FSA engaged with 708 IHEs for technical assistance related to cybersecurity. FSA's contact with these institutions consisted of discussing industry best practices, mitigation strategies, guidance for improving processes, and documentation to improve their security postures. FSA and the Department's Privacy and Technical Assistance Center (PTAC) surpassed the FY 2018-19 APG target and collaborated to conduct 103 outreach activities targeting data privacy and IT security requirements of IHEs.

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

Strategic Goal 4 focuses in general on protecting taxpayers from fraud, waste and abuse. This involves improving internal decision-making and reducing regulatory burden on external stakeholders. The FY 2018-19 APG associated with Strategic Goal 4 aimed 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 Regulatory Reform Task Force (RRTF), which includes a wide cross section of the Department's senior leaders, was established under Executive Order 13777 to review and reduce regulatory inefficiencies. The 2018 RRTF Report highlights the Department's efforts to reduce regulatory burden through December 2018. In response to RRTF recommendations, several cross-office workgroups were established to focus on the Education Department General Administrative Regulations; a web portal for Departmental guidance documents; and an information collections workgroup to reduce paperwork burden. In 2019, the Department issued final regulations on issues such as Programs and Activities Authorized by the *Adult Education and Family Literacy Act* (Title II of the *Workforce Innovation and Opportunity Act of 2010*) and Program Integrity: Gainful Employment. The latter rule eliminates significant paperwork burden and administrative costs for applicable entities and is estimated to yield $160 million in annualized cost savings.

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 18 consecutive years, the Department has earned an unmodified (or "clean") audit opinion. The financial statements and notes for FY 2019 are on pages 32–72 and the Independent Auditors' Report begins on page 82.

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 $1,310.7 billion as of September 30, 2019. The vast majority of the assets relate to credit program receivables, $1,203.5 billion, which comprised 91.8 percent of all assets. Direct Loans comprise the largest share of these receivables. All other assets totaled $107.2 billion, most of which was Fund Balance with Treasury.

The Department's liabilities totaled $1,314.2 billion as of September 30, 2019. 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 $1,192.1 billion as of September 30, 2019.

Figure 1. Assets by Type

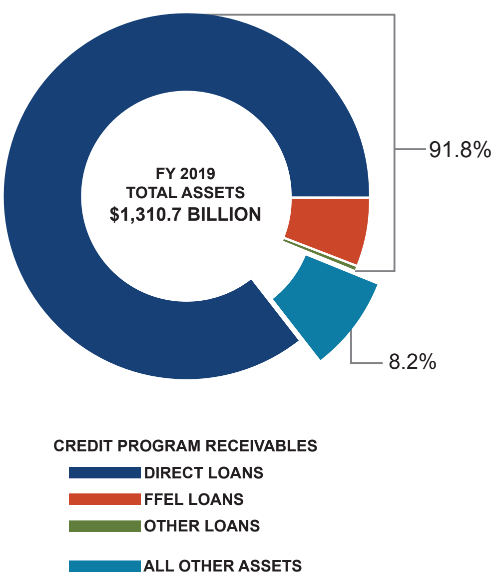


Figure 2. Liabilities by Type

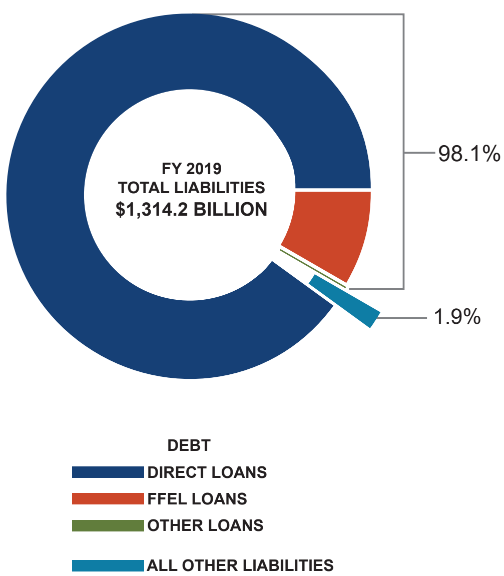
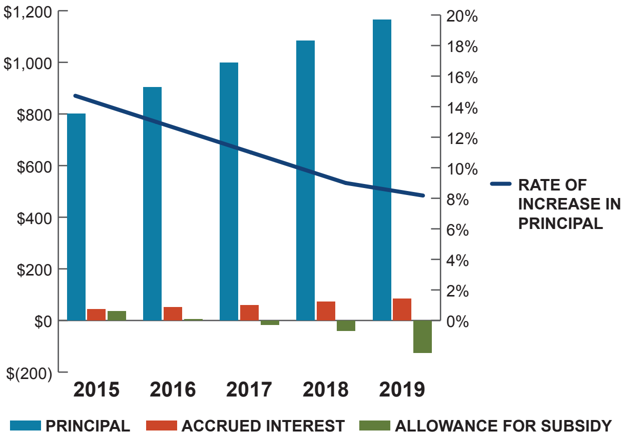


Figure 3. Components of Direct Loan Receivables, Net
(Dollars in Billions)



Direct Loan Component (Dollars in Billions)	Fiscal Year				
	2015	2016	2017	2018	2019
Principal	**$ 800.8**	**$ 902.8**	**$ 998.8**	**$1,083.7**	**$1,164.9**
Rate of Increase in Principal	15.4%	12.7%	10.6%	8.5%	7.5%
Accrued Interest	$ 44.3	$ 50.8	$ 59.5	$ 72.0	$ 83.3
Allowance for Subsidy	$ 35.5	$ 5.3	$ (16.8)	$ (40.7)	$(124.4)
Total No. of Direct Loan Recipients (in Millions)	**29.9**	**31.5**	**33.0**	**34.2**	**35.1**

