



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

Department of Education
Fiscal Year Ended June 30, 2003



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 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.

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.

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.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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

Department of Education

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Jack Hirschfeld, CPA	Auditor-in-Charge
Doreen Bragstad, CPA	Auditor
George Dedan, CPA	Auditor
John Hakes, CPA	Auditor
April Snyder	Auditor
Connie Stein	Auditor
Cheryl Mullan	Intern

Exit Conference

We discussed the results of the audit with the following staff of the Department of Education at an exit conference on March 5, 2004:

Chas Anderson	Deputy Commissioner
Thomas Melcher, Ph.D	Director, Program Finance Division
Tammy McGlone	Director, Administrative Services Division
Rita Schmidt	Supervisor, Budget and Federal Financial Reporting Team

Report Summary

The Minnesota Department of Education distributes \$6 billion in state and federal school aid to Minnesota's K-12 schools.

Key Findings and Recommendations:

The department made errors in its administration of some federal programs:

- The department did not provide the \$40 million state match it had pledged in its grant agreement with the federal government for charter school assistance. In its response to the report, the department stated that it recently renegotiated the grant agreement and eliminated the match requirement. (Finding 1, page 4)
- The department made a \$3 million duplicate payment of federal school aids. It offset the duplicate payment against subsequent school aid payments. We recommend that the department establish payment controls to prevent such mistakes. (Finding 2, page 4)
- The department did not accurately report child nutrition expenditures to the federal government, which resulted in a net under reimbursement to the state of nearly \$300,000. The department is working with the federal government to correct the program expenditure reports and obtain reimbursement. (Finding 7, page 10)
- The department miscalculated its federal special education allocations to the schools. It used incorrect rates and student counts to determine the allocations. The department is working with the federal government to resolve the errors without negatively affecting the individual schools. (Finding 8, page 12)

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 2003 audit, our scope at the Minnesota Department of Education included state and federal school aid payments. The department's response to our recommendations is included in the report.

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Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Dr. Cheri Pierson Yecke, Commissioner
Department of Education

We have performed certain audit procedures at the Department of Education as part of our audit of the basic financial statements of the State of Minnesota as of and for the year ended June 30, 2003. We have also reviewed department procedures related to the state's compliance with certain requirements described in the U.S. Office of Management and Budget's *Circular A-133 Compliance Supplement* that were applicable to the department for the year ended June 30, 2003.

The Department of Education is responsible for establishing education standards for kindergarten through twelfth grade and for processing federal and state financial assistance to school districts. It manages its subsidiary accounting systems, records the federal grant receipts, processes general education aid and federal grant payments to school districts, and incurs administrative expenditures for some programs.

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.

Conclusions

Our December 5, 2003, 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, 2003. In accordance with *Government Auditing Standards*, we also issued our report, dated December 5, 2003, 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. In March 2004, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with the U.S. Office of Management and Budget's Circular A-133.

We identified some internal control weaknesses and federal compliance issues, which we discuss in the following findings.

Department of Education

1. The Department of Education did not provide the required state matching funds for the charter school federal grant (CFDA #84.282). It also improperly drew down funds before incurring program expenses.

The Department of Education did not provide state matching funds for the charter schools federal grant as provided in the grant application. The federal grant provided funds for the planning, development, and initial implementation of charter schools. Although the department uses state funds to support the ongoing operations of charter schools, it did not provide matching funds for charter school planning, development, and initial implementation.

The U.S. Department of Education based its grant award for fiscal years 2002 through 2004 on the department's application budget, showing program costs totaling \$54,870,000, including \$39,870,000 to be paid with state matching funds. An informational bulletin prepared by the U.S. Department of Education states that when the recipient identifies nonfederal funds on the application, even though a cost share is not a legislative requirement, the recipient is required to provide the nonfederal funds.

In late fiscal year 2003, the department revised its process for approving federal grant applications to ensure that the department has available state funds before committing to any federal program match. The process now includes a review by the commissioner's office and approval of any state match on federal grant applications.

