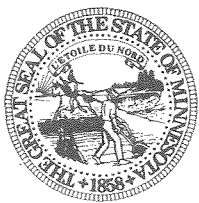


**DEPARTMENT OF EDUCATION
FINANCIAL AND COMPLIANCE AUDIT
FOR THE YEARS ENDED JUNE 30, 1987 AND 1988**

MARCH 1989

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Randolph W. Peterson, Vice-Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

Dr. Ruth E. Randall, Commissioner
Department of Education

Audit Scope

We have completed a financial and compliance audit of the Department of Education for the years ended June 30, 1987 and 1988. Section I provides a brief description of the department's activities and finances. Our audit was made in accordance with generally accepted auditing standards, and the standards for financial and compliance audits contained in the U.S. General Accounting Office Government Auditing Standards, and accordingly, included such audit procedures as we considered necessary in the circumstances. Our audit procedures are further described in the audit techniques section of this letter. Fieldwork was completed on January 31, 1989.

We have issued a separate management letter, dated February 25, 1988, as part of our Statewide Financial and Single Audit work in the department for the year ended June 30, 1987. The management letter contained three findings. We also issued a follow-up letter, dated November 28, 1988, related to the financial and compliance audit of the department for the three years ended June 30, 1986. This report discussed five findings.

The objectives of the audit were to:

- study and evaluate agency internal controls over assets, liabilities, revenues, and expenditures;
- verify that financial transactions were made in accordance with applicable laws, regulations, and policies, including finance-related laws and regulations, and federal laws and regulations pertaining to the federal programs included in the Single Audit scope; and
- verify that financial transactions for the year ended June 30, 1988 were properly recorded on the statewide accounting system (SWA) and appropriately included in the State of Minnesota's Comprehensive Annual Financial Report and supplemental Statements of Expenditures for federal programs included in the Single Audit scope:

<u>CFDA No.</u>	<u>Program</u>
10.550	Food Commodities
10.555	National School Lunch
10.558	Child Care Food Program
84.010	Educationally Deprived Children Program
84.027	Handicapped Preschool and School Program
84.151	Education Consolidation Improvement - Block Grant

Management Responsibilities

The management of Education is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

The management of Education is also responsible for the department's compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by the department. The purpose of our testing of transactions was to obtain reasonable assurance that Education had, in all material respects, administered its programs in compliance with applicable laws and regulations.

Audit Techniques

The Statewide Financial and Single Audit for the year ended June 30, 1988 covered the major federal programs listed above and material state aids. State aids included, but were not limited to, Foundation, Transportation, Special Education, and Child Nutrition. The audit coverage this year was expanded to include additional departmental audit work. Department work covered the two years ended June 30, 1988, and supplemented the Statewide Financial and Single Audit. Department work was specifically designed to review areas not covered during the other audit phases and relate to activities with other types of entities. These areas are included below:

- Management Information Centers
- Interdistrict Coop Aid
- Education Coop
- Curriculum & Tech Integration
- Planning, Evaluation & Reporting
- Program Implementation Grants
- Chemical Dependency

Status of Prior Audit Findings

The status of findings from the fiscal year 1987 Statewide Financial Audit were reviewed. We concur with the corrective action taken by the department relative to findings 2 and 3. We also concur with the corrective

action taken for the portion of finding 1 dealing with Secondary Handicapped Vocational Education Aids. The remainder of the recommendation is repeated in Section II, finding 1.

The follow-up letter, dated November 28, 1988, related to the departmental audit for the three years ended June 30, 1986, showed that the five audit recommendations were fully implemented.

Conclusions

In our opinion, except for the issues addressed in Section II, findings 1, 3, 5-6, and 8-10, the Department of Education's system of internal accounting control in effect on January 31, 1989, taken as a whole, was sufficient to provide management with reasonable, but not absolute, assurance, that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization.


In our opinion, for the year ended June 30, 1988, the financial transactions of the Department of Education were properly recorded in the statewide accounting system, and such transactions were properly reported in the State of Minnesota's Comprehensive Annual Financial Report and supplemental Statement of Expenditures for federal programs included in the Single Audit scope.


In our opinion, except for the issues addressed in Section II, findings 2-4 and 7, and except for the issue raised in our management letter dated February 25, 1988, finding 2, for the years ended June 30, 1987 and 1988, the Department of Education administered its programs in compliance, in all material respects, with applicable finance-related laws and regulations.

Finding 7 of this report has been referred to the Attorney General for resolution. Minn. Stat. Section 3.975 provides that the Attorney General has the responsibility to ensure the recovery of state funds. The Attorney General may negotiate the propriety of individual claims.

The recommendations included in this report are presented to assist you in resolving the audit findings and in improving accounting procedures and controls. We will be monitoring and reviewing the department's progress on implementing these recommendations.