Figure 3 shows the changes in the Direct Loan receivables components over the past five years. The principal amount has continued to grow as the Direct Loan program has originated all new federal loans since July 2010, when originations of new Federal Family Education Loan (FFEL) loans ended. However, the rate of increase in principal has slowed, as the Direct Loan program has disbursed decreased amounts of new loans each year since FY 2015 as a result of stagnant and in some cases declining enrollment, while accrued interest amounts have increased as more loans have moved into active repayment statuses. 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 (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

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

Loan Status	Fiscal Year				
	2015	2016	2017	2018	2019
Total No. of Direct Loan Recipients (in Millions)	**29.9**	**31.5**	**33.0**	**34.2**	**35.1**
Total Dollar Amount of Direct Loans Outstanding	**$ 845.1**	**$ 953.6**	**$1,058.4**	**$1,155.7**	**$1,248.1**
Current Repayment[1]	332.0	406.8	467.9	531.4	594.7
% Current Repayment	39.3%	42.7%	44.2%	46.0%	47.6%
In School, Grace Period, and Education Deferments	284.3	289.6	291.7	291.7	294.8
% In School, Grace Period, and Education Deferments	33.6%	30.4%	27.6%	25.2%	23.6%
Forbearance and Noneducation Deferments	103.0	106.5	122.5	121.9	133.2
% Forbearance and Noneducation Deferments	12.2%	11.2%	11.6%	10.5%	10.7%
Delinquent (Past Due 31-360 Days)	65.1	71.8	79.5	92.2	90.8
% Delinquent (Past Due 31-360 Days)	7.7%	7.5%	7.5%	8.0%	7.3%
Default/ Bankruptcy/ Other	60.7	78.9	96.8	118.5	134.6
% Default/ Bankruptcy/ Other	7.2%	8.2%	9.1%	10.3%	10.8%

[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.

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 2015 is due primarily to higher subsidy costs, the main cause being high participation in income-driven repayment (IDR) 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.

Participation in IDR plans has increased as (a) new plans have become available that are more advantageous to borrowers, (b) new plans have become available that expand the potential pool of borrowers, and (c) the Department has conducted targeted outreach to borrowers to make them aware of their potential eligibility for these plans.

Table 1 shows the payment status of the Direct Loan principal and interest balances outstanding over the past five 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 IDR plans.

Loans in the Delinquent category are past due anywhere from 31 to 360 days. 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 39 percent in FY 2015 to 48 percent in FY 2019, 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. A diagram depicting the Direct Loan program financing process is displayed with related trend data as Figure 6 on page 12 of this report.

STATEMENTS OF NET COST

The consolidated statements of net cost report the Department's components of the net cost of operations for a given 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)

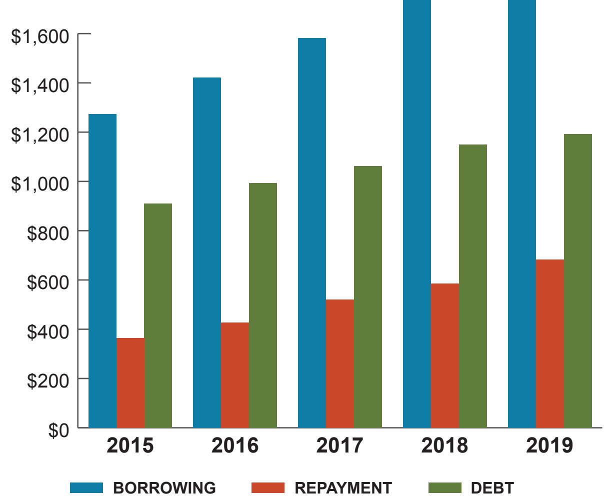


Figure 5. Gross Costs & Earned Revenue
(Dollars in Billions)

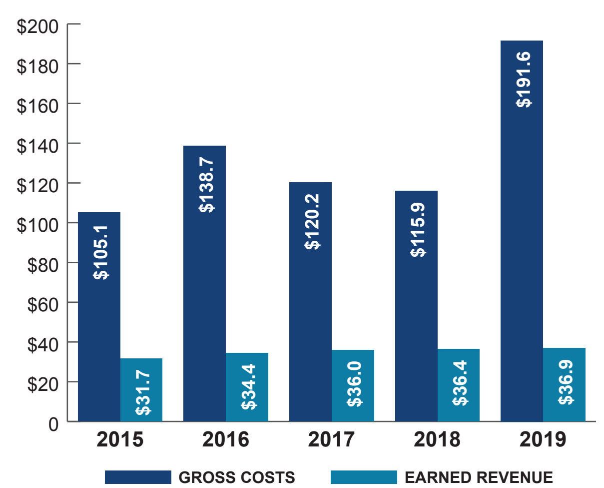
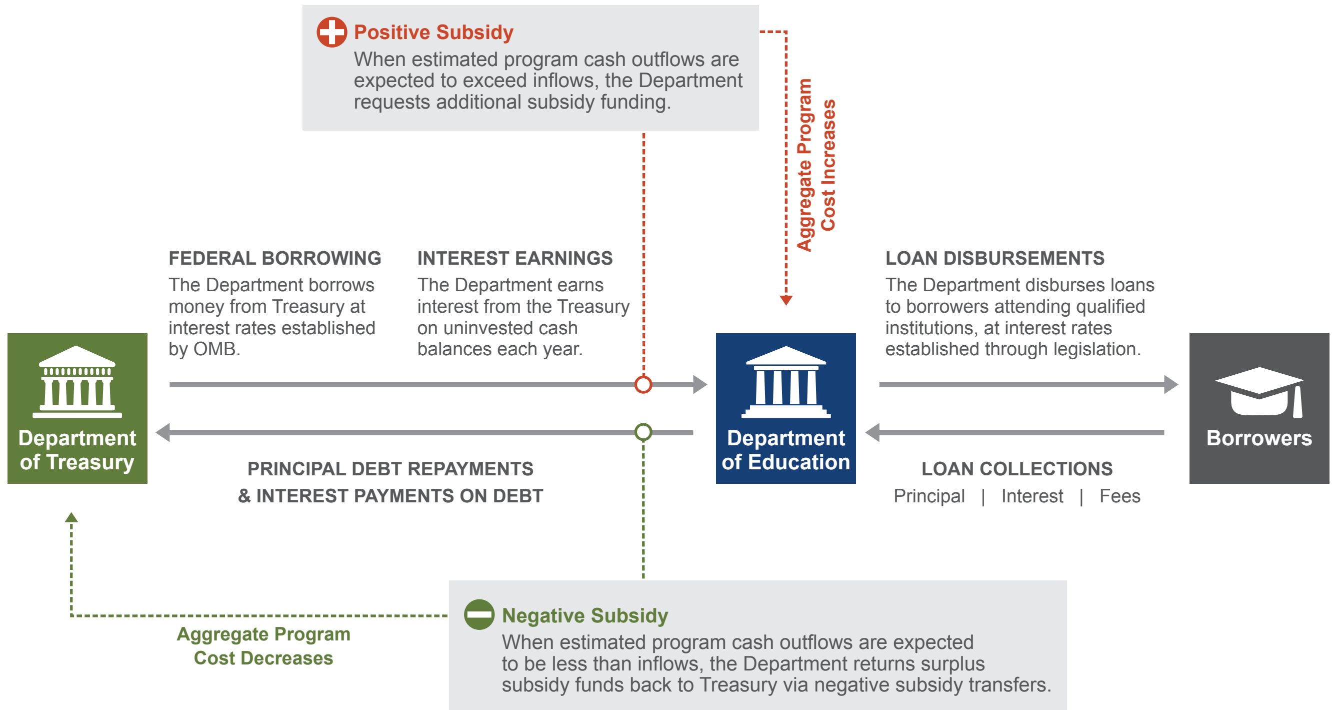


