

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**FINANCIAL AND COMPLIANCE
AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2000**

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

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**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

INTRODUCTION

Reporting Entity And Scope

The reporting entity and scope of this audit and audit report is the revenues, expenditures, and fixed assets reported by the New Hampshire Department of Education (Department) for the year ended June 30, 2000. The Department's responsibilities include providing services that promote equal educational opportunities to enable New Hampshire residents to become fully productive members of society.

Organization

The Department of Education was established pursuant to RSA 21-N and functions under the executive direction of a Commissioner. The Commissioner is appointed by the Board of Education and serves a four year term. The Commissioner nominates each of the Department's Division Directors and the Deputy Commissioner for confirmation by the Board. The Directors and Deputy Commissioner also serve four year terms.

The State Board of Education is comprised of seven members, each of whom is appointed by the Governor and Council for a term of five years. The Board members serve without pay and may not be technical educators or professionally engaged in school work. The members are, however, paid for actual expenses incurred in the performance of their Board duties.

The Department of Education is comprised of five major units: Commissioner's Office, Deputy Commissioner's Office, Division of Educational Improvement, Division of Program Support, and Division of Adult Learning and Rehabilitation. Each of these units is vested with the duties outlined below. The Department employs 330 full and part-time employees.

Responsibilities

The Department of Education is responsible for providing general supervision to the elementary and secondary schools, providing a variety of educational services to schools and particular groups, and providing vocational rehabilitation services to persons with disabilities. The Commissioner, representing the public interest, is responsible to the Governor, the General Court and the public for administration of the Department.

The State Board of Education is responsible for the regular review of all programs and activities of the Department and makes recommendations to the Commissioner of Education with regard to such programs and activities. Similarly, the Board advises the Commissioner on program goals, information gathering and any other aspect of elementary and secondary education within the State of New Hampshire. It also hears appeals and issues decisions in disputes between individuals and school systems or the Department. The Board is also responsible for the appointment of members of the professional standards board and other advisory bodies and the adoption of rules as provided in RSA 21-N:9.

Responsibilities (Continued)

The five units within the Department provide the functions summarized below:

Commissioner's Office – There are two sections within the Commissioner's Office. The first section, Policy and Budget, is responsible for coordinating the development of Department-wide initiatives, such as the statewide assessment program; researching educational trends; and analyzing grant application opportunities. The other section, Governance and Standards, is responsible for coordinating with school districts and private organizations in the development of state and local regulations; coordinating the Department's position on legislation to members of the New Hampshire House and Senate; and organizing impartial due process hearings.

Deputy Commissioner's Office – There are three units within the Deputy Commissioner's Office. The Business Management Office is responsible for managing the Department's budget, maximizing resource utilization, and coordinating with all other support groups on financial issues. The Technology Management Office is responsible for overseeing all computer systems in the Department and integrating data collection across all divisions. The Operations Unit is responsible for the Department's human resource operations. The majority of the Commissioner and Deputy Commissioner Offices' expenditures are state aid expenditures, such as Building and Catastrophic Aid.

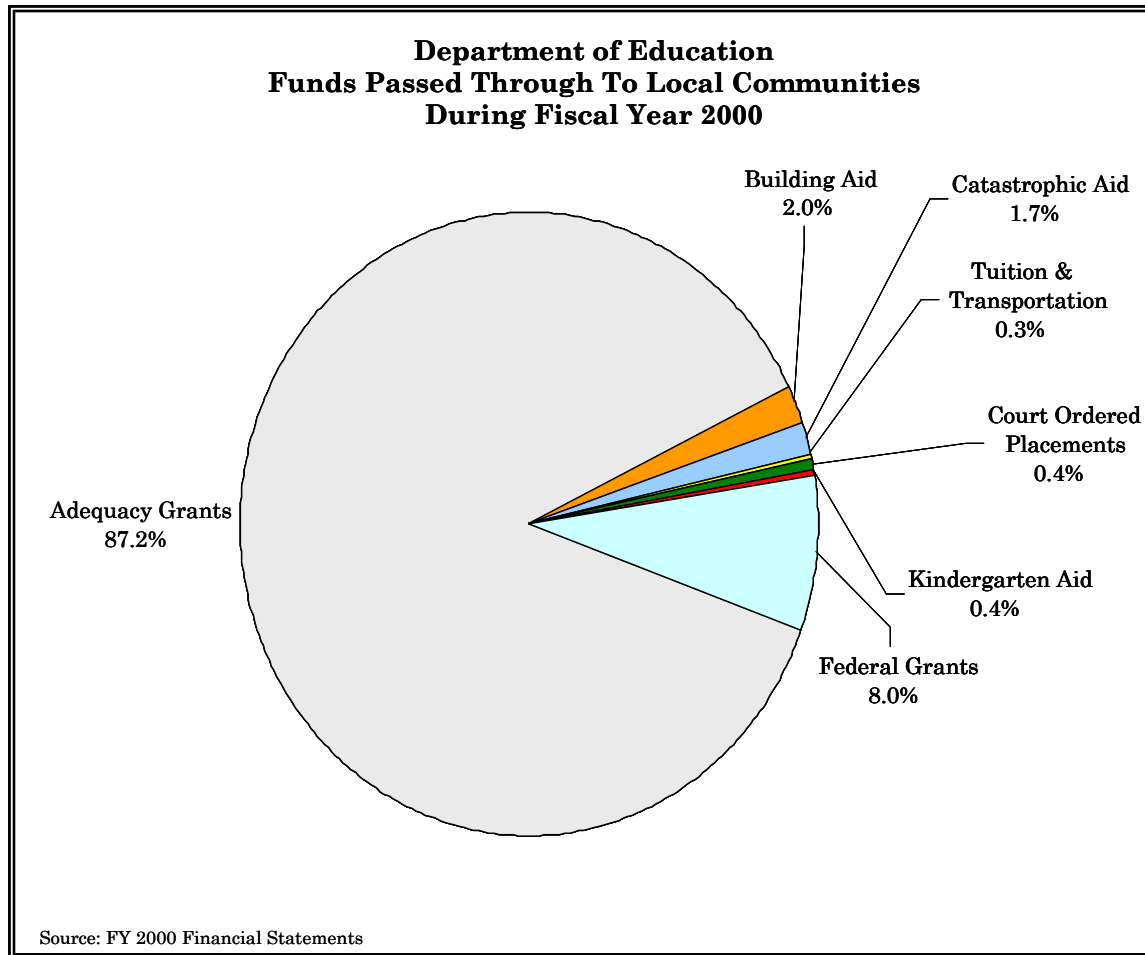
Division of Educational Improvement – There are three bureaus within the Division of Educational Improvement. The Bureau of Integrated Programs provides technical assistance to schools in the integration of various federally funded programs. The Bureau of Professional Development develops and implements policies and standards for improving the professional growth of educational personnel. The Bureau of Special Education develops and provides services to improve special education programs statewide.

Division of Program Support – There are three bureaus within the Division of Program Support. The Bureau of Information Services and Educational Technology collects and processes all school district data for the Department and the State, as well as providing assistance to school districts as they integrate technology into the classroom. The Bureau of Credentialing is responsible for managing and improving the process for certification of educational personnel. The Bureau of Nutrition Programs and Services is responsible for the improvement of nutritional services in schools.

Division of Adult Learning and Rehabilitation – There are six bureaus within the Division. The Bureau of Adult Education provides funding for programs to improve the basic educational skills of adults, eventually leading to a high school degree. The Bureau of Career Development supports career development curriculum in schools as well as the development of education/business partnerships. The Bureau of Customer Service and Technology provides support to the Division regarding technological needs. The Bureau of Policy and Planning conducts planning, policy development, and marketing for the Division. The Bureau of Vocational Rehabilitation Service Delivery provides assistance to eligible New Hampshire residents with disabilities to gain and retain employment. The Bureau of Disability Determination Services provides eligibility determination services for persons applying for social security benefits.

