



Auditing for a Better Oregon

February 3, 2005

Susan Castillo, Superintendent of Public Instruction
Department of Education
255 Capitol Street NE
Salem, Oregon 97310

Dear Ms. Castillo:

The statewide single audit that included selected financial accounts and federal awards at the Department of Education (department) for the year ended June 30, 2004, has been completed.

This statewide single audit work is not a comprehensive audit of your agency. Instead, this audit permits us to give an opinion on the statewide financial statements contained in the State of Oregon's Comprehensive Annual Financial Report and to report on internal control and the state's compliance with laws and regulations. Regular audits of the department will continue on a periodic basis.

The following department accounts and transactions were audited to determine their fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements.

<u>SFMA Account</u>	<u>Description</u>	<u>Audit Amount</u>
<u>Special Revenue Fund</u>		
6600	Distribution to Local School Districts	\$2,764,402,780
1303	Transfer In from General Fund	\$2,435,681,942
<u>General Fund</u>		
6200	Intraagency General Fund/Other Fund Transfer	\$2,435,681,942
<u>Government-Wide Fund</u>		
1714	Bonds Payable (Noncurrent)	\$218,261,675
0852	Buildings and Building Improvements	\$6,495,644

Management Letter No. 581-2005-02-01

We also determined whether the department substantially complied with the federal requirements relevant to the following federal program.

<u>CFDA Number</u>	<u>Program Name</u>	<u>Audit Amount</u>
84.367	Improving Teacher Quality State Grants	\$21,293,230

Based on our audit, we identified one reportable condition and four other conditions needing corrective action. Our findings and recommendations are presented in the enclosed Audit Findings and Recommendations Summary accompanying this letter.

The reportable condition, along with your response, will be included in our statewide audit report. Including your response with responses from other state agencies satisfies the federal requirement that management prepare a Corrective Action Plan (CAP) covering all reported audit findings. Satisfying the federal requirement in this manner, however, can only be accomplished if the response to the reportable finding includes the information specified by the federal requirement, and only if the response is received in time to be included in the audit report. The following information is required for the response.

1. Your agreement or disagreement with the finding. If you do not agree with the audit finding or believe corrective action is not required, include in your response an explanation and specific reasons for your position.
2. The corrective action planned.
3. The anticipated completion date.
4. The name(s) of the contact person(s) responsible for corrective action.

The other conditions are issues of lesser significance that we wanted to communicate to agency management. These conditions do not require a Corrective Action Plan. We will follow up on the department's progress in addressing these issues during the next fiscal year audit.

For the reportable condition, please respond by February 11, 2005.

Should you have any questions, please contact Janice Caley at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Mary E. Wenger, CPA
Deputy State Auditor

MEW:bk

cc: Bret West, Director, Finance and Administration
Jim Scott, Internal Auditor
Laurie Warner, Acting Director, Department of Administrative Services

**Audit Findings and Recommendations Summary
Department of Education Statewide Audit
State Fiscal Year 2004**

REPORTABLE CONDITION

Maintaining Level of Effort

During our review of the Improving Teacher Quality State Grant, we found that the Department of Education (department) has not been monitoring Local Education Agencies (LEA) to ensure they maintain the proper fiscal level of effort. The department reported expenditures of approximately \$21.2 million for this program during fiscal year 2004. The majority of these funds were disbursed to 178 LEAs. The department manager in charge of this program indicated she was not aware this requirement was applicable to this specific program.

Office of Management and Budget (OMB) Circular A-133 requires the department to reduce the amount of the allocation of federal funds in the same proportion by which the LEA falls below the required level of effort. Without a monitoring function in place, the department is unable to determine whether a reduction of funds is necessary.

We recommend the department comply with the federal requirement and monitor LEAs to ensure that the proper level of effort is maintained.

OTHER CONDITIONS

User Access Review

The department does not have a process in place to periodically review access to the School Funding database. We found one employee who no longer had any responsibilities related to school finance, as of April 2004, who continues to have access to the database. When extra users have access to this system, there is an increased risk of inappropriate changes to school funding data. Erroneous or unauthorized activity could ultimately impact the amounts distributed to each school district.