We would like to thank the Department of Education staff for the cooperation extended to us during this audit.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

January 31, 1989

DEPARTMENT OF EDUCATION

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. CURRENT FINDINGS AND RECOMMENDATIONS	2
III. AGENCY RESPONSE	13

AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor participated in this audit:

John Asmussen, CPA	Deputy Legislative Auditor
Renee Redmer	Audit Manager
Michael Hassing	Auditor-in-Charge
Chris Buse, CPA	Auditor
Joan Haskin	Auditor
Sonya Hill	Auditor
Mary Lentsch	Auditor
John Marzitelli	Auditor
Lois McGuire	Auditor

EXIT CONFERENCE

An exit conference was held with the following staff from the Department of Education on February 8, 1989:

Ruth Randall	Commissioner
Robert Wedl	Deputy Commissioner
Jim Sauter	Assistant Commissioner
Nan Skelton	Assistant Commissioner
Dan Skoog	Assistant Commissioner
George Fortmeyer	Administrative Services
Ed Wilkins	Fiscal Services
Wanda Vaillancourt	Fiscal Services
Gary Farland	Finance and Analysis
Norena Hale	Unique Learner Needs
Richard Pearson	District Support Services
Tom Strom	Secondary Vocational Education
Gilbert Valdez	Instructional Design

DEPARTMENT OF EDUCATION

I. INTRODUCTION

The purpose of the Minnesota Department of Education (MDE) is to provide leadership and service in maintaining and improving a uniform and quality system of public education, in providing opportunities for the development of the potential of all learners, and in improving the productivity and performance of learners. To accomplish this, the department's functions include:

- developing, implementing, and monitoring programs and services required in rule and statute;
- developing, modifying, initiating, and recommending educational policies;
- increasing the efficiency and effectiveness of MDE through staff development, increased office automation, and improved information exchange;
- improving the management of educational programs and services at state, regional, and local levels; and
- assisting local school districts in assessing educational needs, planning and restructuring programs and services, and evaluating the effectiveness of programs.

The Commissioner, Dr. Ruth Randall, is the administrative head of the Department of Education. Departmental activities are financed mainly by General Fund appropriations and federal grants. Fiscal year 1988 expenditures were as follows:

	GENERAL FUND	FEDERAL FUND	OTHER FUNDS	TOTAL
Grants and Aids	\$2,034,597,049	\$807,555,128	\$18,902,512	\$2,861,054,689
Personal Services	9,116,107	4,970,902	5,335,988	19,422,997
Supplies and Equipment	1,190,702	425,022	450,313	2,066,037
Contractual Services	985,472	255,451	357,050	1,597,973
Travel	316,672	280,314	302,330	899,316
Other Administra- tive Expenditures	<u>2,853,422</u>	<u>1,055,057</u>	<u>1,114,353</u>	<u>5,022,832</u>
TOTAL	<u>\$2,049,059,424</u>	<u>\$814,541,874</u>	<u>\$26,462,546</u>	<u>\$2,890,063,844</u>

DEPARTMENT OF EDUCATION

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. PRIOR FINDING PARTIALLY RESOLVED: Processing procedures are inadequate to ensure that payments for the Secondary Vocational Education Handicapped Program are accurate.

The goal of the Secondary Vocational Education Handicapped Program is to prepare handicapped children for the working environment. Their preparation includes classroom instruction, training, and actual work experience. During fiscal year 1988, program funds of \$4,137,479 were distributed to school districts and cooperative centers to pay for instructor salaries, supplies, travel, and equipment costs.

Each district or cooperative center participating in the program is required to submit an application and budget for approval. Two sections of the department share processing responsibilities for the program. The Secondary Vocational Education Section reviews the applications to determine expenditures which are reimbursable according to the program guidelines. The Special Education Section then inputs the application data into their computer system which calculates estimated aid entitlements. At year end, the same process is used to adjust the estimated budgets to reflect actual amounts spent. We reviewed this process for the 1987-88 initial applications and the 1986-87 final amendments.

In our prior audit report, dated February 1988, six recommendations were made for improving processing procedures and correcting erroneous data. Although five of the six recommendations were implemented, our testing revealed that problems still exist in the application review and data entry processes. Because the section did not have a systematic method to review payments, the following errors occurred:

- Four districts reviewed during our 1987-88 testing had unreasonable salary amounts approved for entitlement processing. In our 1986-87 final payment testing, three districts had five unreasonable salaries approved. As reported by the districts, instructors earned hourly rates ranging from \$29 to \$145, worked hours instead of days, or days instead of hours. In each of these situations, the failure to detect and correct the unreasonable data resulted in incorrect aid payments to the districts. Final payments for 1987 will have to be adjusted to reflect underpayments and overpayments totalling \$25,197.29 and \$10,823.50, respectively. Adjustments for underpayments of \$14,397.66 will have to be made for the 1988 payments.
- Two districts reviewed were paid inflated entitlements as the result of expenditures which were improperly coded. District 916 and the St. Paul district had a total of 10 coding errors where expenditures for travel and contracted services were coded as salaries and reimbursed at the incorrect percent. This resulted in aid overpayments totalling \$1,371.45 to these districts. None of these coding errors were detected in the post-processing review of data.

DEPARTMENT OF EDUCATION

- Five data entry errors were not detected or corrected during the post-processing review of entitlements. District 916 was entitled \$2,044.50 for equipment expenditures which were determined to be unreimbursable during the application review.
- The Pine to Prairie Cooperative Center was overentitled \$4,308.96 as the result of duplicate entitlements for the same piece of equipment. The St. Paul district had two approved equipment items and one approved salary for which no entitlements were generated. Each of these errors could have been detected by comparing the system output to the approved expenditures.
- The Tracy district reported incorrect time units for a salary expenditure which SVE approved for processing. The failure to correct the data before processing resulted in an underentitlement of \$3915.49.

