MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

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

MICHIGAN DEPARTMENT OF EDUCATION

October 1, 2005 through September 30, 2007

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

313-0100-08

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 can 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:
313-0100-08

Michigan Department of Education

October 1, 2005 through September 30, 2007

Released:
June 2008

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 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 Michigan Department of Education's (MDE's) financial schedules and on the School Aid Fund's financial statements.

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Internal Control Over Financial Reporting

We identified significant deficiencies in internal control over financial reporting (Findings 1 and 2). We consider Finding 1 to be a material weakness.

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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 15 programs as major programs and issued 15 unqualified opinions. The federal programs audited as major programs are identified on the back of this summary.

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Internal Control Over Major Programs

We identified significant deficiencies related to internal control over major programs (Findings 3 through 13). We do not consider these significant deficiencies 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 the U.S. Office of Management and Budget (OMB) Circular A-133 (Findings 3 through 13).

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Systems of Accounting and Internal Control:
We determined that MDE was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*.

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We audited the following programs as major programs:

CFDA Number	***Program or Cluster Title***	***Compliance Opinion***
10.553, 10.555, 10.556, and 10.559	Child Nutrition Cluster	Unqualified
84.010	Title I Grants to Local Educational Agencies	Unqualified
84.011	Migrant Education - State Grant Program	Unqualified
84.027 and 84.173	Special Education Cluster (IDEA)	Unqualified
84.186	Safe and Drug-Free Schools and Communities - State Grants	Unqualified
84.196	Education for Homeless Children and Youth	Unqualified
84.282	Charter Schools	Unqualified
84.287	Twenty-First Century Community Learning Centers	Unqualified
84.298	State Grants for Innovative Programs	Unqualified
84.318	Education Technology State Grants	Unqualified
84.332	Comprehensive School Reform Demonstration	Unqualified
84.357	Reading First State Grants	Unqualified
84.365	English Language Acquisition Grants	Unqualified
84.366	Mathematics and Science Partnerships	Unqualified
84.367	Improving Teacher Quality State Grants	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

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

June 30, 2008

Mr. Michael P. Flanagan
Superintendent of Public Instruction
Michigan Department of Education
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 Michigan Department of Education (MDE) for the period October 1, 2005 through September 30, 2007.

This report contains our report summary; our independent auditor's reports on the financial schedules and financial statements; and the MDE financial schedules, School Aid Fund 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 MDE'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.

AUDITOR GENERAL

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

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

Independent Auditor's Report on the Financial Schedules

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

Dear Mr. Flanagan:

We have audited the accompanying financial schedules of the Michigan Department of Education for the fiscal years ended September 30, 2007 and September 30, 2006, 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 the sources and disposition of authorizations for the Michigan Department of Education's General Fund accounts, presented 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 the sources and disposition of authorizations of the Michigan Department of Education for the fiscal years ended September 30, 2007 and September 30, 2006 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 25, 2008 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.

AUDITOR GENERAL

June 25, 2008

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

Independent Auditor's Report on the Financial Statements

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

Dear Mr. Flanagan:

We have audited the accompanying financial statements of the School Aid Fund, Michigan Department of Education, as of and for the fiscal years ended September 30, 2007 and September 30, 2006, 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, 2007 and September 30, 2006 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, 2007 and September 30, 2006 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 June 25, 2008 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 the Governmental Accounting Standards Board. 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.

AUDITOR GENERAL

June 25, 2008

MICHIGAN DEPARTMENT OF EDUCATION
Schedule of General Fund Revenues
Fiscal Years Ended September 30

	2007	2006
REVENUES		
From federal agencies (Note 1)	$ 44,240,151	$ 46,526,189
From local agencies	30,543	25,174
From licenses and permits	4,488,100	4,041,801
Miscellaneous	1,592,383	1,928,816
Total revenues	$ 50,351,177	$ 52,521,980

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

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

	2007	2006
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations	$ 41,188,300	$ 79,114,400
Balances carried forward	2,723,336	2,979,801
Restricted financing sources	53,896,415	56,246,883
Less: Intrafund expenditure reimbursements	(4,514,846)	(4,251,950)
Total	$ 93,293,205	$ 134,089,134
DISPOSITION OF AUTHORIZATIONS (Note 2)		
Gross expenditures and transfers	$ 94,035,402	$ 134,465,332
Less: Intrafund expenditure reimbursements	(4,514,846)	(4,251,950)
Net expenditures and transfers	$ 89,520,556	$ 130,213,382
Balances carried forward:		
Encumbrances	$ 41,960	$ 100,189
Multi-year projects		325,209
Restricted revenues - not authorized or used	2,047,885	2,297,938
Total balances carried forward	$ 2,089,845	$ 2,723,336
Balances lapsed	$ 1,682,804	$ 1,152,416
Total	$ 93,293,205	$ 134,089,134

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 financial transactions of the Michigan Department of Education (MDE) for the fiscal years ended September 30, 2007 and September 30, 2006. The financial transactions of MDE are accounted for in the State's General Fund and in the School Aid Fund. Both the General Fund and School Aid Fund are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

The notes accompanying these financial schedules relate directly to MDE. 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 accounting principles generally accepted in the United States of America (GAAP). 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 the sources and disposition of authorizations for MDE's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either MDE 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 or used 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 or used.

c. Restricted financing sources: Collections of restricted revenues and restricted transfers, net of 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 or used.

d. Intrafund expenditure reimbursements: Funding from other General Fund departments to finance a program or a portion of a program that is the responsibility of the receiving department.

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

f. Multi-year projects: Unexpended authorizations for work projects and capital outlay projects that are carried forward to subsequent fiscal years for the completion of the projects.

g. Restricted revenues - not authorized or used: 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 2006-07 and 2005-06 carry-forwards of this type were certification fees of $1,176,788 and $1,487,460, respectively.

h. 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
Michigan Department of Education
Balance Sheet
As of September 30
(In Thousands)

	2007	2006
ASSETS		
Current assets:		
Taxes, interest, and penalties receivable (Note 6)	$ 2,151,194	$ 2,092,181
Amounts due from other funds	10,901	18,017
Amounts due from federal agencies	43,168	51,085
Amounts due from local units	41,822	43,574
Total current assets	$ 2,247,084	$ 2,204,857
Noncurrent assets:		
Taxes, interest, and penalties receivable	53,642	48,318
Amounts due from local units	8,457	5,845
Total assets	$ 2,309,183	$ 2,259,020
LIABILITIES AND FUND BALANCE		
Current liabilities:		
Warrants outstanding	$ 413	$ 650
Accounts payable and other liabilities	143,457	139,365
Amounts due to other funds (Note 5)	1,645,750	1,737,986
Deferred revenue	371,925	325,351
Total current liabilities	$ 2,161,545	$ 2,203,352
Long-term liabilities:		
Deferred revenue	53,642	48,318
Total liabilities	$ 2,215,187	$ 2,251,670
Fund balance:		
Reserved fund balance (Note 7)	$ 93,996	$ 7,350
Total fund balance	$ 93,996	$ 7,350
Total liabilities and fund balance	$ 2,309,183	$ 2,259,020

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

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

	2007	2006
REVENUES		
Taxes (Note 2):		
Sales	$ 4,768,554	$ 4,831,254
Personal income	2,110,353	2,038,983
Property	2,080,977	2,003,527
Use	460,381	458,890
Cigarette	450,377	472,199
Industrial facilities	136,691	135,595
Liquor	35,689	34,497
Commercial facilities (forest tax)	3,117	2,904
Casino gaming wagering	106,681	104,069
Real estate transfer	237,483	297,680
Other	13,952	14,378
Total taxes	$10,404,255	$10,393,976
From federal agencies	1,383,340	1,360,742
Miscellaneous	29,300	84,914
Total revenues	$11,816,895	$11,839,632
EXPENDITURES		
Proposal A (Note 2)	$ 6,236,737	$ 6,433,324
Discretionary payment	3,314,286	3,216,903
Special education	942,997	911,146
At risk students	310,457	310,457
Equity payments	19,642	
Declining Enrollment	20,000	
Vision and Hearing	5,150	
Intermediate school districts	64,417	77,702
Adult education	24,000	20,999
School readiness grants	98,799	88,599
Vocational education	38,710	38,992
School lunch	20,799	20,903
Mathematics and science	23,500	2,500
Health and science middle college	2,000	
Pre-college engineering	680	
Court-placed children	8,000	8,000
Juvenile detention facilities	3,000	
Challenge Program	1,253	
School bus inspections and driver safety	2,880	1,578
Gifted and talented	190	180
Bilingual education	2,800	2,800
Renaissance zone	33,819	28,666
Non-Durant district settlements (Note 4)	31,687	66,506
Borrowing costs	22,800	
Teen health centers	3,743	3,743
PILT (payment in lieu of taxes) reimbursement	3,344	3,330
State assessments	27,043	
School breakfast	8,612	
Federal non-special education	1,047,186	1,029,147
Federal special education	340,143	337,840
Court settlements		1,160
Other	19,903	32,007
Total expenditures	$12,678,577	$12,636,481
Excess of revenues over (under) expenditures	$ (861,682)	$ (796,849)
OTHER FINANCING SOURCES (USES)		
Transfers from other funds	$ 990,810	$ 750,731
Transfers to other funds	(42,482)	(44,500)
Total other financing sources (uses)	$ 948,328	$ 706,231
Net change in fund balances	$ 86,646	$ (90,617)
Fund Balance - Beginning of fiscal year	7,350	97,968
Fund Balance - End of fiscal year	$ 93,996	$ 7,350

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, Michigan Department of Education (MDE), as of and for the fiscal years ended September 30, 2007 and September 30, 2006. 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 accounting principles generally accepted in the United States of America. 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 accounting principles generally accepted in the United States of America.

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 2006-07 and 2005-06, MDE 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 avoided in fiscal year 2006-07 by issuing credits to local school districts, intermediate school districts, and charter schools of $262 million to reduce their contribution

to the Michigan Public School Employees Retirement System in lieu of payments under Section 22b of the State School Aid Act.

Note 3 Contingencies

a. *Adair et al.* v *State of Michigan et al.*

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. On March 8, 2006, the Michigan Supreme Court, in lieu of granting leave to appeal, vacated the August 4, 2005 judgment of the Court of Appeals and remanded the case to the Court of Appeals for reevaluation of plaintiffs' claims. 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

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 related to the personal property tax table depreciation schedule of utility companies. The settlement was presented to and approved by the Michigan Tax Tribunal in 2006. As of September 30, 2007, $54.2 million remains to be paid in school aid payments for prior fiscal years because school districts and other taxing units will be required to refund utility companies. These additional payments will be paid from the School Aid Fund as follows:

Fiscal Year	Amount Scheduled To Be Paid
2007-08	$11.0 million
2008-09	$15.0 million
2009-10	$16.3 million
2010-11	$11.9 million

These amounts will be reflected in the School Aid Fund financial statements as they become due and payable.

Note 4 Commitments

Donald 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 2006-07 and 2007-08. The estimated aggregate payments to the non-Durant school districts will total $754.2 million. As of September 30, 2007, the remaining expected amount to be paid to the non-Durant school districts totaled $271.8 million.

Note 5 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 $1.6 billion for fiscal year 2006-07 and $1.7 billion for fiscal year 2005-06.

Note 6 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 and the underlying economic event occurred on or before September 30. For example, sales and use taxes are accrued to the extent that the related sales occurred before October 1 and the State receives tax payments before 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)

	2007	2006
Total taxes receivable	$ 2,545,720	$ 2,480,918
Less allowance for uncollectible receivables	(340,885)	(340,420)
Less taxes to be received more than 12 months after fiscal year-end	(53,642)	(48,318)
Current taxes receivable	$ 2,151,194	$ 2,092,181

Note 7 Reserved Fund Balance

The reserved fund balance as of September 30 consists of the following (in thousands):

	2007	2006
Work projects	$ 1,574	$1,270
Encumbrances	1,614	235
Noncurrent assets	8,457	5,845
Restricted revenues	82,351	
Total reserved	$93,996	$7,350

The restricted revenues are carried forward to the School Aid Stabilization Fund. Act 158, P.A. 2003, effective October 1, 2003, created the School Aid Stabilization Fund as a separate account within the School Aid Fund. Pursuant to this Act, any remaining fund balance in the School Aid Fund at year-end is transferred to this account and is restricted for future appropriations of the School Aid Fund.

Note 8 Subsequent Events

In fiscal year 2007-08, Midland Cogeneration Venture, the City of Midland, and the Michigan Tax Tribunal reached an agreement related to prior year property value assessments for Midland Cogeneration Venture. In the funding formula

for school aid payments, changes in property value assessments result in adjustments to payments to the affected school districts. This agreement will result in additional school aid payments of $36.4 million in fiscal year 2007-08 and $7.7 million in fiscal year 2008-09.

