Report of the Independent Auditors

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 19, 2021

The Honorable Miguel Cardona
Secretary of Education
Washington, D.C. 20202

Dear Secretary Cardona:

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 2021 and 2020 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, 2021, and 2020, 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 2021 and 2020 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 Underlying Data Used in Credit Reform Re-estimates Need Improvement.
- Three significant deficiencies in internal control over financial reporting:
    - Information Technology Controls Need Improvement,
    - Monitoring Controls over Service Organizations Need Improvement, and
    - Entity Level Controls Need Improvement.

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, opinions on the Department's financial statements or internal control over financial reporting, or conclusions on whether the Department's financial management systems complied substantially with the three FFMIA requirements, or on compliance with laws and other matters. KPMG is responsible for the auditor's report dated November 19, 2021, 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, 2021 and 2020, 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. 21-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 21-04 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, 2021 and 2020, 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.

KPMG

Other Matters

Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the FY2021 Agency Financial Report to provide additional information for the users of its consolidated 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 and Required Supplementary 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, the information on page vii, Message from the Chief Financial Officer, About the Financial Section, Other Information section, Appendices, and Acknowledgments 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, 2021, we considered the Department's internal control over financial reporting (internal control) as a basis for designing 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 Underlying Data Used in Credit Reform Re-estimates Need Improvement*, to be a material weakness.

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 Exhibit B, *Information Technology Controls Need Improvement*, *Monitoring Controls over Service Organizations Need Improvement*, and *Entity Level Controls Need 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, 2021 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 consolidated financial statements. 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 21-04.

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 Exhibit C. 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 19, 2021

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Exhibit A

<u>Material Weakness</u>

<u>Controls over the Reliability of Underlying Data Used in Credit Reform Re-estimates Need Improvement</u>

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 re-estimates of the subsidy costs of its direct loan and guaranty programs. These re-estimates are calculated using an internally developed cash flow model. The cash flow model utilizes assumptions based on internally sourced data elements from Information Technology (IT) systems. The 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 re-estimates in accordance with the FCRA, as required by U.S. generally accepted accounting principles.

Condition:

The Department and Federal Student Aid (FSA) did not design and implement effective controls to ensure that the data used to develop the re-estimate is reliable, considering the elevated risk associated with such data caused by the IT control deficiencies discussed in Exhibit B of this report. Specifically, the Department and FSA management did not perform sufficient procedures to ensure that the data elements transmitted to and extracted from the various systems and used in the cash flow model are complete and accurate.

Cause/Effect:

The Department's and FSA's risk assessment process did not identify completeness and accuracy of the underlying data resulting from the IT system control deficiencies as a risk that required additional compensating controls. Inadequate controls over the completeness and accuracy of the underlying data used to develop the re-estimate increases the risk that the financial statements could be materially misstated.

Criteria:

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

– The Standards for Internal Control in the Federal Government issued by the Comptroller General of the United States (the Green Book), Principle No. 10, *Design Control Activities*; Principle No. 11, *Design Activities for the Information* System; Principle No. 13, *Use Quality Information*.

– 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.

Recommendations:

We recommend that the Department and FSA:

1. Strengthen the risk assessment process by considering the impact of IT control deficiencies on internal controls over the reliability of information in the Department's IT systems. Such considerations should be documented.

2. Design and implement additional review controls that operate at a sufficient level of precision over the completeness and accuracy of the underlying data used to develop the re-estimate.

3. Ensure proper documentation of controls identified to evidence the review, the conclusion and actions to be taken to address outstanding differences and/or matters to be researched.

A-1

Exhibit B

Significant Deficiencies

A. Information Technology Controls Need Improvement

The following control deficiencies in the areas of IT logical access, security management, segregation of IT duties, and application change management are related to both the Department and FSA systems.

Conditions:

In FY 2020, we reported a significant deficiency related to FSA's IT controls due to persistent unmitigated IT control deficiencies. During FY 2021, the FSA management demonstrated progress implementing corrective actions to remediate some prior-year deficiencies such as background investigations. 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 configuration management. We noted new and existing IT control deficiencies related to security management, access controls, segregation of IT duties, and application change management for three of FSA's financial and mixed systems and two access control support systems. In addition, we noted deficiencies related to Department-level logical access for its core financial management system. Specifically, we noted the following:

Department:

1. Weakness in IT logical access controls: New and separated contractors were not consistently and accurately tracked resulting in the inconsistent reporting of start and termination dates and system access that was not always removed upon separation from the Department.