In addition, in fiscal year 2003, the department inappropriately drew down \$149,000 from the fiscal year 2002 grant award, even though it had not incurred program expenditures. The department has contacted the federal grantor agency to determine the proper disposition of these funds.

Recommendations

- *The Department of Education should determine whether it has state funds available to comply with the obligation made in the grant application. If not, it should contact the federal grantor agency to revise the agreement or negotiate settlement of the breach of contract.*
- *The department should repay to the federal government the funds it inappropriately drew down in fiscal year 2003.*

2. The Department of Education did not have adequate controls to prevent overpayments of certain federal programs and did not properly allocate some federal program funding to school districts.

In October 2003, on its final school year 2002-2003 payments, the Department of Education made duplicate payments totaling nearly \$3 million to 54 school districts for six federal

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programs. Table 1 identifies the federal programs and summarizes the overpayments. The department learned of the error when a school district notified it of the overpayment. The department then adjusted the 2003-2004 school year payments for the overpayment.

Table 1
Department of Education
Overpayment of Federal Programs

<u>CFDA</u>	<u>Program Name</u>	<u>Overpayment Amounts</u>	<u>Number of Districts</u>
84.010	Title I-Grants to Local Educ. Agencies	\$1,139,000	27
84.298	Title 5-Innovative Education Strategies	311,000	52
84.186	Safe and Drug-Free Schools	247,000	54
84.318	Education Technology State Grants	129,000	40
84.365	English Language Acquisition Grants	72,000	5
84.281	Eisenhower Pro. Develop. Grants	<u>1,072,000</u>	48
	Total Overpayment	<u>\$2,970,000</u>	

Source: Department of Education's accounting records.

The department did not have controls in place to prevent or detect a duplicate payment error:

- The department's subsystem did not have an edit control to prevent an employee from duplicating a prior batch number and payment amount. The department has since incorporated an edit that prevents a duplication of batch payment numbers.
- The employee who processed the payment on the department's federal payment subsystem did not cancel the payment even though the subsystem produced a report that the payment would result in overpayments to the school districts. The employee, who was new to processing these payments, unsuccessfully tried to contact program and other departmental staff to determine whether the payments should be made, but ultimately relied on the program approval process as the authority to make the payments.

In addition, the department did not properly allocate funding to the school districts for five of the six federal programs. When a school district dissolved in June 2000, its students transferred to neighboring school districts. The department did not reallocate federal funds from the old school district to the new school districts but, rather, prorated the funds to all school districts statewide. For instance, the new school districts received about \$48,000 less Title I funding for the transferred students than the old school district had received.

Recommendations

- *The Department of Education should ensure that adequate system controls are in place to detect and prevent overpayments to school districts.*
- *The department should review its federal program allocations to ensure it paid districts the correct amount. The department should adjust future allocations for the fiscal year 2001 through 2003 allocation errors.*

Department of Education

3. The Department of Education did not prepare accurate financial statements for the Maximum Effort School Loan Fund.

The financial statements the Department of Education prepared for the Maximum Effort School Loan Fund did not accurately present the financial activity of the fund. The Department of Finance delegated the responsibility for financial statement preparation for this fund to the Department of Education. These responsibilities included monitoring the fund's loan financial activity, determining the collectibility of the outstanding loans, and maintaining subsidiary records to support the preparation of the financial statements. In fiscal year 2003, the department did not correctly account for certain transactions or properly complete some accounting functions, including:

- The department's subsidiary records did not accurately identify collectible loans and interest default amounts.
- The department did not reconcile account balances on its subsidiary records to amounts on the state's accounting system or to the financial statements. As a result, differences existed between the financial statements and the department's accounting records. For instance, the year-end cash balance on the department's accounting records totaled \$20 million, while the cash balance on the financial statements totaled \$454,000. The difference was due to a transfer to the Debt Service Fund.
- In one instance, the department did not properly record \$452,258 in interest on a repaid loan.

