MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
INCLUDING THE PROVISIONS OF THE SINGLE AUDIT ACT
OF THE

DEPARTMENT OF EDUCATION

October 1, 2003 through September 30, 2005

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

31-100-06

"...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof."

– Article IV, Section 53 of the Michigan Constitution

Audit report information may be accessed at:
http://audgen.michigan.gov

Michigan

Office of the Auditor General

REPORT SUMMARY

Financial Audit

Including the Provisions of the Single Audit Act

Report Number:
31-100-06

Department of Education

October 1, 2003 through September 30, 2005

Released:
June 2006

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Schedules and Financial Statements:

Auditor's Reports Issued

We issued unqualified opinions on the Department's financial schedules and on the School Aid Fund's financial statements.

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Internal Control Over Financial Reporting

We identified reportable conditions related to internal control over financial reporting (Findings 1 and 2).

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Noncompliance or Other Matters Material to the Financial Schedules and/or Financial Statements

We did not identify any instances of noncompliance or other matters applicable to the financial schedules and/or financial statements that are required to be reported under *Government Auditing Standards*.

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 18 programs as major programs and issued 3 qualified and 15 unqualified opinions. The opinions issued by major program are identified on the back of this summary.

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Internal Control Over Major Programs

We identified reportable conditions related to internal control over major programs (Findings 3 through 9). We consider Findings 3 through 6 to be material weaknesses.

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Required Reporting of Noncompliance

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Findings 3 through 9).

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Systems of Accounting and Internal Control:
We determined that the Department was not in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws* (Finding 1).

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We audited the following programs as major programs:

CFDA Number	***Program or Cluster Title***	***Compliance Opinion***
10.550	Food Donation	Unqualified
10.553, 10.555, 10.556, and 10.559	Child Nutrition Cluster	Unqualified
10.558	Child and Adult Care Food Program	Unqualified
10.565	Commodity Supplemental Food Program	Unqualified
10.568 and10.569	Emergency Food Assistance Program Cluster	Unqualified
84.010	Title I Grants to Local Educational Agencies	Unqualified
84.011	Migrant Education - State Grant Program	Qualified
84.027 and 84.173	Special Education Cluster	Unqualified
84.181	Special Education - Grants for Infants and Families with Disabilities	Unqualified
84.213	Even Start - State Educational Agencies	Unqualified
84.282	Charter Schools	Qualified
84.287	Twenty-First Century Community Learning Centers	Unqualified
84.318	Education Technology State Grants	Unqualified
84.332	Comprehensive School Reform Demonstration	Unqualified
84.348	Title I Accountability Grants	Unqualified
84.352	School Renovation Grants	Unqualified
84.365	English Language Acquisition Grants	Qualified
84.369	Grants for State Assessments and Related Activities	Unqualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at:
http://audgen.michigan.gov

Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 30, 2006

Mr. Michael P. Flanagan
Superintendent of Public Instruction
John A. Hannah Building
Lansing, Michigan

Dear Mr. Flanagan:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Education for the period October 1, 2003 through September 30, 2005.

This report contains our report summary; our independent auditor's reports on the financial schedules and financial statements; and the Department of Education financial schedules, School Aid Fund financial statements, notes to the financial schedules and financial statements, required supplementary information, and schedule of expenditures of federal awards. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, this report contains the Department of Education's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section II and Section III of the schedule of findings and questioned costs. The agency preliminary responses are contained in the corrective action plan. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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INDEPENDENT AUDITOR'S REPORTS, FINANCIAL SCHEDULES, AND FINANCIAL STATEMENTS

STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Schedules

Mr. Michael P. Flanagan
Superintendent of Public Instruction
John A. Hannah Building
Lansing, Michigan

Dear Mr. Flanagan:

We have audited the accompanying financial schedules of the Department of Education for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

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 *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for the Department of Education's General Fund accounts, using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either the Department or the State's General Fund in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and other financing sources and the sources and disposition of authorizations of the Department of Education for the fiscal years ended September 30, 2005 and September 30, 2004 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2006 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General
March 24, 2006

STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Statements

Mr. Michael P. Flanagan
Superintendent of Public Instruction
John A. Hannah Building
Lansing, Michigan

Dear Mr. Flanagan:

We have audited the accompanying financial statements of the School Aid Fund, Department of Education, as of and for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents. These financial statements are the responsibility of the School Aid Fund's management and the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the School Aid Fund and do not purport to, and do not, present fairly the financial position of the State of Michigan or its governmental funds as of September 30, 2005 and September 30, 2004 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the School Aid Fund as of September 30, 2005 and September 30, 2004 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2006 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The budgetary comparison schedules and corresponding notes on pages 32 through 35 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Department's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General
March 24, 2006

DEPARTMENT OF EDUCATION
Schedule of General Fund Revenues and Other Financing Sources
Fiscal Years Ended September 30

	2005	2004
REVENUES		
From federal agencies (Note 1)	$ 52,608,807	$ 42,975,257
From local agencies	58,056	13,015
From licenses and permits	3,898,591	4,680,564
Miscellaneous	1,179,514	930,922
Total Revenues	$ 57,744,967	$ 48,599,758
OTHER FINANCING SOURCES		
Transfers from School Aid Fund	$ 0	$ 3,167,471
Total Other Financing Sources	$ 0	$ 3,167,471
Total Revenues and Other Financing Sources	$ 57,744,967	$ 51,767,229

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF EDUCATION
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30

	2005	2004
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations	$ 191,261,700	$ 406,859,700
Balances carried forward	3,410,514	3,453,140
Restricted financing sources	61,202,148	50,522,276
Less: Intrafund expenditure reimbursements	(4,535,370)	(896,140)
Total	$ 251,338,993	$ 459,938,975
DISPOSTION OF AUTHORIZATIONS (Note 2)		
Gross expenditures and transfers	$ 251,472,859	$ 454,668,558
Less: Intrafund expenditure reimbursements	(4,535,370)	(896,140)
Net expenditures and transfers	$ 246,937,489	$ 453,772,418
Balances carried forward:		
Encumbrances	$ 95,989	$ 1,768
Restricted revenues - not authorized	2,883,813	3,408,747
Total balances carried forward	$ 2,979,801	$ 3,410,514
Balances lapsed	$ 1,421,702	$ 2,756,043
Total	$ 251,338,993	$ 459,938,975

The accompanying notes are an integral part of the financial schedules.

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial schedules report the results of the governmental operations of the Department of Education for the fiscal years ended September 30, 2005 and September 30, 2004. The governmental operations of the Department are accounted for principally in the State's General Fund and are reported on in the *State of Michigan Comprehensive Annual Financial Report* (*SOMCAFR*). Department operations also include the School Aid Fund, a major governmental fund that is audited and reported on separately.

The notes accompanying these financial schedules relate directly to the Department of Education. The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; and pension benefits and other postemployment benefits.

b. Measurement Focus, Basis of Accounting, and Presentation

The financial schedules contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting, as provided by generally accepted accounting principles (GAAP) applicable to governments. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable.

The accompanying financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for the Department of Education's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a

complete financial presentation of either the Department or the State's General Fund in conformity with GAAP.

c. Revenues From Federal Agencies

For most federally funded programs, revenue is accrued in the same period as related obligations are recorded. In certain programs, financed entirely by the federal government, expenditures and related revenues are recognized only to the extent of billings received by fiscal year-end. This treatment understates assets and liabilities and expenditures and revenues; however, there is an immaterial impact on the fund balance of the State's General Fund.

Note 2 Schedule of Sources and Disposition of General Fund Authorizations

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenues.

b. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenues - authorized, and restricted revenues - not authorized that were not spent as of the end of the prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenues - not authorized.

c. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted intrafund expenditure reimbursements to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next fiscal year or carried forward to the next fiscal year as either restricted revenues - authorized or restricted revenues - not authorized.

d. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered in the old fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.

e. Restricted revenues - not authorized: Revenues that, by statute, are restricted for use to a particular program or activity. Generally, the expenditure of the restricted revenues is subject to annual legislative appropriation. Significant fiscal year 2004-05 and 2003-04 carry-forwards of this type were certification fees of $1,919,794 and $2,307,671, respectively.

f. Balances lapsed: Authorizations that were unexpended and unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

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SCHOOL AID FUND
Department of Education
Balance Sheet
As of September 30
(In Thousands)

	2005	2004
ASSETS		
Current Assets:		
Taxes, interest, and penalties receivable (Note 7)	$ 1,964,627	$ 1,820,188
Amounts due from other funds	10,579	9,883
Amounts due from component units	41,100	
Amounts due from federal agencies	48,073	59,335
Amounts due from local units	34,182	80,564
Other current assets		466
Total Current Assets	$ 2,098,562	$ 1,970,435
Noncurrent Assets:		
Taxes, interest, and penalties receivable	$ 47,435	$ 44,143
Amounts due from local units	3,554	1,125
Total Assets	$ 2,149,551	$ 2,015,703
LIABILITIES AND FUND BALANCE		
Current Liabilities:		
Warrants outstanding	$ 286	$ 1,228
Accounts payable and other liabilities	124,139	147,952
Amounts due to other funds (Note 6)	1,549,336	1,466,496
Deferred revenue	330,387	281,814
Total Current Liabilities	$ 2,004,148	$ 1,897,490
Long-Term Liabilities:		
Deferred revenue	$ 47,435	$ 44,143
Total Liabilities	$ 2,051,583	$ 1,941,634
Fund Balance:		
Reserved fund balance	$ 97,968	$ 74,070
Total Fund Balance	$ 97,968	$ 74,070
Total Liabilities and Fund Balance	$ 2,149,551	$ 2,015,703

The accompanying notes are an integral part of the financial statements.

SCHOOL AID FUND
Department of Education
Statement of Revenues, Expenditures, and Changes in Fund Balance
Fiscal Years Ended September 30
(In Thousands)

	2005	2004
REVENUES		
Taxes (Note 2):		
Sales	$ 4,805,749	$ 4,716,693
Personal income	1,985,493	1,893,357
Property	1,914,629	1,824,493
Use	467,711	439,091
Cigarette	472,681	485,154
Industrial facilities	138,244	150,159
Liquor	33,112	32,405
Commercial facilities (forest tax)	3,061	2,760
Casino gaming wagering	97,609	95,781
Real estate transfer	313,548	317,480
Other	10,497	13,086
Total Taxes	$ 10,242,334	$ 9,970,459
From federal agencies	1,321,710	1,256,727
Miscellaneous	62,455	11,122
Total Revenues	$ 11,626,499	$ 11,238,308
EXPENDITURES		
Proposal A (Note 2)	$ 6,643,729	$ 6,789,131
Discretionary payment	2,919,969	2,778,749
Special Education	869,745	838,440
At Risk Students	310,452	310,457
Intermediate school districts	77,702	87,488
Adult Education	20,000	19,953
School Readiness Grants	75,358	76,370
Vocational Education	38,821	39,000
School Lunch	20,124	19,592
Mathematics and Science Centers	2,500	2,496
Court-Placed Children	7,759	8,000
Gifted and Talented	250	250
Bilingual Education	2,800	2,800
Renaissance Zone	26,231	22,556
Non-Durant district settlements (Note 4)	31,687	31,687
Teen Health Centers	3,743	3,743
Federal non-special education	1,007,876	988,615
Federal special education	319,257	269,143
Court settlements (Note 5)	1,717	2,287
Other	13,513	8,138
Total Expenditures	$ 12,393,232	$ 12,298,895
Excess of Revenues Over (Under) Expenditures	$ (766,734)	$ (1,060,587)
OTHER FINANCING SOURCES (USES)		
Transfers from other funds	$ 831,722	$ 1,022,683
Transfers to other funds	(41,091)	(3,167)
Total Other Financing Sources (Uses)	$ 790,631	$ 1,019,516
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	$ 23,898	$ (41,071)
Fund Balance - Beginning of fiscal year	74,070	115,141
Fund Balance - End of fiscal year	$ 97,968	$ 74,070

The accompanying notes are an integral part of the financial statements.

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial statements report the financial position and the changes in financial position of the School Aid Fund, Department of Education, as of and for the fiscal years ended September 30, 2005 and September 30, 2004. The School Aid Fund is a part of the State of Michigan's reporting entity and is reported as a governmental fund in the *State of Michigan Comprehensive Annual Financial Report* (*SOMCAFR*).

The notes accompanying these financial statements relate directly to the School Aid Fund. The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; and common cash.

b. Measurement Focus, Basis of Accounting, and Presentation

The financial statements contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting as provided by generally accepted accounting principles (GAAP) applicable to governments. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable.

The accompanying financial statements present only the School Aid Fund. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position of the State of Michigan or its governmental funds in conformity with GAAP.

c. Amounts Due From Federal Agencies

For most federally funded programs, revenue is accrued in the same period as related obligations are recorded. In certain programs, financed entirely by the federal government, expenditures and related revenues are recognized only to the extent of billings received by fiscal year-end. This treatment understates assets and liabilities and expenditures and revenues; however, there is an immaterial impact on the fund balance of the School Aid Fund.