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REQUIRED SUPPLEMENTARY INFORMATION

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

	2007			
Statutory/Budgetary Basis	Original Budget	Final Budget	Actual	Variance With Final Budget
Beginning budgetary fund balance	$ 1,270	$ 1,270	$ 1,270	$ 0
Resources (inflows)				
Taxes	$ 10,842,400	$ 10,404,255	$ 10,404,255	$ 0
From federal agencies	1,411,237	1,383,340	1,383,340	0
Miscellaneous		29,300	29,300	0
Transfers in	745,000	990,810	990,810	0
Total revenue inflows	$ 12,998,637	$ 12,807,704	$ 12,807,704	$ 0
Amount available for appropriation	$ 12,999,907	$ 12,808,974	$ 12,808,974	$ 0
Charges to appropriations (outflows)				
Education	$ 13,093,745	$ 12,733,859	$ 12,722,438	$ 11,421
Total charges to appropriations	$ 13,093,745	$ 12,733,859	$ 12,722,438	$ 11,421
Reconciling items:				
Change in noncurrent assets	$ -	$ (2,612)	$ (2,612)	$ 0
Net reconciling items	$ -	$ (2,612)	$ (2,612)	$ 0
Ending budgetary fund balance	$ (93,838)	$ 72,503	$ 83,925	$ 11,421

See accompanying notes to required supplementary information.

2006			
Original Budget	Final Budget	Actual	Variance With Final Budget
$ 93,668	$ 93,668	$ 93,668	$ 0
$ 10,695,999	$ 10,393,976	$ 10,393,976	$ 0
1,392,587	1,360,742	1,360,742	0
44,500	84,914	84,914	0
717,014	750,731	750,731	0
$ 12,850,100	$ 12,590,363	$ 12,590,363	$ 0
$ 12,943,768	$ 12,684,032	$ 12,684,032	$ 0
$ 12,757,151	$ 12,688,284	$ 12,680,471	$ 7,812
$ 12,757,151	$ 12,688,284	$ 12,680,471	$ 7,812
$ -	$ (2,291)	$ (2,291)	$ 0
$ -	$ (2,291)	$ (2,291)	$ 0
$ 186,617	$ (6,543)	$ 1,270	$ 7,812

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

	2007	2006
Sources/inflows of resources		
Actual amount (budgetary basis) available for appropriation from the budgetary comparison schedule	$ 12,808,974	$ 12,684,031
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	(1,270)	(93,668)
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(990,810)	(750,731)
Total revenues as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance	$ 11,816,894	$ 11,839,632
Uses/outflows of resources		
Actual amount (budgetary basis) of total expenditures and encumbrances from the budgetary comparison schedule	$ 12,722,438	$ 12,680,471
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	(1,378)	509
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(42,482)	(44,500)
Total expenditures as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance	$ 12,678,577	$ 12,636,481

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 2006-07 and 2005-06, as well as the actual revenues and other sources (inflows), expenditures and encumbrances (outflows), 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, 2006 and October 1, 2005, respectively, and the original budget includes multi-year projects budgetary carry-forwards from the prior fiscal year.

Accounting principles generally accepted in the United States of America (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. Therefore, the "Original Budget" and "Final Budget" columns do not include encumbrance authorization balances carried over from the prior 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.

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SUPPLEMENTAL
FINANCIAL SCHEDULE

MICHIGAN DEPARTMENT OF EDUCATION
Schedule of Expenditures of Federal Awards (Note 1)
For the Period October 1, 2005 through September 30, 2007

Federal Agency/Program or Cluster	*CFDA** Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2006 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		$	$ 49,231,281	$ 49,231,281
National School Lunch Program	10.555		21,349	194,923,491	194,944,840
Special Milk Program for Children	10.556			762,470	762,470
Summer Food Service Program for Children	10.559		123,392	4,054,272	4,177,664
Total Child Nutrition Cluster			$ 144,741	$ 248,971,514	$ 249,116,255
Emergency Food Assistance Cluster:					
Direct Program:					
Emergency Food Assistance Program (Administrative Costs)	10.568		$ 47,262	$ 2,189,223	$ 2,236,485
Total Emergency Food Assistance Cluster (Note 2)			$ 47,262	$ 2,189,223	$ 2,236,485
Direct Programs:					
Child and Adult Care Food Program	10.558		$ 455,265	$ 51,354,126	$ 51,809,391
State Administrative Expenses for Child Nutrition	10.560		4,041,494		4,041,494
Commodity Supplemental Food Program	10.565		126,539	4,372,627	4,499,166
Team Nutrition Grants	10.574			180,097	180,097
Child Nutrition Discretionary Grants Limited Availability	10.579		82,620		82,620
Fresh Fruit and Vegetable Program	10.582			741,398	741,398
Total Direct Programs			$ 4,705,918	$ 56,648,248	$ 61,354,166
Total U.S. Department of Agriculture			**$ 4,897,921**	**$ 307,808,985**	**$ 312,706,906**
U.S. Department of Defense					
Direct Program:					
Contract for Defense Activity for Non-Traditional Education Support	12.N3569703MDTM **		$ 128,959	$	$ 128,959
Total U.S. Department of Defense			**$ 128,959**	**$ 0**	**$ 128,959**
U.S. Department of Education					
Special Education Cluster (IDEA):					
Direct Programs:					
Special Education - Grants to States	84.027		$ 13,788,770	$ 356,888,056	$ 370,676,826
Special Education - Preschool Grants	84.173		449,754	12,434,021	12,883,775
Total Special Education Cluster			$ 14,238,524	$ 369,322,077	$ 383,560,601
Direct Programs:					
Contract with National Center for Education Statistics	84.ED03CO0074 **		$ 158,828	$	$ 158,828
Title I Grants to Local Educational Agencies	84.010		4,672,328	425,600,942	430,273,270
Migrant Education - State Grant Program	84.011		412,434	8,587,999	9,000,433
Title I Program for Neglected and Delinquent Children	84.013		7,481	543,769	551,250
Special Education - Grants for Infants and Families with Disabilities	84.181		436,966	13,167,573	13,604,539
Safe and Drug-Free Schools and Communities - National Programs	84.184		657,395		657,395
Safe and Drug-Free Schools and Communities - State Grants	84.186		344,039	12,109,767	12,453,806
Education for Homeless Children and Youth	84.196		205,886	1,430,038	1,635,924
Even Start - State Educational Agencies	84.213		429,953	5,953,749	6,383,702
Fund for the Improvement of Education	84.215		8		8
Charter Schools	84.282		394,502	7,050,003	7,444,505
Twenty-First Century Community Learning Centers	84.287		972,901	27,814,792	28,787,693
State Grants for Innovative Programs	84.298		1,446,876	6,290,344	7,737,220
Education Technology State Grants	84.318		1,064,266	12,650,839	13,715,105
Special Education - State Personnel Development	84.323			1,500,501	1,500,501
Advance Placement Program	84.330		132,399		132,399
Comprehensive School Reform Demonstration	84.332		401,173	8,936,991	9,338,164
Teacher Quality Enhancement Grants	84.336			475,483	475,483
Class Size Reduction	84.340				0

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2007			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
$	$ 50,441,790	$ 50,441,790	$ 99,673,071
78,227	200,961,259	201,039,486	395,984,326
	672,075	672,075	1,434,545
156,802	5,029,801	5,186,603	9,364,267
$ 235,029	$ 257,104,925	$ 257,339,954	$ 506,456,209
$ 30,519	$ 2,072,862	$ 2,103,381	$ 4,339,866
$ 30,519	$ 2,072,862	$ 2,103,381	$ 4,339,866
$ 476,849	$ 51,025,555	$ 51,502,404	$ 103,311,795
4,229,786		4,229,786	8,271,280
99,080	4,561,878	4,660,958	9,160,124
	180,311	180,311	360,408
267,607		267,607	350,227
	961,952	961,952	1,703,350
$ 5,073,322	$ 56,729,696	$ 61,803,018	$ 123,157,184
$ 5,338,870	**$ 315,907,483**	**$ 321,246,353**	**$ 633,953,259**
$ 136,393	$	$ 136,393	$ 265,352
$ 136,393	**$ 0**	**$ 136,393**	**$ 265,352**
$ 9,452,963	$ 367,216,090	$ 376,669,053	$ 747,345,879
574,777	12,601,094	13,175,871	26,059,646
$ 10,027,740	$ 379,817,184	$ 389,844,924	$ 773,405,525
$ 169,221	$	$ 169,221	$ 328,049
5,332,504	446,191,492	451,523,996	881,797,266
427,098	7,005,169	7,432,267	16,432,700
7,393	752,430	759,823	1,311,073
517,025	12,985,503	13,502,528	27,107,067
880,095		880,095	1,537,490
279,385	10,662,191	10,941,576	23,395,382
173,359	1,449,912	1,623,271	3,259,195
122,854	3,377,178	3,500,032	9,883,734
2,140		2,140	2,148
409,449	7,035,726	7,445,175	14,889,680
950,194	26,843,814	27,794,008	56,581,701
806,291	3,433,207	4,239,498	11,976,718
510,677	12,752,675	13,263,352	26,978,457
	856,813	856,813	2,357,314
193,212		193,212	325,611
66,815	6,524,583	6,591,398	15,929,562
	172,605	172,605	648,088
	(2,469)	(2,469)	(2,469)

MICHIGAN DEPARTMENT OF EDUCATION
Schedule of Expenditures of Federal Awards (Note 1)
For the Period October 1, 2005 through September 30, 2007
Continued

Federal Agency/Program or Cluster	*CFDA* * Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2006 Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Reading First State Grants	84.357		$ 7,872,878	$ 29,439,735	$ 37,312,613
Rural Education	84.358		26,997	565,222	592,219
English Language Acquisition Grants	84.365		447,907	9,633,621	10,081,528
Mathematics and Science Partnerships	84.366		290,780	4,188,027	4,478,807
Improving Teacher Quality State Grants	84.367		3,570,207	104,473,645	108,043,852
Grants for State Assessments and Related Activities	84.369		4,951,239		4,951,239
Statewide Data Systems	84.372		19,246		19,246
Hurricane Education Recovery	84.938		1,756,855	932,554	2,689,409
Total Direct Programs			$ 30,673,544	$ 681,345,594	$ 712,019,138
Total U.S. Department of Education			**$ 44,912,068**	**$ 1,050,667,671**	**$ 1,095,579,739**
U.S. Department of Health and Human Services					
Direct Programs:					
Refugee and Entrant Assistance - Discretionary Grants	93.576		$	$ 96,835	$ 96,835
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938		564,646	388,073	952,719
Total Direct Programs			$ 564,646	$ 484,908	$ 1,049,554
Pass-Through Program:					
Michigan Department of Human Services					
Child Care and Development Block Grant	93.575	93.575	$ 26,924	$	$ 26,924
Total U.S. Department of Health and Human Services			**$ 591,570**	**$ 484,908**	**$ 1,076,478**
Corporation for National and Community Service					
Direct Program:					
Learn and Serve America - School and Community Based Programs	94.004		$	$ 967,233	$ 967,233
Total Corporation for National and Community Service			**$ 0**	**$ 967,233**	**$ 967,233**
Total Financial Assistance			$ 50,530,518	$ 1,359,928,797	$ 1,410,459,315
Nonfinancial Assistance					
U.S. Department of Agriculture					
Emergency Food Assistance Cluster:					
Direct Program:					
Emergency Food Assistance Program (Food Commodities)	10.569		$	$ 7,413,076	$ 7,413,076
Total Emergency Food Assistance Cluster (Note 2)			$ 0	$ 7,413,076	$ 7,413,076
Direct Programs:					
Food Donation	10.550		$	$ 22,408,700	$ 22,408,700
Commodity Supplemental Food Program	10.565			17,051,641	17,051,641
Total Direct Programs			$ 0	$ 39,460,341	$ 39,460,341
Total U.S. Department of Agriculture			**$ 0**	**$ 46,873,417**	**$ 46,873,417**
Total Nonfinancial Assistance			$ 0	$ 46,873,417	$ 46,873,417
Total Expenditures of Federal Awards			$ 50,530,518	$ 1,406,802,214	$ 1,457,332,732

* *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, 2007			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
$ 5,687,892	$ 27,405,209	$ 33,093,101	$ 70,405,714
27,263	747,692	774,955	1,367,174
502,109	8,313,908	8,816,017	18,897,545
319,386	3,872,550	4,191,936	8,670,743
1,756,653	105,541,244	107,297,897	215,341,749
5,205,799	7,542,737	12,748,536	17,699,775
423,016		423,016	442,262
(56,558)		(56,558)	2,632,851
$ 24,713,272	$ 693,464,169	$ 718,177,441	$ 1,430,196,579
$ 34,741,012	**$ 1,073,281,353**	**$ 1,108,022,365**	**$ 2,203,602,104**
$	$	$ 0	$ 96,835
570,283	419,522	989,805	1,942,524
$ 570,283	$ 419,522	$ 989,805	$ 2,039,359
$ 12,454	$	$ 12,454	$ 39,378
$ 582,737	**$ 419,522**	**$ 1,002,259**	**$ 2,078,737**
$	$ 754,565	$ 754,565	$ 1,721,798
$ 0	**$ 754,565**	**$ 754,565**	**$ 1,721,798**
$ 40,799,012	$ 1,390,362,923	$ 1,431,161,935	$ 2,841,621,250
$	$ 6,489,901	$ 6,489,901	$ 13,902,977
$ 0	$ 6,489,901	$ 6,489,901	$ 13,902,977
$	$ 28,953,661	$ 28,953,661	$ 51,362,361
	14,952,425	14,952,425	32,004,066
$ 0	$ 43,906,086	$ 43,906,086	$ 83,366,427
$ 0	**$ 50,395,987**	**$ 50,395,987**	**$ 97,269,404**
$ 0	$ 50,395,987	$ 50,395,987	$ 97,269,404
$ 40,799,012	$ 1,440,758,910	$ 1,481,557,922	$ 2,938,890,654

Note 1 Basis of Presentation

This schedule includes the federal grant activity of the Michigan Department of Education (MDE) 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 revenue 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 fund balance of the State's General Fund and the School Aid Fund.

