REPORT OF THE INDEPENDENT AUDITORS

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 15, 2019

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

Dear Secretary DeVos:

The enclosed Independent Auditors' Report (report) presents the results of the audit of the U.S. Department of Education's (Department) financial statements for fiscal years 2019 and 2018 to comply with the Chief Financial Officers Act of 1990, as amended. The report should be read in conjunction with the Department's financial statements and notes to fully understand the context of the information contained therein.

We contracted with the independent certified public accounting firm KPMG LLP (KPMG) to audit the financial statements of the Department as of September 30, 2019 and 2018, and for the years then ended. The contract requires that the audit be performed in accordance with U.S. generally accepted government auditing standards and Office of Management and Budget bulletin, *Audit Requirements for Federal Financial Statements.*

Results of the Independent Audit

KPMG found:

- The fiscal years 2019 and 2018 financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America;
- One material weakness in internal control over financial reporting:
    - Controls over the Reliability of Information Used in the Modeling Activities Need Improvement;
- Two significant deficiencies in internal control over financial reporting:
    - Information Technology Controls Need Improvement, and
    - Effective Monitoring of Service Organizations Needs Improvement; and
- One instance of reportable noncompliance with Federal law related to referring delinquent student loan debts to Treasury.

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

Page 2 – The Honorable Betsy DeVos

In connection with the contract, we reviewed KPMG's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit of the financial statements in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express an opinion on the Department's financial statements, or conclusions on internal control over financial reporting, compliance and other matters. KPMG is responsible for the report dated November 15, 2019, and the conclusions expressed therein. However, our review disclosed no instances where KPMG did not comply, in all material respects, with U.S. generally accepted government auditing standards.

We appreciate the cooperation given KPMG and my office during the audit. If you have any questions or would like to discuss the report, please contact me at (202) 245-6900.

Sincerely,

Sandra D. Bruce
Deputy Inspector General delegated the duties of Inspector General

Enclosure

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

Deputy Inspector General delegated the duties of Inspector General
United States Department of Education

Secretary
United States Department of Education:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the United States Department of Education (Department), which comprise the consolidated balance sheets as of September 30, 2019 and 2018, and the related consolidated statements of net cost, and changes in net position, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 19-03 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the United States Department of Education as of September 30, 2019 and 2018, and its net costs, changes in net position, and budgetary resources for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the *Agency Financial Report* to provide additional information for the users of its financial statements. Such information is not a required part of the basic consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Required Supplementary Information

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

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The information on pages i through iii, Message from the Secretary, message from the Chief Financial Officer, About the Financial Section, Other Information section, and Appendices is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2019, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying exhibits, we did identify certain deficiencies in internal control that we consider to be a material weakness and significant deficiencies.

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

Department management did not report the material weakness, *Controls over the Reliability of Information Used in the Modeling Activities Need Improvement*, in its *Statement of Assurance*, included in the Management's Discussion and Analysis section of the accompanying *Agency Financial Report*.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Exhibit B, *Information Technology Controls Need Improvement* and *Effective Monitoring of Service Organizations Needs Improvement,* to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's consolidated financial statements as of and for the year ended September 30, 2019 are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 19-03, and which is described in the accompanying Exhibit C, *Requirement for Referring Delinquent Student Loan Debts to Treasury*.

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances in which the Department's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

Department's Responses to Findings

The Department's responses to the findings identified in our audit are described in the accompanying Exhibit D. The Department's responses were not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the responses.

Purpose of the Other Reporting Required by Government Auditing Standards

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
November 15, 2019

Exhibit A

Material Weakness

Controls over the Reliability of Information Used in the Modeling Activities Need Improvement

Under the *Federal Credit Reform Act of 1990* (FCRA), the United States Department of Education (Department) is required to perform periodic interest rate and technical reestimates of the subsidy costs of its direct loan and guaranty programs. These reestimates are calculated using an internally developed cash flow model. The cash flow model utilizes assumptions based on internally sourced data elements from the National Student Loan Data System (NSLDS) in unison with external data to provide macro-economic context to the data. These future cash flow outputs generated from the Department's cash flow model, the Student Loan Model (SLM), are then input into the format required by the Office of Management and Budget (OMB) Credit Subsidy Calculator (CSC), a required present value discount tool for agencies with credit reform programs. These procedures are necessary to generate subsidy reestimates in accordance with the FCRA, as required by U.S. generally accepted accounting principles.