Note 2 Description of Fund

The School Aid Fund was created in 1955 by an amendment to the 1908 State Constitution, and its continued existence was provided for by the 1963 State Constitution. The School Aid Fund's purpose is to furnish aid to school districts of the State. Payments to school districts are based on statutory formulas.

The School Aid Fund receives State revenues restricted to school programs, including the constitutional dedication of 60% of the collections of sales tax imposed at a rate of 4% and all of the collections of sales tax imposed at the additional rate of 2%; State Lottery net revenue; approximately 33% of total State use tax revenue; and portions of the personal income, cigarette, liquor, industrial and commercial facilities, and casino gaming wagering taxes. In addition, in fiscal years 2004-05 and 2003-04, the Department received and expended the majority of federal grants through the School Aid Fund.

A constitutional amendment (known as "Proposal A") approved by voters in 1994 made significant structural changes in the method of financing school districts. This amendment authorized the levy of a Statewide education property tax and a real estate transfer tax, all of which is deposited in the School Aid Fund. Annual appropriated transfers also are made from the State's General Fund.

School Aid Fund appropriations are established annually by the Legislature. If total appropriations are less than the payments to be made based on the State School Aid Act of 1979, as amended, then total payments are to be prorated so that they equal the appropriated funding available. Proration was necessary in fiscal year 2003-04 and resulted in payment reduction of approximately $131.1 million.

Note 3 Contingencies

a. *Durant et al.* v *State of Michigan, et al.* and *Adair et al.* v *State of Michigan et al.*

On November 15, 2000, more than 365 Michigan school districts and individuals filed two suits in the Michigan Court of Appeals. The first suit, *Durant et al.* v *State of Michigan et al*. (Durant III), asserted that the current State School Aid Act of 1979 (Act 297, P.A. 2000) violated Article IX, Sections 25 - 34 of the State Constitution (the Headlee Amendment) because it allegedly transfers per pupil revenue guaranteed to school districts under Article IX, Section 11, for unrestricted school operating purposes, in order to satisfy the State's independent funding obligation to those school districts under Article IX, Section 29. The plaintiffs in Durant III requested a monetary remedy, including approximately $1.7 billion for school years 1999-2000 through 2002-03 for the State's alleged underfunding of special education programs and services, including special education transportation services. The Durant III plaintiffs also requested a declaratory judgment that the State, through Act 297, P.A. 2000, is violating Article IX, Section 11 and Article IX, Section 29 of the State Constitution. The Durant III plaintiffs further sought orders declaring that the State has failed, through Act 297, P.A. 2000, to meet its constitutional duty to fund services and activities provided by the plaintiff school districts during school years 1999-2000 through 2002-03 in the same proportion by which they were funded when the Headlee Amendment became effective, and that the State has reduced the State-financed proportion of necessary costs incurred by the plaintiff school districts for special education services for school years 1999-2000 through 2002-03 below that provided by the State when the Headlee Amendment became effective. The Durant III plaintiffs also sought an injunction permanently enjoining the State from making any future reductions below the levels of funding provided when the Headlee Amendment became effective to pay for the cost of the activities and services required of them by State law. They also requested attorneys' fees and costs of litigation.

On May 10, 2002, the Court of Appeals issued a decision in Durant III holding that Act 297 does not violate the State Constitution. On May 31, 2002, the Durant III plaintiffs filed a motion for reconsideration in the Court of Appeals, which was denied on July 17, 2002. On August 14, 2002, the

Durant III plaintiffs filed a delayed application for leave to appeal and a motion for immediate consideration of the delayed application for leave to appeal with the Michigan Supreme Court. On November 19, 2002, the Michigan Supreme Court issued an order denying the plaintiffs' application for leave to appeal. On February 28, 2003, the Michigan Supreme Court denied the plaintiffs' motion for reconsideration of that order. The Durant III case is closed.

The second suit, *Adair et al*. v *State of Michigan et al*. (Adair), asserts that the State, by operation of law, has increased the level of various specified activities and services beyond that which was required by State law as of December 23, 1978 and, after December 23, 1978, added various specified new activities or services by State law, including mandatory increases in student instruction time, without providing funding for these new activities and services, all in violation of the Headlee Amendment.

The Adair plaintiffs are seeking a declaratory judgment that the State has failed to meet its funding responsibility under the Headlee Amendment to provide the plaintiff school districts with revenues sufficient to pay for the necessary increased costs of activities and services first required by State law after December 23, 1978, and to pay for increases in the level of required activities and services beyond that which was required by State law as of December 23, 1978.

On April 23, 2002, the Court of Appeals dismissed the plaintiffs' complaint in Adair in its entirety and with prejudice. The Court held that all of the Adair plaintiffs were barred from prosecuting all but one of their claims by either the doctrine of res judicata or the principle of release. With regard to the remaining recordkeeping claim, the Court held that this is not a new activity or an increase in the level of a State-mandated activity within the meaning of the Headlee Amendment. The Adair plaintiffs filed an application for leave to appeal and a motion for immediate consideration of the application for leave to appeal with the Michigan Supreme Court on May 14, 2002.

The Michigan Supreme Court granted the Adair plaintiffs' application for leave to appeal and an oral argument was held. On June 9, 2004, the Michigan Supreme Court issued an opinion affirming the Court of Appeals'

decision that the majority of the Adair plaintiffs' claims were barred by res judicata or release. Regarding the recordkeeping claim, the Michigan Supreme Court reversed the Court of Appeals and remanded the issue to that Court. On August 4, 2005, the Court of Appeals granted the State's motion for summary disposition and dismissed the plaintiffs' remaining claim with prejudice. On September 14, 2005, the Adair plaintiffs filed an application for leave to appeal with the Michigan Supreme Court. The ultimate disposition of this legal proceeding and the potential liability to the State are not presently determinable.

b. State Education Tax - Personal Property Assessments

The Michigan Department of Treasury estimated that, as of September 30, 2005, there were potential tax tribunal decisions that could have resulted in additional school aid payments for prior years in the amount of $226.5 million. These decisions relate to the personal property tax table depreciation schedule. Because this is still a pending liability and was not due and payable at September 30, 2005, it was not recorded at the fund level under the modified accrual basis of accounting. However, the pending liability was probable and reasonably estimable and it was recorded in the *SOMCAFR* government-wide statements in accordance with GAAP as applicable to governments. These balances are also reflected in the financial table in Note 14 of the *SOMCAFR*.

In December 2005, Detroit Edison, Michigan Consolidated Gas Company, the Department of Treasury, and governmental representatives from Wayne, Oakland, Macomb, and Kent counties agreed to the terms of a global settlement. The settlement was presented to and approved by the Michigan Tax Tribunal. This settlement will result in additional school aid payments related to prior fiscal years. However, the Department of Treasury has not quantified the related effect on prior year school aid payments. These amounts will be reflected in the School Aid Fund financial statements as they become due and payable.

Note 4 Commitments

D*onald Durant, et al.* v *State of Michigan, et al.:* In an order dated June 10, 1997 and a decision rendered July 31, 1997, the Michigan Supreme Court decided, in the consolidated cases of *Durant* v *State of Michigan* and *Schmidt* v *State of Michigan*, that the special education, special education transportation,

bilingual education, driver training, and school lunch programs provided by local school districts are State-mandated programs within the meaning of Article IX, Section 29 of the State Constitution (part of the Headlee Amendment); therefore, the State is obligated to fund these programs at the levels established by the Headlee Amendment. In fashioning a remedy in this case of first impression under the Headlee Amendment, the Court concluded that, in future cases, the correct remedy will typically be limited to a declaratory judgment. However, because of the protracted nature of the *Durant* and *Schmidt* litigation, the Court ruled that the 84 plaintiff school districts should be compensated for the full amount of the underfunding without interest for the State-mandated programs during school years 1991-92, 1992-93, and 1993-94.

On November 19, 1997, the Governor signed legislation providing $212.0 million to the 84 plaintiff school districts to cover the underfunding for those three years. Most of the $212.0 million was paid to the plaintiff school districts on April 15, 1998, through the State School Aid Act of 1979, using funds transferred from the State's Counter-Cyclical Budget and Economic Stabilization Fund to the School Aid Fund. The board of education of each plaintiff school district determined the appropriate distribution of the award between taxpayer relief and/or use by the district for other public purposes. The Court affirmed the award to the plaintiffs of their costs, including attorney fees. Over 400 other school districts asserted claims similar to those asserted by the Durant plaintiffs.

In companion legislation signed by the Governor on November 19, 1997, the State will pay each "non-Durant" school district for its underfunded State-mandated program costs for those same three years if the district agreed by March 2, 1998 to waive any claim against the State of the same nature made by the 84 Durant plaintiffs through September 30, 1997. All of the non-Durant school districts signed waivers on or before March 2, 1998. The payments have been and will continue to be paid through the State School Aid Act of 1979, using funds transferred to the School Aid Fund from the Counter-Cyclical Budget and Economic Stabilization Fund and the General Fund. The payments are paid half in annual payments over 10 years and half in annual payments over 15 years. Eligible non-Durant school districts were allowed to borrow and issue bonds for the amount they were to receive over 15 years. Although the School Aid Fund has no legal liability to pay the debt service

costs for school districts issuing bonds, the School Aid Fund has paid and will continue to pay an additional amount for the related debt service costs as long as sufficient funds are appropriated. As a result of a refinancing of these bonds, there will be no debt service payment for fiscal years 2002-03, 2003-04, and 2004-05. The estimated aggregate payments to the non-Durant school districts will total approximately $754.2 million. As of September 30, 2005, the remaining expected amount to be paid to the non-Durant school districts totaled approximately $374.1 million.

Note 5 Judgments

In a series of orders from 1967 through 1983, the U.S. District Court for the Western District of Michigan and the U.S. Court of Appeals for the Sixth District ordered the State to pay certain amounts of the cost of various comprehensive programs for the Benton Harbor Area School District. Payments of approximately $1.7 million in fiscal year 2004-05 and $2.3 million in fiscal year 2003-04 were made from the School Aid Fund.

Note 6 Treasurer's Common Cash

The State Treasurer manages the State's common cash pool, which is used by most State funds. The pooling of cash allows the State Treasurer to invest money not needed to pay immediate obligations so that investment earnings on available cash are maximized. Investments of the pool are not segregated by fund. Each contributing fund's balance is treated as equity in the pool, which is recorded in separate accounts within the General Fund. Many funds, including retirement funds, use their equity in the pool as a short-term investment vehicle. In the *SOMCAFR,* the pooled cash is not reported as a separate fund. Each fund's balance in the pool is reported on the line "Equity in common cash." All negative balances in the pool are reclassified at year-end as interfund liabilities, with the appropriate fund recording the receivable. This reclassification resulted in a School Aid Fund liability of approximately $1.5 billion for fiscal years 2004-05 and 2003-04.

Note 7 Taxes

Revenues of the School Aid Fund consist primarily of sales, personal income, property, use, cigarette, liquor, industrial and commercial facilities, and casino gaming wagering taxes. Collections of these taxes are the responsibility of other State departments. In general, taxes receivable represent amounts due to the State at September 30 that were received by the State within

approximately 60 days after that date. Sales and use taxes are accrued to the extent that the related sales occurred prior to October 1 and the State receives tax payments prior to December 1. Annual tax payments (those paid with an annual return, such as personal income taxes) have not been accrued because they are neither reasonably estimable nor available.

Delinquent taxes are recognized to the extent that they will be collected within 12 months. The following taxes were due to the School Aid Fund:

Schedule of Current Taxes Receivable
As of September 30
(in Thousands)

	2005	2004
Total taxes receivable	$ 2,355,083	$ 2,203,058
Less allowance for uncollectible receivables	(343,021)	(338,727)
Less taxes to be received more than 12 months after fiscal year-end	(47,435)	(44,143)
Current taxes receivable	$ 1,964,627	$ 1,820,188

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REQUIRED SUPPLEMENTARY INFORMATION

SCHOOL AID FUND
Department of Education
Budgetary Comparison Schedule
Fiscal Years Ended September 30
(In Thousands)

Statutory/Budgetary Basis	2005 Original Budget	2005 Final Budget	2005 Actual	2005 Variance With Final Budget
Beginning Budgetary Fund Balance	$ 72,945	$ 72,945	$ 72,945	$ 0
REVENUES AND OTHER SOURCES				
Taxes	$ 10,371,760	$ 10,242,334	$ 10,242,334	$ 0
From federal agencies	1,353,540	1,321,710	1,321,710	0
Miscellaneous		62,455	62,455	0
Transfers in	802,200	831,722	831,722	0
Total Revenues and Other Sources	$ 12,527,500	$ 12,458,221	$ 12,458,221	$ 0
Amount Available for Appropriation	$ 12,600,445	$ 12,531,167	$ 12,531,167	$ 0
EXPENDITURES AND ENCUMBRANCES				
Education	$ 12,527,950	$ 12,444,503	$ 12,435,069	$ 9,434
Total Expenditures and Encumbrances	$ 12,527,950	$ 12,444,503	$ 12,435,069	$ 9,434
Reconciling Items:				
Encumbrances at September 30	$	$ 745	$ 745	$ 0
Change in noncurrent assets		(2,430)	(2,430)	0
Net Reconciling Items	$ 0	$ (1,684)	$ (1,684)	$ 0
Ending Budgetary Fund Balance	$ 72,495	$ 84,979	$ 94,414	$ 9,434

See accompanying notes to required supplementary information.

