

Analysis of Controls, Systems, and Legal Compliance

This section provides management assurances regarding compliance with the [Federal Managers' Financial Integrity Act of 1982](#) (P.L. 97-255) (FMFIA) and Office of Management and Budget (OMB) [Circular A-123, Management's Responsibility for Internal Control](#). It also provides an analysis of the Department's controls, systems, and legal compliance.

The Department is the smallest of the 15 cabinet level agencies in terms of government staff, yet it has the third largest grant portfolio among the 26 federal grant-making organizations. The Department manages the second largest loan portfolio in the federal government. As such, the Department relies heavily on its internal controls and system frameworks to ensure that the Department maintains appropriate stewardship over funds entrusted to it by the American people.

Controls Framework and Analysis

The FMFIA requires agencies to establish internal controls that provide reasonable assurance that the following objectives are achieved:

- effectiveness and efficiency of operations,
- compliance with applicable laws and regulations, and
- reliability of financial reporting.

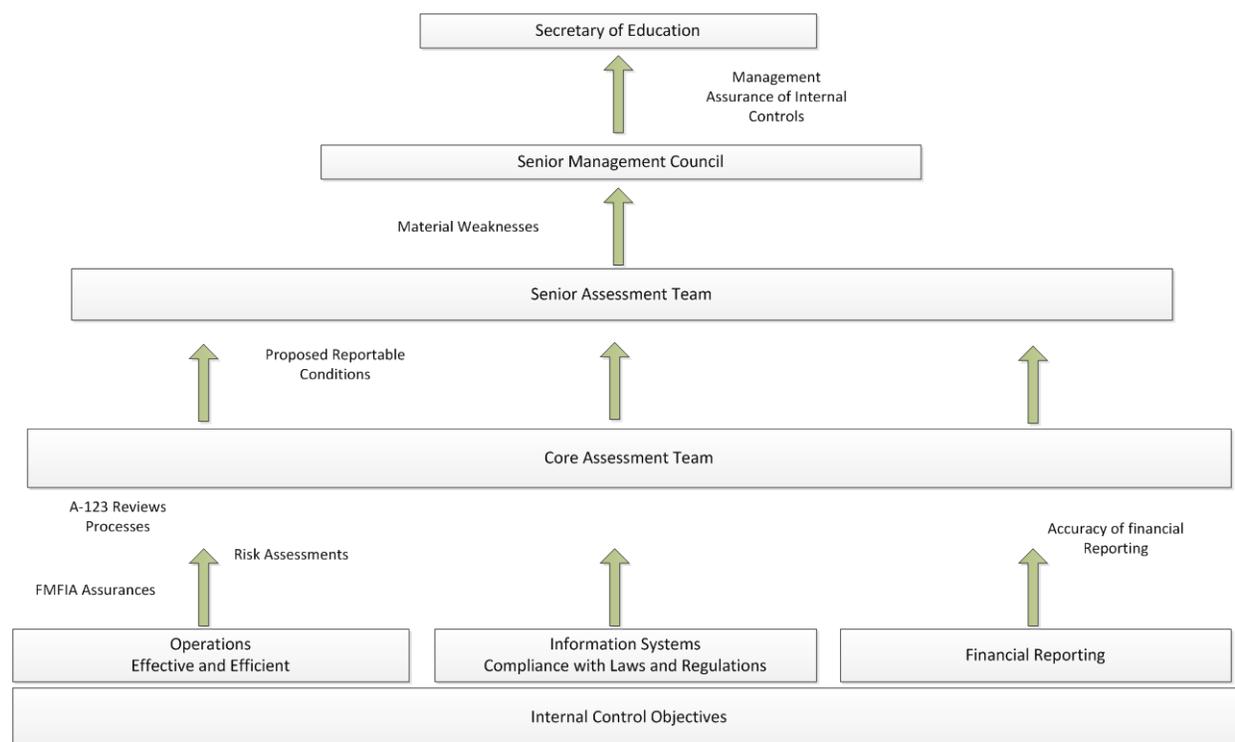
OMB Circular A-123 implements the FMFIA and defines management's responsibility for internal control in federal agencies.

The Department's internal control framework is robust. Consistent with Circular A-123, the Department established a Senior Management Council (SMC) comprised of senior leaders from across the Department to provide oversight over the internal control framework. This oversight role includes identifying focus areas, determining when internal control deficiencies are significant, setting expectations for their correction, and monitoring the implementation of corrective actions. The Department also established a Senior Assessment Team (SAT) and Core Assessment Team (CAT) to help guide the internal control process.

