OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

Department of Children, Families & Learning

Fiscal Year Ended June 30, 2002

MARCH 13, 2003

03-15

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota State government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately fifty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year and one best practices review.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of Representatives and Senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

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If you have comments about our work, or you want to suggest an audit, investigation, evaluation, or best practices review, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

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Audit Participation

The following members of the Office of the Legislative Auditor prepared the report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
Connie Stein	Auditor
Irene Hass	Auditor
Kristen Poore	Auditor
Linda Pha	Auditor

Exit Conference

We discussed the findings and recommendations with the following representatives of the Department of Children, Families & Learning at the exit conference held on February 25, 2003:

Chas Anderson	Assistant Commissioner
Anne Cutler	Manager of Learner Options
Patricia King	ESEA Program Supervisor
Tammy McGlone	Administrative Services Director, Board of Water & Soil Resources

Report Summary

Key Findings and Recommendations:

The Department of Children, Families & Learning (CFL) relied on one employee to maintain its critical information systems. In fiscal year 2002, these subsystems processed over $5.4 billion of state and federal school aids. Reliance on a single employee's knowledge for the ongoing operation of these critical systems is a significant weakness in the department's internal control structure. We recommended that the department document the design of the systems and that it cross train other programmers to ensure the ongoing maintenance of these critical systems. (Finding 1, page 5)

CFL's contracts with it s test development vendor did not comply with certain contracting policies. CFL repeatedly did not have a contract in place before the start of work by the test development vendor. By allowing the contractor to perform services before the execution of the contract or the encumbrance of funds, the department placed the state at unnecessary risk. We recommended that the department fully execute contracts before allowing work to commence and that the department encumber funds before incurring obligations. (Finding 2, page 5)

The department could not provide documentation to support administrative salaries charged to federal school aid programs. It also could not support all of the figures in its annual State Per Pupil Expenditure report to the federal government. We recommended that the department maintain documentation to support its administrative charges and the figures it uses in its reports to the federal government. (Findings 3 and 4, pages 6 and 7)

CFL did not comply with certain requirements for the Migrant Education Program. It used about $42,000 of Migrant Education funds to reimburse a school district for a portion of a deficit in the school district's summer food service program. The school district's summer food program provided meals to a broader population than children eligible for the Migrant Education Program. We recommended that the department only allow school districts to use Migrant Education funds in accordance with federal requirements, and that it seek reimbursement of the funds paid for meals served to ineligible people. (Finding 5, page 7)

Management letters address internal control weaknesses and noncompliance issues found during our annual audit of the state's financial statements and federally funded programs. The scope of our work in individual agencies is limited. During the fiscal year 2002 audit, our scope at the Department of Children, Families & Learning included state and federal school aid payments, totaling approximately $4.5 billion, and nearly $600 million of federally funded programs, including Title I, Special Education, Child Care, and various nutrition programs. The department's response to our recommendations is included in the report.

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OLA

OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Dr. Cheri Yecke, Commissioner
Department of Children, Families & Learning

We have performed certain audit procedures at the Department of Children, Families & Learning (CFL) as part of our audit of the financial statements of the State of Minnesota as of and for the year ended June 30, 2002. We have also reviewed certain department procedures related to the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to the department for the year ended June 30, 2002. We emphasize that this has not been a comprehensive audit of the Department of Children, Families & Learning.

The scope of our audit work at the Department of Children, Families & Learning included state and federal school aid payments made through the department's IDEAS and PAYS subsystems. Cash basis payments through these subsystems totaled nearly $4.5 billion for state school aids and nearly $600 million for federal programs such as Title I, Special Education, Child Care, and various nutrition programs. We performed certain audit procedures on these subsystems as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 2002, were free of material misstatement.

Table 1 identifies the State of Minnesota's major federal programs administered by the Department of Children, Families & Learning. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its major federal programs.

