



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

**Department of
Education**

Federal Compliance Audit

Year Ended June 30, 2014

March 25, 2015

Report 15-08

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Financial Audit Division

The 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 has a staff of forty 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.

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Conclusion on Internal Controls

The Financial Audit Division bases its conclusion about an organization's internal controls on the number and nature of the control weaknesses we found in the audit. The three possible conclusions are as follows:

Conclusion	Characteristics
Adequate	The organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Generally Adequate	With some exceptions, the organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Not Adequate	The organization had significant weaknesses in the design and/or implementation of its internal controls and, as a result, the organization was unable to effectively manage the risks related to its financial operations.



OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

March 25, 2015

Representative Sondra Erickson, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Dr. Brenda Cassellius, Commissioner
Minnesota Department of Education

This report presents the results of our audit of certain federal financial assistance programs administered by the Minnesota Department of Education during fiscal year 2014. We conducted this audit as part of our audit of the state's compliance with federal program requirements. We emphasize that this has not been a comprehensive audit of the Minnesota Department of Education.

We discussed the results of the audit with department staff at an exit conference on March 16, 2015. This audit was conducted by Scott Tjomsland, CPA, CISA (Audit Manager), and assisted by auditors Tracia Polden, Sandy Ludwig, Abdul Suleyman, CPA, Thom Derus, Nicholas Ludwig, and Melissa Strunc.

We received the full cooperation of the department's staff while performing this audit.

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Table of Contents

	<u>Page</u>
Report Summary	1
Federal Program Overview	3
Objective, Scope, and Methodology	4
Conclusion	4
Findings and Recommendations	7
1. The Minnesota Department of Education did not identify and analyze its risks related to noncompliance with federal requirements. This is a repeat finding	7
2. The Minnesota Department of Education did not comply with federal standards for payroll cost allocations to federal programs. This is a repeat finding	8
3. The Minnesota Department of Education did not comply with the reporting requirements of the Federal Funding Accountability and Transparency Act. This is a repeat finding	10
4. The Minnesota Department of Education did not ensure that all recipients of federal grants through the department met the audit requirements established by the federal government.....	11
Appendix A	13
Agency Response.....	15

Report Summary

Conclusion

The Minnesota Department of Education generally complied with and had controls to ensure compliance with certain legal requirements applicable to its major federal programs for fiscal year 2014. However, the department had some internal control weaknesses and noncompliance with federal requirements, as noted in the four findings presented in this report, including three unresolved findings from the prior audit.¹

Audit Findings

- The Minnesota Department of Education did not identify and analyze its risks related to noncompliance with federal requirements. This is a repeat finding. ([Finding 1, page 7](#))
- The Minnesota Department of Education did not comply with federal standards for payroll cost allocations to federal programs. This is a repeat finding. ([Finding 2, page 8](#))
- The Minnesota Department of Education did not comply with the reporting requirements of the Federal Funding Accountability and Transparency Act. This is a repeat finding. ([Finding 3, page 10](#))
- The Minnesota Department of Education did not ensure that all recipients of federal grants through the department met the audit requirements established by the federal government. ([Finding 4, page 11](#))

Audit Scope

Programs material to the State of Minnesota's federal program compliance for fiscal year 2014:

<u>Program Title</u>	<u>CFDA</u>²
Child Nutrition Cluster ³	10.553, 10.555, 10.556, and 10.559
Child and Adult Care Food	10.558
Title I – Grants to Local Education Agencies	84.010
Special Education Cluster ³	84.027 and 84.173

¹ Office of the Legislative Auditor's Financial Audit Division Report 14-09, *Department of Education*, issued March 21, 2014.

² The Catalog of Federal Domestic Assistance (CFDA) includes unique numbers assigned by the federal government to identify its programs.

³ A cluster of programs is a group of closely related programs that have similar compliance requirements and are treated as a single program.

Department of Education

Federal Program Overview

The Minnesota Department of Education administered federal programs that we considered major federal programs for the State of Minnesota, subject to audit under the federal Single Audit Act.⁴ Table 1 identifies these major federal programs. Appendix A, on page 13, provides the federal award numbers associated with these programs.