Each principal office within the Department implements internal controls to achieve operational goals, which include internal controls over: operations, financial reporting, and information technology systems. The process begins with risk assessments of the Department's business processes and information technology systems. The SAT considers the potential impact of risks using a multi-dimensional framework comprised of numerous risk factors. The SAT recommends higher risk processes and systems for more frequent and rigorous internal control evaluations. Through the evaluations, Department offices document key controls, evaluate and test the design and effectiveness of those controls, and communicate results to the SAT. Each office must develop and implement corrective action plans for all reported deficiencies. Throughout this process, the CAT provides technical support.

The office of Federal Student Aid (FSA) maintains a parallel governance structure that is integrated with the Department's. FSA's Chief Operating Officer both chairs the FSA SMC and participates as a member of the Department's SMC, FSA's Chief Financial Officer both chairs the FSA SAT and participates as a member of the Department's SAT, and the chair of the Federal Student Aid CAT participates as a member of the Department's CAT. Additional information on Federal Student Aid's internal control framework, assessment of controls, and

related assurances can be found in the Analysis of Systems, Controls, and Legal Compliance section of the [FY2013 Federal Student Aid Annual Report](#).



Controls over Operations

The Department's two primary areas of operation are administering grants and loans. Other significant business activities include the management of contracts and interagency agreements, human capital, facilities, and legal enforcement activities. To ensure the efficient and effective implementation of these and other operations, including compliance with applicable laws and regulations, the Department issued a Directive, establishing in policy that all managers are responsible for ensuring the development, maintenance, documentation, evaluation, and improvement of internal control for the programs and administrative functions for which they are responsible. The Directive also designates the Chief Financial Officer (CFO) as the Senior Internal Control Official for the Department. In this role, the Office of the CFO develops and issues policies, procedures, and reporting requirements; develops and provides training and technical assistance; coordinates with the SMC, SAT, and CAT; conducts selected internal control reviews; and develops and maintains internal control and audit follow-up systems.

Each principal office assesses the design and operation of applicable key controls in their respective areas of responsibility and prepares an annual FMFIA assurance which highlights internal control processes and reports material weaknesses and significant deficiencies identified. These management assurances, along with the results of internal control reviews and external audits serve as the basis for the Secretary's assurance statement provided later in this section of the report.

In FY 2013, the Department identified no material weaknesses in internal controls over the effectiveness and efficiency of operations. The Department, however, continues to identify challenges in the administration of grants, loans, and other program operations. Additionally, the OIG has identified five FY 2014 management challenges: improper payments, information technology security, oversight and monitoring, data quality and reporting, and information technology system development and implementation. A summary of the OIG report with links to the full report are provided in the Other Information section.

Controls over Financial Reporting

Internal Control over Financial Reporting (ICOFR) is a subset of FMFIA, Section 2. For the Department to comply with [ICOFR](#), each principal office must annually assess and report on the adequacy and effectiveness of the applicable internal controls they have in place to protect the reliability and integrity of the Department's financial reporting. The [Office of Management and Budget \(OMB\) implementation guidance](#) describes a process for accessing internal control over financial reporting. The Department's assessment of the effectiveness of control over financial reporting is performed in accordance with OMB Circular A-123, [Appendix A](#) (A-123A) and leverages the implementation guidance. A-123A requires each agency to provide an annual statement of assurance on the effectiveness of internal control over financial reporting as part of the overall FMFIA assurance statement.

Planning is a critical step in the A-123A compliance process. Key decisions that drive the assessment are made during the planning phase. Management must decide the materiality threshold, the scope of the assessments (e.g., which financial processes to review), and the test approach/methodology as well as other key decisions. Materiality levels were established for each of the four principal financial statements based on the [Government Accountability Office \(GAO\) Financial Audit Manual \(FAM\)](#) guidance and taking into consideration the Department's established materiality threshold.

Each year, as a function of the risk assessment and analysis process, management identifies areas to test. For any deficiency identified during testing, the CFO staff works with control owners to facilitate Corrective Action Plan development, approval, and implementation. The Department also considers the status of ongoing corrective actions and results of the financial statement audit.

In FY 2013, the Department focused on 10 business processes and assessed 60 key controls. The testing process was primarily focused on assessing whether key controls were operating effectively as of June 30, 2013. Additionally, follow-up testing and the results of the financial statement audit were considered to determine the effectiveness of controls as of September 30, 2013. The Department concluded that internal controls over financial reporting were in place and working.

FSA conducted its assessment of effectiveness of internal control over financial reporting and provided its assurances to the Department. Overall, the results of the FSA self-assessments revealed no material weaknesses.