The department did not provide adequate training and supervision to the employee responsible for preparing the Maximum Effort School Loan Fund's financial statements. The employee stated that he attempted to prepare the financial statements in the same manner as had been done in previous years. The department did not review the financial statements before it submitted them to the Department of Finance.

The department needs to ensure that its subsidiary records will provide the data needed for financial reporting. The Department of Finance will be meeting with the Department of Education for the purpose of correcting errors and revising the subsidiary records supporting the fund. The department needs to verify the ending loan balances for fiscal year 2003 on its subsidiary records and ensure that financial activity recorded in fiscal year 2004 is correct.

Recommendation

- *The department should work with the Department of Finance to update its subsidiary records and to obtain instructions for properly preparing the Maximum Effort School Loan Fund's financial statements.*

Department of Education

4. The Department of Education sometimes allowed vendors to provide services before it fully executed the contract or encumbered funds.

The department did not properly encumber funds for five contracts with three vendors paid through the federal special education (CFDA #84.027) program. The department did not fully execute the contracts or encumber funds before the start of work. The contracts totaled \$3,769,470. Similarly, for all five charter school program (CFDA #84.282) administrative expenditures tested, the department permitted work to be completed before final approval was obtained and funds were encumbered.

State statutes prohibit a state agency from authorizing work to begin before a contract has been fully executed and an encumbrance has been established on the accounting system. If the department does violate the statute, it must write a letter of explanation, addressed to the head of the agency, to document the reason why the violation occurred and the corrective action that the department will take to prevent future violations of the statutory requirements. The letter should accompany the encumbrance or payment document.

Recommendations

- *The Department of Education should ensure that it fully executes contracts and encumbers funds before allowing work to begin.*
- *The department should ensure that it prepares a violation letter in any instances where it authorizes work to begin before the contract is fully executed or the funds are encumbered.*

5. PRIOR FINDING NOT FULLY RESOLVED: The Department of Education did not properly record some expenditure transactions on the state's accounting system.

While improvements have been made in recording expenditure transactions, the department continues to have trouble properly recording the date the department incurred a liability. For example:

- The department used incorrect record dates on 7 of the 19 sample items tested for fiscal year 2003 special education (CFDA #84.027) administrative expenditures, totaling about \$533,000. We tested an additional seven administrative expenditure transactions in fiscal year 2004 and noted that the department incorrectly recorded two of those transactions, totaling over \$108,000. The department incorrectly used the date it entered the transactions onto the accounting system or another date as the record date.
- The department also did not properly record the liability date for some charter school (CFDA #84.282) transactions. For two of the five transactions we tested, the department incorrectly used the date it entered the transactions onto the accounting system or another

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date as the record date. For the other three transactions, the department correctly entered the date services were received into the accounting system but, because of a programming error, the state's accounting system did not properly record the correct service date.

An analysis of all of the department's payments identified 141 payment transactions (totaling \$164,455) that the accounting system posted to the wrong fiscal year because of the programming error.

- Finally, we noted that 7 out of 25 tested transactions paid through the department's federal payment system had incorrect record dates. These transactions represented various federal programs and totaled over \$12 million.

Generally accepted accounting principles require that the state recognize a liability when the department obtains the services or the goods are received. The Department of Finance uses the accounting system's record date to determine the period in which to 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

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

6. The Department of Education did not properly administer a contract with the U.S. Department of Veterans Affairs.

The department did not properly administer a contract for the U.S. Department of Veterans Affairs' Education Program. The purpose of the contract was to determine the qualifications of educational institutions and/or training institutions that furnish education courses for veterans in Minnesota. The fiscal year 2003 contract limited the amount of federal funding for salary, travel, and administrative expenses to \$295,931. In reviewing the department's management of this contract, we identified several concerns related to the administration of this program.