Responsibilities (Continued)

The various divisions are also responsible for the disbursement of millions of dollars of state and federal funds to school districts and non-profit agencies. During fiscal year 2000, the Department expended approximately \$91 million in federal funds, of which 79% (\$72 million) was passed through to school districts. In addition, the Department allocated \$872 million in state funds to school districts, \$825 million of which represents education adequacy grants. Of the Department's \$1 billion operating budget, approximately 92% was passed through to school districts in fiscal year 2000 as shown in the graph below.



The Department's main office is located in Londergan Hall on the grounds of the State Office Park South, 101 Pleasant Street, Concord, NH. The Bureau of Vocational Rehabilitation is located at 78 Regional Drive, Concord, NH with seven regional field offices located around the state.

Funding

The Department of Education is funded primarily by appropriations from the General, Special, Capital Projects, and Education Trust Funds. Fiscal year 2000 appropriations combined with supplemental warrants, balances forward, and transfers resulted in fiscal year 2000 spending authority for the General, Special, Capital Projects, and Education Trust Funds of \$55,237,060, \$131,228,538, \$8,244,526, and \$825,911,797 respectively. Estimated restricted revenue combined with supplemental warrants, balances forward, and transfers resulted in anticipated fiscal year 2000 revenues for the Special and Education Trust Funds of \$125,220,945, and \$417,974,904 respectively. There were no anticipated revenue sources for the General and Capital Projects Funds. The actual financial activity of the Department, as reported in the General, Special, Capital Projects, and Education Trust Funds for the fiscal year ended June 30, 2000, is summarized in the following table.

**Summary Of Revenues And Expenditures
For The Year Ended June 30, 2000**

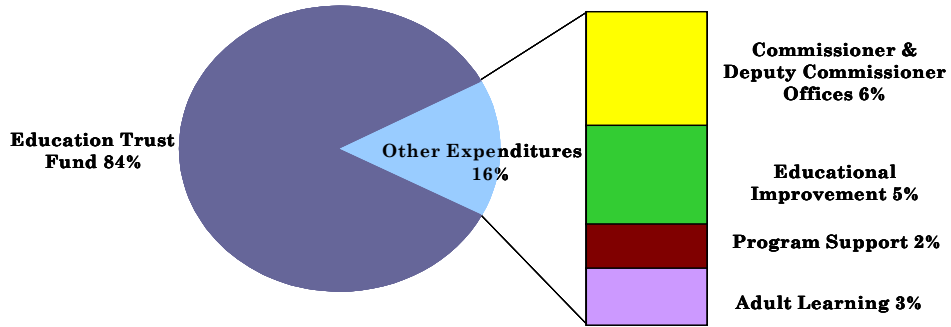
	<u>General Fund</u>	<u>Special Fund</u>	<u>Capital Fund</u>	<u>Education Fund</u>
Unrestricted Revenues	\$ 47,288	\$ -0-	\$ -0-	\$ -0-
Restricted Revenues	<u>66,619</u>	<u>95,458,968</u>	<u>-0-</u>	<u>417,974,904</u>
Total Revenues	<u>\$ 113,907</u>	<u>\$ 95,458,968</u>	<u>\$ -0-</u>	<u>\$ 417,974,904</u>
Expenditures	<u>\$ 51,583,972</u>	<u>\$ 98,566,022</u>	<u>\$ 4,303,411</u>	<u>\$ 824,820,847</u>
Excess (Deficiency) of Revenues Over(Under) Expenditures	<u>\$ (51,470,065)</u>	<u>\$ (3,107,054)</u>	<u>\$ (4,303,411)</u>	<u>\$ (406,845,943)</u>

Prior Audits

The most recent prior financial and compliance audit of the Department was for the fiscal year ended June 30, 1992. Appendix A on page 79 of this report, contains a summary of the current status of the observations contained in that prior report. We have also provided a status of the audit findings from the July 1999 performance audit of the Catastrophic Aid Program in Appendix B on page 81.

Copies of prior audit reports can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House Room 102, Concord, New Hampshire 03301-4906.

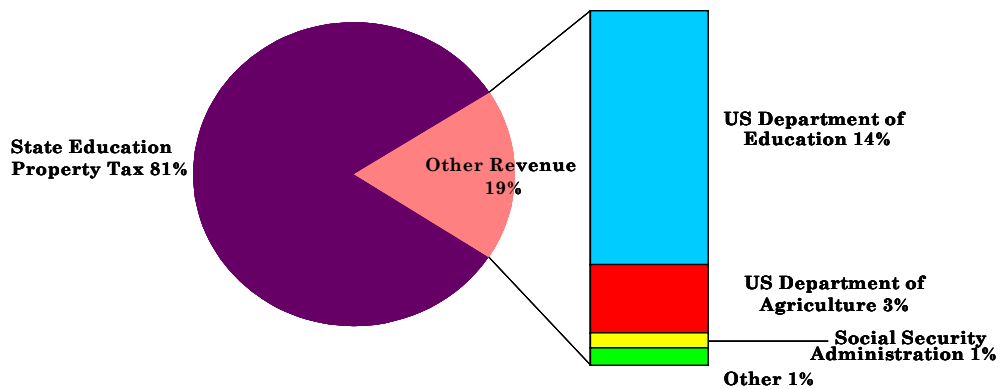
Department Of Education Fiscal Year 2000 Expenditures By Division



<u>Expenditures</u>	
Education Trust Fund	\$824,820,847
Commissioner & Deputy Commissioner Offices	56,093,456
Division of Educational Improvement	49,871,952
Division of Program Support	21,609,955
Division of Adult Learning and Rehabilitation	26,878,042
Total	<u>\$979,274,252</u>

SOURCE: FY 2000 Financial Statements

Fiscal Year 2000 Revenues By Source



<u>Revenues</u>	
State Education Property Tax	\$417,974,904
US Department of Education	69,285,971
US Department of Agriculture	17,772,502
Social Security Administration	3,840,286
Other	4,674,116
Total	<u>\$513,547,779</u>

SOURCE: FY 2000 Financial Statements

Audit Objectives And Scope

The primary objective of our audit is to express an opinion on the fairness of the presentation of the financial statements. As part of obtaining reasonable assurance about whether the financial statements are free from material misstatement, we considered the effectiveness of the internal controls in place at the Department of Education and tested the Department's compliance with certain provisions of applicable state and federal laws, rules, and contracts. Major accounts or areas subject to our examination included, but were not limited to, the following:

- Internal controls,
- Revenues and appropriations,
- Expenditures and encumbrances,
- Equipment, and
- State and federal compliance.

Our reports on state and federal compliance, internal control over financial reporting, management issues, the related observations and recommendations, our independent auditor's report, and the financial statements of the Department of Education are contained in the report that follows.

Auditor's Report On Compliance And On Internal Control Over Financial Reporting

To The Fiscal Committee Of The General Court:

We have audited the accompanying financial statements of the New Hampshire Department of Education as of and for the year ended June 30, 2000, and have issued our report thereon dated December 7, 2001, which was qualified with respect to the lack of presentation of the financial position of the Department in the General, Special, Capital Projects, and Education Trust Funds and a limitation on the scope of our audit caused by the lack of documentation to support the amounts reported for fixed assets. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Department of Education's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of 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 that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance which are described in observations No. 15 through No. 30 of this report.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department of Education's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted several matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department of Education's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in observations No. 1 through No. 14 of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider observations No. 1 and No. 2 to be material weaknesses.

This auditor's report on compliance and on internal control over financial reporting is intended solely for the information and use of the management of the Department of Education and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

December 7, 2001

Internal Control Comments
Material Weaknesses

Observation No. 1 – The Department Must Establish And Implement Formal Policies And Procedures To Strengthen Controls Over Education Adequacy Grant Calculations

Observation:

The Department needs to develop a comprehensive set of management controls to assure that the assumptions and determinations made in calculating the different components of the adequacy grant formula are consistent and reflect the public policy established by law. The Department, in calculating the different components of the adequacy grant formula for fiscal years 2000 and 2001, made assumptions or determinations that understated the average base per pupil cost of \$3,201 by \$66 per student, or by \$16 million for each of the fiscal years 2000 and 2001. While the Attorney General's Office believes the likelihood for additional State disbursements for fiscal years 2000 and 2001 is remote, there remains a concern for a lack of management controls at the Department over the calculation of the adequacy formula.

