



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



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

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:

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Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Including the Provisions of the Single Audit Act

Report Number:
313-0100-12

Michigan Department of Education

October 1, 2009 through September 30, 2011

Released:
June 2012

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 did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, we did identify significant deficiencies (Findings 1 through 3).

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Noncompliance and 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 19 programs (including 7 programs with ARRA funding) as major programs and identified known questioned costs of \$9.5 million. MDE expended a total of \$5.2 billion in federal awards, including \$1.4 billion of ARRA funding, during the two-year period ended September 30, 2011. We issued 18 unqualified opinions and 1 adverse opinion. The opinions issued by major program are identified on the back of this summary.

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Internal Control Over Major Programs

We identified material weaknesses in internal control over federal program compliance (Findings 5, 10, 13, and 15). We also identified significant deficiencies in internal control over federal program compliance (Findings 4 through 8, 11 through 15, and 17).

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Required Reporting of Noncompliance

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Findings 4 through 17).

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Internal Accounting and Administrative Control System:

Section 18.1489 of the *Michigan Compiled Laws* requires the Auditor General to evaluate the implementation of Sections 18.1483 - 18.1488 of the *Michigan Compiled Laws* and report to the Legislature in the financial audit of each department. As a result of Executive Reorganization Order No. 2007-31 (Consolidating Internal Audit Functions), in which responsibility for most of the sections was moved to the Office of Internal Audit Services, State Budget Office, we have evaluated the implementation of only Section 18.1485 in this financial audit. Section 18.1485 requires each department director to establish an internal accounting and administrative control system, defines the elements of that system, defines the duties of the department director, and provides for certain reports. We determined that MDE was in substantial compliance with Section 18.1485 of the *Michigan Compiled Laws*.

The remaining sections (Sections 18.1483, 18.1484, and 18.1486 - 18.1488 of the *Michigan Compiled Laws*) will be evaluated and reported on in a performance audit of the Office of Internal Audit Services, State Budget Office.

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We audited the following programs as major programs:

<i>CFDA Number</i>	<i>Program or Cluster Title</i>	<i>Compliance Opinion</i>
	<u>Child Nutrition Cluster:</u>	Unqualified
10.553	• School Breakfast Program	
10.555	• National School Lunch Program	
10.556	• Special Milk Program for Children	
10.559	• Summer Food Service Program for Children	
10.558	Child and Adult Care Food Program	Unqualified
	<u>Emergency Food Assistance Program Cluster:</u>	Unqualified
10.568	• Emergency Food Assistance Program (Administrative Costs)	
10.568	• ARRA - Emergency Food Assistance Program (Administrative Costs)	
10.569	• Emergency Food Assistance Program (Food Commodities)	
10.569	• ARRA - Emergency Food Assistance Program (Food Commodities)	
45.310	Grants to States	Unqualified
	<u>Title I, Part A Cluster:</u>	Unqualified
84.010	• Title I Grants to Local Educational Agencies	
84.389	• ARRA - Title I Grants to Local Educational Agencies, Recovery Act	
84.011	Migrant Education - State Grant Program	Unqualified
	<u>Special Education Cluster (IDEA):</u>	Unqualified
84.027	• Special Education - Grants to States	
84.173	• Special Education - Preschool Grants	
84.391	• ARRA - Special Education Grants to States, Recovery Act	
84.392	• ARRA - Special Education - Preschool Grants, Recovery Act	
	<u>Early Intervention Services (IDEA) Cluster:</u>	Unqualified
84.181	• Special Education - Grants for Infants and Families	
84.393	• ARRA - Special Education - Grants for Infants and Families, Recovery Act	
84.186	Safe and Drug-Free Schools and Communities - State Grants	Unqualified
84.282	Charter Schools	Unqualified
84.287	Twenty-First Century Community Learning Centers	Unqualified
	<u>Education Technology State Grants Cluster:</u>	Unqualified
84.318	• Educational Technology State Grants	
84.386	• ARRA - Education Technology State Grants, Recovery Act	
84.357	Reading First State Grants	Unqualified
84.365	English Language Acquisition Grants	Unqualified
84.367	Improving Teacher Quality State Grants	Unqualified
	<u>School Improvement Grants Cluster:</u>	Unqualified
84.377	• School Improvement Grants	
84.388	• ARRA - School Improvement Grants, Recovery Act	
84.378	College Access Challenge Grant Program	Adverse
	<u>State Fiscal Stabilization Fund Cluster:</u>	Unqualified
84.394	• ARRA - State Fiscal Stabilization Fund (SFSF) - Education State Grants, Recovery Act	
84.410	Education Jobs Fund	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 28, 2012

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, 2009 through September 30, 2011.

This report contains our report summary; our independent auditor's reports on the financial schedules and financial statements; and MDE financial schedules, School Aid Fund financial statements, required supplementary information, and the 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 that could have a direct and material effect on 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 plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,


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

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



STATE OF MICHIGAN
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, 2011 and September 30, 2010, 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, 2011 and September 30, 2010 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 21, 2012 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is written in a cursive style with a long horizontal line extending to the left.

Thomas H. McTavish, C.P.A.

Auditor General

June 21, 2012



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, 2011 and September 30, 2010, as identified in the table of contents. These financial statements are the responsibility of the Department's and Fund'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, 2011 and September 30, 2010 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, 2011 and September 30, 2010 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 21, 2012 on our consideration of the Fund's and Department's internal control over financial reporting and on our tests of their 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 36 through 39 are not a required part of the Fund's 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 Fund's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General
June 21, 2012

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

	<u>2011</u>	<u>2010</u>
REVENUES		
From federal agencies (Note 1)	\$ 59,866,807	\$ 52,721,494
From local agencies	122,079	53,680
From licenses and permits	5,011,921	4,640,670
Miscellaneous	<u>424,450</u>	<u>225,101</u>
Total revenues	<u>\$ 65,425,257</u>	<u>\$ 57,640,945</u>

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

	2011	2010
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations	\$ 40,012,307	\$ 50,061,400
Balances carried forward	2,020,303	2,665,519
Restricted financing sources	69,794,231	62,319,029
Less: Intrafund expenditure reimbursements	(4,337,232)	(4,844,960)
Total	\$ 107,489,609	\$ 110,200,988
 DISPOSITION OF AUTHORIZATIONS (Note 2)		
Gross expenditures and transfers	\$ 107,963,624	\$ 110,987,015
Less: Intrafund expenditure reimbursements	(4,337,232)	(4,844,960)
Net expenditures and transfers	\$ 103,626,392	\$ 106,142,056
Balances carried forward:		
Encumbrances	\$ 479,164	\$ 23,022
Multi-year projects	167,000	
Restricted revenues - authorized	463,940	428,330
Restricted revenues - not authorized or used	2,644,992	1,568,951
Total balances carried forward	\$ 3,755,096	\$ 2,020,303
Balances lapsed	\$ 108,120	\$ 2,038,629
Total	\$ 107,489,609	\$ 110,200,988

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

Notes to 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, 2011 and September 30, 2010. 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 the 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; 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. 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 accounting principles generally accepted in the United States of America.

c. Revenue From Federal Agencies

Federal reimbursement for MDE administration costs were recorded in the State's General Fund. 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 no 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. Significant balances carried forward consisted of \$1.2 million and \$1.6 million of certification fees for fiscal years 2010-11 and 2009-10, respectively.
- c. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted intrafund expenditure reimbursements used 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 and 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 - authorized: Revenues that, by statute or the Michigan Constitution, are restricted and authorized for use to a particular program or activity. Generally, these revenues may be expended upon receipt without additional legislative authorization.
- h. 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 carry-forwards of this type consisted of certification fees of \$2.1 million and \$1.2 million for fiscal years 2010-11 and 2009-10, respectively.
- i. 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.

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

	<u>2011</u>	<u>2010</u>
ASSETS		
Current assets:		
Taxes, interest, and penalties receivable (Note 6)	\$ 1,856,883	\$ 1,873,442
Amounts due from federal agencies	69,931	62,538
Amounts due from local units	61,693	71,389
Other current assets		<u>2</u>
Total current assets	<u>\$ 1,988,506</u>	<u>\$ 2,007,371</u>
Noncurrent assets:		
Taxes, interest, and penalties receivable	59,931	51,861
Amounts due from local units	<u>3,687</u>	<u>433</u>
Total assets	<u><u>\$ 2,052,124</u></u>	<u><u>\$ 2,059,666</u></u>
LIABILITIES AND FUND BALANCE		
Current liabilities:		
Warrants outstanding	\$ 989	\$ 934
Accounts payable and other liabilities	168,397	194,342
Amounts due to other funds (Note 5)	654,284	1,209,461
Deferred revenue (Note 6)	414,959	343,598
Total current liabilities	<u>\$ 1,238,629</u>	<u>\$ 1,748,335</u>
Long-term liabilities:		
Deferred revenue (Note 6)	<u>59,931</u>	<u>51,861</u>
Total liabilities	<u><u>\$ 1,298,561</u></u>	<u><u>\$ 1,800,196</u></u>
Fund balance:		
Restricted fund balance (Note 1)	<u>\$ 753,563</u>	<u>\$ 259,469</u>
Total fund balance	<u><u>\$ 753,563</u></u>	<u><u>\$ 259,469</u></u>
Total liabilities and fund balance	<u><u>\$ 2,052,124</u></u>	<u><u>\$ 2,059,666</u></u>

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)

	<u>2011</u>	<u>2010</u>
REVENUES		
Taxes (Notes 2 and 6):		
Sales	\$ 4,878,664	\$ 4,488,874
Personal income	1,972,926	1,836,158
Property	1,845,086	1,930,480
Use	516,316	527,991
Cigarette	376,360	392,943
Industrial facilities	43,595	55,249
Liquor	39,089	37,552
Commercial facilities (forest tax)	3,042	2,961
Casino gaming wagering	114,017	101,816
Real estate transfer	123,254	121,632
Michigan Business Tax	611,433	604,395
Other	19,487	14,123
Total taxes	<u>\$ 10,543,269</u>	<u>\$ 10,114,174</u>
From federal agencies	2,468,558	2,392,903
Miscellaneous	26,323	33,155
Total revenues	<u>\$ 13,038,151</u>	<u>\$ 12,540,232</u>
EXPENDITURES		
American Recovery and Reinvestment Act (ARRA)	\$ 617,287	\$ 829,003
Proposal A (Note 2)	5,831,205	5,838,454
Discretionary payment	3,286,307	3,068,572
Special education	909,086	938,507
At risk students	308,947	308,956
Declining enrollment	20,000	20,000
Vision and hearing	5,150	5,150
Intermediate school districts	65,377	77,747
Adult education	21,735	21,995
District grants	108,929	106,966
School readiness grants	35,304	35,578
Vocational education	21,626	21,664
School lunch	2,625	2,625
Mathematics and science	2,000	2,000
Health and science middle college	905	905
Pre-college engineering	8,000	8,000
Court-placed children	1,440	1,751
Juvenile detention facilities	742	642
Cultural access grants	2,544	2,825
Challenge Program	1,299	1,300
School bus inspections and driver safety	2,800	2,800
Out-of-formula districts	22,931	25,995
Gifted and talented	38,774	38,790
Bilingual education	6,846	11,894
Renaissance zone	3,557	3,557
Non-Durant district settlements (Note 4)	3,400	3,394
Borrowing costs	23,910	31,362
Teen health centers	3,800	9,258
PILT (payment in lieu of taxes) reimbursement	1,497,206	1,227,608
State assessments	357,168	338,238
School breakfast		8,000
Federal non-special education	25,624	
Federal special education	1,500	
American Recovery and Reinvestment Act (ARRA) (Note 2)	300	
Other	48,862	19,536
Total expenditures	<u>\$ 13,287,187</u>	<u>\$ 13,013,073</u>
Excess of revenues over (under) expenditures	<u>\$ (249,036)</u>	<u>\$ (472,840)</u>
OTHER FINANCING SOURCES (USES)		
Transfers from other funds (Note 7)	\$ 745,967	\$ 729,590
Transfers to other funds (Note 7)	(2,837)	(248,400)
Total other financing sources (uses)	<u>\$ 743,130</u>	<u>\$ 481,190</u>
Net change in fund balances	\$ 494,094	\$ 8,350
Fund balance - Beginning of fiscal year	<u>259,469</u>	<u>251,119</u>
Fund balance - End of fiscal year	<u>\$ 753,563</u>	<u>\$ 259,469</u>

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

Notes to 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, 2011 and September 30, 2010. 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 Treasurer's 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. Revenue and 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.

d. Accounting Changes and Restatements

During fiscal year 2010-11, the State implemented Governmental Accounting Standards Board* (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

The financial statements in this report have been restated to retroactively implement GASB Statement No. 54 for fiscal year 2009-10. MDE requested and was granted approval from the Office of Financial Management within the State Budget Office to present the financial statements in this report differently from the *SOMCAFR* by restating fiscal year 2009-10 to comply with the reporting requirements of GASB Statement No. 54.

The objective of GASB Statement No. 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to honor constraints imposed upon the use of the resources reported in governmental funds.

As a result of MDE implementing GASB Statement No. 54, amounts previously classified as reserved fund balance are now classified as restricted fund balance. Restricted fund balance includes amounts that are restricted when constraints placed on the use of the resources are either externally imposed by creditors, grantors, contributors, or laws or

* See glossary at end of report for definition.

regulations of other governments or imposed by law through constitutional provisions or enabling legislation.

Note 2 Description of Fund

The School Aid Fund was created in 1955 by an amendment to the 1908 Michigan Constitution, and its continued existence was provided for by the 1963 Michigan 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 2010-11 and 2009-10, 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 are 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 for fiscal years 2010-11 and 2009-10 by using federal grant funds (State Fiscal Stabilization Fund) from the American Recovery and Reinvestment Act of 2009* (ARRA) in lieu of payments (\$184.3 million and \$450.0 million, respectively) under Section 22b of the State School Aid Act.

* See glossary at end of report for definition.

Note 3 Contingencies

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

Adair et al. v State of Michigan et al. (Adair) was filed on November 15, 2000, by more than 400 school districts and asserts that the State has, by operation of law, increased the level of various specified activities and services beyond that which was required by State law as of December 23, 1978 and, subsequent to 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 sought an unspecified money judgment equal to the reduction in the State financed proportion of necessary costs incurred by the plaintiff school districts for each school year from 1997-1998 through the date of any judgment and for attorneys' fees and litigation costs. The Adair plaintiffs also sought 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 for 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 January 2, 2001, plaintiffs filed a first amended complaint in both Durant III and Adair increasing the number of school district plaintiffs to 443. On February 22, 2001, plaintiffs filed a second amended complaint in Durant III increasing the number of school district plaintiffs to 457. On April 16, 2001, plaintiffs filed a second amended complaint in Adair increasing the number of school district plaintiffs to 463. The second amended complaint includes a request for declaratory relief, attorneys' fees and litigation costs but does not include a request for money judgment.

On April 23, 2002, the Court of Appeals dismissed the complaint in its entirety and with prejudice. Plaintiffs filed an application for leave to appeal in the Michigan Supreme Court on May 14, 2002, which was granted on December 18, 2002.

On June 9, 2004, the Michigan Supreme Court issued its opinion in *Adair*. The court held that, with three exceptions, all of the plaintiffs' claims were barred by the doctrines of *res judicata* and release. The court ruled that all but three of the claims that plaintiffs alleged were new or increased activities could have been included in the Durant I litigation because the activities existed during the time that the Durant I litigation was pending.

The other three claims involve statutes that were enacted after the court's 1997 Durant I decision. The court ruled that two of these post-Durant I statutes were not new mandates because the activities are either not new or are merely permissive. The third claim involves the record keeping activities and the operation of the Center for Educational Performance and Information (CEPI), which was created by executive order in 2000 (Michigan Compiled Laws (MCL) Section 388.1752; Executive Order (EO) 2000-9). Plaintiffs alleged that the statute and executive order require districts to create and maintain student data following State-specified data-gathering procedures and transmit the data electronically to the State. The Supreme Court ruled that the plaintiffs' allegation that districts had to now actively participate in maintaining data that the State requires for its own purposes presents a colorable claim under the Headlee Amendment. The court reversed the Court of Appeals' dismissal of the claim and remanded the issue to the Court of Appeals to determine whether this claim constitutes a new State-mandated activity in violation of the Headlee Amendment.

On August 4, 2005, the Court of Appeals held that the school districts failed to present documentary support from which it can be inferred that either MCL Section 388.1752 or EO 2000-9 mandates the school districts to actively participate in the maintenance of data that the State requires for its purposes. Further, the record keeping claim cannot survive summary disposition in the absence of any factual support, either expressed or implied, demonstrating that a genuine issue of material fact exists with regard to whether the dictates of the statute and the EO impermissibly shift a State obligation to the school districts to avoid the costs of obligation. The Court of Appeals granted summary disposition in the State's favor. Plaintiffs estimated their claim to be \$30 million plus

ongoing costs. The plaintiff school districts filed an application for leave to appeal with the Michigan Supreme Court. A brief in opposition was filed on October 11, 2005.

On March 8, 2006, the Supreme Court issued an order vacating the August 4, 2005 Court of Appeals decision and remanded the issue to the Court of Appeals for reevaluation of plaintiffs' record keeping claim. The Court of Appeals appointed a Special Master to oversee discovery and make proposed findings to the Court of Appeals. An evidentiary hearing before the Special Master was held in the summer of 2007.

On January 27, 2008, the Special Master issued her opinion. She found that the increased recordkeeping and reporting requirements imposed upon the school districts by the State was an attempt by the State to shift the burden to comply with additional requirements to the districts without appropriating the necessary costs to comply. She concluded that this was a shifting of the recordkeeping and reporting requirement burden from the State to the local units of government in violation of the Headlee Amendment.

The State filed objections to the Special Master's Opinion in the Court of Appeals. The school districts sought attorney fees in the Court of Appeals.

On July 3, 2008, the Court of Appeals issued its Opinion on Second Remand, essentially adopting the conclusions of law and factual findings of the Special Master. The Court entered a declaratory judgment in favor of the plaintiff school districts, requiring the State to fund the "necessary costs associated with the data collection reporting mandates" associated with CEPI. The Court denied plaintiff's request for attorney fees.

Both parties filed applications for leave to appeals in the Michigan Supreme Court. On April 3, 2009, the Michigan Supreme Court granted leave on two issues: (1) whether the prohibition of unfunded mandates in Article 9, Section 29 of the State Constitution, requires plaintiffs to prove specific costs, either through reallocation of funds or out-of-pocket

expenses in order to establish their entitlement to a declaratory judgment; and (2) whether plaintiffs are entitled to recover the "costs incurred in maintaining" this suit pursuant to Article 9, Section 32, of the State Constitution.

Following the submission of briefs, the Michigan Supreme Court heard oral arguments on October 6, 2009.

On July 14, 2010, the Michigan Supreme Court issued a 4-3 decision in favor of the plaintiffs on both issues. The court held that the school district record keeping requirements was an increase in the level of activities or services mandated by the State and therefore, subject to Headlee. The court also held that in a declaratory judgment action under Headlee, where no legislative appropriation is made, a plaintiff is not required to show a quantified dollar amount increase in necessary costs, and the State has the burden to demonstrate that the school district's costs were not necessary under one or more of the exceptions in MCL 21.233(6) (a) through (d). In evaluating whether the costs from an increased level of activity were necessary, the question is what would be the cost to the State if it performed the mandated activity. The court also held that plaintiffs are entitled to attorney fees sustained in maintaining this action.

The case was remanded to the Court of Appeals to determine costs and attorney fees. An evidentiary hearing before the court-appointed Special Master occurred in June 2011. The recommendation and decision of the Special Master is currently pending. The State estimates that the award of attorney fees and costs is between \$1.8 million and \$4.0 million, which may be paid from fiscal year 2012's budget. The Legislature allocated up to \$1.0 million in Section 22b(7) of the State School Aid Act, MCL 388.1627b(7) for this anticipated expense. The Legislature appropriated \$25.6 million in fiscal year 2011, and \$34 million in fiscal year 2012 to be used solely for the purpose of paying necessary costs related to the state-mandated collection, maintenance, and reporting of data to this state.

On January 19, 2011, the Adair plaintiffs filed a new complaint seeking, among other things, a declaratory judgment that the appropriation is insufficient to pay the full costs of the imposed record keeping requirements, and that the new requirements for teacher and administrator evaluations enacted in the Race to the Top legislation, 2009 Public Acts 201-205, also violate the Headlee Amendment. The complaint also sought compensable damages for the amount of costs incurred by the school districts to provide required data and attorney fees, injunctive relief to cease requiring school districts from complying with the record keeping requirements, and injunctive relief to enjoin Defendants from enforcing the Race to the Top legislation.

On October 10, 2011, plaintiffs filed a second amended complaint primarily based on the changes in the teacher and administrator evaluation provisions contained in 2011 PA 100-102, the July 2011 amendments to Section 1249 of the School Code, MCL 380.1249, as well as the changes to the Tenure Act. In addition, the districts added a count related to the Teacher Student Data Link and allege that Section 94a of the School Aid Act mandates that schools collect and report new data without an appropriation to pay the districts for costs of the new activity including: "costs incurred for their staff members necessary to perform the required services for the purpose of TSDL data acquisition, maintenance and reporting to CEPI, to acquire necessary software to track, record and report the required data, and to train school district staff in order to otherwise implement the new TSDL reporting requirements, all of which have never before been required by the State."

