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SEP 06 2002

Mr. Thomas D. Watkins, Jr.
Superintendent of Public Instruction
Michigan Department of Education
608 West Allegan Street
P.O. Box 30008
Lansing, MI 48909

Dear Mr. Watkins:

This **Final Audit Report** (Control Number ED-OIG/A05B0038) presents the results of our audit of the Michigan Department of Education's (MDE) administration of selected federal funds provided to charter schools for the period October 1, 1999, through September 30, 2000. This report incorporates the comments you provided in response to the draft audit report. The objective of our audit was to determine if charter schools in the State of Michigan expended federal funds for their intended purposes and according to applicable laws and regulations.

AUDIT RESULTS

For the period October 1, 1999, through September 30, 2000, the MDE allocated $5,611,803 in Public Charter Schools Program (PCSP) funds; $5,096,796 in Elementary and Secondary Education Act of 1965 (ESEA), as amended, Title I, Part A (Title I), funds; and $454,480 in Individuals with Disabilities Education Act - Part B (IDEA – Part B) funds to charter schools operating in the State of Michigan. The 10 charter schools selected for audit used and accounted for federal funds awarded by MDE in accordance with applicable federal laws and regulations. The 10 charter schools we audited maintained adequate documentation to support expenditures charged to the three federal programs. We selected these 10 charter schools as the best representation of Michigan charter schools as a whole. However, the results of our audit cannot be projected beyond the schools audited.

All 10 schools that we audited operated on a July 1, 1999, through June 30, 2000, fiscal year and reported expenditures of federal funds for the same period. Representatives from each charter school and/or the educational service provider (ESP), hired by the charter school's board, provided us with a list of expenditures charged to the three federal programs for that period. Our audit work demonstrated that the charter schools that hired an ESP generally relied on that entity to administer federal funds provided to the school. The ESP would receive guidance and direction from a publicly appointed school board who was ultimately responsible for the federal funds that the school received.

We judgmentally selected a sample of expenditures charged to each program and traced them to supporting documentation such as vouchers, purchase orders, invoices, and canceled checks. We performed these tests to ensure that the service or item was provided to the school and related to the purpose of the program. We verified that the totals from the source documents agreed with the accounting records. We also gained a limited understanding of each school's system of internal controls over the administration of federal funds. We concluded that all 10 schools had sufficient controls in place to provide reasonable, but not absolute, assurance that federal funds were being expended according to appropriate federal laws and regulations.

Finally, we interviewed MDE personnel who provided us with information about their role in awarding, monitoring, and accounting for federal funds granted to charter schools. We concluded that MDE had controls in place to provide reasonable assurance that, during our audit period, federal funds were adequately supported and properly expended.

OTHER MATTERS

One charter school (of the 10 we audited) was unable to readily identify expenditures charged to the PCSP and Title I programs during the fiscal year ended June 30, 2000. Office of Management and Budget (OMB) Circular A-87, Attachment A (C) (1), describes general criteria for costs to be allowable under federal awards (in this case, the PCSP and Title I programs). According to this criterion, costs must be allocable to federal awards and adequately documented.

The charter school had not implemented an accounting system that identified and tracked costs charged to federal programs as required by OMB Circular A-87. The charter school eventually provided supporting documentation for expenses associated with these two federal programs. After we brought this matter to their attention, officials from the school's ESP agreed to work with an accounting firm to implement an accounting system that tracks costs by federal program. We provided MDE officials with information regarding this school.

We concluded that this charter school was not indicative of charter schools in the State of Michigan. We recommend that MDE provide guidance and assistance to charter schools to ensure they implement accounting systems that track expenditures by federal program.

In its August 8, 2002, response to our draft audit report, MDE stated it asked that the one charter school work closely with its accounting firm to ensure compliance with federal and state regulations. Included in MDE's response was a letter from the accounting firm describing improvements in the school's accounting system to better track federal expenditures. MDE also provided assurance that it will continue to work with its charter schools that receive federal funds to ensure their compliance with federal laws and regulations governing accounting for and tracking federal funds. We have included MDE's response as an Attachment to this final report.

MDE's actions indicate that it is monitoring the situation at the one charter school adequately. Its assurance to work with its charter schools to ensure compliance with federal laws and regulations satisfactorily addresses our recommendation above.