The department incurred over \$100,000 of program costs before it had fully executed the contractual agreement with the federal government. Although the contract period was from October 1, 2002, to September 30, 2003, the contract was not fully executed until February 20, 2003, due to federal budgetary issues. The department risked not recovering reimbursement for these costs if the contract was not signed. Minn. Stat. Section 16A.15 does not permit an agency to incur an obligation without sufficient funding.

The department did not monitor the financial activity of the contract to ensure that it complied with spending limits and that it requested reimbursement for all allowable costs. For instance, in fiscal year 2003, the department requested travel reimbursement totaling \$2,500 more than was provided for in the contract.

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The department also did not determine why it received less administrative money than allowed in the contract. The contract provides administrative funds as a percentage of the direct payroll and travel costs related to the contract. The department did not always receive the administrative funds it was entitled to under the contract. Also, as a use of the administrative funds, the department annually charged the program \$10,773 for office space provided to the two program staff. The department was unable to explain how it determined this amount and estimates that an annual rent charge of about \$5,785 more closely approximates the space used by program staff.

The department did not adequately review employee expense reports submitted by program staff. Problems related to employee travel expense reimbursement requests include:

- One employee did not follow the state's travel policy for employee mileage reimbursement. This employee was allowed to telecommute four days a week. His responsibilities included travel to various educational institutions south of Highway 94. On his travel reimbursement forms, he listed Roseville as the starting point for his trips. However, for many of the trips, he did not report to the office in Roseville but actually started his trips from home, which reduced the amount of miles he could claim for reimbursement. We analyzed several trips in fiscal year 2003 and noted a discrepancy of 327 miles, or \$118 of reimbursement. Adequate supervisory review of the employee's travel reimbursement claim may have prevented this problem.
- We also noted that the staff did not record the start and ending time of their trips as required by the state's travel policy. An employee is eligible for reimbursement for breakfast if he leaves the trip starting point by 6:00 a.m. and is eligible for dinner if he does not return until after 7 p.m. In one instance, an employee claimed breakfast but did not record his starting time, preventing validation that the employee was eligible for reimbursement of his breakfast.
- The state travel policy also requires that employees record all local stops on their reimbursement form. The listing of all local stops allows the agency to verify the reasonableness of local miles claimed on the employee expense reimbursement form. Our review of local miles charged on the employee expense reimbursement form identified several days with high local mileage claims. The employee could not substantiate the validity of this mileage because all stops were not recorded.

Adequate monitoring of employee expense reimbursement requests is essential to ensure the proper reimbursement amount is paid to the employee and charged to the federal program.

This program was transferred to a different state agency on December 30, 2003. The following recommendations are intended to assist the Department of Education in administering similar programs. It should also assist the next state agency in establishing adequate controls over this program.

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Recommendations

- *Future contracts with the federal agency should be either signed on a timely basis, or arrangements should be made to ensure funding until signed.*
- *The department needs to properly account for all revenues and expenditures charged to contracts, including verifying any unclaimed revenues and ensuring expenditures do not exceed contract amounts.*
- *The department needs to analyze the administrative costs charged to the program and adjust for inappropriate charges.*
- *The program supervisors should ensure that timesheets and employee expense reimbursement claims are accurate and comply with state travel policies.*
- *The department should review employee travel reimbursement for prior years and seek reimbursement for any improper mileage claims.*

7. The Department of Education did not properly report child nutrition expenditures to the federal grantor agency and did not properly drawdown federal funds.

The food and nutrition services section did not accurately report to the U.S. Department of Agriculture the correct number of meals and the correct rates used in reimbursing school districts for the child nutrition programs (CFDA #s 10.553, 10.555, 10.556, and 10.559). The department also identified additional eligible costs not originally submitted to the federal grantor agency. The department also drew down federal grant money from incorrect grant years and did not always timely drawdown federal nutrition grant funds.