Plaintiffs allege this is occurring in direct violation of the provisions of the second sentence of Const 1963, Article 9, Section 29, the Headlee Amendment. Although this is a declaratory judgment action, plaintiffs are entitled to costs including attorney fees estimated between \$1.2 million and \$4 million. Plaintiffs claim cost of compliance with the reporting is over \$34 million annually. The cost of compliance with the teacher and administrator evaluation requirements has not been determined.

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 personal property tax table depreciation schedule of utility companies. The settlement was presented to and approved by the Michigan Tax Tribunal in 2006. In fiscal years 2010-11 and 2009-10, \$11.9 and \$16.3 million, respectively, were paid in school aid payments for prior fiscal years because school districts and other taxing units were required to refund utility companies. Fiscal year 2010-11 represented the final payment related to this settlement.

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 Michigan 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 were paid half in annual payments over 10 years that ended in November 2007. The other half is being paid 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. The estimated aggregate payments to the non-Durant school districts will total approximately \$780.4 million. As of September 30, 2011, the remaining expected amount to be paid on behalf of the non-Durant school districts totaled approximately \$155.9 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. Due to the timing of the collection of tax revenues, the School Aid Fund borrows cash at year-end to make school aid payments. This reclassification resulted in a School Aid Fund liability of approximately \$654 million for fiscal year 2010-11 and \$1.2 billion for fiscal year 2009-10.

Note 6 Tax Revenue, Deferred Revenue, and Receivables

Revenues of the School Aid Fund consist primarily of sales, personal income, property, Michigan Business Tax, use, cigarette, liquor, industrial and commercial facilities, real estate transfer, and casino gaming wagering taxes. Collections of these taxes are the responsibility of other State departments. Delinquent taxes are recognized as revenue to the extent that they will be collected within 12 months.

Deferred revenues (\$474.9 million and \$395.5 million as of September 30, 2011 and September 30, 2010, respectively) are recognized if the tax revenue is not considered "available," e.g., received within 60 days of the fiscal year-end.

In general, taxes receivable represent amounts due to the State at September 30 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 prior to October 1 and the State receives tax payments prior to December 1. Annual tax payments (those paid with an annual return, such as personal income taxes) have not been accrued because they are neither reasonably estimable nor available.

The following taxes were due to the School Aid Fund:

Schedule of Taxes Receivable		
<u>As of September 30</u>		
(In Thousands)		
	2011	2010
Gross taxes receivable	\$ 2,291,537	\$ 2,273,827
Less allowance for uncollectible receivables	(374,723)	(348,524)
Net taxes receivable	\$ 1,916,814	\$ 1,925,303
Current taxes receivable	\$ 1,856,883	\$ 1,873,442
Noncurrent taxes receivable	\$ 59,931	\$ 51,861

Note 7 Transfers

Interfund transfers are reported as other financing sources and uses on the statement of revenues, expenditures, and changes in fund balance and consisted of the following (in millions):

	Fiscal Year	
	2010-11	2009-10
Transfers from other funds:		
State Lottery Fund	\$ 727.3	\$ 701.3
General Fund	18.6	28.3
Total transfers from other funds	\$ 746.0	\$ 729.6
Transfers to other funds:		
General Fund	\$	\$ (208.4)
School Loan Bond Redemption Fund	(2.8)	(40.0)
Total transfers to other funds	\$ (2.8)	\$ (248.4)

Transfers from other funds include the transfer of State Lottery net revenue as required by law and annual appropriated transfers from the State's General Fund. Transfers to other funds include payments to the School Loan Bond Redemption Fund on behalf of school districts.

Transfers to other funds for fiscal year 2009-10 also included a supplemental appropriation, Act 158, P.A. 2010, that transferred \$208.4 million in School Aid Fund revenues to the General Fund to cover the community college appropriations. Section 301 of the Act indicated that the legislative intent was that the amount appropriated should be considered a loan to the General Fund to be repaid over a period of five fiscal years beginning in the fiscal year ended September 30, 2012. However, unless established in law, the intent of one Legislature cannot bind future legislative actions. Therefore, because there is no binding requirement for repayment, the amount was recorded as an interfund transfer.

REQUIRED SUPPLEMENTARY INFORMATION

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

<u>Statutory/Budgetary Basis</u>	2011			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Beginning budgetary fund balance	\$ 257,840	\$ 257,840	\$ 257,840	\$ 0
Resources (inflows)				
Taxes	\$ 10,232,463	\$ 10,543,269	\$ 10,543,269	\$ 0
From federal agencies	1,861,201	2,468,558	2,468,558	0
Miscellaneous		26,323	26,323	0
Transfers in	770,206	745,967	745,967	0
Total revenue inflows	<u>\$ 12,863,870</u>	<u>\$ 13,784,118</u>	<u>\$ 13,784,118</u>	<u>\$ 0</u>
Amount available for appropriation	<u>\$ 13,121,710</u>	<u>\$ 14,041,958</u>	<u>\$ 14,041,958</u>	<u>\$ 0</u>
Charges to appropriations (outflows)				
Education	<u>\$ 12,845,130</u>	<u>\$ 13,302,718</u>	<u>\$ 13,296,844</u>	<u>\$ 5,874</u>
Total charges to appropriations	<u>\$ 12,845,130</u>	<u>\$ 13,302,718</u>	<u>\$ 13,296,844</u>	<u>\$ 5,874</u>
Reconciling items:				
Change in noncurrent assets	<u>\$ 0</u>	<u>\$ (3,253)</u>	<u>\$ (3,253)</u>	<u>\$ 0</u>
Net reconciling items	<u>\$ 0</u>	<u>\$ (3,253)</u>	<u>\$ (3,253)</u>	<u>\$ 0</u>
Ending budgetary fund balance	<u><u>\$ 276,580</u></u>	<u><u>\$ 735,987</u></u>	<u><u>\$ 741,861</u></u>	<u><u>\$ 5,874</u></u>

See accompanying notes to required supplementary information.

2010

Original Budget	Final Budget	Actual	Variance With Final Budget
\$ 246,298	\$ 246,298	\$ 246,298	\$ 0
\$ 10,064,605	\$ 10,114,173	\$ 10,114,173	\$ 0
2,051,759	2,392,903	2,392,903	0
	33,155	33,155	0
707,206	729,590	729,590	0
<u>\$ 12,823,570</u>	<u>\$ 13,269,822</u>	<u>\$ 13,269,822</u>	<u>\$ 0</u>
<u>\$ 13,069,869</u>	<u>\$ 13,516,120</u>	<u>\$ 13,516,120</u>	<u>\$ 0</u>
<u>\$ 12,823,571</u>	<u>\$ 13,304,145</u>	<u>\$ 13,259,497</u>	<u>\$ 44,648</u>
<u>\$ 12,823,571</u>	<u>\$ 13,304,145</u>	<u>\$ 13,259,497</u>	<u>\$ 44,648</u>
<u>\$ 0</u>	<u>\$ 1,216</u>	<u>\$ 1,216</u>	<u>\$ 0</u>
<u>\$ 0</u>	<u>\$ 1,216</u>	<u>\$ 1,216</u>	<u>\$ 0</u>
<u><u>\$ 246,298</u></u>	<u><u>\$ 213,191</u></u>	<u><u>\$ 257,840</u></u>	<u><u>\$ 44,648</u></u>

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

	2011	2010
Sources/inflows of resources		
Actual amount (budgetary basis) available for appropriation from the budgetary comparison schedule	\$ 14,041,958	\$ 13,516,120
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	(257,840)	(246,298)
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(745,967)	(729,590)
Total revenues as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance	\$ 13,038,151	\$ 12,540,232
Uses/outflows of resources		
Actual amount (budgetary basis) total charges to appropriations from the budgetary comparison schedule	\$ 13,296,844	\$ 13,259,497
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	(6,820)	1,976
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(2,837)	(248,400)
Total expenditures as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance	\$ 13,287,187	\$ 13,013,073

Notes to Required Supplementary Information

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 2010-11 and 2009-10, 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, 2010 and October 1, 2009, 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.

SUPPLEMENTAL FINANCIAL SCHEDULE

MICHIGAN DEPARTMENT OF EDUCATION
Schedule of Expenditures of Federal Awards (Note 1)
For the Period October 1, 2009 through September 30, 2011

Federal Agency/Program or Cluster	CFDA * Number	For the Fiscal Year Ended September 30, 2010		
		Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Financial Assistance				
<u>U.S. Department of Agriculture</u>				
Child Nutrition Cluster:				
Direct Programs:				
School Breakfast Program	10.553	\$ 11,769	\$ 79,111,263	\$ 79,123,032
National School Lunch Program	10.555	32,440	265,432,672	265,465,112
Special Milk Program for Children	10.556		423,781	423,781
Summer Food Service Program for Children	10.559	238,689	7,427,520	7,666,209
Total Child Nutrition Cluster (Note 2)		<u>\$ 282,898</u>	<u>\$ 352,395,236</u>	<u>\$ 352,678,134</u>
Emergency Food Assistance Program Cluster:				
Direct Program:				
Emergency Food Assistance Program (Administrative Costs)	10.568	\$ 31,474	\$ 2,667,866	\$ 2,699,340
ARRA - Emergency Food Assistance Program (Administrative Costs)	10.568		992,905	992,905
Total Emergency Food Assistance Program Cluster (Note 3)		<u>\$ 31,474</u>	<u>\$ 3,660,771</u>	<u>\$ 3,692,245</u>
Direct Programs:				
Child and Adult Care Food Program	10.558	\$ 777,989	\$ 61,948,235	\$ 62,726,224
State Administrative Expenses for Child Nutrition	10.560	4,432,652		4,432,652
Commodity Supplemental Food Program (Note 4)	10.565	129,682	5,350,961	5,480,643
Team Nutrition Grants	10.574	240,134	90,525	330,659
Child Nutrition Discretionary Grants Limited Availability	10.579	\$ 93,763	\$ 29,678	\$ 123,441
ARRA - Child Nutrition Discretionary Grants Limited Availability	10.579		2,231,101	2,231,101
Total Child Nutrition Discretionary Grants Limited Availability		<u>\$ 93,763</u>	<u>\$ 2,260,779</u>	<u>\$ 2,354,542</u>
Supplemental Nutrition Assistance Program, Outreach/Participation Program	10.580			0
Fresh Fruit and Vegetable Program	10.582	56,118	1,516,664	1,572,782
Total Direct Programs		<u>\$ 5,730,338</u>	<u>\$ 71,167,164</u>	<u>\$ 76,897,502</u>
Total U.S. Department of Agriculture		<u>\$ 6,044,710</u>	<u>\$ 427,223,171</u>	<u>\$ 433,267,881</u>
<u>U.S. Department of Defense</u>				
Direct Program:				
Contract for Defense Activity for Non-Traditional Education Support	12.N3569703MDTM **	\$ 6,747	\$	\$ 6,747
Total U.S. Department of Defense		<u>\$ 6,747</u>	<u>\$ 0</u>	<u>\$ 6,747</u>
<u>Institute of Museum and Library Services</u>				
Direct Program:				
Grants to States	45.310	\$ 7,113,322	\$ 106,771	\$ 7,220,093
Total Institute of Museum and Library Services		<u>\$ 7,113,322</u>	<u>\$ 106,771</u>	<u>\$ 7,220,093</u>
<u>U.S. Department of Education</u>				
Title I, Part A Cluster:				
Direct Programs:				
Title I Grants to Local Educational Agencies	84.010	\$ 5,825,764	\$ 524,338,446	\$ 530,164,210
ARRA - Title I Grants to Local Educational Agencies, Recovery Act	84.389	139,493	167,234,046	167,373,539
Total Title I, Part A Cluster		<u>\$ 5,965,257</u>	<u>\$ 691,572,492</u>	<u>\$ 697,537,749</u>

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2011			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$	\$ 82,711,155	\$ 82,711,155	\$ 161,834,187
	265,060,110	265,060,110	530,525,222
	502,227	502,227	926,008
153,075	7,397,483	7,550,558	15,216,767
\$ 153,075	\$ 355,670,975	\$ 355,824,050	\$ 708,502,184
\$ 30,693	\$ 2,255,935	\$ 2,286,628	\$ 4,985,968
	1,174,707	1,174,707	2,167,612
\$ 30,693	\$ 3,430,642	\$ 3,461,335	\$ 7,153,580
\$ 851,666	\$ 65,433,386	\$ 66,285,052	\$ 129,011,276
4,799,560		4,799,560	9,232,212
124,644	4,322,326	4,446,970	9,927,613
304,771	31,337	336,108	666,767
\$ 15,050	\$ 503,277	\$ 518,327	\$ 641,768
	62,916	62,916	2,294,017
\$ 15,050	\$ 566,193	\$ 581,243	\$ 2,935,785
83,122	505,034	588,156	588,156
81,325	2,628,308	2,709,633	4,282,415
\$ 6,260,138	\$ 73,486,584	\$ 79,746,722	\$ 156,644,224
\$ 6,443,906	\$ 432,588,201	\$ 439,032,107	\$ 872,299,988
\$ 128,050	\$	\$ 128,050	\$ 134,797
\$ 128,050	\$ 0	\$ 128,050	\$ 134,797
\$ 5,347,440	\$	\$ 5,347,440	\$ 12,567,533
\$ 5,347,440	\$ 0	\$ 5,347,440	\$ 12,567,533
\$ 4,861,597	\$ 531,983,197	\$ 536,844,794	\$ 1,067,009,004
1,364,815	199,688,878	201,053,693	368,427,232
\$ 6,226,412	\$ 731,672,075	\$ 737,898,487	\$ 1,435,436,236

MICHIGAN DEPARTMENT OF EDUCATION
Schedule of Expenditures of Federal Awards (Note 1)
For the Period October 1, 2009 through September 30, 2011
Continued

Federal Agency/Program or Cluster	CFDA * Number	For the Fiscal Year Ended September 30, 2010		
		Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Special Education Cluster (IDEA):				
Direct Programs:				
Special Education - Grants to States	84.027	\$ 14,740,100	\$ 359,149,649	\$ 373,889,749
Special Education - Preschool Grants	84.173	618,521	11,037,473	11,655,994
ARRA - Special Education Grants to States, Recovery Act	84.391	9,677	190,460,888	190,470,565
ARRA - Special Education - Preschool Grants, Recovery Act	84.392	874	5,881,848	5,882,722
Total Special Education Cluster (IDEA)		<u>\$ 15,369,172</u>	<u>\$ 566,529,858</u>	<u>\$ 581,899,030</u>
Early Intervention Services (IDEA) Cluster:				
Direct Programs:				
Special Education - Grants for Infants and Families	84.181	\$ 688,411	\$ 11,183,826	\$ 11,872,237
ARRA - Special Education - Grants for Infants and Families, Recovery Act	84.393	6,648	4,976,799	4,983,447
Total Early Intervention Services (IDEA) Cluster		<u>\$ 695,059</u>	<u>\$ 16,160,625</u>	<u>\$ 16,855,684</u>
Education of Homeless Children and Youth Cluster				
Direct Programs:				
Education for Homeless Children and Youth	84.196	\$ 329,169	\$ 1,674,239	\$ 2,003,408
ARRA - Education for Homeless Children and Youth, Recovery Act	84.387		818,970	818,970
Total Education of Homeless Children and Youth Cluster		<u>\$ 329,169</u>	<u>\$ 2,493,209</u>	<u>\$ 2,822,378</u>
Education Technology State Grants Cluster				
Direct Programs:				
Educational Technology State Grants	84.318	\$ 325,707	\$ 8,243,311	\$ 8,569,018
ARRA - Education Technology State Grants, Recovery Act	84.386	5,144	7,826,652	7,831,796
Total Education Technology State Grants Cluster		<u>\$ 330,851</u>	<u>\$ 16,069,963</u>	<u>\$ 16,400,814</u>
Statewide Data Systems Cluster				
Direct Programs:				
Statewide Data Systems	84.372	\$ 1,478,406	\$	\$ 1,478,406
ARRA - Statewide Data Systems, Recovery Act	84.384	11,238		11,238
Total Statewide Data Systems Cluster		<u>\$ 1,489,644</u>	<u>\$ 0</u>	<u>\$ 1,489,644</u>
School Improvement Grants Cluster				
Direct Programs:				
School Improvement Grants	84.377	\$ 523,410	\$ 7,199,764	\$ 7,723,174
ARRA - School Improvement Grants, Recovery Act	84.388	24,803	25,310	50,113
Total School Improvement Grants Cluster		<u>\$ 548,213</u>	<u>\$ 7,225,074</u>	<u>\$ 7,773,287</u>
State Fiscal Stabilization Fund Cluster:				
Direct Program:				
ARRA - State Fiscal Stabilization Fund (SFSF) - Education State Grants, Recovery Act	84.394	\$	\$ 448,369,608	\$ 448,369,608
Total State Fiscal Stabilization Fund Cluster		<u>\$ 0</u>	<u>\$ 448,369,608</u>	<u>\$ 448,369,608</u>
Direct Programs:				
Migrant Education - State Grant Program	84.011	\$ 619,160	\$ 8,202,901	\$ 8,822,061
Title I State Agency Program for Neglected and Delinquent Children and Youth	84.013	60,091	566,764	626,855
Career and Technical Education - Basic Grants to States	84.048	1,935,888	37,079,703	39,015,591
Migrant Education - Coordination Program	84.144	33,706		33,706
Safe and Drug-Free Schools and Communities - National Programs	84.184			0

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2011			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$ 14,444,425	\$ 378,221,491	\$ 392,665,916	\$ 766,555,665
718,674	11,367,210	12,085,884	23,741,878
391,443	186,467,681	186,859,124	377,329,689
	6,835,512	6,835,512	12,718,234
<u>\$ 15,554,542</u>	<u>\$ 582,891,894</u>	<u>\$ 598,446,436</u>	<u>\$ 1,180,345,466</u>
\$ 623,332	\$ 8,723,819	\$ 9,347,151	\$ 21,219,388
15,858	6,903,233	6,919,091	11,902,538
<u>\$ 639,190</u>	<u>\$ 15,627,052</u>	<u>\$ 16,266,242</u>	<u>\$ 33,121,926</u>
\$ 515,517	\$ 2,096,257	\$ 2,611,774	\$ 4,615,182
	1,209,566	1,209,566	2,028,536
<u>\$ 515,517</u>	<u>\$ 3,305,823</u>	<u>\$ 3,821,340</u>	<u>\$ 6,643,718</u>
\$ 412,960	\$ 6,700,415	\$ 7,113,375	\$ 15,682,393
257,505	10,019,461	10,276,966	18,108,762
<u>\$ 670,465</u>	<u>\$ 16,719,876</u>	<u>\$ 17,390,341</u>	<u>\$ 33,791,155</u>
\$ 1,858,306	\$	\$ 1,858,306	\$ 3,336,712
823,122		823,122	834,360
<u>\$ 2,681,428</u>	<u>\$ 0</u>	<u>\$ 2,681,428</u>	<u>\$ 4,171,072</u>
\$ 763,658	\$ 11,141,324	\$ 11,904,982	\$ 19,628,156
270,955	16,521,679	16,792,634	16,842,747
<u>\$ 1,034,613</u>	<u>\$ 27,663,003</u>	<u>\$ 28,697,616</u>	<u>\$ 36,470,903</u>
\$	\$ 187,398,157	\$ 187,398,157	\$ 635,767,765
\$ 0	\$ 187,398,157	\$ 187,398,157	\$ 635,767,765
\$ 658,401	\$ 6,565,643	\$ 7,224,044	\$ 16,046,105
26,997	416,101	443,098	1,069,953
1,961,785	39,472,739	41,434,524	80,450,115
		0	33,706
697,730	558,943	1,256,673	1,256,673

MICHIGAN DEPARTMENT OF EDUCATION
Schedule of Expenditures of Federal Awards (Note 1)
For the Period October 1, 2009 through September 30, 2011
Continued