Condition:

During the fiscal year (FY) 2018 audit, we reported a number of deficiencies in controls over management's review and documentation of the subsidy reestimate. During FY 2019 audit, we noted improvements in certain processes and controls; however, the documentation supporting the subsidy reestimate, with respect to key assumptions used, and management's review control of the reestimate are still not at a sufficient level of detail and precision that would detect and prevent material misstatements.

For example, in FY 2019, management updated the Income Driven Repayment (IDR) model and the most significant update within the model was the reduction of the income assumption by 20%. Although management included in its documentation an analysis noting that the NSLDS derived borrower income data was 30% lower than the projected income data sourced from the 2013 Internal Revenue Service (IRS) data, management could not provide sufficient documentation to support its determination that 20% reduction is appropriate. This lack of documentation does not allow an independent reviewer to assess the reasonableness of this key assumption used in the calculation of the subsidy reestimate.

Cause/Effect:

Management's review controls were not designed to ensure that key assumptions used to develop the subsidy reestimate are properly supported and such support is reviewed and maintained. Insufficient documentation supporting the credit reform reestimate model and management review, including documentation supporting key assumptions, could lead to a material misstatement of the financial statements.

Criteria:

The following criteria were considered in the evaluation of the material weakness presented in this exhibit:

- *Green Book* (GAO-14-704G – Federal Internal Control Standards), Principle 10.03
- FASAB Technical Release 6, *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reforms Act*, Paragraphs 20 and 40

Recommendation:

We recommend that the Cost Estimation and Analysis Division (CEAD) design and implement policies and procedures requiring a formalized review, approval, and documentation of key assumption updates and risk assessments. This documentation should be at a sufficient level of detail to demonstrate management determinations and rationale for their decisions, and the process for selecting specific assumption values, specifically in cases where management's determination differ from the assumption values supported by the available evidence. The documentation should also address any limitations of the available evidence and how these impact management's determination of selected assumption values.

Exhibit B

Significant Deficiencies

A. Information Technology Controls Need Improvement

Conditions:

In FY 2018, we reported a significant deficiency related to Federal Student Aid's (FSA's) Information Technology (IT) controls due to persistent unmitigated IT control deficiencies. During FY 2019, the FSA management demonstrated progress implementing corrective actions to remediate some prior year deficiencies. However, management has not fully remediated prior-year deficiencies related to logical access administration, separated/transferred user access removal, user access reviews and recertification, and data validation upon system conversion. We noted IT control deficiencies related to logical access, segregation of IT duties, and application change control for two of FSA's financial and mixed systems. In addition, we noted deficiencies related to logical access for Education's Central Automated Processing System (EDCAPS) servers at the Department. Specifically, we noted the following:

Department:

1. Weaknesses in IT logical access controls. A user was granted access to EDCAPS server without a completed access authorization form.

FSA:

1. Weaknesses in IT logical access controls. For a number of selected new users in the two FSA systems, FSA could not provide completed access authorization forms; FSA did not remove separated users' access timely for one FSA system; and FSA did not verify the completeness and accuracy of the user lists utilized for the quarterly access review for one FSA system.
2. Weaknesses in IT controls related to the segregation of IT duties. For one FSA system, developers retained greater than read-only access to the application in the production environment.
3. Weaknesses in IT controls related to application change control where FSA was unable to provide a complete and accurate list of changes for one FSA application. Consequently, FSA was unable to demonstrate that it tested and approved all changes to this application prior to migration to production.

Cause/Effect:

There was a lack of effective monitoring controls by the Department and FSA to ensure:

1. Systems and support processes consistently adhered to documented agency-wide policies and procedures and the National Institute of Standards and Technology (NIST) security control requirements for the financially and mixed systems hosted and managed by FSA, the Department, or by service organizations.

Additionally, there was a lack of effective monitoring controls by FSA to ensure:

1. Corrective actions to remediate prior-year conditions and associated causes are fully implemented, as well as verifying and validating that these corrective actions were successful; and

2. The change management system generates a complete and accurate population of changes, and the change tickets had no errors due to manual updates resulting in human error.

Ineffective IT controls increases the risk of unauthorized use, disclosure, disruption, modification, or destruction of information and information systems that could impact the integrity and reliability of information processed in the associated applications which may lead to misstatements of the financial statements.