The Department did not have procedures in place to ensure that management or an individual otherwise independent of the preparation of these calculations reviewed, challenged or approved the results of this work. These calculations formed the basis for the allocation of hundreds of millions of dollars to local communities. The Department did not re-verify the correctness of the calculation even after four separate amendments were made within two and one half months of the passage of Chapter 17, Laws of 1999, the law mandating adequacy grant payments.

The State of New Hampshire, through the enactment of Chapter 17, Laws of 1999 and subsequent amendments, established a formula for the determination of state aid for educational adequacy. This formula is codified in statute in RSA 198:38-49. In order for the Department to determine the amount of state aid for any one year, it must perform multiple calculations, relying on financial and attendance information provided by school districts.

An error in the calculations or misinterpretation of statute could have a significant impact on total state aid, making it imperative that effective controls be in place over these calculations. We noted several issues with the computation of the adequacy grants for fiscal years 2000 and 2001 as detailed below. While there were no changes made to the law or differences in the data collected, the Department changed the fiscal year 2002 and 2003 calculations to reflect these issues.

1. The Department in calculating total base costs for school districts deducted certain special education costs twice resulting in an understatement of the base expenditure per pupil amount. RSA 198:40 requires that as part of the calculation for base costs certain costs including tuition payments and special education costs be deducted. According to Department personnel, certain tuition payments to private schools for special education students were deducted twice, once as special education costs and again as tuition payments.

Observation No. 1 – The Department Must Establish And Implement Formal Policies And Procedures To Strengthen Controls Over Education Adequacy Grant Calculations (Continued)

Observation (Continued):

2. In calculating the base expenditure per pupil for Nashua, the Department failed to adjust the cost figures for 9th grade students. Nashua is unique in that its 9th grade students are part of the elementary school totals and as such the cost to educate those students is included under the elementary school costs rather than under the high school costs. When the Department calculated Nashua's base expenditure per pupil it correctly excluded 9th grade students from the attendance total, however, it included the costs to educate those students, thus inflating its base expenditure per pupil. As Nashua was in the group of school districts used to determine the average base per pupil cost, this had an impact on the actual base cost used to distribute grants to every school district in fiscal years 2000 and 2001.
3. The Department used October 1997 pupil enrollment data instead of the average daily membership in attendance (ADM-A) data when calculating the base expenditure per pupil. RSA 198:40,I,(b),(3), states that the Department shall calculate the average base cost per pupil by multiplying the base expenditure per pupil by the ADM-A.

The cumulative impact of the three issues discussed above on the calculation of the average base per pupil cost is to increase the base cost from \$3,201 to \$3,267. With a statewide student count of 246,327 based on weighted average daily membership in residence as prescribed in law, the underpayment of the total adequacy grants is estimated to be \$16 million per year.

It is also critical when performing a calculation of this financial magnitude to the State that it receive an independent review prior to its release to outside parties (i.e. the legislature, other state agencies, local governments and interested parties). Management should review and challenge all the calculations prior to release. While we recognize that the first year of this process was complicated by constant changes, refinements, and revisions, the chaotic environment made it more crucial that the Department be deliberate in its calculations and document all assumptions and interpretations of statute made when performing the final calculation.

Recommendation:

The Department should establish formal policies and procedures regarding the calculation of education adequacy grants. The Department should continually review computations and assumptions made in determining the amount of education adequacy grants for agreement with the statute. All decisions and assumptions made should be documented and legal interpretations sought as deemed necessary. Additionally, all aspects of these technical and critical calculations should be challenged, reviewed, and approved by management.

Observation No. 1 – The Department Must Establish And Implement Formal Policies And Procedures To Strengthen Controls Over Education Adequacy Grant Calculations (Continued)

Recommendation (Continued):

It is also recommended that the Department seek advice from the Attorney General's Office regarding the procedures to be followed if corrections or amendments to calculations are made in the future when there has been no change in law or difference in data being used.

The Department should consider having an independent party review the calculations prior to release to outside parties.

Auditee Response:

The Department does not concur with the audit observation that errors resulted in a FY 00/01 Adequacy base cost that was too low. We believe that the Adequacy base cost of \$3,201 was both a reasonable and valid interpretation of HB 117, HB 300, HB 684, HB 265, and HB 999 enacted between April 29 and November 3, 1999, utilizing the best knowledge of district expenditures and student membership available at the time that this cost was calculated. The introduction to HB 117 states that there is no precise method to calculate the per pupil cost of an adequate education. Furthermore, Section 7 of Chapter 65 of the Laws of 1999 authorized the Department to use the best available data in making Adequacy calculations. Moreover, to the extent there were errors, these resulted in a higher base cost for FY00/01, not a lower one.

We concur with the recommendation that the Department should establish policies and procedures regarding the calculation of education adequacy grants. We agree that the Department should review and document the computations and assumptions used to make Adequacy cost and aid calculations. The Department implemented such a review and documented procedures in the summer of 2000. As a result, the Department made several improvements in the calculations used to compute the FY 02/03 Adequacy base cost and discussed them with the Attorney General's office before implementing the changes. The Department also notes the auditor's concern for an independent party review of the calculation prior to the release to outside parties. This concern will be raised with the legislature.

In addition, the Department has improved the quality of the data used to compute Adequacy costs and aid by enhancing the process used to test the validity of financial and student membership data provided by the districts. Furthermore, even better data will be available when the Adequacy base cost for FY 04/05 is computed since the new DOE-25 form, which provides detailed information on income and expenditures, will be the source of district-level financial data.

Other Tuition. It is important to recognize that the Department's deduction of "Other Tuition" in calculating the FY00-01 base cost was carried out in accordance with the wording of RSA 198:40, I (a). This statute states that "tuition to other school districts or approved educational programs" should be deducted. Tuition is reported on the MS-25 in four categories: (1) to other school districts within New Hampshire; (2) to other school districts

Observation No. 1 – The Department Must Establish And Implement Formal Policies And Procedures To Strengthen Controls Over Education Adequacy Grant Calculations (Continued)

Auditee Response (Continued):

outside of New Hampshire; (3) to Public Academies (i.e. Pinkerton and Coe Brown); and (4) “Other Tuition”. Since the two public academies are high schools, elementary tuition payments are either to “other schools districts,” or for “Other Tuition.” The statutory reference to “approved educational programs” can only mean the “Other Tuition” on the MS-25.

The fact that the Department interpreted the language of the statute differently in calculating the FY02/03 Adequacy base cost calculation does not render the calculation for FY00/01 an error. The treatment of “Other Tuition” in calculating the Adequacy base cost for FY00/01 was the result of the use of the best available data, a literal reading of the statute, and the best available knowledge at that time. It does not constitute an error.

Nashua 9th Graders. In retrospect, it now appears that the process used to determine the base cost for the Nashua School District produced a cost that was higher than the actual base cost for the elementary students of Nashua. The process used for FY00/01 divided the elementary base expenditures, as reported on Nashua’s MS-25, by Nashua’s elementary ADM-A reported on the A3. This procedure was carried out in accordance with the wording of RSA 198:40, I (a). However, it did not take into account the unique situation that Nashua’s 9th graders are educated in middle schools. Prior to passage of HB 117, when aid simulations were being run and the statutory language was being developed, no one involved took into account the fact that in this one district’s 9th graders were being educated outside the high school. Therefore, no language was added to HB 117 that would have provided guidance on how to deal with this anomaly.

To get a true elementary per pupil cost for Nashua would require removing 9th grade expenditures from the elementary costs reported on the MS-25. The process suggested by the auditors, to add the 9th grade ADM-A into the elementary ADM-A divisor, is one approach. However, it does not provide a true representation of Nashua’s strictly elementary costs.

A true determination of the elementary base cost for Nashua would require that costs that are exclusively elementary (i.e. grade 8 and below) be divided by an ADM-A that is exclusively elementary. The 9th graders in Nashua receive educational services in accordance with the state minimum standards for high school education. These services, which include such things as subject-certified teachers, expanded course offerings, and enhanced guidance services, cost more than elementary services. Unfortunately, due to the integrated nature of the middle school budgets, the Nashua school district is unable to isolate these costs.