Note 2 Emergency Food Assistance Cluster

The Emergency Food Assistance Cluster is made up of financial assistance (*CFDA* 10.568) totaling $2.2 million and $2.1 million and nonfinancial assistance (*CFDA* 10.569) valued at $7.4 million and $6.5 million as of September 30, 2006 and September 30, 2007, respectively.

Note 3 Reporting Entity

In fiscal years 2005-06 and 2006-07, the majority of federal grants were reported in the School Aid Fund. Administrative federal expenses and transfers to other State agencies were reported in the State's General Fund. In addition, the Emergency Impact Aid Hurricane Relief 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
FAX (517) 334-8079

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
Michigan Department of Education
John A. Hannah Building
Lansing, Michigan

Dear Mr. Flanagan:

We have audited the financial schedules and financial statements of the Michigan Department of Education as of and for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents, and have issued our report thereon dated June 25, 2008. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial schedules and financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in the next paragraph, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than

a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in Findings 1 and 2 in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules and/or financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described in the third paragraph of this section, we consider Finding 1 to be 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/or 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*.

The Department's response*s* to the finding*s* identified in our audit are described in the accompanying corrective action plan. We did not audit the Department's response*s* and, accordingly, we express no opinion on them.

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.

AUDITOR GENERAL

June 25, 2008

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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
Michigan Department of Education
John A. Hannah Building
Lansing, Michigan

Dear Mr. Flanagan:

Compliance

We have audited the compliance of the Michigan 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, 2007. 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.

In our opinion, the Michigan Department of Education complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each of its major federal programs for the two-year period ended September 30, 2007. However, the results of our auditing procedures disclosed 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 3 through 13.

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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the Department's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Findings 3 through 13 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not consider any of the deficiencies described in the preceding paragraph to be material weaknesses.

The Department's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

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.

AUDITOR GENERAL

June 25, 2008

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?	Yes
Significant deficiencies* 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?	No
Significant deficiencies* identified that are not considered to be material weaknesses?	Yes
Type of auditor's report issued on compliance for major programs:	Unqualified
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
10.553, 10.555, 10.556, and 10.559	Child Nutrition 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 (IDEA)

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

84.186	Safe and Drug-Free Schools and Communities - State Grants
84.196	Education for Homeless Children and Youth
84.282	Charter Schools
84.287	Twenty-First Century Community Learning Centers
84.298	State Grants for Innovative Programs
84.318	Education Technology State Grants
84.332	Comprehensive School Reform Demonstration
84.357	Reading First State Grants
84.365	English Language Acquisition Grants
84.366	Mathematics and Science Partnerships
84.367	Improving Teacher Quality State Grants

Dollar threshold used to distinguish between type A and type B programs: $8,816,672

Auditee qualified as a low-risk auditee*? No

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

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

FINDING (3130801)

1. Security and Application Controls

The Michigan Department of Education (MDE), in conjunction with the Department of Information Technology (DIT), did not implement a comprehensive security program to protect its application systems and data. In addition, MDE and DIT's implementation of MDE's new Cash Management System (CMS) did not ensure that subrecipients received only the payments to which they were entitled.

Without a comprehensive security program, management cannot ensure that MDE's internal control is operating as intended and that the integrity of its data is safeguarded. Insufficient internal control over implementation of the new CMS resulted in $9.7 million of improper payments to local educational agencies (LEAs). We consider these weaknesses to be material. We noted:

a. MDE's security policies and procedures over critical systems had the following control weaknesses:

(1) MDE did not restrict the system developers from administrative access privileges to MDE's information systems and databases. As a result, unauthorized changes to MDE's systems and data could be made and go undetected. System developers possess a detailed knowledge about the systems and its controls. Granting these individuals privileged access gives them the ability to bypass established system controls and make changes to data. In addition, it increases the risk that an individual could commit and conceal a fraudulent or unauthorized transaction.

(2) MDE, in conjunction with DIT, did not have effective controls to identify unauthorized changes to application systems. An effective change control process would ensure that all program modifications are properly authorized and tested.

(3) Responsibilities of MDE's security officer did not include granting and monitoring access to all MDE data or application and operating systems.

Periodic monitoring of access ensures that only authorized users have access to data and systems.

We reported MDE's weaknesses in two prior audits issued in 2001 and 2006. MDE agreed with our recommendation and informed us that improvements to security were implemented. However, we found that MDE had not taken steps to establish an effective and comprehensive information security program.

b. MDE's internal control over the implementation of its new CMS in fiscal year 2006-07 did not ensure that grant subrecipients received only the payments to which they were entitled. As a result, 189 duplicate payments totaling $9.3 million were issued to subrecipients and 4 payments totaling $369,000 were made to the wrong subrecipients.

MDE's CMS issued duplicate payments as a result of incomplete data conversions from its former Grants Cash Management Reporting System (GCMRS) to CMS. In addition, MDE issued 4 payments totaling $369,000 to the wrong subrecipients because of inaccurate school identification information within CMS and the Michigan Administrative Information Network* (MAIN).

CMS is used extensively by MDE to ensure that payments to subrecipients are valid and are made in accordance with federal and State requirements.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT MDE, IN CONJUNCTION WITH DIT, IMPLEMENT A COMPREHENSIVE SECURITY PROGRAM TO PROTECT ITS APPLICATION SYSTEMS AND DATA.

We also recommend that MDE, in conjunction with DIT, implement a cash management system that ensures that subrecipients receive only the payments to which they are entitled.

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

FINDING (3130802)

2. Monitoring of Internal Control Over Financial Reporting

MDE did not periodically monitor the effectiveness of its internal control over financial reporting. As a result, MDE was not assured that its internal control was sufficiently designed to ensure that its assets were safeguarded and the accounting data was accurate and properly reported.

Monitoring the effectiveness of MDE's internal control should include assessing risk related to MDE's accounting systems and processes, determining if controls have been designed to mitigate risk, and periodically evaluating the controls to determine if the controls are functioning as designed.

Section 18.1485 of the *Michigan Compiled Laws* requires State agencies to establish and maintain an internal control system and to document the system, communicate system requirements, and ensure that the system is functioning as prescribed. In addition, this section requires State agencies to complete a biennial assessment of risks and identify controls over financial accounting and reporting.

In accordance with Section 18.1485 of the *Michigan Compiled Laws*, MDE completed its biennial assessment, which included assessing risks and determining key controls that were related to the assessed risks. However, our review disclosed that MDE did not periodically evaluate and test the reliability of most of the key controls over financial reporting that it had listed in its biennial assessment.

For example, to ensure that all general ledger transactions were for valid items, were properly valued, and were correctly recorded, MDE documented that one of its key controls was that divisions had monitored their accounts for proper recording and classification. However, MDE did not test this control. MDE could have reviewed a sample of transactions to ensure that the transactions were properly recorded to determine if this control was working.

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. The internal auditor could play an important role in evaluating the effectiveness of controls by independently testing and verifying the integrity of the department's system of internal control. However, MDE's internal auditor had

conducted only one audit of direct vouchers during our audit period. We noted that the internal auditor had not reviewed MDE's key controls over financial reporting.

RECOMMENDATION

We recommend that MDE periodically monitor the effectiveness of its internal control over financial reporting.

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 (3130803)

3. Title I Grants to Local Educational Agencies, ***CFDA*** 84.010 - Cash Management

U.S. Department of Education	*CFDA* 84.010: Title I Grants to Local Educational Agencies
Award Number: S010A030022, S010A030022A S010A030022B S010A040022, S010A040022A S010A050022, S010A050022A S010A060022, S010A060022A	Award Period: 07/01/2003 - 09/30/2004 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005 07/01/2005 - 09/30/2006 07/01/2006 - 09/30/2007
	Questioned Costs: $0

MDE's internal control did not ensure that it complied with federal laws and regulations regarding cash management. Internal control that does not ensure compliance with federal cash management requirements could result in the State incurring additional interest costs to federal agencies.

The Cash Management Improvement Act of 1990 (CMIA), as amended, requires agreements between the State and the Secretary of the U.S. Department of Treasury and covers major federal programs with federal assistance in excess of amounts established annually by the U.S. Department of Treasury. The agreement

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

identifies funding techniques and methods used by the State for requesting federal funds as close as reasonably possible to when it disburses those funds. Title 31, Part 205, section 15 of the *Code of Federal Regulations (CFR)* provides that the State may accrue a liability for interest if the State receives federal funds before the day that the State pays out the funds for federal assistance program purposes. MDE annually provides documentation of those draws that were not in compliance with its funding technique to the Michigan Department of Treasury. The Michigan Department of Treasury calculates each department's interest liability and submits the annual report to the U.S. Department of Treasury.

During our audit period, the State's CMIA agreement covered four of MDE's federal programs. These four federal programs had federal cash draws totaling $2.2 billion for the two-year period ended September 30, 2007.

Our audit disclosed the following deviations from MDE's approved funding technique that were not reported to the Michigan Department of Treasury:

a. MDE did not identify and report to the Michigan Department of Treasury when it drew federal funds before disbursing the funds to subrecipients. Our review disclosed that MDE made two federal cash draws totaling $23,784,461 from two grants that were about to close. MDE processed recoding transactions to move expenditures from one grant year to the closing grant year. However, MDE had previously drawn federal funds for these recoded expenditure transactions. MDE did not delay current draws to offset the $23,784,461 in recoded expenditures. As a result, MDE took up to 82 days to incur expenditures for a federal draw of $12,602,294 and up to 19 days to incur expenditures for a federal draw of $11,182,167. Therefore, the State may have an interest liability of approximately $106,000 to the federal government.

   Because the federal funds were received by MDE before the disbursement of these funds to its subrecipients, MDE should have reported the two draws to the Michigan Department of Treasury for calculation of the State's interest liability.

b. MDE did not identify and return to the federal government the refunds over $50,000 that were received from its subrecipients for federal programs included in the CMIA agreement in which the grant had closed. We reviewed 5 refunds for closed grants and determined that 5 refunds (100%) totaling

$1.8 million were not returned to the federal government nor used for allowable program purposes, as of the end of March 2008. As of September 30, 2007, we estimated that MDE may have a potential interest liability of $60,000.

Federal regulation 31 *CFR* 205.15 provides that the State incurs interest liability on refunds of federal funds from the day the refund is credited to a State's account until the day the refund is either paid out for federal assistance program purposes or credited to the federal government. Section 8.4.1 of the CMIA agreement provides that the State is liable for interest on all refund transactions over $50,000. By having a process to identify and return refunds to the federal government, MDE would help ensure that refunds are remitted to the federal government in a timely manner.

RECOMMENDATION

We recommend that MDE improve its internal control to ensure that it complies with federal laws and regulations regarding cash management.

FINDING (3130804)

4. Title I Grants to Local Educational Agencies, ***CFDA*** 84.010

U.S. Department of Education	*CFDA* 84.010: Title I Grants to Local Educational Agencies
Award Number:	Award Period:
S010A030022, S010A030022A	07/01/2003 - 09/30/2004
S010A030022B	07/01/2003 - 09/30/2004
S010A040022, S010A040022A	07/01/2004 - 09/30/2005
S010A050022, S010A050022A	07/01/2005 - 09/30/2006
S010A060022, S010A060022A	07/01/2006 - 09/30/2007
	Questioned Costs: $1,766,442

MDE internal control over the Title I Grants to Local Educational Agencies Program did not ensure its compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and subrecipient monitoring. As a result, we questioned costs of $1,766,442. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Title I Grants to Local Educational Agencies Program awards.