FSA:

1. Weakness in IT security management controls: Plan of Action and Milestone (POA&M) closure documentation for FSA systems did not always address the root cause of the deficiencies, thereby not preventing future reoccurrences.
2. Weakness in IT logical access controls: The account management and access control processes were not consistently followed for three FSA systems and two access control support systems. We noted evidence supporting new, modified, or separated users could not be provided or was provided and missing required information and/or approvals. Additionally, we noted evidence supporting complete and accurate access reviews and recertifications was not provided or retained. Finally, we noted the Department's requirement for two-factor authentication was not met for all internal system users.
3. Weaknesses in IT controls related to the segregation of IT duties: For one FSA system, users with developer access had access to the system's production environment or update access to the production and development environments.
4. Weakness in IT application change management controls: The application change management process was not consistently followed for one FSA system. FSA was unable to provide a complete and accurate population of application changes. We also noted the documentation for a selection of changes contained inaccuracies in recorded testing and migration dates.

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 for the financially and mixed systems hosted and managed by FSA and the Department.

B-1

Additionally, there was a lack of effective IT controls implemented 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 effectively addressing the weakness with adequate documented supporting evidence.
2. The established logical access control process is followed and requests for new, modified, or separated users were retained, documented completely and accurately, and approved.
3. Segregation of duties and least privilege principles are followed and enforced.
4. The established change process is followed and application change tickets accurately document the testing and migration dates.

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 OCIO 3-112, Cybersecurity Policy.

– Department Baseline Cybersecurity Standard, OCIO-STND-01, dated April 1, 2020, Section 3.13. Personnel Access.

– The Standards for Internal Control in the Federal Government issued by the Comptroller General of the United States (the Green Book), Section OV3.08 *Effect of Deficiencies on the Internal Control System*, Principle 3 *Establish Structure, Responsibility, and Authority, Documentation of the Internal Control System*, Principle No. 3.08 *Assignment of Responsibility and Delegation of Authority*, Principle No. 8.07 *Response to Fraud Risks*, Principle No. 10.3 *Design of Appropriate Types of Control Activities*, Principle No.10.12 *Segregation of Duties*, Principle No. 11, *Design Activities for the Information System*, and Principle No. 13, *Use Quality Information*, Principle No.17, *Evaluate Issues and Remediate Deficiencies*.

– 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 PM-4 Plan of Action and Milestone, 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.

Recommendations:

We recommend that the Department:

1. Evaluate, develop, and implement a formal process to track and report all new and separated contractors.

2. Ensure separated contractors are off-boarded and system personnel are notified in a timely manner to disable or remove access to IT resources.

3. Provide training and oversight to Education personnel with on/off-boarding responsibilities to help ensure new/separated contractors are properly tracked.

B-2

We recommend that FSA:

4. Implement a process to evaluate the significance of a deficiency by considering the magnitude of impact, likelihood of occurrence, and nature of the deficiency and tailor the corrective actions to remediate the risk and address the root cause. Further, update guidance to ensure that quality reviews over the POA&M closure documentation are conducted to confirm the noted deficiencies are fully addressed to help prevent future reoccurrences.

5. Formally develop and implement a quality control review process to ensure that logical access control processes are followed completely and accurately to validate logical access requests, reviews, and recertifications.

6. Ensure segregation of duties and least privilege principles are adhered to when granting user access to prevent users with the ability to develop and/or change application code from having update access to the environment where the final tested and approved changes are staged prior to migration to the financial and mixed systems' production environment; and prevent users with access to develop code from having update access to the production environment.

7. Ensure a complete and accurate population of application changes can be provided. Formally develop and implement a quality control review process to ensure that the application change control process is followed and consistently and accurately documented.

B. <u>Monitoring Controls over Service Organizations Need Improvement</u>

The Department and FSA rely on a certain IT system to store data for student loan programs. The Cost Estimation and Analysis Division (CEAD) within the Department also uses the data in the system for the development and update of the assumptions used in the re-estimation of subsidy allowance, a critical component of management's financial reporting process. The IT system is owned and controlled by FSA, who is responsible for the application-level internal controls, and is hosted by a service organization, who is responsible for internal controls at the data center.

Condition:

The Department and FSA did not have effective monitoring controls in place to ensure that the scope of the System and Organization Controls (SOC) 1, Type 2 report for the service organization and/or management's internal control processes sufficiently cover the relevant key controls to support the reliability and integrity of the data stored in the IT system. For example, we noted that there were no sufficient relevant controls identified and tested for data transmission/batch job processing at the host level for one FSA system to ensure the completeness and accuracy of the data used in the re-estimate.

Cause/Effect:

FSA did not perform a comprehensive assessment of key relevant controls to appropriately assess the risks in the financial reporting process.