A third approach would have been to exclude Nashua from the base cost calculation. If this had been done, the base cost for Adequacy would have been lower. In the absence of statutory guidance for dealing with this anomaly, the Department believes that carrying out calculations in accordance with the language of the statute does not constitute an error. This issue, however, will be raised with the legislature.

Observation No. 1 – The Department Must Establish And Implement Formal Policies And Procedures To Strengthen Controls Over Education Adequacy Grant Calculations (Continued)

Auditee Response (Continued):

Enrollment Data. The Department concurs with the observation that, in calculating the Adequacy base cost for FY 00/01, enrollment rather than ADM-A was used to derive the weighted average base cost. RSA 198:40 I (b) relative to the calculation of the Adequacy base cost, specifies that ADM-A be used to derive the weighted average base cost. The Department attributes the use of enrollment to derive the weighted average base cost to the fact that the cost of Adequacy for FY00/01 was calculated before the statute was finalized. Apparently, no one working with the data or language of HB 117 noticed that enrollment data, not ADM-A data, had been used for all the simulations presented to the legislature.

The Department has applied a model of continuous improvement to the Adequacy calculations from the beginning. The Department has studied and recognized needed adjustments when new information was made available. The Department maintains that no definitive conclusion can be made to show that the number calculated for FY 00/01 base cost was an error.

The Department's goal is to use the best available knowledge and the best available data to carry out Adequacy cost and aid calculations consistent with the legislative intent. To this end, the Department is committed to the use of a continuous improvement process to enhance not only the data it collects and its knowledge base, but also the quality of its work relative to school funding.

Observation No. 2 - The Department Needs An Effective Mechanism To Assess The Quality Of Financial And Attendance Data Submitted By School Districts

Observation:

The Department has no audit or review process in place to verify the accuracy of financial or attendance information provided by school districts and used by the Department in determining the allocations for various federal and state programs including education adequacy grants.

In determining the amount of education adequacy grants, the Department relies heavily on financial and attendance information provided by the school districts on the Department's MS-25 financial form and various attendance forms. (The MS-25 form has been recently revised and is now called the DOE-25). This information is not verified by the Department nor does the Department require school districts to have the information audited prior to submission. For fiscal year 2000, the Department relied on this information to calculate the \$825 million in total adequacy aid to school districts.

While we acknowledge that the Department verifies the mathematical accuracy of the information within the MS-25s, it does not analyze this information to determine if the figures reported are reasonable and consistent. The Department has been relying on the MS-25 and attendance data for many years to calculate various funding allocations including Foundation Aid (repealed), Catastrophic Aid, Court Ordered Placements, and various federal grants, including Title I, Title II, and Class Size Reduction grants.

It does not appear that errors or misstatements in the MS-25 or attendance forms submitted by school districts would be detected and corrected by the Department in a timely manner. As we have shown in Observation No. 1, incorrect information can have a significant impact on the calculation and amount of adequacy grants distributed to school districts.

Recommendation:

Given the increased reliance on the financial and attendance information provided by school districts, the Department should establish additional control procedures to assure that the information upon which the education adequacy grants and other state and federal program allocations are based is accurate. The Department should consider seeking the resources needed to develop an audit function to verify and assess the quality of the information provided by school districts. At a minimum, analysis should be performed on the data submitted from year to year, to look for and follow-up on unexplained variances, and to determine whether the information appears reasonable and consistent.

Auditee Response:

We concur in part with the auditor's observation. While the Department does not audit the financial and attendance data provided by school districts, we have always checked the data for reasonableness. Beginning with the data used to calculate FY 02 Adequacy, the Department increased three-fold the amount of time spent scrutinizing district data.

Observation No. 2 - The Department Needs An Effective Mechanism To Assess The Quality Of Financial And Attendance Data Submitted By School Districts (Continued)

Auditee Response (Continued):

The number of numerical cross checks on the DOE-25 has increased from 30 to 36 and experienced staff has a checklist of 30 additional items to review for reasonableness. ADM data is compared to previous years and October enrollment figures. When inconsistencies are identified, the Department asks districts to check their calculations. In an effort to improve data quality, we have rewritten the instructions for reporting financial and attendance data, and developed training sessions.

We agree with the auditor's recommendation that, given the significant sum that is being distributed by the state, a process to verify the accuracy of the data submitted by school districts is warranted.

At this time, the Department does not have sufficient staff to audit financial and enrollment data submitted by school districts. Over the next few months, we will assess our current capabilities. We will ask the LBA Audit Division to assist us in developing criteria for an audit program and then develop a proposal for an audit unit that will support Adequacy Aid, Building aid and other programs. In the meantime, we will continue to critically scrutinize the data reported to the Department and provide training and support to districts.

Reportable Conditions

Observation No. 3 - The Department Needs To Design And Implement An Integrated Financial Management Information System

Observation:

The Department needs to fully computerize and integrate its four separate accounting systems into a single management information system. We noted a similar issue regarding the lack of computerization in our 1987 audit and again in our 1992 audit of the Department.

During fiscal year 2000, the Department received \$90 million in funding through 45 different federal programs categorized into 97 individual federal grants. These 97 grants are further broken down into multiple projects. The Department accounts for these federal programs through four separate accounting systems; the Form 2 system, the Federal Ledgers, the Grant Control Ledgers, and the state accounting system (NHIFS). These systems appear to have been developed independent of each other and are not integrated, requiring each transaction to be posted multiple times. This results in a duplication of effort and an increased risk of error. The separate systems also make it difficult for the Department's Bureau of Business Management (BBM) to efficiently respond to internal and external requests for information.

The Form 2 system tracks individual awards to subrecipients using project numbers within each grant. For fiscal year 2000, there were approximately 3,000 projects tracked in the Form 2 system. Expenditures made through this system are manually posted to NHIFS and a weekly report is generated to post expenditures to the Federal Ledgers.

The Federal Ledgers, comprised of thousands of Excel spreadsheets, are used to track federal expenditures and requests for funds by NHIFS organization code and grant number. All entries are keyed into the Federal Ledgers which are reconciled to NHIFS on a monthly basis. From the Federal Ledgers, a weekly federal funds draw report and a monthly summary of expenditures report is generated by grant for posting to the Grant Control Ledgers.

The Grant Control Ledgers are handwritten ledger books that track each of the 97 grants from inception to completion. Each individual federal draw and the monthly summary of expenditures is manually posted to the Grant Control Ledgers.

Due to the lack of integration between the systems there is a tremendous amount of redundant postings. Each transaction is posted an average of seven times, resulting in the need to reconcile the postings from one system to another. These reconciliations are time consuming and may not be effective in detecting errors timely.

Observation No. 3 - The Department Needs To Design And Implement An Integrated Financial Management Information System (Continued)

Observation (Continued):

While BBM has replaced some of the handwritten ledger sheets noted in our previous audit reports with Excel spreadsheets, it has not yet computerized its accounting system. An efficient and effective integrated management information system would eliminate the duplication of effort and multiple reconciliations currently required, and increase the Department's management control over the accounting of its federal programs.

Recommendation:

The Department should design and implement an integrated management information system that provides for its federal grant record keeping needs and gives BBM the ability to generate financial information for management, program administrators, and external users in a timely and efficient manner. A complete management information system will eliminate the current duplication of effort and allow BBM to meet the growing financial accounting and reporting needs of the Department. Consideration should be given to allow for integration of the information system with NHIFS and other Department systems.

Auditee Response:

We concur with the observation that the Department needs to design and implement an integrated financial management information system. Staff from our offices of Technology Management and Business Management is currently working with the Department of Administrative Services, Division of Information Technology Management to design and implement a management information system that provides for federal grant record keeping. Funding of \$650,000 for developing a Grants Management System has been provided in the current Capital Budget. Our design will adopt current technology, emphasize workflow, eliminate redundant keying of data, provide management reporting and analysis, eliminate paper ledgers and move the Department into the electronic era. An integrated financial management information system is a cornerstone for the Department and when implemented will remedy other observations found in this audit.