Federal expenditures for the Title I Grants to Local Educational Agencies Program totaled $881.8 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $425.6 million and $446.2 million to subrecipients in fiscal years 2005-06 and 2006-07, respectively. Subrecipients of the Title I Grants to Local Educational Agencies Program were LEAs.

Our audit disclosed the following exceptions by compliance area:

a. Allowable Costs/Cost Principles

MDE's internal control did not ensure it allocated grant awards for the Title I Grants to Local Educational Agencies Program in accordance with the federal requirements. In addition, MDE's internal control did not ensure that costs charged were supported and documented. As a result, we questioned costs in the amount of $1,518,084. Our review disclosed:

(1) MDE's formula used to allocate education finance incentive grant funds included an error that resulted in incorrect education finance incentive grant allocations to some LEAs. MDE incorrectly allocated $1,016,669 to 31 LEAs and charter schools during fiscal year 2005-06 and $488,297 to 27 LEAs and charter schools during fiscal year 2006-07. As a result, 602 and 455 LEAs and charter schools did not receive the total education finance incentive grant awards that they were entitled to receive in fiscal years 2005-06 and 2006-07, respectively. MDE's error in its allocation formula did not include all eligible students in accordance with Title I, Section 1125A requirements. MDE informed us that it was unaware that this formula was in error and that the error had been in existence for several years.

(2) MDE processed a duplicate payment to one LEA resulting in questioned costs in the amount of $13,118. Appendix A, Section C(1) of federal regulation 2 *CFR* 225 (OMB Circular A-87*) requires that costs be adequately supported and documented. MDE informed us that the duplicate payment occurred as a result of the conversion from its former GCMRS to its current cash management system (CMS). As of March 31, 2008, MDE had not recovered the $13,118 overpayment from the LEA.

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

b. Matching, Level of Effort, and Earmarking

MDE's internal control did not ensure that it complied with federal requirements relating to earmarking. As a result, we questioned costs in the amount of $248,358.

Federal regulation 34 *CFR* 200.100(b) authorizes states to reserve not more than 1% from amounts allocated under Sections 1002(a), 1002(c), and 1002(d) of the Elementary and Secondary Education Act for State administration.

MDE's Title I Grants to Local Educational Agencies Program award for the federal funding period July 1, 2005 through September 30, 2006 totaled $433,983,135, of which not more than 1% ($4,339,831) could be allocated by MDE for State administrative costs. However, our review disclosed that MDE directly expended $4,588,189 for administrative costs, or $248,358 in excess of the amount allocated.

c. Subrecipient Monitoring

MDE needs to improve its internal control over subrecipient monitoring to ensure that subrecipients submit compliance plans that address noted deficiencies. Ensuring the receipt of plans would provide MDE with additional assurances that subrecipients use federal awards for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements and that performance goals were achieved.

MDE requires that when the on-site monitoring review identifies the need for corrective action, the subrecipient must submit a compliance plan to MDE within 30 days after receipt of the on-site review report.

MDE conducted 59 on-site monitoring visits during our audit period. For 58 of the on-site visits, MDE's on-site reports included recommendations requiring corrective action. However, 11 (19%) of the 58 subrecipients did not submit compliance plans to MDE as required by MDE procedures.

RECOMMENDATION

We recommend that MDE improve its internal control over the Title I Grants to Local Educational Agencies Program to ensure its compliance with federal laws

and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and subrecipient monitoring.

FINDING (3130805)

5. Special Education Cluster (IDEA), *CFDA* 84.027 and 84.173

U.S. Department of Education	*CFDA* 84.027 and 84.173: Special Education Cluster (IDEA)
Award Number:	Award Period:
H027A010110A	07/01/2001 - 09/30/2002
H027A020110A	07/01/2002 - 09/30/2003
H027A030110A	07/01/2003 - 09/30/2004
H027A040110A	07/01/2004 - 09/30/2005
H027A050110A	07/01/2005 - 09/30/2006
H027A060110A	07/01/2006 - 09/30/2007
H027A070110A	07/01/2007 - 09/30/2008
H173A030117	07/01/2003 - 09/30/2004
H173A040117	07/01/2004 - 09/30/2005
H173A050117	07/01/2005 - 09/30/2006
H173A060117	07/01/2006 - 09/30/2007
H173A070117	07/01/2007 - 09/30/2008
	Questioned Costs: $0

MDE's internal control over the Special Education Cluster did not ensure its compliance with federal laws and regulations regarding reporting and subrecipient monitoring. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Special Education Cluster awards.

Federal expenditures for the Special Education Cluster totaled $773.4 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $369.3 million and $379.8 million to subrecipients in fiscal years 2005-06 and 2006-07, 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

MDE's internal control did not ensure that the number of students reported to the U.S. Department of Education (USDOE) as having exited special education was an unduplicated count. As a result, MDE reported duplicate student counts to the 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, Title 20, section 1418(a)(1)(A) of the *United States Code (USC)* 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. Federal regulation 34 *CFR* 300.752 requires each state to report to the USDOE an accurate and unduplicated count of the number of students. Duplicate counts can occur if students attend and exit more than one school during the year.

We identified 1,119 (7%) duplicate student records within the total 16,678 students reported to the USDOE by MDE as having exited special education from December 2005 through December 2006.

b. Subrecipient Monitoring

MDE's needs to improve its internal control over its monitoring of subrecipients' compliance with reporting requirements by documenting its review of project goal progress reports.

Our review of MDE's subrecipient monitoring activities disclosed that MDE reviewed subrecipient program budgets for allowable activities and costs, provided training, appropriately identified federal award information to its subrecipients, monitored and tracked its subrecipients' maintenance of effort, reconciled subrecipients' final expenditure reports (FERs) to approved budgets, and conducted on-site monitoring.

However, MDE did not document that its staff reviewed the final narrative progress reports required to be submitted by subrecipients to document that

project goals were met. The subrecipient grant applications state that a final narrative report is due at the end of the two-year grant period for Part B Flow-Through and Preschool Flow-Through grants and at the end of the one-year grant period for Enhancing Opportunities for Students With Disabilities grants and Transition Services grants.

We reviewed progress reports for 25 of the 57 LEAs that received Flow-Through funding, Enhancing Opportunities for Students With Disabilities funding, and Transition Services funding during the two-year period ended September 30, 2007. We noted that MDE did not document its review of 7 (14%) of the 49 final narrative progress reports submitted by 25 LEAs during our audit period.

RECOMMENDATION

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

FINDING (3130806)

6. Safe and Drug-Free Schools and Communities - State Grants (SDFSC), ***CFDA*** 84.186

U.S. Department of Education	*CFDA* 84.186: Safe and Drug-Free Schools and Communities - State Grants
Award Number: S186A030023A Q186A040023 Q186A050023 Q186A060023 Q186A070023	Award Period: 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005 07/01/2005 - 09/30/2006 07/01/2006 - 09/30/2007 07/01/2007 - 09/30/2008
	Questioned Costs: $153,290

MDE's internal control over the SDFSC Program did not ensure its compliance with federal laws and regulations regarding matching, level of effort, and earmarking; subrecipient monitoring; and special tests and provisions. As a result, we questioned costs of $153,290. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions in SDFSC Program awards.

Federal expenditures for the SDFSC Program totaled $23.4 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $12.1 million and $10.7 million to subrecipients in fiscal years 2005-06 and 2006-07, respectively. Subrecipients of the SDFSC Program were LEAs, intermediate schools districts, and regional educational service agencies.

Our audit disclosed the following exceptions by compliance area:

a. Matching, Level of Effort, and Earmarking

MDE's internal control did not ensure its compliance with federal requirements relating to earmarking of State administrative costs. As a result, we questioned costs in the amount of $153,290.

Sections 4112(b)(1) and 4112(b)(2) of the SDFSC Act allow the State to reserve or earmark not more than 3% of its total allocation for administrative costs for the SDFSC Program grants.

MDE's administrative costs of $486,312 exceeded the 3% earmarking cap by $96,148 for the SDFSC Program grant for the federal funding period of July 1, 2003 through September 30, 2005. In addition, MDE's administrative costs of $445,867 exceeded the 3% earmarking cap by $57,142 for the SDFSC Program grant for the federal funding period of July 1, 2005 through September 30, 2007.

b. Subrecipient Monitoring

MDE's internal control over the SDFSC Program did not ensure its compliance with the subrecipient monitoring requirements. If MDE does not sufficiently monitor subrecipient activities, MDE cannot be assured that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements and that performance goals were achieved.

MDE, in conjunction with Office of Drug Control Policy (ODCP), Department of Community Health, monitored subrecipients that received SDFSC grants. MDE and ODCP reviewed subrecipients' program budgets for allowable activities and costs, provided training, appropriately identified federal award information to subrecipients, and performed on-site monitoring and desk reviews for selected subrecipients.

However, our review of the subrecipient monitoring activities by either MDE or ODCP for 33 grants disclosed:

(1) MDE and ODCP did not review the discrepancies identified during the reconciliation of FERs to approved budgets.

We noted that in 9 subrecipient grants, the subrecipients reported expenditures that exceeded the budgeted amount by more than 10%. MDE's process for monitoring subrecipients' expenditures includes following up on those expenditures that exceed budgeted amounts by more than 10%. However, MDE could not provide us with documentation that these expenditures had been reviewed and approved by MDE or ODCP.

In addition, we noted that, in 6 subrecipient grants, with approved budgets for funding of services and benefits for private school children, the subrecipients did not report expenditures for private school children in the FERs. Sections 5142 and 9501 of the Elementary and Secondary Education Act require that expenditures for services and benefits to eligible private school children and their teachers and other educational personnel must be equal on a per pupil basis to the expenditures for participating public school children and their teachers and other educational personnel. Because the subrecipients did not report expenditures for private school children in the FERs, MDE was unable to determine if benefits and services were provided on an equal per pupil basis.

(2) MDE and ODCP did not monitor subrecipient cash draws to ensure that the draws were only for reimbursement and/or three-day cash needs. We noted that 3 subrecipients each requested a cash draw that may have been in excess of their respective three-day cash needs. The three cash draws were for 62%, 65%, and 82% of each subrecipient's total awards. Because MDE allows subrecipients to draw funds electronically without providing supporting documentation, monitoring unusually large subrecipient cash draws would help ensure that subrecipients are in compliance with cash management requirements.

c. Special Tests and Provisions

MDE's and ODCP's internal control did not ensure that SDFSC Program funds were allocated to new or significantly expanded charter schools. As a result, 11 new charter schools were not included in the allocation of SDFSC Program grant funds for fiscal year 2005-06.

Federal regulation 34 *CFR* 76.789 requires that the states must determine a new or expanding charter school's eligibility based on actual enrollment or other eligibility data available on or after the date that the charter school opens or significantly expands. In addition, MDE must ensure that a charter school that opens for the first time or significantly expands its enrollment receives the funds for which it is eligible, even if eligibility and allocation amounts for other LEAs are based on prior year data.

ODCP allocated SDFSC Program funds based on the prior year's allocations for Title I Grants to Local Educational Agencies and did not consider new charter schools in its allocation of funds. Therefore, the 11 charter schools were not notified that the schools were eligible to apply for the SDFSC grant.

RECOMMENDATION

We recommend that MDE improve its internal control over the SDFSC Program to ensure its compliance with federal laws and regulations regarding matching, level of effort, and earmarking; subrecipient monitoring; and special tests and provisions.

FINDING (3130807)

7. Charter Schools, ***CFDA*** 84.282

U.S. Department of Education	*CFDA* 84.282: Charter Schools
Award Numbers: S282A010007-03 U282A040002-06	Award Period: 10/01/2001 - 09/30/2005 10/01/2004 - 09/30/2007
	Questioned Costs: $369,027

MDE's internal control over the Charter Schools Program (CSP) did not ensure that it processed payments only for eligible charter schools in compliance with federal laws and regulations regarding eligibility. As a result, we questioned costs in the amount of $369,027. Internal control that does not ensure compliance with federal

laws and regulations could result in sanctions, disallowances, and/or future reductions in CSP awards.

Federal expenditures for CSP totaled $14.9 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $7.1 million and $7.0 million to 39 subrecipients and 32 subrecipients in fiscal years 2005-06 and 2006-07, respectively. CSP subrecipients were charter schools.

MDE inadvertently processed four payments totaling $369,027 to three ineligible charter schools that had not received CSP grants during the two-year audit period. Inaccurate CMS data fields resulted in controls failing to prevent three valid subrecipients' requests for grant funds to be issued to three other ineligible charter schools. MDE issued additional payments to the eligible charter schools, but it had not recouped the payments to the ineligible charter schools as of the end of our audit period. Subsequent to our audit period, MDE recouped $354,045 from two of the charter schools.

RECOMMENDATION

We recommend that MDE improve its internal control over CSP to ensure its compliance with federal laws and regulations regarding eligibility.

