



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

**Department of
Education**

Federal Compliance Audit

Year Ended June 30, 2013

March 21, 2014

Report 14-09

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

March 21, 2014

Senator Roger Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Dr. Brenda Cassellius, Commissioner
Minnesota Department of Education

This report presents the results of our audit of certain federal financial assistance programs administered by the Minnesota Department of Education during fiscal year 2013. We conducted this audit as part of our audit of the state's compliance with federal program requirements. We emphasize that this has not been a comprehensive audit of the Minnesota Department of Education.

We discussed the results of the audit with department staff at an exit conference on March 12, 2014. This audit was conducted by Scott Tjomslund, CPA, CISA (Audit Manager) and Susan Kachelmeyer, CPA, CISA (Auditor-in-Charge), assisted by auditors Scott Dunning, Sandy Ludwig, Natalie Mehlhorn, Tracia Polden, Pat Ryan, and Abdul Suleyman, CPA.

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

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Minnesota Department of Education generally complied with and had controls to ensure compliance with certain legal requirements applicable to its major federal programs for fiscal year 2013. However, the department had some internal control weaknesses and noncompliance with federal requirements, as noted in the three findings presented in this report, including two unresolved findings from the prior audit.¹

Audit Findings

- The Minnesota Department of Education did not identify and analyze its risks related to noncompliance with federal requirements. This is a repeat finding. ([Finding 1, page 7](#))
- The Minnesota Department of Education did not comply with federal standards for payroll cost allocations to federal programs. A portion of this is a repeat finding. ([Finding 2, page 8](#))
- The Minnesota Department of Education did not comply with the reporting requirements of the Federal Funding Accountability and Transparency Act. ([Finding 3, page 10](#))

Audit Scope

Programs material to the State of Minnesota's federal program compliance for fiscal year 2013:

<u>Program Title</u>	<u>CFDA</u> ²
Child Nutrition Cluster ³	10.553, 10.555, 10.556, and 10.559
Child and Adult Care Food	10.558
Title I – Grants to Local Education Agencies	84.010
Special Education Cluster ³	84.027 and 84.173
Improving Teacher Quality State Grants	84.367

¹ Office of the Legislative Auditor's Financial Audit Division Report 13-14, *Minnesota Department of Education*, issued June 28, 2013.

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

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

Department of Education

Federal Program Overview

The Minnesota Department of Education administered federal programs that we considered major federal programs for the State of Minnesota, subject to audit under the federal Single Audit Act.⁴ Table 1 identifies these major federal programs. Appendix A, on page 11, provides the federal award numbers associated with these programs.

Table 1
Major Federal Programs
Administered by the Minnesota Department of Education
Fiscal Year 2013

<u>CFDA</u> ¹	<u>Program Name</u>	<u>Expenditures</u>
	<u>Child Nutrition Cluster:</u> ²	
10.553	School Breakfast	\$ 39,563,686
10.555	National School Lunch	173,573,918
10.556	Special Milk Program for Children	750,927
10.559	Summer Food Service Program for Children	<u>6,591,893</u>
	Total Child Nutrition Cluster	<u>\$220,480,424</u>
10.558	Child and Adult Care Food	\$ 63,497,802
84.010	Title I Grants to Local Education Agencies	\$154,494,712
	<u>Special Education Cluster:</u> ²	
84.027	Special Education – Grants to States	\$175,173,389
84.173	Special Education – Preschool Grants	<u>7,152,048</u>
	Total Special Education Cluster	<u>\$182,325,437</u>
84.367	Improving Teacher Quality State Grants	\$ 38,564,519

¹The Catalog of Federal Domestic Assistance (CFDA) includes unique numbers 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 are treated as a single program for audit purposes.

Source: State of Minnesota's accounting system.

The programs in the Child Nutrition Cluster provide funding to local education agencies and child-care institutions for meals served to children in need. The Child and Adult Care Food program provides funding to child care centers, adult day care centers, outside-school-hours care centers, at-risk afterschool programs, family and group day care homes, and emergency shelters for meals served to

⁴ We defined a major federal program for the State of Minnesota in accordance with a formula prescribed by the federal Office of Management and Budget as a program or cluster of programs whose expenditures for fiscal year 2013 exceeded \$30 million.

individuals in need. Title 1 Grants provide funding to local educational agencies based on the number of children from low-income families, while the programs in the Special Education Cluster provide funding to local educational agencies to assist them in providing special education and related services to children with disabilities. Finally, Improving Teacher Quality grants provide funding to local educational agencies to improve teacher and principal quality through professional development and other activities. While the department retains a portion of the federal funds to pay for the costs of administering these programs, it passes nearly 97 percent of the federal funds on to other entities, primarily school districts. The federal government requires those entities to have annual audits of their compliance with the federal program requirements. The Department of Education reviews those reports to monitor subrecipient compliance.