Observation No. 4 - Bureau Of Special Education Should Better Document And Control Adjustments To SPEDIS Information

Observation:

There is a lack of documentation for adjustments made by the Bureau of Special Education to information recorded in the Special Education Information System (SPEDIS) by school districts, and a lack of formal policies and procedures related to those adjustments. These adjustments affect payments to school districts for the federal Special Education and the State Catastrophic Aid programs. For fiscal year 2000, the Department expended \$18 million in federal Special Education funds and \$15.9 million in State Catastrophic Aid.

**Observation No. 4 - Bureau Of Special Education Should Better Document
And Control Adjustments To SPEDIS Information (Continued)**

Observation (Continued):

SPEDIS is a database application used by all school districts to report various special education data, including student cost information, to the Department. We confirmed with 18 school districts the Catastrophic Aid costs and the Special Education child counts as reported by the Department. Eight of the 18 (44%) school districts reported a variance in either the Catastrophic Aid costs or the child counts. The variances are caused by adjustments made by the Bureau of Special Education to account for excess costs over allowable costs, double counted or unapproved students. Bureau personnel were unable to document the adjustments and the reasons why adjustments were made. There are no policies or procedures in place regarding these adjustments nor are there controls within SPEDIS to identify information that was adjusted.

Per RSA 186-C:18, Catastrophic Aid payments are made annually by January 1 based on information provided by school districts by the previous June 30. For fiscal year 2000, the Department made its annual Catastrophic Aid distribution of \$15.3 million to 133 school districts in December 1999. We noted that a second Catastrophic Aid distribution was made to 44 school districts in June 2000, totaling approximately \$730,000. This payment was for costs that had been previously disallowed by the Bureau when calculating the annual Catastrophic Aid distribution and were categorized in SPEDIS as unallowed costs. Bureau personnel reported the second distribution was made to districts that had not provided cost information timely. However, there is no documentation to determine when the additional information was provided and why the Bureau allowed costs that exceeded its own established rates for tuition and room and board. The Bureau, on an annual basis, establishes approved rates for tuition and other related costs.

This same issue regarding the lack of policies and procedures was noted in our July 1999 performance audit of the Catastrophic Aid Program.

Recommendation:

The Bureau of Special Education should implement policies and procedures to address adjustments made to the SPEDIS information, for both Catastrophic Aid data and child counts, as well as other data as deemed necessary. These policies and procedures should include language regarding proper documentation and supervisory approval of adjustment activities.

Auditee Response:

We concur with the observation. Allowable expenses are determined by information provided by local school districts or private providers. If this information is later found incomplete or inaccurate, the Bureau of Special Education is obligated to make corrections. Ed 1132, a new rule governing the distribution of Catastrophic Aid, is currently in the rulemaking process. It provides guidance for the development of policies and procedures that will be implemented for the distribution of FY 2003 Catastrophic Aid funds. The bureau is in the process of

**Observation No. 4 - Bureau Of Special Education Should Better Document
And Control Adjustments To SPEDIS Information (Continued)**

Auditee Response (Continued):

developing forms within SPEDIS that will document any adjustments necessary to either the distribution of Catastrophic Aid or the child count. Additionally, only designated persons in the bureau will be able to make adjustments to SPEDIS data. This practice will better control the data and minimize the error rate.

**Observation No. 5 - Controls Over Authorization Levels Within The Vocational
Rehabilitation Case Management System Should Be
Strengthened**

Observation:

The controls over approval levels within the Vocational Rehabilitation (VR) Case Management System (CMS) are weak. Currently, VR has established controls where supervisory approval is only required for single service costs exceeding \$5,000 or for any Individual Plan for Employment (IPE) totaling over \$20,000. These thresholds can easily be circumvented in CMS.

CMS was designed in part to segregate the case management aspect of the system used by counselors, from the financial aspect used by the account technicians. While VR has established controls segregating the two aspects of the CMS system, controls within each segment need to be enhanced. VR counselors have full autonomy, from processing an application to IPE approval. This creates incentives to avoid the established thresholds in order to increase the speed of processing and increases the opportunity for misuse of funds without detection. The \$20,000 threshold may be avoided by creating amendments to the IPE rather than including all services in the original plan. CMS does not consider the amendments when requiring the upper-level review and approval for total IPEs in excess of \$20,000. The \$5,000 threshold may be avoided by creating two separate cost lines for the same service, as CMS only requires upper-level review and approval based on individual line items. We also noted that regional supervisors do not perform a formal periodic review of case files thus decreasing the chances of errors being detected.

Recommendation:

Controls within CMS should be enhanced to flag any changes that cause the IPE or cost lines to exceed the established thresholds. VR should implement a formalized review process for case files. This may include reviewing a sample of case files for proper documentation, as well as for proper treatment of the individual cost lines. Services provided should also be reviewed for reasonableness. Additionally, VR should review the approval level thresholds established in CMS to determine their reasonability in relation to the cases served.

Observation No. 5 - Controls Over Authorization Levels Within The Vocational Rehabilitation Case Management System Should Be Strengthened (Continued)

Auditee Response:

We concur with the observation and Vocational Rehabilitation (VR) is in the process of developing a formalized review process for case files which will include reviewing a sample of cases for proper documentation as well as for proper treatments of the Case Plan Line Item (CPLI) within the Case Management System (CMS). An informal review process by supervisors is completed throughout the year. A formalized review process that augments the current review activities will be put in place. The controls within the CMS will be enhanced to flag the current thresholds.

The current thresholds for individual CPLI's are based on cost of service most frequently provided by VR (transitional employment, programmable hearing aids and college tuition). The \$20,000 threshold for total plans was established for the first time during the development of our new CMS. Prior to the new CMS, we did not have the capacity to track total plans electronically.

The \$20,000 represents an average of many 4-year college plans and most home modifications. Van modifications and other unusually high price plans would exceed this threshold, thereby flagging extraordinary cases. VR will regularly review the approval thresholds to determine their reasonability in relation to cases served.

Observation No. 6 - Financial Approval Controls Within The Vocational Rehabilitation Case Management System Should Be Tightened

Observation:

Intended system controls over the financial approval authorizations in the Case Management System (CMS) of the Bureau of Vocational Rehabilitation (VR) are easily circumvented.

As a CMS system control, when an account technician enters an amount for a service in excess of 10% over the cost approved by a VR counselor, a warning box appears stating that the entered amount cannot exceed the 10% latitude from the approved amount. However, the account technician is able to close the box and continue creating the vendor authorization, effectively circumventing the intended control. Proper system controls include providing mechanisms to block the user from performing tasks they are not authorized to perform. Although the VR counselor may detect a large change in amount when they sign the vendor authorization, the control within CMS is ineffective.

Recommendation:

VR should create a more reliable control within CMS to ensure that changes in financial authorizations exceeding the 10% threshold are flagged for further approval. This will ensure that additional funds requested will be subject to all normal review and approval procedures.

Observation No. 6 - Financial Approval Controls Within The Vocational Rehabilitation Case Management System Should Be Tightened (Continued)

Auditee Response:

We concur and VR will create a more reliable control within CMS to ensure that any Financial Plan Line Item (FPLI) that exceeds the 10% latitude may not be processed. This will ensure that an amendment will be required if the additional funds are necessary, and therefore the increase line item amount will be subject to all normal approval procedures.

Observation No. 7 - Authorization For Vocational Rehabilitation Services And Approval For Payment Should Be Segregated

Observation:

The Vocational Rehabilitation (VR) counselors sign the service authorizations (VR-5s) and subsequently approve the related invoice for payment. No one independent of the process approves the payment for any service under \$5,000.

When invoices for customer services are received at the regional offices, the account technicians match the VR-5 and the invoice, and send both documents back to the counselor who initially authorized the VR-5. The same counselor then approves the invoice for payment. The account technician's role in this process is only clerical, and does not appear to mitigate the weakness in the control process.

As noted in Observation No. 5, VR counselors have a great deal of autonomy in providing customer services. The ability to create a requisition for services and approve the payment for those services could result in a misuse of funds, which would not be easily detected, as there is no formal independent review process.