Federal Agency/Program or Cluster	CFDA * Number	For the Fiscal Year Ended September 30, 2010		
		Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Safe and Drug-Free Schools and Communities - State Grants	84.186	\$ 530,896	\$ 9,489,441	\$ 10,020,337
Even Start - State Educational Agencies	84.213	80,493	2,128,016	2,208,509
Fund for the Improvement of Education	84.215		31,630	31,630
Tech-Prep Education	84.243	207,062	3,389,101	3,596,163
Charter Schools	84.282	233,799	7,548,502	7,782,301
Twenty-First Century Community Learning Centers	84.287	844,181	50,646,352	51,490,533
State Grants for Innovative Programs	84.298		279,317	279,317
Special Education - State Personnel Development	84.323		1,388,507	1,388,507
Advance Placement Program (Advanced Placement Test Fee; Advanced Placement Incentive Program Grants)	84.330	431,463		431,463
Comprehensive School Reform Demonstration	84.332			0
Reading First State Grants	84.357	616,408	4,631,124	5,247,532
Rural Education	84.358	22,560	1,467,432	1,489,992
English Language Acquisition Grants	84.365	358,197	6,618,493	6,976,690
Mathematics and Science Partnerships	84.366	274,928	7,634,003	7,908,931
Improving Teacher Quality State Grants	84.367	2,972,376	86,934,688	89,907,064
Grants for State Assessments and Related Activities	84.369	10,848,579		10,848,579
Striving Readers	84.371	17,399	400,878	418,277
Special Education - Technical Assistance on State Data Collection	84.373	195,941		195,941
College Access Challenge Grant Program	84.378			0
Education Jobs Fund	84.410			0
Contract with National Center for Education Statistics	84.ED03CO0074	** 178,030		178,030
Total Direct Programs		\$ 20,461,157	\$ 228,436,852	\$ 248,898,009
Total U.S. Department of Education		\$ 45,188,522	\$ 1,976,857,681	\$ 2,022,046,203
U.S. Department of Health and Human Services				
Temporary Assistance for Needy Families Cluster:				
Direct Program:				
Temporary Assistance for Needy Families	93.558	\$	\$	\$ 0
Total Temporary Assistance for Needy Families Cluster		\$ 0	\$ 0	\$ 0
Direct Programs:				
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	\$ 91,402	\$	\$ 91,402
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	617,984	232,349	850,333
Total Direct Programs		\$ 709,386	\$ 232,349	\$ 941,735
Total U.S. Department of Health and Human Services		\$ 709,386	\$ 232,349	\$ 941,735
Corporation for National and Community Service				
Direct Program:				
Learn and Serve America - School and Community Based Programs	94.004	\$	\$ 446,248	\$ 446,248
Total Corporation for National and Community Service		\$ 0	\$ 446,248	\$ 446,248
Total Financial Assistance		\$ 59,062,687	\$ 2,404,866,220	\$ 2,463,928,907

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2011			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$ 364,843	\$ 7,920,905	\$ 8,285,748	\$ 18,306,085
66,275	2,181,369	2,247,644	4,456,153
58		58	31,688
191,941	3,205,764	3,397,705	6,993,868
212,408	8,976,350	9,188,758	16,971,059
891,700	48,439,902	49,331,602	100,822,135
	(177,616)	(177,616)	101,701
	1,549,486	1,549,486	2,937,993
606,074		606,074	1,037,537
	(402)	(402)	(402)
(15,354)	2,950,493	2,935,139	8,182,671
37,242	1,959,681	1,996,923	3,486,915
622,999	10,291,143	10,914,142	17,890,832
372,959	3,865,204	4,238,163	12,147,094
3,970,214	112,337,283	116,307,497	206,214,561
14,105,340		14,105,340	24,953,919
78,789	1,888,725	1,967,514	2,385,791
28,966		28,966	224,907
707,510	1,728,286	2,435,796	2,435,796
194,093	229,153,382	229,347,475	229,347,475
202,634		202,634	380,664
\$ 25,983,604	\$ 483,283,381	\$ 509,266,985	\$ 758,164,994
\$ 53,305,771	\$ 2,048,561,261	\$ 2,101,867,032	\$ 4,123,913,235
<u>\$ (26)</u>	<u>\$</u>	<u>\$ (26)</u>	<u>\$ (26)</u>
<u>\$ (26)</u>	<u>\$ 0</u>	<u>\$ (26)</u>	<u>\$ (26)</u>
\$ 10,110	\$	\$ 10,110	\$ 101,512
561,087	232,254	793,341	1,643,674
\$ 571,197	\$ 232,254	\$ 803,451	\$ 1,745,186
\$ 571,171	\$ 232,254	\$ 803,425	\$ 1,745,160
<u>\$</u>	<u>\$ 512,105</u>	<u>\$ 512,105</u>	<u>\$ 958,353</u>
\$ 0	\$ 512,105	\$ 512,105	\$ 958,353
<u>\$ 65,796,338</u>	<u>\$ 2,481,893,821</u>	<u>\$ 2,547,690,159</u>	<u>\$ 5,011,619,066</u>

MICHIGAN DEPARTMENT OF EDUCATION
Schedule of Expenditures of Federal Awards (Note 1)
For the Period October 1, 2009 through September 30, 2011
Continued

Federal Agency/Program or Cluster	CFDA *	For the Fiscal Year Ended September 30, 2010		
		Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<u>Nonfinancial Assistance</u>				
U.S. Department of Agriculture				
Child Nutrition Cluster:				
Direct Programs:				
National School Lunch Program	10.555	\$	\$ 31,034,536	\$ 31,034,536
Summer Food Service Program for Children	10.559		62,342	62,342
Total Child Nutrition Cluster (Note 2)		\$ 0	\$ 31,096,878	\$ 31,096,878
Emergency Food Assistance Program Cluster:				
Direct Program:				
Emergency Food Assistance Program (Food Commodities)	10.569	\$	\$ 21,612,014	\$ 21,612,014
ARRA - Emergency Food Assistance Program (Food Commodities)	10.569		1,459,545	1,459,545
Total Emergency Food Assistance Program Cluster (Note 3)		\$ 0	\$ 23,071,559	\$ 23,071,559
Direct Program:				
Commodity Supplemental Food Program (Note 4)	10.565	\$	\$ 18,789,860	\$ 18,789,860
Total Direct Program		\$ 0	\$ 18,789,860	\$ 18,789,860
Total U.S. Department of Agriculture		\$ 0	\$ 72,958,297	\$ 72,958,297
Total Nonfinancial Assistance		\$ 0	\$ 72,958,297	\$ 72,958,297
Total Expenditures of Federal Awards		\$ 59,062,687	\$ 2,477,824,517	\$ 2,536,887,204

* 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, 2011			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$	\$ 31,999,250	\$ 31,999,250	\$ 63,033,786
	88,679	88,679	151,021
<u>\$ 0</u>	<u>\$ 32,087,929</u>	<u>\$ 32,087,929</u>	<u>\$ 63,184,807</u>
\$	\$ 18,792,409	\$ 18,792,409	\$ 40,404,423
	134,650	134,650	1,594,195
<u>\$ 0</u>	<u>\$ 18,927,059</u>	<u>\$ 18,927,059</u>	<u>\$ 41,998,618</u>
\$	\$ 18,610,069	\$ 18,610,069	\$ 37,399,929
<u>\$ 0</u>	<u>\$ 18,610,069</u>	<u>\$ 18,610,069</u>	<u>\$ 37,399,929</u>
<u>\$ 0</u>	<u>\$ 69,625,057</u>	<u>\$ 69,625,057</u>	<u>\$ 142,583,354</u>
<u>\$ 0</u>	<u>\$ 69,625,057</u>	<u>\$ 69,625,057</u>	<u>\$ 142,583,354</u>
<u>\$ 65,796,338</u>	<u>\$ 2,551,518,878</u>	<u>\$ 2,617,315,216</u>	<u>\$ 5,154,202,420</u>

Notes to the Schedule of Expenditures of Federal Awards

Note 1 Basis of Presentation

This schedule presents the federal grant activity of the Michigan Department of Education (MDE) on the modified accrual basis of accounting and in accordance with the requirements of U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial schedules. Also, 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 no impact on the fund balance of the State's General Fund.

Note 2 Child Nutrition Cluster

The Child Nutrition Cluster is made up of financial assistance (*CFDA* 10.553, 10.555, 10.556, and 10.559) totaling \$352.7 million and \$355.8 million as well as nonfinancial assistance (*CFDA* 10.555 and 10.559) valued at \$31.1 million and \$32.1 million as of September 30, 2010 and September 30, 2011, respectively.

Note 3 Emergency Food Assistance Program Cluster

The Emergency Food Assistance Program Cluster is made up of financial assistance (*CFDA* 10.568) totaling \$3.7 million and \$3.5 million and nonfinancial assistance (*CFDA* 10.569) valued at \$23.1 million and \$18.9 million as of September 30, 2010 and September 30, 2011, respectively.

Note 4 Commodity Supplemental Food Program

The Commodity Supplemental Food Program (*CFDA* 10.565) is made up of financial assistance totaling \$5.5 million and \$4.5 million as well as nonfinancial assistance distributed to subrecipients valued at \$18.8 million and \$18.6 million as of September 30, 2010 and September 30, 2011, respectively.

Note 5 Program Transfers

This schedule presents the federal grant activity for the Grants to States Program (*CFDA* 45.310) for the fiscal years ended September 30, 2010 and September 30, 2011 and the College Access Challenge Grant Program (*CFDA* 84.378) for the fiscal year ended September 30, 2011. On July 13, 2009, the Governor issued Executive Order No. 2009-36, which abolished the Department of History, Arts and Libraries and transferred oversight related to Library of Michigan programs to MDE effective October 1, 2009. Act 164, P.A. 2010, appropriated the College Access Challenge Grant Program within MDE beginning in fiscal year 2010-11. This grant was previously appropriated within the Michigan Department of Treasury.

Note 6 Reporting Entity

In fiscal years 2009-10 and 2010-11, the majority of federal grants were reported in the School Aid Fund. Administrative federal expenses and transfers to other State agencies were recorded 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, 2011 and September 30, 2010, as identified in the table of contents, and have issued our reports thereon dated June 21, 2012. 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

Management of the Department is responsible for establishing and maintaining effective 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.

A deficiency in internal control 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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial schedules and financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs in Findings 1 through 3, that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

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

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 Governor, the Legislature, the State Board of Education, the Department's management, others within the Department, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,



Thomas H. McTavish, C.P.A.

Auditor General

June 21, 2012



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 That Could Have a Direct and Material Effect on
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 Michigan Department of Education's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Department's major federal programs for the two-year period ended September 30, 2011. 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 of its major federal programs 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 preceding paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

As described in Finding 15 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding matching, level of effort, and earmarking that are applicable to its College Access Challenge Grant Program. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to that program.

In our opinion, because of the effects of the noncompliance described in the preceding paragraph, the Department did not comply, in all material respects, with the compliance requirements referred to in the first paragraph that could have a direct and material effect on the College Access Challenge Grant Program. Also, in our opinion, the Department complied, in all material respects, with the compliance requirements referred to in the first paragraph that could have a direct and material effect on each of its

other major federal programs for the two-year period ended September 30, 2011. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs in Findings 4 through 17.

Internal Control Over Compliance

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 the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs in Findings 5, 10, 13, and 15 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs in Findings 4 through 8, 11 through 15, and 17 to be significant deficiencies.

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 Governor, the Legislature, the State Board of Education, the Department's management, others within the Department, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,



Thomas H. McTavish, C.P.A.

Auditor General

June 21, 2012

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Schedules and Financial Statements

Type of auditor's report issued: Unqualified*

Internal control* over financial reporting:

Material weaknesses* identified?	No
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?	Yes
Significant deficiencies* identified that are not considered to be material weaknesses?	Yes

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

Unqualified for all major programs except for the College Access Challenge Grant Program, which is adverse*.

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:

<i>CFDA</i> * Number	Name of Federal Program or Cluster*
	<u>Child Nutrition Cluster:</u>
10.553	• School Breakfast Program
10.555	• National School Lunch Program
10.556	• Special Milk Program for Children
10.559	• Summer Food Service Program for Children

* See glossary at end of report for definition.

10.558	Child and Adult Care Food Program
	<u>Emergency Food Assistance Program Cluster:</u>
10.568	• Emergency Food Assistance Program (Administrative Costs)
10.568	• ARRA - Emergency Food Assistance Program (Administrative Costs)
10.569	• Emergency Food Assistance Program (Food Commodities)
10.569	• ARRA - Emergency Food Assistance Program (Food Commodities)
45.310	Grants to States
	<u>Title I, Part A Cluster:</u>
84.010	• Title I Grants to Local Educational Agencies
84.389	• ARRA - Title I Grants to Local Educational Agencies, Recovery Act
84.011	Migrant Education - State Grant Program
	<u>Special Education Cluster (IDEA):</u>
84.027	• Special Education - Grants to States
84.173	• Special Education - Preschool Grants
84.391	• ARRA - Special Education Grants to States, Recovery Act
84.392	• ARRA - Special Education - Preschool Grants, Recovery Act
	<u>Early Intervention Services (IDEA) Cluster:</u>
84.181	• Special Education - Grants for Infants and Families
84.393	• ARRA - Special Education - Grants for Infants and Families, Recovery Act
84.186	Safe and Drug-Free Schools and Communities - State Grants
84.282	Charter Schools

84.287	Twenty-First Century Community Learning Centers
	<u>Education Technology State Grants Cluster:</u>
84.318	• Educational Technology State Grants
84.386	• ARRA - Education Technology State Grants, Recovery Act
84.357	Reading First State Grants
84.365	English Language Acquisition Grants
84.367	Improving Teacher Quality State Grants
	<u>School Improvement Grants Cluster:</u>
84.377	• School Improvement Grants
84.388	• ARRA - School Improvement Grants, Recovery Act
84.378	College Access Challenge Grant Program
	<u>State Fiscal Stabilization Fund Cluster:</u>
84.394	• ARRA - State Fiscal Stabilization Fund (SFSF) - Education State Grants, Recovery Act
84.410	Education Jobs Fund

Dollar threshold used to distinguish between type A and type B programs: \$15,462,607

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 (3131201)

1. Grants and Cash Management Systems' Access Controls

The Michigan Department of Education (MDE) had not established effective access controls over its grants and cash management systems. As a result, MDE could not ensure that it could prevent or detect errors or irregularities that may be caused by users performing unauthorized activities.

Title 34, Part 80, section 20 of the *Code of Federal Regulations** (CFR) requires states to establish effective internal control over their financial management systems to ensure accountability over all grant and subgrant assets and to ensure that grant and subgrant assets are used only for authorized purposes. Access controls should be designed and implemented to provide reasonable assurance that only authorized personnel have access to an information system and perform authorized activities within the system.

Our review of MDE's access controls over its grants and cash management systems disclosed:

- a. MDE did not limit the number of users with privileged access rights and did not assign appropriate security levels to some users to ensure proper segregation of duties. We noted 11 users with the ability to perform system administrator activities within one of MDE's grants systems and 6 users with the ability to perform system administrator activities within MDE's cash management system. The 11 users with privileged access rights in the grant system also could approve grants and make grant funds available. The 6 users with privileged access rights in the cash management system also could request funds for a project and approve fund requests.

* See glossary at end of report for definition.

- b. MDE assigned access rights to some users in one of its grants systems that were incompatible with their job requirements. Our review of access levels within this grant system noted:
 - (1) MDE assigned access levels to 28 users that allowed these users to log in as other users and perform activities unrelated to their job responsibilities. MDE informed us that this permission level was established to provide help desk resources to subrecipients accessing the grants system. Although MDE restricted users from logging in as a user with a higher security level and from changing or submitting applications while logged in as another user, MDE did not restrict users from approving grant awards and making grant funds available in grant programs that they were not responsible for.
 - (2) MDE assigned access levels to 2 project managers and 1 Department of Technology, Management, and Budget (DTMB) employee that allowed these users to approve grant awards although these users do not have any responsibility for administering any grant programs.
- c. MDE did not monitor user activity in its grants systems, including the activity of those with privileged access rights, to ensure that users are performing only authorized activities relevant to their respective jobs and positions.
- d. MDE did not periodically monitor user access rights to MDE grants and cash management systems to ensure that only authorized users have access to the data and applications. In our prior audit, we reported that MDE had not developed policies for monitoring access to MDE systems. We noted that although MDE developed policies (such as periodically reviewing user access lists and performing an annual security audit of user access), it had not implemented these policies.
- e. MDE did not ensure the protection of passwords from unauthorized use by forcing users to change their passwords after they were assigned by a system administrator.

RECOMMENDATION

We recommend that MDE establish effective access controls over its grants and cash management systems.

FINDING (3131202)

2. Schedule of Expenditures of Federal Awards (SEFA)

MDE's internal control over financial reporting did not ensure the preparation of its SEFA in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and State financial management policies. As a result, MDE overstated total SEFA expenditures by \$6.6 million and \$5.9 million for the fiscal years ended September 30, 2010 and September 30, 2011, respectively. Also, MDE reported \$5.1 million in expenditures to an incorrect federal program and misclassified \$1.7 million in expenditures as directly expended on the SEFA for the fiscal year ended September 30, 2011.

OMB Circular A-133 requires each recipient of federal awards to prepare a SEFA for the period covered by the recipient's financial schedules and financial statements and to include the SEFA in the recipient's single audit* report. In addition, Section 18.1461 of the *Michigan Compiled Laws* requires MDE to prepare an annual SEFA and submit it to DTMB, the Senate and House Fiscal Agencies, and the Office of the Auditor General. Part II, Chapter 24 of the State of Michigan Financial Management Guide sets forth the content and format of the SEFA and requires that the SEFA be reconcilable to the information in MDE's financial schedules and financial statements.

Our review of MDE's SEFA preparation process and verification of MDE's SEFA for the two-year period ended September 30, 2011 disclosed:

- a. MDE did not properly account for adjustments related to prior year accounts payable write-offs. As a result, MDE overstated Child Nutrition Cluster expenditures by \$6,600,643 and \$5,892,492 on the SEFA for the fiscal years ended September 30, 2010 and September 30, 2011, respectively.

* See glossary at end of report for definition.

- b. MDE did not periodically reconcile subrecipient payments recorded in the Michigan Administrative Information Network* (MAIN) to its cash management system to ensure that payments were classified to the proper grant. As a result, MDE overstated English Language Acquisition Grants expenditures and understated Title I, Part A Cluster expenditures by \$5,122,896 in fiscal year 2010-11. We also reported on this issue in Finding 13. Upon our notification of this misstatement, MDE made the necessary adjustment to the SEFA and corrected its federal cash draws.

MDE disagrees with this finding in its corrective action plan and informed us that it reconciles all subrecipient payments in MAIN to its cash management system for each grant after the grant is closed. For most federal programs administered by MDE, this occurs 27 months after the beginning date of a grant. MDE also informed us that automated controls built into its financial management system would have detected and corrected the misstatement. However, we noted that MDE's automated controls would not have detected and corrected the misstatement in circumstances where other subrecipients had not drawn down all of their allotted funds. MDE should perform reconciliations of subrecipient payments in a more timely manner to ensure the accurate presentation of its SEFA and to detect and correct errors in costs charged to incorrect federal awards.

- c. MDE did not evaluate internal information to determine the classification of federal awards expended to amounts recorded in MAIN. As a result, MDE understated amounts "Distributed to Subrecipients" and overstated amounts "Directly Expended" by \$1,728,286 for the fiscal year ended September 30, 2011 for the College Access Challenge Grant Program. Upon our notification of this misstatement, MDE made the necessary adjustment to the SEFA.

RECOMMENDATION

We recommend that MDE improve its internal control over financial reporting to ensure the preparation of its SEFA in accordance with OMB Circular A-133 and State financial management policies.

* See glossary at end of report for definition.

FINDING (3131203)

3. 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 effectively designed to ensure that its assets were safeguarded and accounting data was accurate, reliable, and properly reported.

Monitoring of the effectiveness of internal control over financial reporting should include assessing risk related to MDE's accounting systems and processes, determining if controls have been designed to mitigate risk, and a periodic evaluation of established controls to determine if the controls are functioning as designed. Also, Section 18.1485 of the *Michigan Compiled Laws* (a section of Act 431, P.A. 1984, as amended) 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 the head of each principal department to complete a biennial internal control evaluation (ICE) of the department's internal accounting and administrative control system and provide a report on this evaluation to the Governor, the Senate and House Fiscal Agencies, and the DTMB director. The State of Michigan Financial Management Guide (Part VII, Chapter 1, Section 300) provides that, as part of each department's responsibility in planning and conducting an evaluation of its internal control system, departments must routinely monitor internal control to ensure that controls are functioning as intended.

MDE completed its biennial assessment, which included assessing risks and determining key controls that were related to the assessed risks. However, our review disclosed:

- a. MDE did not periodically evaluate and test the reliability of most of the key controls over financial reporting that it had listed in its ICE report.

For example, to ensure that non-payroll expenditures were valid and properly approved, MDE documented that one of its key controls was that MDE's Office of Financial Management staff review all supporting documentation before entering a payment request into MAIN. However, MDE did not test this control. MDE could periodically review a sample of transactions to ensure that the control is working.

We reported on this issue in our prior single audit, and MDE responded that it will more fully monitor the effectiveness of its internal control over financial reporting if additional resources become available.

- b. MDE did not establish appropriate time lines to ensure completion of its most recent ICE report in a timely manner. Although MDE initially submitted the ICE report, which was due May 1, 2011, on April 27, 2011, DTMB advised MDE that its evaluation efforts were materially deficient. Therefore, MDE elected to complete additional procedures, which resulted in a more thorough evaluation, and did not submit a final ICE report until July 25, 2011.

MDE's failure to appropriately complete the ICE report could prevent the timely completion and implementation of corrective actions to improve internal control.

RECOMMENDATION

We again 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

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires the auditor to test key controls at a level that would provide sufficient evidence that the established control structure would provide a high probability that material federal program noncompliance would be prevented or detected and corrected. This requires that the auditor set the tolerable exception rate of occurrence at a very low level. During the audit fieldwork, the auditor, in close consultation with the auditee, identifies the key controls that the auditee has established to ensure federal program compliance. In those cases in which the auditor's tests of key controls identify

* See glossary at end of report for definition.

exception rates in excess of the tolerable exception rate of occurrence, the auditor must generally report the observed exception rate in the report finding.