BACKGROUND

The PCSP was authorized in October 1994, under Title X, Part C of the ESEA, as amended (20 U.S.C. Sections 8061-8067). In October 1998, the Charter School Expansion Act of 1998 amended the program. The PCSP, which provides support for the planning, program design, and initial implementation of charter schools, is intended to enhance parent and student choices among public schools and give more students the opportunity to learn to challenging standards. Grants are awarded for a period of not more than three years, including not more than 18 months for planning and program design, and not more than two years for the initial implementation of a charter school. Allowable activities for the planning and implementation periods are defined in the law.

Title I, Part A, of the ESEA, as amended, (20 U.S.C, Chapter 70, Sections 6301 – 6514), provides funds for supplemental educational services for eligible public and private school children living in high-poverty areas. The Title I, Part A program provides formula grants through state educational agencies to local educational agencies (LEA) to assist low-achieving children meet challenging state curriculum and student performance standards in core academic subjects.

IDEA – Part B, also known as the Grants to States Program, Section 611 (20 U.S.C. 1411-1419), provides funding for disabled children from the ages of 3 through 21. These funds help to ensure that all children with disabilities have available to them a free appropriate public education that emphasizes special education and related services designed to meet their unique needs and prepare them for employment and independent living.

There were a total of 192 charter schools approved to operate in the State of Michigan for the period October 1, 1999, through September 30, 2000. Only 146 schools received federal PCSP, Title I, or IDEA – Part B program funding. According to MDE's records, the 146 schools, in total, were allocated $5,611,803 in PCSP funds, $5,096,796 in Title I funds, and $454,480 in IDEA – Part B funds.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to determine if charter schools in the State of Michigan expended selected federal funds for their intended purposes and according to applicable laws and program regulations. Specifically, we identified the amounts of federal PCSP, Title I, and IDEA – Part B funding that charter schools received and determined whether a sample of charter schools had implemented procedures to ensure adherence to applicable federal laws and program regulations or obtained waivers from such requirements. Our original audit period was October 1, 1999, through September 30, 2000. We expanded our audit period to the fiscal year October 1, 2000, through September 30, 2001, as necessary. We did not assess the academic performance of the charter schools audited.

We audited 10 charter schools in the State of Michigan. We randomly selected seven schools and judgmentally selected three. Initially, we randomly selected the schools based on the authorizing agency that issued the school its charter. We later selected schools based on whether the school used an ESP to perform administrative and financial duties for the school.

To accomplish our objective, we reviewed

- federal laws, including the ESEA, as amended, for the PCSP grant fund and Title I – Part A grant funds;
- the law covering special education funds, as specified under the Individuals with Disabilities Education Act;
- policies and procedures for the accounting of federal funds for these programs at the individual schools;
- accounting and payroll records, purchase orders, and cancelled checks for judgmentally selected transactions;
- State of Michigan charter school budget plans;
- individual school's financial audit reports;
- audit working papers at independent accounting firms; and
- MDE federal fund performance and expenditures reports.

We also interviewed representatives from each school, its ESP, and, if applicable, its independent public accounting firm; officials of a major authorizing agency; and MDE officials.

We relied on computer-processed accounting data provided to us by each charter school or its ESP. We tested the data by comparing it to MDE's records and tracing selected expenditures to source documents. The purpose of our tests was to determine the data's suitability for use in meeting the audit objective. We concluded that the data, when used for its intended purposes, was sufficiently reliable to be used in meeting our audit objective.

We performed on-site field work at MDE's administrative offices in Lansing, Michigan, and at 10 charter schools. We started the school audits on December 4, 2001, and completed the last on-site charter school audit on March 25, 2002. We held a field exit discussion with MDE officials on May 13, 2002. Our audit was performed in accordance with government auditing standards appropriate to the scope described above.

STATEMENT ON MANAGEMENT CONTROLS

As part of this audit, we did not assess the adequacy of MDE's system of management controls applicable to its administration of federal funding as a whole, because this step was not necessary to achieve our audit objective. Instead, we gained an understanding of MDE's role in awarding, monitoring, and accounting for federal funds granted to charter schools. We also determined whether individual charter schools had controls in place to ensure that federal funds were spent according to federal laws and regulation. Because of inherent limitations, an assessment made for the limited purpose described would not necessarily disclose all material weaknesses in management's controls. However, nothing from the information that we obtained at MDE, or at the individual charter schools, demonstrated that the controls in place were not sufficient to ensure that federal funds were expended according to the applicable laws and regulations.

ADMINISTRATIVE MATTERS

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officals.

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Department of Education official, who will consider them before taking final Departmental action on the audit.