Criteria:

The following criteria were considered in the evaluation of the significant deficiency presented in this exhibit:

- The Departmental Directive OM 3-104, *Clearance of Personnel for Separation or Transfer*
- Baseline Cybersecurity Standard, OCIO-STND-01, dated October 15, 2018, Section 3.8, *Personnel Access*
- Departmental Handbook, OCIO 01, Section 4.9 *Personnel Security*
- National Institute of Standards and Technology Special Publication 800-53, *Security and Privacy Controls for Federal Information Systems and Organizations*, Revision 4, dated April 2013, specifically security control requirements AC-2 *Account Management*, AC-5 *Separation of Duties*, AC-6 *Least Privilege*, CM-3 *Configuration Change Control*, and CM-5 *Access Restrictions for Change*
- Federal Information Processing Standards 200, *Minimum Security Requirements for Federal Information and Information systems*
- The *Standards for Internal Control in the Federal Government*, issued by the Comptroller General of the United States (Green Book), Principle No. 7, *Identify, Analyze, and Respond to Risks*, Principle No. 11, *Design Activities for the Information System*, and Principle No. 13, *Use Quality Information*

Recommendations:

We recommend that the Department:

1. Implement a quality control process to ensure that accounts and associated privileges are properly reviewed and approved prior to creating the account in the system.

We recommend that FSA:

1. Implement a quality control process to ensure that user accounts and associated privileges are properly reviewed and approved prior to creating the account in the system.
2. Implement processes and procedures to timely deactivate separated users' accounts.
3. Perform comprehensive user access reviews and confirm the access lists received for review by designated management are complete and accurate prior to commencing the review.
4. Prevent or limit developer access in the production environment to read-only.
5. Evaluate its change/configuration management process ensuring that it is completely and accurately capturing all changes throughout the various phases of the change management life cycle. Additionally, identify, implement, and follow a quality control review process to make sure that the change process was completely and accurately followed prior to closing the change ticket.

B. Effective Monitoring of Service Organizations Needs Improvement

Conditions:

The Department and FSA rely on service organizations to host and administer financial and mixed systems, such as NTT Data Services[1] and PIVOT, which hosted the Department's core financial management system and consolidated general ledger, and Next Generation Data Center (NGDC) [2] and Amazon Web Services (AWS), which host FSA's financial information, student loan information, and loan origination and disbursement systems. Each servicer has either begun or concluded their contracts with the Department or FSA within the last two fiscal years. We noted the following deficiencies with the testing performed over the design and operation of the controls at these service organizations:

1. The Department management did not receive a System and Organization Controls (SOC) 1, Type 2, reports from NTT and PIVOT to cover the controls at the service organizations.
2. The SOC 1, Type 2, report for the NGDC service organization did not sufficiently provide assurance over key processes and controls at NGDC. Specifically, we noted the following:
    - The SOC 1, Type 2, report covered the period of May 1, 2018 through April 30, 2019 but did not cover the remaining five months of the current fiscal year. We noted that a bridge letter would not be sufficient to cover the operating effectiveness of the controls for the remainder of the fiscal year.
    - The SOC 1, Type 2, report only covered physical security and environmental controls. It did not address controls over security management, logical access, change and configuration management, production control, incident handling, and backups.

    In addition, the testing performed by FSA was not sufficient to address relevant internal control over financial reporting considerations that should have been addressed through management's internal control processes and/or an adequately scoped SOC 1, Type 2 report issued by service organizations' auditors.
3. The AWS SOC 1 report covered the period of October 1, 2018 through March 31, 2019 but did not cover the remaining six months of the current fiscal year.

Cause/Effect:

The Department's plan for the systems migration from NTT to PIVOT did not ensure testing of controls at the service organizations would be performed for FY 2019.

FSA's monitoring controls were insufficient to ensure that the collective controls at the service organization and at FSA were properly designed and implemented throughout the fiscal year.

The Department and FSA have limited assurance on the implementation and operating effectiveness of the hosting controls and processes they are relying on for their systems, at the service organization. Therefore, the Department and FSA may not be aware of existing or potential weaknesses that could impact the integrity of their financial and mixed systems production data.

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[1] In April 2019, the Department of Education began migrating its core financial management system and consolidated general ledger from the legacy service organization, NTT, to the new service organization, PIVOT.