Table 1
Major Federal Programs
Administered by the Minnesota Department of Education
Fiscal Year 2014

CFDA¹	Program Name	Expenditures
	<u>Child Nutrition Cluster:</u> ²	
10.553	School Breakfast	\$ 41,272,021
10.555	National School Lunch	176,237,393
10.556	Special Milk Program for Children	784,841
10.559	Summer Food Service Program for Children	6,563,364
	Total Child Nutrition Cluster	<u>\$224,857,619</u>
10.558	Child and Adult Care Food	\$ 64,206,497
84.010	Title I Grants to Local Education Agencies	\$152,351,941
	<u>Special Education Cluster:</u> ²	
84.027	Special Education – Grants to States	\$189,854,659
84.173	Special Education – Preschool Grants	7,061,612
	Total Special Education Cluster	<u>\$196,916,271</u>

¹ The Catalog of Federal Domestic Assistance (CFDA) includes unique numbers assigned by the federal government to identify its programs.

² A cluster of programs is a grouping of closely related programs that have similar compliance requirements and are treated as a single program for audit purposes.

Source: State of Minnesota's accounting system.

The programs in the Child Nutrition Cluster provide funding to local education agencies and child-care institutions for meals served to children in need. The Child and Adult Care Food program provides funding to child care centers, adult day care centers, outside-school-hours care centers, at-risk afterschool programs, family and group day care homes, and emergency shelters for meals served to individuals in need. Title I Grants provide funding to local educational agencies based on the number of children from low-income families, while the programs in

⁴ We defined a major federal program for the State of Minnesota in accordance with a formula prescribed by the federal Office of Management and Budget as a program or cluster of programs whose expenditures for fiscal year 2014 exceeded \$30 million.

the Special Education Cluster provide funding to local educational agencies to assist them in providing special education and related services to children with disabilities. While the department retains a portion of the federal funds to pay for the costs of administering these programs, it passes over 97 percent of the federal funds on to other entities, primarily school districts. The federal government requires those entities to have annual audits of their compliance with the federal program requirements. The department reviews those audit reports to monitor subrecipient compliance.

Objective, Scope, and Methodology

The objective of our audit was to determine whether the Minnesota Department of Education complied with federal program requirements in its administration of these federal programs for fiscal year 2014. This audit is part of our broader federal single audit designed to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its federal programs.⁵ In addition to specific program requirements, we examined the department's general compliance requirements related to federal assistance, including its cash management practices. We also followed up on findings and recommendations reported to the department's management in our previous audit.⁶

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States of America, and with the U.S. Office of Management and Budget's *Circular A-133* and its *Compliance Supplement*.

Conclusion

The Minnesota Department of Education generally complied with and had controls to ensure compliance with certain legal requirements applicable to its major federal programs for fiscal year 2014. However, the department had some internal control weaknesses and noncompliance with federal requirements, as

⁵ The State of Minnesota's single audit is an entity audit of the state that includes both the financial statements and the expenditures of federal awards by all state agencies. We issued an unqualified audit opinion, dated December 12, 2014, on the State of Minnesota's basic financial statements for the year ended June 30, 2014. In accordance with *Government Auditing Standards*, we also issued our report on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. (Office of the Legislative Auditor's Financial Audit Division Report 15-02, *Internal Controls Over Statewide Financial Reporting*, issued February 19, 2015.) This report did not include control deficiencies related to the Minnesota Department of Education.

⁶ Office of the Legislative Auditor's Financial Audit Division Report 14-09, *Department of Education*, issued March 21, 2014.

noted in the four findings presented in this report, including three unresolved from the prior audit.⁷

We will report these weaknesses to the federal government in the *Minnesota Financial and Compliance Report of Federally Assisted Programs*, prepared by the Department of Management and Budget. This report provides the federal government with information about the state's use of federal funds and its compliance with federal program requirements. The report includes the results of our audit work, conclusions on the state's internal controls over and compliance with federal programs, and findings about internal control and compliance weaknesses.