The Secondary Vocational Education Section subsequently conducted a more extensive review and found additional errors. These problems indicate that controls are inadequate to ensure that accurate entitlements will be calculated and processed for all school districts. To strengthen the controls, the section should closely scrutinize all expenditures to verify that they are reasonable and properly reported. As of July 1, 1988, the Secondary Vocational Education Section will be solely responsible to process aids. Therefore, the section should verify that all approved expenditures were properly processed.

RECOMMENDATIONS

- The Secondary Vocational Education Section should verify that all expenditures approved for entitlement processing are reasonable and properly reported.
- The Secondary Vocational Education Section should correct all errors and unreasonable expenditures contained in the 1986-87 final reports and 1987-88 initial reports. The resulting adjustments should be collected from or paid to the districts.

2. The Department of Education did not comply with the statutory guidelines for managing the Nonpublic Pupil Aid Program.

The Nonpublic Pupil Aid Program is designed to provide for distribution of educational aids such as textbooks, standardized tests, and pupil support services. Students attending a nonpublic school can apply for aid in the following categories: textbooks, health, counseling, and guidance. Aid from this program is also available to home school students. These students are taught at home by their parents. The Minnesota Department of Education (MDE) indirectly administers this program by distributing aid to the nonpublic schools through the local school districts. During fiscal

DEPARTMENT OF EDUCATION

year 1988, program funds of \$7,947,328 were distributed to the school districts to pay for expenses incurred on behalf of nonpublic schools. The program is governed by Minn. Stat. Sections 123.931 to 123.947 and 124.195, Subd. 11, and by State Board of Education Rules Chapter 3540.

MDE sends student applications and report forms to the school districts. The districts are responsible for providing applications to the nonpublic schools within their jurisdiction. The nonpublic schools provide students with applications and summarize the responses on the student report forms. The student report forms are submitted by the nonpublic schools to the school district. School districts forward these forms to the program staff at MDE. An entitlement is calculated by MDE based on this data, and the initial payment is 85 percent of this amount. At the end of the year, districts report actual nonpublic pupil aid expenditures on the Uniform Financial Accounting and Reporting System (UFARS). An Expenditure Summary Statement comparing the entitlement with actual reported expenditures is sent to the school district for certification. Final payments, made in the subsequent year, are based on actual expenditures not to exceed the entitlement.

MDE Rules Chapter 3540 have not been updated in a number of years. Many of the policies and procedures are outdated, and payment dates and amounts are incorrectly stated. Also, no policies exist detailing procedures to be followed when a nonpublic school wishes to apply for aid past the deadline. Due to the indirect administrative process and conflicting guidelines, the following problems occurred:

- The final payment for 1986-1987 was not made until February of 1988. Pursuant to Minn. Stat. Section 124.195, Subd. 11, final aid payments are to be made by October 31. The final payment was based on entitlements computed at the beginning of fiscal year 1987 rather than actual data as required by statute. An adjusted payment was made in March 1988 after the school districts were allowed to make manual changes to reported UFARS expenditures. UFARS data is supposed to be finalized by December 31. Twenty-eight of the 158 participating districts reported changes resulting in a \$78,653.88 net increase in aid payments. Final payment should be based on expenditures as reported on UFARS.
- MDE is not receiving student reports used to calculate entitlements from school districts by the agency deadline. To ensure that the advance payments were made by the October 31 deadline, MDE rolled the prior year's entitlements forward, and made an estimated payment. Department regulations stipulate that all nonpublic schools should submit the reports to school districts by September 25, and that the school districts are to submit these forms to MDE by October 15. Four of the 14 districts tested submitted student reports after the deadline. MDE staff indicated reports from home schools were submitted to them as late as March of 1988. Actual 1987-88 entitlements were not computed until this time.

DEPARTMENT OF EDUCATION

- The roll forward of entitlements resulted in inaccurate aid payments. In fiscal year 1988, \$59,460 was paid to ten districts who did not apply for aid because the districts had entitlements in the system from the previous year. Additionally, one district received an \$8,970 overpayment because its prior year entitlement, which was rolled forward, was greater than its current year expenditures. Adjustments will be necessary to correct these incorrect aid payments.
- The program automatically pays an administrative allocation that is five percent of the total aid to be received. According to Minn. Stat. Section 123.9361, school districts may claim and receive from MDE an additional sum for the actual cost of administering the program which shall not exceed five percent of the district's allocation for that year. School districts do not report actual administrative expenses separately on UFARS nor do they provide an accountability to MDE.

To maintain a strong system of controls over aid entitlements and payments, it is important to abide by the established statutory guidelines and agency rules. The accuracy of the aid distribution system should be checked by department staff to ensure the propriety of the amounts paid.