Ineffective monitoring controls over the service organization increase the risk of disruption, modification, or destruction of information that could impact the integrity and reliability of information processed in the associated application 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 Standards for Internal Control in the Federal Government issued by the Comptroller General of the United States (the Green Book), Section OV4.01 *Additional Consideration, Service Organizations*, Principle 16.08 - *Perform Monitoring Activities.*

– 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 SA-9 External Information System Services.

Recommendations:

We recommend that FSA:

1. Enhance their risk assessment to identify risks impacting financial reporting processes.

2. Identify the controls at the service organization for the systems that are responsive to risks and that are relevant to FSA's financial statements.

3. Regularly monitor and meet with the service organization to communicate and ensure that controls that are relevant to FSA for financial reporting are adequately tested for design, implementation, and operating effectiveness.

4. Assess the need to implement compensating controls for financial reporting in the event relevant controls at the service organization are not within the scope of the SOC 1 report.

C. Entity Level Controls Need Improvement

The Department and FSA are continually seeking ways to improve accountability in achieving the entity's mission. A key factor in improving accountability in achieving an entity's mission is to implement an effective internal control system. The control environment sets the tone of an organization by influencing the control consciousness of its personnel. It is also the foundation for all components of internal control, providing discipline and structure. The Department and FSA need to address weaknesses in its entity-wide control environment as we have observed two entity-wide control environment conditions through our procedures that have a pervasive influence on the effectiveness of controls. These common themes, which contributed to the deficiencies noted above, are related to the entity's risk assessment and monitoring activities.

Conditions:

1. Risk Assessment- The Department and FSA's entity level controls were not designed and implemented appropriately in order to define objectives related to the financial reporting process to enable the identification of risks, define risk tolerances and identified processes and controls responsive to those risks.

2. Monitoring Activities- The Department and FSA's entity level controls were not designed and implemented appropriately in order to remediate identified internal control deficiencies in a timely manner.

Cause/Effect

1. Risk Assessment considerations address the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses. Specifically, inadequate risk assessment throughout the Department and FSA, prevented the proper identification and analysis of risks related to the financial reporting process at the Department and FSA, and from designing appropriate risk responses. For example, the Department did not identify the risk objectives that should have been either addressed by the SOC1, Type 2 report or through compensating controls at the Department and FSA, to support the reliability and integrity of the data used in the financial reporting process.

2. Monitoring Activities considerations address management's processes to establish and implement operations that assess the quality of performance over time and promptly resolve the findings of audits and other reviews. Specifically, insufficient monitoring has prevented the Department and FSA from ensuring that corrective action plans are implemented, and control deficiencies are remediated timely.

Criteria

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

– GAO Standards for Internal Control in the Federal Government (Green Book) Principle 6, *Management should define objectives clearly to enable the identification of risks and define risk tolerances.*

– GAO Standards for Internal Control in the Federal Government (Green Book) Principle 17, *Management should remediate identified internal control deficiencies on a timely basis*

Recommendations

We recommend that management implement the following to improve the effectiveness of entity-level controls:

1. Improve the risk assessment process at the financial statement assertion level and at the process level to ensure the department is appropriately defining objectives to enable the identification of risks and define risk tolerances.

2. Implement key monitoring controls to ensure that corrective action plans are implemented to timely remediate control deficiencies identified. In addition, increase oversight, review, and accountability over the process among various offices and directorates within the Department and FSA.

Exhibit C

Management's Response

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF FINANCE AND OPERATIONS

November 16, 2021

MEMORANDUM

TO:
Bryon S. Gordon
Assistant Inspector General for Audit

FROM: Denise L. Carter Denise Carter Digitally signed by Denise Carter Date: 2021.11.16 15:38:29 -05'00'
Delegated the authority to perform the functions and duties of the position of Chief Financial Officer

Jason Gray JASON GRAY Digitally signed by JASON GRAY Date: 2021.11.16 15:40:36 -05'00'
Chief Information Officer

SUBJECT: DRAFT INDEPENDENT AUDITORS' REPORT
Fiscal Years 2021 and 2020 Financial Statements
U.S. Department of Education
ED-OIG/A21FS0021

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 2021 Financial Statement Audit Report. We concur and agree with the Independent Auditors' Report, including the Opinion on the Financial Statements, Internal Control over Financial Reporting, and 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.

Please contact Gary Wood, Deputy Assistant Secretary, Office of Financial Management, Office of Finance and Operations, and Acting Deputy Chief Financial Officer, at 202-453-7631 with any questions or comments.

400 MARYLAND AVE., S.W., WASHINGTON, DC 20202
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.

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