[2] FSA has a contractual relationship with the Mid-Atlantic Data Center (MDC) to host its financial and mixed systems and refers to this service organization as NGDC.

Criteria:

The following criteria were considered in the evaluation of the significant deficiency presented in this exhibit:

- The United States Government Accountability Office, Standards for Internal Control in the Federal Government, September 2017*,* and (the Green Book) *Section 4 – Additional Considerations, Service Organizations* and *Principle 16 – Perform Monitoring.*
- National Institute of Standards and Technology (NIST) Special Publication 800-53, *Security and Privacy Controls for Federal Information Systems and Organizations*, Revision 4, dated April 2013, security control requirement *SA-9 External Information System Services Control.*

Recommendations:

We recommend that the Department:

1. On an annual basis, obtain an annual SOC1, Type 2, report for the core financial management system and consolidated general ledger that covers the appropriate time period for financial reporting operations and includes IT controls in relevant control areas, such as security management, logical and physical access controls, change and configuration management, backup, and production control.
2. Develop a process to review new and existing contracts with service organizations to require the service organizations to provide appropriate SOC 1, Type 2, reports and bridge letters. Such review should include assessing the relevancy to Department's controls to be tested in the SOC 1 report, the period covered, and understanding of complementary user controls to be performed by the Department.
3. Obtain a bridge letter from the service organization on their environment and/or design and operation of the controls covered in the SOC 1 report did not change from the SOC report date through September 30.

We recommend that the FSA:

1. Ensure the contractual requirements are met to obtain the required SOC report(s) and related bridge letter(s) applicable for the user's operational and business needs, to include internal control over financial reporting considerations. The SOC reports, and bridge letters, as applicable, should cover the appropriate time period for the financial reporting operations.
2. Review and revise, as necessary, contracts with service organizations to ensure appropriate SOC 1, Type 2, reports and bridge letters are required.
3. Consider additional controls for new service organizations to set proper expectations and needs of the user entity with respect to SOC 1, Type 2, reports.

Exhibit C

Compliance Matter

Requirement for Referring Delinquent Student Loan Debts to Treasury

In 2014, Federal Law (31 U.S. Code Section 3716(c) (6)) was amended (Public Law 113-101 (*DATA Act*) Section 5) to require agencies to notify the Secretary of the Treasury of valid, delinquent nontax debts that are over 120 days delinquent – 60 days earlier than the previous 180 days requirement – for the purpose of administrative offset (i.e., collection through the reduction of future Federal payments). Due to the number of entities and systems involved in handling student loan debts and the decentralized nature of such processes, FSA is not yet capable of meeting this accelerated timeline. Accordingly, as of September 30, 2019, the Department and FSA are not in compliance with the requirement to refer student debt delinquent for 120 days to the Department of the Treasury.

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

Recommendation:

We recommend that the Department continue to execute the corrective actions as outlined in FSA’s project plan to comply with the timing requirement for the referral of delinquent non-tax debts.

Management's Response **Exhibit D**

UNITED STATES DEPARTMENT OF EDUCATION

November 8, 2019

MEMORANDUM

TO: Sandra D. Bruce
Deputy Inspector General, delegated the duties of Inspector General

FROM: Denise L. Carter
Delegated the authority to perform the functions and duties
of the position of Chief Financial Officer

Jason Gray
Chief Information Officer

SUBJECT: DRAFT INDEPENDENT AUDITORS' REPORT
Fiscal Years 2019 and 2018 Financial Statements
U.S. Department of Education
ED-OIG/A17T0001

Please convey the Department's sincere thanks to everyone on your staff who worked diligently on this financial statement audit. The Department reviewed the draft Fiscal Year 2019 Financial Statement Audit Report. We concur and agree with the Independent Auditors' Report, including the Opinion on the Financial Statements, Report on Internal Control over Financial Reporting, and Report on Compliance and Other Matters.

We will share the final audit results with responsible senior officials, other interested program managers, and staff. At that time, we will also request the preparation of corrective action plans to be used in the resolution process.

Again, please convey our appreciation to everyone on your staff whose efforts permitted the Department to complete the audit within the established timeframe.

Please contact Gary Wood, Deputy Assistant Secretary, Office of Financial Management, Office of Finance and Operations, at (202) 245-8118 with any questions or comments.

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www.ed.gov

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