RECOMMENDATIONS

- MDE should update agency rules so they accurately reflect statutes and clearly outline current policies and procedures governing the program. A specific policy should be established detailing procedures to be followed when a nonpublic school wishes to apply for aid after the agency deadline.
- MDE should make final payments based on actual UFARS data by the October 31 statutory deadline.
- MDE should make initial payments (85 percent) based on current year data. If current data is not available and prior year entitlements need to be rolled forward, entitlements should be adjusted as soon as current data is available.
- MDE should collect 1987-88 overpayments when final payments are made in fiscal year 1989.
- MDE should recover payments made to districts that have not submitted student report forms to the department.
- Administrative allocations must be supported by an accounting of all expenses incurred by the district for administering the program, or a change in the law should be pursued.

DEPARTMENT OF EDUCATION

3. Internal controls over the Food Distribution Program need to be improved.

MDE is responsible for administering the United States Department of Agriculture (USDA) Food Distribution Program. The primary objectives of the program are to help meet the nutritional requirements of children and needy adults, while increasing the market for foods acquired under surplus removal and price support operations. MDE distributed \$18,024,255 of USDA commodities during fiscal year 1988, with approximately 74 percent of those distributions going directly to school districts. Our review of the Food Distribution Program indicates that MDE does not properly safeguard the goods, and that it is not in compliance with federal commodity regulations.

MDE did not physically count inventory in two of four public warehouses under contract. In one case, MDE compared and adjusted their perpetual inventory balances to reflect those calculated by warehouse personnel. In the other, MDE sent the warehouse a copy of the perpetual inventory balances and instructed them to fill in the amounts actually on hand. The inventories actually counted by MDE were performed by the person responsible for all inventory recordkeeping functions, and they were not signed by warehouse personnel to indicate their agreement. Along with being a federal requirement, the physical examination of inventory is a strong internal accounting control. Without physical counts, MDE is unable to determine if their calculated balances of USDA commodities actually exist and if the stock is properly rotated and stored. Allowing warehouse personnel custody to the state's perpetual inventory balances significantly increases the risk of commodity theft. To improve internal controls, MDE should count the commodities in all warehouses. The counts should be performed by an individual independent of the recordkeeping functions, and be certified for accuracy by warehouse personnel. Under no circumstances, should warehouse personnel be allowed access to the state's inventory records.

Internal controls are also diminished by the lack of procedures for verifying the receipt of commodities released for shipment. Recipients' quarterly inventory reports could be used to confirm that all goods released are included as additions to their inventory. Currently, the reports are simply filed without being reviewed. Procedures for confirming the receipt of goods are necessary since shipments are made approximately three months after orders are placed. Furthermore, orders may be prorated when orders exceed supply. These untimely and prorated deliveries reduce the recipients' ability to verify the accuracy of their shipments. To strengthen internal controls over USDA commodities, MDE needs to implement procedures to verify that all goods released for shipment are actually received.

Monitoring and reporting for inventories in the possession of commercial food processors needs improvement. Recipients of commodities have the option of contracting with commercial companies to process the goods. During fiscal year 1988, 167 recipients entered into such agreements. Under current regulations, processors are required to account to MDE for

DEPARTMENT OF EDUCATION

the quantity and quality of commodities in their possession. MDE, in turn, must submit processing inventory reports to USDA on a quarterly basis. Federal regulations mandate on-site reviews of at least 50 percent of commercial food processors each year to determine compliance with program regulations. MDE did not review any food processors during fiscal year 1988. In addition, the quarterly processing inventory reports were not submitted to USDA within the 60 days allowed by federal regulations. The fiscal year 1988 quarterly reports were all submitted in fiscal year 1989, and none of the fiscal year 1989 reports have been submitted. To ensure the state's ability to participate in the Food Distribution Program, it is critical that MDE comply with federal monitoring and reporting requirements.

RECOMMENDATIONS

- MDE should count the USDA commodities in all public warehouses. The counts should be performed by an individual independent of the recordkeeping functions, and be certified for accuracy by warehouse personnel.
- MDE should implement procedures to confirm that all commodities released for shipping are actually received by the intended recipients.
- MDE should perform on-site reviews of at least 50 percent of all commercial food processors each year.
- MDE should submit processing inventory reports to USDA within 60 days of the close of each quarter.

4. Special Education Aids were not paid on a timely basis.

In fiscal year 1988, school districts received approximately \$157 million in Special Education Aid for handicapped students. Aid is paid over a two year period, with 85 percent distributed during the first year based on estimated costs and the remainder paid in the following year based on actual district expenditures. According to Minn. Stat. Section 124.195, Subd. 6, final payments are to be made in September or October based on actual expenditures. If that information is not available, the payment should be based on the most current information, with an adjusted payment made later.

The final special education payment for the school year 1986-1987 was not made until May 1988, seven months after the required due date. Special Education Aids for summer school programs were also late. Summer school aids are paid in full during the subsequent fiscal year. According to a timetable established by the department, summer school aid for 1987 was due to the school districts by November 30, 1987. However, the final payments were not made until June 1988. School districts rely on aid payments being made on a timely basis so they can sufficiently fund their programs.

DEPARTMENT OF EDUCATION

RECOMMENDATIONS

- The final adjusted payment for Special Education Aids should be made in September or October, in accordance with Minn. Stat. Section 124.195, Subd. 6.
- Special education summer school aids should be paid on a timely basis.