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Table 1
Department of Children, Families & Learning
Major Federal Programs
Fiscal Year 2002
(in thousands)

CFDA No.	Program Name	Total Expenditures
	Child Nutrition Cluster	
10.555	National School Lunch Program	$75,311
10.553	School Breakfast Program	$17,022
10.559	Summer Food Service Program for Children	$ 3,280
10.556	Special Milk Program for Children	$ 821
	Child Care Cluster	
93.596	Child Care & Development Program	$84,951
93.575	Child Care & Development Block Funds	$12,472
	Special Education Cluster	
84.027	Special Education State Grants	$97,103
84.173	Special Education – Preschool Grants	$ 5,551
84.010	Title I Grants to Local Educational Agencies	$83,308
84.340	Class Size Reduction	$14,049
84.048	Vocational Education	$ 6,422
84.011	Migrant Education – Basic State Grant Program	$ 2,334

Source: Minnesota Accounting and Procurement System.

We conducted our audit in accordance with auditing standards generally accepted in the United State of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

Our December 6, 2002, report included an unqualified opinion on the State of Minnesota's basic financial statements included in its Comprehensive Annual Financial Report for the year ended June 30, 2002. In accordance with *Government Auditing Standards*, we have also issued our report, dated December 6, 2002, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulation, contracts, and grants. In March 2003, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

Our work at the Department of Children, Families & Learning identified the following internal control weaknesses or instances of noncompliance with finance-related legal provisions.

Department of Children, Families & Learning

1. PRIOR FINDING NOT RESOLVED: The Department of Children, Families & Learning relies on one employee to maintain its critical information systems.

The Department of Children, Families & Learning's dependence on a single employee puts at risk the department's ability to make timely and accurate payments to school districts and counties. This employee designed, wrote, and tested the computer subsystems that calculate and process state and federal school aid payments. The employee initially designed the Cobol based subsystems specifically for the department and modified the programs as needed to accommodate changing school financing formulas and to interface with the state's accounting system. In fiscal year 2002, these subsystems processed over $5.4 billion of state and federal school aids.

CFL has not documented the design of the systems. The manual process of reviewing code in order to write documentation can be extremely time consuming and labor intensive. Software is available to extract information from existing code based on specified rules to generate information for documentation and analysis purposes.

Reliance on a single employee's knowledge for the ongoing operation of these critical systems is a significant weakness in the department's internal control structure. Should the employee leave his position, the department would have difficulty maintaining and modifying the systems, which could result in errors or delays in school aid payments. While the department does have other staff with Cobol programming knowledge, they are not familiar with the code for these programs and may not be able to make timely modifications.

Recommendations

- *CFL should document the design of the state and federal school aid payments systems.*
- *CFL should cross train other programmers to ensure the ongoing maintenance of the state and federal school aid payment systems.*

2. CFL's contracts with its test development vendor did not comply with certain contracting policies.

CFL repeatedly did not have a contract in place before the start of work by the test development vendor, even though the timetable for the administration of basic skills and comprehensive assessment tests was well established. Since fiscal year 1995, CFL had five major contracts with the testing vendor, with payments exceeding $25 million. None of the contracts were in place when the vendor started to provide services. CFL incurred approximately $5.3 million of obligations before it fully executed the contracts, including $1.9 million before it encumbered funds in the accounting system. For example, the service period for one contract was January 10, 2002, through November 30, 2002. The state did not fully execute that contract until June 27, 2002. Because of the untimely contract executions, CFL also did not establish timely encumbrances and often paid for contract obligations with subsequent fiscal year funding. In addition, CFL considered some of the contracts to be extensions of prior contracts, although the language in the prior contract did not address extensions. They believed that the terms of the prior expired contract provided a safe harbor until the current contract became effective.

As required by statute and Department of Finance policy, CFL explained its reasons for allowing work to begin on these contracts. CFL citied time needed to negotiate payment schedules with the vendor, disputes with the vendor over the contract liability clauses, a vacant key CFL position, the threat of a state shutdown, and the state employee strike as reasons for the delays. CFL did not effectively resolve its contract timeliness problems with this vendor. It did not fully execute its most recent contract with the vendor, covering a period from July 1, 2001, through June 30, 2003, until July 10, 2002.