Further, Circular A-133 requires the auditor to report in this section of the audit report known questioned costs that are greater than \$10,000 for a type of compliance requirement for a major program and known questioned costs that are less than \$10,000 for a type of compliance requirement for a major program if it is likely that total questioned costs would exceed \$10,000.

As a result of these low required reporting thresholds, the reader may note that, in some cases, the observed exception rates of occurrence and reported known questioned costs appear insignificant in relation to the overall federal expenditures of the auditee. After the audit report is filed with the federal audit clearinghouse, the responsible federal agency is required to issue a management decision within six months of the receipt of the audit report. The management decision may include a request for the return of the known questioned costs.

FINDING (3131204)

4. Child Nutrition Cluster, CFDA 10.553, 10.555, 10.556, and 10.559

U.S. Department of Agriculture	Child Nutrition Cluster: CFDA 10.553: School Breakfast Program CFDA 10.555: National School Lunch Program CFDA 10.556: Special Milk Program for Children CFDA 10.559: Summer Food Service Program for Children
Award Number: 2MI300060 2MI300060	Award Period: 10/01/2009 - 09/30/2010 10/01/2010 - 09/30/2011
	Known Questioned Costs: \$0

MDE's internal control over the Child Nutrition Cluster 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 in Child Nutrition Cluster awards.

Federal expenditures for the Child Nutrition Cluster totaled \$708.5 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$352.4 million and \$355.7 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

MDE also distributed U.S. Department of Agriculture (USDA) donated food commodities valued at \$63.2 million to School Food Authorities (SFAs) that participate in the National School Lunch Program (NSLP) during the two-year period ended September 30, 2011. MDE has entered into agreements with three consortiums to distribute USDA donated food commodities. The consortiums, in turn, contract directly with their own processors and distributors to process, warehouse, and distribute food commodities to SFAs. SFAs receive commodity entitlements based on the number of eligible lunches served to school children.

Our exceptions, by compliance area, are as follows:

a. Subrecipient Monitoring

MDE's internal control did not ensure its compliance with subrecipient monitoring requirements. As a result, MDE cannot be assured that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements.

MDE's subrecipient monitoring activities include reviewing subrecipient applications for allowable activities and costs, appropriately identifying federal award information to its subrecipients, and performing on-site reviews of subrecipients. However, our review disclosed:

- (1) MDE did not conduct required inspections of food service management company facilities that prepared meals for Summer Food Service Program for Children (SFSPC) subrecipients.

Federal regulation 7 *CFR* 225.7(d)(6) provides that as part of the review of any SFSPC vended sponsor (sponsors that contract for the preparation of meals with a food service management company), state agencies must inspect the food service management company's facilities.

Our review of MDE's on-site reviews of 18 SFSPC sponsors disclosed that MDE did not inspect the food service management company facilities in 4 (100%) of 4 reviews of vended sponsors.

- (2) MDE did not always comply with federal regulations regarding administrative reviews of NSLP subrecipients.

Federal regulation 7 *CFR* 210.18(c)(1) provides that state agencies must conduct administrative reviews of all SFAs (subrecipients) at least once every six years. Also, federal regulation 7 *CFR* 210.18(h)(3) requires that the administrative reviews shall include an examination of the SFA's compliance with civil rights provisions.

Our review of MDE's administrative reviews of 25 NSLP SFAs disclosed that MDE did not complete 1 (4%) review within the six-year requirement. Also, MDE did not include a review of compliance with civil rights provisions in its review of 1 (4%) SFA.

b. Special Tests and Provisions

MDE's internal control did not ensure its compliance with federal laws and regulations regarding semiannual verification of sales of food commodities to SFAs participating in NSLP. As a result, MDE could not ensure that the value of USDA donated commodities was properly passed through to the SFAs and that any problems were identified and corrected.

Federal regulation 7 *CFR* 250.19(b)(2) requires MDE, the State's distributing agency of food commodities, to conduct a semiannual review of a sample of sales for the previous six-month period for selected processors utilized to process, warehouse, and distribute food commodities. Since MDE has delegated this responsibility to processors, federal regulations require that MDE must review the processors' findings, select a random subsample of at least 10% of all sales verified by the processors, and re-verify the sample items by direct confirmation with the SFA.

We reviewed MDE's process for reviewing the sales verifications for a six-month period submitted by 10 processors. MDE did not select the required

number of sales verifications to re-verify with SFAs for 1 (10%) processor. Also, MDE did not ensure that all SFAs responded to MDE's request for re-verification of sales verifications submitted by all 10 (100%) processors. In total, MDE did not receive a response from SFAs for 103 (54%) of 190 sales re-verification requests.

RECOMMENDATION

We recommend that MDE improve its internal control over the Child Nutrition Cluster to ensure its compliance with federal laws and regulations regarding subrecipient monitoring and special tests and provisions.

FINDING (3131205)

5. Emergency Food Assistance Program Cluster, CFDA 10.568 and 10.569

U.S. Department of Agriculture	Emergency Food Assistance Program Cluster: CFDA 10.568: Emergency Food Assistance Program (Administrative Costs) CFDA 10.568: ARRA - Emergency Food Assistance Program (Administrative Costs) CFDA 10.569: Emergency Food Assistance Program (Food Commodities) CFDA 10.569: ARRA - Emergency Food Assistance Program (Food Commodities)
Award Number: 2MI810053 2MI840053	Award Period: 10/01/2009 - 09/30/2011 10/01/2009 - 09/30/2010
	Known Questioned Costs: \$0

MDE's internal control over the Emergency Food Assistance Program (TEFAP) Cluster did not ensure compliance with federal laws and regulations regarding procurement and suspension and debarment and subrecipient monitoring. Our review disclosed material weaknesses in internal control over subrecipient monitoring.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of TEFAP Cluster awards.

MDE's federal expenditures for the TEFAP Cluster totaled \$7.2 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$3.7 million and \$3.4 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively. MDE also distributed donated food commodities valued at \$42.0 million to subrecipients during the two-year period ended September 30, 2011.

Our exceptions, by compliance area, are as follows:

a. Procurement and Suspension and Debarment

MDE's internal control over the TEFAP Cluster did not ensure compliance with federal regulations regarding procurement and suspension and debarment.

Federal regulation 7 *CFR* 3016.35 prohibits MDE from awarding grants to individuals or organizations that have been suspended or debarred or otherwise excluded from doing business with the federal government. Federal regulation 7 *CFR* 3017.300 requires MDE to verify that its subrecipients and its principals are not suspended or debarred or otherwise excluded. This verification can be accomplished by checking the Excluded Parties List System (EPLS), collecting a certification from the subrecipient, or adding a clause or condition to agreement(s) with the subrecipients.

MDE asserted that it reviewed the EPLS annually to verify that subrecipients and their principals were not suspended or debarred; however, it did not maintain documentation to support this review.

b. Subrecipient Monitoring

MDE's internal control over the TEFAP Cluster did not ensure compliance with subrecipient monitoring requirements. As a result, MDE cannot be assured that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of grant agreements.

OMB Circular A-133, section 400(d)(3) requires MDE to monitor the operations of its subrecipients to ensure compliance with applicable federal program requirements. Effective monitoring of subrecipients can be accomplished using various methods, depending on the nature and timing of the compliance requirement.

MDE performed on-site monitoring visits for selected subrecipients, provided training, and collected quarterly cost reports from subrecipients. However, our review disclosed that MDE did not document its review and approval of the subrecipient quarterly cost reports. As a result, MDE could not always ensure that subrecipient expenditures were for allowable activities and costs, were within the proper period of availability, and followed acceptable cash management practices.

RECOMMENDATION

We recommend that MDE improve its internal control over the TEFAP Cluster to ensure compliance with federal laws and regulations regarding procurement and suspension and debarment and subrecipient monitoring.

FINDING (3131206)

6. Title I, Part A Cluster, CFDA 84.010 and 84.389 (ARRA)

U.S. Department of Education	Title I, Part A Cluster: CFDA 84.010: Title I Grants to Local Educational Agencies CFDA 84.389: ARRA - Title I Grants to Local Educational Agencies, Recovery Act
Award Number: S389A090022A S010A090022A S010A100022A	Award Period: 02/17/2009 - 09/30/2010 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011
	Known Questioned Costs: \$8,334,405

MDE's internal control over the Title I, Part A Cluster did not ensure its compliance with federal laws and regulations regarding allowable costs/cost principles and matching, level of effort, and earmarking. We identified known questioned costs of \$8,334,405.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Title I, Part A Cluster awards.

Federal expenditures for the Title I, Part A Cluster totaled \$1.4 billion for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$691.6 million and \$731.7 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

Our exceptions, by compliance area, are as follows:

a. Allowable Costs/Cost Principles

MDE's internal control did not ensure its compliance with allowable costs/cost principles. Our review disclosed that MDE did not maintain sufficient documentation to support its decision to award Title I, Part A Cluster grant funds to one subrecipient. As a result, we are questioning the total amount distributed to this subrecipient of \$8,334,405 during the two-year period ended September 30, 2011.

OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments* (federal regulation 2 CFR 225) requires that costs charged to a federal program be necessary and reasonable and supported by adequate documentation. MDE did not require submission of a grant application prior to awarding Title I, Part A Cluster funds to one subrecipient for the purpose of providing services related to school improvement activities to local educational agencies (LEAs). Also, MDE did not maintain documentation to support whether it solicited applications from any other entities for these grant funds. MDE originally awarded Title I, Part A Cluster funds to this subrecipient during fiscal year 2006-07 and then awarded continuation grants to this subrecipient during fiscal years 2007-08, 2008-09, and 2009-10. We noted that MDE awarded funds to this same subrecipient during fiscal year 2010-11 under a separate federal program; however, MDE used a formal process for soliciting applications.

b. Matching, Level of Effort, and Earmarking

MDE's internal control did not ensure its compliance with federal laws and regulations regarding level of effort.

Our review disclosed that MDE did not maintain auditable data to demonstrate whether it met the criteria to treat State Fiscal Stabilization Fund (SFSF)

Cluster funds as non-federal funds for purposes of meeting Title I, Part A Cluster level of effort requirements. As a result, MDE may have incorrectly calculated level of effort for LEAs under the Title I, Part A Cluster by treating SFSF Cluster funds as non-federal funds in the calculations.

Section 14012(d) of the American Recovery and Reinvestment Act of 2009 (ARRA) provides that states must obtain prior approval from the U.S. Department of Education (USDOE) in order to treat ARRA funds that are used for elementary, secondary, or postsecondary education as non-federal funds for the purpose of meeting any requirement to maintain fiscal effort. Further, USDOE guidance in *Funds under Title I, Part A of the Elementary and Secondary Education Act of 1965 Made Available Under The American Recovery and Reinvestment Act of 2009* (Question C-6b) provides that, in order to obtain prior approval to treat ARRA funds as non-federal, a state must: (1) maintain auditable data to demonstrate that it is complying with the SFSF Cluster level of effort requirements and (2) maintain auditable data to demonstrate that the percentage of total state revenues available to support elementary, secondary, and public higher education combined in the most recently completed fiscal year did not decrease from the previous fiscal year.

Our review disclosed that although MDE met criteria (1), the lack of auditable data did not allow MDE to determine whether it met criteria (2) prior to treating SFSF Cluster funds as non-federal in its level of effort calculations for fiscal years 2009-10 and 2010-11. As a result, MDE was not in compliance with level of effort requirements.

MDE partially agrees with this finding in its corrective action plan. In May 2012, seven months after the close of fiscal year 2010-11, MDE obtained and provided us with auditable data related to criteria (2). Our review of this data noted that MDE incorrectly applied \$442.0 million in fiscal year 2011-12 School Aid Fund appropriations in the calculation to support fiscal year 2010-11 activity. Also, MDE's calculation supported compliance with level of effort requirements for fiscal year 2009-10 only after rounding to whole number percentages.

RECOMMENDATION

We recommend that MDE improve its internal control over the Title I, Part A Cluster to ensure its compliance with federal laws and regulations regarding allowable costs/cost principles and matching, level of effort, and earmarking.

FINDING (3131207)

7. Migrant Education - State Grant Program, CFDA 84.011

U.S. Department of Education	CFDA 84.011: Migrant Education - State Grant Program
Award Number: S011A070022 S011A080022A S011A090022A S011A100022	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011
	Known Questioned Costs: \$73,762

MDE's internal control over the Migrant Education - State Grant Program did not ensure its compliance with federal laws and regulations regarding allowable costs/cost principles. We identified known questioned costs of \$73,762.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Migrant Education - State Grant Program awards.

Federal expenditures for the Migrant Education - State Grant Program totaled \$16.0 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$8.2 million and \$6.6 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

MDE did not ensure that all administrative costs charged to the Migrant Education - State Grant Program were properly authorized by employees knowledgeable of program requirements. As a result, MDE could not ensure that all administrative expenses were for allowable activities and costs.

OMB Circular A-87 (federal regulation 2 *CFR* 225) provides that any costs allocable to a particular federal award must be authorized. Our review disclosed

that Migrant Education - State Grant Program employees did not document their review and approval of 6 invoices totaling \$73,762 from DTMB for administrative costs charged to the Migrant Education - State Grant Program prior to payment. We noted a total of 94 transactions totaling \$599,344 for payments to DTMB for administrative costs charged to the Migrant Education - State Grant Program during our audit period.

RECOMMENDATION

We recommend that MDE improve its internal control over the Migrant Education - State Grant Program to ensure its compliance with federal laws and regulations regarding allowable costs/cost principles.

FINDING (3131208)

8. Special Education Cluster (IDEA), CFDA 84.027, 84.173, 84.391 (ARRA), and 84.392 (ARRA)

U.S. Department of Education	Special Education Cluster (IDEA): CFDA 84.027: Special Education - Grants to States CFDA 84.173: Special Education - Preschool Grants CFDA 84.391: ARRA - Special Education Grants to States, Recovery Act CFDA 84.392: ARRA - Special Education - Preschool Grants, Recovery Act
Award Number: H027A070110 H027A080110 H027A090110 H027A100110 H027A110110 H173A070117 H173A080117 H173A090117 H173A100117 H173A110117 H391A090110 H392A090117	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012 02/17/2009 - 09/30/2010 02/17/2009 - 09/30/2010
	Known Questioned Costs: \$0

MDE's internal control over the Special Education Cluster did not ensure compliance with federal laws and regulations regarding 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 \$1.2 billion for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$566.5 million and \$582.9 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

Our audit disclosed that MDE's internal control 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.

MDE's subrecipient monitoring activities include performing on-site monitoring, reviewing subrecipients' program budgets for allowable activities and costs, and reconciling subrecipients' final expenditure reports (FERs) to approved budgets. However, our review disclosed:

- a. MDE did not ensure that subrecipients receiving Special Education Cluster grant awards funded by ARRA were informed of the correct *CFDA* number at the time of the subaward. As a result, 57 subrecipients may not have been aware that the funding for certain Special Education Cluster grant awards was from ARRA, which could result in the subrecipients not properly identifying ARRA awards on their SEFAs.

Federal regulation 2 *CFR* 176.210(c) requires recipients to separately identify to each subrecipient the federal award number, *CFDA* number, and amount of ARRA funds at the time of the subaward. When a recipient awards ARRA funds for an existing program, the information furnished to subrecipients shall distinguish the subawards of incremental ARRA funds from regular subawards under the existing program.

Our review of 8 subrecipient grant awards disclosed that MDE included the correct *CFDA* number on amended subrecipient grant award notifications.

However, the amended grant award notifications did not specifically inform the subrecipient that the *CFDA* number had been corrected. Also, by using amended grant award notifications as the method of informing subrecipients of the corrected *CFDA* number, subrecipients were not informed of the change in a timely manner. We noted that the 8 subrecipients received amended grant award notifications between 8 and 245 days (an average of 121 days) after the incorrect *CFDA* number was originally reported to the subrecipients.

- b. MDE did not monitor intermediate school districts (ISDs) to ensure that ISDs properly allocated Special Education Cluster funds to new or significantly expanded charter schools. As a result, MDE could not ensure that 19 new charter schools and 7 significantly expanded charter schools received the funds for which they were eligible for the two-year period ended September 30, 2011.

Federal regulation 34 *CFR* 76.792 requires that the states must implement procedures to ensure that new or expanding charter schools receive the proportionate amount of funds for which the charter schools are eligible.

RECOMMENDATION

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

FINDING (3131209)

9. Career and Technical Education - Basic Grants to States, *CFDA* 84.048

U.S. Department of Education	<i>CFDA</i> 84.048: Career and Technical Education - Basic Grants to States
Award Number: V048A070022A V048A080022A V048A090022A V048A100022A V048A110022-11B	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012
	Known Questioned Costs: Undeterminable

MDE's Career and Technical Education - Basic Grants to States Program did not comply with federal laws and regulations regarding matching, level of effort, and earmarking. Noncompliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Career and Technical Education Program awards.

Federal expenditures for the Career and Technical Education - Basic Grants to States Program totaled \$80.5 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$37.1 million and \$39.5 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

Section 311(b)(1)(A) of the Carl D. Perkins Vocational and Technical Education Act of 2006 requires that a state must expend, for career and technical education programs in each fiscal year, an amount equal to or exceeding the amount expended for career and technical education programs in the preceding fiscal year. A state can meet this level of effort requirement on either an aggregate or a per-student basis.

Our review disclosed that total State funds expended for career and technical education programs decreased in fiscal year 2010-11 by \$38,205 in the aggregate and by \$0.49 on a per-student basis. We have reported an undeterminable amount of questioned costs because the federal regulations only indicated that the State would not be eligible for subsequent year awards if it fails to maintain its level of effort in preceding years.

We previously reported that the Career and Technical Education - Basic Grants to States Program did not meet the level of effort requirement in fiscal year 2008-09 in our prior single audit. The USDOE Office of Vocational and Adult Education (OVAE) issued a program determination letter in January 2011 requiring MDE to submit for approval a new proposed methodology for calculating level of effort consistent with federal regulations. MDE revised its methodology used to calculate level of effort and submitted it to the USDOE in April 2011 but has not yet obtained formal approval for this revised methodology. Although MDE's revised methodology included categories of expenditures that were consistent with federal regulations, MDE incorrectly calculated level of effort on a per-student basis, indicating that MDE met the level of effort requirement when, in fact, it did not.

MDE has developed and implemented written policies and procedures for maintaining copies of, and supporting documentation for, its annual maintenance of effort (MOE) calculations that were also required by OVAE in the January 2011 program determination letter.

RECOMMENDATION

We again recommend that MDE's Career and Technical Education - Basic Grants to States Program comply with federal laws and regulations regarding matching, level of effort, and earmarking.

FINDING (3131210)

10. Early Intervention Services (IDEA) Cluster, CFDA 84.181 and 84.393 (ARRA)

U.S. Department of Education	Early Intervention Services (IDEA) Cluster: CFDA 84.181: Special Education - Grants for Infants and Families CFDA 84.393: ARRA - Special Education - Grants for Infants and Families, Recovery Act
Award Number: H181A070012 H181A080012 H181A090012 H181A100012 H181A110012 H393A090012	Award Period: 07/13/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012 02/17/2009 - 09/30/2010
	Known Questioned Costs: Undeterminable

MDE's internal control over the Early Intervention Services (IDEA) Cluster did not ensure its compliance with federal laws and regulations regarding matching, level of effort, and earmarking. Our review disclosed a material weakness in internal control. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of the Early Intervention Services (IDEA) Cluster awards.

Federal expenditures for the Early Intervention Services (IDEA) Cluster totaled \$33.1 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$16.2 million and \$15.6 million to subrecipients in

fiscal years 2009-10 and 2010-11, respectively. Subrecipients of the Early Intervention Services (IDEA) Cluster included LEAs, institutions of higher education, and nonprofit organizations.

Our review disclosed that MDE did not have a method to identify the State and local program budgeted and actual expenditures funded by non-federal sources for fiscal years 2009-10 and 2010-11. Consequently, MDE could not determine its compliance with the federal regulation related to level of effort.

Federal regulation 34 *CFR* 303.124 states that the total amount of State and local funds budgeted for expenditures in the current fiscal year for early intervention services for children eligible under this part and their families must be at least equal to the total amount of State and local funds actually expended for early intervention services for these children and their families in the most recent preceding fiscal year for which the information is available.

We reported on this weakness in our prior single audit, and MDE informed us that it was developing a process for identifying and reporting State and local expenditures, with an anticipated completion date of July 1, 2012. MDE will also need to obtain the amounts budgeted for the current year by the locals.

RECOMMENDATION

We again recommend that MDE improve its internal control over the Early Intervention Services (IDEA) Cluster by obtaining State and local budgetary and actual expenditure information to determine its compliance with federal laws and regulations regarding matching, level of effort, and earmarking.

FINDING (3131211)

11. Safe and Drug Free Schools and Communities - State Grants, CFDA 84.186

U.S. Department of Education	CFDA 84.186: Safe and Drug-Free Schools and Communities - State Grants
Award Number: Q186A070023 Q186A080023 Q186B080024 Q186A090023 Q186B090024	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2009 - 09/30/2010
	Known Questioned Costs: \$0

MDE's internal control over the Safe and Drug-Free Schools and Communities - State Grants (SDFSC) 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 in SDFSC Program awards.