Figure 6. William D. Ford Federal Direct Loan Program: *Following the Funding*



Treasury Financing and Subsidy Cost of Direct Loans (Dollars in Billions)*					
Fiscal Year	2015	2016	2017	2018	2019
Net Borrowing	**90.9**	**84.4**	**67.3**	**89.1**	**41.5**
Borrowing from Treasury	159.7	147.0	160.5	155.3	137.6
Debt Repayments to Treasury	(68.7)	(62.6)	(93.2)	(66.2)	(96.1)
Interest Expense to Treasury	(27.6)	(30.5)	(31.3)	(32.3)	(33.8)
Interest Earned from Treasury	4.2	3.9	4.3	3.9	4.1
Cumulative Taxpayer Cost / (Savings)	(35.5)	(5.3)	16.8	40.7	124.4
Current Subsidy Expense (Revenue)	(0.9)	16.1	5.3	4.4	61.5

Direct Loan Program Cash Transactions with Borrowers (Dollars in Billions)*					
Fiscal Year	2015	2016	2017	2018	2019
Loan Disbursements	**142.2**	**140.5**	**142.5**	**134.1**	**130.7**
Stafford Subsidized	24.0	23.8	23.4	20.3	20.0
Stafford Unsubsidized	52.7	52.3	51.4	49.0	48.1
PLUS	19.2	19.0	18.7	23.1	22.7
Consolidation[1]	46.4	45.5	49.0	41.6	39.8
Loan Collections[2]	**65.1**	**73.2**	**82.0**	**84.9**	**91.3**
Principal	50.0	55.9	62.6	63.5	67.0
Interest	13.4	15.5	17.6	19.5	22.4
Fees	1.8	1.8	1.9	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 FFEL program, in addition to Direct Loans.

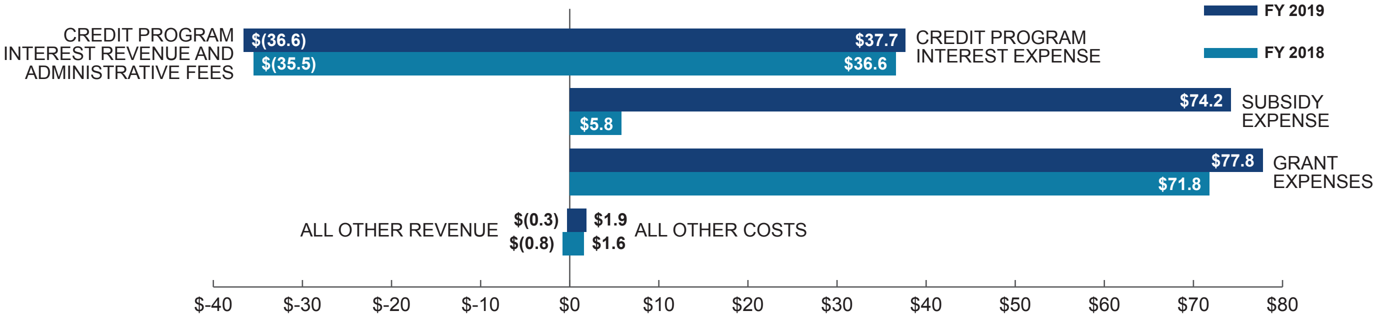
[2] Loan collections include prepayments, including prepayments in full due to consolidation of underlying Direct Loans.

GROSS COSTS AND EXCHANGE REVENUE BY TYPE

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. Primary Components of Gross Costs and Earned Revenue
(Dollars in Billions)

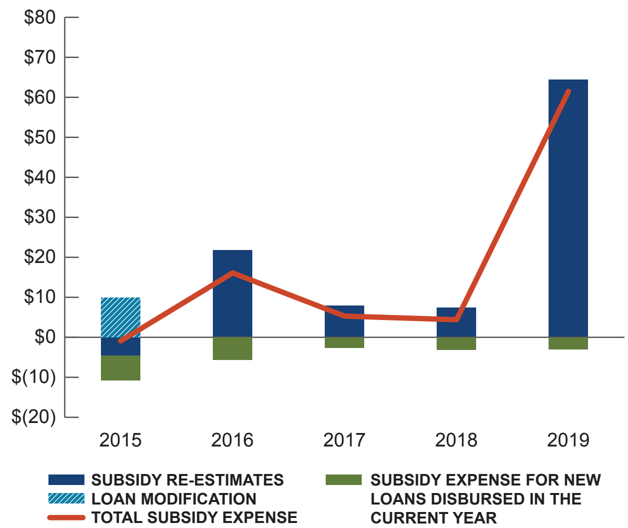


ANALYSIS OF DIRECT LOAN PROGRAM SUBSIDY EXPENSE

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. The increase in the subsidy expense for Direct Loans in FY 2019 accounts for 75.4 percent of the total increase in the Department's gross costs from FY 2018. 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.

