



FINANCIAL AUDIT DIVISION REPORT

Department of Education
Federal Compliance Audit
Year Ended June 30, 2008

March 26, 2009

Report 09-08

FINANCIAL AUDIT DIVISION

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

March 26, 2009

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Alice Seagren, Commissioner
Department of Education

This report presents the results of our audit of certain federal financial assistance programs administered by the Department of Education during fiscal year 2008. We conducted this audit as part of our audit of the state's compliance with federal program requirements. We emphasize that this has not been a comprehensive audit of the Department of Education.

We discussed the results of the audit with department staff at an exit conference on March 16, 2009. This audit was conducted by David Polisenio, CPA, CISA, CFE (Audit Manager) and Tim Rekow, CPA (Auditor-in-Charge), assisted by auditors Lat Anantaphong, Eric Krenz, Jennifer Nevers, CPA, Kathy Rootham, and David Westlund, CPA.

This report is intended for the information and use 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 26, 2009.

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

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Department of Education generally complied with and had controls to ensure compliance with provisions of laws, regulations, contracts, and grants applicable to the federal programs we audited for fiscal year 2008. However, the department had several weaknesses as noted in the five findings presented in this report.

Key Findings

- The Department of Education did not identify, analyze, and document their internal controls over compliance with federal single audit requirements. ([Finding 1, page 7](#))
- The Department of Education did not have adequate controls to ensure that it accurately calculated and received reimbursement for its share of indirect costs from the federal government. ([Finding 2, page 8](#))

Audit Scope

Programs material to the State of Minnesota's federal program compliance for fiscal year 2008.

Selected Audit Areas:

- Child Nutrition Cluster¹ (CFDA 10.553, 10.555, 10.556, and 10.559).
- Child and Adult Care Food (CFDA 10.558)
- Title 1 – Grants to Local Education Agencies (CFDA 84.010)
- Special Education Cluster (CFDA 84.027 and 84.173)
- Improving Teacher Quality State Grants (CFDA 84.367)

¹ A cluster of programs is a group of closely related programs that have similar compliance requirements and are treated as a single program.

Department of Education

Federal Program Overview

The Department of Education administered federal programs that we considered major federal programs for the State of Minnesota, subject to audit under the federal Single Audit Act.² Table 1 identifies these major federal programs.

Table 1
Major Federal Programs
Administered by the Department of Education
Fiscal Year 2008

| <u>CFDA¹</u> | <u>Program Name</u> | <u>Expenditures</u> |
|-------------------------|---|---------------------|
| | <u>Child Nutrition Cluster:²</u> | |
| 10.553 | School Breakfast | \$ 25,343,145 |
| 10.555 | National School Lunch | 105,838,267 |
| 10.556 | Special Milk Program for Children | 843,848 |
| 10.559 | Summer Food Service Program for Children | <u>2,870,160</u> |
| | Total Child Nutrition Cluster | \$134,895,420 |
| 10.558 | Child and Adult Care Food | \$ 57,327,783 |
| 84.010 | Title 1—Grants to Local Education Agencies | \$117,172,035 |
| | <u>Special Education Cluster:</u> | |
| 84.027 | Special Education State Grants | \$188,505,200 |
| 84.173 | Special Education Preschool Grants | <u>7,108,750</u> |
| | Total Special Education Cluster | \$195,613,950 |
| 84.367 | Improving Teacher Quality State Grants | \$ 35,731,443 |

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

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

Source: Minnesota Accounting and Procurement System.

² We defined a major federal program for the State of Minnesota in accordance with a formula prescribed by the federal Office of Management and Budget as a program or cluster of programs whose expenditures for fiscal year 2008 exceeded \$23.8 million.

Objectives, Scope, and Methodology

The objective of our audit was to determine whether the Department of Education complied with federal program requirements in its administration of these federal programs for fiscal year 2008. This audit is part of our broader federal single audit 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 federal programs.³ In addition to specific program requirements, we examined the department's general compliance requirements related to federal assistance, including its cash management practices.

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

Conclusions

The Department of Education generally complied with and had controls to ensure compliance with certain provisions of laws, regulations, contracts, and grants applicable to its major federal programs for fiscal year 2008. However, the department had some weaknesses, as noted in the following *Findings and Recommendations* section.

We have reported these weaknesses to the federal government in the *Minnesota Financial and Compliance Report of Federally Assisted Programs*, prepared by the Department of Finance.⁴ This report provides the federal government with

³ The State of Minnesota's single audit is an entity audit of the state that includes both the financial statements and the expenditures of federal awards by all state agencies. We issued an unqualified audit opinion, dated December 9, 2008, on the State of Minnesota's basic financial statements for the year ended June 30, 2008. In accordance with *Government Auditing Standards*, we also issued our report, dated December 9, 2008, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. (Office of the Legislative Auditor's Financial Audit Division Report 09-03, *Report on Internal Control Over Financial Reporting*, issued February 13, 2009.) This report included control deficiencies related to the Department of Education.