Recommendation:

VR should have an individual independent of the purchasing process approve the invoices associated with the VR-5s for payment. At a minimum, there should be a formal review process implemented to detect any misuse of funds, and those reviews should be documented.

Auditee Response:

We concur and will implement an independent review process, which includes a review sample of expenditures for appropriateness of service expenditures. An informal review process by supervisors is completed throughout the year. A formalized review process that will augment the current review activities will be put in place.

Observation No. 8 - Controls Over The Form 2 Payment System Should Be Enhanced

Observation:

The Form 2 system, a federal grant tracking system maintained by the Bureau of Business Management, has no automated controls to prevent expenditures from being incurred in excess of funding authorizations. The authorizations tracked in the Form 2 system are the individual project awards to subrecipients as approved by various program staff. The person who prepares the payment voucher is responsible for manually reviewing the balances on the Form 2 system to ensure that subrecipients do not exceed the project award authorizations. There is no system control to prevent payment in excess of the project award amount. During fiscal year 2000, the Department processed approximately \$54 million in payments through the Form 2 system.

When program personnel approve a subrecipient's grant application, they sign a funding authorization form. The funding amount is keyed into the Form 2 system under a project number and serves as the authorization source. The Form 2 system tracks the authorization and expenditures by individual project number, and that information is reported on a Grant Balance Report for each program. The system is not programmed to flag any payments that exceed the authorized amounts.

Recommendation:

The Department should create a control within the Form 2 system to flag expenditures in excess of authorizations or to generate an exception report when the expenditures exceed the authorizations. Alternatively, someone independent of the payment process should periodically review payments in the Form 2 system or a report thereof to ensure that the total payments do not exceed the amounts authorized.

Auditee Response:

We concur with the audit observation that the Form 2 software does not flag expenditures exceeding authorizations. Modifying or enhancing the existing software is not cost-effective. The Department is designing an integrated financial management system that will address deficiencies within the Form 2 software. Having a more automated system will reduce the manual effort. Currently, the Accountant I in our Centralized Federal Funding Branch manually reviews each payment request for authorization amounts before keying into the Form 2 system. Also, staff of the Grant Award Administration Analysis and Reconciliation Section posts and review all payments coming from Form 2. We are confident that this type of error is caught either by the Accountant I, or at month-ending reconciliation. During the past year, we identified two such overpayments.

Observation No. 9 - The Department Needs To Enhance Its Operational Expertise Of Its Form 2 Payment System

Observation:

The critical function of processing payments through the Form 2 system is essentially a one-person operation. While payments are approved by employees outside of this process, no one is fully cross-trained with the functioning of this system. Approximately \$54 million in payments to school districts was processed through the Form 2 system during fiscal year 2000. There is one individual, an Accountant I, who fully understands the Form 2 payment cycle and if this person were to leave state service, the Department would have a difficult time processing, both timely and accurately, payments to school districts. With the exception of school lunch reimbursements, almost all federal grant payments to school districts are processed through the Form 2 system.

Efficient and effective internal controls include documented procedures for performing all jobs and duties. In the event an employee cannot perform his/her duties, there should be a written procedures manual to instruct another appropriate employee to perform those duties. If the position is of critical importance to the operation of the Department, additional personnel should be trained to perform the necessary tasks to allow the Department to continue operations without major difficulty or delays.

While the Department has designated other individuals to fill in when the Accountant I is absent, the person who most often fills in also has approval authority over the payment request thus creating a lack of segregation of duties when this individual is both approving and processing the payment.

During testing, we noted several instances where school districts were overpaid and required to remit refund checks to the Department. While these transactions were detected and corrected in a timely manner, we noted that a majority of the errors occurred when the Accountant I was on leave.

By not having another employee fully cross-trained in the functioning of the Form 2 system, the Department has no back-up in the event that the Accountant I is on extended leave. While there is a procedures manual to assist in the training of a replacement employee, given the complexity of the Form 2 system, it would be difficult for another employee to learn this function quickly without the benefit of instruction from the Accountant I.

In reviewing this critical function, we also looked at other areas where the Department is potentially at risk due to a combination of a lack of policies and procedures manuals, a lack of cross-training and thinness in operational expertise. The other areas we consider to have similar potential risks are the School Building Aid section, the Special Education bureau and the Internal Audit section.

Observation No. 9 - The Department Needs To Enhance Its Operational Expertise Of Its Form 2 Payment System (Continued)

Recommendation:

The Department should review all its critical operational functions, determine where a lack of operational expertise exists, and implement procedures, to the extent possible, to mitigate the risks. Regarding the Form 2 system, the Department should cross-train employees independent of the grants process in this critical function.

Auditee Response:

We concur with the audit observation that the Department lacked operational expertise in the Form 2 system. This increased the possibility of errors in processing payments when the Accountant I was absent. The Department has conducted cross training in the functions of the Form 2 system. The Accountant III in the Office of Business Management now has operational expertise and will serve as backup to the Accountant I when necessary.

Observation No. 10 - The Department Should Document Allocations Of The Federal Special Education Grant

Observation:

The Bureau of Special Education does not maintain adequate documentation to support the determination of special education grant funds allocated to school districts. For fiscal year 2000, the special education federal entitlement grants awarded to school districts totaled approximately \$14 million.

Per federal regulation 34 CFR 300.602, the State may not retain more than 25% of the grant for administration and other State-level activities, requiring the amount awarded to school districts to be not less than 75% of the total grant award. The grant award has a period of availability of 27 months, so each year the amount to be allocated is a portion of the current year grant, plus unused funds from the previous year's allocation and some discretionary funds. Currently, the Special Education Bureau calculates the annual grants and informs school districts of their proportional share. We were unable to recalculate amounts awarded to school districts for fiscal year 2000 because supporting calculations for the allocation were not available. One individual prepares this calculation and the methodology used to generate the award allocations is undocumented. If this person were to leave state service, it would be extremely difficult for the Department to duplicate the allocation.

While we were unable to recalculate the fiscal year 2000 allocation, we did recalculate the allocation for the federal fiscal year 1998 grant award, which was the latest closed grant year. We tested the fiscal year 1998 grant and determined that the amount awarded to school districts was actually greater than the 75% requirement, therefore the Department was in compliance with the allocation percentages for that year.

Observation No. 10 - The Department Should Document Allocations Of The Federal Special Education Grant (Continued)

Recommendation:

The Bureau of Special Education should prepare and retain documentation of all future calculations to provide evidence as to the source of the amounts, as well as other information, used in the calculations. This will help ensure compliance with federal regulations, and will provide a guide for future staff to follow in preparing entitlement calculations.

Auditee Response:

We concur with this observation. At the time of the audit, circumstances existed to prevent auditors from recalculating fiscal year 2000 allocations. The SPEDIS system did not contain a locked, separate file that could be used at a later date. The Bureau of Special Education will seek guidance from the Office of the Legislative Budget Assistant when developing systems that ensure the accuracy and verifiability of SPEDIS data. As of FY 2001, a separate file copy of the child count data used to calculate allocations for each year will be locked so calculations can be reproduced. In addition an Accountant III within the bureau will determine allocations and these figures will be verified by a Program Specialist IV. Further, the bureau will fully document calculations of allocations so that multiple persons will be capable of reproducing the calculations or create subsequent calculations.

Observation No. 11 - Final Approval Of Special Education Project Applications And Budgets Should Be Better Documented

Observation:

There is no consistent evidence of review and final approval by the Department of either project or budget applications submitted by school districts for federal special education funds. The completeness and the content of the project application are reviewed separately from the budget submission (Form 1).

A checklist is used by the Department as a tool for reviewing and approving project applications. The checklist was designed to ensure that each page of a project application was completed to the Department's satisfaction and is in compliance with federal regulations. During our testing of fiscal year 2000 applications, counselors did not complete and sign checklists for 5 of 25 applications tested. In three of these instances, final approval was withheld because the school district failed to supply certain required compliance information including maintenance of effort information, however, funding to those school districts was authorized nonetheless.