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



	2015	2016	2017	2018	2019
Subsidy Expense for New Loans Disbursed in the Current Year	$ (6.2)	$ (5.7)	$ (2.6)	$ (3.1)	$ (3.0)
Subsidy Re-estimates	(4.6)	21.8	7.9	7.4	64.5
Loan Modification	9.9	-	-	0.1	-
Total Subsidy Expense	**$ (0.9)**	**$ 16.1**	**$ 5.3**	**$ 4.4**	**$ 61.5**

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 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.

The Direct Loan program subsidy re-estimate increased subsidy expense in FY 2019 by $64.5 billion. Re-estimated costs only include cohorts that are 90 percent disbursed; cohort years 1994–2018. The re-estimate reflects the assumption updates and other changes described below.

- **IDR Model Changes.** During FY 2019, the Department enhanced the IDR model by examining the most current available IDR application data from NSLDS to supplement information previously used from the Department of Treasury's Office of Tax Analysis, in order to calibrate projected incomes. The Department's analysis determined a downward calibration was warranted, with the Departmental and FSA senior management concurrence. The impact of this calibration was the most significant factor in the IDR component of the re-estimate. The IDR update also reflects further refinement in the logic for switching borrowers among IDR plans and the appropriate balance to be paid off when they do switch. These updates led to a net upward re-estimate of $43.6 billion.

- **Deferment and Forbearance.** The Department made enhancements in the methodology for delinquency, to more precisely reflect interest accrual and the extension of the payment period than the method previously employed. These enhancements resulted in a lower rate of forbearance which led to an upward re-estimate of subsidy as less interest is accrued, capitalized, and collected. Deferment rates increased for PLUS loans eligible for in-school deferments. The combined effect of these changes, in addition to updated data from NSLDS, was a net upward re-estimate of $18.3 billion.

- **Maturity, Prepayment, and Loan Payoff.** The Department further enhanced the forecasting of amount of debt distributions and aligned all three sub-components of this assumption to enter repayment cohorts. The loan payoff component was improved as well by using a more precise method to estimate payoff for loans enrolled in graduated repayment plans. As mentioned above, the impact on repayment of delinquency was moved to the payoff maturity assumption to better reflect interest accrual and the extension of the payment period. These adjustments resulted in longer assumed terms, resulting in a longer stream of payments, more interest accrual and less subsidy. The combined effect of these changes led to a net downward re-estimate of $26.1 billion.

- **Financing Account Interest Adjustment.** Beginning in FY 2019, the Department implemented a process to calculate and execute a financing account interest adjustment to address differences between net financing account interest executed for cohorts each year and amounts earned based on final Treasury interest rates for those cohorts. This resulted in a net upward re-estimate of $6.3 billion.

- **Default.** The Department updated the data and made a change in methodology to a weighted fractional logit in order to more appropriately reflect the different sizes of the grouped data. The combined effect of these changes led to a net downward re-estimate of $1.0 billion.

- **Collections.** As a result of analyzing updated Debt Management and Collection System (DMCS) data, collection rate estimates were revised which resulted in a net upward re-estimate of $4.2 billion.

- **2018 Cohort Assumption Changes.** The technical re-estimate cannot reflect the impacts of certain assumption changes applicable to the current year loan cohort until the following fiscal year per OMB guidance. The current year's re-estimate includes a net upward adjustment of $5.8 billion for these prior year changes attributable to the FY 2018 cohort.

- **Interest on the Re-estimate.** Interest on re-estimates is the amount of interest that would have been earned or paid by each cohort on the subsidy re-estimate, if the re-estimated subsidy had been included as part of the original subsidy estimate. The interest on the re-estimate calculated on the overall subsidy re-estimate resulted in a net upward re-estimate of $9.7 billion.

- **Interactive Effects.** The re-estimate includes a net upward re-estimate of $3.2 billion attributed to the interactive effects of the assumption changes described above.

The Department has more than 100 grant and loan programs. The Department's FY 2019 expenses for grant programs totaled $77.8 billion. The three largest grant program areas are:

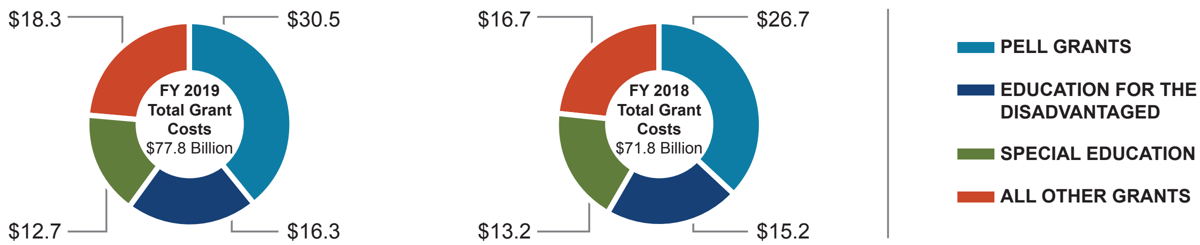
- **Pell Grants**—provides need-based grants to students to promote access to postsecondary education. Grant amounts are dependent on: the student's expected family contribution; the cost of attendance (as determined by the institution); the student's enrollment status (full-time or part-time); and whether 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 fund 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.

In addition to student loans and grants, the Department offers other discretionary grants under a variety of authorizing legislation, with approximately 90 percent of non-student aid funds awarded by formula and 10 percent through competitive processes.