2004			
Original Budget	Final Budget	Actual	Variance With Final Budget
$ 113,978	$ 113,978	$ 113,978	$ 0
$ 10,120,218	$ 9,970,459	$ 9,970,459	$ 0
1,316,682	1,256,727	1,256,727	0
	11,122	11,122	0
867,100	1,022,683	1,022,683	0
$ 12,304,000	$ 12,260,991	$ 12,260,991	$ 0
$ 12,417,978	$ 12,374,969	$ 12,374,969	$ 0
$ 12,553,679	$ 12,342,013	$ 12,302,572	$ 39,440
$ 12,553,679	$ 12,342,013	$ 12,302,572	$ 39,440
$	$ 510	$ 510	$ 0
	38	38	0
$ 0	$ 549	$ 549	$ 0
$ (135,701)	$ 33,505	$ 72,945	$ 39,440

SCHOOL AID FUND
Department of Education
Budgetary Comparison Schedule
Budget-to-GAAP Reconciliation
Fiscal Years Ended September 30
(In Thousands)

	2005	2004
Sources/inflows of resources		
Actual amount (budgetary basis) available for appropriation from the budgetary comparison schedule	$ 12,531,167	12,374,969
Differences - Budget to GAAP:		
Budgetary fund balance at the beginning of the year is a budgetary resource but is not a current-year revenue for financial reporting purposes	(72,945)	(113,978)
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(831,722)	(1,022,683)
Total Revenues as Reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance	$ 11,626,499	$ 11,238,308
Uses/outflows of resources		
Actual amount (budgetary basis) of total expenditures and encumbrances from the budgetary comparison schedule	$ 12,435,069	$ 12,302,572
Differences - Budget to GAAP:		
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes, but in the year the supplies are received for financial reporting purposes	(745)	(510)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(41,091)	(3,167)
Total Expenditures as Reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance	$ 12,393,232	$ 12,298,895

Note 1 Statutory/Budgetary Presentation

School Aid Fund appropriations are established annually by the Legislature.

The budgetary comparison schedule presents the original and final appropriated budgets for fiscal years 2004-05 and 2003-04, as well as the actual revenues and other sources, expenditures and encumbrances, and fund balance stated on the budgetary basis.

The original budget and related estimated revenues represent the spending authority enacted into law by the appropriation bills as of October 1, 2004 and October 1, 2003, respectively, and the original budget includes encumbrance budgetary carry-forwards from the prior fiscal year.

Generally accepted accounting principles (GAAP) require that the final legal budget be reflected in the "Final Budget" column. Therefore, updated revenue estimates available for appropriations as of November 30, rather than the amounts shown in the original budget, are reported. The November 30 date is used because Act 431, P.A. 1984, as amended, permits budget adjustments by the Legislature through 60 days after year-end.

Note 2 Statutory/Budgetary Reconciliation

The statutory/budgetary basis presentation differs from GAAP in ways that do not affect the ending fund balance.

For budgetary reporting purposes, encumbrances are included with expenditures in the "Actual" columns because they are considered uses of spending authority in the year the State incurs an obligation. The "Original Budget" and "Final Budget" columns include encumbrance authorization balances carried over from the prior year because they provided spending authority in the current year. In financial statements prepared in accordance with GAAP, encumbrances are not included as expenditures. The effect of this difference is reflected as a reconciling item on the budgetary comparison schedule. The encumbrance of spending authority is recorded as a reservation of fund balance under both the statutory/budgetary basis and the GAAP basis of accounting.

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SUPPLEMENTAL
FINANCIAL SCHEDULE

DEPARTMENT OF EDUCATION
Schedule of Expenditures of Federal Awards (Note 1)
For the Period October 1, 2003 through September 30, 2005

Federal Agency/Program or Cluster	*CFDA** Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2004 Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Financial Assistance					
U.S. Department of Agriculture					
Child Nutrition Cluster:					
Direct Programs:					
School Breakfast Program	10.553		$	$ 44,136,408	$ 44,136,408
National School Lunch Program	10.555			174,070,077	174,070,077
Special Milk Program for Children	10.556			725,709	725,709
Summer Food Service Program for Children	10.559		167,980	4,311,527	4,479,507
Total Child Nutrition Cluster			$ 167,980	$ 223,243,721	$ 223,411,701
Emergency Food Assistance Program Cluster:					
Direct Program:					
Emergency Food Assistance Program (Administrative Costs)	10.568		$ 32,333	$ 2,644,011	$ 2,676,344
Total Emergency Food Assistance Program Cluster (Note 2)			$ 32,333	$ 2,644,011	$ 2,676,344
Direct Programs:					
Child and Adult Care Food Program	10.558		$ 902,616	$ 50,299,615	$ 51,202,231
State Administrative Expenses for Child Nutrition	10.560		2,778,042	18,869	2,796,911
Nutrition Education and Training Program	10.564				
Commodity Supplemental Food Program	10.565		105,828	4,412,203	4,518,031
Team Nutrition Grants	10.574			230,479	230,479
Child Nutrition Discretionary Grants Limited Availability	10.579				
Total Direct Programs			$ 3,786,486	$ 54,961,166	$ 58,747,652
Total U.S. Department of Agriculture			**$ 3,986,799**	**$ 280,848,898**	**$ 284,835,697**
U.S. Department of Defense					
Direct Program:					
Contract for Defense Activity for Non-Traditional Education Support	12.N3569701MDTM1**		$ 6,447	$	$ 6,447
Contract for Defense Activity for Non-Traditional Education Support	12.N3569703MDTM1**		109,142		109,142
Total U.S. Department of Defense			**$ 115,589**	**$ 0**	**$ 115,589**
U.S. Department of Education					
Special Education Cluster:					
Direct Programs:					
Special Education - Grants to States	84.027		$ 12,184,772	$ 287,517,496	$ 299,702,268
Special Education - Preschool Grants	84.173		224,353	12,379,124	12,603,477
Total Special Education Cluster			$ 12,409,125	$ 299,896,620	$ 312,305,745
Direct Programs:					
Contract with National Center for Education Statistics	84.ED03CO0074 **		$ 115,524	$	$ 115,524
Title I Grants to Local Educational Agencies	84.010		4,491,837	424,287,041	428,778,878
Migrant Education - State Grant Program	84.011		290,775	8,863,541	9,154,316
Title I Program for Neglected and Delinquent Children	84.013			677,622	677,622
Media and Captioning Services for Individuals with Disabilities	84.026		5,453		5,453
Immigrant Education	84.162			(43,575)	(43,575)
Special Education - Grants for Infants and Families with Disabilities	84.181		254,763	13,721,930	13,976,693
Safe and Drug-Free Schools and Communities - National Programs	84.184			1,803,367	1,803,367
Safe and Drug-Free Schools and Communities - State Grants	84.186		264,289	12,470,203	12,734,492
Education for Homeless Children and Youth	84.196		134,305	1,378,436	1,512,741
Even Start - State Educational Agencies	84.213		353,303	8,695,571	9,048,874
Fund for the Improvement of Education	84.215		50,933	116,070	167,003
Eisenhower Professional Development State Grants	84.281		1,375	245,460	246,835
Charter Schools	84.282		231,582	3,077,869	3,309,451
Twenty-First Century Community Learning Centers	84.287		658,837	18,257,144	18,915,981
State Grants for Innovative Programs	84.298		1,857,763	11,038,838	12,896,601
Even Start - Statewide Family Literacy Program	84.314		(292)		(292)
Education Technology State Grants	84.318		655,772	19,878,517	20,534,289
Special Education - State Personnel Development	84.323			991,312	991,312

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2005			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
$	$ 47,825,250	$ 47,825,250	$ 91,961,658
	185,138,443	185,138,443	359,208,520
	865,225	865,225	1,590,934
67,069	3,944,614	4,011,683	8,491,190
$ 67,069	$ 237,773,532	$ 237,840,601	$ 461,252,302
$ 34,276	$ 2,034,682	$ 2,068,958	$ 4,745,302
$ 34,276	$ 2,034,682	$ 2,068,958	$ 4,745,302
$ 431,025	$ 52,941,847	$ 53,372,872	$ 104,575,103
3,808,481		3,808,481	6,605,392
6		6	6
110,945	4,416,329	4,527,274	9,045,305
	210,538	210,538	441,017
5,843		5,843	5,843
$ 4,356,300	$ 57,568,714	$ 61,925,014	$ 120,672,666
$ 4,457,645	**$ 297,376,928**	**$ 301,834,573**	**$ 586,670,270**
$	**$**	**$**	$ 6,447
116,512		116,512	225,654
$ 116,512	**$ 0**	**$ 116,512**	**$ 232,101**
$ 12,345,941	$ 338,218,998	$ 350,564,939	$ 650,267,207
232,487	12,570,614	12,803,101	25,406,578
$ 12,578,428	$ 350,789,612	$ 363,368,040	$ 675,673,785
$ 107,273	$	$ 107,273	$ 222,797
4,298,964	403,220,790	407,519,754	836,298,632
251,301	7,466,029	7,717,330	16,871,646
	430,550	430,550	1,108,172
		0	5,453
		0	(43,575)
305,003	13,803,599	14,108,602	28,085,295
121,359	1,744,248	1,865,607	3,668,974
408,854	13,205,381	13,614,235	26,348,727
149,294	1,537,233	1,686,527	3,199,268
436,155	6,947,007	7,383,162	16,432,036
12,355	74,033	86,388	253,391
	15	15	246,850
300,451	7,430,394	7,730,845	11,040,296
828,469	27,811,902	28,640,371	47,556,352
1,785,837	8,943,521	10,729,358	23,625,959
		0	(292)
779,890	26,489,369	27,269,259	47,803,548
	2,423,039	2,423,039	3,414,351

DEPARTMENT OF EDUCATION
Schedule of Expenditures of Federal Awards (Note 1)
For the Period October 1, 2003 through September 30, 2005
Continued

Federal Agency/Program or Cluster	*CFDA* * Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2004 Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Advance Placement Program	84.330		$ 303,162	$	$ 303,162
Comprehensive School Reform Demonstration	84.332		272,842	10,968,316	11,241,158
Teacher Quality Enhancement Grants	84.336			780,880	780,880
Class Size Reduction	84.340			(1,418)	(1,418)
Title I Accountability Grants	84.348			4,560,642	4,560,642
School Renovation Grants	84.352		77,370	790,735	868,105
Reading First State Grants	84.357		4,660,165	18,021,744	22,681,909
Rural Education	84.358		33,634	912,496	946,130
English Language Acquisition Grants	84.365		182,979	7,397,477	7,580,456
Mathematics and Science Partnerships	84.366		113,011	277,934	390,945
Improving Teacher Quality State Grants	84.367		3,264,346	107,698,173	110,962,519
Grants for State Assessments and Related Activities	84.369		7,265,781		7,265,781
Total Direct Programs			$ 25,539,509	$ 676,866,325	$ 702,405,834
Total U.S. Department of Education			**$ 37,948,632**	**$ 976,762,945**	**$ 1,014,711,579**
U.S. Department of Health and Human Services					
Direct Programs:					
Refugee and Entrant Assistance - Discretionary Grants	93.576		$ 57,920	$ 866,073	$ 923,993
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938		563,920	588,624	1,152,544
Total Direct Programs			$ 621,840	$ 1,454,697	$ 2,076,537
Pass-Through Program:					
Michigan Department of Human Services					
Child Care and Development Block Grant	93.575	93.575	$ 7,114	$	$ 7,114
Total U.S. Department of Health and Human Services			**$ 628,954**	**$ 1,454,697**	**$ 2,083,651**
Corporation for National and Community Service					
Direct Program:					
Learn and Serve America - School and Community Based Programs	94.004		$ 245,175	$ 889,887	$ 1,135,062
Total Corporation for National and Community Service			**$ 245,175**	**$ 889,887**	**$ 1,135,062**
Total Financial Assistance			$ 42,925,151	$ 1,259,956,427	$ 1,302,881,578
Nonfinancial Assistance					
U.S. Department of Agriculture					
Emergency Food Assistance Program Cluster:					
Direct Program:					
Emergency Food Assistance Program (Food Commodities)	10.569		$	$ 9,512,258	$ 9,512,258
Total Emergency Food Assistance Program Cluster (Note 2)			$ 0	$ 9,512,258	$ 9,512,258
Direct Programs:					
Food Donation	10.550		$	$ 26,321,399	$ 26,321,399
Commodity Supplemental Food Program	10.565			21,747,389	21,747,389
Total Direct Programs			$ 0	$ 48,068,788	$ 48,068,788
Total U.S. Department of Agriculture			**$ 0**	**$ 57,581,046**	**$ 57,581,046**
Total Nonfinancial Assistance			$ 0	$ 57,581,046	$ 57,581,046
Total Expenditures of Federal Awards			$ 42,925,151	$ 1,317,537,473	$ 1,360,462,624

* *CFDA* is defined as *Catalog of Federal Domestic Assistance.*

** *CFDA* number not available. Number derived from federal agency number and contract number.

The accompanying notes are an integral part of this schedule.