FINDING (3130808)

8. State Grants for Innovative Programs, *CFDA* 84.298

U.S. Department of Education	*CFDA* 84.298: State Grants for Innovative Programs
Award Number: S298A040022 S298A050022 S298A060022	Award Period: 07/01/2004 - 09/30/2005 07/01/2005 - 09/30/2006 07/01/2006 - 09/30/2007
	Questioned Costs: $0

MDE needs to improve internal control over State Grants for Innovative Programs to ensure its compliance with federal laws and regulations regarding subrecipient monitoring. If MDE does not sufficiently monitor subrecipient activities, MDE cannot be assured that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements and that performance goals were achieved.

Federal expenditures for the State Grants for Innovative Programs totaled $12.0 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $6.3 million and $3.4 million to subrecipients in fiscal years 2005-06 and 2006-07, respectively.

MDE's subrecipient monitoring activities include conducting on-site visits. MDE requires that when the on-site monitoring review identifies the need for corrective action, the subrecipient must submit a compliance plan to MDE within 30 days after receipt of the on-site review report.

MDE conducted 57 subrecipient on-site visits during our audit period. For 16 of the on-site visits, MDE's on-site reports included recommendations requiring corrective action. However, 3 (19%) of the 16 subrecipients did not submit compliance plans to MDE.

RECOMMENDATION

We recommend that MDE improve its internal control over the State Grants for Innovative Programs to ensure its compliance with federal laws and regulations regarding subrecipient monitoring.

FINDING (3130809)

9. Education Technology State Grants, *CFDA* 84.318

U.S. Department of Education	*CFDA* 84.318: Education Technology State Grants
Award Number: S018X03022 S018X04022 S318X050022A S318X060022A	Award Period: 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005 07/01/2005 - 09/30/2006 07/01/2006 - 09/30/2007
	Questioned Costs: $978,578

MDE's internal control over the Education Technology State Grants Program did not ensure its compliance with federal laws and regulations regarding eligibility and subrecipient monitoring. As a result, we questioned costs in the amount of $978,578. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Education Technology State Grants Program awards.

Federal expenditures for the Education Technology State Grants Program totaled $27.0 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $12.7 million and $12.8 million to 642 subrecipients and 644 subrecipients in fiscal years 2005-06 and 2006-07, respectively. Subrecipients of the Education Technology State Grants Program included LEAs.

The Education Technology State Grants Program requires that states must use at least 95% of their award amount to make subgrants to LEAs, of which up to half must be distributed to eligible LEAs on a formula basis. States may award the remaining amount to eligible LEAs on a competitive basis.

Our review disclosed the following exceptions by compliance area:

a. Eligibility

MDE's internal control did not ensure that it awarded the competitive grants to only eligible LEAs in accordance with federal laws and regulations. As a result, we questioned costs in the amount of $668,200.

Federal law 20 *USC* 6753 provides that an eligible local entity must be a high-need LEA or an eligible local partnership that includes at least one high-need LEA. A high-need LEA is an LEA: (a) that is among the LEAs in a state with the highest numbers or percentages of children from families with incomes below the poverty line and (b) that operates one or more schools identified for improvement or corrective action or has a substantial need for assistance in acquiring and using technology.

MDE established scoring criteria for these grants to determine if the LEA met the definition of a high-need LEA as federally required and met additional State-defined criteria. We reviewed scoring documentation for 14 LEA competitive grants and noted that 5 (36%) competitive grants were awarded to LEAs that did not document that they met the high-need definition. We questioned the total amount of $668,200 disbursed to these 5 ineligible subrecipients.

b. Subrecipient Monitoring

MDE's internal control did not ensure that the Education Technology State Grants Program complied with federal laws and regulations regarding

subrecipient monitoring. As a result, we questioned costs in the amount of $310,378.

Our review of MDE's subrecipient monitoring activities disclosed that MDE performed on-site monitoring of 68 (5%) 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 noted that MDE did not always review its subrecipients' FERs to ensure that subrecipients actually met their earmarking requirement for professional development activities.

Federal law 20 *USC* 6766(a) provides that LEAs receiving awards under this Program must use at least 25% of the funds to provide ongoing, sustained, and intensive high-quality professional development. Our review of the 33 subrecipients' FERs disclosed that 5 (15%) subrecipients did not meet their professional development earmarking requirement. We computed questioned costs based on the difference between 25% of the final total expenditures and the total professional development expenditures reported on the subrecipients' FERs.

RECOMMENDATIONS

We recommend that MDE improve its internal control over the Education Technology State Grants Program to ensure its compliance with federal laws and regulations regarding eligibility.

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

FINDING (3130810)

10. Reading First State Grants, *CFDA* 84.357

U.S. Department of Education	*CFDA* 84.357: Reading First State Grants
Award Number:	Award Period:
S357A040023	07/01/2004 - 09/30/2005
S357A040023A	07/01/2004 - 09/30/2005
S357A040023B	07/01/2004 - 09/30/2005
S357A050023	07/01/2005 - 09/30/2006
S357A050023A	07/01/2005 - 09/30/2006
S357A050023B	07/01/2005 - 09/30/2006
S357A060023	07/01/2006 - 09/30/2007
	Questioned Costs: $525,878

MDE's internal control over the Reading First State Grants (Reading First) Program did not ensure its compliance with federal laws and regulations relating to matching, level of effort, and earmarking and subrecipient monitoring. As a result, we questioned costs in the amount of $525,878. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Reading First Program awards.

Federal expenditures for the Reading First Program totaled $70.4 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $29.4 million and $27.4 million to subrecipients in fiscal years 2005-06 and 2006-07, respectively. Subrecipients of the Reading First Program included LEAs.

Our audit disclosed the following exceptions by compliance area:

a. Matching, Level of Effort, and Earmarking

MDE's internal control did not ensure that costs charged to the Reading First Program complied with federal earmarking requirements. As a result, we questioned costs in the amount of $525,878.

Federal law 20 *USC* 6362(d) provides that the State may not spend more than a total of 20% for professional development and review; technical assistance; and planning, administration, and reporting.

MDE's Reading First Program grant totaled $29,886,224 for the federal funding period July 1, 2005 through September 30, 2006. Our review disclosed that MDE expended $6,503,123 (22%) from the Reading First Program award for professional development and review, technical assistance, and planning. MDE was not eligible for federal reimbursement for the excess amount of $525,878 under federal earmarking regulations.

b. Subrecipient Monitoring

MDE's internal control over the Reading First Program did not ensure its compliance with subrecipient monitoring requirements. If MDE does not sufficiently monitor subrecipient activities, MDE cannot be assured that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements and that performance goals were achieved.

MDE did not follow up or did not document its follow-up on discrepancies identified from the reconciliation of subrecipients' FERs to approved budgets. We reviewed 13 FERs, compared them with approved budgets, and noted that in 2 (15%) FERs the LEAs reported line-item expenditures that varied more than 10% from approved budgets. MDE's process for monitoring subrecipients' expenditures includes following up on those expenditures that exceed budgeted amounts by more than 10%. However, MDE could not provide us with documentation indicating that it had reviewed and approved these expenditures.

MDE's process for monitoring subrecipients' expenditures for authorized purposes includes approving subrecipients' proposed budgets and requiring LEAs to submit a budget transfer request when actual expenditures deviated from approved budgets. MDE also indicated that it reviewed some, but not all, of the FERs and compared final reported expenditures with budgeted amounts.

RECOMMENDATION

We recommend that MDE improve its internal control over the Reading First Program to ensure its compliance with federal laws and regulations relating to matching, level of effort, and earmarking and subrecipient monitoring.

FINDING (3130811)

11. English Language Acquisition (ELA) Grants, *CFDA* 84.365

U.S. Department of Education	*CFDA* 84.365: English Language Acquisition Grants
Award Number: T365A030022 T365A040022 T365A050022 T365A060022	Award Period: 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005 07/01/2005 - 09/30/2006 07/01/2006 - 09/30/2007
	Questioned Costs: $0

MDE's internal control over the ELA Grants Program did not ensure its compliance with federal laws and regulations regarding subrecipient monitoring and special tests and provisions. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of ELA Grants Program awards.

Federal expenditures for the ELA Grants Program totaled $18.9 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $9.6 million and $8.3 million to subrecipients in fiscal years 2005-06 and 2006-07, respectively. Subrecipients of the ELA Grants Program included LEAs and nonprofit organizations.

Our audit disclosed the following exceptions by compliance area:

a. Subrecipient Monitoring

MDE's internal control over the ELA Grants Program did not ensure that subrecipients submitted compliance plans and that MDE followed up on discrepancies identified from its review of subrecipients' FERs. Ensuring receipt of compliance plans and following up on discrepancies identified in reviews of the subrecipients' FERs would provide MDE with reasonable assurance that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements and that performance goals were achieved. We noted:

(1) MDE did not ensure that subrecipients submitted compliance plans for 2 (15%) of the 13 on-site visits requiring corrective action. MDE requires that when the on-site monitoring review identifies the need for corrective

action, the subrecipient must submit a compliance plan to MDE within 30 days after receipt of the on-site review report.

(2) MDE did not follow up or did not document its follow-up on discrepancies identified from the reconciliation of subrecipients' FERs to approved budgets. We reviewed 37 FERs, compared them with approved budgets, and noted that 7 (19%) of the FERs reported line-item expenditures that varied more than 10% from approved budgets. MDE's process for monitoring subrecipients' expenditures includes following up on those expenditures that exceed budgeted amounts by more than 10%. MDE could not document follow-up for any of the 7 discrepancies.

b. Special Tests and Provisions

MDE had not disseminated the annual measurable achievement objectives to its subrecipients. As a result, MDE did not have a basis for determining if its subrecipients were meeting such annual measurable achievement objectives or whether limited English proficient children were making adequate yearly progress.

Federal law 20 *USC* 6842 requires MDE to develop annual measurable achievement objectives for limited English proficient children concerning their development of English proficiency while meeting challenging State academic standards. Federal law 20 *USC* 6842 also requires MDE to hold its subrecipients accountable for meeting these annual measurable achievement objectives, including making adequate yearly progress for limited English proficient children.

RECOMMENDATION

WE AGAIN RECOMMEND THAT MDE IMPROVE ITS INTERNAL CONTROL OVER THE ELA GRANTS PROGRAM TO ENSURE ITS COMPLIANCE WITH FEDERAL LAWS AND REGULATIONS REGARDING SUBRECIPIENT MONITORING AND SPECIAL TESTS AND PROVISIONS.

FINDING (3130812)

12. Mathematics and Science Partnerships (MSP), *CFDA* 84.366

U.S. Department of Education	*CFDA* 84.366: Mathematics and Science Partnerships
Award Number: S366B040023 S366B050023 S366B060023	Award Period: 07/01/2004 - 09/30/2005 07/01/2005 - 09/30/2006 07/01/2006 - 09/30/2007
	Questioned Costs: $0

MDE's internal control over the MSP Program did not ensure its compliance with federal laws and regulations regarding subrecipient monitoring. If MDE does not sufficiently monitor subrecipient activities, MDE cannot be assured that the subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements and that performance goals were achieved.

Federal expenditures for the MSP Program totaled $8.7 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $4.2 million and $3.9 million to subrecipients in fiscal years 2005-06 and 2006-07, respectively. MSP subrecipients included eligible partnerships which consisted of LEAs and institutions of higher education.

Our review of MDE's subrecipient monitoring activities for the MSP Program disclosed that MDE reviewed subrecipient program budgets and FERs for allowable activities and costs, provided technical assistance training to subrecipients, and provided appropriate federal award information to its subrecipients. For 8 of 11 subrecipients, we sampled grants administered by MDE during the two-year period ended September 30, 2007. Our review disclosed:

a. MDE's review of one subrecipient's budget did not question $48,040 of budget administrator's salaries and wages and general office costs. These costs should have been included in the indirect cost rate and should have been excluded from the direct costs charged to the grant.

   Federal law 20 *USC* 6662(c) provides that subrecipients shall use MSP Program funds for a variety of activities, such as professional development activities for mathematics and science teachers; recruitment of mathematics,

engineering, and science majors to teaching through the use of signing and performance incentives; stipends to be used for certifications; and scholarships to pursue advanced course work. Appendix A, Section C(1) of federal regulation 2 *CFR* 225 provides that general office supplies and administrative salaries and wages may be allocated to a federal award as an indirect cost through an indirect cost rate and should be excluded from the direct costs charged to a grant.

b. MDE did not perform sufficient monitoring of subrecipients to ensure compliance with special tests and provisions relating to participation of private school children.

Federal law 20 *USC* 7881(a) provides that subrecipients of grant funds under the MSP Program must engage in timely and meaningful consultation with private school officials during the design and development of the grant program and provide eligible private school children and their teachers or other educational personnel with equitable services or other benefits under the MSP Program.