Statutes state that a contract is not valid unless it is signed or executed by the appropriate parties, and that the accounting system reflects an obligation for the contract liability. The contracts also prohibited the vendor from starting work until CFL notified them that it had obtained all the required contract signatures. By allowing the contractor to perform services before the execution of the contract or the encumbrance of funds, CFL placed the state at unnecessary risk. Contract provisions regarding product ownership, data privacy, and liability may not apply without a valid contract. In addition, incurring obligations without prior recording in the state's accounting system makes it difficult to account for professional/technical contract obligations.

Recommendations

- *CFL should ensure there is a fully executed contract before allowing work to commence.*

- *CFL should encumber funds before incurring obligations.*

3. The Department of Children, Families & Learning could not provide documentation to support administrative salaries charged to federal school aid programs, including Title I, Part A (CFDA #84.010) and Migrant Education (CFDA #84.011).

The Department of Children, Families & Learning could not locate supporting documentation for administrative salaries charged to federal school aid programs, including Title I, Part A (CFDA #84.010), and Migrant Education (CFDA #84.011). The federal government requires that when a state consolidates the administrative funds of several Improving America's Schools Act programs, as Minnesota does, it needs to document time and effort for those employees paid solely or in part from the consolidated administrative funds. In fiscal year 2002, the department used over $850,000 of its consolidated administrative funds for salaries. The department's internal policy requires that managers review and document their employees' time and effort allocations quarterly. Department staff stated that it complied with this provision but had no evidence of its compliance.

Recommendation

- *CFL should maintain documentation of its employee time and effort reviews for employees paid from federal consolidated administrative funds.*

4. The Department of Children, Families & Learning could not support all of the figures in its annual State Per Pupil Expenditure report to the federal government.

CFL did not maintain adequate supporting documentation for all of the figures in its State Per Pupil Expenditure report to the federal government. The department compiles the report's data through various database queries at a specific point in time. As the data in the data base changes, the results of the queries change. Department staff did not keep the original query results to support the figures used in the report. Federal regulations require the department to annually submit this data to the National Center for Education Statistics. The U.S. Department of Education uses the data to determine allocations for several Improving America's Schools Act programs, including Title I, Part A (CFDA #84.010), and Migrant Education (CFDA #84.011).

Recommendation

- *The department should maintain adequate documentation for the figures in the State Per Pupil Expenditure report to support its accuracy and completeness.*

5. The Department of Children, Families & Learning used Migrant Education funds (CFDA #84.011) to reimburse a school district for meals provided to ineligible people.

CFL used about $42,000 of Migrant Education funds to reimburse a school district for a portion of a deficit in its summer food service program. The deficit resulted, in part, because of meals provided to adult migrants or to other walk-ins who did not qualify as eligible participants of the Migrant Education Program. Only meals provided to eligible migratory children would qualify for reimbursement, as an additional support service, under the Migrant Education Program (CFDA #84.011). The documentation provided by the school district did not provide sufficient detail to determine what part, if any, of the school district's food program deficit was attributable to meals provided to eligible migratory children.

Recommendations

- *CFL should only use Migrant Education funds for allowed activities and allowable costs in accordance with federal requirements.*

- *CFL should seek reimbursement of the funds paid for meals served to ineligible people.*

6. PRIOR FINDING NOT RESOLVED: The Department of Children Families & Learning did not properly record some expenditure transactions on the state's accounting system.

CFL did not properly record the date the state incurred a liability for some expenditure transactions. The department used incorrect record dates on 8 of 17 tested special education (CFDA #84.027) administrative expenditure transactions, totaling approximately $402,603. For the majority of these transactions, the department used the date it entered the transaction on the accounting system as the record date.

The department used incorrect record dates on 25 of 48 close period transactions tested. Payments totaling $11.1 million had incorrect record dates that could have understated liabilities by $7.6 million. Further analysis of Office of Economic Opportunity grant expenditures identified another $1.2 million of liabilities that accrued to the wrong fiscal year due to incorrect record dates. Nearly half of the transactions tested had incorrect record dates.