5. Aid adjustments recommended by the Special Education Monitoring Office are not made on a timely basis.

The Special Education Monitoring Office conducts reviews of special education programs for all school districts in the state. Programs are monitored on a three-year cycle. Compliance and fiscal monitoring are performed to determine that state and federal funds are appropriately expended at the local level. The Monitoring Office informs the Special Education Section of any noncompliance issues involving the use of funds. The Special Education Section has the responsibility to follow up the issues with the districts. If adjustments need to be made, the Special Education Section notifies the State Aids Section so that future aid payments can be adjusted to reflect the proper amounts.

The Special Education Section has not promptly responded to the recommendations made by the Monitoring Office. The Monitoring Office recommended the recovery of \$250,400 of state aid overpayments from fiscal years 1986 and 1987. The recommendations included an overpayment of \$4,644.16 discovered in October 1987. However, the recommendations were not submitted to the State Aids Section for processing until December 1988. There should be a system of follow-up procedures for aid adjustments recommended by the Monitoring Office. By not adjusting aids on a timely basis, payments do not accurately reflect the expenditures of the school districts. Additionally, the impact of the monitoring function is reduced.

RECOMMENDATION

- Aid adjustments recommended by the Special Education Monitoring Office need to be made on a timely basis.

6. Special Education Aid for contracted student placements was calculated incorrectly.

School districts are authorized to contract with public and private agencies to provide services and programs for handicapped pupils. State aid is paid on these contracts on the basis of 55 percent of the difference between the contracted cost and the foundation aid formula allowance per pupil. Foundation aid formula allowance is the amount of revenue per pupil unit used in the computation of foundation aid for a particular school year. For each handicapped kindergarten pupil, the number of pupil units is equal to the number of hours of education services in the pupil's plan

DEPARTMENT OF EDUCATION

divided by 875. Each handicapped prekindergarten pupil who receives up to 437 hours of education services during the school year is counted as one-half pupil unit.

The formula entered into the computer system to calculate state aid for contracted student placements used an incorrect figure for determining the pupil unit for handicapped prekindergarten pupils who received less than 437 hours of services during the year. The programming error resulted in fiscal year 1987 aid overpayments to 63 districts totalling \$165,498.65. To enhance internal controls, it is necessary to verify the accuracy of system inputs and outputs so errors can be detected and corrected.

RECOMMENDATIONS

- Special Education should review programming changes and system output to verify that formulas are entered correctly into the system.
- Special Education should reduce future aid payments to the affected districts to recover the \$165,498.65 in overpayments.

7. Special Education Aids were paid for an unlicensed teacher.

The Board of Teaching licenses teachers. School districts have the responsibility to employ appropriately licensed staff and to have on file a certified copy of the teaching license. Minn. Stat. Section 125.04 defines a qualified teacher as one who holds a valid teaching license. Only qualified teachers are eligible for school aid reimbursements. Minn. Stat. Section 124.15 states that aid should be reduced, "whenever a district authorizes or permits within a district violations of law by employment in a public school of the district of a teacher who does not hold a valid teaching license or permit."

The Fergus Falls School District received aid for fiscal year 1987 of \$6,812.54 for a teacher whose license had expired on July 1, 1984. Although the school district hired him in January 1987, the teacher did not apply for a license until November 30, 1987 and was not officially licensed until December 10, 1987. The Special Education Section initially denied the school district's reimbursement request for aid. However, the superintendent of the school district appealed and department management directed the Special Education Section to pay the aid.

We believe the law is specific in that aid should be paid only for appropriately licensed personnel. We question the department's authority to bypass state law. Accordingly, we have referred this issue to the Attorney General.

RECOMMENDATION

- MDE should recover aid paid to the district for unlicensed personnel by reducing future aid payments.

DEPARTMENT OF EDUCATION

8. Controls over the Instructional Design and Courseware Duplication Program receipts are inadequate.

MDE purchases large volumes of instructional software for resale to school districts. MDE deposits receipts into a revolving account in the statewide accounting system. The funds are used to purchase additional software.

We cited the following problems:

- Untimely depositing of receipts. - Minn. Stat. Section 16A.275 states that agencies, "shall deposit receipts totalling \$250 or more in the state treasury daily." As of December 22, 1988, MDE had on hand \$12,046 in cash and checks. The date on one check was October 26, 1988. In addition, the date of the last deposit to the revolving account was December 6, 1988. Daily deposits decrease the likelihood of theft or misplacement of the checks as well as the loss of investment income.
- Inadequate safeguarding of receipts. - The secretary in the Instructional Design Division receives the receipts and forwards them, approximately once a month, to Fiscal Services. Fiscal Services restrictively endorses the checks and prepares the deposit slip. Between deposits, receipts are kept in the back of a three-ring binder on the secretary's desk. We also noted several checks payable to a MDE employee. Proper internal controls require the safeguarding of assets. These controls would include prompt endorsing of checks, storing receipts in a secured area and requiring all checks to be payable to MDE.
- Uncompleted duties during an employee's absence. - The secretary who handled the receipts process was out on sick leave for more than a week and no one performed her daily functions. Mail was unopened until the employee returned to work. It is necessary to appoint another employee who could perform the daily operations when the regular employee is absent.