Objective, Scope, and Methodology

The objective of our audit was to determine whether the Minnesota Department of Education complied with federal program requirements in its administration of these federal programs for fiscal year 2013. This audit is part of our broader federal single audit designed to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its federal programs.⁵ In addition to specific program requirements, we examined the department's general compliance requirements related to federal assistance, including its cash management practices. We also followed up on findings and recommendations reported to the department's management in our previous audit.⁶

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

⁵ The State of Minnesota's single audit is an entity audit of the state that includes both the financial statements and the expenditures of federal awards by all state agencies. We issued an unqualified audit opinion, dated December 18, 2013, on the State of Minnesota's basic financial statements for the year ended June 30, 2013. In accordance with *Government Auditing Standards*, we also issued our report on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. (Office of the Legislative Auditor's Financial Audit Division Report 14-04, *Report on Internal Control Over Statewide Financial Reporting*, issued February 14, 2014.) This report included control deficiencies related to the Minnesota Department of Education.

⁶ Office of the Legislative Auditor's Financial Audit Division Report 13-14, *Minnesota Department of Education*, issued June 28, 2013.

Conclusion

The Minnesota Department of Education generally complied with and had controls to ensure compliance with certain legal requirements applicable to its major federal programs for fiscal year 2013. However, the department had some internal control weaknesses and noncompliance with federal requirements, as noted in the three findings presented in this report, including two unresolved findings from the prior audit.⁷

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

⁷ Office of the Legislative Auditor's Financial Audit Division Report 13-14, *Minnesota Department of Education*, issued June 28, 2013.

Findings and Recommendations

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

Finding 1

The department did not make sufficient progress to implement a comprehensive internal control structure for fiscal year 2013.⁸ It developed a plan to identify and assess risks related to noncompliance with federal requirements for its major federal programs; however, it had not identified and assessed those risks or documented internal controls designed to limit those risks. In response to this finding in our fiscal year 2012 report, the department stated that it would complete its risk assessment and internal control review by June 30, 2014. Since we first reported this deficiency for fiscal year 2008, the department has repeatedly missed their initial and revised target implementation dates.⁹

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

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

⁸ This finding affects all major federal programs identified in Table 1. See Appendix A (on page 11 of this report) for the federal award numbers for these programs.

⁹ Office of the Legislative Auditor, Financial Audit Division Report 09-08, *Department of Education*, issued March 26, 2009.

analysis of risks relevant to achievement of its objectives, forming a basis for determining how the risk should be managed.”

In addition to the federal requirements, the state’s internal controls policy states, “An effective system of internal controls will increase the state’s operational effectiveness and efficiency, safeguard public funds, ensure compliance with state and federal laws, rules, and regulations, and minimize instances of fraud, waste, and abuse.”¹⁰ The policy requires the department to use the *Internal Control-Integrated Framework* as its standard model for organizing, documenting, and discussing internal controls.

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

Recommendation

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

Finding 2

The Minnesota Department of Education did not comply with federal standards for payroll cost allocations to federal programs. A portion of this is a repeat finding.¹¹

The department did not have sufficient controls to ensure that it complied with federal standards for payroll cost allocations to federal programs.¹² In fiscal year 2013, the department allocated payroll costs, totaling about \$18.6 million, to its federal program funds; about \$9.5 million of that amount was allocated to the major federal programs included in our audit.

¹⁰ The Department of Management and Budget’s Statewide Operating Policy 0102-01, *Internal Controls*.

¹¹ Office of the Legislative Auditor’s Financial Audit Division Report 13-14, *Minnesota Department of Education*, issued June 28, 2013.

¹² This finding affects all major federal programs identified in Table 1. See Appendix A (on page 11 of this report) for the federal award numbers for these programs.

The department had the following instances of noncompliance:

- The department did not create and retain the required documentation for some employees' payroll costs charged directly to federal programs. The department did not have certifications or some personnel activity reports for 14 of the 38 employees we tested. Specifically, the department did not have certifications for five employees who worked on a single federal program, did not have any personnel activity reports for four employees who split their time between two or more federal or state programs, and did not have personnel activity reports for some pay periods for five employees. This is a repeat finding.

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

- The department did not ensure that personnel activity reports matched the actual allocation of payroll costs to federal programs, as required by Office of Management and Budget Circular A-87, Attachment B, section 8.h.(5a), which states, "*Personnel activity reports. . . must reflect an after-the-fact distribution of the actual activity of each employee.*" We compared the hours reported by employees on the certifications and personnel activity reports available for 29 employees in our sample, to the state's accounting system showing the federal programs that paid for that work. For five (17 percent) of the employees we tested, there were discrepancies between payroll cost allocations on personnel activity reports for a single pay period and actual payroll cost allocations in the state's accounting system. Discrepancies for those five employees affected about \$2,200 in payroll costs allocated between both major and nonmajor federal programs.