As part of the MSP Program grant application, MDE required subrecipients to certify that they invited private schools to participate in planning and implementing the grant activities. In our review of 8 grant applications, program budgets, and FERs, the 8 subrecipients did not provide any evidence that private schools were invited to participate in the grant activities. We identified 259 private schools located within the school districts and partnership school districts of the 8 subrecipients. We noted that other grant programs administered by MDE required subrecipients to submit documentation substantiating that they invited private schools to participate in planning activities.

RECOMMENDATION

We recommend that MDE improve its internal control over the MSP Program to ensure its compliance with federal laws and regulations regarding subrecipient monitoring.

FINDING (3130813)

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

U.S. Department of Education	*CFDA* 84.367: Improving Teacher Quality State Grants
Award Number: S367A030021A, S367B030019A S367A040021A, S367B040019A S367A050021A, S367B050019A S367A060021A, S367B060019A S367A070021A, S367B070019A	Award Period: 07/01/2003 - 09/30/2004 07/01/2004 - 09/30/2005 07/01/2005 - 09/30/2006 07/01/2006 - 09/30/2007 07/01/2007 - 09/30/2008
	Questioned Costs: $91,631

MDE's internal control over the Improving Teacher Quality State Grants (Improving Teacher Quality) Program did not ensure its compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and subrecipient monitoring. As a result, we questioned costs in the amount of $91,631. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Improving Teacher Quality Program awards.

Federal expenditures for the Improving Teacher Quality Program totaled $215.3 million for the two-year period ended September 30, 2007. Of these expenditures, MDE distributed $104.5 million and $105.5 million to subrecipients in fiscal years 2005-06 and 2006-07, respectively. Subrecipients of the Improving Teacher Quality Program included both LEAs and institutions of higher education.

Our audit disclosed the following exceptions by compliance area:

a. Allowable Costs/Cost Principles

MDE's internal control did not ensure that costs charged were supported and documented. As a result, we questioned costs in the amount of $40,656.

Appendix A, Section C(1) of federal regulation 2 *CFR* 225 requires that costs be adequately supported and documented. MDE informed us that during the conversion from its former GCMRS to its current CMS, MDE processed two duplicate payments under this grant in the amounts of $34,910 and $5,746 to two LEAs, causing the LEAs to exceed their approved budgets. MDE had not identified these fiscal year 2006-07 overpayments until March 2008.

b. Matching, Level of Effort, and Earmarking

MDE's internal control did not ensure that it complied with federal requirements relating to earmarking. As a result, we questioned costs in the amount of $50,975.

Section 2113(d) of the Elementary and Secondary Education Act allows the State to reserve or earmark not more than 1% of its total allocation for administrative costs for the Improving Teacher Quality Program.

MDE's Improving Teacher Quality Program award for the federal funding period July 1, 2005 through September 30, 2006 totaled $109,399,197, of which not more than 1% ($1,093,992) could be allocated by MDE for administrative costs. However, our review disclosed that MDE expended $1,144,967 for administrative costs, or $50,975 in excess of the amount allocated.

c. Subrecipient Monitoring

MDE's internal control did not ensure that subrecipients submitted compliance plans that addressed noted deficiencies. Ensuring the receipt of compliance plans would provide MDE with reasonable assurance that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements and that performance goals were achieved.

In our review of 30 on-site visits, MDE's on-site reports included recommendations requiring corrective action for all 30 of the subrecipients. However, 5 (17%) of the 30 subrecipients did not submit compliance plans to MDE.

MDE requires that when the on-site monitoring review identifies the need for corrective action, the subrecipient must submit a compliance plan to MDE within 30 days after receipt of the on-site review report.

RECOMMENDATIONS

We recommend that MDE improve its internal control over the Improving Teacher Quality Program to ensure its compliance with federal laws and regulations

regarding allowable costs/cost principles and matching, level of effort, and earmarking.

WE AGAIN RECOMMEND THAT MDE IMPROVE ITS INTERNAL CONTROL OVER THE IMPROVING TEACHER QUALITY PROGRAM TO ENSURE ITS COMPLIANCE WITH FEDERAL LAWS AND REGULATIONS REGARDING 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

MICHIGAN DEPARTMENT OF EDUCATION
Summary Schedule of Prior Audit Findings
As of June 25, 2008

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES AND FINANCIAL STATEMENTS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 310601
Finding Title: Act 272 Compliance

Finding: The Michigan Department of Education's (MDE'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*.

Comments: MDE agrees with the underlying intent of the recommendation and completed audits when requested by the Department of Management and Budget.

Audit Findings Not Fully Corrected or Partially Corrected:

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 310602
Finding Title: General Controls

Finding: MDE, 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.

Comments: Several changes regarding MDE's security program were instituted. MDE assigned an individual as the information security

officer. MDE staff are working with the DIT client service director to develop comprehensive standard operating procedures with regard to data, application systems, and operating systems. MDE staff are working with DIT to review and update existing procedures and to document the information security program. Development on the updated State Aid Management System (SAMS) was interrupted for a period of 14 months due to personnel shortages. A new DIT developer was hired in December 2007 to continue the process of updating SAMS.

The two internal control weaknesses identified in the audit resulted in immediate changes. The internal control weaknesses that were noted concerned access by developers to production data and ineffective change management controls.

Comprehensive Security Program:

- MDE's Office of Grants Coordination and School Support, in collaboration with DIT, developed an integrated security program for the Michigan Electronic Grants System (MEGS), the Child Nutrition Application Program (CNAP), and the Cash Management System (CMS). CMS was developed to replace the Grants Cash Management Reporting System (GCMRS).

- Each application is developed with an exclusive user management module to manage the users of that particular application.

- Security administrators for each system are responsible for managing access to their application. This includes managing the security agreement forms as well as providing or revoking access.

Restricting Application Developers to Production Data:

- Any direct access to the production code and production database by application developers was revoked. This is the case for MEGS, CNAP, CMS, and GCMRS. SAMS is

currently undergoing a rewrite that will update it to a more secure platform. After the conversion is complete, the same controls will be instituted for SAMS.

For MEGS, CNAP, and CMS, the following controls are in place:

- Database and application code changes are pushed to quality assurance servers and production servers by the DIT database administrators and DIT server administrators, respectively:

    1. The application project manager requests a DIT service help ticket for pushes to production by DIT.

    2. Based on the service help tickets, the DIT database administrators push the code to production servers.

    3. The database administrators then notify members of the application notification list of the completion of the push and close the service help ticket.

Documented Change Control:

- There is a documented change control process established in development and implementation of all applications managed by the Grants Coordination and School Support Unit.

- All new development and modifications to existing applications are tested in the demonstration and quality assurance environment before being pushed to production.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 310604
Finding Title: Migrant Education - State Grant Program, *CFDA* 84.011

Finding: MDE'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.

Comments:

a. Activities Allowed or Unallowed - The allocation process has been automated through the use of the new Migrant Education Database System. Numbers no longer need to be transferred from one set of data to another. Issues raised in the audit are in the hands of the Office of Migrant Education at the U.S. Department of Education for the final determination of questioned costs.

b. Subrecipient Monitoring - MDE staff implemented a telephone and on-site monitoring process in the 2006-07 school year. Seven sites were monitored via telephone and another three received joint federal and MDE staff on-site visits in addition to any conducted by the Field Services Unit (FSU) staff.

(1) Review of Eligible Students - Completed through the re-interview project begun for the 2002-03 school year and continuing. In every instance, the State's error rate has been below the national average error rate and, in the last two years, is at or below the 5% error rate, a number that appears to be acceptable to the Office of Migrant Education. Since districts with any error rates will be bringing documentation to the next State directors' meeting in October, there will be a further

reduction in the error rate. Local educational agencies (LEAs) producing documentation that the questioned Certificates of Eligibility are valid will result in a further reduction of the Statewide error rate. The State's Re-Interview project is also under federal review. With one possible exception (a question about unaccompanied youth), the process has been deemed acceptable by the independent review.

(2) On-Site Monitoring - See comments above for migrant program on-site process for the 2006-07 school year.

(3) Final Expenditure Reports - Staff have reviewed the final expenditure report process. The analyst assigned to the Academic Support Unit is responsible for providing program staff with the reports, identifying discrepancies. Staff will contact the schools for explanations of the discrepancies and request that budget changes be made. If approved, the funds will be allowed to be utilized in the manner described in the revised budget descriptions. If disapproved, steps to recoup the funds will be taken.

(4) Subrecipient Cash Draws - MDE has designed a system that requires greater follow-up on the part of program staff. MDE has developed a new payment system (CMS), which limits cash draws for ongoing grants until the grantee has reported expenditures of at least the amount of the initial cash advance.

(5) Federal Audit Clearinghouse Database Information - This factor is under consideration as a component of those subrecipients to be monitored through either telephone or on-site visits. The Office of Audits provides each office with a summary of Single Audit activity and findings by district and program for use in these risk assessments.

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 310605
Finding Title: Charter Schools, *CFDA* 84.282

Finding: MDE'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).

Comments:

a. MDE now uses criteria to select and perform on-site reviews.

b. MDE's desk audit process now ensures that a sample of drawdowns is used for reimbursement or 30-day cash needs. Further, MDE has developed a new payment system (CMS), which limits cash draws for ongoing grants until the grantee has reported expenditures of at least the amount of the initial cash advance.

c. Single Audit status is one factor that MDE now considers in determining its on-site visit schedule. The Office of Audits provides each office with a summary of Single Audit activity and findings by district and program for use in assessing risk related to subrecipient monitoring.

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 310606
Finding Title: Comprehensive School Reform Demonstration, *CDFA* 84.332

Finding: MDE's internal control did not ensure that the Comprehensive School Reform Demonstration Program complied with federal laws and regulations regarding the period of availability of federal funds.

Comments: The Comprehensive School Reform staff have aggressively monitored allocations and expenditures of the 2006-07 school year. Each school has been visited and both school level and

district personnel have been required to discuss expenditures, their alignment with the approved budget, and the timeliness of the expenditures. Drawdowns have been monitored first, on a quarterly basis; then, on a monthly basis; and now, on a weekly basis. Schools that have not expended all funds have been asked for detailed budget adjustments with accompanying narrative. Where schools cannot expend all funds prior to the end of the grant period on September 30, 2007, the funds are being removed from the approved allocation and reallocated to schools with demonstrated needs. The goal was to have no unexpended funds and all funds properly expended in accordance with the grant criteria.

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 310603
Finding Title: English Language Acquisition Grants, *CFDA* 84.365

Finding: MDE did not comply with federal requirements regarding matching, level of effort, and earmarking for the English Language Acquisition Grants Program. In addition, MDE'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.

Comments:

a. Matching, Level of Effort, and Earmarking

Information has been supplied to the federal government explaining that the changes in State support for bilingual education was the result of an economic downturn in the State and not a direct result of the additional funds provided for English Language Learners through Title III of the No Child Left Behind Act. No response has been received to date.

b. Subrecipient Monitoring

(1) On-site Reviews - MDE staff participated in on-site reviews in conjunction with FSU staff. During the same time, MDE staff completed development and review of a self-assessment tool designed to be used for telephone monitoring and on-site monitoring. The self-assessment tool will be shared with LEAs in September. Telephone monitoring will begin in December and on-site monitoring in the spring. This will be combined with the FSU monitoring visits to round out the monitoring program. The number of schools monitored through telephone visits and on-site visits will change due to current staff vacancies. Once filled, the new staff person will be responsible for completing the visits.

(2) Final Expenditure Reports - Staff have reviewed the final expenditure report process. The analyst assigned to the Academic Support Unit is responsible for providing program staff with the reports, identifying discrepancies. Staff will contact the schools for explanations of the discrepancies and request that budget changes be made. If approved, the funds will be allowed to be utilized in the manner described in the revised budget descriptions. If disapproved, steps to recoup the funds will be taken.

(3) Subrecipient Cash Draws - MDE has designed a system that requires greater follow-up on the part of program staff. MDE has developed a new payment system (CMS), which limits cash draws for ongoing grants until the grantee has reported expenditures of at least the amount of the initial cash advance.

(4) Federal Audit Clearinghouse Database Information - This factor is under consideration as a component of those subrecipients to be monitored through either telephone or on-site visits. The Office of Audits

provides each office with a summary of Single Audit activity and findings by district and program for use in these risk assessments.

c. Special Tests and Provisions

MDE contracted with statisticians to compile the necessary reports to make determinations regarding annual measurable achievement objectives (AMAO) status for all subrecipients for the preceding school years (2002-03, 2003-04, and 2004-05) and for the 2006-07 test administration. For the first two years of the AMAO period, LEAs were permitted to use 1 of 6 possible assessment tools. In 2004-05 and 2006-07 school years, the State administered the English Language Proficiency Assessment and its partner screener. MDE did not have sufficient staff available to calculate 2 of the 3 criteria for each of the programs. The contractors are using statistical analyses designed to allow for the variability of the assessments and comparisons over time. The report is due to MDE in early September. All schools will be notified of their status and the necessary steps that they will need to follow if they are subject to any one of the sanctions.