The Instructional Design and Courseware Duplication Program receipts are rapidly increasing. The program had receipts of approximately \$50,000 in fiscal year 1988 and anticipates \$300,000 for fiscal year 1989. MDE should establish procedures which include strong controls over the depositing and safeguarding of receipts.

RECOMMENDATION

MDE should:

- deposit receipts in accordance with Minn. Stat. Section 16A.275;
- restrictively endorse checks upon receipt;
- require all checks to be payable to MDE;

DEPARTMENT OF EDUCATION

- keep receipts in a secure area; and
- appoint a person to perform the receipt process when the regular employee is absent.

9. Control over the Instructional Design and Courseware Duplication Program inventory is inadequate.

MDE maintains the inventory of various software programs and video instructional aids. In fiscal year 1988, MDE received an appropriation of \$550,000 to purchase courseware rights, contract for the development of courseware packages, purchase large volume software and courseware packages, duplicate courseware, and evaluate proposed courseware packages. MDE has accumulated a substantial inventory of software. Controls over the inventory need to be improved.

MDE does not have the inventory in secured areas. Various instructional items are stored in five separate areas. Most areas are unlocked, making the inventory highly accessible to department staff and visitors.

MDE does not maintain accurate inventory records. All items should be promptly and accurately posted to inventory records. When an order is received, the department does not compare the quantities ordered to those received. In addition, the person in charge of maintaining the inventory records is not always promptly notified when the goods arrive. Thus, inventory records are inaccurate. We noted some quantities on the inventory records that did not reflect the amount of units actually received. Additionally, MDE staff use software packages for both advertising and training school districts, yet there are no records of the items checked out to staff.

MDE has not completed a physical inventory of all items on hand nor have they established procedures for periodic spot-checks of inventory. Without performing inventory counts, the possibility of misplacing items or theft increases.

RECOMMENDATION

- MDE should strengthen inventory controls by securing all storage areas, maintaining adequate records, and performing physical counts of inventory.

10. A pricing strategy for software sold by the Instructional Design Section needs to be established.

Currently, the department does not have a consistent methodology for determining the price to be charged for the various software programs sold to the school districts. Minn. Stat. Section 129B.39 requires the software to be available to the districts at cost, including nominal costs of reproduction and distribution. MDE does not consistently include

DEPARTMENT OF EDUCATION

transportation or other charges when determining its price. MDE is unsure what qualifies as nominal costs. Minn. Stat. Section 16A.128 provides that the Department of Finance is responsible for setting fees. Finance could assist MDE in determining what costs would qualify as nominal costs to ensure that all necessary program costs are being recovered.

RECOMMENDATION

- MDE should work with the Department of Finance to establish a formal pricing strategy for the software program.



Minnesota Department of Education

Capitol Square 550 Cedar Street Saint Paul, Minnesota 55101

Phone: 612/296-2358

March 15, 1989

Mr. James R. Nobles
Legislative Auditor
Veterans Service Building
St. Paul, MN 55155

Dear Mr. Nobles:

Enclosed are responses to the 1987-88 Statewide Financial and Single Audit for inclusion with the final report. The responses are listed numerically according to the Findings on your February 28, 1989, Draft Report. We are in basic agreement with your Findings which we understand necessarily must focus on final results rather than the rationale of our actions and decisions. Since the scope of your review was broad and comprehensive, we concluded that the majority of our programs utilized sound fiscal practices, while others need additional attention particularly where there have been vacancies in key positions or activities involving new programs.

Please extend our appreciation to your staff for the useful recommendations and assistance with our financial management.

Sincerely,

Dr. Ruth E. Randall
Commissioner of Education

RER/EW:mpb

Enclosures

1. PRIOR FINDING PARTIALLY RESOLVED: Processing procedures are inadequate to ensure that payments for the Secondary Vocational Education Handicapped Program are accurate:

The Secondary Vocational Education Section has established and is following a written procedure and processing format that should reasonably assure that expenditures are properly reported and reimbursed.

Errors and unreasonable expenditures contained in the 1986-87 final reports and 1987-88 initial reports have been corrected and appropriate adjustments have been made with the affected school districts.

Refer to written procedures, Attachment 1A and 1B. Ron Koebnick and Nick Waldoch are responsible for implementation.

The following is a step-by-step process for the validation of vocational handicapped budget requests.

Program Specialist:

- 1) The turnaround reports are reviewed October 25 and February 25 and at year end, August 15. The review includes the accuracy of salary, teacher time and course data. If inaccuracies are suspected the LEA is contacted and data is verified.

Program Supervisor:

- 1) Reviews a sample of the turnaround reports using the same process as above to assure accuracy.

Finance Specialist:

- 1) Data is keyed and edited. Edits include a verification of data to assure accuracy with handicapped rules.
- 2) After accuracy of data is assured data is uploaded to IDEAS and aid payments are adjusted as necessary.
- 3) IDEAS data verified; an entitlement report is currently generated four times a year as a means of verifying the accuracy of data. This report is reviewed by the program specialist.