We also noted that for 5 of 25 districts tested, one or more of the budget applications or amendments contained no approval signature.

**Observation No. 11 - Final Approval Of Special Education Project Applications
And Budgets Should Be Better Documented (Continued)**

Recommendation:

The Department should require that the checklist be completed and signed prior to authorization of the school districts' application award. The control over the checklists could be strengthened by requiring a checklist with final approval be submitted with the approved budget before the funding authorization is generated.

Auditee Response:

We concur with the observation. The Department is in the process of reviewing the procedures for standardized practice that will ensure complete documentation of application and final approval of the Form 1. One person has been designated and a procedure developed to check signatures on Form 1's. All Form 1's will be signed. Further, elements of the application checklist will be modified to allow for signatures of the preparer and the approving authority. Future application checklists will be fully completed and signed.

**Observation No. 12 - Formal Fraud Deterrence And Detection Program Should
Be Established**

Observation:

The Department of Education does not have a formal fraud deterrence and detection program.

Fraud encompasses an array of irregularities and illegal acts characterized by intentional deception. Persons outside or inside the organization can perpetuate it for the benefit or to the detriment of the organization.

Deterrence consists of those actions taken to discourage the perpetration of fraud and limit the exposure if fraud does occur. The principal mechanism for deterring fraud is the establishment of effective internal controls. Management has the primary responsibility for establishing and maintaining controls.

Detection consists of identifying indicators of fraud sufficient to warrant recommending an investigation. These indicators may arise as a result of controls established by management, tests conducted by internal auditors, and other sources both within and outside the entity.

Management is responsible for assisting in the deterrence and detection of fraud by examining and evaluating the adequacy and effectiveness of controls, commensurate with the extent of the potential exposure/risk in the various segments of and entity's operations.

Observation No. 12 - Formal Fraud Deterrence And Detection Program Should Be Established (Continued)

Observation (Continued):

In carrying out this responsibility, management should, for example, determine whether:

- The organizational environment fosters control consciousness;
- Realistic organizational goals and objectives are set;
- Written policies (e.g. code of conduct, fraud reporting policy) exist that describe prohibited activities and the action required whenever violations are discovered;
- Appropriate authorization policies for transactions are established and maintained;
- Policies, practices, procedures, reports, and other mechanisms are developed to monitor activities and safeguard assets, particularly in high-risk areas;
- Communication channels provide management with adequate and reliable information; and
- Recommendations need to be made for the establishment or enhancement of cost effective controls to help deter fraud.

As noted above, the principal mechanism for deterring and detecting fraud is the establishment and operation of effective controls. An integral factor of an entity's control environment is the control consciousness of its people. Management is responsible for establishing controls and monitoring compliance, and is the primary influence on the degree of importance its employees attach to controls. High control consciousness at all levels of an entity is a significant factor in deterring fraud.

Recommendation:

The Department should establish a formal fraud deterrence and detection program. Establishing a formal program should help limit the Department's exposure to fraud and should promote timely detection. The Department should also take measures to foster a high degree of control consciousness among its employees and ensure that its employees understand that adhering to controls is a primary concern of management.

Auditee Response:

We concur with the audit observation that a fraud deterrence and detection program should be established. The Department will work with the Department of Administrative Services and seek advice from the Office of the Legislative Budget Assistant regarding the specification of such a system. If necessary, the Department will request an appropriation and resources in the next State budget to fund the development and maintenance of a fraud deterrence and detection program. Once approved and after this program is established the Department will hold workshops and/or training sessions to ensure all employees understand that adhering to controls is a primary concern of management.

Observation No. 13 - Formal Fraud Reporting Policy Should Be Established

Observation:

The Department of Education has no formal fraud reporting policy. The lack of a written policy may delay the reporting of fraudulent activity.

The attributes of an effective fraud reporting policy include:

- The policy is in writing;
- The reporting policy describes fraudulent activities and the actions required when fraud is suspected or detected;
- The policy is communicated to all employees; and
- Management obtains written assurance from each employee that the policy and related reporting mechanism is understood.

The effectiveness of a fraud reporting policy is enhanced when employees have a clear understanding of fraud indicators and what constitutes a fraudulent act. It is important that the reporting procedure is non-threatening for the reporter and provides for the reasonable protection of all parties.

Recommendation:

The Department should establish a formal fraud reporting policy and provide its employees with fraud awareness training. The Department should take measures to ensure that the policy facilitates and encourages reporting and protects all parties involved.

Auditee Response:

We concur with the audit observation that a formal policy on reporting fraud should be established. The Department of Education is in the process of establishing a formal fraud reporting policy. We are contacting other State agencies in search of an appropriate model for the Department. Once established, we will communicate the policy to all Department employees. This will ensure that employees clearly understand fraud indicators, what constitutes a fraudulent act and their responsibility in reporting fraud. This policy will be incorporated into the employee handbook.

Observation No. 14 - Complete Equipment Valuation Records Should Be Maintained

Observation:

The Department does not maintain equipment cost records in accordance with the State's Fixed Asset Policies and Procedures Manual, and therefore is unable to support the majority of the June 30, 2000 reported equipment balance of \$3.9 million. The Fixed Asset Policies and Procedures Manual, issued by the Department of Administrative Services in August 1996, gives agencies guidance on the proper accounting and reporting of assets. It requires agencies maintain adequate documentation, such as invoices, contracts, purchase orders, in permanent files to support the recorded cost value of its equipment. Currently, the Department does not retain this information.

In 16 of 25 (64%) equipment items tested, we noted the Department was unable to supply supporting documentation for the reported values. We also noted several items were either misstated on the inventory listing or not removed from the listing in a timely manner. As a result of the Department not being able to support the reported equipment amounts, we have qualified our opinion on the Department's financial statements.

Recommendation:

The Department should adhere to the record keeping requirements set out in the Fixed Asset Policies and Procedures Manual. It should establish procedures to retain equipment cost records until the equipment is disposed of in accordance with the Manual.

Auditee Response:

We concur with the audit observation that the Department should maintain complete equipment valuation records. Generally, our record retention follows the destruction schedule provided by the Department of Administrative Services. We were unaware of the policy to maintain evidential information such as invoices and purchase orders for the lifetime of the equipment until surplus as prescribed in the Fixed Assets Policies and Procedure Manual (issued August 1996). The Department now maintains evidential information on equipment purchases for the lifetime of the asset or until surplus. We understand that in light of GASB 34, a new fixed asset policy and procedure is about to be issued by the Department of Administrative Services. Once released, we will adhere to all aspects of the new Fixed Assets Policies and Procedure Manual.

State Compliance

Observation No. 15 - Audit And Financial Monitoring Function Should Be Expanded

Observation:

The Department currently does not have internal audit staffing resources needed to comply with statute. The Internal Audit section is staffed by one internal auditor and a secretary.

The Internal Audit section's primary responsibility is the review of approximately 200 subrecipient audit reports and 300 certifications to ensure subrecipient compliance with federal regulations. This responsibility consumes the majority of the internal auditor's time. The internal auditor does not perform any internal reviews, examinations or analysis of the various divisions and bureaus of the Department as required by statute.

RSA 21-N:4, IX, states that the audit and financial monitoring functions within the Department shall, "Provide analytical reports of examinations conducted of the department's various divisions, bureaus, sections, programs and functions. ...Reports shall contain analyses, appraisals, comments, and recommendations relating to the accuracy and competence of accounting, financial and management procedures in use."

An effective internal audit function provides for an independent review and analysis of the various bureaus and divisions of an organization to help an organization meet its goals and objectives, allows for compliance with applicable laws, and aids in the efficient and effective use of Department resources.

During the course of our audit we noted various issues with regard to lack of controls, lack of segregation of duties, and insufficient documentation. We believe a fully functioning internal audit section may have identified and recommended resolution of some of these issues.

As we have noted in other observations, since the Department places heavy reliance on information provided by school districts for numerous federal and state programs, including education adequacy grants, it is imperative that it develop a mechanism to provide greater assurance that the information being provided by school districts is accurate. In order to accomplish this goal, a restructuring and enlargement of the internal audit section would most likely be necessary.