⁴ Effective June 2008 the Legislature reorganized the Department of Finance to include the duties of the Department of Employee Relations. Although still identified in statute as the Department of Finance, in October 2008, the department changed its name to Minnesota Management and Budget. The department will seek legislative approval for the name change in the 2009 legislative session.

information about the state's use of federal funds and its compliance with federal program requirements. The report includes the results of our audit work, conclusions on the state's internal controls over and compliance with federal programs, and findings about control and compliance weaknesses.

Findings and Recommendations

The Department of Education did not identify, analyze, and document their internal controls over compliance with federal single audit requirements.

Finding 1

The department did not have a comprehensive risk assessment pertaining to its internal controls over compliance with federal single audit requirements. The department has an increased likelihood of a control deficiency if it does not clearly communicate to all staff its risk, control activity, and monitoring policies and procedures.

State policy details that each agency head has the responsibility to identify, analyze, and manage business risks that impact an entity's ability to maintain its financial strength and the overall quality of its products and government services.⁵ This policy also requires communication of the internal control policies and procedures to all staff so they understand what is expected of them and the scope of their freedom to act. The policy further requires follow-up procedures that, at a minimum, should include mechanisms for monitoring results and reporting significant control deficiencies to individuals responsible for the process or activity involved, including executive management and those individuals in a position to take corrective action. A new audit standard⁶ reinforced management's responsibility to have effective internal controls over its financial operations. The federal government expects that those controls also ensure compliance with federal program requirements.

The Department of Education is aware of certain risks, has many control activities in place, and performs selected internal control monitoring functions. However, the department has not comprehensively identified and analyzed the risks, designed its controls to address significant risks, or developed monitoring procedures to ensure the controls are in place and are effective to reduce the significant risks identified.

Findings 2 through 5 identify deficiencies in the department's internal control procedures and specific noncompliance with federal requirements which were not prevented or detected by the department's internal control structure. These deficiencies created an unacceptable risk of noncompliance or did not prevent or detect the noncompliance. It is likely that the department will continue to have noncompliance and weaknesses in internal controls over compliance until it operates within a comprehensive internal control structure.

⁵ Department of Finance Policy Number 0102-01.

⁶ Statement on Auditing Standards #109.

Recommendation

- *The department should frequently review and clearly document its risks, control activities, and internal control monitoring functions for federal program requirements.*

Finding 2

The Department of Education did not have adequate controls to ensure that it accurately calculated and received reimbursement for its share of indirect costs from the federal government.

The department lacked adequate controls to ensure indirect cost rate calculations were accurate and in compliance with federal guidelines.⁷ In addition, the department did not collect indirect cost reimbursements in a timely manner according to state policy.⁸ In fiscal year 2008, the department received about \$3.4 million in indirect cost reimbursements from the U.S. Department of Education at the approved rate of 15.8 percent. As a result, the department had the following weaknesses with its administering of indirect costs:

- Our analysis as of January, 2009 showed the department may have erroneously included as much as \$2.6 million of unallowable contract costs and erroneously excluded \$175,000 of equipment purchases from its calculation of the federal indirect cost rate. These two errors may have resulted in the department understating the indirect cost rate by about one percent and shorting the state's federal reimbursement amount by about \$215,000.
- During the audit, the department could not provide us with support or explain why it excluded \$7.2 million from its determination of the indirect cost rate. Since the end of our fieldwork, the department reconstructed support for the excluded amount. However, because the department did not provide us with this critical information in a timely manner, we did not have an opportunity to audit it. If the exclusion of the amount was not appropriate, it would have impacted the indirect cost rate calculation.
- The department applied the indirect costs rate to an inaccurate amount of direct program costs to determine the amount of reimbursement from the federal government. As of August 2008, the department overstated its direct costs by about \$446,000, resulting in a \$72,000 over-reimbursement of indirect costs from the federal government.
- The department did not collect all indirect cost reimbursements for its federal programs within 30 days after the end of each quarter, as required

⁷ OMB Circular No. A-87 and OMB Circular No. A-133.

⁸ Department of Finance Policy Number 0304-02.

by state policy. Although the department calculated the amount of the indirect cost reimbursement claim each quarter, it sometimes delayed the actual reimbursement claim until the next quarter. As an example, for the quarter ending March 31, 2008, the department did not collect about \$81,000 in federal reimbursement in a timely manner. The department received the indirect cost reimbursement in the next quarter. By delaying reimbursement, the department risks that funds will not be available to cover indirect costs when processing future reimbursements.