Figure 9. Grant Costs by Program Areas



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 $358.2 billion for the period ended September 30, 2019, decreasing from $358.5 billion, or approximately 0.1 percent from the prior year. Budgetary resources are comprised of appropriated budgetary resources of $137.2 billion and non-budgetary credit reform resources of $221.0 billion. The non-budgetary credit reform resources are predominantly borrowing authority for the loan programs.

The Department's gross outlays totaled $307.5 billion for the period ended September 30, 2019. 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 $150.8 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

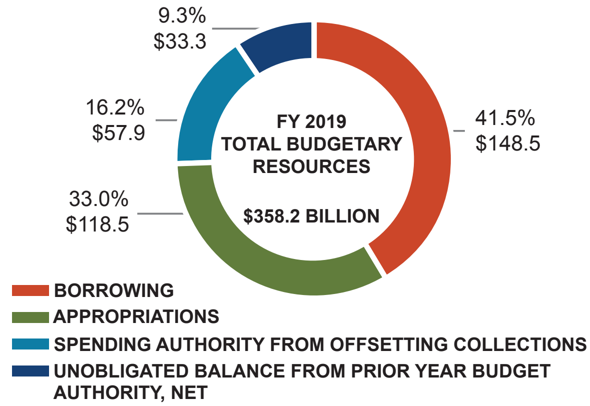
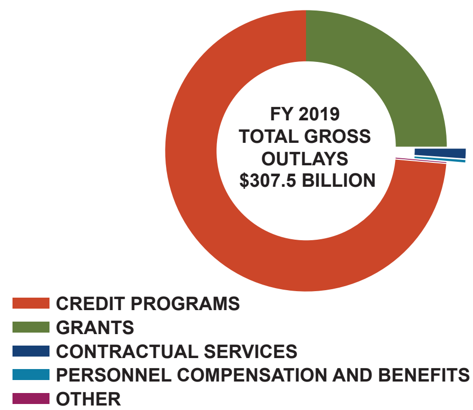


Figure 11. Gross Outlays by Type



	Billions	%
CREDIT PROGRAMS	**$ 226.8**	**73.8%**
DIRECT LOAN PROGRAM	208.0	67.6%
FFEL PROGRAM	18.4	6.1%
OTHER CREDIT PROGRAMS FOR HIGHER EDUCATION	0.4	0.1%
GRANTS	**$ 76.9**	**25.0%**
PELL GRANTS	29.0	9.4%
EDUCATION FOR THE DISADVANTAGED	16.2	5.3%
SPECIAL EDUCATION - INDIVIDUALS WITH DISABILITIES EDUCATION ACT (IDEA) GRANTS	13.2	4.3%
ALL OTHER GRANTS	18.5	6.0%
CONTRACTUAL SERVICES	**$ 3.1**	**1.0%**
PERSONNEL COMPENSATION AND BENEFITS	**$ 0.6**	**0.2%**
OTHER	**$ 0.1**	**0.0%**
TOTAL	**$ 307.5**	**100.0%**

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

MANAGEMENT ASSURANCES

The Secretary of Education's 2019 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, the independent auditor identified a material weakness and significant deficiencies in the auditors' report, and the Office of Inspector General identified management challenges in the Office of Inspector General's Management and Performance Challenges For Fiscal Year 2020 report.

STATEMENT OF ASSURANCE
FISCAL YEAR 2019
November 15, 2019

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, 2019.

Betsy DeVos

INTRODUCTION

Strong risk management practices and internal controls 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:

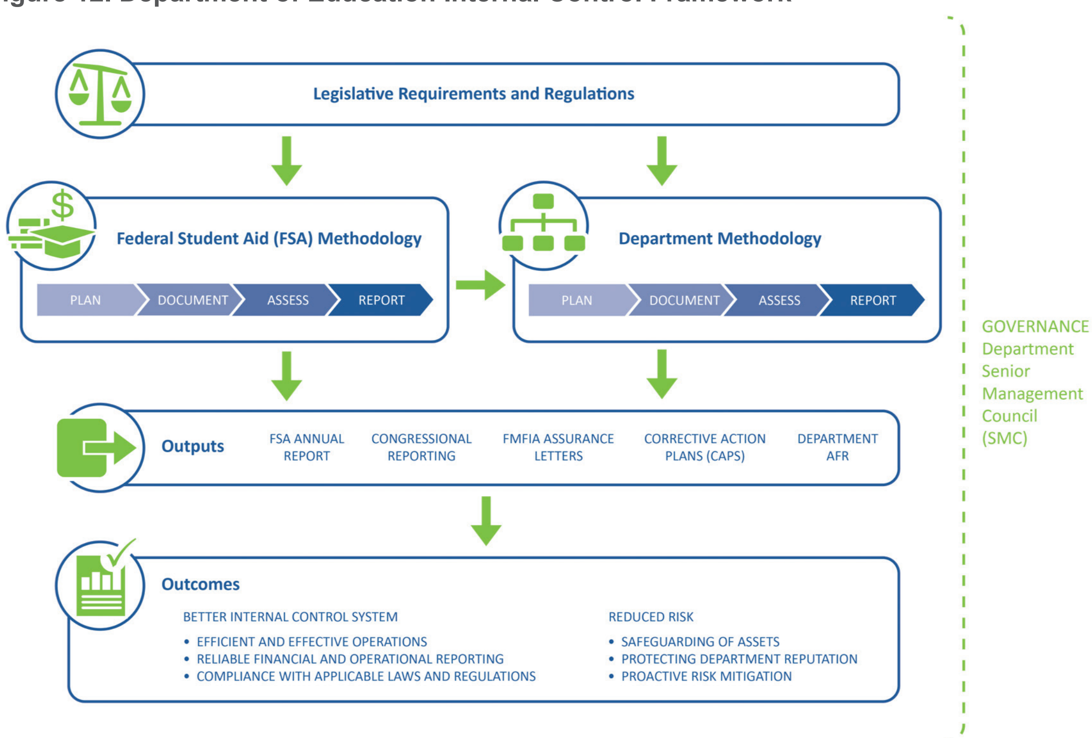
- *Operations*—Effectiveness and efficiency of operations;
- *Reporting*—Reliability of reporting for internal and external use; and
- *Compliance*—Compliance with applicable laws and regulations.