Federal expenditures for the SDFSC Program totaled \$18.3 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$9.5 million and \$7.9 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

Our exceptions, by compliance area, are as follows:

a. Subrecipient Monitoring

MDE did not ensure that subrecipients receiving SDFSC Program awards were informed of all of the federal identifying information. As a result, 33 fiscal year 2009-10 SDFSC subrecipients may not have been aware of the CFDA title and number, which could result in the subrecipients not complying with federal grant regulations.

OMB Circular A-133 requires recipients to separately identify to each subrecipient the federal award number, CFDA title and number, and the name of the federal agency. MDE informed us that these subrecipients received awards under the Governor's Discretionary Grant, a separate grant award

administered by the Department of Community Health (DCH) at the time of the award, and DCH did not inform these subrecipients of this required information when awarding the funds. Responsibility for administering the Governor's Discretionary Grants was transferred from DCH to MDE in October 2009. MDE did not inform these subrecipients of the required information at the time the awards were transferred.

b. Special Tests and Provisions

MDE's internal control did not ensure that SDFSC Program funds were allocated to new or significantly expanded charter schools. As a result, MDE did not determine the eligibility of 10 new charter schools and 4 significantly expanded charter schools for SDFSC Program funds for fiscal year 2009-10.

Federal regulation 34 *CFR* 76.791 requires that the states 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.

MDE allocated SDFSC Program funds based on the prior year's allocations for Title I Grants to LEAs and did not consider new charter schools in its allocation of funds. Therefore, the 10 new charter schools were not notified that the schools were eligible to apply for the SDFSC grant and MDE did not consider current year data for the 4 significantly expanded charter schools in its allocation of funds.

We reported on the allocation to new or expanded charter schools in our last two single audits, and MDE informed us that it had implemented a procedure to ensure that grant funds were earmarked to account for new and expanded charter schools. However, MDE did not implement this procedure.

RECOMMENDATIONS

We again recommend that MDE improve its internal control over the SDFSC Program to ensure its compliance with federal laws and regulations regarding special tests and provisions.

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

FINDING (3131212)

12. Twenty-First Century Community Learning Centers, CFDA 84.287

U.S. Department of Education	CFDA 84.287: Twenty-First Century Community Learning Centers
Award Number: S287C070022 S287C080022A S287C090022A S287C100022 - 10A S287C110022	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012
	Known Questioned Costs: \$0

MDE's internal control over the Twenty-First Century Community Learning Centers (21st CCLC) Program did not ensure its compliance with federal laws and regulations regarding eligibility and subrecipient monitoring. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions in 21st CCLC Program awards.

Federal expenditures for the 21st CCLC Program totaled \$100.8 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$50.6 million and \$48.4 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

Our exceptions, by compliance area, are as follows:

a. Eligibility

MDE's internal control did not ensure that it awarded 21st CCLC Program grants to only eligible applicants in accordance with federal laws and regulations.

Title 20, section 7174(i) of the *United States Code (USC)* provides that, in awarding 21st CCLC grants, states shall give priority to applications that (1) propose to target services to students attending schools that have been identified as in need of improvement; and (2) are submitted jointly by eligible entities consisting of at least one LEA receiving funds under Title I, Part A and one community-based organization or other public or private entity.

MDE compiles the necessary information to help assess the priority in awarding 21st CCLC Program funds to eligible applicants and reports this information on a priority assessment form for each applicant. MDE consultants are required to approve the priority assessment forms after verifying the information. Our review disclosed that MDE did not document its review and approval of priority assessment forms for 2 (17%) of 12 applications. Therefore, MDE could not be assured that it awarded 21st CCLC Program funds to high-priority subrecipients.

b. Subrecipient Monitoring

MDE's internal control did not ensure its compliance with subrecipient monitoring requirements. As a result, MDE cannot be assured that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of grant agreements.

Federal regulation 34 *CFR* 74.51 and OMB Circular A-133, section 400(d)(3) require MDE to monitor the operations of its subrecipients to ensure compliance with applicable federal program requirements. Effective monitoring of subrecipients can be accomplished using various methods, depending on the nature and timing of the compliance requirement.

MDE reviewed subrecipient grant award budgets for allowable activities and costs, appropriately identified federal award information to its subrecipients, and performed program site visits. However, our review of MDE's subrecipient monitoring activities disclosed that MDE did not perform fiscal site visits of subrecipients that included a review of the documentation that supported expenditures, which is necessary for effective monitoring of allowable costs/cost principles, cash management, and period of availability of federal funds.

RECOMMENDATION

We recommend that MDE improve its internal control over the 21st CCLC Program to ensure its compliance with federal laws and regulations regarding eligibility and subrecipient monitoring.

FINDING (3131213)

13. English Language Acquisition Grants, CFDA 84.365

U.S. Department of Education	CFDA 84.365: English Language Acquisition Grants
Award Number: T365A060022 T365A070022A T365A080022A S365A090022A S365A100022 S365A110022	Award Period: 07/01/2006 - 09/30/2007 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012
	Known Questioned Costs: \$90,786

MDE's internal control over the English Language Acquisition (ELA) Grants Program did not ensure its compliance with federal laws and regulations regarding allowable costs/cost principles, subrecipient monitoring, and special tests and provisions. Our review disclosed material weaknesses in internal control over allowable costs/cost principles. We identified known questioned costs of \$90,786.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions in ELA Grants Program awards.

Federal expenditures for the ELA Grants Program totaled \$17.9 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$6.6 million and \$10.3 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

Our exceptions, by compliance area, are as follows:

a. Allowable Costs/Cost Principles

MDE's internal control did not ensure its compliance with allowable costs/cost principle requirements. As a result, we questioned costs totaling \$90,786. Our review disclosed:

- (1) MDE incorrectly charged the ELA Grants Program \$5,122,896 for services related to the Title I, Part A Cluster and not related to the ELA Grants Program. OMB Circular A-87 (federal regulation 2 *CFR* 225) provides that any cost allocable to a particular federal award may not be charged to other federal awards. Although the error was caused by MDE recording a payment totaling this amount to one LEA using an incorrect grant, MDE did not detect the error through regular monitoring of program expenditures. Upon our notification, MDE corrected its federal cash draws to reclassify these costs to the Title I, Part A Cluster and corrected this amount on its SEFA. Therefore, we are not questioning this amount.

MDE disagrees with this finding in its corrective action plan and informed us that the Secretary of Education ruled that adjustments to accounting records to produce a completely reconciled set of books do not have to occur within the Tydings period but could occur far after the close of the period. MDE also informed us that the Secretary of Education finds the legally relevant question to be when the obligation arose that gave rise to the entry, not in what account that entry was initially recorded. While we acknowledge that the ruling allows MDE to record certain accounting adjustments after the Tydings period, this does not relieve MDE of its responsibility for regular monitoring of program expenditures to ensure the prevention, detection, and correction of errors in a timely manner.

- (2) MDE allowed 4 (17%) of 23 subrecipients to exceed their earmarking limitation for administrative expenditures. As a result, we questioned costs totaling \$90,786 based on the difference between the total administrative expenditures reported on the subrecipients' FERs and 2% of the award amount.

Federal law 20 USC 6825(b) provides that LEAs receiving Limited English Proficient awards under the ELA Grants Program may use no more than 2% of their grants for administrative costs.

We noted that 3 of these 4 subrecipients reported administrative costs that exceeded their earmarking limitation on their budgets when submitting their applications for the grant award; however, MDE approved their applications and budgets.

b. Subrecipient Monitoring

MDE's internal control did not ensure its compliance with subrecipient monitoring requirements. As a result, MDE cannot be assured that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of grant agreements.

MDE's subrecipient monitoring activities include performing on-site monitoring, reviewing subrecipients' program budgets for allowable activities and costs, and appropriately identifying federal award information to its subrecipients. However, our review disclosed that MDE's internal control did not ensure that subrecipients complied with earmarking requirements. Our review of subrecipient FERs disclosed that 4 (17%) of 23 subrecipients had exceeded their earmarking limitation for administrative costs. As a result, we questioned costs totaling \$90,786 in the Allowable Costs/Cost Principles section (part a.(2)) of this finding.

c. Special Tests and Provisions

MDE's internal control did not ensure that ELA Grants Program funds were allocated to new or significantly expanded charter schools. MDE allocated ELA Grants Program funds to LEAs based on prior year data and did not consider new and significantly expanded charter schools in its allocation of funds due to the lack of prior year data available for new charter schools. As a result, MDE did not determine the eligibility of 22 new charter schools and 8 significantly expanded charter schools for ELA Grants Program funds during the two-year period ended September 30, 2011.

Federal regulation 34 *CFR* 76.791 requires that the states must determine a new or expanding charter school's eligibility based on actual enrollment or other data available on or after the date that the charter school opens or significantly expands. In addition, states 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.

RECOMMENDATIONS

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.

We also recommend that MDE improve its internal control over the ELA Grants Program to ensure its compliance with federal laws and regulations regarding allowable costs/cost principles and special tests and provisions.

FINDING (3131214)

14. School Improvement Grants Cluster, *CFDA* 84.377 and 84.388 (ARRA)

U.S. Department of Education	School Improvement Grants Cluster: <i>CFDA</i> 84.377: School Improvement Grants <i>CFDA</i> 84.388: ARRA - School Improvement Grants, Recovery Act
Award Number: S377A070023 S377A080024 S377A090023A S377A100023 S388A090023A	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 02/17/2009 - 09/30/2013
	Known Questioned Costs: \$0

MDE's internal control over the School Improvement Grants Cluster did not ensure its compliance with federal laws and regulations regarding procurement and suspension and debarment 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 School Improvement Grants Cluster awards.

Federal expenditures for the School Improvement Grants Cluster totaled \$36.5 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$7.2 million and \$27.7 million to subrecipients in fiscal years 2009-10 and 2010-11, respectively.

Our exceptions, by compliance area, are as follows:

a. Procurement and Suspension and Debarment

MDE's internal control did not ensure compliance with federal regulations regarding procurement and suspension and debarment.

Federal regulation 34 *CFR* 74.13 prohibits MDE from awarding grants to individuals or organizations that have been suspended or debarred or otherwise excluded from doing business with the federal government. Federal regulation 34 *CFR* 85.300 requires MDE to verify that its subrecipients and its principals are not suspended or debarred or otherwise excluded. This verification can be accomplished by checking the Excluded Parties List System (EPLS), collecting a certification from the subrecipient, or adding a clause or condition to the agreement(s) with the subrecipients.

MDE relies on a certification form that should be included in the grant application submitted by each subrecipient to certify that the subrecipient has not been suspended or debarred or otherwise excluded from doing business with the federal government. However, our review of 5 subrecipient applications disclosed that 2 (40%) applications did not include the required certification asserting that the subrecipient was not suspended or debarred. Expenditures related to these two grant awards accounted for 47% of the amounts distributed to subrecipients during the two-year period ended September 30, 2011. Although our review of the EPLS did not identify the subrecipients or any of its principals as suspended or debarred, MDE should implement controls to ensure all subrecipients and principals of those subrecipients are not suspended or debarred prior to awarding funds.

b. Subrecipient Monitoring

MDE's internal control did not ensure compliance with subrecipient monitoring requirements. As a result, MDE cannot be assured that subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and provisions of grant agreements.

Federal regulation 34 *CFR* 74.51 and OMB Circular A-133, section 400(d)(3) require MDE to monitor the operations of its subrecipients to ensure compliance with applicable federal program requirements. Effective monitoring of subrecipients can be accomplished using various methods, depending on the nature and timing of the compliance requirement.

MDE reviewed subrecipient grant award budgets for allowable activities and costs, appropriately identified federal award information to its subrecipients, reconciled subrecipients' FERs to approved budgets, and performed program site visits of LEAs. However, our review of MDE's subrecipient monitoring activities disclosed that MDE did not perform site visits of LEAs that included a review of the documentation that supported expenditures, which is necessary for effective monitoring of allowable costs/cost principles, cash management, and period of availability of federal funds.

RECOMMENDATION

We recommend that MDE improve its internal control over the School Improvement Grants Cluster to ensure its compliance with federal laws and regulations regarding procurement and suspension and debarment and subrecipient monitoring.

FINDING (3131215)

15. College Access Challenge Grant Program, *CFDA* 84.378

U.S. Department of Education	<i>CFDA</i> 84.378: College Access Challenge Grant Program
Award Number: P378A100022	Award Period: 08/14/2010 - 08/13/2012
	Known Questioned Costs: \$971,428

MDE's internal control over the College Access Challenge Grant (CACG) Program did not ensure its compliance with federal laws and regulations regarding matching, level of effort, and earmarking and reporting. Our review disclosed material weaknesses in internal control and material noncompliance* with federal laws and regulations regarding matching, level of effort, and earmarking. As a result, we issued an adverse opinion on compliance with federal laws and regulations for the CACG Program. We identified known questioned costs of \$971,428.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of CACG Program awards.

The CACG Program was transferred to MDE from the Department of Treasury effective October 1, 2010. Federal expenditures for the CACG Program totaled \$2.4 million for the fiscal year ended September 30, 2011. Of these expenditures, MDE distributed \$1.7 million to subrecipients.

Our exceptions, by compliance area, are as follows:

a. Matching, Level of Effort, and Earmarking

Our review disclosed:

(1) Matching

MDE's internal control did not ensure compliance with federal regulations regarding matching. As a result, we questioned costs totaling \$971,428.

The federal statute under the Higher Education Act of 1965, as amended (Title VII, Part E), requires a non-federal matching contribution of not less than one-third of the costs of project activities and services. This federal statute further states that if a state fails to provide the full non-federal share required, the grant payment shall be reduced proportionately. The non-federal share may be provided from state resources, contributions from private organizations, or both. MDE received a grant of \$4,268,548 in August 2010 and expended \$2,435,796 in fiscal year 2010-11. Based on the amount expended by MDE, we calculated the required match to be \$1,217,898.

* See glossary at end of report for definition.

MDE relied on the subrecipients of the CACG Program to expend the required match amount. However, MDE did not obtain documentation to support the match amount of \$971,428 expended by 1 of the 5 CACG subrecipients, and we questioned these costs.

(2) Level of Effort

MDE did not comply with federal regulations regarding level of effort.

Section 137 of the Higher Education Opportunity Act requires that, beginning after July 1, 2008, a state shall provide to public institutions of higher education an amount which is equal to or greater than the average amount provided to such institutions of higher education during the five most recent preceding academic years for which satisfactory data is available and for private institutions of higher education an amount which is equal to or greater than the average amount provided for student financial aid for paying costs associated with postsecondary education during the five most recent preceding academic years for which satisfactory data is available.

Our review disclosed that MDE provided public and private institutions \$31.6 million and \$22.7 million, respectively, less than the amounts required to meet level of effort requirements for fiscal year 2010-11. MDE requested a waiver from the USDOE, citing reduced funding for higher education and student financial aid programs as the reason for noncompliance. The USDOE denied MDE's waiver request and did not award new funds for the CACG Program. As a result, we did not report questioned costs for the noncompliance with the level of effort compliance requirement.

(3) Earmarking

MDE's internal control did not ensure compliance with federal laws and regulations regarding earmarking.

The federal statute under the Higher Education Act of 1965, as amended (Title VII, Part E), requires that a grantee use not more than 6% of the total amount of the sum of the federal share provided and the non-federal share required for administrative purposes.

MDE did not separately track and monitor its administrative costs; therefore, MDE could not determine its compliance with federal regulations related to earmarking. MDE's limit on administrative expenditures based on its total budget for federal and non-federal sources was \$384,169. Our review of MDE's expenditures for the CACG Program in fiscal year 2010-11 identified \$679,943 in expenditures for salaries and wages and other administrative costs, which exceeded MDE's limit by \$295,774. MDE subsequently informed us that a portion of these expenditures was related to employees providing outreach activities. We did not report questioned costs related to earmarking because the grant period had not yet ended.

b. Reporting

MDE's internal control did not ensure the accuracy of financial information reported to the USDOE in its annual CACG Program performance report.

The federal statute under the Higher Education Act of 1965, as amended (Title VII, Part E), requires a grantee to prepare and submit an annual performance report to the awarding agency on the activities and services carried out under the grant, and on the implementation of such activities and services. This report is to include financial information such as the cost of providing each activity or service under the grant award and the total matching contributions from private organizations.

MDE did not maintain documentation to support the financial information reported on its 2010-11 CACG annual performance report.

RECOMMENDATION

We recommend that MDE improve its internal control over the CACG Program to ensure its compliance with federal laws and regulations regarding matching, level of effort, and earmarking and reporting.

FINDING (3131216)

16. Education Jobs Fund, CFDA 84.410

U.S. Department of Education	CFDA 84.410: Education Jobs Fund
Award Number: S410A100023-10A	Award Period: 08/10/2010 - 09/30/2011
	Known Questioned Costs: \$0

MDE did not comply with federal laws and regulations related to matching, level of effort, and earmarking for the Education Jobs Fund Program. Noncompliance with federal laws and regulations could result in sanctions and/or disallowances of Education Jobs Fund Program expenditures.

Federal expenditures for the Education Jobs Fund Program totaled \$229.3 million for the two-year period ended September 30, 2011. Of these expenditures, MDE distributed \$229.2 million to subrecipients.

Public Law No. 111-226, the authorizing legislation for the Education Jobs Fund Program, provides that states must maintain state support for both elementary and secondary education and for public institutions of higher education for its fiscal year 2010-11 by complying with one of four optional methods. MDE chose to utilize method number 4, which provided that it will:

- (1) Maintain State support for elementary and secondary education at a percentage of total revenues available to the State that is equal to or greater than the percentage maintained in fiscal year 2005-06; and
- (2) Maintain State support for public institutions of higher education (not including support for capital projects or for research and development or tuition and fees paid by students) at a percentage of the total revenues available to the State that is equal to or greater than the percentage maintained in fiscal year 2005-06.

MDE relied on DTMB to calculate MOE for the Education Jobs Fund Program. Our review of DTMB's calculation disclosed that it incorrectly included \$442 million in fiscal year 2011-12 School Aid Fund appropriations within the calculation of fiscal year 2010-11 State support for elementary and secondary education.

We recalculated the MOE for fiscal year 2010-11 and determined that MDE did meet the MOE requirements for public institutions of higher education; however, MDE did not meet the MOE requirements for elementary and secondary education by 1.42% (approximately \$411 million).

RECOMMENDATION

We recommend that MDE comply with federal laws and regulations related to matching, level of effort, and earmarking for the Education Jobs Fund Program.