Susan B. Neuman, Ed.D.
Assistant Secretary for
Elementary and Secondary Education
U.S. Department of Education
FB6-3W315
400 Maryland Avenue, SW
Washington, DC 20202

Office of Management and Budget Circular A-50 directs Federal agencies to expedite resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of any additional comments within 30 days would be greatly appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

If you have any questions, please call me at 312-886-6503.

Sincerely,

Richard J. Dowd
Regional Inspector General
for Audit, Region V

JOHN ENGLER
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF EDUCATION
LANSING

MICHIGAN Department of Education
THOMAS D. WATKINS, JR.
SUPERINTENDENT OF
PUBLIC INSTRUCTION

August 8, 2002

Mr. Richard J. Dowd
Regional Inspector General
for Audit Region V
U.S. Department of Education
Office of Inspector General
111 N. Canal Street, Suite 940
Chicago, Illinois

Dear Mr. Dowd:

In response to the Draft Audit Report (Control Number ED-OIG/A05B0038) dated July 31, 2002, we are pleased that your audit findings for the expenditure of federal funds under ESEA Title I program, Public Charter School Grant program and Special Education programs for the period October 1, 1999 through September 30, 2000 indicate funds were expended in accordance with federal law and regulation.

As you note in the Draft Report under the section "Other Matters," one of the ten audited charter school programs was unable to readily identify expenditures charged to the Charter School Grant program and Title I programs during the fiscal year ended June 30, 2000. In response to those findings, we have asked that this charter school work closely with their accounting firm to insure increased accounting and tracking controls that comply with federal and state regulations. The charter school's key administrative staff is aware of the need for these accounting procedure enhancements and is currently working with the accounting firm to assure current and future compliance. Enclosed for your review is a letter from the accounting firm engaged by the charter school confirming their recommendations to the school to improve tracking and accounting procedures.

We trust that you will find these assurances a satisfactory response to your audit report. We will continue to work with the charter school programs that are recipients of ESEA Title I, Public Charter School Grant program and Special Education program funds to assure continued current and future compliance with federal laws and regulations regarding accounting and tracking of funds expended.

Sincerely,

Tom Watkins

Thomas D. Watkins, Jr.

Enclosure

cc: Elaine Madigan
Kathleen Weller
Jacquelyn Thompson
Dorothy Van Looy

KATHLEEN N. STRAUS - PRESIDENT • SHARON L. GIRE - VICE PRESIDENT
MICHAEL DAVID WARREN, JR. - SECRETARY • EILEEN LAPPIN WEISER - TREASURER
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August 6, 2002

Mr. Greg Olszta
Michigan Dept of Education
Office of Education Options
John A Hannah Building
608 West Allegan Street
PO Box 30008
Lansing MI 48909

Dear Mr. Olszta:

I am writing to document for you the status of the accounting procedure enhancements relating to federal grant programs of the [redacted]

As you are aware, Plante & Moran, LLP has been engaged by the Academy to provide annual accounting assistance, including preparation of the general ledger and financial statements for the Academy.

Historically, the chart of accounts utilized for the Academy contained the functional expense detail required by the Michigan School Accounting Manual (1022 Manual). The general ledger did not utilize sub accounts to segregate expenditures relating to federal grant programs from other academy expenditures.

For the 2001/2002 school year, [redacted] of the Academy have utilized expenditure tracking systems outside of the general ledger for the federal grants. When they expend federal dollars, they notify us of the applicable grant program so that we may properly segregate the funds within the general ledger and financial reporting systems.

We are still in the process of finalizing May and June accounting matters with the Academy and expect to complete the general ledger, financial statements and summary of federal expenditures shortly.

For the 2002/2003 school year, we intend to expand the Academy's chart of accounts to segregate all federal expenditures at the time they are initially posted to the general ledger.

[redacted], at the Academy, retain responsibility for monitoring of grant expenditures and notifying us when applicable federal funds are spent.

The initial ltr. Draft # 17627

Mr. Greg Olszta
Michigan Dept of Education

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August 6, 2002

We discussed these procedures with Mr. Ken Oba and Mr. Frank Boenzi of the U.S. Department of Education Office of Inspector General. Mr. Oba and Mr. Boenzi indicated their approval of the accounting changes to be made.

We are confident the new procedures will provide a more straightforward and accurate accounting of expenditures by applicable federal grant.

Please do not hesitate to contact me if you require additional information or have any questions.

Very truly yours,

Teresa L. Pollock, CPA
Plante & Moran, LLP

Cc: [redacted]

plante moran