In FY 2012, FSA identified and disclosed two material weaknesses related to the issues with the large-scale system conversions for the Debt Management Collection System/2 (DMCS2) and Affiliated Computer Services (ACS), Inc. Education Servicing (ACES) that occurred during that review period. Nine Corrective Action Plans (CAPs), with underlying action items, were developed to address those issues, and another CAP was added in FY 2013. At the end of FY 2013, nine of the ten CAPs have been closed and the issues remediated. The remaining

CAP continues to be worked and will be tracked and monitored through to resolution, or will be resolved through new contract actions.

In addition, throughout FY 2013, FSA has been committed to responding to external audit recommendations in its Report on Internal Controls over Financial Reporting. At the end of FY 2013, 22 CAPs have been developed to address the recommendations. Corrective actions taken in 2013 sufficiently remediated the underlying conditions such that, for the year ended September 30, 2013, these deficiencies no longer aggregate to a material weakness.

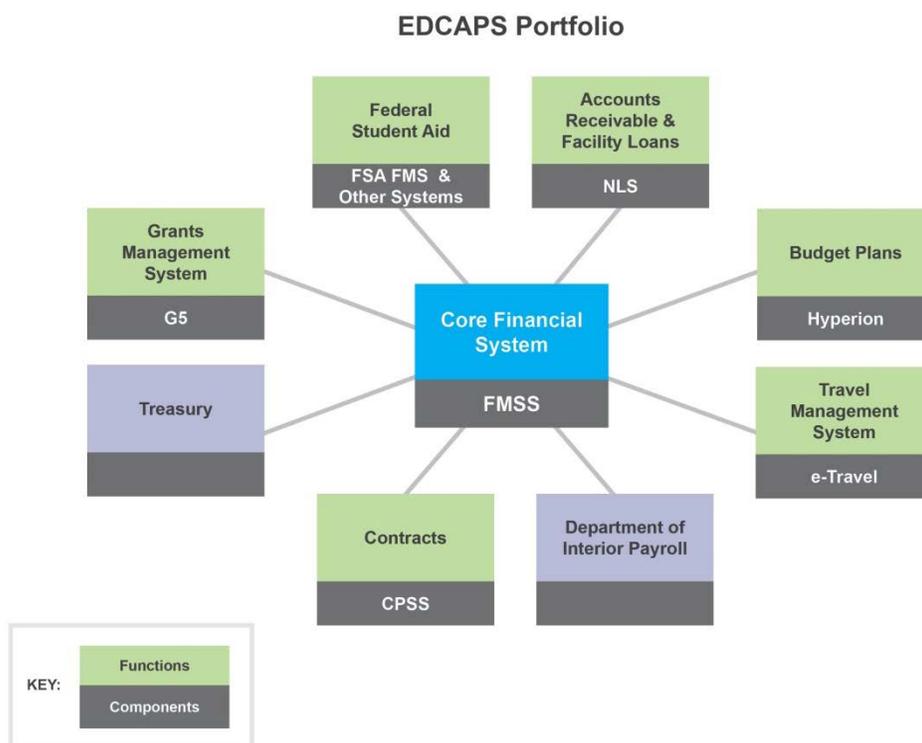
Additional information on FSA's assessment of controls and related assurances can be found in the Analysis of Systems, Controls, and Legal Compliance section of the [FY2013 Federal Student Aid Annual Report](#).

Controls over Systems

Among the guidance applied by the Department in assessing controls over systems during FY 2013 were FMFIA (section 4) and OMB Circular A-127, *Financial Management Systems*, or Appendix D of OMB A-123, *Compliance with the Federal Financial Management Improvement Act of 1996*.

The Department's core financial applications have been brought together under the umbrella of the Education Central Automated Processing System (EDCAPS). EDCAPS is a suite of financial applications, including commercial off-the-shelf and custom code and interfaces that encompass the Department's core financial management processes.

The Department's financial management systems are designed to support effective internal controls and to produce accurate, reliable, and timely financial information. Our current financial systems (EDCAPS) portfolio is depicted in the image below:



The components of EDCAPS are linked through custom interfaces to provide the Department with real-time financial management capabilities. EDCAPS serves approximately 4,200 departmental users in Washington, DC, as well as 10 regional offices throughout the United States. EDCAPS also serves approximately 100,000 external users.

Components of EDCAPS

Financial Management System Software (FMSS)—The FMSS is the Department's core financial system. It provides financial management functions for the Department, including general ledger, financial statement production, funds control and budget reporting, cost accounting, and accounts receivable/administrative accounts payable functions.

Contracts and Purchasing Support System (CPSS)—The CPSS provides users with a central repository to enter, retrieve, manage, and view acquisition/contract-related data. The centralized data provides enhanced information dissemination with the ability to respond to internal and external information requests. Various other systems and processes are used to augment and supplement the business process management gaps in the current environment.