For the Fiscal Year Ended September 30, 2005			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
$ 115,919	$	$ 115,919	$ 419,081
249,716	10,877,970	11,127,686	22,368,844
	548,565	548,565	1,329,445
	(24,858)	(24,858)	(26,276)
	(51,006)	(51,006)	4,509,636
104,237		104,237	972,342
5,087,804	23,554,645	28,642,449	51,324,358
25,266	418,071	443,337	1,389,467
228,729	8,409,616	8,638,345	16,218,801
218,684	2,107,530	2,326,214	2,717,159
3,868,057	106,294,178	110,162,235	221,124,754
15,716,130		15,716,130	22,981,911
$ 35,399,747	$ 673,661,821	$ 709,061,568	$ 1,411,467,402
$ 47,978,175	**$ 1,024,451,433**	**$ 1,072,429,608**	**$ 2,087,141,187**
$ 31,689	$ 529,635	$ 561,324	$ 1,485,317
635,463	578,782	1,214,245	2,366,789
$ 667,152	$ 1,108,417	$ 1,775,569	$ 3,852,106
$ 16,165	$	$ 16,165	$ 23,279
$ 683,317	**$ 1,108,417**	**$ 1,791,734**	**$ 3,875,385**
$ 273,074	$ 827,431	$ 1,100,505	$ 2,235,567
$ 273,074	**$ 827,431**	**$ 1,100,505**	**$ 2,235,567**
$ 53,508,723	$ 1,323,764,209	$ 1,377,272,932	$ 2,680,154,510
$	$ 10,647,534	$ 10,647,534	$ 20,159,792
$ 0	$ 10,647,534	$ 10,647,534	$ 20,159,792
$	$ 31,127,214	$ 31,127,214	$ 57,448,613
	14,947,832	14,947,832	36,695,221
$ 0	$ 46,075,046	$ 46,075,046	$ 94,143,834
$ 0	**$ 56,722,580**	**$ 56,722,580**	**$ 114,303,626**
$ 0	$ 56,722,580	$ 56,722,580	$ 114,303,626
$ 53,508,723	$ 1,380,486,789	$ 1,433,995,512	$ 2,794,458,136

Note 1 Basis of Presentation

This schedule includes the federal grant activity of the Department of Education and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. In certain programs, financed entirely by the federal government, expenditures and related revenues are recognized only to the extent of billings received by fiscal year-end. This treatment understates assets and liabilities and expenditures and revenues; however, there is an immaterial impact on the fund balance of the State's General Fund and the School Aid Fund.

Note 2 Emergency Food Assistance Program Cluster

The Emergency Food Assistance Program Cluster is made up of financial assistance (*CFDA* 10.568) totaling $2.7 million and $2.1 million and nonfinancial assistance (*CFDA* 10.569) valued at $9.5 million and $10.6 million as of September 30, 2004 and September 30, 2005, respectively.

Note 3 Reporting Entity

In fiscal year 2003-04, the majority of federal grants were reported in the School Aid Fund. Administrative federal expenses and the U.S. Department of Education's School Renovation Grants and Title I Program for Neglected and Delinquent Children grants were reported in the State's General Fund.

In fiscal year 2004-05, the majority of federal grants were reported in the School Aid Fund. Administrative federal expenses and the U.S. Department of Education's Title I Program for Neglected and Delinquent Children and the Safe and Drug-Free Schools and Communities - National Program grants were reported in the State's General Fund.

INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. Michael P. Flanagan
Superintendent of Public Instruction
John A. Hannah Building
Lansing, Michigan

Dear Mr. Flanagan:

We have audited the financial schedules and financial statements of the Department of Education as of and for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents, and have issued our report thereon dated March 24, 2006. 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 *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial schedules and financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 1 and 2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing

their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that neither of the reportable conditions identified in the previous paragraph is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial schedules and financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule and financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the State Board of Education, the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General
March 24, 2006

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With
Requirements Applicable to Each Major Program
and on Internal Control Over Compliance in
Accordance With OMB Circular A-133

Mr. Michael P. Flanagan
Superintendent of Public Instruction
John A. Hannah Building
Lansing, Michigan

Dear Mr. Flanagan:

Compliance

We have audited the compliance of the Department of Education with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2005. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

As described in Findings 3 through 5 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding matching, level of efforts, and earmarking that are applicable to its English Language Acquisition Grants; with requirements regarding subrecipient monitoring that are applicable to its English Language Acquisition Grants, Migrant Education - State Grant Program, and Charter Schools Program; and with requirements regarding special tests and provisions that are applicable to its English Language Acquisition Grants. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the previous paragraph, the Department of Education complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each major federal program for the two-year period ended September 30, 2005. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Findings 4 and 6 through 9.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 3 through 9.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions identified in the previous paragraph, we consider Findings 3 through 6 to be material weaknesses.

This report is intended solely for the information and use of the State Board of Education, the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General
March 24, 2006

SCHEDULE OF FINDINGS
AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Schedules and Financial Statements

Type of auditor's reports issued:	Unqualified*
Internal control* over financial reporting:	
Material weaknesses* identified?	No
Reportable conditions* identified that are not considered to be material weaknesses?	Yes
Noncompliance or other matters material to the financial schedules and/or financial statements?	No

Federal Awards

Internal control over major programs:	
Material weaknesses identified?	Yes
Reportable conditions identified that are not considered to be material weaknesses?	Yes

Type of auditor's report issued on compliance for major programs:

Unqualified for all major programs except for Migrant Education - State Grant Program, Charter Schools, and English Language Acquisition Grants, which are qualified*.

Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)?	Yes

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
10.550	Food Donation
10.553, 10.555, 10.556, and 10.559	Child Nutrition Cluster

** See glossary at end of report for definition.*

10.558	Child and Adult Care Food Program
10.565	Commodity Supplemental Food Program
10.568 and 10.569	Emergency Food Assistance Program Cluster
84.010	Title I Grants to Local Educational Agencies
84.011	Migrant Education - State Grant Program
84.027 and 84.173	Special Education Cluster
84.181	Special Education - Grants for Infants and Families with Disabilities
84.213	Even Start - State Educational Agencies
84.282	Charter Schools
84.287	Twenty-First Century Community Learning Centers
84.318	Education Technology State Grants
84.332	Comprehensive School Reform Demonstration
84.348	Title I Accountability Grants
84.352	School Renovation Grants
84.365	English Language Acquisition Grants
84.369	Grants for State Assessments and Related Activities

Dollar threshold used to distinguish between type A and type B programs: $8,383,374

Auditee qualified as a low-risk auditee*? No

Section II: Findings Related to the Financial Schedules and Financial Statements

FINDING 310601

1. Act 272 Compliance

The Department of Education's internal auditor did not perform all of the duties and functions of an internal auditor and was not organizationally independent as required by Sections 18.1486(4) and 18.1486(2), respectively, of the *Michigan Compiled Laws*. As a result, the Department's programs may be subject to increased risk of noncompliance, fraud, and/or abuse. Our review disclosed that the Department was not in substantial compliance with State statute.

Section 18.1486(2) of the *Michigan Compiled Laws* requires the internal auditor to report to and be under the general supervision of the Department head. In addition, Section 18.1486(4) of the *Michigan Compiled Laws* requires the internal auditor to conduct audits relating to financial activities of the Department's operations, to review the Department's programs and operations for efficiency, to recommend policies for the Department's operations to protect the State's assets and prevent and detect fraud and abuse, and to review and recommend activities designed to ensure compliance with State and Department directives. Also, Part VII, Chapter 3, Section 100 of the State of Michigan's Financial Management Guide requires the internal auditor of each executive branch agency to annually prepare an internal audit plan and provide a copy to the Office of Financial Management, Department of Management and Budget.

Our review of the Department's internal audit position disclosed that the internal auditor was not organizationally independent. The internal auditor reports to the executive director of School Finance and School Law, two levels below the Department head. This organizational placement impairs the internal auditor's ability to function independently and audit impartially.

** See glossary at end of report for definition.*

In addition, our review of the Department's internal audit activities disclosed that the internal auditor had conducted only two audits during our audit period, both of which were mandated by the Department of Management and Budget. We noted that the internal auditor had not reviewed the Department's programs and operations for efficiency or formally reviewed or recommended activities designed to ensure compliance with directives. In addition, the internal auditor had not updated the internal audit plan since July 2002.

The Department's internal auditor had other assigned duties, including technical assistance, pupil membership audits, and subrecipient* monitoring of certified public accountant audits.

We reported the issue regarding the internal auditor's duties and functions in our prior Single Audit. The Department agreed with the underlying intent of the recommendation but responded that it was unable to comply due to a lack of resources.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT THE DEPARTMENT'S INTERNAL AUDITOR PERFORM ALL OF THE DUTIES AND FUNCTIONS REQUIRED BY SECTION 18.1486(4) OF THE *MICHIGAN COMPILED LAWS*.

We also recommend that the Department's internal auditor be organizationally independent as required by Section 18.1486(2) of the *Michigan Compiled Laws.*

FINDING 310602

2. General Controls

The Department, in conjunction with the Department of Information Technology (DIT), did not implement a comprehensive security program to protect its data, application systems, and operating systems. Without a comprehensive security program, management cannot ensure that the Department's controls related to automated systems are operating as intended and the integrity of its data is safeguarded.

** See glossary at end of report for definition.*

A comprehensive security program often includes an information security officer and the development and implementation of effective security policies and procedures. An information security officer would be responsible for granting and monitoring access to all Department data, application systems, and operating systems.

We identified the following internal control weaknesses:

a. The Department did not restrict system developers' access to production databases and operating system software. In addition, the Department did not restrict system developers' administrative privileges to application system software. As a result, unauthorized changes to the Department's data and application and operating system software could be made and not be detected. System developers possess detailed knowledge about the systems and their controls. Allowing the system developers to have access, and the ability to administer access, to production databases and systems increases the risk that data edits, system security features, or other controls in the systems could be turned off or bypassed. In addition, this access increases the risk that an individual could commit and conceal a fraudulent or unauthorized transaction. The Department should restrict system developers' access to production databases and systems.

b. The Department, in conjunction with DIT, did not have effective controls to identify unauthorized changes to data and application systems. DIT informed us that after the audit period, it implemented a change control process for some application systems. However, because of the cost of replacing old technology, it has not yet implemented effective change controls for all of the Department's application systems. An effective change control process would ensure that all program modifications are properly tested and approved.

We reported this issue in our performance audit* of Technology Services and the Automated Information Systems, Department of Education, released in May 2001. The Department agreed with our recommendation and informed us that many improvements to security were implemented. However, we found that the Department had not taken steps necessary to establish an effective and comprehensive information security program.

** See glossary at end of report for definition.*

RECOMMENDATION

We recommend that the Department, in conjunction with DIT, implement a comprehensive security program to protect its data, application systems, and operating systems.

The status of the findings related to the financial schedules and financial statements that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.

Section III: Findings and Questioned Costs* Related to Federal Awards

FINDING 310603

3. English Language Acquisition Grants, *CFDA* 84.365

U.S. Department of Education	*CFDA* 84.365: English Language Acquisition Grants
Award Number: T365A020022 T365A030022 T365A040022	Award Period: 07/01/2002 - 09/30/2003 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005
	Questioned Costs: $1,412,000

The Department did not comply with federal requirements regarding matching, level of effort, and earmarking for the English Language Acquisition Grants Program. In addition, the Department's internal control did not ensure that the English Language Acquisition Grants Program complied with federal laws and regulations regarding subrecipient monitoring and special tests and provisions. As a result, we questioned costs in the amount of $1.4 million. Noncompliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of English Language Acquisition Grant awards. We consider these to be material noncompliance* with federal laws and regulations regarding matching, level of effort, and earmarking; subrecipient monitoring; and special tests and provisions. We also consider these to be material weaknesses in internal control regarding subrecipient monitoring and special tests and provisions.