The errors came to the department's attention as the result of a management evaluation conducted by the U.S. Department of Agriculture in fiscal year 2002. The department's further review of child nutrition for fiscal years 1999 through 2002 resulted in adjustments to its original reimbursement requests for all four years because of incorrect rates and meals reported and inaccurate drawdowns of federal funds. Table 2 summarizes the reporting errors and adjustments by fiscal year.

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Table 2
Department of Education
Child Nutrition Reporting Errors

Federal Fiscal Year	Original Reimbursement Amount	Correct Reimbursement Amount	Difference	(Note 1) Department Adjustments	Final Overpayment (Underpayment)
1999	\$137,749,222	\$138,671,946	\$ 922,724	\$ 0	(\$922,724)
2000	\$141,987,966	\$142,162,146	174,180	\$191,846(a)	17,666
2001	\$145,855,742	\$146,099,591	243,849	\$ 74,581(b)	(318,430)
2002	\$153,031,852	\$151,534,313	<u>1,497,539</u>	\$531,544(c)	<u>965,995</u>
Total			<u>\$2,838,292</u>		<u>(\$257,493)</u>

Note 1: Adjustments by the department to original reimbursement claims:

- a) The department credited the program for approximately \$191,846 of unspent nutrition funds returned by the school districts.
- b) Child and Adult Care Food Program federal receivables of \$74,581 was added to receivables of \$243,849 for a total amount owed to the department of \$318,430.
- c) The department incorrectly drew down \$531,444 from the fiscal year 2003 grant award to offset the receivable for fiscal year 2002.

Source: Department of Education records.

In November 2003, the department revised the reports submitted to the U.S. Department of Agriculture and has requested additional reimbursement, totaling \$257,393, for the four years. As of February 9, 2004, the department had not heard from the U.S. Department of Agriculture.

The errors occurred because of the implementation of new software, the lack of review over input data, and the lack of reconciliations between the various reporting and payment systems. Employees are now more familiar with the software; the department has instituted data reviews to ensure it reports the correct number of meals and rates; and the department has instituted reconciliations to compare data between the subsystems and balance federal aid drawdowns to payment amounts.

The Department of Education also did not always timely drawdown child nutrition (CFDA #10.555) grant funds. The state's agreement with the U.S. Department of the Treasury allows the Minnesota Department of Education to drawdown federal school nutrition money the same day it makes payments to the school districts. The Department of Education did not drawdown federal child nutrition funding for the May 15 payment date, totaling nearly \$10 million, until June 20, 2003. The missed drawdown was due to staff turnover. The Department of Finance's Treasury Division identified the missing deposit while reconciling the state's bank accounts and notified Education employees, who processed the drawdown. Because of the delay in drawing down federal funds, the state lost investment income of approximately \$13,000. Additionally, the department did not timely drawdown federal administrative money during June and August 2003. In these months, it only drew down administrative money once per month, instead of after each pay period, as provided for in the agreement.

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Recommendations

- *The department should continue to pursue with the U.S. Department of Agriculture reimbursement of the department's costs totaling \$257,393.*
- *The Department of Education should ensure that it draws all federal funds on a timely basis.*

8. The Department of Education did not allocate federal special education grant funding to school districts according to federal requirements.

The Department of Education found that it had not allocated federal special education funding to school districts according to program requirements. The federal special education grant (CFDA #84.027) program regulations require the state to allocate a portion of its flow-through money based upon the number of children with disabilities on December 1, 1998. However, for fiscal years 2001 through 2003, the department based its allocation to the school districts on the number of children with disabilities in the preceding year. The department made a similar error in fiscal years 1999 through 2003, when it determined its allocations for a portion of the special education preschool money using the preceding years' child counts rather than using the number of children with disabilities at December 1, 1996. The department also did not incorporate new charter schools into the allocation formula. New charter schools did not receive special education funding, and significantly expanded charter schools did not receive increased funds resulting from the expansion.