Recommendations

- *The department should work with the federal government to resolve the question cost of \$72,000.*
- *The department should strengthen its internal controls over its indirect cost process to ensure it:*
 - *Properly includes or excludes direct costs when developing its indirect cost rates and requesting federal reimbursement.*
 - *Maintains supporting documentation related to key processes and decisions.*
 - *Complies with the Department of Finance policy for timely reimbursement of indirect costs from the federal government.*

The Department of Education did not retain supporting documentation for some of its Title 1- Grants to Local Education Agencies (CFDA 84.010) payment transactions.

Finding 3

The department did not retain documentation to support its February 2008 Title 1 grant expenditures of \$9,723,508 to the school districts. Federal regulations require states to maintain documentation for payments for three years.⁹ Without this documentation, the department could not support its February 2008 Title 1 payments.

Recommendation

- *The department should improve internal controls to ensure the retention of documentation supporting its financial transactions.*

⁹ General Education Provision Act and the Education Department General Administration Regulations.

Finding 4

The Department of Education did not comply with federal subrecipient monitoring requirements for certain federal programs.

The department did not provide federal award information or notification of applicable compliance requirements when awarding funds for the Title 1 - Grants to Local Education Agencies Program (CFDA 84.010), and Improving Teacher Quality State Grants Program (CFDA 84.367). Federal regulations require pass-through entities, such as the Department of Education, to communicate specific award information to subrecipients.¹⁰ Required information includes the Catalog of Federal Domestic Assistance (CFDA) title and number, award name, name of federal agency providing funds, and applicable compliance requirements. By not disclosing all required information, subrecipients may not be aware that they are receiving federal funds, which are subject to specific federal compliance requirements.

Recommendation

- *The department should provide federal award information and applicable compliance requirements when awarding federal funds to subrecipients.*

Finding 5

The Department of Education did not require all federally funded professional and technical contracts to include a certification that prohibited using suspended or debarred vendors.

The department's professional and technical contracts did not always include a certification that the vendor was not federally suspended or debarred. (Vendors are suspended or debarred when the federal government determines that they have abused the public trust, perhaps by violating program provisions). Federal requirements prohibit state agencies from awarding contracts of more than \$25,000 to applicants that are debarred or suspended.¹¹ The department included this prohibition in its contracts exceeding \$50,000, but did not have it in its agreements for contracts between \$25,000 and \$50,000.

Recommendation

- *The department should comply with federal requirements by verifying debarment and suspension for all federally funded contracts exceeding \$25,000.*

¹⁰ OMB Circular No. A-133.

¹¹ OMB Circular No. A-102, OMB Circular No. A-110, and OMB Circular No. A-133.



March 19, 2009

James Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155-1063

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings included in the audit for fiscal year ending on June 30, 2008. You will find below the response to each finding.

Finding 1 “The Department of Education did not identify, analyze, and document their internal controls over compliance with federal audit single audit requirements.”

- *Recommendation: “The department should frequently review and clearly document its risks, control activities, and internal control monitoring functions for federal program requirements.”*

As outlined in our response to the OLA dated February 6, 2009, the Minnesota Department of Education (“Department”) will complete a risk assessment process and identify policies to document all controls. We will use the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and Governance Institute COBIT frameworks and direction provided by Minnesota Management and Budget as our guide through this process. It is expected that this entire process will take two years to complete with our tentative schedule included below. Tammy McGlone and Al Louismet are responsible for resolving Finding #1.

Deadlines for resolving Finding #1:

June 30, 2009: Completion of framework for the risk assessment

September 30, 2009: Completion of the risk assessments for all agency programs.

December 31, 2009: Evaluation of the risk assessment findings and identification of risk.

December 31, 2010: Completion of all policy revisions including documentation of internal controls.

Finding 2 “The Department of Education did not have adequate controls to ensure that it accurately calculated and received reimbursement for its share of indirect costs from the federal government.”

- *Recommendation – “The department should work with the federal government to resolve the question cost of \$72,000.”*
- *“The department should strengthen its internal controls over its indirect cost process to ensure it:*
 - *Properly includes or excludes direct cost when developing its indirect cost rates and requesting federal reimbursement.*
 - *Maintain supporting documentation related to key processes and decisions.*
 - *Complies with the Department of Finance policy for timely reimbursement of indirect costs from the federal government.”*

The Department has implemented a new process for indirect cost plan billing as a result of recommendations from an on-site visit from the U.S. Department of Education (USDE) in 2007. The Department continues to receive clarification on issues and is documenting those communications to have a complete record of all direction from USDE.

The Department does not agree that it did not have proper documentation for the 2008 plan. The documentation was provided to the auditor, but it was presented late in the audit process. Unfortunately, the appropriate Department staff was not aware the auditor was waiting for this information or it would have been provided in a timely manner.