** See glossary at end of report for definition.*

Federal expenditures for the English Language Acquisition Grants Program totaled approximately $16.2 million for the two-year period ended September 30, 2005. The Department distributed approximately $8.4 million and $7.4 million of the total program expenditures to English Language Acquisition Grant subrecipients in fiscal years 2004-05 and 2003-04, respectively.

Our audit disclosed the following exceptions by compliance area:

a. Matching, Level of Effort, and Earmarking

The Department did not comply with federal requirements relating to level of effort. As a result, we questioned costs in the amount of $1,412,000. Title III, Part A, Subpart 1, Section 3115(g) of the No Child Left Behind (NCLB) Act requires that English Language Acquisition Grants be used to supplement State funds that would have been expended for programs for limited English proficient children and, in no case, be used to supplant such State funds.

The State's bilingual instruction program and the federal English Language Acquisition Grants Program can be used to provide funding for bilingual instruction. In Section 41 of the State school aid appropriations acts, the Department's appropriation for the State's bilingual instruction program for pupils of limited English-speaking ability was reduced from $4.2 million in fiscal year 2002-03 to $2.8 million in fiscal year 2003-04. However, the English Language Acquisition Grants Program funding was not decreased by a corresponding amount, resulting in federal funds supplanting the $1,412,000 reduction in the State's bilingual instruction program in fiscal year 2003-04.

b. Subrecipient Monitoring

The Department's internal control was not effective in ensuring compliance regarding subrecipient monitoring in accordance with OMB Circular A-133, Section 400(d)(3). If the Department does not sufficiently monitor the activities of subrecipients, the Department cannot be assured that federal awards are used for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements.

Our review of the Department's subrecipient monitoring activities determined that the Department reviewed subrecipient program budgets for allowable activities and costs, provided training, and appropriately identified federal

award information to its subrecipients. However, we identified the following weaknesses:

(1) The Department did not perform a sufficient number of on-site reviews of its subrecipients to ensure that the federal awards were used for allowable activities and costs. Our review disclosed that the Department conducted on-site reviews of 1 (1%) and 2 (2%) of the 132 and 106 subrecipients in fiscal years 2004-05 and 2003-04, respectively.

(2) The Department did not follow up on discrepancies identified from the reconciliation of final expenditure reports to approved budgets.

(3) The Department did not monitor subrecipients' cash draws to ensure that they were for reimbursement and 30-day cash needs only, in compliance with cash management requirements. The Department allows subrecipients to draw funds electronically without providing supporting documentation. Therefore, the monitoring of the 30-day cash needs by Department program staff becomes more relevant as a monitoring activity.

(4) The Department had not analyzed the Federal Audit Clearinghouse database information to identify the subrecipients with Single Audits that audited the English Language Acquisition Grant as a major program. Our review of the Federal Audit Clearinghouse database disclosed that 22% of the English Language Acquisition Grants Program's total payments to subrecipients for fiscal year 2003-04 were audited as major program expenditures in the subrecipients' Single Audits. Consideration of the Single Audit coverage in determining which subrecipients to visit could increase the Department's subrecipient monitoring coverage and reduce duplication of effort in monitoring subrecipients that are in compliance with federal requirements.

c. Special Tests and Provisions

The Department's internal control was not effective in ensuring compliance with federal requirements regarding program achievement objectives. During our review, we determined that the Department had not disseminated the annual measurable achievement objectives for limited English proficient children to its subrecipients. As a result, the Department did not have a basis

for determining whether limited English proficient children were making adequate yearly progress as intended by the NCLB Act.

Section 3122(a) of the NCLB Act requires the Department to develop annual measurable achievement objectives that relate to limited English proficient children's development and attainment of English proficiency. In addition, Section 3122(b) of the NCLB Act requires that the Department hold the subrecipients accountable for meeting the annual measurable achievement objectives.

RECOMMENDATIONS

We recommend that the Department comply with federal requirements regarding matching, level of effort, and earmarking for the English Language Acquisition Grants Program.

We also recommend that the Department improve its internal control to ensure that the English Language Acquisition Grants Program complies with federal laws and regulations regarding subrecipient monitoring and special tests and provisions.

FINDING 310604

4. Migrant Education - State Grant Program, *CFDA* 84.011

U.S. Department of Education	*CFDA* 84.011: Migrant Education - State Grant Program
Award Number: S011A010022 S011A020022 S011A030022 S011A040022	Award Period: 07/01/2001 - 09/30/2002 07/01/2002 - 09/30/2003 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005
	Questioned Costs: $61,568

The Department's internal control did not ensure that the Migrant Education - State Grant Program complied with federal laws and regulations regarding activities allowed or unallowed and subrecipient monitoring. As a result, we questioned costs in the amount of $61,568. Noncompliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Migrant Education - State Grant Program awards. We consider this to be a material

weakness in internal control and material noncompliance with federal laws and regulations regarding subrecipient monitoring.

Federal expenditures for the Migrant Education - State Grant Program totaled $16.9 million for the two-year period ended September 30, 2005. The Department distributed approximately $7.5 million and $8.9 million of the total program expenditures to 43 and 42 Migrant Education - State Grant Program subrecipients in fiscal years 2004-05 and 2003-04, respectively. Subrecipients of the Migrant Education - State Grant Program were local educational agencies (LEAs).

Our audit disclosed the following exceptions by compliance area:

a. Activities Allowed or Unallowed

The Department needs to improve internal control in its approval process for grantees' allocations to help ensure compliance with the activities allowed or unallowed requirement. Our review identified questioned costs in the amount of $41,522 related to one LEA.

The Department uses migrant student enrollment data in determining the amounts to be allocated to LEAs. For the 2005 migrant programs' summer school allocation, the Department incorrectly input a migrant student count of 169 instead of 54 students for one LEA. As a result, the Department provided awards to LEAs and LEAs expended and received reimbursement for expenditures based on this inaccurate allocation.

b. Subrecipient Monitoring

The Department's internal control was not effective in ensuring compliance regarding subrecipient monitoring as required in OMB Circular A-133, Section 400(d)(3), and Title 34, Subtitle A, section 80.40 of the *Code of Federal Regulations (CFR)*. If the Department does not sufficiently monitor the activities of subrecipients, the Department cannot be assured that federal awards are used for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements and that performance goals are achieved.

Our review of the Department's subrecipient monitoring activities determined that the Department reviewed subrecipient program budgets for allowable activities and costs, provided training, appropriately identified federal award

information to its subrecipients, and performed a limited number of on-site compliance reviews. However, we also identified the following weaknesses:

(1) The Department's on-site compliance reviews did not review documentation to support the LEA's student count or review student files for eligibility. The Department performed 3 (7%) and 2 (5%) on-site compliance reviews of the 43 and 42 LEAs in fiscal years 2004-05 and 2003-04, respectively. We determined that the Department provided funding to 3 LEAs for 30 ineligible migrant children during the audit period. Based on these ineligible children, we questioned costs in the amount of $20,046.

(2) The Department did not perform any on-site program reviews in either fiscal year 2004-05 or fiscal year 2003-04. Without program reviews, the Department may not have assurance that migrant programs are providing allowable services and achieving program objectives. Prior to our audit period, the Department performed on-site program reviews intended to review the goals of the local program, the services provided to the students, the curriculum in relation to State curriculum standards, the student assessment process, student program eligibility requirements, and professional development of staff.

(3) The Department did not follow up on discrepancies identified from the reconciliation of final expenditure reports to approved budgets. Follow-up of discrepancies would help ensure that the federal awards are used for authorized purposes.

(4) The Department did not document that it monitored subrecipients' cash draws to ensure that they were for reimbursement and 30-day cash needs only, in compliance with cash management requirements. The Department allows subrecipients to draw funds electronically without providing supporting documentation. Therefore, the monitoring of the 30-day cash needs by Department program staff becomes more relevant as a monitoring activity.

(5) The Department had not analyzed the Federal Audit Clearinghouse database information to identify the subrecipients with Single Audits that audited the Migrant Education - State Grant Program as a major program.

Our review of the Federal Audit Clearinghouse database disclosed that 25% of the Migrant Education - State Grant Program total payments to subrecipients for fiscal year 2003-04 were audited as major program expenditures in the subrecipients' Single Audits. Consideration of the Single Audit coverage in determining which subrecipients to visit could increase the Department's subrecipient monitoring coverage and reduce duplication of effort in monitoring subrecipients that are in compliance with federal requirements.

RECOMMENDATION

We recommend that the Department improve internal control to ensure that the Migrant Education - State Grant Program complies with federal laws and regulations regarding activities allowed or unallowed and subrecipient monitoring.

FINDING 310605

5. Charter Schools, *CFDA* 84.282

U.S. Department of Education	*CFDA* 84.282: Charter Schools
Award Numbers: S282A010007 U282A040002	Award Period: 10/01/2001 - 09/30/2005 10/01/2004 - 09/30/2007
	Questioned Costs: $0

The Department's internal control did not ensure that the Charter Schools Program (CSP) complied with federal laws and regulations regarding subrecipient monitoring, as required by OMB Circular A-133, Section 400(d)(3). If the Department does not sufficiently monitor the activities of subrecipients, the Department cannot be assured that federal awards are used for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements. Noncompliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of CSP awards. We consider this to be a material weakness in internal control and material noncompliance with federal laws and regulations regarding subrecipient monitoring.

CSP expenditures totaled $11.0 million for the two-year period ended September 30, 2005. The Department distributed approximately $7.4 million and

$3.1 million of the total CSP expenditures to subrecipients in fiscal years 2004-05 and 2003-04, respectively. CSP subrecipients were public school academies.

Our review of the Department's subrecipient monitoring activities determined that the Department reviewed subrecipient program budgets for allowable activities and costs, provided training, and appropriately identified federal award information to its subrecipients. However, we identified the following weaknesses:

a. The Department did not perform, or did not document its performance of, on-site reviews of the subrecipients to ensure that federal awards were used for allowable activities and costs.

b. The Department did not document that it monitored subrecipients' cash draws to ensure that they were for reimbursement and 30-day cash needs only, in compliance with cash management requirements. The Department allows subrecipients to draw funds electronically without providing supporting documentation. Therefore, the monitoring of the 30-day cash needs by Department program staff becomes more relevant as a monitoring activity.

c. The Department did not analyze the Federal Audit Clearinghouse database information to identify the subrecipients with Single Audits that audited CSP as a major program. Our review of the Federal Audit Clearinghouse database disclosed that only 15% of CSP's total payments to subrecipients for fiscal year 2003-04 were audited as major program expenditures in the subrecipients' Single Audits. Consideration of the Single Audit coverage in determining which subrecipients to visit could increase the Department's subrecipient monitoring coverage and reduce duplication of effort in monitoring subrecipients that are in compliance with federal requirements.

We reported on the Department's deficiencies in subrecipient monitoring in our prior Single Audit.

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE DEPARTMENT IMPROVE ITS INTERNAL CONTROL TO ENSURE THAT CSP COMPLIES WITH FEDERAL LAWS AND REGULATIONS REGARDING SUBRECIPIENT MONITORING.

FINDING 310606

6. Comprehensive School Reform Demonstration, *CFDA* 84.332

U.S. Department of Education	*CFDA* 84.332: Comprehensive School Reform Demonstration
Award Number: S332A010023 S332A020023 S332A030023 S332A040023	Award Period: 07/01/2001 - 09/30/2002 07/01/2002 - 09/30/2003 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005
	Questioned Costs: $505,511

The Department's internal control did not ensure that the Comprehensive School Reform Demonstration (CSR) Program complied with federal laws and regulations regarding the period of availability of federal funds. As a result, we questioned costs in the amount of $505,511. Noncompliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of CSR funds. We consider this to be a material weakness in internal control regarding period of availability of federal funds.

CSR expenditures totaled approximately $22.4 million for the two-year period ended September 30, 2005.

Federal regulation 34 *CFR* 80.23(a) states that where a funding period is specified, a grantee may only charge to the award costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted. CSR Program guidance indicates that CSR funds can be obligated for a 27-month period from the time they become available. In addition, federal regulation 34 *CFR* 80.23(b) provides an additional 90 days after the end of the funding period to liquidate all obligations.

Our analysis of fiscal year 2004-05 and 2003-04 expenditures identified 11 expenditure transactions totaling $505,511 that had been made subsequent to their respective periods of availability. The Department did not have a control in place to prevent payments to subrecipients after the period of availability.

RECOMMENDATION

We recommend that the Department improve its internal control to ensure that the CSR Program complies with federal laws and regulations regarding the period of availability of federal funds.