⁷ Office of the Legislative Auditor's Financial Audit Division Report 14-09, *Department of Education*, issued March 21, 2014.

Findings and Recommendations

The Minnesota Department of Education did not identify and analyze its risks related to noncompliance with federal requirements. This is a repeat finding.⁸

Finding 1

The department did not make sufficient progress to implement a comprehensive internal control structure for fiscal year 2014.⁹ It continued to work on its risk assessment plan by identifying significant business processes within its various divisions and assessing risks related to those processes; however, it had not yet completed that work for several divisions, including those primarily responsible for its major federal programs. As a result, the department did not identify or assess the effectiveness of its controls over compliance with federal requirements for its major federal programs. In response to this finding in our prior audit report, the department stated that its goal was to complete the risk assessment plan by December 31, 2014. Since we first reported this deficiency for fiscal year 2008, the department has repeatedly missed their initial and revised target implementation dates.¹⁰

The federal government has the following requirements for the state to have effective internal controls to ensure compliance with federal program requirements:

- U.S. Office of Management and Budget Circular A-133, Subpart C, section 300, states that entities receiving federal awards, “*Shall maintain internal control over Federal programs that provides reasonable assurance that [it] is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.*”
- U.S. Office of Management and Budget Circular A-133 Compliance Supplement, Part 6, provided to help nonfederal entities comply with internal control requirements states, “*The characteristics of internal control are presented in the context of the components of internal control discussed in Internal Control-Integrated Framework (COSO Report), published by the Committee of Sponsoring Organizations of the Treadway Commission. The COSO report provides a framework for organizations to design, implement, and evaluate control that will facilitate compliance*

⁸ Office of the Legislative Auditor’s Financial Audit Division Report 14-09, [Department of Education](#), issued March 21, 2014.

⁹ This finding affects all major federal programs identified in Table 1. See Appendix A (on page 13 of this report) for the federal award numbers for these programs.

¹⁰ Office of the Legislative Auditor’s Financial Audit Division Report 09-08, [Department of Education](#), issued March 26, 2009.

with the requirements of Federal laws, regulations, and program compliance requirements.” Risk assessment, one of the Internal Control-Integrated Framework’s five components of internal control, is described in the compliance supplement as “...the entity’s identification and analysis of risks relevant to achievement of its objectives, forming a basis for determining how the risk should be managed.”

In addition to the federal requirements, the state’s internal controls policy states, “An effective system of internal controls will increase the state’s operational effectiveness and efficiency, safeguard public funds, ensure compliance with state and federal laws, rules, and regulations, and minimize instances of fraud, waste, and abuse.”¹¹ The policy requires the department to use the Internal Control-Integrated Framework as its standard model for organizing, documenting, and discussing internal controls.

The findings in this report identify deficiencies in the department’s internal control procedures and specific noncompliance with federal requirements that the department’s internal control structure did not prevent or detect. If the department had a comprehensive internal control structure, it may have identified these deficiencies, assessed the degree of risk for these deficiencies, designed control procedures to address significant risks, and monitored whether controls were working as designed and effective in reducing the risks to an acceptably low level. It is likely that the department will continue to have noncompliance and weaknesses in internal controls over compliance until it operates within a comprehensive internal control structure.

Recommendation

- *The Minnesota Department of Education should identify and assess its risks related to noncompliance with federal requirements for its major federal programs and document internal controls designed to limit those risks.*

Finding 2

The Minnesota Department of Education did not comply with federal standards for payroll cost allocations to federal programs. This is a repeat finding.¹²

The department did not have sufficient controls to ensure that it complied with federal standards for payroll cost allocations to federal programs. In fiscal year 2014, the department allocated payroll costs, totaling about \$19.2 million, to its

¹¹ The Department of Management and Budget’s Statewide Operating Policy 0102-01, *Internal Controls*.

¹² Office of the Legislative Auditor’s Financial Audit Division Report 14-09, *Department of Education*, issued March 21, 2014. The department did resolve the portion of the prior finding related to inequitable allocations of the costs of fringe benefits to federal programs.

federal program funds; about \$9.2 million of that amount was allocated to the major federal programs included in our audit.