The department used incorrect record dates on 5 of 15 tested Migrant Education (CFDA #84.011) administrative expenditure transactions, totaling $44,045. The department used the purchase order date, the invoice date, and the invoice approval date as the record dates on the accounting system.

Generally accepted accounting principles require that the state recognize a liability when the grantee incurs an allowable cost. The Department of Finance uses the accounting system's "record date" to determine in which period it should recognize transactions. If the record date is incorrect and if the department of Finance or the auditors do not detect the error, the transactions will accrue to the wrong fiscal year in the state's financial statements.

Recommendation

- *CFL should properly record the date of liability in the state's accounting system.*

7. PRIOR FINDING NOT RESOLVED: The Department of Children, Families & Learning did not comply with certain state indirect costs requirements.

During fiscal year 2002, CFL staff did not properly or timely reimburse the General Fund for statewide indirect costs. Statewide indirect cost recoveries reimburse the state's General Fund for state funded services, such as the state's accounting system, used to deliver federal programs. The department made the first and second quarterly payments late, miscalculated the first quarter payment, and used expenditure amounts for the third and fourth quarter payments that did not agree with the supporting schedules. Since it properly calculated the final payment in August 2002, it offset the prior quarterly overpayments. Department of Finance policy requires reimbursement of statewide and agency indirect costs on a quarterly basis when the agency's annual liability exceeds $2,000. The department needs to be more conscientious to ensure the timeliness and accuracy of quarterly payments.

Recommendations

- *CFL should make statewide indirect cost payments quarterly as outlined in the Department of Finance policy.*
- *CFL should ensure that it uses the correct expenditure totals when calculating indirect cost payments.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Children, Families & Learning. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 13, 2003.

/s/ James R. Nobles	*/s/ Claudia J. Gudvangen*
James R. Nobles Legislative Auditor	Claudia J. Gudvangen, CPA Deputy Legislative Auditor

End of Fieldwork: January 10, 2003

Report Signed On: March 10, 2003

Status of Prior Audit Issues
As of January 10, 2003

March 14, 2002, Legislative Audit Report 02-16, examined the Department of Children, Families & Learning's activities and programs material to the *State of Minnesota's Comprehensive Annual Financial Report,* or the Single Audit, for the year ended June 30, 2001. The scope included General Education Aids, Title I Grants to Local Educational Agencies, Special Education Aid, and other federal and state programs. The audit report contained eight findings: The department did not comply with some federal cash management provisions. The department did not return unexpended Nutrition Cluster funds to the federal government or properly report expenditures. CFL had no backup for the employee who maintains some critical information systems. An employee inappropriately contracted with a relative resulting in violations of statutes and state contracting policies. The department could not support compliance with certain federal requirements for the Learn and Serve and Byrd Scholarship Programs. The department did not timely submit federal reports for the Americorps Program. The department did not comply with certain state indirect costs requirements. Finally, CFL did not properly record the date of liability for some transactions.

In fiscal year 2002, the department resolved four of the eight findings. In addition, the department substantially resolved the finding relating to the Nutrition Cluster funds. However, the department did not provide backup for the employee who maintains critical information systems, did not properly record the date of liability for some transactions, and did not comply with indirect cost requirements. We repeat these issues in this report as Findings 1, 6, and 7.

State of Minnesota Audit Follow-up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applicable to audits of the University of Minnesota, any quasi-state organizations, such as the metropolitan agencies, or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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March 7, 2003

James Nobles
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Dear Mr. Nobles:

Thank you for your audit of specific programs and functions within the Department of Children, Families and Learning. I appreciate your willingness to meet with the new administration and work through the findings and recommendations. Listed below are the findings and the Department's corrective actions.

Finding #1: The Department of Children, Families and Learning relies on one employee to maintain its critical information systems.