FINDING 310607

7. Improving Teacher Quality State Grants, *CFDA* 84.367

U.S. Department of Education	*CFDA* 84.367: Improving Teacher Quality State Grants
Award Number: S367A020021, S367B020019 S367A030021, S367B030019 S367A040021, S367B040019 S367A050021	Award Period: 07/01/2002 - 09/30/2003 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005 07/01/2005 - 09/30/2006
	Questioned Costs: $31,489

The Department's internal control did not ensure that the Improving Teacher Quality State Grants (Improving Teacher Quality) Program complied with federal laws and regulations regarding subrecipient monitoring, as required by OMB Circular A-133, Section 400(d)(3). As a result, we questioned costs in the amount of $31,489. If the Department does not sufficiently monitor the activities of subrecipients, the Department cannot be assured that federal awards are used for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements. Noncompliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Improving Teacher Quality awards to the Department.

Expenditures for the Improving Teacher Quality Program totaled $221.0 million for the two-year period ended September 30, 2005. The Department distributed approximately $106.3 million and $107.7 million to subrecipients in fiscal years 2004-05 and 2003-04, respectively. Program subrecipients included LEAs and institutions of higher education.

Our audit disclosed the following exceptions:

a. The Department did not reduce allocations for LEAs that failed to meet the maintenance of effort requirement.

Title 20, section 7901(b) of the *United States Code (USC)* requires the state educational agency (SEA) to reduce the amount of the allocation of funds in any fiscal year in the exact proportion by which the LEA failed to meet the maintenance of effort requirements. Federal law 20 *USC* 7901(a) requires that LEAs may receive funds only if the SEA finds that either the combined fiscal effort per student or the aggregate expenditures of the LEA from state and local funds for free public education by such agency for the preceding fiscal year was not less than 90% of the combined fiscal effort or aggregate expenditures for the second preceding fiscal year.

Because of the timing of financial data submitted by the LEAs, allocation reductions made by the Department for one fiscal year are based on maintenance of effort data for the fiscal year two years prior. Our prior audit noted that the Department identified 10 LEAs that had been allocated Improving Teacher Quality grants in fiscal year 2002-03 that had failed to meet the maintenance of effort requirement in fiscal year 2000-01. However, the Department had not reduced these LEAs' fiscal year 2002-03 Improving Teacher Quality allocations. The amount of questioned costs related to fiscal year 2002-03 allocations is $19,977.

In addition, we reviewed the fiscal year 2004-05 and 2003-04 subrecipients' allocations in relation to the maintenance of effort requirement. We determined that 1 and 5 subrecipients had failed to meet the maintenance of effort requirement in fiscal years 2002-03 and 2001-02, respectively, and the Department should have reduced these subrecipients' fiscal year 2004-05 and 2003-04 allocations by $18,808. We determined that through September 30, 2005, the Department had not distributed $7,296 of the reduced allocation amount. Therefore, the amount of questioned costs related to fiscal year 2004-05 and 2003-04 allocations is $11,512.

b. The Department did not perform a sufficient number of on-site reviews of the LEA subrecipients to ensure that federal awards were used for allowable activities and costs. Our review disclosed that the Department conducted on-site reviews of 9 (1%) and 23 (3%) of the 750 and 735 subrecipients in fiscal years 2004-05 and 2003-04, respectively.

c. The Department did not follow up on discrepancies identified from the reconciliation of final expenditure reports to approved budgets. Follow-up of significant discrepancies would help ensure that the federal awards are used for authorized purposes.

d. The Department did not monitor subrecipients' cash draws to ensure that they were for reimbursement and 30-day cash needs only, in compliance with cash management requirements. The Department allows subrecipients to draw funds electronically without providing supporting documentation. Therefore, the monitoring of the 30-day cash needs by Department program staff becomes more relevant as a monitoring activity.

e. The Department had not analyzed the Federal Audit Clearinghouse database information to identify the subrecipients with Single Audits that audited the Improving Teacher Quality Program as a major program. Our review of the Federal Audit Clearinghouse database disclosed that 44% of the Improving Teacher Quality Program's total payments to subrecipients for fiscal year 2003-04 were audited as major program expenditures in the subrecipients' Single Audits. Consideration of the Single Audit coverage in determining which subrecipients to visit could increase the Department's subrecipient monitoring coverage and reduce duplication of effort in monitoring subrecipients that are in compliance with federal requirements.

We reported on the Department's deficiencies in subrecipient monitoring in our prior Single Audit. The Department's summary schedule of prior audit findings in this report indicates that the Department used a risk analysis to ensure adequate subrecipient monitoring. However, our review determined that the Department's internal control still did not ensure compliance with the subrecipient monitoring requirement.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT THE DEPARTMENT IMPROVE ITS INTERNAL CONTROL TO ENSURE THAT THE IMPROVING TEACHER QUALITY PROGRAM COMPLIES WITH FEDERAL LAWS AND REGULATIONS REGARDING SUBRECIPIENT MONITORING.

WE ALSO AGAIN RECOMMEND THAT THE DEPARTMENT REDUCE THE IMPROVING TEACHER QUALITY PROGRAM ALLOCATIONS FOR THOSE LEAs THAT THE DEPARTMENT HAS DETERMINED HAVE FAILED TO MEET THE MAINTENANCE OF EFFORT REQUIREMENT.

WE FURTHER AGAIN RECOMMEND THAT THE DEPARTMENT RECOVER THE $31,489 FROM THE LEAs THAT HAVE BEEN OVERPAID.

FINDING 310608

8. Education Technology State Grants, *CFDA* 84.318

U.S. Department of Education	*CFDA* 84.318: Education Technology State Grants
Award Number: S318X020022 S318X030022 S318X040022	Award Period: 10/01/2001 - 09/30/2003 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005
	Questioned Costs: $7,411

The Department's internal control did not ensure that the Education Technology State Grants Program complied with federal laws and regulations regarding subrecipient monitoring, as required by OMB Circular A-133, Section 400(d)(3). As a result, we questioned costs in the amount of $7,411. If the Department does not sufficiently monitor the activities of subrecipients, the Department cannot be assured that federal awards are used for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements. Noncompliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Education Technology State Grants Program awards.

Expenditures for the Education Technology State Grants Program totaled $47.8 million for the two-year period ended September 30, 2005. The Department distributed approximately $26.5 million and $19.9 million of the total program expenditures to 645 and 651 subrecipients in fiscal years 2004-05 and 2003-04, respectively. Program subrecipients included LEAs.

Our review of the Department's subrecipient monitoring activities determined that the Department performed on-site monitoring of 60 (9%) of its subrecipients,

reviewed subrecipient program budgets for allowable activities and costs, provided training, and appropriately identified federal award information to its subrecipients. However, we identified the following weaknesses:

a. The Department did not follow up on identified deficiencies for 3 (25%) of the 12 monitoring visits that we sampled.

b. The Department did not review its subrecipients' final expenditure reports to ensure that final expenditures reconciled to the approved budgets for 30 (91%) of the 33 subrecipients that we sampled. As a result, the Department did not determine whether its subrecipients actually met their earmarking requirement for professional development activities. Our review of the 33 subrecipients' final expenditure reports disclosed that 10 (30%) subrecipients did not meet their professional development earmarking requirement. As a result, we questioned costs in the amount of $7,411.

c. The Department did not monitor the cash draws for 30 (91%) of the 33 subrecipients to ensure that draws were for reimbursement and 30-day cash needs only, in compliance with cash management requirements. The Department allows subrecipients to draw funds electronically without providing supporting documentation. Therefore, the monitoring of the 30-day cash needs by Department program staff becomes more relevant as a monitoring activity.

d. The Department had not analyzed the Federal Audit Clearinghouse database information to identify the subrecipients with Single Audits that audited the Education Technology State Grants as a major program. Our review of the Federal Audit Clearinghouse database disclosed that 27% of the Education Technology State Grants Program's total payments to subrecipients for fiscal year 2003-04 was audited as major program expenditures in the subrecipients' Single Audits. Consideration of the Single Audit coverage in determining which subrecipients to visit could increase the Department's subrecipient monitoring coverage and reduce duplication of effort in monitoring subrecipients that are in compliance with federal requirements.

We reported on the Department's deficiencies in subrecipient monitoring in our prior Single Audit. The Department's summary schedule of prior audit findings in this report indicates that the Department used a risk analysis to ensure adequate

subrecipient monitoring. However, our review determined that the Department's internal control still did not ensure compliance with the subrecipient monitoring requirement.

RECOMMENDATION

WE AGAIN RECOMMEND THE DEPARTMENT IMPROVE ITS INTERNAL CONTROL TO ENSURE THAT THE EDUCATION TECHNOLOGY STATE GRANTS PROGRAM COMPLIES WITH FEDERAL LAWS AND REGULATIONS REGARDING SUBRECIPIENT MONITORING.

FINDING 310609

9. Special Education Cluster, *CFDA* 84.027 and 84.173

U.S. Department of Education	*CFDA* 84.027 and 84.173: Special Education Cluster
Award Number:	Award Period:
H027A980110	07/01/1998 - 09/30/1999
H027A990110	07/01/1999 - 09/30/2000
H027A000110	07/01/2000 - 09/30/2001
H027A010110	07/01/2001 - 09/30/2002
H027A020110	07/01/2002 - 09/30/2003
H027A030110	07/01/2003 - 09/30/2004
H027A040110	07/01/2004 - 09/30/2005
H027A050110	07/01/2005 - 09/30/2006
H173A980117	07/01/1998 - 09/30/1999
H173A990117	07/01/1999 - 09/30/2000
H173A000117	07/01/2000 - 09/30/2001
H173A010117	07/01/2001 - 09/30/2002
H173A020117	07/01/2002 - 09/30/2003
H173A030117	07/01/2003 - 09/30/2004
H173A040117	07/01/2004 - 09/30/2005
H173A050117	07/01/2005 - 09/30/2006
	Questioned Costs: $208,717

The Department's internal control did not ensure that the Special Education Cluster complied with federal laws and regulations regarding reporting and subrecipient monitoring. As a result, we questioned costs in the amount of $208,717. Noncompliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Special Education Cluster awards.

Expenditures for the Special Education Cluster totaled approximately $675.7 million for the two-year period ended September 30, 2005. The Department distributed approximately $350.8 and $299.9 million of the total Special Education Cluster expenditures to 65 and 64 subrecipients in fiscal years 2004-05 and 2003-04, respectively. Subrecipients of the Special Education Cluster included LEAs, other State departments, nonprofit organizations, and private companies.

Our audit disclosed the following exceptions by compliance area:

a. Reporting

The Department's internal control did not ensure compliance with the reporting requirements for the Special Education Cluster. As a result, the Department reported inaccurate student counts to the Office of Special Education Programs (OSEP), U.S. Department of Education (USDOE), and may have miscalculated grant allocations to individual school districts.

Federal regulations 34 *CFR* 300.750 - 300.751 require each state to complete a count of students ages 3 through 21 residing in the state who are receiving special education and related services as of December 1 of each year. In addition, federal law 20 *USC* 1418(a)(1)(A) requires each state to complete a count of the number of students, ages 14 through 21, who exited special education and related services during the 12-month reporting period. The Department allocates certain special education funds to LEAs based on these student counts. The number of students reported to OSEP must be an unduplicated count.

Our review of the special education data submitted to the USDOE disclosed:

(1) The Department did not verify that the number of students reported to the USDOE as having exited special education from December 2, 2002 through December 1, 2004 was an unduplicated count. We identified 975 duplicate student records within the total 26,941 students reported to OSEP by the Department as having exited special education from December 2003 through December 2004. We identified 923 duplicate student records within the total 26,175 students reported as exiting special education from December 2002 through December 2003.

(2) The Department did not verify the validity of the student data contained within the Michigan Compliance Information System (MiCIS). Beginning with the December 2003 count, the Department discontinued the data verification process. Prior to the December 2003 count, the Department sampled student data records included within the counts, traced the information back to source documents maintained at the LEAs, verified the student's age, and verified that special education services were provided to the student.

(3) The Department did not submit special education data to the USDOE by the required deadline. The Department is required to report the number of children who are receiving special education and related services to the USDOE by February 1 of each year. We noted that the Department's February 1, 2004 report was submitted 45 days late.

b. Subrecipient Monitoring

The Department's internal control did not ensure compliance with the subrecipient monitoring requirement for the Special Education Cluster as required by OMB Circular A-133, Section 400(d)(3). As a result, we questioned costs in the amount of $208,717. If the Department does not sufficiently monitor the activities of subrecipients, the Department cannot be assured that federal awards are used for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements.

Our review of the Department's subrecipient monitoring activities determined that the Department reviewed subrecipient program budgets for allowable activities and costs, provided training, appropriately identified federal award information to its subrecipients and performed program fiscal reviews. However, we identified the following weaknesses:

(1) The Department did not reduce the allocations of 12 LEAs that had not complied with the federal maintenance of effort requirement by a total of $208,717 during fiscal years 2003-04, 2002-03, and 2001-02. Federal regulation 34 *CFR* 300.231 requires LEAs to expend local funds for the education of children with disabilities greater than or equal to the level of those expenditures provided in the preceding fiscal year. Federal regulation 34 *CFR* 300.197 requires the Department to reduce or not provide any further payments to any LEA in noncompliance with this

requirement until the Department is satisfied that the LEA is complying with the requirement.