Audit Period: October 1, 2003 through September 30, 2005

Finding Number: 310607

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

Finding: MDE'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).

Comments:

a. FSU reduced the 2006-07 school year allocations. Detailed documentation is available in MEGS as attached to the 2006-07 allocations.

b. FSU increased on-site reviews: 11 in fiscal year 2004-05; 27 in fiscal year 2005-06; 34 in fiscal year 2006-07.

c. The deviation report is active in MEGS. Regional consultants reviewed each report. FSU drafted letters about the deviations. FSU is still working on the deviations in relation to development of the new CMS activities.

d. MDE has developed a new payment system (CMS), which limits cash draws for ongoing grants until the grantee has reported expenditures of at least the amount of the initial cash advance.

MDE considered the Single Audit status in assessing risk related to subrecipient monitoring on-site reviews in fiscal year 2006-07. The Office of Audits provides each office with a summary of Single Audit activity and findings by district and program for use in these risk assessments.

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 310608
Finding Title: Education Technology State Grants, *CFDA* 84.318

Finding: MDE'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).

Comments:

a. The reduction in FSU staff has continued. The work load in FSU has increased to include review and approval of the LEA Planning Cycle, the Title I School Selection Application, and the Comparability Applications. Three consultants retired in spring 2007, and two consultants will retire effective October 1, 2007. FSU has not received approval to fill these positions to date. FSU ran the deviation report, which was

reviewed by the regional consultants. CMS was initiated. The development of new procedures is ongoing at this time.

b. This procedure was added to the FSU protocol. The amount set aside was reviewed by the consultant as part of the final review before making funds available.

c. MDE has developed a new payment system (CMS), which limits cash draws for ongoing grants until the grantee has reported expenditures of at least the amount of the initial cash advance.

MDE considered the Single Audit status in assessing risk related to subrecipient monitoring on-site reviews in fiscal year 2006-07. The Office of Audits provides each office with a summary of Single Audit activity and findings by district and program for use in these risk assessments.

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 310609
Finding Title: Special Education Cluster, *CFDA* 84.027 and 84.173

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

Comments:

a. (1) In the future, data will be pulled from the Single Record Student Database.

(2) The Office of Special Education and Early Intervention Services (OSE/EIS) has built into its Continuous Improvement and Monitoring System a process to validate its student data, verifying student age and that special education services were received.

(3) Completed: A primary point of contact has been established with the Office of Educational Assessment and Accountability in order to ensure that the special education data will be submitted on time.

b. (1) Completed: The repayment letters for the three years in question were sent on July 3, 2006 to the LEAs that had not complied with the maintenance of effort requirements. At the time of mailing, the number of LEAs that had to pay the maintenance of effort shortfall was reduced from 12 to 7, which reduced the total from $208,717 to $67,902.

(2) The OSE/EIS has created a flow-through team that has used the process mapping technique to identify critical submission deadlines, follow-up correspondence, and formalized the process for LEA grant performance reporting and timely review by the OSE/EIS. This process is integrated with the OSE/EIS responsibility for supervision and monitoring.

(3) Completed on April 10, 2006.

(4) Completed: MDE considers the Single Audit status in assessing risk related to subrecipient monitoring. The Office of Audits provides each office with a summary of Single Audit activity and findings by district and program for use in these risk assessments.

MICHIGAN DEPARTMENT OF EDUCATION
Corrective Action Plan
As of June 25, 2008

FINDINGS RELATED TO THE FINANCIAL SCHEDULES AND FINANCIAL STATEMENTS

Finding Number: 3130801
Finding Title: Security and Application Controls

Management Views: The Michigan Department of Education (MDE) and the Department of Information Technology (DIT) acknowledge the findings, although MDE and DIT disagree that the findings are material to the financial schedules and financial statements.

a. MDE's Security Policies and Procedures Over Critical Systems - MDE does not believe the general and application control weaknesses could have a material impact on the financial schedules and financial statements.

b. MDE's Internal Control Over the Implementation of CMS - MDE implemented a new Cash Management System (CMS) on October 1, 2006, consisting of one major program divided into four grants: Special Ed Flow-Through, Preschool, Enhancing Opportunities for Students with Disabilities (EOSD), and Transition Services. These grants totaled $351,042,482. Throughout the year, 21 other major programs were converted from the old system to the new CMS. At the end of the conversion process, 63,079 payment records had been converted and processed totaling $2.8 billion. The 189 duplicate payments totaling $9.3 million were all corrected and collected through the overpayment

functionality edit checks in CMS. The percentage of error due to conversion omissions and program bugs totaled three tenths of a percent (.3%). MDE does not believe that the control deficiencies are a material weakness. During the conversion process, a program bug doubled the expenditures for 46 recipients. MDE staff corrected these expenditures instead of having the recipients do it since they were oblivious to the conversion error. MDE did not erroneously record expenditure transactions as disallowed costs. It was a calculated and controlled internal fix for a data conversion error. After the data was fixed, the final expenditure report (FER) total equaled the subrecipient FER total.

Corrective Action:

a. MDE's Security Policies and Procedures Over Critical Systems

(1) MDE has reviewed developer access for all of its systems. Immediate changes were made to reduce the type of access and the number of developers with system access in all systems. The goal will be to limit system developer access in accordance with industry standards. With the exception of a system that does not handle any federal transactions, there was no direct access by developers to any production databases. The exception is a legacy system that is being rewritten. Monitoring processes have been developed to track all transactions in that system. MDE, in coordination with DIT, will develop a centralized approach to controlling access for all information technology (IT) systems.

(2) MDE, in conjunction with DIT, will review the change control process for all of its IT systems. MDE will develop procedures to ensure that all program modifications are properly authorized and tested.

(3) MDE will review the procedures for granting and monitoring access to all of its IT systems. MDE will take a centralized approach to monitoring access to its systems. Several changes have already been planned. User accounts that remain inactive for a period of time will automatically be inactivated. MDE will require authorization forms for all State of Michigan employees. Periodic monitoring of user accounts will be MDE policy. The security system to log-in to MDE systems is being updated and will have additional features that will help improve access control.

b. MDE's Internal Control Over the Implementation of CMS - Since the data is already converted to the new system, MDE will monitor existing reports to ensure that all converted data is accounted for and accurately reported.

Anticipated Completion Date: May 2009

Responsible Individuals: Louis Burgess, Scott Thompson, and Craig Thurman

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Finding Number: 3130802

Finding Title: Monitoring of Internal Control Over Financial Reporting

Management Views: The internal audit function was transferred out of MDE by Executive Order No. 2007-31.

Due to lack of State funding, MDE was not able to complete many internal audit activities during the audit period. However, MDE reviewed controls reported in the biennial assessment on a sample basis.

Corrective Action: MDE expects that the internal auditor assigned will periodically monitor the effectiveness of its internal control over financial reporting.

Anticipated Completion Date: Immediate

Responsible Individual: Kathleen Weller

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 3130803

Finding Title: Title I Grants to Local Educational Agencies, *CFDA* 84.010 - Cash Management

Management Views: MDE disagrees with the finding. MDE did not draw federal funds before distributing to subrecipients. MDE applies the reimbursement method of payment to recipients. MDE drew federal funds at the end of an award period and then applied the first in, first out (FIFO) method of accounting to "link" eligible expenditures to those funds. MDE did not make the linkage before the Tydings period expired, which is not required under federal regulations, nor did MDE notify the Department of Treasury because it was not an advance. These end-of-award-period transactions are recordkeeping in nature and have no negative impact on the federal award program.

Corrective Action: MDE will monitor cash management practices more closely and try to make recordkeeping transactions before the Tydings period expires.

Anticipated Completion Date: Ongoing

Responsible Individual: Craig Thurman

Finding Number: 3130804

Finding Title: Title I Grants to Local Educational Agencies, *CFDA* 84.010

Management Views:

a. Allowable Costs/Cost Principles

(1) MDE agrees with the finding. The Field Services Unit (FSU) is aggressively reviewing detailed analysis of the formula as disseminated for 2007-08. MDE has contacted the U.S. Department of Education for advice on the most expeditious way to address this finding.

(2) MDE agrees with the fact that a duplicate payment was made to a local educational agency (LEA) as a result of a system conversion error; however, MDE disagrees with the write-up of the finding. The auditors give the impression that the recipient reported costs that were questionable, when, in fact, MDE inadvertently paid an LEA without any action on the LEA's part.

b. Matching, Level of Effort, and Earmarking - MDE disagrees with this finding. MDE did not violate federal regulations concerning earmarkings. MDE did not record reconciling journal entries in

its internal accounting records before the Tydings period ended and before the audit period started.

c. Subrecipient Monitoring - MDE agrees with the finding.

Corrective Action:

a. Allowable Costs/Cost Principles

(1) MDE will:

- Review detailed audit and allocation work papers.
- Run 2007-08 allocations based on the audit check of detailed formula procedures.
- Assess impact on districts identified in the audit sample and review impact on all districts in the State.
- Proceed to ensure that actual allocated corrections are made to increase or decrease funds to districts impacted by the allocation procedure.
- Correct simultaneously with the release of the 2008-09 allocations.

(2) MDE has identified the problem and recovery is in process.

b. Matching, Level of Effort, and Earmarking - The reconciling entry was subsequently recorded during the audit period. At no time were the actual detailed expenditures in the accounting

records in excess of the earmarkings stipulated by the grant award, thus violating federal regulations.

c. Subrecipient Monitoring - FSU has been approved to fill all vacant consultant positions. In response to the federal audit, a plan exists to contract with individual consultants that will be trained to conduct random audits on required components of Title I legislation. Initially, this contracted auditing will include Title I Schoolwide Plans or Targeted Assistance Plans, the LEA and School Report Cards and will assist in review of Deviation Reports. All of these reviews are currently underway. FSU plans to implement a 10% penalty for any district that fails to submit its compliance plan within 60 days of the on-site review report. The 10% of the current year allocation will be placed on hold until an approvable plan is received.

Anticipated Completion Date: August 1, 2008

Responsible Individuals: Craig Thurman and Betty Underwood

Finding Number: 3130805

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

Management Views: MDE agrees with this finding.

Corrective Action:

a. Reporting - The MDE Office of Special Education and Early Intervention Services (OSE/EIS) implemented a data system change based upon a similar finding in the prior Single Audit covering the period October 1, 2003 through

September 30, 2005. The data system change impacted only the second year data in the current Single Audit covering the period October 1, 2006 through September 30, 2007. The duplicates reported in the current Single Audit are identified only in the first year data. No duplicates were identified in the second year data, demonstrating that this finding has now been resolved.

b. Subrecipient Monitoring - OSE/EIS did reconcile all subrecipient FERs to approved budgets. All budgets are linked directly to approved program components. The process for OSE/EIS review of all final narrative progress reports has been going through a system change that ensures a more complete and thorough review. The process is now in place for all final narrative progress reports to be reviewed in a timely manner.

Anticipated Completion Date:

a. Reporting - Completed

b. Subrecipient Monitoring - Completed

Responsible Individual: Jacque Thompson

Finding Number: 3130806

Finding Title: Safe and Drug-Free Schools and Communities (SDFSC) State Grants, *CFDA* 84.186

Management Views:

a. Matching, Level of Effort, and Earmarking - MDE agrees in part with the exception noted. As noted in the report, the administrative funds in two different years were overcharged. Award S186A030023A was overspent in the amount of $89,672.61, and this amount will be returned to the federal government. The difference in the

amount is a result of an administrative recode completed on December 17, 2007 that charged some of the administrative expenses to a different index. For the award Q186A050023 (end date September 30, 2007), it was noted that an incorrect index was used to charge the funds. The funds have been properly charged to the correct index, with the result that MDE properly charged 3% of the grant award to administrative funds.

b. Subrecipient Monitoring - MDE and the Department of Community Health's (DCH's) Office of Drug Control Policy (ODCP) acknowledge this finding. The report lists three specific areas that are in need of improvement. The management of the Title IV, SDFSC Program is done by ODCP, with MDE bearing all of the responsibilities of the State Education Agency. The cooperative relationship between ODCP and MDE is governed by a memorandum of agreement that specifies the duties for each of the departments. The two offices have met and reviewed the findings of the audit and the responsibilities outlined in the memorandum of agreement.

c. Special Tests and Provisions - MDE and DCH agree with this finding.