FINDING (3131217)

17. Subrecipient Monitoring

U.S. Department of Agriculture	Child Nutrition Cluster: CFDA 10.553: School Breakfast Program CFDA 10.555: National School Lunch Program CFDA 10.556: Special Milk Program for Children CFDA 10.559: Summer Food Service Program for Children
Award Number: 2MI300060 2MI300060	Award Period: 10/01/2009 - 09/30/2010 10/01/2010 - 09/30/2011
	Known Questioned Costs: \$0
U.S. Department of Agriculture	CFDA 10.558: Child and Adult Care Food Program
Award Number: 2009IN202042 2010N202042 2011N202042	Award Period: 10/01/2008 - 09/30/2009 10/01/2009 - 09/30/2010 10/01/2010 - 09/30/2011
	Known Questioned Costs: \$0

U.S. Department of Agriculture	Emergency Food Assistance Program Cluster: CFDA 10.568: Emergency Food Assistance Program (Administrative Costs) CFDA 10.568: ARRA - Emergency Food Assistance Program (Administrative Costs) CFDA 10.569: Emergency Food Assistance Program (Food Commodities) CFDA 10.569: ARRA - Emergency Food Assistance Program (Food Commodities)
Award Number: 2MI810053 2MI840053	Award Period: 10/01/2009 - 09/30/2011 10/01/2009 - 09/30/2010
	Known Questioned Costs: \$0

U.S. Department of Education	Title I, Part A Cluster: CFDA 84.010: Title I Grants to Local Educational Agencies CFDA 84.389: ARRA - Title I Grants to Local Educational Agencies, Recovery Act
Award Number: S389A090022A S010A090022A S010A100022A	Award Period: 02/17/2009 - 09/30/2010 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011
	Known Questioned Costs: \$0

U.S. Department of Education	CFDA 84.011: Migrant Education - State Grant Program
Award Number: S011A070022 S011A080022A S011A090022A S011A100022	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011
	Known Questioned Costs: \$0

U.S. Department of Education	Special Education Cluster (IDEA): CFDA 84.027: Special Education - Grants to States CFDA 84.173: Special Education - Preschool Grants CFDA 84.391: ARRA - Special Education Grants to States, Recovery Act CFDA 84.392: ARRA - Special Education - Preschool Grants, Recovery Act
Award Number: H027A070110 H027A080110 H027A090110 H027A100110 H027A110110 H173A070117 H173A080117 H173A090117 H173A100117 H173A110117 H391A090110 H392A090117	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012 02/17/2009 - 09/30/2010 02/17/2009 - 09/30/2010
	Known Questioned Costs: \$0

U.S. Department of Education	Early Intervention Services (IDEA) Cluster: CFDA 84.181: Special Education - Grants for Infants and Families CFDA 84.393: ARRA - Special Education - Grants for Infants and Families, Recovery Act
Award Number: H181A070012 H181A080012 H181A090012 H181A100012 H181A110012 H393A090012	Award Period: 07/13/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012 02/17/2009 - 09/30/2010
	Known Questioned Costs: \$0

U.S. Department of Education	CFDA 84.186: Safe and Drug-Free Schools and Communities - State Grants
Award Number: Q186A070023 Q186A080023 Q186B080024 Q186A090023 Q186B090024	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2009 - 09/30/2010
	Known Questioned Costs: \$0

U.S. Department of Education	CFDA 84.282: Charter Schools
Award Number: U282A070009-09 U282A100003A	Award Period: 08/01/2007 - 07/31/2011 08/01/2010 - 07/31/2015
	Known Questioned Costs: \$0

U.S. Department of Education	CFDA 84.287: Twenty-First Century Community Learning Centers
Award Number: S287C070022 S287C080022A S287C090022A S287C100022 - 10A S287C110022	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012
	Known Questioned Costs: \$0

U.S. Department of Education	Education Technology State Grants Cluster: CFDA 84.318: Education Technology State Grants CFDA 84.386: ARRA - Education Technology State Grants, Recovery Act
Award Number: S318X070022 S318X080022 S318X090022 S318X100022 S386A090022	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 02/17/2009 - 09/30/2010
	Known Questioned Costs: \$0

U.S. Department of Education	CFDA 84.357: Reading First State Grants
Award Number: S357A060023 S357A070023 S357A080023	Award Period: 07/01/2006 - 09/30/2007 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009
	Known Questioned Costs : \$0

U.S. Department of Education	CFDA 84.365: English Language Acquisition Grants
Award Number: T365A060022 T365A070022A T365A080022A S365A090022A S365A100022 S365A110022	Award Period: 07/01/2006 - 09/30/2007 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 07/01/2011 - 09/30/2012
	Known Questioned Costs: \$0

U.S. Department of Education	CFDA 84.367: Improving Teacher Quality State Grants
Award Number: S367A060021A, S367B060019A S367A070021A, S367B070019A S367A080021A, S367B080019A S367A090021A, S367B090019A S367A100021A, S367B100019A	Award Period: 07/01/2006 - 09/30/2007 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011
	Known Questioned Costs: \$0

U.S. Department of Education	School Improvement Grants Cluster: CFDA 84.377: School Improvement Grants CFDA 84.388: ARRA - School Improvement Grants, Recovery Act
Award Number: S377A070023 S377A080024 S377A090023A S377A100023 S388A090023A	Award Period: 07/01/2007 - 09/30/2008 07/01/2008 - 09/30/2009 07/01/2009 - 09/30/2010 07/01/2010 - 09/30/2011 02/17/2009 - 09/30/2013
	Known Questioned Costs: \$0

U.S. Department of Education	CFDA 84.378: College Access Challenge Grant Program
Award Number: P378A100022	Award Period: 08/14/2010 - 08/13/2012
	Known Questioned Costs: \$0

U.S. Department of Education	State Fiscal Stabilization Fund Cluster: CFDA 84.394: ARRA - State Fiscal Stabilization Fund - Education State Grants, Recovery Act
Award Number: S394A090023A	Award Period: 05/28/2009 - 09/30/2010
	Known Questioned Costs: \$0

U.S. Department of Education	CFDA 84.410: Education Jobs Fund
Award Number: S410A100023-10A	Award Period: 08/10/2010 - 09/30/2011
	Known Questioned Costs: \$0

MDE's internal control did not ensure compliance with federal laws and regulations regarding subrecipient monitoring. Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions in grant program awards.

Our review of MDE's centralized subrecipient monitoring disclosed:

- a. MDE did not comply with federal requirements related to issuing management decisions to subrecipients regarding subrecipient single audit findings.

Failure to issue management decisions to subrecipients hinders MDE's ability to ensure subrecipients' corrective action for audit findings to prevent future sanctions or disallowed costs. Also, if the subrecipient does not receive a management decision within two years after the subrecipient's audit report was issued, the subrecipient may consider that the finding does not warrant further action.

OMB Circular A-133, section 400(d)(5) requires MDE to issue management decisions on audit findings within six months after receipt of a subrecipient's audit report. OMB Circular A-133, section 405 provides that a management decision should clearly state whether the audit finding is sustained, the reasons for the decision, and the expected action the subrecipient is required to take.

Our review noted that MDE issued letters to subrecipients to require repayment of disallowed costs that were questioned in the subrecipients' single audit reports. However, MDE did not issue written management decisions informing subrecipients of MDE's evaluation of the audit findings and the expected corrective action necessary to respond to findings that did not involve repayment of disallowed costs.

- b. MDE's internal control did not ensure that it began its reviews of subrecipient single audit reports in a timely manner. As a result, MDE could not ensure the timely recovery of disallowed costs that may result from audit findings.

OMB Circular A-133, section 405(d) requires MDE to initiate any applicable corrective action within six months after receipt of subrecipient audit reports and proceed as rapidly as possible.

Our review noted that MDE did not begin its reviews of 3 (23%) of 13 subrecipient single audit reports obtained during fiscal years 2009-10 and 2010-11 until at least six months after receipt of the reports. On average, MDE did not begin its reviews of these reports until 210 days after receipt of the reports, ranging from 182 to 246 days.

RECOMMENDATION

We recommend that MDE improve its internal control 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 21, 2012

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES AND FINANCIAL STATEMENTS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131001
Finding Title: Security and Application Controls

Finding: The Michigan Department of Education (MDE), in conjunction with the Michigan Department of Information and Technology (MDIT), did not implement a comprehensive security program to protect its application systems and data.

- a. MDE did not restrict the system developers and project management personnel from administrative access privileges for MDE's information systems database.
- b. MDE, in conjunction with MDIT, did not have effective controls to identify unauthorized changes to application systems.
- c. MDE had not developed policies for monitoring access to all MDE data or applications.

Agency Comments: a. Prior to October 31, 2008, MDE 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.

- b. MDE and the Department of Technology, Management, and Budget (DTMB) reviewed change control procedures for the systems. Current procedures were deemed adequate. The noted shortcomings were an issue with practice not always following procedure. MDE and DTMB have continued to review change control procedures and update them as necessary. DTMB now has a dedicated application manager that supports MDE applications.

- c. MDE has reviewed the procedures for granting and monitoring access to all of its information technology systems. Several changes have been implemented. User accounts in the Michigan Electronic Grants System Plus (MEGS+), Michigan Electronic Grants System (MEGS), Child Nutrition Application Program (CNAP), and Cash Management System (CMS) that remain inactive for 15 months will automatically be inactivated. MDE requires authorization forms for all State of Michigan employees for MEGS+, MEGS, CNAP, State Aid Management System (SAMS), and CMS. In addition, MDE has a security access policy for electronic systems that was approved and posted on the MDE intranet. Individual systems also have developed security access policies.

Audit Period: October 1, 2007 through September 30, 2009

Finding Number: 3131003

Finding Title: Accounting Controls

Finding: MDE's year-end closing procedures did not ensure that all accrual transactions were properly recorded in the School Aid Fund.

Agency Comments: MDE's year-end closing procedures related to processing accruals for special education costs and taxable value changes to ensure accrual transactions are properly recorded in the School Aid Fund.

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131002
Finding Title: Monitoring of Internal Control Over Financial Reporting

Finding: MDE did not periodically monitor the effectiveness of its internal control over financial reporting.

Agency Comments: Although MDE values accurate financial reporting, MDE does not have sufficient staff to increase its current level of self-monitoring.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2008 through September 30, 2009
Finding Number: 2511005 (Department of History, Arts and Libraries, 251-0100-10)
Finding Title: Grants to States, *CFDA* 45.310

Finding: The Grants to States Program's internal control did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles and procurement and suspension and debarment.

Agency Comments: a. Allowable Costs:

(1) The Library of Michigan, now under MDE, continues to work with DTMB to finalize a service level agreement for information technology services provided by DTMB. An agreement has been drafted, is under review, and will be signed by December 30, 2011 for the services provided by DTMB.

- (2) The Library of Michigan has adopted the timekeeping system of MDE and is in compliance with federal timekeeping requirements.
 - (3) The Library of Michigan does independently verify the accuracy of consumer price index (CPI) increases before processing payments if an increase indicated on the invoice is based on the CPI. The Library staff review all invoices received for maintenance against the contract terms and conditions to ensure compliance prior to processing payment. The Library has not received an invoice that contains an increase based on CPI since the audit finding was identified. The current contract does not include a reference to increases based on CPI and, therefore, this is no longer an issue.
 - (4) Since the finding was brought to the attention of the Library of Michigan staff during the audit of fiscal year 2008-09, segregation of duties for payroll submission has been maintained and followed by all staff. A supervisor has not entered and approved time for an employee under any circumstance since the finding was identified.
- b. The Library of Michigan uses the procurement services of MDE and is in compliance with federal suspension and debarment requirements.

Audit Period: October 1, 2007 through September 30, 2009

Finding Number: 3131004

Finding Title: Food Donation, *CFDA* 10.550

Finding: MDE's internal control over the Food Donation Program did not ensure its compliance with federal laws and regulations regarding special tests and provisions.

- Agency Comments:**
- a. Each consortium is required to maintain records for a period of three years after the end of the fiscal year to which they pertain, or until final resolution of outstanding audits or claims per the memorandum of understanding with MDE. Language was added to the memorandum of understanding regarding the monitoring and review of records being maintained by each consortium.
 - b. MDE informed all processors of the requirement for submitting written justification for inventories in excess of six months. Processors were notified of this requirement in the National Processing Agreement/State Participation Agreement between MDE and the processor by adding more specific language, detailing expectations for the processors.
 - c. MDE's procedure for conducting semiannual sales verification was revised and implemented in January 2010. The following outlines the process:

Sales Verification Report was reviewed for each processor conducting sales verification for net of invoice processed products. Ten percent of the processor's required sample sized was verified by the MDE. Schools were notified by e-mail to verify the Pass Through Value of each sale made during the previous six months.
 - d. To ensure that sales verification was completed by the processor and MDE, documentation was maintained and reviewed regularly.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131005
Finding Title: Child and Adult Care Food Program, *CFDA* 10.558

Finding: MDE's internal control over the Child and Adult Care Food Program did not ensure its compliance with federal laws and regulations regarding eligibility and reporting.

Agency Comments:

- a. To ensure that sites do not receive reimbursement for the same children for both programs, a question has been added to each site page in the applications for both the Child and Adult Care Food Program (CACFP) and the Special Milk Program. The two applications will be cross-referenced and each site participating in both programs will be contacted to ensure that the same children are not participating in both programs. The CACFP Department Manager ran a report of all such institutions and double checked each site to ensure the same children were not claimed in both programs. This process will be followed each fiscal year.
- b. MDE has appropriate internal control in place to detect such errors. This was a one-time incident in which MDE reported revenue instead of expenditures on the line.

Audit Period: October 1, 2007 through September 30, 2009

Finding Number: 3131006

Finding Title: Monitoring ARRA Grants, *CFDA* 10.568, 10.569, 84.389, 84.391, 84.392, 84.393, and 84.394

Finding: MDE's internal control over the American Recovery and Reinvestment Act of 2009 (ARRA) funded grant programs did not ensure its compliance with federal laws and regulations regarding subrecipient monitoring specific to ARRA grants.

Agency Comments:

- a. MDE has worked with the Center for Educational Performance and Information (CEPI) to add two fields to the Education Entity Master. The fields are a Data Universal Numbering System (DUNS) number field and a Central Contractor Registration (CCR) date field. This will allow

MDE to track entities to ensure that they maintain an active registration in the CCR. Grants unit staff reviewed the CCR to find subrecipients of ARRA grants that were not currently registered in the CCR. The subrecipients were then contacted and walked through the registration update process to ensure that they had valid DUNS numbers and that the numbers were registered in the CCR. CCR registration is an annual requirement.

- b. MDE informed the agencies of the federal identifying information needed for reporting the Emergency Food Assistance Program (TEFAP) awards (regular and ARRA food and funding). Memorandums FD-104 and FD-106 were issued to the agencies clarifying the assigning of a value to donated U.S. Department of Agriculture (USDA) foods and the tracking of TEFAP food and funds for auditing purposes.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131007
Finding Title: Title I, Part A Cluster, *CFDA* 84.010 and 84.389

Finding: MDE's internal control over the Title I, Part A Cluster did not ensure its compliance with federal laws and regulations regarding allowable costs/costs principles, subrecipient monitoring, and special tests and provisions.

Agency Comments: All findings were corrected. Although MDE has not received a federal program determination letter, informal communications with the Student Achievement and School Accountability (SASA) office confirm that the U.S. Department of Education (USDOE) has accepted MDE's corrective actions. The Office of Field Services (OFS) has a detailed contract procedure, and the monitoring and oversight have been expanded. One full-time and four contracted fiscal auditors have been hired. The monitoring time line has been expanded and a contractor has been hired to provide an initial review of all comparability requirements.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131012
Finding Title: State Grants for Innovative Programs, *CFDA* 84.298

Finding: MDE's internal control over the State Grants for Innovative Programs did not ensure compliance with federal laws and regulations regarding subrecipient monitoring.

Agency Comments: All findings were corrected. Although MDE has not received a federal program determination letter, informal communications with the SASA office confirm that the USDOE has accepted MDE's corrective actions. OFS continues to use a protocol for the review of final expenditure reports (FERs). A contractor conducts the initial review for deviations at the subtotal line item. Then each district is contacted for follow-up on the deviations. MDE's Tiered Compliance Model is then implemented to review the district response and determine appropriate follow-up.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131013
Finding Title: Education Technology State Grants, *CFDA* 84.318

Finding: 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.

Agency Comments: a. MDE responded to this finding by tying Title IID competitive grant eligibility more closely to Title I eligibility and requiring that the applicant be either a high needs school in need of academic improvement or a consortium of schools with at least one high needs school in need of academic

improvement. The following language was included in all Title IID competitive grants:

Is among those districts in Michigan with the highest numbers or percentages of children from families with incomes below the poverty line as defined by the TITLE I - PART A, ALLOCATIONS School Year 2008-09 found at: http://www.michigan.gov/documents/mde/MDE-P2_FS_08_T1aAllocListOrig_199917_7.pdf

and

Serves one or more schools identified for improvement or corrective action under section 1116 of the No Child Left Behind Act of 2001.

- b. MDE appointed an analyst as an internal auditor, dedicated to the Educational Technology and Data Coordination unit through the remainder of the Title IID program in fiscal year 2011-12. This employee began participating in every aspect of the Title IID program, including reviewing the announcement, selection of grant winners, technical assistance during the grant period, final expenditure reporting, and individual grant audits.

Audit Period: October 1, 2007 through September 30, 2009

Finding Number: 3131014

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

Finding: MDE's internal control did not ensure that the Reading First State Grants Program complied with federal requirements relating to subrecipient monitoring.

Agency Comments: The program office has developed an Excel document to assist in monitoring subrecipient FERs. This spreadsheet has improved internal control and aided in proper subrecipient monitoring.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131015
Finding Title: English Language Acquisition Grants, *CFDA* 84.365

Finding: MDE's internal control over the English Language Acquisition (ELA) Grants Program did not ensure its compliance with federal laws and regulations regarding subrecipient monitoring.

Agency Comments: All findings were corrected. OFS continues to use a protocol for the review of FERs. A contractor conducts the initial review for deviations at the subtotal line item. Then each district is contacted for follow-up on the deviations. MDE's Tiered Compliance Model is then implemented to review the district response and determine appropriate follow-up.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131016
Finding Title: Improving Teacher Quality State Grants, *CFDA* 84.367

Finding: 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 subrecipient monitoring and special tests and provisions.

Agency Comments: All findings were corrected. Although MDE has not received a federal program determination letter, informal communications with the SASA office confirm that the USDOE has accepted MDE's corrective actions. OFS continues to use a protocol for the review of FERs. A contractor conducts the initial review for deviations at the subtotal line item. Then each district is contacted for follow-up on the deviations. MDE's Tiered Compliance Model is then implemented to review the district response and determine appropriate follow-up.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131017
Finding Title: State Fiscal Stabilization Fund Cluster, *CFDA* 84.394

Finding: MDE's internal control over the State Fiscal Stabilization Fund (SFSF) Cluster did not ensure its compliance with federal laws and regulations regarding subrecipient monitoring.

Agency Comments:

- a. As of May 20, 2010, all FERs in the reviewed sample had been certified, processed, and reviewed by MDE staff. As noted, not all FERs from the 33 subrecipients had been submitted during the audit period. MDE has updated its procedures to ensure that all FERs are submitted within 60 days of 100% draw of all funds. To ensure this happens, MDE has adjusted the end date for all grants where there is 100% draw of funds. This forces the FER to be generated. MDE staff have been assigned to monitor these draws on a weekly basis. MDE will continue to conduct timely reviews of all submitted FERs.
- b. MDE has reviewed 100% of all processed FERS for both fiscal year 2008-09 and fiscal year 2009-10 SFSF funds. CMS was forced to generate FER notifications for all subrecipients of both fiscal year 2008-09 and fiscal year 2009-10 SFSF funds that had not yet submitted FERs but had drawn 100% of funds on June 4, 2010. MDE has reviewed all FERS submitted in a timely manner.

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2008 through September 30, 2010
Finding Number: 2711104 (Department of Treasury, 271-0100-11)
Finding Title: College Access Challenge Grant Program, *CFDA* 84.378A

Finding: The Department of Treasury's internal control over the College Access Challenge Grant (CACG) Program did not ensure compliance with federal laws and regulations regarding matching, level of effort, and earmarking and procurement and suspension and debarment.

Agency Comments: Part a.(1): Matching:
In January 2009, the Department of Treasury, with USDOE approval, amended the original CACG scope and budgetary line items. This had the effect of reducing one contractor's non-federal match from \$1,000,000 to \$500,000. With the change in scope, the Department of Treasury, along with the Michigan College Access Network, sought additional sources of non-federal match to fulfill its statutory requirement.

For the subsequent award (P378A090022), a documented non-federal match of \$1,015,000 was secured in fiscal year 2010-11 from a foundation of the CACG in addition to \$500,000 from subgrantees for the purposes of establishing local college access networks throughout Michigan.

For award number P378A080022, the Department of Treasury was allotted \$2,092,786 in CACG funds and, for award number P378A090022, the allotment was \$2,202,422. The total non-federal match for these two awards is \$2,147,604. The Department of Treasury has documented and secured a total of \$2,313,622 for these two awards to meet its commitment in providing non-federal match contributions of not less than one-third of total project costs and services.

The Department of Treasury has obtained the required non-federal match for the CACG Program by obtaining additional matching funds for award number P378A090022 to make up for the shortage of matching funds for award number P378A080022.

Part a.(2): Level of Effort (Maintenance of Effort):

Because of legislative actions, State funding for private institutions was replaced with federal Temporary Assistance for Needy Families (TANF) funding at the end of each fiscal year beginning with fiscal year 2007-08. In subsequent years, State dollars were appropriated and awarded to Michigan's private institutions and subsequently replaced with TANF funds, reducing the State's level of effort.

Although federal regulations do not allow for a calculation in total, the Department of Treasury determined that, in total, for award number P378A080022, Michigan provided \$1,768,447,830 in State funds to public colleges and universities and financial aid to private institutions. The average total amount from 2004 through 2008 was \$1,774,319,085 and the level of effort, in total, was missed by 0.33%. For award number P378A090022, Michigan provided \$1,760,208,035 in State funds to public colleges and universities and financial aid to private institutions. The average total amount from 2005 through 2009 was \$1,785,037,284 and the level of effort, in total, was missed by 1.39%.

MDE submitted a maintenance of effort waiver request to the USDOE in June 2011. The USDOE denied the waiver on September 8, 2011. MDE is in the process of appealing the waiver denial.

Part b.(1): Procurement:

The Department of Treasury received verbal guidance from DTMB that contracts with vendors in excess of \$25,000 that are named in federal grants are not required to follow the bid requirements in Act 431, P.A. 1984, as amended. Prior to the issuance of contracts by the Department of Treasury, approval of programmatic and budgetary changes to the Department of Treasury's original CACG application was received from the USDOE.

Part b.(2): Suspension and Debarment:

The CACG Program was transferred to MDE effective October 1, 2010. The CACG Program uses the procurement services of the MDE and is in compliance with federal suspension and debarment requirements.

Audit Period: October 1, 2007 through September 30, 2009

Finding Number: 3131008

Finding Title: Special Education Cluster (IDEA), *CFDA* 84.027, 84.173, 84.391, (ARRA), and 84.392 (ARRA)

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

Agency Comments: a. This finding was corrected. Although MDE has not received a federal program determination letter, informal communications confirm that the USDOE Office of Special Education Programs has accepted MDE's corrective actions.

(1) Final Narrative Progress Reports: All final narrative progress reports have been received and reviewed. A process has been developed to ensure that all final narrative reports have been received and reviewed. A vacant position was filled, then vacated and reposted and filled with a start date of September 19, 2011.

(2) Subrecipient Monitoring: All supportive documentation and communications are electronically maintained utilizing TeamMate audit software. There are no longer paper files to be misplaced. The acquiring and maintaining documentation electronically with backup procedures ensures that information related to each program fiscal review will be retained.