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 2019 to meet the three objectives.

Internal 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, complies with applicable laws and regulations, and prepares accurate reports. The Department maintains a comprehensive internal control framework and assurance process as depicted in the following diagram.

Figure 12. Department of Education Internal Control Framework



The Department has a renewed focus on streamlining and coordinating internal control activities to ensure efficiency of operations, recognizing the connection points across areas, and enabling transparency of information across the Department. This framework enables increased visibility across compliance processes to allow for greater oversight and more informed monitoring of activities related to internal controls and risk management by all offices and governance bodies, including the Department's Senior Management Council. This framework also allows for the Department to obtain the outcomes of a better control system and a reduced risk landscape. Furthermore, this streamlined approach helps the Department provide reasonable assurance to internal and external stakeholders that the data produced by the Department is complete, accurate and reliable, that internal controls are in place and working as intended, and operations are efficient and effective.

ANALYSIS OF CONTROLS

Overall, the Department relies on annual assurances provided by the heads of its principal offices, supported by risk-based internal control evaluations and testing, and annual internal control training for all employees, to provide reasonable assurance that its internal controls are well designed and in place and working as intended. The Department's annual assurance process conforms to the 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") and OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*.

In FY 2019, the Department identified no material weaknesses related to effective, efficient program operations and no areas of noncompliance with laws and regulations other than those noted in the Analysis of Legal Compliance 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 2020 Management Challenges report. As an example, the creation of the Office of Grants Administration (OGA) in FY 2019 helped strengthen internal control in grants management at the Department. OGA provides guidance and oversight of the Department's discretionary and formula grants policy, training, audit resolution, and indirect cost negotiation.

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

Internal Control over Reporting

The Department maintains processes and procedures to identify, document, and assess internal control over reporting, which includes:

- Comprehensive process documentation for the Department's significant business processes and subprocesses;
- Maintenance of an extensive library of key financial, operations, and Information Technology (IT) controls;
- Technical assistance provided to principal offices to help them understand and monitor key controls;
- A Data Quality Plan to improve reporting controls and data quality;
- A risk-based control testing strategy; and
- A process to develop corrective action plans when internal control deficiencies are found and to track progress against those plans.

The FY 2019 internal controls assessment detected some deficiencies, but none that would rise to the level of material weakness. Corrective actions have been initiated for the deficiencies identified.

ANALYSIS OF 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 vision for its financial management systems is to provide objective financial information to stakeholders to support data-driven decision-making, promote sound financial management, and to enhance financial reporting and compliance activities. The Department's core financial applications have been brought together under common management control under the umbrella of Education Central Automated Processing System (EDCAPS). EDCAPS is a suite of financial applications (subsystems), including commercial off-the-shelf and custom code and interfaces that encompass the Department's core financial management processes. Specifically, EDCAPS provides the following functions:

- General ledger - Preparation of financial statements and reconciliation of general ledger balances with subsystems maintained in program areas and Treasury;
- Funds management - Budget formulation, budget execution, and funds control;
- Grants pre- and post-award processing, including grant payment processing;
- Contract pre- and post-award processing;
- Receivable management;
- Cost management;
- Recipient management; and
- Administrative processes (e.g., purchasing, travel, and miscellaneous payments).

EDCAPS is composed of five main integrated components:

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

EDCAPS is serving approximately 5,300 Departmental internal users in Washington, D.C. and 10 regional offices throughout the United States. EDCAPS is serving approximately 37,900 external users, mostly users of G5. In FY 2019, the Department conducted an annual risk assessment of EDCAPS and tested 82 IT security controls out of a baseline of 630 IT security controls. No significant deficiencies or material weaknesses were identified.

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 2019:

- 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; and
- Transmitting the Department's spending data related to contracts, grants, loans, and other financial assistance awards for the DATA Act implementation.

Budget constraints limit funding for innovation and modernization, requiring the Department to direct available funding and resources to support the steady state of existing investments. However, in November 2018, the Department completed 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. The Department's primary objective is to stabilize Oracle R12, which is the Department's core financial system (FMSS), and any implications of the infrastructure upon which it is hosted (Portfolio of Integrated, Value Oriented Technologies – Hosting), with the goal of achieving a future state where core financial systems and related business systems, support services, and infrastructure have migrated to the maximum extent possible to standard applications and shared services.

The FMSS Oracle E-Business Suite application is behind the Department firewall and not external-facing. FMSS includes the following interfaces to multiple applications which are either not part of the Oracle suite of applications in the Enterprise Resource Planning or are outside the financial management segment:

- Hyperion Budget Planning module – currently only the license fees are included in FMSS investment;
- ED Facilities Loan System (Nortridge) – currently only the license fees are included in FMSS investment;
- The Invoice Processing Platform;
- FSA-FMS financial data;
- Lockbox;
- Department of the Treasury systems; and
- Department of Interior systems.

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 these systems. The Department has also determined that its financial management systems substantially comply with FFMIA requirements. However, as noted below in the Analysis of Legal Compliance section, the Department continues to address issues and improve its controls over systems.

ANALYSIS OF LEGAL COMPLIANCE

The Department is committed to maintaining compliance with applicable laws and regulations. Below are some examples:

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 General Counsel's July 2015 legal determination, 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, 2019, 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 2019, 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 will build DCIA requirements into the NextGen FSA servicing platform. This area of noncompliance is noted in the independent auditor's report, exhibit C.