(2) The Department did not ensure that subrecipients submitted final narrative progress reports for each grant and did not document that program staff reviewed the progress reports to ensure that project goals were met. The two-year subrecipient grant application states that a final narrative progress report is due at the end of the two-year grant period for Part B flow-through grants.

We reviewed progress reports for 18 of the 59 LEAs that received Part B flow-through funding during the two-year period ended September 30, 2005. We noted that 3 (17%) of the 18 LEAs did not submit one of the final narrative progress reports required during our audit period. In addition, the Department did not document its review of 13 (41%) of the 32 final narrative progress reports submitted by the 18 LEAs during our audit period.

(3) The Department did not adequately document all program fiscal reviews. The Special Education Grants Manual describes a program fiscal review and identifies specific objectives that should be evaluated during each review. We reviewed the supporting documentation for 10 (43%) of the 23 program fiscal reviews performed during fiscal years 2004-05 and 2003-04. We could not determine that the Department reviewed all program fiscal review objectives during 3 (30%) of these 10 reviews.

(4) The Department had not analyzed the Federal Audit Clearinghouse database information to identify the subrecipients with Single Audits that audited the Special Education Cluster as a major program. Our review of the Federal Audit Clearinghouse database disclosed that 78% of the Special Education Cluster's total payments to subrecipients for fiscal year 2003-04 was audited as major program expenditures in the subrecipients' Single Audits. Consideration of the Single Audit coverage in determining which subrecipients to visit could increase the Department's subrecipient monitoring coverage and reduce duplication of effort in monitoring subrecipients that are in compliance with federal requirements.

We reported on the Department's deficiencies in reporting and subrecipient monitoring in our prior Single Audit. The Department agreed with the findings related to reporting and partially agreed with the findings related to subrecipient monitoring.

RECOMMENDATION

WE AGAIN RECOMMEND THAT THE DEPARTMENT IMPROVE ITS INTERNAL CONTROL TO ENSURE THAT THE SPECIAL EDUCATION CLUSTER COMPLIES WITH FEDERAL LAWS AND REGULATIONS REGARDING REPORTING AND SUBRECIPIENT MONITORING.

The status of the findings related to federal awards that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.

OTHER SCHEDULES

DEPARTMENT OF EDUCATION
Summary Schedule of Prior Audit Findings
As of September 30, 2005

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES AND FINANCIAL STATEMENTS

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310401
Finding Title: Act 272 Compliance

Finding: The Department of Education's internal auditor did not perform all of the duties and functions required by Section 18.1486(4) of the *Michigan Compiled Laws* (a section of Act 272, P.A. 1986).

Comments: The only change that the Department made was to give the Office of Audits a small amount of State funds for pupil audit activities.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310402
Finding Title: Food Donation, *CFDA* 10.550

Finding: The Department's internal control did not ensure that the Food Donation Program complied with federal laws and regulations regarding reporting.

Comments: This has been corrected. The Department implemented a process that requires staff to list every commodity that has a six-month inventory level for both the December and June reports.

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310404
Finding Title: Eisenhower Professional Development State Grants, *CFDA* 84.281

Finding: The Department's internal control did not ensure that the Eisenhower Professional Development State Grants Program complied with federal laws and regulations regarding subrecipient monitoring.

Comments: This finding is no longer applicable. The Eisenhower Professional Development State Grants Program has been replaced by the Title II, Part A Program, which does not require a local match.

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310406
Finding Title: Class Size Reduction, *CFDA* 84.340

Finding: The Department's internal control did not ensure that the Class Size Reduction Program complied with federal laws and regulations regarding subrecipient monitoring.

Comments: This finding is no longer applicable. Fiscal year 2001-02 was the last award year for this federal program.

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310407
Finding Title: Cash Management

Finding: The Department's internal control did not ensure compliance with federal cash management requirements.

Comments: The Department believes that its cash management clarification practices not only meet but exceed the federal requirements. In addition, the Grants Cash Management and Reporting System is

being enhanced to address the cash management issue at the subrecipient level.

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310408
Finding Title: Child Nutrition Cluster, *CFDA* 10.553, 10.555, and 10.556

Finding: The Department's internal control did not ensure that the Child Nutrition Cluster complied with federal laws and regulations regarding subrecipient monitoring.

Comments: This has been corrected. See the corrective action plan in the prior Single Audit for details.

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310409
Finding Title: Special Education - Grants for Infants and Families with Disabilities, *CFDA* 84.181

Finding: The Department's internal control did not ensure that the Special Education - Grants for Infants and Families with Disabilities (Early On) Program complied with federal laws and regulations regarding reporting and subrecipient monitoring.

Comments: The Department has complied with this finding.

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310411
Finding Title: Title I Accountability Grants, *CFDA* 84.348

Finding: The Department's internal control did not ensure that the Title I Accountability Grants Program complied with federal laws and regulations regarding subrecipient monitoring.

Comments: This finding is no longer applicable. Fiscal year 2002-03 was the last award year for this federal program.

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310412
Finding Title: School Renovation Grants, *CFDA* 84.352

Finding: The Department's internal control did not ensure that the School Renovation Grants Program complied with federal laws and regulations regarding subrecipient monitoring.

Comments: This finding was significantly complied with.

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310403
Finding Title: Special Education Cluster, *CFDA* 84.027 and 84.173

Finding: The Department's internal control did not ensure that the Special Education Cluster complied with federal laws and regulations regarding reporting and subrecipient monitoring.

Comments:
3.a.(1)(a) - Completed
3.a.(1)(b) - Completed
3.a.(1)(c) - Ongoing Michigan Compliance Information System (MiCIS) and Single Record Student Database (SRSD) development.
3.a.(2) - Ongoing
3.b.(1) - Ongoing
3.b.(2) - Ongoing
3.b.(3) - Ongoing

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310405
Finding Title: Charter Schools, *CFDA* 84.282

Finding: The Department's internal control did not ensure that the Charter Schools Program complied with federal laws and regulations regarding activities allowed or unallowed and subrecipient monitoring.

Comments: The Department now reviews both dissemination and planning grants against its more thorough understanding of allowable expenditures. On a bimonthly basis, the Department uses the grant project status report (R7140) to identify any grants that have completed their planned expenditures and uses the Michigan Education Grant System to monitor final expenditure reports against the approved budget. Other subrecipient monitoring activities have not changed.

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 310410
Finding Title: Education Technology State Grants, *CFDA* 84.318

Finding: The Department's internal control did not ensure that the Education Technology State Grants Program (formerly named Technology Literacy Challenge Fund) complied with federal laws and regulations regarding subrecipient monitoring.

Comments: The Grants Cash Management and Reporting System is being enhanced to address the cash management issue at the subrecipient level.

The Michigan Education Grants System has been enhanced to automatically reconcile final expenditure reports to approved budgets. In addition, the Michigan Education Grants System is being enhanced to produce a deviation report that will provide for efficient follow-up.

Regarding on-site fiscal reviews of subrecipients, although the U.S. Department of Education (USDOE) has not been specific about the level of fiscal monitoring required, the Department prepared a risk analysis to determine the adequacy of its subrecipient monitoring system. The risk analysis demonstrates the adequacy of the Department's system. The Department has not received a response to the contrary from the USDOE.

Audit Period: October 1, 2001 through September 30, 2003

Finding Number: 310413

Finding Title: Improving Teacher Quality State Grants, *CFDA* 84.367

Finding: The Department's internal control did not ensure that the Improving Teacher Quality State Grants (Improving Teacher Quality) Program complied with federal laws and regulations regarding subrecipient monitoring.

Comments: The Grants Cash Management and Reporting System is being enhanced to address the cash management issue at the subrecipient level.

The Michigan Education Grants System has been enhanced to automatically reconcile final expenditure reports to approved budgets. In addition, the Michigan Education Grants System is being enhanced to produce a deviation report that will provide for efficient follow-up.

Regarding on-site fiscal reviews of subrecipients, the Department prepared a risk analysis to determine the adequacy of its subrecipient monitoring system. The risk analysis demonstrates the adequacy of the Department's system. The Department has not received a response to the contrary from the USDOE.

DEPARTMENT OF EDUCATION
Corrective Action Plan
As of June 30, 2006

FINDINGS RELATED TO THE FINANCIAL SCHEDULES AND FINANCIAL STATEMENTS

Finding Number: 310601
Finding Title: Act 272 Compliance

Management Views: The Department of Education agrees with the underlying intent of the recommendation but is unable to comply due to a lack of resources.

The Office of Audits has historically focused its resources on the areas of highest risk. The first and second risk priorities are to provide adequate oversight of the $1.4 billion of federal assistance and $13 billion of State school aid. The Office of Audits has been given State funds for 20% of a position. The intent of the funds is to provide oversight of pupil membership audits. Twenty percent of a position is not adequate to do that and internal audit activities.

Due to ongoing budget cuts, the Department's General Fund administrative appropriations have been reduced by over 60%, while federal funds coming to the Department continue to increase. These reduced administrative dollars have significantly affected the Department's ability to carry out its State-mandated functions. Consequently, the Office of Audits is left with only 20% of a position for State-mandated internal audit activities.

In the past, as resources permitted, the Department increased time spent on its third priority, which is internal audit activities. Due to ongoing budget cuts,

the Department can do very few internal audits at this time. If State funding should become available, the Department will resume internal audit activities. When internal audit activities resume, the issue of organizational independence will be revisited.

Corrective Action: Not applicable

Anticipated Completion Date: Not applicable

Responsible Individual: Kathleen Weller

Finding Number: 310602
Finding Title: General Controls

Management Views: The Department agrees with the finding. System security for information technology (IT) applications is very important to the Department. The Department strongly supports comprehensive IT security during all phases of its IT projects. The Department has worked closely with its Department of Information Technology (DIT) partners to implement improvements over the last several years. The Department will continue to work with DIT to ensure that it has fundamentally sound IT security policies in effect.

Corrective Action: The Department is working with DIT to establish a comprehensive security policy, including the assignment of an information security officer and a set of procedures for the Department that will guide all of the IT related projects. With DIT support, the Department will be using some of the procedures that have been developed by the Center for Educational Performance and Information (CEPI). Access to data by programmers has already been addressed as part of the ongoing upgrades of the Grants Cash

Management and Reporting System and the State Aid Management System applications.

Anticipated Completion Date: December 2007

Responsible Individual: Louis Burgess

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 310603

Finding Title: English Language Acquisition Grants, *CFDA* 84.365

Management Views: The Department agrees with part of the finding and disagrees with part of it.

Corrective Action:

3.a. The Department disagrees with the questioned costs related to this part of the finding. The State of Michigan's economy has not made a robust recovery. The State has faced serious budgetary shortfalls in recent years and cuts have been made in several programs. The State's overall General Fund expenditures went down from $9.2 billion in fiscal year 2002-03 to $8.9 billion in fiscal year 2003-04. This overall reduction in general funds affected several programs, including the State's bilingual instruction program.

3.b. The Department will have difficulty fulfilling all of its monitoring responsibilities using a traditional model given the current levels of staffing allocations and caps imposed upon the Department. This is especially true if on-site monitoring is the most acceptable form for compliance with federal guidelines.

3.b.(1) Visits to schools in recent years have declined due to staffing levels and requirements to put other initiatives in place. During school year 2006-07, monitoring efforts will be increased through the use of a variety of monitoring techniques, including document review and telephone monitoring systems used by the federal government.

3.b.(2) A review of responses from local districts on the final expenditure report (DS-4044) will be checked against initial approved budgets and the discrepancies investigated via telephone conference. These changes will commence with school year 2006-07. Proposed procedural changes will be submitted to management and the Office of Audits by August 2006.

3.b.(3) The Department will discontinue the use of cash advances. Cash draws will be limited to reimbursements.

3.b.(4) The Office of Audits has provided program offices with a summary of Single Audit activities and results for use in their risk analyses.

3.c. The Department has not been able to monitor adequate yearly progress on a student-by-student basis because there was no unified test in place to test the acquisition of English by students served by Title III funds. However, with the use in spring 2006 of the English Language Proficiency Assessment (ELPA), a baseline will be determined for all limited English proficient students. The 2007 test will allow for

measurement of progress on a student-by-student basis.

Although the Department will diligently pursue corrective actions, due to corrective actions already completed, the Department believes that this is no longer material.

Anticipated Completion Date: School Year 2006-07

Responsible Individual: Linda Forward

Finding Number: 310604

Finding Title: Migrant Education - State Grant Program, *CFDA* 84.011

Management Views: The Department partially agrees with the finding.