The department had the following instances of noncompliance:

- The department did not create and retain the required documentation for some employees' payroll costs charged directly to federal programs.¹³ The department did not have certifications or some personnel activity reports for 10 of the 53 employees we tested. Specifically, the department (1) did not have certifications for two employees who worked on a single federal program, (2) did not have any personnel activity reports for six employees who split their time between two or more federal or state programs, and (3) did not have personnel activity reports for some pay periods for two employees.

Office of Management and Budget Circular A-87, Attachment B, sections 8.h.(3) and (4) states, *"Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification.... Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports..."*

The department also reallocated \$46,431 of an employee's fiscal year 2013 payroll costs from a nonmajor federal program to the Summer Food Service Program for Children (CFDA 10.559), but did not have sufficient documentation to validate that amount. The department originally charged all of that employee's payroll costs to the nonmajor program, but subsequently determined that the employee had worked on activities for both programs. However, the employee did not complete any certifications or personnel activity reports to document her actual work activities. Instead, the employee's supervisor told us that the department used the employee's work plan to estimate the payroll costs related to the major program, and provided us with copies of the employee's monthly calendars. Although those calendars did show that the employee worked on activities related to the major program, they were not sufficient to support the amount reallocated.

- The department did not ensure that personnel activity reports matched the actual allocation of payroll costs to federal programs, as required by Office of Management and Budget Circular A-87, Attachment B, section 8.h.(5a), which states, *"Personnel activity reports...must reflect an*

¹³ This portion of the finding affects the Child and Adult Care Food Program (CFDA 10.558), Title I Grants to Local Education Agencies (CFDA 84.010), Special Education – Grants to States (CFDA 84.027), and Special Education – Preschool Grants (CFDA 84.173).

after-the-fact distribution of the actual activity of each employee.”¹⁴ We compared the hours reported by employees on the certifications and personnel activity reports available for 45 employees in our sample, to the state’s accounting system showing the federal programs that paid for that work. For five of those employees, there were discrepancies in some pay periods between payroll cost allocations on certifications or personnel activity reports and actual payroll cost allocations in the state’s accounting system. Those discrepancies affected about \$11,836 in payroll costs allocated between both major and nonmajor federal programs.

The purpose of the certifications and personnel activity reports is to ensure that each federal program only pays for payroll costs necessary to accomplish its objectives. Because the department did not have a process to identify and resolve these types of discrepancies, it is likely that other payroll discrepancies existed.

In its response to this finding in our prior audit report, the department stated that it would develop tools to ensure compliance with payroll documentation requirements. We observed that the department did develop a new automated process to create personnel activity reports each pay period for each employee and procedures to ensure that employees and supervisors either certify the accuracy of those reports or identify necessary corrections. The department tested this new process for some employees during the last half of fiscal year 2014 and fully implemented it for fiscal year 2015.

Recommendation

- *The Minnesota Department of Education should ensure that it complies with federal standards for payroll cost allocations to federal programs.*

Finding 3

The Minnesota Department of Education did not comply with the reporting requirements of the Federal Funding Accountability and Transparency Act. This is a repeat finding.¹⁵

The department did not establish a process to report information about recipients of subawards of federal grants,¹⁶ as required by the Federal Funding

¹⁴ This portion of the finding affects the Child and Adult Care Food Program (CFDA 10.558), Summer Food Service Program for Children (CFDA 10.559), and Title I Grants to Local Education Agencies (CFDA 84.010).

¹⁵ Office of the Legislative Auditor’s Financial Audit Division Report 14-09, *Department of Education*, issued March 21, 2014.

¹⁶ A subaward is a grant to an entity (a local unit of government, private nonprofit, or Indian tribe) by the state to accomplish the purpose for which the state received this federal grant.