(3) Maintenance of Effort (MOE)

Maintenance of Effort Testing 2006-07: Of the fourteen (14) LEAs identified:

- MDE has reviewed all 14 LEAs.
- Seven (7) LEAs have met their MOE.
- Four (4) LEAs were determined to have shortfalls and all received recapture memos totaling \$84,894.
 - Three (3) recapture payments have been received in the amount of \$59,969.
 - One (1) recapture payment remains outstanding.
 - Three (3) LEAs remain in progress.

Maintenance of Effort Testing 2007-08: Of the sixty five (65) LEAs identified:

- MDE has reviewed all 65 LEAs.
- Fifty-three (53) LEAs have met their MOE.
- Eleven (11) were determined to have shortfalls and all received recapture memos totaling \$835,863.
- Seven (7) recapture payments have been received in the amount of \$110,459.
- Three (3) recapture payments remain outstanding.
- One (1) recapture payment is under appeal.
- One (1) LEA remains in progress.

- b. This finding was corrected. Although MDE has not received a federal program determination letter, informal communications confirm that the USDOE Office of Special Education Programs has accepted MDE's corrective actions.

The MDE Office of Special Education and Early Intervention Services (OSE-EIS) established a procedure to ensure that all federal requirements related to new or expanding charter schools are met.

The OSE-EIS did identify new or significantly expanding charter schools during the 2010-11 school year, collected the number of students with individualized education programs (IEPs), and provided additional allocations to those intermediate school districts (ISDs) to provide allocations to the identified charter schools. Also, documentation was provided demonstrating that the OSE-EIS did communicate the federal requirement and the process the ISDs are to use in allocating to new or significantly expanding charter schools.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131009
Finding Title: Career and Technical Education - Basic Grants to States, *CFDA* 84.048

Finding: MDE's Career and Technical Education - Basic Grants to States Program did not comply with federal laws and regulations regarding matching, level of effort, and earmarking.

Agency Comments: Action Subsequent to Audit Release:
In a letter dated July 30, 2010, the USDOE requested additional information before proceeding with the audit resolution. In a letter dated August 23, 2010, MDE requested an extension for response to this letter until the USDOE issues a response to the prior finding (ACN 05-08-912068).

The USDOE's Program Determination Letter ACN 05-09-013115 and ACN 05-08-912068, received January 14, 2011, did not sustain the auditors' finding that MDE failed to maintain fiscal effort, but concurred with the recommendation to strengthen internal control to ensure compliance with the MOE requirement. The USDOE determined that DLEG and MDE violated two EDGAR provisions (§76.730(e) and §76.731).

The Program Determination Letter specified corrective action requirements to be addressed by MDE. Corrective actions must include:

1. A new proposed methodology to calculate annually and in writing its State fiscal effort for Career and Technical Education (CTE) both in the aggregate and on a per-student basis.
2. The new methodology includes all categories of State expenditures for CTE that meet the definition in section 3(5) of Perkins IV, include student counts, document the sources of the expenditure data and student counts, are applied consistently from year to year, and provide for a procedure and schedule to review the categories of State expenditures to be used in the MOE calculations.
3. A written explanation of its reason for including or excluding each category of costs in its current or proposed MOE methodologies.
4. Policies and procedures for maintaining copies of, and supporting documentation for, its annual MOE calculations both in aggregate and on a per-student basis.

The USDOE considered this finding to be significant and material to MDE's CTE State grant program due to the importance of the MOE requirement issue and required MDE to ensure that it includes this finding in the summary schedule of prior audit findings that it is required to prepare for the next single audit. The USDOE considered this finding to be resolved.

MDE's Response to Program Determination Letter:

MDE submitted responses to the required corrective actions in a letter dated April 6, 2011.

On May 4, 2011, MDE received an e-mail from the USDOE stating that the review of MDE's Program Determination Letter response would be delayed. As of June 12, 2012, MDE is still waiting to hear from the USDOE.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131010
Finding Title: Early Intervention Services (IDEA) Cluster, *CFDA* 84.181 and 84.393 (ARRA)

Finding: MDE's internal control over the Early Intervention Services (IDEA) Cluster did not ensure its compliance with federal laws and regulations regarding matching, level of effort, and earmarking.

Agency Comments: Progressing on the corrective action. As indicated in the response for this finding, it is anticipated that there will be a completion date of July 1, 2012.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 3131011
Finding Title: Safe and Drug-Free Schools and Communities - State Grants, *CFDA* 84.186

Finding: MDE's internal control over the Safe and Drug-Free Schools and Communities - State Grants (SDFSC) Program did not ensure its compliance with federal laws and regulations regarding subrecipient monitoring and special tests and provisions.

Agency Comments: a. MDE acknowledged that on-site monitoring/desk reviews were not conducted during fiscal year 2007-08. This issue has been corrected. A total of 16 on-site/desk reviews were conducted in fiscal year 2008-09, 0 on-site/desk reviews were conducted in fiscal year 2009-10, 22 on-site/desk reviews were conducted in fiscal year 2010-11, and

5 on-site/desk reviews will be conducted in fiscal year 2011-12.

MDE acknowledged that MDE and the Office of Drug Control Policy (ODCP) did not monitor subrecipient cash draws to ensure that draws were only for reimbursement needs. This issue has been corrected. Because education grants are often program driven, it is not unusual to see programs run in the middle of the school year that result in large cash draws (e.g., prevention curriculum purchase for program implementation). An even draw of funds throughout the school year is not expected in all subrecipient situations. Since the previous audit finding, procedures were followed and reports were run in the Cash Management System quarterly to monitor these draws. These reports were saved, but follow-up documentation was not available regarding specific districts cited in this audit. However, this documentation is available for other subrecipients participating in this grant program. MDE continued to follow the approved procedures of running quarterly cash timing reports and continued to document follow-up correspondence with districts with cash draws that may have been in excess of accumulated expenditures. This included reviewing cash timing reports that were run at several intervals throughout the school year. If cash draws appeared to be excessive, the recipient was contacted for further clarification. The reason given by the recipient was noted in an Excel spreadsheet, generated by the cash timing query, and saved on the server. Any draws that were not in compliance with cash management requirements would be returned to MDE, including applicable interest. Further subrecipient monitoring will be unnecessary due to the elimination of this program at the federal level.

- b. MDE acknowledged that funds were not allocated to new or significantly expanded charter schools. This issue has been corrected. Program offices that are responsible for the management of federal formula grants follow a set process to prepare allocations for upcoming school years. Estimated allocations based on estimated federal awards are prepared and then announced in the March time frame, prior to the notification deadline for new or significantly expanded charter schools. A portion of the grant award is set aside to allow for allocations for new or significantly expanded charter schools to be determined later in the year. The grant application opportunities are announced to all eligible applicants in the spring and usually have a July 1 deadline for earliest possible funding. Allocations are confirmed once the federal award is approved and the Superintendent of Public Instruction approves all allocations.

Charter schools are required to notify MDE's Public School Academy Program (MPSAP) staff of any schools that either will open or significantly expand for the new school year by May. MPSAP staff, in turn, notifies MDE program offices of new or significantly expanded charter school local educational agencies (LEAs). This notification gives program offices the advance warning for the preparation and subsequent release of additional allocations for these charter schools.

In accordance with the No Child Left Behind (NCLB) Act, section 5206, any charter school that opens or expands its enrollment on or before November 1 will be offered the proportionate amount of federal formula funds for which it is eligible within five months of the date the charter school opens or significantly expands. Based on the Michigan school calendar, this action is done on or before the first week of February, but is usually planned for January. A

charter school that opens or expands after November 1 but before February 1 will receive a pro rata portion of the funds for which it is eligible on or before the date the state education agency (SEA) allocates funds to other LEAs for the succeeding year.

The allocations for the new or significantly expanded charter schools are dependent on enrollment data that is collected in the Fall Michigan Student Data System collection. Once enrollment figures are certified, it is possible to determine the allocations for the new or significantly expanded charter schools. Allocations are made using the amount set aside from the previous spring. Once the allocations are determined, they are announced to the applicants along with information on how to apply for the various grants.

The SDFSC team will follow these same procedures when managing their assigned grant. Once initial allocations are calculated for SDFSC funds, they are posted to the MDE Web site and the grant opportunity is announced. New and expanded charter schools will be notified of the amount of their SDFSC allocation when they are determined during the January time frame. These allocations are also posted on the MDE Web site, along with a description of the SDFSC program. Outreach to charter schools is conducted via official MDE communications and through various partner organizations' Listservs. Charter schools are invited to apply for the funds and are offered technical assistance as necessary.

Based on MDE's experience with the size of the SDFSC grant, \$20,000 is set aside to account for any charter schools that will open or significantly expand in the new school year. Excess funds not required or utilized by the new and expanded charter schools are added to the federal award for the succeeding year and distributed using the traditional formula.

MICHIGAN DEPARTMENT OF EDUCATION

Corrective Action Plan

As of June 22, 2012

FINDINGS RELATED TO THE FINANCIAL SCHEDULES AND FINANCIAL STATEMENTS

Finding Number: 3131201
Finding Title: Grants and Cash Management Systems' Access Controls

Management Views: Part a.: The Michigan Department of Education (MDE) agrees with part a. as it relates to the Michigan Electronic Grants System (MEGS). As a result of the audit review, MDE has reviewed the security access levels and has lowered 4 of the 11 MEGS users access in question. The 7s security access was granted to provide additional support to specific grant and application activities and/or projects.

MDE disagrees with part a. as it relates to the Cash Management System (CMS). Privileged access to the CMS is limited to six MDE users. These privileged users are necessary to ensure that there is never a time in which the CMS processes are not performed. The CMS must be functional at all times and the privileged user is the only access level that can ensure complete functionality. Monitoring reports have been developed to review any and all high-risk transactions associated with privileged access.

Part b.(1): MDE disagrees. As a result of the audit review, MDE has reviewed the security access levels of the 28 users' access in question. MDE has determined that the 28 users have been granted the appropriate security level to allow them to perform the

functions of their assigned job responsibilities. Level 7 security forms are approved by the program office director and the Grants Unit supervisor. Level 7s security forms are approved by the Grants Unit supervisor. MDE security levels in MEGS are not segregated by program office or application.

Part b.(2): MDE partially agrees. As a result of the audit review, MDE reviewed the security access levels for the two project managers and the Department of Technology, Management, and Budget (DTMB) employee. MDE has determined that appropriate levels were assigned to the two project managers. DTMB access has been downgraded to read only.

Part c.: MDE agrees. A high-risk transaction report was created for MEGS. During the audit period, the report was run multiple times by contract staff and reviewed by the supervisor of the Grants Administration and Coordination Unit. However, the review was not documented. In addition, there were not any high-risk reports defined for the Child Nutrition Application Program (CNAP). The purpose of both reports will be to review all high-risk transactions to ensure that they are being completed by authorized personnel.

Part d.: MDE agrees.

Part e.: MDE agrees.

Planned Corrective Action:

Part a. - MEGS: The remaining MEGS users with 7s security access are all Grants Coordination and School Support (GCSS) staff. The 7s security access level is appropriate for these staff members in order to perform their specific job duties such as managing

assigned grants, providing support and backup to program offices across MDE, providing support to MEGS users, and/or conducting assigned MEGS general job responsibilities.

While GCSS staff with 7s security level could approve applications and make grant funds available, the accepted MDE process is that program offices (only) review/approve applications and make grant funds available for grant applications within their assigned program area. GCSS would only approve an application or make grant funds available as a backup support function for the program offices. In addition, while staff can make grant funds available, they cannot submit applications on behalf of applicants when utilizing the "log in as" function, nor can they make cash requests. Any transactions such as making grant funds available would also appear on the high-risk transaction log and would be addressed immediately upon identification.

GCSS staff will review the high-risk transaction report on a monthly basis and report any discrepancies to the assistant director of GCSS.

CMS: At the time of this finding, MDE had the director, assistant director, three staff members, and the project manager with privileged access rights. MDE has since deactivated the director and changed the access rights of one user from privilege to view data; therefore, CMS has a minimum of four users with privileged access rights to ensure continued daily operations.

Part b.(1): The MDE accepted process is that program offices only review/approve applications and make grant funds available for grant applications within their

assigned program area. In addition, these types of transactions would be noted on the high-risk transaction log. If a consultant was to approve an application that was not within his/her program area, it would be noted immediately upon identification.

The "Login as" is a function that is essential to the program offices in order to provide support for MEGS users. As noted, program office consultants (level 7) actions performed are logged and submission of applications is disabled.

Appropriate GCSS staff have been provided level 7s access in order to manage assigned grants, provide support and backup to program offices, provide support to MEGS users, and/or to conduct assigned MEGS general job responsibilities.

Only two GCSS staff have been assigned the level 8 security access which provides "Superintendent" approval (in MEGS) of entire grant awards as already approved by the Superintendent of Public Instruction. The purpose of having two assigned staff allows for a backup of critical program functions in order to release grant program funds so the program offices may in turn grant these funds, as appropriate, to applicants.

GCSS staff will review the high-risk transaction report on a monthly basis and report any discrepancies to the assistant director of GCSS.

Part b.(2): The DTMB employee has been downgraded to read only access. One project manager access was downgraded from level 7s to level 7, which still allows him to approve grants. The second project manager had his access revoked due

to departure from MDE. All of these staff have signed and approved security access forms.

GCSS staff will review the high-risk transaction report on a monthly basis and report any discrepancies to the assistant director of GCSS. The report will be able to identify if there have been any improper transactions by anyone with level 7 access.

Part c.: MDE has hired a MEGS manager that oversees the day-to-day operations of MEGS. Part of the responsibility for the MEGS manager will be to review the MEGS high-risk transaction report on a monthly basis and to report any discrepancies to the supervisor of the Grants Administration and Coordination Unit. Similarly, MDE will define high-risk transactions for all of the Food Nutrition System Fiscal Reporting System (FNS-FRS), which will include the former CNAP application. These transaction reports will be run and reviewed on a monthly basis by the supervisor of the Fiscal and Administrative Services Team. In both cases, any discrepancies will be reported to the assistant director of School Support Services.

Part d.: MDE will periodically monitor user access rights as suggested in the recommendation. MDE will monitor at least 20% of all users annually.

Part e.: The Michigan Education Information System (MEIS) application currently does not have password expirations implemented. DTMB is proposing enhancements to the MEIS application, of which password expirations are a recommendation. The implementation of this is not yet determined and dependent upon availability of resources.

Anticipated Completion Date: a.: MEGS: September 30, 2012
CMS: April 1, 2012

b.: September 30, 2012

c.: September 30, 2012

d.: September 30, 2012

e.: December 31, 2012

Responsible Individuals: a.: MEGS: Shulawn Doxie
CMS: Craig Thurman

b.: Shulawn Doxie

c.: Louis Burgess

d.: Louis Burgess, Craig Thurman, and Brandon Reed

e.: Maria Thomas (DTMB)

Finding Number: 3131202

Finding Title: Schedule of Expenditures of Federal Awards (SEFA)

Management Views: Part a.: MDE agrees. MDE has prepared the schedule of expenditures of federal awards (SEFA) consistently for that past 15 years and has never been cited by the Office of the Auditor General (OAG) for the process it follows; however, MDE will improve its internal control over financial reporting to ensure that the preparation of the SEFA is in accordance with State financial management policies.

Part b.: MDE disagrees. MDE has automated internal control built into its financial management system that would have detected and corrected the

misclassification had the threshold been met; however, the auditor found it first. To reconcile more frequently as suggested would be burdensome and would not yield benefits that exceed costs.

Part c.: MDE agrees. However, the College Access Challenge Grant Program was transferred from the Department of Treasury to MDE in fiscal year 2010-11, and it had grants that were coded as contract; thus, MDE did not discern this before the start of the audit.

Planned Corrective Action:

- a.: MDE will properly account for prior year accounts payable write-offs to be included on the SEFA.
- b.: No further action required by MDE.
- c.: MDE will ensure that transactions are properly classified on the SEFA.

Anticipated Completion Date: May 1, 2012

Responsible Individual: Craig Thurman

Finding Number: 3131203
Finding Title: Monitoring of Internal Control Over Financial Reporting

Management Views: MDE disagrees with part a. and agrees with part b.

Part a.: MDE agrees with the underlying intent of the recommendation to have effective internal control, but MDE is concerned about unequal implementation. MDE has asked for the legal basis of this requirement and has asked for examples of other small departments that have implemented this requirement. The auditors have been unable to supply either. MDE

uses management reviews to ensure the accuracy of its transactions and believes that management reviews are cost beneficial. MDE is unable to do more with current resources.

Part b.: MDE will do its best to meet future internal control evaluation (ICE) deadlines.

- Planned Corrective Action:**
- a. If sufficient resources become available, MDE will more fully monitor the effectiveness of its internal control over financial reporting.
 - b. MDE will do its best to meet future ICE deadlines.

Anticipated Completion Date: Ongoing

Responsible Individual: Janet Laverty

FINDINGS RELATED TO FEDERAL AWARDS

- Finding Number:** 3131204
- Finding Title:** Child Nutrition Cluster, *CFDA* 10.553, 10.555, 10.556, and 10.559
- Management Views:** MDE agrees with the finding. The School Nutrition Programs have a process in place to track reviews. The Food Distribution Unit has a process in place for conducting sales verifications every six months.
- Planned Corrective Action:** Part a.: To ensure that School Nutrition Programs meet all review requirements of the National School Lunch Program (NSLP) and Summer Food Service Program for Children (SFSPC), MDE will implement a

new procedure to track all reviews. This procedure will include weekly and monthly reviews of two managers. In addition, MDE just recently hired another department manager for NSLP and SFSPC to ensure that all reviews are being completed on time. In regard to the inspection of food service management company facilities, MDE will collaborate with the Michigan Department of Agriculture and Rural Development to determine an effective method of complying with this regulation.

Part b.: To ensure that MDE selects the required number of sales verifications for each processor, a spreadsheet will be maintained to identify the sample size and the number of e-mails sent to and responses received from the School Food Authorities (SFAs) selected for verification. If the required response rate is not achieved, e-mails will be resent to non-responding SFAs or additional e-mails will be sent to achieve the sample size necessary for verification.

Anticipated Completion Date: a. October 2012
b. September 2012

Responsible Individuals: a. Howard Leikert
b. Cheryl Schubel

Finding Number: 3131205
Finding Title: Emergency Food Assistance Program Cluster,
CFDA 10.568 and 10.569

Management Views: Part a.: MDE agrees. The Food Distribution Unit reviews the Excluded Parties List System (EPLS) annually to ensure recipients are not suspended or

debarred prior to their receipt of administrative funds for the Emergency Food Assistance Program (TEFAP).

Part b.: MDE agrees. Quarterly cost reports for TEFAP were submitted to the Food Distribution Unit's consultant in fiscal years 2009-10 and 2010-11. In fiscal year 2010-11, costs were submitted electronically by the agencies in the Michigan Nutrition Data (MiND) system and approved by the consultant weekly. Payments were then issued to the agencies through the CMS to cover these costs. An e-mail paper trail did exist to show that the costs were reviewed and approved by the Unit's consultant and supervisor. The supervisor then notified the fiscal unit that the payments for these costs were ready to be processed and sent to CMS.

Planned Corrective Action:

Part a.: The EPLS will be reviewed and documentation will be maintained annually to verify that recipients are not suspended or debarred prior to receiving any federal grants from MDE.

Part b.: The Food Distribution Unit will continue to weekly review and approve costs submitted and certified electronically by the agencies. An e-mail trail will be maintained as documentation that a review and approval process is in place. Desk audits will be conducted at random during fiscal year 2011-12 to verify that the subrecipient expenditures are for allowable activities and costs. A spreadsheet will be generated every six months to show the agency representative responsible for electronically submitting and certifying costs and the Food Distribution Unit staff responsible for reviewing and approving those costs.

Anticipated Completion Date: September 2012

Responsible Individual: Cheryl Schubel

Finding Number: 3131206

Finding Title: Title I, Part A Cluster, *CFDA* 84.010 and 84.389 (ARRA)

Management Views: Part a.: MDE disagrees. Funds awarded to the subrecipient were in compliance with the necessary and reasonable requirements of Section 80.36 of EDGAR and OMB Circular A-87, as defined in Part 225, Appendix A, Sections A.3.e.3 and C.1.a.

The Elementary and Secondary Education Act (ESEA), Title I, Part A, Section 1117(a) requires states to create a Statewide System of Support (SSoS) for Title I Schools that utilizes Title I, Section 1003(a) funding. The system created by MDE relies heavily on a partnership with the 57 intermediate school districts (ISDs) in Michigan. Through this system, the ISDs provide multiple supports and technical assistance to Title I schools.

Fiscal year 2006-07 began the first full year of the fully operationalized SSoS; prior to that implementation, it was deemed necessary to have an outside partner to coordinate activities and support between the ISDs, MDE, and the schools receiving services. This was due to a lack of capacity/human resources at MDE to fully operationalize the system.