We recommend the department develop a process to periodically review access to the School Funding database and ensure access is only given to appropriate users.

SFMA Reconciliations

State School Fund amounts apportioned per legislative mandates did not agree to amounts recorded in the accounting system (SFMA). Additionally, total federal expenditures reported in the Schedule of Expenditures of Federal Awards (SEFA) did not agree to SFMA.

We tested fiscal year 2004 payments to 46 LEAs and found that amounts paid per SFMA did not agree to amounts apportioned per legislative mandates for all 46 items. We requested the department reconcile 17 of the items that contained significant differences. The department was

able to materially explain the differences. The amounts recorded in SFMA should agree to the underlying supporting documentation. At a minimum, there should be a documented reconciliation between apportioned amounts and amounts actually disbursed as per SFMA to ensure that LEAs are paid the amounts mandated by the legislature. We also requested that the department reconcile fiscal year 2004 total federal expenditures it reported on the SEFA to amounts it recorded in SFMA. After several attempts, the department was able to materially reconcile the amounts. Without performing such reconciliations, errors may occur and fail to be detected.

We recommend the department regularly perform reconciliations between the amounts mandated by the legislature and payments made to the LEAs as recorded in SFMA. We also recommend the department reconcile federal expenditure amounts reported on the SEFA to SFMA.

Monitoring of Allowed Activities

The United States Department of Education (USDOE) allocates federal funds to the department, which are passed-through to the LEAs for the Improving Teacher Quality State Grant. The department provides these funds to the LEAs on a reimbursement basis for costs incurred on allowable program activities.

The department does not require the LEAs to submit supporting documentation when requesting reimbursement for program costs. Program managers indicated that they require each LEA to submit a *Consolidated Subgrant Application* at the beginning of each grant year, which includes a plan for activities to show how the LEA intends to spend the funds. However, the plan for activities only shows intent and does not provide assurance that the districts are actually spending the funds for allowed activities.

OMB Circular A-133 provides guidance on the types of allowed activities under this federal program. Furthermore, the USDOE provides non-regulatory guidance on the Improving Teacher Quality program, specifying activities for which a LEA may use the funds. In addition, best practices suggest that transactions should be supported by appropriate documentation. Such documentation should provide evidence of the authenticity of the transaction and the purpose or reason for the transaction. Valid documentation should support that the transaction actually occurred.

Program managers believe the current system of honoring reimbursement requests without supporting documentation is adequate to ensure districts are spending the Improving Teacher Quality funds on only allowed activities. However, without adequate supporting documentation or other monitoring, risk of misuse of funds is increased.

We recommend the department establish a mechanism to ensure the LEAs are using program funds as intended. At a minimum, this should include requiring the LEAs to provide a summary schedule showing how they used program funds during the reimbursement period in comparison to their intended use. The department should follow up on significant variances and request to see detailed supporting documentation when appropriate.

Subrecipient Monitoring

The department was assigned to be the audit agency for 150 subrecipients receiving federal funds. One of the requirements of the *Oregon Accounting Manual* (30.40.00.PR.109(g)) is that the audit agency should identify differences in amount or omission of grants on the subrecipient's Schedule of Expenditures of Federal Awards (SEFA) audit report by comparing it to the federal funds reported to the Statewide Accounting and Reporting Section (SARS), and determining the cause for material differences.

We tested 10 subrecipient audit reports and noted there were 117 out of 201 federal programs with unexplained material differences between the subrecipient audit report and amounts reported to SARS. We noted approximately \$13 million in material differences out of the \$101 million in federal expenditures that were reported to SARS. Department personnel stated that they do not investigate material differences due to the volume of audit reports they are required to review and the lack of personnel available to review them.

We recommend the department identify and document when material differences exist between the state's SEFA and the subrecipients' audit reports and determine the cause for the differences by communicating with the subrecipient as to the reasons for the discrepancies.