The Department agrees that the FY 2008 billings were not timely for a specific reason. The final billing for FY 2008 and first two quarters of FY 2009 were held intentionally to be sure the Department would be able to address all of the issues identified in the approval process for the FY 2009 plan. The 2009 plan was sent to USDE in February 2008. The 2009 plan was completed using all the assumptions and direction received from the USDE site visit. Because it was the first plan done incorporating the new guidance, it was important to be sure all the assumptions and documentation were reviewed and accepted by USDE before closing out the 2008 billing process. It was not anticipated that we would not have the 2009 plan approved by USDE until January 31, 2009.

The Department is not in full agreement with the auditors on the amount of unallowable contract costs as detailed in the auditor’s query provided to the department. In the auditor’s query, there is a negative number that the Department has not been able to identify specific transactions for or relate to specific contracts yet. Part of the difference between the auditor calculation and the departments is staff augmentation contracts. The auditor includes them in the query to apply the \$25,000 professional technical services contract cap on qualified expense. The Department did not exclude them. We have confirmed with USDE that staff contracts (which the department did not include in its

plan as exclusions) are treated as staff or operational services for the purpose of indirect cost application. This means that the entire expenditure for professional technical services staff augmentation should not have been included in the auditor's worksheet.

The Department does agree there was an inaccurate interpretation by department staff previously responsible for the plan development and invoice process on contract allocation for addressing the \$25,000 cap on indirect costs. The \$25,000 being applied to all funding sources per contract per year was inaccurate. Also, applying the \$25,000 each year for multi-year contracts was incorrect as well. We have received direction on this through communication with USDE and our final billing for FY 2008 takes into account the corrections for this error. We have also confirmed the appropriate method for allocation of the contract cap and the inclusion of this cap to general fund contracts in the direct cost development of the plan.

It should be noted that the Department was not and will not be reimbursed less than its entitlement. There is a process required in plan preparation that calculates, based on final expenditures, the over/under factor plan calculation for the plan. We will be able to assure the correct number is included when the 2010 plan is submitted.

As previously mentioned, the Department did provide the supporting documentation for the plan submission to the auditor's but not in a timely manner. We significantly differ on the amount that could not be identified in the tables and supplemental MAPS reports. The amount the Department has identified supported in the plan documentation leaves only \$12,129 that is not identified within the plan documentation and supporting MAPS reports. Tammy McGlone and Al Louismet are responsible for resolving Finding #2.

Finding 3 “The Department of Education did not retain supporting documentation for some of its Title 1 – Grant to Local Education Agencies (CFDA 84010) payment transactions.”

- *Recommendation – “The department should improve internal controls to ensure the retention of documentation supporting its financial transaction.”*

The Department has reviewed this issue and discovered that the February 2008 Title I payment detail report was not properly saved and archived as a result an employee error. As a result of that error, the Information Technology Division (IT) implemented an auto save process so that employees do not have to do anything to save a file. It is automatically generated to the saved location and then backed up in case future retrieval is necessary. In researching the issue in this finding, Department management staff looked at the risk potential for the missing documentation. We observed this as a one time occurrence, confirmed by reviewing information on the archives. We also reviewed final closing information to determine if it was possible that incorrect payments may have been made in the February 2008 payment batch and did not discover any incorrect payment amounts. Tammy McGlone and Al Louismet are responsible for resolving Finding #3.

Finding 4 “The Department of Education did not comply with federal sub recipient monitoring requirements for certain federal programs.”

- *Recommendation – “The department should provide federal award information and applicable compliance requirements when awarding federal funds to sub recipients.”*

The Department agrees that for the Title I, CFDA 84.010 and Improving Teacher Quality State Grants Program, CFDA 84.367 systems, the assurances are not recognizable in the grant management system processing these grants. The Department found that in all of our other grant forms we have electronic documents that identify in the assurance sections the requirements of OMB Circular A-133. This can only be explained as an oversight and not an intended omission. In addition, the Department has several documents on training for sub-grantees that clearly document the requirements for compliance. The Department has verified that all school districts receive the information.

Elizabeth Stephens is responsible for resolving Finding #4.

Finding 5 “The Department of Education did not require all federally funded professional and technical contracts to include a certification that prohibited using suspended or debarred vendors.”

- *Recommendation – “The department should comply with federal requirements verifying debarment and suspension for all federally funded contracts exceeding \$25,000.”*

The Department agrees with this finding and is immediately implementing this recommendation. The Department will add the standard suspension and debarment to all of our contract documents, not just those required over \$50,000. This finding should be fully implemented and communicated to all contract processing staff by March 31, 2009. Elizabeth Stephens is responsible for resolving Finding #5. In addition, the Department will contact the Minnesota Department of Administration and request that they provide clearer direction to state agencies regarding this issue.

I appreciate the opportunity to respond to the findings on behalf of the Department. Please contact Tammy McGlone, Director, Administrative Services Division, at 651-582-8835, if you have any questions.

Sincerely,



Alice Seagren
Commissioner