MDE maintains that the subrecipient was at that time the only viable entity in the State that could perform such a function, as it is a professional organization of

ISDs and as such has established ties with all 57 ISDs and their superintendents. The SSoS at that time was, for all intents and purposes, a brand new initiative and no other entity in the State was in a position to assist MDE in the efficient and timely launch of the system, MDE asserts that, had any other entity received the grant, the implementation of the system would have been delayed by as much as two years due to the efforts to form a cohesive network connected to the individual ISDs. As such, MDE believes that Section 80.36 of EDGAR applies, which states "Procurement by noncompetitive proposals may be used only when the award of a contract is infeasible under small purchase procedures, sealed bids or competitive proposals and one of the following circumstances applies: (A) The item is available only from a single source (B) The public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation."

As such, MDE contends that it has met the requirements of OMB Circular A-87, Appendix A, Section C.1.a that the award was "necessary and reasonable for proper and efficient performance and administration of Federal awards."

With regard to a competitive bid process, MDE acknowledges that none of the current staff members were in their current position or working with the SSoS and associated grants during fiscal year 2006-07. As noted above, MDE contends that a competitive grant bid process would not have been an option at the time. To that end, current staff cannot verify whether or not a competitive bid process took place, regardless if it was necessary or not. MDE maintains that Section 80.42 of EDGAR (Retention and access

requirements for records) does not require documents to be retained beyond 3 years. This would of course include any competitive bid documents that may or may not have been supplied by other agencies and explains why MDE has not been able to locate or verify their existence.

Part b.: MDE partially agrees. MDE did not coordinate with the State Budget Office prior to determining that SFSF Program funds would be used for Title I fiscal effort. After the fact, MDE coordinated with the State Budget Office to identify auditable data to demonstrate that the State of Michigan met the criteria to treat SFSF for purposes of meeting Title I, Part A level of effort requirements. The State specified in the Amended Application for Funding under the SFSF Program (submitted on March 3, 2011) the amount of SFSF funds that would be used for State uses to maintain fiscal effort in fiscal years 2008-09 through 2010-11. The funds were only used to meet Title I fiscal effort. The revised (March 2010) guidance from the U.S. Department of Education (USDOE) on funds under Title I, Part A of the Elementary and Secondary Education Act of 1965 states that the Secretary of Education will permit a state and its local educational agencies (LEAs) to treat SFSF funds as state or local funds if two criteria are met. The State has met the first criteria related to section 15005(d)(1) maintenance of effort. The second criteria requirement is that the "State maintains auditable data to demonstrate the percentage of total State revenues that was available to support elementary, secondary, and public higher education combined in the most recently completed fiscal year did not decrease from the previous fiscal year." The term "total revenues

available to the State" as stated in the criterion means either (a) projected or actual total State revenues for education and other purposes for the relevant years or (b) projected or actual State appropriations for education and other for those years. The State Budget Office provided MDE with a spreadsheet which has been developed by the Office of Financial Management to demonstrate that the State's percentages of total State revenues available to support elementary, secondary, and public higher education. The spreadsheet has data for fiscal year 2007-08, fiscal year 2008-09, fiscal year 2009-10, and fiscal year 2010-11 to support the percentage of appropriations used to support elementary, secondary, and public higher education. The spreadsheet shows that the percentage of support was 44% in fiscal year 2007-08 and then went to 45% for the next three years.

Planned Corrective Action: N/A

Anticipated Completion Date: N/A

Responsible Individuals:

- a. Linda Forward
- b. Louis Burgess and Mike Radke

Finding Number: 3131207

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

Management Views: Management acknowledged that the contract with the other State agency (DTMB) did result in the identified finding. The Office of Field Services (OFS) acknowledges and intends to improve internal control. OFS continued to meet with the contracted

programmer during the audit period. OFS ensured that all related systems development, data elements, and systems continued in operation and that systems were maintained throughout this period. OFS believes this questioned cost represents no harm to the federal interest.

Planned Corrective Action: OFS will continue the existing contract with DTMB. OFS will initiate procedures to ensure compliance with the audit principle. The Migrant Program manager and the consultant will meet monthly with the contracted programmer to project required grant work and an acceptable time line. The programmer will be required to log time related to this specific grant. The manager will review the program-specific log monthly and approve the activities as fulfilling the request in our projected time line.

Anticipated Completion Date: Initiated by September 15, 2012; Continuous

Responsible Individual: Shereen Tabrizi

Finding Number: 3131208
Finding Title: Special Education Cluster (IDEA), *CFDA* 84.027, 84.173, 84.391 (ARRA), and 84.392 (ARRA)

Management Views: MDE agrees with this finding.

Planned Corrective Action: Part a.: MDE will monitor *CFDA* numbers in the future to ensure correct subawards are disclosed and notify subrecipients if incorrect information is communicated. All subrecipients understood what grants were funded by the American Recovery and Reinvestment Act of 2009 (ARRA) and were reported to the federal regulators correctly to meet their requirements.

Part b.: MDE does acknowledge better controls are necessary to ensure ISDs allocate to new or significantly expanded public school academies and will develop a system that monitors ISD's distribution by implementing internal control to those subrecipients through improved communications and the grant approval process. However, the MDE Office of Special Education (OSE) was never notified by the Charter School Office of charter schools meeting the "significantly expanding" definition. If the MDE OSE is to fulfill this requirement, MDE communications must improve.

Anticipated Completion Date: Immediate

Responsible Individual: Eleanor White

Finding Number: 3131209

Finding Title: Career and Technical Education - Basic Grants to States, *CFDA* 84.048

Management Views: MDE agrees with the finding. However, because the MOE shortfall is less than 2%, MDE believes the impact to the program is minimal and the federal interest has not been harmed.

Planned Corrective Action: MDE will again request additional General Fund appropriations from the Legislature to meet the MOE requirement.

Anticipated Completion Date: September 30, 2013

Responsible Individual: Patty Cantú

Finding Number: 3131210
Finding Title: Early Intervention Services (IDEA) Cluster, CFDA 84.181 and 84.393 (ARRA)

Management Views: MDE agrees with the finding.

Planned Corrective Action: As indicated in the prior audit finding 3131010 with a completion date of July 1, 2012, MDE will compare expenditures reported in the Financial Information Database (FID) from one year to the next to ensure that effort is maintained. MDE will also compare the budgeted amount reported in MEGS+ to the most recently reported year's actual expenditures as reported in the FID to ensure that all ISDs are planning to maintain effort. MDE will verify the reported justifications for any reduction in effort by an ISD by checking child counts from year to year in the Michigan Compliance Information System [MICIS] (Michigan Student Data System [MSDS]) or reporting of major expenditures in the FID.

Anticipated Completion Date: July 1, 2012

Responsible Individual: Jayne Klein

Finding Number: 3131211
Finding Title: Safe and Drug Free Schools and Communities - State Grants, CFDA 84.186

Management Views: MDE agrees with the finding.

Planned Corrective Action: Part a.: This grant has ended, but if MDE receives this type of funding (federal formula) in the future MDE will follow policy and ensure that funds are allocated to

new or significantly expanded charter schools. As outlined in the last audit response, the office has procedures in place to ensure that new and significantly expanded charter schools are included in the formula calculations. The Office of School Support Services will follow the same procedures that have been established by OFS.

Part b.: When the responsibility for an existing, ongoing grant is transferred to MDE, the Grants Coordination and School Support Unit will do a review of all grant awards to ensure that MDE policies are followed for the duration of the grant. It is standard procedure for MDE to provide subrecipients with a grant award notification that includes the *CFDA* title and number.

Anticipated Completion Date: May 1, 2012

Responsible Individual: Kyle Guerrant

Finding Number: 3131212
Finding Title: Twenty-First Century Community Learning Centers, *CFDA* 84.287

Management Views: Part a.: MDE agrees. To understand why the majority, but not all, of applications did follow written procedures for review, the program supervisor and departmental technician scrutinized the applications. They found that the difference was that during the application review process, additional office staff were utilized beyond the Twenty-First Century Community Learning Centers (21st CCLC) program staff, and these staff were not made aware of the procedural checks in the review and approval of priority assessment forms for the applications. Therefore, the

additional staff verified the final application scoring sheet, but did not also verify and sign off on the priority assessment forms.

Part b.: MDE agrees with the finding that fiscal site visits of subrecipients were not performed.

Planned Corrective Action:

Part a.: The 21st CCLC program staff will brief any additional office staff that assist in the application process on the procedural checks for review and approval of priority assessment forms as part of the application process. In addition, a revision to the procedure will happen so that not only MDE consultants, but other appropriate representatives of MDE, may also legitimately review and approve the priority assessment forms as part of the application process.

Part b.: An Auditor 12 position was hired in July 2011 with the primary focus to be on performing fiscal site visits of subrecipients. After several months of training, fiscal site visits of subrecipients began in December 1, 2011, and a schedule of audits has been created to ensure that each subrecipient has two fiscal site visits within the period of its five year grant cycle.

Anticipated Completion Date:

a. The revision of the procedure will be completed by June 1, 2012.

b. Completed

Responsible Individual:

Lindy Buch

Finding Number:

3131213

Finding Title:

English Language Acquisition Grants, *CFDA* 84.365

Management Views:

Part a.(1): MDE disagrees because the recipient properly requested allowable costs to the appropriate Title 1 Grant Program; however, an accounting error posted it to the English Language Acquisition Grants Program by mistake. However, there was no harm to the federal government program and the accounting error would have been corrected through the reconciling process which had not taken place yet because the grant is still open under waiver until September 30, 2012. The Secretary of Education ruled that adjustments to accounting records to produce a completely reconciled set of books does not have to occur within the Tydings period but could occur far after the close of the period. The secretary finds the legally relevant question to be when the obligation arose that gave rise to the entry, not in what account that entry was initially recorded. This view was communicated with the auditors but was not accepted but remains MDE's position.

Parts a.(2) and b: MDE agrees that OFS did not identify all districts that exceeded the 2% administrative limit, either in approval or in final expenditures. OFS is strengthening its internal control and intends to notify districts that the funds must be carried over and used for allowable costs in the current year. Letters notifying districts of this determination were prepared based on the findings in this audit.

Part c.: OFS did contact the consultant for the USDOE for this question. The consultant reiterated for the MDE guidance that specifically outlines the responsibilities of the charter school as well as the State in relation to allocations of Title III funds (§76.788 - §76.793). The State will change its procedures to meet the requirements as identified in this guidance.

Planned Corrective Action: Part a.(1).: None.

Parts a.(2) and b.: OFS made substantial effort to ensure that this 2% requirement was adhered to. To date, OFS has and will continue to 1) post specific directions for this requirement on the Web site, 2) discuss the item in all meetings related to Title III, and 3) strengthen internal review protocols to ensure consultant attention to this requirement. In addition, OFS will contract a professional with experience in Title III to conduct a mid-year audit of these fields in our Michigan Electronic Grants System Plus (MEGS+) and require mid-term amendments if the requirement is not in place. The current auditors reviewing deviations in the final expenditure report will include review of the maximum 2% administrative limit as part of this existing review.

Part c.: OFS will contact the public school academies with authorization to begin operation in the 2012-13 school year. OFS will follow the required procedure to set aside funds to provide preliminary allocations to these public school academies. LEAs will be notified of their requirement to provide eligibility data and the date it is due. Based on this data, allocations will be adjusted and calculated according to the guidance. Questions during the process will be clarified with the USDOE consultant. OFS will work with the MDE Public School Academies Office to identify a clear procedure to meet the time line required to ensure implementation of this procedure within the allocation processes used for the consolidated application. OFS will ensure through this process that all requirements of this Legislation related to allocations are included in the process and fully implemented.

Anticipated Completion Date: Part a.(1): N/A

Parts a.(2) and b: November 30, 2012

Part c.: Implemented effective with this school year,
2012-13.

Responsible Individuals: Craig Thurman, Margaret Madigan, and
Shereen Tabrizi

Finding Number: 3131214

Finding Title: School Improvement Grants Cluster, *CFDA* 84.377
and 84.388 (ARRA)

Management Views: MDE agrees with part a. and partially agrees with part
b.

Planned Corrective Action:

- a. All grant applications and requests for proposals from this point forward will include language regarding compliance with suspension and debarment requirements as described in federal regulation 34 *CFR* 74.13.
- b. MDE has a program monitoring presence in every building receiving an ARRA School Improvement Grant (SIG). These monitors are in buildings monthly, and in some cases, weekly. The on-site fiscal monitoring process for ARRA SIG recipients has only recently begun, with the first visit occurring in March 2012. The monitoring report is now available. MDE will continue the process of scheduling on-site fiscal monitoring visits of SIG recipients throughout the 2011-12 school year in

accordance with federal regulation 34 *CFR* 74.51 and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section 400(d)(3).

Anticipated Completion Date: a. May 2012
b. March 2012

Responsible Individual: Linda Forward

Finding Number: 3131215

Finding Title: College Access Challenge Grant Program,
CFDA 84.378

Management Views: Part a.(1) - Matching: MDE agrees that the match amount for fiscal year 2010-11 (October 1, 2010 to September 30, 2011) was not achieved. MDE has worked with its grant partners and identified matching funds that will ensure that MDE has secured a 1/3 non-federal share of the costs of the activities and services that have been performed under the College Access Challenge Grant Program. Match amounts required for each subrecipient were detailed in the grant application. Total non-federal match required for the life of the grant (August 14, 2010 to August 13, 2012) is \$2,134,274. To date, match received and committed totals \$3,569,757.

Part a.(2) - Level of Effort: The State of Michigan did not meet federal requirements regarding level of effort, and MDE correctly reported this. Because of legislative actions, State funding for all main postsecondary student aid programs was replaced with federal Temporary Assistance to Needy Families (TANF) funding beginning in fiscal year 2007-08. This

action has served to reduce the State's level of effort to the extent that meeting the grant's current requirement for State effort is not possible. MDE took all available measures to appeal for a waiver of this requirement, but ultimately USDOE denied the waiver in a letter dated February 27, 2012.

Part a.(3) - Earmarking: MDE partially agrees. Although administrative costs were not initially tracked or monitored, MDE took corrective action and implemented new tracking practices to separate administrative and outreach expenditures resulting in an adjustment to administrative expenditures of \$377,889. One staff member (supervisor) is solely responsible for grant administration, and three staff have outreach duties. These new procedures for the tracking of employee costs through separate index codes will be followed so as to ensure compliance with grant requirements regarding administrative costs.

Part b. - Reporting: MDE agrees. Although documentation was collected for the information provided on the annual performance report, some of it was not adequate and/or was held by a subrecipient and not routinely reported to MDE. One subrecipient reported match received in the reporting period by a summary memorandum, and it should have been required to submit the information regularly through the invoicing process.

Planned Corrective Action:

Part a.(1) - Matching: MDE will require subrecipients to provide needed documentation for all sources and amounts of match and implement procedures to regularly collect match documentation from each sub-recipient. This will be done through the cash request (invoicing) process in which subrecipient

matching funds are reported. Subrecipients will be required to obtain match amounts by the end of the grant period, August 13, 2012.

Part a.(2) - Level of Effort: College Access Challenge Grants funding will cease as of August 13, 2012. MDE will apply for fiscal year 2012-13 funding if the program's level of effort requirements change.

Part a.(3) - Earmarking: MDE now has procedures in place to separately track and monitor administrative expenditures for the grant through the use of separate index codes.

Part b. - Reporting: See a.(1).

Anticipated Completion Date: June 15, 2012

Responsible Individual: Tom Freeland

Finding Number: 3131216

Finding Title: Education Jobs Fund, *CFDA* 84.410

Management Views: MDE disagrees with the finding. As noted, the State Budget Office DTMB prepared the maintenance of effort (MOE) calculations. There was an increase in fiscal year 2010-11 revenues, which was not known prior to September 30, 2011. The only option for the State to get these funds to the school districts was to earmark a portion of the ending fund balance for specific purposes, which is what the Legislature did in Act 62, P.A. 2011. This increase of funds (\$442,000,000) was included in the MOE calculations for the State to meet the Education Jobs Fund level of effort requirement. DTMB determined that the

appropriation in Act 62, P.A. 2011 was appropriate and in accordance with the federal guidance.

Planned Corrective Action: MDE and DTBM are reviewing the MOE methodology and calculations with the USDOE.

Anticipated Completion Date: July 31, 2012

Responsible Individuals: Louis Burgess, MDE;
Robbie Jameson, DTMB

Finding Number: 3131217

Finding Title: Subrecipient Monitoring

Management Views: MDE agrees and will comply.

Planned Corrective Action: Part a.: MDE has developed a standard template for program offices to report management decisions to the Office of Audits. The Office of Audits will, in turn, issue management decisions to the subrecipients.

Part b.: MDE will review all corrective action plans for completeness when the audits are received in order to expedite the review process.

Anticipated Completion Date: Immediate

Responsible Individual: Janet Laverty

GLOSSARY

Glossary of Acronyms and Terms

21st CCLC	Twenty-First Century Community Learning Centers.
adverse opinion	An auditor's opinion in which the auditor states that the audited entity did not comply, in all material respects, with the cited compliance requirements that are applicable to each major federal program.
American Recovery and Reinvestment Act of 2009 (ARRA)	An economic stimulus package enacted by the 111 th United States Congress in February 2009.
CACFP	Child and Adult Care Food Program.
CACG	College Access Challenge Grant.
<i>Catalog of Federal Domestic Assistance (CFDA)</i>	The catalog that provides a full listing, with detailed program descriptions, of all federal programs available to state and local governments.
CCR	Central Contractor Registration.
cluster	A grouping of closely related federal programs that have similar compliance requirements. Although the programs within a cluster are administered as separate programs, a cluster of programs is treated as a single program for the purpose of meeting the audit requirements of OMB Circular A-133.
CMS	Cash Management System.
CNAP	Child Nutrition Application Program.

<i>Code of Federal Regulations (CFR)</i>	The codification of the general and permanent rules published by the departments and agencies of the federal government.
CPI	consumer price index.
CTE	Career and Technical Education.
DCH	Department of Community Health.
deficiency in internal control over federal program compliance	The design or operation of a control over compliance that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis.
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 and correct, misstatements on a timely basis.
DTMB	Department Technology, Management, and Budget.
ELA	English Language Acquisition.
EPLS	Excluded Parties List System.
FER	final expenditure report.
FID	Financial Information Database.
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.

GCSS	Grants Coordination and School Support.
generally accepted accounting principles (GAAP)	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
Governmental Accounting Standards Board (GASB)	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities.
ICE	internal control evaluation.
IDEA	Individuals with Disabilities Education Act.
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.
ISD	intermediate school district.
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 deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial schedules and/or financial statements will not be prevented, or detected and corrected, on a timely basis.
MDE	Michigan Department of Education.
MDIT	Michigan Department of Information Technology.
MEGS	Michigan Electronic Grants System.
MEIS	Michigan Education Information System.
Michigan Administrative Information Network (MAIN)	The State's automated administrative management system that supports accounting, purchasing, and other financial management activities.

MOE	maintenance of effort.
MPSAP	MDE's Public School Academy Program.
NSLP	National School Lunch Program.
OEII	Office of Educational Improvement and Innovation.
OFM	Office of Financial Management.
OFS	Office of Field Services.
OSE-EIS	Office of Special Education and Early Intervention Services.
other noncompliance	Violations of contracts or grant agreements that are not material to the financial schedules or financial statements but should be communicated to management in accordance with <i>Government Auditing Standards</i> . Other noncompliance also includes violations of laws, regulations, contracts, or grant agreements; fraud; abuse; or other internal control deficiencies that may be communicated to management in accordance with <i>Government Auditing Standards</i> .
OVAE	Office of Vocational and Adult Education.
Proposal A	Michigan residents approved Proposal A in March 1994. Proposal A provisions dedicated new revenue sources to the School Aid Fund including the two percentage point increase in the sales and use tax rate and the 6-mill State Education Tax (SET). The increase in the sales and use tax rate became effective May 1, 1994. The 6-mill SET was first levied in July 1994. Proposal A also created a minimum per pupil foundation allowance, which is paid from the School Aid Fund to local schools districts from the dedicated revenues of the School Aid Fund.

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.
SDFSC	Safe and Drug-Free Schools and Communities - State Grants.
SEFA	schedule of expenditures of federal awards.
SFA	School Food Authority.
SFSF	State Fiscal Stabilization Fund.
SFSPC	Summer Food Service Program for Children.
SIG	School Improvement Grants.
significant deficiency in internal control over federal program compliance	A deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.
significant deficiency in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 <i>Government Auditing Standards</i> 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.
<i>SOMCAFR</i>	<i>State of Michigan Comprehensive Annual Financial Report.</i>
SSoS	Statewide System of Support.
subrecipient	A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.
TEFAP	the Emergency Food Assistance Program.
unqualified opinion	An auditor's opinion in which the auditor states that: <ul style="list-style-type: none"> a. The financial schedules and/or financial statements presenting the basic financial information of the audited entity are fairly presented in conformity with the disclosed basis of accounting; or b. The financial schedules 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 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 taken by themselves; or

- c. The audited entity complied, in all material respects, with the cited compliance requirements that are applicable to each major federal program.

USC

United States Code.

U.S. Office of Management and Budget (OMB)

A cabinet-level office that assists the President in overseeing the preparation of the federal budget and in supervising its administration in executive branch agencies.

USDA

U.S. Department of Agriculture.

USDOE

U.S. Department of Education.