Corrective Action:

a. Matching, Level of Effort, and Earmarking - MDE has initiated a procedure of checking on the administrative expenses for this grant on a regular basis. As specified in a new memorandum of agreement, MDE will work closely with DCH to monitor all expenses related to this grant program. An MDE analyst will review the grant

spending plan on a monthly basis. He will coordinate directly with ODCP on any issues that arise with spending plan issues. The Grants Administration and Coordination supervisor will coordinate directly with ODCP on any issues requiring higher level action.

b. Subrecipient Monitoring - The responsibilities for subrecipient monitoring of program and fiscal areas related to this grant have been assigned to ODCP per the signed memorandum of agreement. MDE will work with ODCP to ensure that it has sufficient training and support to handle all subrecipient monitoring tasks. MDE's CMS has several tools that will allow staff to review all FERs, as well as reviewing all cash draws. ODCP will continue to monitor the involvement of private schools; in addition, the review of FERs will include looking for expenditures related to private school involvement.

c. Special Tests and Provisions - ODCP will follow the same procedures that MDE's Office of School Improvement uses when determining the allocations for all districts. It will work with the Charter School Office to determine estimated enrollments of any new charter schools planning to open. Based on the estimated enrollments, ODCP will ensure that funds are set aside to cover the allocations. These set-aside funds will then be allocated to new charter schools when the fall enrollment counts are finalized. This process will be part of the ongoing procedures for ODCP.

Anticipated Completion Date: May 22, 2008

Responsible Individuals: Mark Steinberg and Louis Burgess

Finding Number: 3130807
Finding Title: Charter Schools, *CFDA* 84.282

Management Views: MDE agrees with the findings but disagrees with the questioned cost. These errors were caused by the conversion process from the Grants Cash Management Reporting System to CMS and had nothing to do with eligibility. Plymouth Educational was paid monies that should have gone to Northpointe in the amount of $204,045. Vista Charter was paid monies that should have gone to Vista Meadows in the amount of $150,000. Chandler Woods was paid monies that should have gone to Taylor in the amount of $14,992. The payments were processed as a result of the State of Michigan's Vendor Registration File mail codes not matching those in CMS.

Corrective Action: MDE has corrected the conversion error and updated the mail code in CMS. MDE has recovered the incorrect payments and forwarded them to the correct payees.

Anticipated Completion Date: June 30, 2008

Responsible Individual: Craig Thurman

Finding Number: 3130808
Finding Title: State Grants for Innovative Programs, *CFDA* 84.298

Management Views: MDE agrees with the finding. FSU has been understaffed by at least seven consultants during the

audit period. MDE has approved recruitment and hiring for the vacant positions. The monitoring responsibilities for this program are considered an essential part of consultant responsibilities.

Corrective Action:

- Consultant positions will be filled by September 2008.
- On-site reviews conducted during 2006-07 will have 100% follow-up during 2007-08.
- FSU will hold 10% of the 2008-09 allocation for any district reviewed in 2006-07 that is not in compliance by July 1, 2008.

Anticipated Completion Date: Ongoing

Responsible Individual: Betty Underwood

Finding Number: 3130809

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

Management Views: MDE agrees with part of this finding and disagrees with part of it.

a. Eligibility - MDE disagrees with the eligibility finding. The grants in question were competitive grants awarded as part of the State's Freedom to Learn grant program. This innovative program was part of a Statewide initiative to provide laptops to sixth grade students to use technology in order to improve student achievement and engagement by changing the manner in which students learn and teachers teach. The program was started in 2003 and continued through 2007.

In four of the five cases cited in the audit, the fiscal agent had properly been awarded an earlier grant to start the laptop program within their district. In the fifth case, the district was one of the seven demonstration sites from the first year of the State's Learning Without Limits laptop program. In subsequent years, districts that were earlier winners were encouraged to continue to expand their one-to-one teaching and learning wireless computer solutions by either adding new classes or expanding the program within their districts. These subsequent grant awards were treated as continuation grants. The intent of the awards was to provide continuity and to sustain successful implementations of educational technology programs. In two districts, schools that had failed to meet adequate yearly progress (AYP) were able to achieve AYP status, and participation in the Freedom to Learn program was cited as one of the prime causes of increasing student achievement.

b. Subrecipient Monitoring - One of the FERs that was reviewed was for a competitive grant that was awarded to a charter school under the Freedom to Learn program. This subrecipient did not properly report its 25% professional development expenditures. Once MDE notified the district of the issue, it corrected, resubmitted, and then certified its FER. This action was completed on May 23, 2008.

Corrective Action:

a. Eligibility - Since 2006, MDE has published a list of high-need LEA districts that meet the State's definition of the Title II, Part D, Enhancing Education Through Technology grant eligibility criteria. Only schools that are on the approved

list are eligible to apply for the grant. Other districts may apply for the Ed Tech competitive grant if they form an eligible local partnership with at least one high-need LEA as a member.

b. Subrecipient Monitoring - MDE has a policy to review all FERs for subrecipients. CMS has a screen that records consultant review of all FERs.

Anticipated Completion Date: a. March 1, 2006

b. October 10, 2007

Responsible Individuals: Louis Burgess and Bruce Umpstead

Finding Number: 3130810

Finding Title: Reading First State Grants, *CFDA* 84.357

Management Views: MDE agrees with the two audit findings and disagrees with the questioned costs.

a. Matching, Level of Effort, and Earmarking - A recode was to be completed during the Tydings amendment period. A staff member left MDE and the recode was not completed during the Tydings time. The questioned costs of $525,878 were allowable costs.

b. Subrecipient Monitoring - The Reading First Program agrees with this finding. The program office has monitored a sample of the FERs from LEAs.

Corrective Action: a. Matching, Level of Effort, and Earmarking - The Reading First Program completed a financial recode on January 10, 2008, to bring the program

into compliance with the matching, level of effort, and earmarking requirement.

The Reading First Program hired a financial analyst to budget, execute, and monitor Reading First expenditures. The analyst was hired January 14, 2008. She will file a spending plan with the office director. In this spending plan, the Reading First Program will ensure that the expenditures do not exceed the 20% threshold and earmarking as outlined. Once the spending plan is approved, the financial analyst, along with the program supervisor, will carry out the budget. She will monitor budget expenditures and make certain that the program is in compliance.

The Office of School Improvement hired a financial manager on February 25, 2008. His responsibilities include monitoring expenditures for the Reading First Program.

b. Subrecipient Monitoring - MDE's process for monitoring subrecipients' expenditures for authorized purposes include approving subrecipients' proposed budgets and requiring LEAs to submit a budget transfer request when actual expenditures deviate from approved budgets.

In the past, the program staff reviewed a sample of FERs. MDE now will review all FERs. The program office hired a financial analyst January 14, 2008, and she will be responsible for reviewing all FERs. She will document this review and report any findings to the program staff and the office director. The program staff will follow up with LEAs to ensure that expenditures

are authorized. The Reading First staff will document the follow-up with LEAs.

Anticipated Completion Date: June 1, 2008

Responsible Individuals: Craig Thurman and Betty Underwood

Finding Number: 3130811

Finding Title: English Language Acquisition (ELA) Grants, *CFDA* 84.365

Management Views: MDE agrees with the findings.

Corrective Action:

a. Subrecipient Monitoring - MDE will ensure that all on-site reviews contemplated by MDE staff for English Language Learners (ELL) programs are built into the review plan, which is based on risk elements, and that each of those reviewed has appropriate follow-up based on monthly meetings with all staff concerned. The charting process will allow MDE to ensure that the appropriate schools/programs have been selected for review, that there is adequate follow-up when necessary, and that any issues requiring a follow-up visit to ensure completeness of implementation will take place in a timely manner.

   With the addition of an analyst and a full-time consultant with responsibilities for ELL programs, the FER monitoring will be built into the chart mentioned in the preceding paragraph with appropriate follow-up noted.

b. Special Tests and Provisions - The Annual Measurable Achievement Objective (AMAO) status of every program has been calculated and

the letters are being vetted as of June 19, 2008. Following completion of the vetting process, letters will be mailed to all programs in the State (electronically). It is anticipated that the AMAO status for the 2007-08 school year will have been calculated by August/September of 2008 and schools notified by October. Training and technical assistance plans for those schools negatively affected by AMAO status are planned throughout the 2008-09 school year and beyond.

Anticipated Completion Date: June 2009

Responsible Individual: Betty Underwood

Finding Number: 3130812

Finding Title: Mathematics and Science Partnerships (MSP), *CFDA* 84.366

Management Views: MDE agrees with these findings.

Corrective Action:

a. A discussion with the subrecipient revealed this budget item was indeed a direct cost. In the future, it will better describe the budget item so that it more clearly reflects the nature of the job.

b. In the new MSP applications in the Michigan Electronic Grants System (MEGS) (applications due June 19, 2008), applicants are required to submit documentation that private schools were invited to participate in the professional development opportunities proposed.

Anticipated Completion Date: Completed

Responsible Individuals: Betty Underwood and Ruth Ann Hodges

Finding Number: 3130813

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

Management Views:

a. Allowable Costs/Cost Principles - MDE acknowledges the finding that $40,656 in duplicate payments were made to two LEAs; however, these overpayments were not created as a result of the LEAs' reporting of questionable costs. MDE has experienced some difficulty in converting all expenditure data from the old accounting system to the new CMS and, as a result, MDE overpaid two LEAs.

b. Matching, Level of Effort, and Earmarking - MDE agrees with this finding.

c. Subrecipient Monitoring - FSU has been understaffed by at least seven consultants during the audit period. MDE has approved recruitment and hiring for the vacant positions. The monitoring responsibilities for this program are considered an essential part of consultant responsibilities.

Corrective Action:

a. Allowable Costs/Cost Principles - MDE has recovered the overpayment and corrected the error.

b. Matching, Level of Effort, and Earmarking - MDE will improve internal control over Improving Teacher Quality State Grants by closely monitoring spending plans and internal

accounting records in order to fully comply with federal laws and regulations. Administrative cost of $52,396 is being returned to Title II, Improving Teacher Quality State Grants Program.

c. Subrecipient Monitoring

- Consultant positions will be filled by September 2008.

- On-site reviews conducted during 2006-07 will have 100% follow-up during 2007-08.

- FSU will hold 10% of the 2008-09 allocation for any district reviewed in 2006-07 that is not in compliance by July 1, 2008.

Anticipated Completion Date: Ongoing

Responsible Individuals: Craig Thurman (a. and b.) and Betty Underwood (c.)

GLOSSARY

AMAO	annual measurable achievement objectives.
AYP	adequate yearly progress.
CFDA	*Catalog of Federal Domestic Assistance.*
CFR	*Code of Federal Regulations.*
CMIA	Cash Management Improvement Act of 1990.
CMS	Cash Management System.
CNAP	Child Nutrition Application Program.
control deficiency in internal control over federal program compliance	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis noncompliance with a type of compliance requirement of a federal program.
control deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
CSP	Charter Schools Program.
DCH	Department of Community Health.
DIT	Department of Information Technology.
ELA	English Language Acquisition.
ELL	English Language Learners.

FER	final expenditure report.
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 presented fairly in all material respects in conformity with the disclosed basis of accounting.
FSU	Field Services Unit.
GAAP	accounting principles generally accepted in the United States of America.
GCMRS	Grants Cash Management Reporting System.
HIV	human immunodeficiency virus.
IDEA	Individuals with Disabilities Education Act.
Improving Teacher Quality	Improving Teacher Quality State Grants.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
IT	information technology.
LEA	local educational agency.
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 misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material noncompliance	Violations of laws, regulations, contracts, and grants that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
material weakness in internal control over federal program compliance	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected.
material weakness in internal control over financial reporting	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules and/or financial statements will not be prevented or detected.
MDE	Michigan Department of Education.
MEGS	Michigan Electronic Grants System.
Michigan Administrative Information Network (MAIN)	The State's fully integrated automated administrative management system that supports the accounting, payroll, purchasing, contracting, budgeting, personnel, and revenue management activities and requirements. MAIN consists of four major components: MAIN Enterprise Information System (EIS); MAIN Financial Administration and Control System (FACS); MAIN Human Resource System (HRS); and MAIN Management Information Database (MIDB).

MSP	Mathematics and Science Partnerships.
ODCP	Office of Drug Control Policy.
OMB	U.S. Office of Management and Budget.
OMB Circular A-87	Guidance regarding "Cost Principles for State, Local, and Indian Tribal Governments," which has been incorporated into the *Code of Federal Regulations* as Title 2, Part 225 (i.e., federal regulation 2 *CFR* 225).
OSE/EIS	Office of Special Education and Early Intervention Services.
pass-through entity	A nonfederal entity that provides a federal award to a subrecipient to carry out a federal program.
questioned cost	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.
Reading First	Reading First State Grants.
SAMS	State Aid Management System.
SDFSC	Safe and Drug-Free Schools and Communities - State Grants.

significant deficiency in internal control over federal program compliance	A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected.
significant deficiency in internal control over financial reporting	A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected.
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	A 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

OFFICE of the AUDITOR GENERAL