Accountability and Transparency Act.¹⁷ Title 2, Part 170 of the Code of Federal Regulations states that an entity “...must report each action that obligates \$25,000 or more in Federal funds...for a subaward to an entity...no later than the end of the month following the month in which the obligation was made.” The department did not report subaward information for any of the 2,285 recipients of subawards exceeding \$25,000 in fiscal year 2014; in total, the department provided these subaward recipients with nearly \$580 million from its major federal programs.¹⁸

In response to this finding in our prior audit report, the department stated that it would assign an employee to implement a reporting process. Department staff told us that they did assign that task to an employee, but that the employee did not complete it before leaving the department in July 2014. The department then assigned the task to a different employee, but the process had not been implemented as of March 2015.

Recommendation

- *The Minnesota Department of Education should establish a process to report subawards of federal grants, as required by the Federal Funding Accountability and Transparency Act.*

The Minnesota Department of Education did not ensure that all recipients of federal grants through the department met the audit requirements established by the federal government.

Finding 4

The department did not determine whether 21 of its subrecipients¹⁹ of federal funds had audits performed on their federal expenditures.²⁰ The federal Office of Management and Budget’s *Circular A-133* requires nonfederal entities that expend at least \$500,000 in federal awards during a fiscal year to have compliance audits conducted on federal expenditures. It also requires that entities (like the Department of Education) that pass federal awards through to subrecipients ensure that those subrecipients have audits conducted. The Department of Management and Budget identified all of the state’s subrecipients

¹⁷ The Federal Funding Accountability and Transparency Act of 2006 (Public Law 109-282) requires the federal Office of Management and Budget to maintain a single, searchable website (<http://www.usaspending.gov/>) that contains information on all federal recipient spending awards.

¹⁸ This finding affects all major federal programs identified in Table 1. See Appendix A (on page 13 of this report) for the federal award numbers for these programs.

¹⁹ A subrecipient is an entity that received a grant from the state paid from a federal award to accomplish the purpose for which the state received that award.

²⁰ This finding affects the Special Milk Program for Children (CFDA 10.556), Child and Adult Care Food Program (CFDA 10.558), Summer Food Service Program for Children (CFDA 10.559), Title I Grants to Local Education Agencies (CFDA 84.010), Special Education – Grants to States (CFDA 84.027), and Special Education – Preschool Grants (CFDA 84.173).

of federal awards and assigned monitoring responsibilities for each to the state agency that provided the most federal funds. The Department of Education was assigned to monitor 407 subrecipients that received at least \$500,000 in federal funds from state agencies during fiscal year 2013. The department ensured that schools and sponsors of family day care homes met the audit requirements; however, the department had not developed procedures to ensure that 21 other subrecipients met the audit requirements.

Recommendation

- *The Minnesota Department of Education should establish procedures to ensure that subrecipients meet federal audit requirements.*

Appendix A
Major Federal Programs
Minnesota Department of Education
Fiscal Year 2014

<u>CFDA</u>¹	<u>Program Name</u>	<u>Federal Award Number</u>
	<u>Child Nutrition Cluster:</u> ²	
10.553	School Breakfast	2MN300061
10.555	National School Lunch	Same as above
10.556	Special Milk Program for Children	Same as above
10.559	Summer Food Service Program for Children	Same as above
10.558	Child and Adult Care Food	2MN300061, 2MN300066
84.010	Title 1 Grants to Local Education Agencies	S010A120023, S010A130023
	<u>Special Education Cluster:</u> ²	
84.027	Special Education – Grants to States	H027A120087, H027A130145
84.173	Special Education – Preschool Grants	H173A120086, H173A130086

¹ The Catalog of Federal Domestic Assistance (CFDA) includes unique numbers assigned by the federal government to identify its programs.

² A cluster of programs is a grouping of closely related programs that have similar compliance requirements and is treated as a single program for audit purposes.



March 20, 2015

Mr. James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Thank you for your work on behalf of the citizens of the State of Minnesota and the opportunity to respond to the draft report issued by the Office of Legislative Audit for the Minnesota Department of Education (MDE) Federal Compliance Audit for the year ended June 30, 2014.