In 2004, the department identified the incorrect allocation when reviewing the allocation formula to the school districts. It analyzed the impact of the improper allocation and contacted the federal grantor agency. The department is now working with the federal agency to determine the overall impact of the improper allocation and identifying various options for correcting the erroneous payments.

Recommendations

- *The department needs to ensure that program staff members understand and properly allocate federal special education money to the school districts and charter schools.*
- *The department should work with the federal grantor agency to resolve the inaccurate allocation of grant money for fiscal years 1999 through 2003.*

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9. The Food and Nutrition Section did not keep support for an amount in its report to the U.S. Department of Agriculture.

The department's Food and Nutrition Section did not keep support for an amount on the Annual State Revenue Matching (FNS-13) Report it submitted to the U.S. Department of Agriculture. Employees prepared the report using queries to the Cyber-Linked Interactive Child Nutrition System database. The employees did not keep the query results. Since the database changed as new amounts were entered, it was not possible to substantiate the query results later. The department may want to use the state's accounting system as a basis for its report preparation, since queries to the system can be later replicated, if needed, and since the system is the complete record of the account's financial activity. For fiscal year 2003, the department reported \$13,411,834. Our query of the state's accounting system showed a total state match of \$12,739,174, approximately \$673,000 less than reported. Despite the discrepancy, the department did meet the minimum state match requirement of \$4,617,933.

The department submits the Annual State Revenue Matching (FNS-13) Report to the U.S. Department of Agriculture each fiscal year to show that it met its minimum match requirements for the federal School Breakfast Program (CFDA #10.553), National School Lunch Program (CFDA #10.555), and Special Milk Program for Children (CFDA #10.556). Federal instructions require that the state agency maintain an audit trail documenting state expenditures.

Recommendation

- *The Food and Nutrition Services Section should keep documentation or other support for the state match amount reported in the Annual State Revenue Matching (FNS-13) Report. The department could also consider using the state accounting system as the source of the state match.*

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: February 13, 2004

Report Signed On: March 15, 2004

**Status of Prior Audit Issues
As of February 13, 2004**

Legislative Audit Report 03-15, Issued March 13, 2003, examined the department's activities and programs material to the State of Minnesota's Comprehensive Annual Financial Report and the Single Audit for the year ended June 30, 2002. The audit scope included state and federal school aid payments made through the department's IDEAS and PAYS subsystems. We also perform certain audit procedures on these subsystems 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. The report contained seven findings. The department implemented or substantially implemented six of the seven recommendations. The department documented the design of its school aid payment systems and has developed a training program for other programmers. Documentation is now maintained for employee time charged to federal programs and for figures in the State Per Pupil Expenditure Report. The department no longer permits Migrant Education funding to be used for unallowable activities. Finally, the department makes statewide indirect cost payments timely and used the correct expenditure total when calculating indirect cost payments. However, the department has not resolved the issues related to the proper recording of record dates on the accounting system. Finding 6 discusses the issues related to the recording of record dates.

Legislative Audit Report 03-58, Issued November 6, 2003, was a special review of the Department of Education's administration of the Implement Provision 2 and 3 grant (CFDA #10.573) and the Team Nutrition 2001 grant (CFDA #10.574). The audit scope included a review of expenditures charged to the two grants, as well as compliance with grant provisions and federal administrative requirements. The report contained two findings. The department did not properly charge costs to the Implement Provision 2 and 3 grant and did not comply with grant requirements. The department also did not properly charge payroll to the Team Nutrition grant and did not comply with specific grant requirements.

Other Audit Coverage:

U.S. Department of Agriculture completed a Management Evaluation in March 2002 of the Minnesota Department of Education's Food and Nutrition Service. The purpose of this evaluation was to review the department's reporting function in six areas. The department was required to complete corrective action in three of the six reporting functions, including revising the method of reporting expenditures, reviewing salary costs charged to two projects, timely reporting of prior year refunds, and using MAPS detail when submitting quarterly financial data.