Federal Student Aid's Financial Management System (FSA's FMS)—FSA's FMS is an integrated financial management system, utilizing Oracle Federal Financials, which incorporates full financial business functionality, including general ledger, accounts payable, and accounts receivable across multiple FSA program areas. FMS supports FSA service areas, enterprise areas, and partners and provides timely and consistent financial data for strategic decision making. The core of FMS encompasses interfaces (file transfers of data) from program applications to the Oracle Financials application and the consolidation and centralization of all accounting and financial data into one system for FSA programs. There are also customized modules or extensions that provide additional functionality to FMS allowing for the collection of data from financial partners in various FSA programs. FMS, in turn, interfaces with the Department's general ledger and with other systems to provide accounting and payment transactions. In addition, FMS provides FSA with a fully auditable accounting system incorporating appropriate security, controls, and audit trails.

Grants Management System (G5)—G5 manages all grant activities from initial recipient contact, through grant processing, to payments and grant closeout. This single system approach provides improved grant information management, recipient response time, and accuracy of financial management information.

Travel Management System (TMS)—The Department participates in e-Travel. Under e-Travel, travel system functionality is provided under contract by E2 solutions. EDCAPS interfaces with E2 in accordance with an established memorandum of understanding.

Hyperion Budget Planning—Hyperion Budget Planning is used by the Department for preparing annual spending plans. The Plan versus Actuals Report is generated from this system.

EDCAPS also has interfaces with the Department of Interior for payroll data, the Department of Treasury for payment data, and the Nortridge Loan System (NLS) for promissory note data.

Self-Assessments

The Department is keenly aware of the importance of strong internal controls and adequate security controls over system access and data and continually looks for ways to strengthen

these controls. The Department's System Security Plan (SSP) identifies management, operational, and technical security controls for EDCAPS. The SSP is based upon a review of the environment, documentation, and interviews with information system personnel. While the Department has not eliminated all risks, management reviews confirm that all favorable actions are taken to diminish deficiencies and strengthen internal control overall. Risks are routinely monitored and contingency and mitigation plans are maintained.

Because EDCAPS is a moderate-impact application per [Federal Information Processing Standards \(FIPS\) 199](#), this system is subject to the moderate-impact baseline required by National Institute of Standards and Technology (NIST) Special Publication (SP) 800 53 Rev 3. Therefore, EDCAPS uses the NIST SP 800 53 Rev 3 moderate-impact baseline as its minimum security control requirements.

All internal EDCAPS user accounts are established using an EDCAPS Access Request Form. This form is used to grant initial access to EDCAPS subsystems and must be validated by the user's supervisor and the appropriate Information System Security Officer. Access is based on the user's role or job title. Principles of least privilege and segregation of incompatible duties are applied at all times. Access to all EDCAPS applications is protected by a user ID and password. Each application has a security administrator who is responsible for vetting individual EDCAPS access forms and for establishing their accounts. Access is granted based on the "need to know" and the least privilege the user requires performing his or her duties.

The [Federal Financial Management Improvement Act](#) (FFMIA) requires federal agencies to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger at the transaction level. Agencies are required to assess and report on whether these systems comply with FFMIA on an annual basis.

EDCAPS has been designed to deliver efficient and effective operations, while complying with FFMIA. In determining whether the Department's financial systems comply with system controls, management considered available information from annual audit reports and other relevant and appropriate information. The Department's determination leverages the results of related annual reviews. The Department is committed to continually improving all controls and acknowledges the ongoing efforts of security management to strengthen financial management systems.

Based on self-assessments and results of external audits, the Department has concluded that there are no material weaknesses in control over systems. However, self-assessments and external audits continue to identify significant challenges associated with maintaining highly effective controls over the multiple areas of system controls.

FSA conducted its assessment of effectiveness of internal control over financial reporting and has provided its assurances to the Department. A significant component of FSA's assessment includes Statements on Standards for Attestation Engagements (SSAE) 16 audits over its loan servicers' controls, including system controls. No material weaknesses were identified. Of the more than 3,200 controls tested, about 6 percent of them had control weaknesses. Overall, the impact of those weaknesses was immaterial to the FSA financial statements. Accordingly, FSA concluded that its systems substantially complied with the requirements of the *Federal Financial Management Improvement Act* (FFMIA). However, FSA considers the deficiencies to be significant and continues to act on them. Additional information on FSA's internal control framework, assessment of controls, and related assurances can be found in the Analysis of Systems, Controls, and Legal Compliance section of the FY 2013 Federal Student Aid Annual Report.