HANDICAPPED AIDS

Activity	March 1	April 1	June 1	July 1	Oct. 25	Nov. 30	Feb. 25	Aug. 15	Sept. 15	Oct. 15	Oct. 30
Budget/Reports Received	JC				JC		JC	JC			
Budget/Report Review Completed	JC	RK					JC		RK		
LEA Informed of Entitle			JC							JC	
Voc Data Loaded into IDEAS				JC							JC
Program Budget Review					JC RK		JC RK				
Spot Audit @ School					RK		RK				
Keypunch Review					RK		RK		RK		
Spot Review Calc. of Aid					RK		RK		RK		
Sample Budget Review					NW		NW		NW		
Sample Keypunch Verification					TA		TA				
Licensure Verification						JC					

Key:

JC - Janet Christenson NW - Nick Waldoch
 RK - Ron Koebnick TA - Terry Alvarado

2. MDE did not comply with the statutory guidelines for managing the Nonpublic Pupil Aid Program.

In general, the finding is that problems in calculating and distributing aid payments occurred as a result of conflicting guidelines for administering the program. Specific problems are cited regarding outdated rules, late reporting of data by school districts, use of estimated data in calculating aid entitlements, late processing of the 15% final adjustment payment, and inclusion of a standard 5% administrative cost for all participating districts.

Response

The audit finding begins with a description of the aid program and the operating procedures used by MDE in administering the program. The following comments are intended to clarify this description:

1. Students attending any school, other than a state public school, which meets the requirements of the state's compulsory attendance laws are considered nonpublic students.
2. Nonpublic students may apply to the public school district for eligible materials and/or health and guidance services. They do not apply for state aid.
3. MDE does not distribute aid to nonpublic schools through the local school districts. The districts are reimbursed for authorized expenditures incurred in providing the materials/services requested by nonpublic students.

The audit finding next identifies four problems that occurred during the years audited.

First, the final adjustment payment for 1986-87 was not made on the October 31 statutory date, and when it was made, the aid entitlements had not been finalized and adjustments to district expenditure data were permitted after the data was to have been final. Although the finding correctly describes the process as it occurred, the following clarification is necessary to better understand the process.

1986-87 was the first year for which UFARS expenditure data, rather than a paper claim report, was used as the basis for calculating final aid entitlements, and a new computer system was being developed for this purpose. Whenever UFARS data is first used as the sole basis for aid calculations, there are problems in district mis-reporting or non-reporting of data. It is important to allow adjustments to occur in order that students and districts not be penalized as a result of changes in administrative procedures.

The gathering of data corrections from a large number of districts is a long and often difficult task. This work had to be completed before the final aid calculations were made because there was a real possibility of having an insufficient appropriation which would necessitate a proration of the aid.

Second, the current advance payment for 1987-88 was based on the prior year aid entitlements rather than on reports of student requests for materials and services for the current year. Some student reports were received and accepted by MDE after the October 15 deadline in State Board Rule. Again, the process is described correctly, but the following clarification is necessary.

Because it was known that the final payment for 1986-87 could not be made on October 31, it was essential that the current payment for 1987-88 not be delayed. The statutes provide a separate payment schedule for nonpublic pupil aids in recognition of the districts' need for cash flow to meet the program expenditure patterns.

With the knowledge that the current payment calculations would not be available from the new aid payment system due to programming and testing delays, the previous year entitlements were used. Use of previous year entitlements as the basis for aid calculations may occur, particularly at the beginning of a fiscal year when current data is incomplete, in the various categorical aid programs that have a high stability factor (i.e., generally the same districts participate in the program each year).

This procedure is necessary in order to ensure adequate cash flow to the districts for current operations. If, as a result, aid adjustments are necessary, they are made either during the year using standard procedures for updating aid entitlements, or on the final payment the following October which is intended for adjusting aid payments to the appropriate amount.

With regard to the student reports, MDE is to reimburse district expenditures for a student only if the materials/services are requested by the September 25 deadline in State Board Rule. There are two types of situations where the reports may be accepted after this date. One is where the student does make the request by September 25 but the district delays submitting the report (after October 15). The other is where a nonpublic school is new to the program, that is, is either in its first year of existence or is participating in the program for the first time. Again, this process is designed to prevent students from being unduly penalized as a result of administrative procedures.

Third, the use of previous year entitlements resulted in inaccurate aid payments to eleven districts for which adjustments will be necessary.

As noted in the second problem area discussed above, the use of previous year entitlements can in certain situations be the basis for current year estimated aid calculations. The aid adjustments necessary will be made according to the standard operating procedures routinely used to implement aid adjustments on a timely basis.

Fourth, MDE has included a 5% administrative cost entitlement to all participating districts, rather than limit the entitlement to actual cost not to exceed 5%.

District reporting of administrative costs was a required part of the reporting procedure prior to 1986-87. The paper claim report was eliminated for 1986-87 with the conversion to use of UFARS expenditure data. It was subsequently noted that allocation of district administrative costs were not available in the required level of detail from the UFARS data. As a result, the reporting of administrative costs was reinstated effective in 1987-88.

Historically, the districts have reported administrative costs that generally were equal to or greater than the 5% limit. As a result, MDE has now proposed legislation that will eliminate the need for this reporting requirement of the districts.

Recommendation 1

MDE should update agency rules so they accurately reflect statutes and clearly outline current policies and procedures governing the program. A specific policy should be established detailing procedures to be followed when a nonpublic school wishes to apply for aid after the agency deadline.