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

- The department did not ensure that it equitably allocated the costs of fringe benefits to federal programs. Office of Management and Budget Circular A-87, Attachment B, section 8.d.(2) states, "*The cost of fringe benefits in the form of regular compensation paid to employees during*
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periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other similar benefits, are allowable if...the costs are equitably allocated to all related activities, including Federal awards. . .” Eight of the thirty-eight employees we tested did not have the costs of fringe benefits allocated to federal programs in the same proportion as regular hours worked. For these eight employees, we estimated that the department did not equitably allocate about \$15,000 of payroll costs between both major and nonmajor federal programs and state funds. Because the department did not have a process to ensure the equitable allocation of fringe benefits, it is likely that other inequitable allocations occurred.

Recommendation

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

Finding 3

The Minnesota Department of Education did not comply with the reporting requirements of the Federal Funding Accountability and Transparency Act.

The department did not establish a process to report information about recipients of subawards, as required by the Federal Funding Accountability and Transparency Act.^{13,14} Title 2, Part 170 of the Code of Federal Regulations states that an entity, “...must report each action that obligates \$25,000 or more in Federal funds...for a subaward to an entity...no later than the end of the month following the month in which the obligation was made.” The department did not report subaward information for any of the nearly 2,500 recipients of subawards exceeding \$25,000 in fiscal year 2013; in total, the department provided these subaward recipients with more than \$575 million from its major federal programs.

Recommendation

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

¹³ The Federal Funding Accountability and Transparency Act of 2006 (Public Law 109-282) requires the federal Office of Management and Budget to maintain a single, searchable Web site (<http://www.usaspending.gov/>) that contains information on all federal recipient spending awards.

¹⁴ This finding affects all major federal programs identified in Table 1. See Appendix A (on page 11 of this report) for the federal award numbers for these programs.

**Appendix A
Major Federal Programs
Minnesota Department of Education
Fiscal Year 2013**

<u>CFDA</u> ¹	<u>Program Name</u>	<u>Federal Award Number</u>
	<u>Child Nutrition Cluster:</u> ²	
10.553	School Breakfast	2MN300061
10.555	National School Lunch	Same as above
10.556	Special Milk Program for Children	Same as above
10.559	Summer Food Service Program for Children	Same as above
10.558	Child and Adult Care Food	2MN300061, 2MN300066
84.010	Title 1 Grants to Local Education Agencies	S010A110023, S010A120023
	<u>Special Education Cluster:</u> ²	
84.027	Special Education – Grants to States	H027A110087, H027A120087
84.173	Special Education – Preschool Grants	H173A110086, H173A120086
84.367	Improving Teacher Quality State Grants	S367A110022, S367A120022

¹The Catalog of Federal Domestic Assistance (CFDA) includes unique numbers 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.



March 14, 2014

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

Dear Mr. Nobles:

Thank you for your work on behalf of the citizens of the State of Minnesota and the opportunity to respond to the findings for the Minnesota Department of Education (MDE) which were included in the Federal Compliance Audit for the year ended June 30, 2013.

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

Audit Recommendation:

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

Agency Response:

MDE believes strongly in financial integrity and concurs with this finding. During this review period, the department continued its intensive agency-wide risk assessment efforts. We have completed the initial risk assessment phase of the major financial business processes. Based on the results of the risk assessments, the agency will identify the most significant risks and begin the internal control review and risk mitigation process for those areas with a goal for completion of December 31, 2014. In addition, a plan will be developed and implemented to ensure the on-going review of risks and internal controls.

Resolution of this finding is the responsibility of Denise Anderson, MDE Chief Financial Officer.

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

Audit Recommendation:

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

Agency Response:

MDE is in the final stages updating the department's administrative policy titled: Time Reporting, Time & Effort (PAR) and Semi-Annual Certification Reporting. The administrative policy includes policies and procedures for meeting the federal reporting requirements. MDE's goal is to demonstrate compliance with the time reporting requirements for FY14.

MDE employees are expected to meet state and federal time reporting requirements for Personnel Activity Reporting, Semi-Annual certification and Fringe Benefit Allocation. Training and assistance will be provided via cross-divisional collaboration to MDE staff, supervisors and leadership. Tools will be made available to facilitate consistent implementation and ensure compliance. Training and assistance will cover time reporting policies generally, but will specifically touch on semi-annual certification, Personnel Activity Reports (PAR), and Equitable allocation of fringe benefits.

Resolution of this finding is the responsibility of Denise Anderson, MDE Chief Financial Officer.

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

Audit Recommendation:

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

Agency Response:

MDE's Agency Finance Unit will identify all current and future federal awards subject to FFATA reporting. For each award subject to reporting, an individual in the agency will be assigned responsibility for reporting in FSRS.gov. Agency Finance will provide training and technical assistance for those programs with a goal to complete the reporting requirements for FY14.

Mr. James R. Nobles, Legislative Auditor
March 14, 2014
Page 3 of 3

Resolution of this finding is the responsibility of Denise Anderson, MDE Chief Financial Officer.

Again, thank you for the opportunity to respond to your findings and recommendations. We appreciate the professional and helpful manner of the staff from your office. Please contact Denise Anderson at 651-582-8560 if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "Brenda Cassellius". The signature is written in a cursive, flowing style.

Dr. Brenda Cassellius
Commissioner

cc: Denise Anderson, MDE CFO