Corrective Action:

4.a. Where the auditors found that the Department did not properly account for funds, it is suggested that, according to Title 34, Part 81, section 32 of the *Code of Federal Regulations* (*CFR*), only the amount that is proportional to the extent of the harm caused should be questioned. Since only eligible beneficiaries were served or benefited from the allocations, the extent of the harm is negligible. This will be remedied for future allocations and the students should not be negatively affected with a disallowance. Future allocations will be based on an automated calculation system now in place through the Migrant Education Database System.

4.b.(1) The Department has willingly participated in the re-interview process that the Office of Migrant Education, U.S. Department of

Education (USDOE), requested for the 2000 through 2004 migrant seasons and beyond. It is anticipated that this new form of monitoring will uncover issues such as those found in the audit sample. Although the Department's error rate is well below the national average, it is working with the USDOE Office of Migrant Education to remedy the situation. This process will address the finding. Additional on-line evaluation and subsequent targeted training for recruiters will alleviate the issue. The first on-line evaluation will take place in June 2006.

4.b.(2) The Department will have difficulty fulfilling all of its monitoring responsibilities given the current levels of staffing allocations and caps imposed upon the Department. This is especially true if on-site monitoring is the most acceptable form for compliance with federal guidelines.

Visits to schools in recent years have declined due to staffing levels and requirements to put other initiatives in place. During school year 2006-07, monitoring efforts will be increased through the use of a variety of monitoring techniques, including document review and telephone monitoring systems used by the federal government.

4.b.(3) Additionally, a review of responses from local districts on the final expenditure report (DS-4044) will be checked against initial approved budgets and the discrepancies investigated via telephone conference. These changes will commence with school year

2006-07. Proposed procedural changes will be submitted to management and the Office of Audits by August 2006.

4.b.(4) The Department will discontinue the use of cash advances. Cash draws will be limited to reimbursements.

4.b.(5) The Office of Audits has provided program offices with a summary of Single Audit activities and results for use in their risk analyses.

Although the Department will diligently pursue corrective actions, due to corrective actions already completed, the Department believes that this is no longer material.

Anticipated Completion Date: School Year 2006-07

Responsible Individual: Linda Forward

Finding Number: 310605

Finding Title: Charter Schools, *CFDA* 84.282

Management Views: In response to the noted exception regarding subrecipient monitoring, the Public School Academy Program (PSAP), Office of School Improvement, has devised a plan for implementation of a process for subrecipient monitoring of grantees. PSAP has developed draft documents for use in subrecipient monitoring of the federal Charter School Program grants to subrecipients. Beginning with the 2004-05 grant period, PSAP will conduct desk audits of 100% of grantees, including grants awarded for the Planning/Implementation, Implementation, and Dissemination grant projects.

Corrective Action:

The desk audit will review the school's compliance with legal requirements as evidenced in the charter contract documents, project requirements, and fiscal requirements. Based upon the desk review of the Planning/Implementation grantees, a risk analysis will be completed to determine those to be selected for on-site review of approximately 25% of the Implementation (second year) project subrecipients. The risk analysis will be based upon: (1) PSAP review of cash drawdowns for grant expenditures, (2) whether a Single Audit was completed by the subrecipient in the past fiscal year, (3) PSAP history with the school operator or educational service provider in meeting other grant criteria and requirements, and (4) other concerns identified by PSAP staff in their work with the school or its educational service provider in the administration of the Planning/Implementation grant. PSAP will finalize its monitoring processes in April for implementation by May 1, 2006. It is expected that subrecipient grantees (Implementation grant projects) will be identified in May for on-site monitoring to begin by June 15, 2006. Because of the small number of subgrantees awarded the Dissemination grant, all project subrecipients will be included in on-site monitoring and review following the desk review.

On-site monitoring will review: (1) subgrantee procurement procedures and their effectiveness upon internal control, (2) compliance with procedures for competitive bidding and purchase of supplies, materials, and equipment as required under Section 380.1274 of the *Michigan Compiled Laws* (Section 1274 of the Revised School Code), (3) determination of purchasing decisions and review of a sample of purchases to determine allowability under federal and State requirements, (4) whether durable supplies, equipment, and materials purchased

with grant funds are properly inventoried and a sample selected for review of those items and current use in the school, and (5) salaries and contractual services charged to the grant and their allowability under federal and State requirements.

The Department will discontinue the use of cash advances. All cash draws will be limited to reimbursements.

The Office of Audits has provided program offices with a summary of Single Audit activities and results for use in their risk analyses.

Although the Department will diligently pursue corrective actions, due to corrective actions already completed, the Department believes that this is no longer material.

Anticipated Completion Date: September 2006

Responsible Individual: Joann Neuroth

Finding Number: 310606

Finding Title: Comprehensive School Reform Demonstration, *CFDA* 84.332

Management Views: The Department partially agrees.

Corrective Action: Where the auditors found that the Department did not properly account for funds, it is suggested that, according to federal regulation 34 *CFR* 81.32, only the amount that is proportional to the extent of the harm caused should be questioned. Since only eligible beneficiaries were served or benefited from the allocations, only eligible services were allowed and the extent of the harm is negligible. This will be remedied

in 2006 and the students should not be negatively affected by a disallowance.

This is the last year of the grant. The Department will monitor the districts' expenditures to ensure that they are made during the period of availability.

Although the Department will diligently pursue corrective actions, due to corrective actions already completed, the Department believes that this is no longer material.

Anticipated Completion Date: Ongoing

Responsible Individual: Linda Forward

Finding Number: 310607

Finding Title: Improving Teacher Quality State Grants, *CFDA* 84.367

Management Views: The Department agrees with the finding.

Corrective Action:

7.a. Although maintenance of effort reductions were calculated, they were not entered into the Michigan Electronic Grants System or the Grants Cash Management and Reporting System. The Department will recover the overpayments to districts by reducing their 2006-07 allocations.

7.b. The number of on-site reviews conducted by the Department will be increased to ensure that the funds are used for allowable activities. The Field Services Unit is planning to increase compliance activities in addition to the on-site review. This new procedure, for monitoring and oversight, will be implemented beginning in school year 2006-07.

7.c. The Department is developing a computerized system to identify subrecipients with deviations between their final expenditure reports and approved budgets that exceed the limits allowed by the Education Department General Administrative Regulations (EDGAR). Staff will follow up with these subrecipients to determine whether the deviation is a reporting error, can be resolved through a budget amendment, or must be disallowed. This review is being added to the revised compliance and oversight plan to ensure that it happens annually.

7.d. The Department will discontinue the use of cash advances. All cash draws will be limited to reimbursements.

7.e. The Office of Audits has provided program offices with a summary of Single Audit activities and results for use in their risk analyses. The Field Services Unit will use this reference when planning on-site reviews beginning in school year 2006-07.

Anticipated Completion Date: School Year 2006-07

Responsible Individual: Yvonne Caamal Camul

Finding Number: 310608

Finding Title: Education Technology State Grants, *CFDA* 84.318

Management Views: The Department agrees with this finding.

Corrective Action: 8.a. Although the Department maintains a tracking system for following up on deficiencies identified through on-site monitoring, the system did not ensure appropriate follow-up in all cases. The

importance of utilizing the tracking system to ensure that deficiencies are corrected will be emphasized with staff. The manager will add safeguards to the system to ensure that efforts to follow up on every on-site review are documented.

8.b. The Department has developed a computerized system to identify subrecipients whose final expenditure reports indicate that they did not meet their professional development earmarking requirement. Staff will follow up with these districts to determine whether this is the result of a reporting error or an actual failure to spend the required amount on professional development. Districts that did not spend the required amount will be required to budget the additional amount needed in their budgets for the following year. This review is being added to the revised compliance and oversight plan.

8.c. The Department will discontinue the use of cash advances. Cash draws will be limited to reimbursements.

8.d. The Office of Audits has provided program offices with a summary of Single Audit activities and results for use in their risk analyses. The Field Services Unit will use this reference when planning on-site reviews beginning in school year 2006-07.

Anticipated Completion Date: School Year 2006-07

Responsible Individual: Yvonne Caamal Camul

Finding Number: 310609

Finding Title: Special Education Cluster, *CFDA* 84.027 and 84.173

Management Views:

9.a.(1) The Office of Special Education and Early Intervention Services (OSE/EIS) agrees that there was a duplication error with the data for exited special education students. The duplication error occurred when the same student exited multiple districts within the same year.

9.a.(2) OSE/EIS agrees that verification was not done to validate the student data contained within the Michigan Compliance Information System (MiCIS).

9.a.(3) OSE/EIS agrees that the Department did not submit special education data to the USDOE by the required deadline. Reports since this time have been submitted on time, with the exception of the new Assessments Table #6, which was sent in two days late in February 2006.

9.b.(1) OSE/EIS agrees. OSE/EIS continues to work to resolve the maintenance of effort shortfall amounts with the districts.

9.b.(2) OSE/EIS agrees that not all of the reports for Part B flow-through funding that ended June 30, 2005 were submitted or reviewed by their prospective time lines. Of the 3 local educational agencies (LEAs) that had not submitted a final narrative progress report, 2 have since submitted their reports. These 2 reports have since had a documented review done. Of the 13 LEAs that did not have a

documented review for the final narrative progress report, all 13 have since been reviewed.

9.b.(3) OSE/EIS agrees that adequate documentation was not completed for three program fiscal reviews.

Corrective Action:

9.a.(1) The collection process will be changed this summer to using Single Record Student Database (SRSD) data, which will eliminate duplicate records from different districts for the same student.

9.a.(2) A process will be developed by OSE/EIS that provides assurance of an accurate count.

9.a.(3) A process will be established to create a standard working condition among the Department offices that will ensure that necessary data is collected and reported to the requesting Department office in order to meet time lines.

9.b.(1) OSE/EIS is determining what corrective action, repayment, or allocation reduction options are/were available. For the three audit periods in question, OSE/EIS is preparing a repayment letter that will be sent to the LEAs. The LEAs must then use their local funds to repay the maintenance of effort shortfall. Beginning with the 2004-05 maintenance of effort reporting year, OSE/EIS will immediately seek repayment from the LEAs by the amount of the shortfall.

9.b.(2) A process will be established to ensure both timely submissions by the LEAs and a timely review process by OSE/EIS. Additional personnel have been added to the process to aid in the review of these reports.

9.b.(3) A fiscal control review sheet is currently being used to ensure that all steps of a program fiscal review are completed. An additional line will be added to this form that includes a verification that the checklist has been completed and has been placed in the file.

9.b.(4) The Office of Audits has provided program offices with a summary of Single Audit activities and results for use in their risk analyses.

Anticipated Completion Date:

9.a.(1): Summer 2006
9.a.(2): June 30, 2006
9.a.(3): September 30, 2006
9.b.(1): June 30, 2006
9.b.(2): September 30, 2006
9.b.(3): Completed
9.b.(4): Completed

Responsible Individuals:

9.a.(1)/9.a.(2)/9.a.(3): Darren Warner (517.241.0786)
9.b.(1): Monica Butler (517.241.4518)
9.b.(2): Linda Domine (517.373.6309)
9.b.(3): John Andrejack (517.373.2949)
9.b.(4): Kathleen Weller (517.335.6858)

GLOSSARY

CFDA	*Catalog of Federal Domestic Assistance.*
CFR	*Code of Federal Regulations.*
CSP	Charter Schools Program.
CSR	Comprehensive School Reform Demonstration.
DIT	Department of Information Technology.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
GAAP	generally accepted accounting principles.
Improving Teacher Quality	Improving Teacher Quality State Grants.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
IT	information technology.
LEAs	local educational agencies.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single

	Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
material noncompliance	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
NCLB	No Child Left Behind.
OMB	U.S. Office of Management and Budget.
OSE/EIS	Office of Special Education and Early Intervention Services.
OSEP	Office of Special Education Programs.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
PSAP	Public School Academy Program.

qualified opinion An auditor's opinion in which the auditor:

a. Identifies a scope limitation or one or more instances of misstatements that impact the fair presentation of the financial schedules and/or financial statements presenting the basic financial information of the audited agency in conformity with the disclosed basis of accounting or the financial schedules presenting supplemental financial information in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or

b. Expresses reservations about the audited agency's compliance, in all material respects, with the cited requirements that are applicable to each major federal program. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves.

questioned costs A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document

governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

reportable condition — A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Violations of State laws, regulations, contracts, and grant agreements that should be communicated to management but are not material to the financial schedules and/or financial statements may also be reported.

SEA — state educational agency.

Single Audit — A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

SOMCAFR — *State of Michigan Comprehensive Annual Financial Report.*

subrecipient	An nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.
unqualified opinion	An auditor's opinion in which the auditor states that: a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.
USC	*United States Code.*
USDOE	U.S. Department of Education.

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STATE OF MICHIGAN

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