Response

This is needed. MDE will seek authority and proceed to update the State Board Rules as soon as possible. (Farland, Lewis)

Recommendation 2

MDE should make final payments based on actual UFARS data by the October 31 statutory deadline.

Response

MDE will make an estimated final adjustment payment on October 31 based on unedited UFARS data. The actual final payment will be made as soon thereafter as the edited UFARS data are available, but no later than January 15. (Lewis, Pfiffner)

Recommendation 3

MDE should make initial payments (85%) based on current year data. If current data is not available and prior year entitlements need to be rolled forward, entitlements should be adjusted as soon as current data is available.

Response

This is standard operating procedure which will be monitored more closely to ensure compliance. (Lewis, Pfiffner)

Recommendation 4 and 5

MDE should collect 1987-88 overpayments when final payments are made in fiscal year 1989.

MDE should recover payments made to districts that have not submitted student report forms to the department.

Response

These will be accomplished as part of standard operating procedures. (Pfiffner)

Recommendation 6

Administrative allocations must be supported by an accounting of all expenses incurred by the district for administering the program, or a change in the law should be pursued.

Response

The reporting requirement for administrative costs was reinstated effective in 1987-88. This requirement will be continued unless the MDE proposal to eliminate it is enacted into law. (Farland, Lewis)

3. Internal controls over the Food Distribution Program need to be improved.

Physical inventory: Due to a staff shortage, the Child Nutrition Section had difficulty taking physical inventories at all warehouses. The section will take the required inventories by someone independent of the record keeping functions annually, at the close of the fiscal year beginning June 1989. Allen Ophoven will implement.

Verify receipt of commodities by recipient agencies: At the start of the 1989-90 school year, recipient agencies will be required to submit to MDE a signed receiving report each time they receive commodities. Commodities will be delivered on a monthly basis. Allen Ophoven will implement.

Perform on-site reviews of 50 percent of commercial processors: Review procedures will be in place for Fiscal Year 1990. Interim rules effective July 5, 1988, required that an on-site review be conducted at least once every two years of all processors. Comments on this new rule were taken until November 1988 and, at present, steps are being taken to comply. Allen Ophoven will conduct the reviews.

Inventory reports to USDA: Processing inventory reports are now being submitted to USDA within 60 days in accordance with regulations. Allen Ophoven is responsible.

4. Special Education Aids were not paid on a timely basis.

Special Education Aids for the 1986-87 school year were paid late due to a variety of reasons including staff shortage and computer system problems. These problems have been corrected. Payments for 1987-88 were made within timelines. There is a new data reporting system in place for 1988-89 which should insure that we continue to have timely, accurate school district aid payments. Robert Fischer is responsible for implementation.

5. Aid adjustments recommended by the Special Education Monitoring Office are not made on a timely basis.

There had been a staffing shortage which created a backlog of reports and hampered follow-up efforts. The problems have been corrected and a system has been established for processing these monitoring recommendations. Robert Fischer and Barbara Troolin are responsible.

6. Special Education Aid for contracted student placements was calculated incorrectly.

There was a formula error in the computer system for state aid calculations which has since been corrected. Aid payments for the affected districts have been reduced to recover resulting overpayments. Don Krukow and Robert Fischer are responsible for implementation and will pay special attention to this process in the future.

7. Special Education Aids were paid for an unlicensed teacher.

The matter has been referred to the Attorney General for a determination on the \$6,812.54 of questioned costs. James Sauter and Robert Fischer will work with that agency for a final resolution.

8. Controls over the Instructional Design and Courseware Duplication Program receipts are inadequate.

Untimely depositing of receipts: Checks received by Instructional Design Section will be recorded, then hand carried to Fiscal Services on a daily basis for deposit. Persons responsible are Ardys Miller and Deborah Pope.

Inadequate safeguarding of receipts: Ordinarily, checks will be recorded and forwarded to Fiscal Services immediately. If checks are received late in the day or are otherwise not processed, they will be secured in a locked file. Ardys Miller and Deborah Pope are responsible.

Uncompleted duties during an employee's absence: An employee has been assigned a backup role in periods of absence of the regular employee. Deborah Pope will provide backup.

Require all checks to be payable to MDE: The instructions now require the checks to be made payable to the Minnesota Department of Education, however, apparently it is not clear enough. The materials will be re-printed soon with special attention to the payee designation.

Harold MacDermot has overall responsibility for implementation of this finding.

9. Control over the Instructional Design and Courseware Duplication Program inventory is inadequate.

Space has been identified to serve as secure storage area for the software inventory. In addition, record keeping has been established that entails prompt identification of the shipments and computer assisted record keeping of the inventory. A physical inventory of all items on hand will be conducted within the next 30 days as materials are moved to the secure storage space. The inventory will be spot checked at least every six months and a complete physical inventory conducted annually.

Harold MacDermot has overall responsibility for implementation of this finding.

10. A pricing strategy for software sold by the Instructional Design Section needs to be established.

Before the price of new software is determined, a pricing strategy will be established and submitted to the Department of Finance for approval. Harold MacDermot is the person responsible. The timeline is 30 days.