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 applied 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 12, 2004

James Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Building, Room 140
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for your audit of specific programs and functions within the Department of Education. 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.

OLA Finding #1:

The Department of Education did not provide the required state matching funds for the charter school federal grant (CFDA #84.282). It also improperly drew down funds before incurring program expenses.

MDE Response:

In December 2003, MDE determined it did not have funds to meet the match requirement as indicated in the grant application for charter school federal grant (CFDA#84.282) and so notified the U.S. Department of Education (USDOE). A letter and updated grant application material was sent to Dean Kern at the Office of Innovation and Improvement at USDOE. On March 10, 2004, the department was notified by Rik Lanzendorfer at USDOE that the amendment to our grant application to eliminate the state match reported in the application was approved.

All grant applications require approval by the Commissioner's office. Part of this review is to authorize the reported match requirements. In the event that match requirements are authorized, necessary budget accounts will be established to manage and report the grant

match using the Minnesota Accounting and Procurement System (MAPS), the State's accounting system.

The department has revised the financial status report for FFY 2002 and submitted it to USDOE. The re-payment of funds has also been entered. The department has also reviewed its reconciliation processes and will implement steps to prevent re-occurrence of this issue. Schedules for cash draws will be created and adhered to and expenditures will be documented for cash drawn from the federal system.

OLA Finding #2:

The Department of Education did not have adequate controls to prevent overpayments of certain federal programs and did not properly allocate some federal program funding to school districts.

MDE Response:

Several steps have been taken to prevent duplicate payments. An edit control has been implemented in the federal program database that will cause an error message to appear to the program person requesting the payment if a previously used batch number is accessed again. Federal program staff who create and attest to the accuracy and validity of the payment requests have developed a spreadsheet that carefully tracks payment amounts, dates and batch numbers. Duplicate payments or batch numbers should be readily apparent using this new spreadsheet. The person responsible for making the payments has now had further training regarding any error messages that occur during the loading of payment requests. While that person cannot independently assess the accuracy of specific payment amounts, further investigation will occur if error messages warrant.

The department will review the federal program allocations to school districts for fiscal year 2001 through 2003 to determine if allocation errors occurred. The department will review its reallocation policies with USDOE to determine compliance.

OLA Finding #3:

The Department of Education did not prepare accurate financial statements for the Maximum Effort School Loan Fund.

MDE Response:

Department staff is working with the Department of Finance to develop procedures that will assure accurate fund balance statements. Staff will receive training in preparation of financial statements that comply to standards. These statements will be reviewed prior to submission for use in the CAFR. Department staff in Administrative Services and Program Finance will maintain records and full documentation of loan payments made by the agency, interest payments received, accrued interest, and outstanding loan balances. Steps are being taken to develop assumptions regarding collectability to establish a reserve for those loans where collection is unlikely. A model will assist in forecasting and tracking required maximum effort levy and required debt service levy based on current district tax capacity growth to estimate district refunding and payoff. This reserve will be reviewed annually.

OLA Finding #4:

The Department of Education sometimes allowed vendors to provide services before it fully executed the contract or encumbered funds.

MDE Response:

The department has a continued commitment to fully execute contracts and encumber funds prior to the start of any work. There are some unusual circumstances that do arise where work has begun prior to the contracts. The five special education contracts or vendor payments did follow the procedure required by M.S. 16A.15, subdivision 3 and the explanations were included with those contracts.

The five charter school items tested did not have the appropriate violation explanation letters attached to them. The department has not consistently required the violation letters for honorarium or purchase order transactions as has been the practice for professional technical services contracts.

The department will make every attempt to have funds fully encumbered prior to the receipt of goods or services and in the event that circumstances make it impossible to do so, will require M.S. 16A.15 explanations for every transaction out of compliance.

OLA Finding #5:

The Department of Education did not properly record some expenditure transactions on the state's accounting system.