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

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 several significant activities in FY 2019 to improve cybersecurity capabilities and functions, some of which included:

- OCIO publishes monthly Cyber Security Framework (CSF) Risk Scorecards as part of the Department's Information Security Continuous Monitoring (ISCM) efforts to identify cybersecurity risks, issues, and opportunities for improvements in our cybersecurity protections. The CSF Risk Scorecard provides a detailed analysis tool for Authorizing Officials, Information System Owners (ISOs), and Information System Security Officers (ISSOs) to prioritize and mitigate risks to the Department's information systems. The CSF Risk Scorecard was enhanced during FY 2019 to allow for automated risk scoring, improved accessibility, more granular and user-friendly data filtering capabilities, and enhanced data modeling. The continued use of the CSF Risk Scorecards enabled the Department to prioritize resources to resolve identified vulnerabilities. This prioritization led to the closure of all past due Plan of Actions & Milestones (POA&Ms) for the Department's High Value Assets. Overall, the Department has reduced total POA&Ms by more than 83% and delayed POA&Ms by 95%.

- Annually, all Department users are required to complete multiple computer security and privacy awareness training courses. The Department strictly enforces compliance with the training requirements and disables network accounts for users who fail to complete required trainings by established deadlines. In FY 2019, the Department employed increasingly complex phishing scenarios and established administrative mechanisms to enhance user education and awareness of the risks associated with their susceptibility to cyber threats. The Department experienced increases in the Department of Education Security Operations Center (EDSOC) reporting rates for phishing exercises.

- OCIO revised the Department's cybersecurity policy and guidance.

- The updated policy framework was revised to include a new review and approval process for cybersecurity policies, standards, and instructions. This process includes automated workflows, pre-defined review timelines, and delegated approval authorities which will improve the Department's agility in providing critical time-sensitive guidance and requirements to Department system stakeholders.

- OCIO developed and published Departmental Guidance/Standard Operating Procedures (SOPs) to assist the Department points of contact (POCs) with finalizing the quarterly and annual FISMA reporting requirements. OCIO developed and published both an internal OCIO review procedure and external guidance document for use by POCs. These documents collectively outline a new process for ensuring that the POCs are reporting accurately, and that reports are reviewed, approved and submitted in accordance with established timelines.

- OCIO identified and documented all FedRAMP Cloud Service Providers (CSPs) currently leveraged by the Department and established a Cloud Service Portfolio of CSPs that have been authorized for use. The activities enabled the Department to streamline the processes associated with selecting, assessing and authorizing CSPs. This prevents the acquisition of potentially redundant or duplicative cloud services and streamlines the process of obtaining new service offerings or migrating existing systems to cloud services.

- The Department has begun creating an externally hosted provider inventory to facilitate documentation of externally hosted providers currently leveraged by Department systems, similar to the efforts to strengthen security controls for CSPs. This inventory enables documentation of the various externally hosted providers being leveraged and allows for the imposition of security control inheritance for Department systems that are hosted externally.

- FSA completed a system Personally Identifiable Information (PII) risk assessment process to determine and evaluate how PII is identified, minimized, categorized, and safeguarded, and how incident responses are provided for PII security incidents. FSA also implemented a PII dashboard to report PII risk and developed mitigation strategies for PII risks identified through the initial risk assessment process.

- The Department conducted quarterly Contingency Plan Testing (CPT) and Incident Response Plan (IRP) tabletop exercises. This service allowed Department ISOs and ISSOs to complete the required annual contingency and incident response testing through a professionally facilitated workshop which exposes system stakeholders to new requirements, test scenarios and Department resources. As a result of this effort, CPT and IRP testing compliance across the Department increased from 63 percent to 92 percent.

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.

In FY 2020, the Department envisions a streamlined, simplified approach to ERM implementation. Guiding principles supporting this vision include securing senior leadership buy-in and continued support and involvement with the ERM program through an established governance structure and routine engagement. The Department will revise its Risk Profile and other ERM deliverables and resources to capture only necessary and useful information. 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 2019, the Department took further steps to set up a formal ERM program within the Office of Finance and Operations (OFO). In doing so, the Department continued to leverage expertise of colleagues in the Office of Federal Student Aid (FSA), as well as across the Federal Government through the ERM Community of Practice led by Treasury. Additionally, it ensured internal control activities are more efficiently focused on highest priority risks by adding a group of internal control experts to the ERM team.

The Department aims to develop a more risk-aware culture that facilitates increased focus on the range of risks the Department faces and fosters open discussions about how those risks might impact the accomplishment of the Department's mission and whether resources are aligned accordingly. In addition, the ERM program will expand enterprise capacity to achieve optimal performance and operational outcomes by leveraging data and analytical solutions to successfully identify and manage risks, strengthen internal controls through continuous process improvement, and inform strategic planning and decision-making. Finally, the ERM program will leverage partnerships across the agency to identify, measure, and assess challenges related to mission delivery in order to manage risk to a tolerable level and develop actionable response plans and assign owners.

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,[1] 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 (IDR) 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**.

[1] **https://libertystreeteconomics.newyorkfed.org/2019/06/despite-rising-costs-college-is-still-a-good-investment.html**

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 2019, nearly 7.7 million Direct Loan recipients were enrolled in IDR plans, representing an 8 percent increase from June 2018 and a 22 percent increase from June 2017.

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), see page 26.
- Continue to support additional tools such as 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: IDR plans tend to be more costly to the government than non-IDR plans; for the 2019 loan cohort, it is estimated that the government will recover 37 percent less for loans in IDR 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 IDR 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 IDR plans are available on the **Department's website**. Future commitment to market and increased participation in these plans are areas of uncertainty. Future legislative and regulatory activity could also affect the underlying cost of IDR plans.