MDE believes strongly in internal controls and risk management and has been taking steps over the past several years to enhance our activities in these areas. The department prepares and submits annual internal control certifications, control environment self-assessments and annual risk assessment plans as required by state policy. In addition, on an annual basis the department requires every employee to certify their understanding of their responsibilities under the Code of Conduct state policy. While these activities did not specifically address the controls over compliance with federal requirements, we believe that major progress has been made.

As noted in the report, however, more work is needed. Below are specific activities that will be taken to address the findings. In addition, MDE is hosting a workshop in April on the new Omni Circular that will provide information on key topics such as the new financial management regulations, internal controls and risk assessments. All personnel who are involved in the distribution, monitoring, awarding, allocating or contracting with federal funds are invited to attend.

Audit Finding 1: The Minnesota Department of Education did not identify and analyze its risks related to noncompliance with federal requirements. This is a repeat finding.

Audit Recommendation:

- *The Minnesota Department of Education should identify and assess its risks related to noncompliance with federal requirements for its major federal programs and document internal controls designed to limit those risks.*

Agency Response:

MDE believes strongly in financial integrity and concurs with this finding. During this review period, the department continued its intensive agency-wide risk assessment and mitigation efforts. We focused our work on the major financial business processes for state funding, which represents over \$8.0 billion annually. The activities included the financial reconciliations for special education payments but did not encompass all federal requirements or divisions responsible for major federal programs. We will adjust the FY15 risk plan to provide the necessary coverage of major federal program areas. By making this adjustment, we plan to complete the risk assessment and identify mitigation activities for major federal program areas by June 30, 2015.

Resolution of this finding is the responsibility of Paul Kurtenbach, Internal Audit Unit and Denise Anderson, Chief Financial Officer.

Audit Finding 2: The Minnesota Department of Education did not comply with federal standards for payroll cost allocations to federal programs. This is a repeat finding.

Audit Recommendation:

- *The Minnesota Department of Education should ensure that it complies with federal standards for payroll cost allocations to federal programs.*

Agency Response:

MDE concurs with this finding. An application to conduct PAR reporting was developed, and the administrative policy titled: Time Reporting, Time & Effort (PAR) and Semi-Annual Certification Reporting was updated to reflect policies and procedures for meeting the federal reporting requirements. MDE piloted the new application between January 1, 2013 and June 30, 2014. Training was provided and the application went live on July 1, 2014. The new policy and reporting application will enable MDE to stay in compliance with federal standards for payroll cost allocation to federal programs. Additional reviews of payroll cost allocations occur periodically throughout the year.

This finding is resolved for FY15 and on-going.

Audit Finding 3: The Minnesota Department of Education did not comply with the reporting requirements of the Federal Funding Accountability and Transparency Act. This is a repeat finding.

Audit Recommendation:

- *The Minnesota Department of Education should establish a process to report sub-awards, as required by the Federal Funding Accountability and Transparency Act.*

Agency Response:

MDE's Agency Finance Division is developing a policy on FFATA reporting at MDE. The policy will provide a mechanism to identify all current and future federal awards subject to FFATA reporting, and outline the process for reporting in FSRS.gov. This policy will be implemented by July 1, 2015.

Resolution of this finding is the responsibility of Andre' Prahl, Director of Agency Finance and Denise Anderson, Chief Financial Officer.

Audit Finding 4: The Minnesota Department of Education did not ensure that all recipients of federal grants through the department met the audit requirements established by the federal government.

Audit Recommendation:

- *The Minnesota Department of Education should establish procedures to ensure that sub-recipients meet federal audit requirements.*

Agency Response:

MDE's Internal Audit Unit is developing an agency-wide policy and process to provide the necessary oversight and monitoring to ensure compliance. The new process will be a coordinated effort with federal program areas, as necessary, to strengthen audit review and corrective action follow-up. This policy will be implemented by December 30, 2015.

Resolution of this finding is the responsibility of Paul Kurtenbach, Internal Audit Unit and Denise Anderson, Chief Financial Officer.

Again, thank you for the opportunity to respond to your findings and recommendations. Please contact Denise Anderson at 651-582-8560 if you have any questions.

Sincerely,



Dr. Brenda Cassellius
Commissioner

cc: Denise Anderson, CFO