MDE Response:

The department intends to fully comply with this finding. However, there are two issues, one is staff error in input of information for transaction dates when two fiscal years are open. This can be remedied through a training process and use of the Department of Finance document date material in that training to be sure there is complete understanding of the date issues for transactions.

The larger issue is system related for payments that feed to the accounting system from the CFMS system or our payment interface system. MDE will work with the Department's of Finance and Administration to identify the problem and/or come up with other possible solutions. This problem is a system wide problem and is not isolated to the department.

OLA Finding #6:

The Department of Education did not properly administer a contract with the U.S. Department of Veterans Affairs.

MDE Response:

The federal agency did not sign the contract timely because Congress did not authorize funding. At that time, it was outside the scope of control of the department. This program has been transferred to the Department of Veterans Affairs.

As it relates to employee travel, the department will conduct an internal audit as it relates to employee travel and will recover any overpayment of travel reimbursements. The department's policy is consistent with state policy and law.

OLA Finding #7:

The Department of Education did not properly report child nutrition expenditures to the federal grantor agency and did not properly draw down federal funds.

MDE Response:

A schedule is in place to draw down federal school nutrition money on the 14th and 29th of each month. Federal nutrition administrative money is drawn down bi-weekly. Additionally, cross-training has taken place to ensure that no draws will be delayed do to staff absence.

OLA Finding #8:

The Department of Education did not allocate federal special education grant funding to school districts according to federal requirements.

MDE Response:

Responsibility for special education funding and data collection was transferred from the Special Education Division to the Program Finance Division in early 2003. With this reorganization, the allocation of federal special education money to school districts and charter schools has been placed under the direction of a manager and supervisor with greater experience in education finance and data management. Weekly meetings are held with program staff to discuss problems and issues arising in the administration of special education funding and data collection. Recommendations from program staff are reviewed by Program Finance and Special Education Policy managers, and final decisions are conveyed back to program staff. To maintain a record of current policies and practices that is available to school districts and charter schools as well as program staff, the *Special Education Funding and Data Manual* will be updated on a regular basis, with updates posted to the Department's web site. Annual allocations of federal special education money to school districts and charter schools will be reviewed and approved by the Program Finance Director, after consulting with the Special Education Policy Director.

After identifying the incorrect allocation of federal special education funding to school districts and charter schools, the department reported the errors to the Office of Special Education Policy (OSEP) of the U.S. Department of Education. Two conference calls were held with OSEP officials to explain the nature and impact of the errors and to receive direction from OSEP on corrective action plans. On February 13, 2004, MDE received a memorandum from Stephanie Smith Lee, OSEP Director, outlining the timelines and parameters for corrective action to be taken by the Department. Under the direction of Tom Melcher, Program Finance Director, MDE will determine the Part B, Section 611 and 619 allocations that each school district and charter school should have received for the years in question, and the difference between those amounts and the

amounts of the allocations that each school district and charter school actually received. By April 30, 2004, the department will prepare a plan, consistent with the OSEP memorandum, to make whole the school districts and charter schools that received less than the allocations to which they are entitled. After the plan is reviewed and approved by OSEP, the Department will implement the plan and provide quarterly reports, beginning July 31, 2004, as required by OSEP.

OLA Finding #9:

The Food and Nutrition Section did not keep support for an amount in its report to the U.S. Department of Agriculture.

MDE Response:

The department agrees that documentation should be retained in order to substantiate reports produced by the Cyber-linked Interactive Child Nutrition System database. The department will also pursue the use of the state accounting system as an additional measure to track state match.

We continue to look forward working with the Office of the Legislative Auditor. If you should have any questions, please do not hesitate to contact Chas Anderson at 651-582-8207.

Sincerely,

A handwritten signature in black ink that reads "Cheri Pierson Yecke". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Cheri Pierson Yecke, Ph.D.
Commissioner

C: Chas Anderson
Tammy McGlone
Tom Melcher
Jessie Montano
Karen Carlson
Rita Schmidt
Audrey Bomstad