It is unfortunate that this finding was not corrected in the OLA's previous report issued in March 2002 to the Department of Children, Families and Learning. We are concerned about this issue as well, and are in the process of making the following corrective actions:

- Ken Gorsegner, the newly appointed Director of Management Services, is working to correct this finding.
  - Management Services currently has a staff of five Cobol developers to maintain approximately 35 mainframe application systems. Two of those developers, Mike Bergquist and Scott McKenna have been selected to work closely with Paul Ward to cross-train on the critical PAYS and IDEAS systems.
  - The newly designated team leader, Mike Rauscher, will coordinate all cross-training and documentation efforts.

Finding #2: CFL's contracts with its test development vendor did not comply with certain contracting policies.

This issue was also addressed by OLA's report in January 2003 on state contracting, and we have taken the following corrective actions:

- Testing vendors are told expressly that they are not authorized in any way to begin work on test related contracts until the contracts are fully executed. At the time contracts are executed, funds must be encumbered. The administration will ensure that this policy is fully implemented and supported.

Finding #3: The Department of Children, Families and Learning could not provide documentation to support administrative salaries charged to federal school aid programs, including Title I, Part A and Migrant Education.

While directors and supervisors are required to document their employee time each pay period, the documentation was unfortunately lost and was not found. However, the new administration of CFL has taken the following corrective actions to prevent a similar situation in the future.

- Directors and supervisors are required to document, in writing, an employee's time so that CFL is correctly charging administrative salaries to federal accounts. The documentation will be maintained with the director of the appropriate division, with the director of administrative services and in human resources. This will provide a "back up" system in case documentation is lost. A form is being developed for supervisors and directors.

Finding #4: The Department of Children, Families & Learning could not support all of the figures in its annual State Per Pupil Expenditure report to the federal government.

- Tom Melcher, Director of Program Finance, and Ken Gorsegner, Director of Management Services, are working to correct this finding. Beginning with the report on expenditures for FY 2002, staff preparing the report will retain an electronic copy of each query as well as a paper copy. A copy of the report and all supporting database queries will also be provided to the Director of Program Finance at the time the report is submitted to the federal government, and retained in the Director's files.

Finding #5: The Department of Children, Families and Learning use Migrant Education funds to reimburse a school district for meals provided to ineligible people.

- CFL migrant staff has already contacted the school district acting as the fiscal agent for the summer Migrant Program to investigate the finding. Through our investigation, staff discovered that the district was using inappropriate accounting procedures that did not differentiate the costs of the food program between Migrant eligible and non-eligible participants. As a result, the district has reimbursed the CFL Migrant Education Program for the over expenditures for the summer of 2001. This amount is shown as a credit for the 2002 Migrant Summer Food Program.

- CFL staff will provide technical assistance to the fiscal agent for the summer of 2003 MEP program so that the district will use appropriate accounting practices to bill only eligible MEP participants for meals served for the Summer Food Service Program. The formal food service agreement with the district will reflect these new accounting requirements. In addition, staff will make site visits to the MEP projects throughout the summer to assure that CFL charges only for the excess costs of the meals of MEP participants.

Finding #6: The Department of Children, Families and Learning did not properly record some expenditure transactions on the state's accounting system.

- Staff within the administrative services division and staff within each appropriate division will be required to attend training within the next 30 days with regard to state laws on contracting, grantmaking, indirect costs and the state's accounting principles and systems, including properly recording transactions on the state's accounting system. We agree that it is not acceptable to improperly record expenditure transactions, and will work with staff so that the department is using generally accepted accounting principles.

Finding #7: The Department of Children, Families and Learning did not comply with certain state indirect costs requirements.

- Staff within the administrative services division and staff within each appropriate division will be required to attend training within the next 30 days with regard to state laws on contracting, grantmaking, indirect costs and the state's accounting principles and systems, including properly recording transactions on the state's accounting system. We will take internal steps to ensure that CFL complies with indirect cost requirements.

The new administration looks forward to continuing to work with you and your staff. If you have any questions or concerns, please contact Chas Anderson at 651-582-8207.

Sincerely,

Cheri Pierson Yecke

Cheri Pierson Yecke, Ph.D.
Commissioner