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, 2019, the total number of borrowers who received forgiveness totaled 1,139. The value of this forgiveness totaled $71.90 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, 2019, the number of borrowers with certified employment totaled 1,195,497. 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. Congress provided an additional $350 million in funding for up to $500 million in face-value forgiveness in the *Department of Education Appropriations Act*, FY 2019. 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: On August 21, 2019, the President issued a memorandum directing the Department of Education to ease the processing of loan discharges for borrowers who have been determined by the Secretary of Veterans Affairs to be unemployable due to a service-connected condition. Previously, borrowers were required to sign and return the application to complete the process of applying for a total and permanent disability (TPD) discharge. The ultimate effect of the new process is 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 2019 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 IDR, 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 $356 billion in FY 2011 to more than $1.2 trillion as of the end of FY 2019. 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. $3.6 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 IDR 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 10.1 percent for loans entering repayment in FY 2016. 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 IDR 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 IDR 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. Incidents like this may happen without warning and disrupt not only student loan administration but also resulting cash flows. Hence, 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 $1.5 trillion.[2] It is critical that we provide a customer experience that is on par with world-class financial services firms and establishes 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 and streamlining our student aid systems and processes. This broad effort will deliver an improved 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 are being 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 has already begun to meet customers where they are, letting them connect with FSA on the device of their choice. Customers will soon have additional access to 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.

[2] Includes lender-held FFEL loans and school-held Perkins loans.

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 commercial partners 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 first major element of Next Gen FSA, the Digital and Customer Care contract that will deliver our integrated mobile, web, and telephonic solution and single customer view, was awarded in February 2019. A series of additional awards, for enterprise data architecture and standards, was completed in August 2019. Contracts to support the remaining Next Gen FSA efforts are expected to be awarded in late 2019 or early 2020.

The current Title IV Additional Servicing (TIVAS) and Not-for-Profit indefinite-delivery, indefinite-quantity contracts are set to expire in December 2019 and March 2020, respectively. Should FSA require continued servicing support beyond these dates, there are multiple avenues it can pursue. The appropriate contractual actions will be taken to ensure continued servicing capabilities until this portion of the Next Gen FSA vision is implemented. FSA is taking a similar approach to all legacy contracts that will be impacted by the Next Gen FSA vision to ensure as smooth a transition as possible for our customers and partners.

LEVERAGING DATA AS A STRATEGIC ASSET

The Department is focusing on further leveraging its data as a strategic asset, in part in response to new requirements in the *Foundations for Evidence-Based Policymaking Act* (Evidence Act; **P.L. 115-435**). This section highlights three initiatives intended to help the Department realize the power of data in daily operations and national policy: (1) the establishment of the Office of the Chief Data Officer; (2) the chartering of an ED Data Governance Board; and (3) a new focus for the Evidence Leadership Group in advising the Evaluation Officer and developing the Department's learning agenda.

Office of the Chief Data Officer

The Department has established an Office of the Chief Data Officer (OCDO), effective October 2019, which is responsible for managing and improving the Department's ability to leverage data as a strategic asset. In accordance with the Evidence Act, the Secretary has named a Department Chief Data Officer (CDO), whose responsibilities include, but are not limited to, lifecycle data management across the Department and developing and enforcing the Department's data strategy and governance policies. The OCDO has oversight over the Department's information collections approval and associated Office of Management and Budget (OMB) clearance process. It is responsible for developing and enforcing the Department's open data plan, including management of a centralized comprehensive data inventory accounting for all data assets across the Department. The CDO submits annual reports to Congress on agency compliance with the Evidence Act. The OCDO is also responsible for developing and maintaining a technological and analytical infrastructure that is responsive to the Department's strategic data needs and exploiting traditional and emerging analytical methods to improve decision making, optimize outcomes, and create efficiencies.

ED Data Governance Board

In accordance with OMB guidance on the implementation of the Evidence Act, the CDO will convene an ED Data Governance Board (DGB). The DGB will gather input from across the Department to develop and enforce sound data governance policy and process decisions. The DGB will sponsor agency-wide actions to develop an open data culture and work to improve the Department's capacity to leverage data as a strategic asset for evidence building and operational decisions, including developing the capacity of data professionals in program offices. The DGB will help the Department implement a coordinated and collaborative approach to oversee strategic data collection and acquisition, responsible lifecycle data management, open and transparent release of its data assets, and advance internal and external uses of data.

Evaluation Officer and Evidence Leadership Group

The Evidence Act created a new role, a Department "Evaluation Officer" (EO), who is responsible for: (a) developing the Department's learning agenda by assessing the Department's portfolio of evaluations, policy research, and ongoing evaluation activities; (b) assessing the Department's capacity to support the development and use of evaluation; (c) establishing and implementing the Department's evaluation policy; and (d) coordinating a Department-wide evidence-building plan. IES's Commissioner of the National Center for Education Evaluation and Regional Assistance is the Department's EO.

The Evidence Leadership Group (ELG) serves in an advisory capacity to the EO on these statutory responsibilities and serves additional functions to inform the Department's programs and policies. In addition, the ELG advises the Department's policy officials on how best to build, use, and disseminate evidence throughout the policy development and implementation lifecycle. The ELG is cochaired by the Evaluation Officer and a designee of the Assistant Secretary of the Office of Planning, Evaluation and Policy Development.

The work of the ELG depends upon strong partnerships across the Department's principal offices, with other agencies, states and localities, private sector innovators, and other stakeholders in the education community. It benefits from a shared vision and common language around evidence-building, use, and dissemination, and the Department's history of promoting the use of evidence.

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 is one of the Department's key initiatives.

Technology Business Management Solutions (TBMS)

The purpose of the TBMS project is to provide greater cost transparency into IT spend. The TBMS project will allow OCIO to communicate the cost drivers for, and the value of, IT to senior leadership, improve the efficiency and predictability of the formulation of the IT budget, and optimize IT costs.

Beginning in 2017, OMB required agencies to begin reporting IT spending in alignment with the TBM Framework, including using Cost Pools and IT Towers to classify IT spending. The Department intends to leverage TBM beyond the minimum OMB reporting requirements to encompass the full implementation of the TBM cost accounting framework. The project started with a pilot that incorporated OCIO's operating budget of approximately $120 million into a TBM module designed to provide cost transparency and was then broadened to the Department's entire IT budget of approximately $750 million. One of the ultimate goals is to be able to provide a "bill of IT" to form the basis of a show-back model to drive more informed decision-making around 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; and
- Prepare accurate pricing through a show-back model to client offices for the services provided.