



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Department of Education
Fiscal Year Ended June 30, 2004



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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All OLA reports are available at our Web Site: <http://www.auditor.leg.state.mn.us>

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
John Hakes, CPA	Auditor
Steve Johnson, CPA	Auditor
Gena Hoffman	Auditor
Nisha Bhattarai	Intern

Exit Conference

We discussed the results of the audit with the following staff of the Department of Education at the exit conference held on February 16, 2005:

Alice Seagren	Commissioner
Chas Anderson	Deputy Commissioner
Tammy McGlone	Director, Administrative Services Division

Report Summary

Key Finding:

The department did not properly calculate the year-end accrual for federal program expenditures reported in the state's annual financial statements. (Finding 1, page 2)

The audit report contains one audit finding relating to financial reporting. The department resolved the nine findings included in our prior report.

Audit Scope:

Programs material to the State of Minnesota's financial statements and to federal program compliance for fiscal year 2004.

Selected Audit Areas:

- State School Aids
- Child Nutrition Cluster (CFDA 10.553, 10.555, 10.556, 10.559)
- Child and Adult Care Food Program (CFDA 10.558)
- Special Education Cluster (CFDA 84.027, 84.173)
- Title 1 Grants to Local Educational Agencies (CFDA 84.010)
- Reading Excellence Program (CFDA 84.338)
- Improving Teacher Quality Program (CFDA 84.367)
- Food Commodities (CFDA 10.550)

Background:

The Minnesota Department of Education distributes approximately \$7 billion in state and federal school aid.



Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Alice Seagren, 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, 2004. 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, 2004.

The Department of Education is responsible for establishing education standards for grades kindergarten through twelve and for processing federal and state financial assistance to school districts. It manages its subsidiary accounting systems, records federal grant receipts, and processes general education aid and federal grant payments to school districts.

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 November 19, 2004, 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, 2004. In accordance with *Government Auditing Standards*, we also issued our report, dated November 19, 2004, 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 2005, 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.

As a result of our financial statement audit work, we identified a weakness in the department's financial reporting process, which we discuss in the following finding.

Department of Education

Finding and Recommendation

1. The department did not properly estimate the year-end financial statement accrual for federal school aid expenditures.

The department did not provide accurate information to the Department of Finance on federal program accrued liabilities for inclusion in the state's annual financial statements. Each year, the Department of Finance requests that the Department of Education provide an estimate of federal school aid reimbursements due to school districts at June 30. The department made certain errors when preparing the estimate for June 30, 2004, as discussed below.

- In its initial estimate of the federal liability, the department did not include about \$48 million it paid in July and August 2004 to reimburse schools for costs they incurred before June 30. Although paid with fiscal year 2004 funding, other accounting system coding excluded these transactions from the liability accrual determined by the state's automated financial reporting process. Department personnel were not aware that the transactions had not accrued. The department needs to review transactions recorded on the state's accounting system through the close of the state's accounting cycle and determine the amount that will be included in the state's liability accrual.
- The department mistakenly included in its liability estimate \$31 million of federal grant entitlements that were available for carryover to the next fiscal year. The financial statement liability estimate should only include amounts owed to the schools for costs incurred before the end of the fiscal year.

Adjustments made by the department and the auditors resulted in proper recording of the federal program liability in the state's financial statements.

Recommendation

- *The Department of Education needs to work with the Department of Finance to understand the financial reporting process and ensure that the department's estimate of the federal liability will result in proper presentation of the total federal liability in the state's financial statements.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Education. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 3, 2005.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: February 3, 2005

Report Signed On: February 28, 2005

**Status of Prior Audit Issues
As of December 30, 2004**

Legislative Audit Report 04-12, Issued March 18, 2004, examined the department's activities and programs material to the State of Minnesota Comprehensive Annual Financial Report and the Single Audit for the year ended June 30, 2003. The audit scope included state and federal school aid payments made through the department's IDEAS and PAYS subsystems. We also performed certain audit procedures on federal 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. The report contained nine findings. The department has implemented the recommendations for all nine findings.

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 #10.373) and 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. Both findings have been implemented.

Legislative Audit Report 04-31, Issued July 28, 2004, was a special review of the African American Mentor Program, a nonprofit organization that received the majority of its funding through grants from the Minnesota Department of Education. The audit scope included a review of the organization's management practices and use of state funds. The report contained three findings. All three findings have been implemented.

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.



February 23, 2005

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 and work through the recommendations. As to the specific findings within this report, there is one finding and recommendation as follows:

OLA Finding # 1

The Department did not properly estimate the year-end financial statement accrual for federal school aid expenditures.

OLA Recommendation # 1

The Department of Education needs to work with the Department of Finance to understand the financial reporting process and ensure that the department's estimate of the federal liability will result in proper presentation of the total federal liability in the state's financial statements.

The Department will work with the Department of Finance and fully implement the recommendations on this finding for the close of Fiscal Year 2005 so that federal liabilities are properly recorded. We appreciate your recommendation and look forward to working with your office again. Should you have any questions regarding this report, please do not hesitate to contact Deputy Commissioner Chas Anderson at 651-582-8207.

Sincerely,

A handwritten signature in black ink that reads "Alice Seagren". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Alice Seagren
Commissioner