Recommendation:

The Department should review the current structure of the internal audit section to determine how best to meet its growing responsibilities and comply with RSA 21-N:4, IX. Based on that review, the Department should seek appropriate resources to comply with statute. The Department should also consider seeking an amendment to RSA 21-N:4 to expand the internal audit responsibilities to include audits and/or reviews of school districts.

Observation No. 15 - Audit And Financial Monitoring Function Should Be Expanded (Continued)

Auditee Response:

We concur with the audit observation that the audit and financial monitoring function should be expanded. Currently, our internal auditor does periodic technical reviews of the school districts. The internal auditor also reviews the OMB Circular A 133 audit reports that are required of all school districts with annual federal expenditures of over \$300,000.

The internal auditor also reviews the quarterly reports from the Department's Form 2 system and holds two training sessions per year for the school districts concerning the Form 2 system. As noted in the observation, this leaves little time for internal auditing.

The Department will pursue adding auditing resources through budgetary additions in the biennial budget process.

Observation No. 16 - The Department Should Better Control And Document Payments For School Building Aid In Compliance With Statute And Administrative Rule

Observation:

The Department of Education does not adhere to the requirements in statute and administrative rule to adequately control and document payments for school building aid. For fiscal year 2000, the Department expended \$18.9 million in school building aid.

RSA 198:15-c requires the Department to approve school building plans, specifications, and cost estimates prior to the start of construction. The Department's administrative rules mirror this requirement. Further, according to Department administrative rule ED 305.12, preliminary project costs, final project costs, and bond schedule forms are required to be filed before any building aid is provided. However, the current practice is to begin making payments upon approval of the preliminary application. Payments are made based on data in spreadsheets containing information such as project name, number, school district, number of years building aid will be paid, cost, and projected payment schedule. The spreadsheets are created by the statistical clerk when the projects meet preliminary approval requirements. There is no independent review of the spreadsheets for accuracy or completeness.

Nineteen school building aid payments representing 79 individual construction projects were tested for accuracy and compliance. The results of our work revealed the following:

- Thirty of the 79 (38%) project folders were missing the final project costs form. The form serves as the school districts' certification as to final project costs. The Department is making payments based on bond schedules or preliminary project cost information.

Observation No. 16 - The Department Should Better Control And Document Payments For School Building Aid In Compliance With Statute And Administrative Rule (Continued)

Observation (Continued):

- Of those 30 folders, five were missing both the final project costs form and the bond schedule. Payments on these five projects totaled \$204,541 for fiscal year 2000. For one of the five projects the Department was unable to locate the project folder. While the Department has since been able to obtain copies of the missing bond schedules from the school districts, it still has not obtained final project cost forms.
- The Department does not require bond schedules be certified as official repayment schedules by either the bond issuers or the school districts. The majority of school building aid payments are based on bond schedule information. Some project files included faxed or copied bond schedules that may or may not have a relationship to the amount approved by voters. The Department assumes greater risk when it relies on uncertified information to make disbursements of millions of dollars.

In nearly every project folder we reviewed, required information was missing from the files. Missing information included Fire Marshal approvals, educational specifications, preliminary site approvals, Department final completion form notifications, preliminary and final drawings, and final project specification and unit cost forms. This issue regarding the lack of complete information in the project folders was identified in the LBA's September 2001 performance audit of the School Building Aid program.

Recommendation:

The Department should comply with existing statute and administrative rules to provide better control over payments for School Building Aid. Payments should not be made without the required documentation on file. Consideration should be given to requiring certified bonds schedules be sent by the official bonding agency directly to the Department. The Department should also consider having its internal audit section perform reviews of project costs. Additionally, the work of the statistical clerk should be periodically reviewed by supervisory personnel.

Auditee Response:

The Department concurs in part with the recommendation. Policies will be reviewed and recommendations for rules changes will be made to the State Board of Education concurrent with other rules revisions so that Administrative Rules will reflect current procedure. The Department does not have sufficient internal auditor resources to provide an independent review of the spreadsheets of payment data. A more careful review of the work of the Statistical Clerk has already been initiated. The Department will pursue adding auditing resources through budgetary additions in the biennial budget process.

Observation No. 16 - The Department Should Better Control And Document Payments For School Building Aid In Compliance With Statute And Administrative Rule (Continued)

Auditee Response (Continued):

Because of procedures currently used, active project files do not include all project forms. When all the forms are in and final adjustments are made to control cards, the projects are issued a certificate of final approval and the folder moves to the inactive file drawer. We concur that this practice is not entirely consistent with the present wording of Ed 305. There has been turnover in the Statistical Clerk position (3 persons in 5 years) with long vacant periods between hires. This has resulted in a considerable backlog of projects not up to date. The Division Director has provided part-time help to clear the backlog. In fact, excluding the A23M (fire marshal review), all the missing forms cited in the observation except one are now in the folders.

Observation No. 17 – Disbursements For Court-Ordered Placements Should Be Made In Accordance With Statute

Observation:

Payments related to educating children in court-ordered placements are not being made in compliance with statute. For fiscal year 2000, the department incurred \$3,050,000 in court-ordered placement costs. RSA 186-C:19-b establishes the Department's financial liability for educating children in court-ordered placement as costs in excess of three times the estimated state average expenditure per pupil. For fiscal year 2000, we noted the following issues.

- RSA 186-C:19-b requires the Department to distribute payments to the education service providers on or before January 1st based on costs reported by the service providers to the school districts through the previous June 30th. The statute requires the department to verify the amounts submitted by the school districts and then "...distribute the appropriate amounts for the previous fiscal year [emphasis added] on or before January 1 of each year." In practice, the Department begins paying once the school districts have exceeded their liability of 3 times the estimated state average expenditure per pupil (referred to as the cap). For fiscal year 2000, the school districts submitted invoices to the Department for payment directly to the service providers as soon as the cap was exceeded.

As a result of this policy, the Department is making payments earlier than the date set in statute. This may also result in the Department assuming a higher share of the costs. Each year the cap is recalculated and historically has increased. For example, the cap for fiscal years 2000 and 2001 were \$17,880 and \$19,008, respectively, an increase of \$1,128. When the Department reimburses for costs in the current year it assumes a higher liability than if it waited until the following year to make the reimbursements. In the example above, the Department is assuming an increased liability of \$1,128 per student more than if it waited until fiscal year 2001 to make payment.

Observation No. 17 – Disbursements For Court-Ordered Placements Should Be Made In Accordance With Statute (Continued)

Observation (Continued):

- RSA 186-C:19-b states that the school districts' liability for the court-ordered placement costs are to be prorated in cases where placements are for less than one year. The Department has not established policies or procedures regarding the prorating of district liability in cases where placement of a student is for less than the school year. The allocation of district liability for partial year placements may be inconsistent since there is no policy.
- RSA 186-C:19-b requires the courts notify the Department directly when placement orders are written for out-of-district placements. According to discussions with Department personnel, the Department does not generally receive notification of placement orders from the courts in compliance with the statute. The Department relies on the school districts to maintain court orders.

Recommendation:

The Department should:

- Comply with the statute regarding the timing of payments or seek legislation to change the statute so that it reflects current practice,
- Establish policies and procedures related to the pro-ration of costs for partial year placements, and
- Work with the courts to establish a procedure whereby the Department is notified in cases of out-of-district placements. Such notification should then be used by the Department in approving court-ordered placement costs.

Auditee Response:

We concur with the recommendation. The Department is in the process of developing legislative action to amend RSA 186-C:19b, II (c) to reflect the current practice of payment directly to the service provider after the school district has reached the three times the estimated state average expenditure per pupil. The Department will amend current procedures to reflect its ongoing and consistent policy for handling pro-ration of district liability in a multi-district placement of students. The Department is working with the courts to acquire the placement orders of all students who come under the provisions of RSA 186-C:19.

Observation No. 18 - Statutory Filing Deadline For Special Education Cost Information Should Be Met Or Amended

Observation:

The Department is not enforcing the statutory requirement that school districts submit certain special education costs by June 30 of each year. This reporting is necessary for the Department to comply with statutory catastrophic aid program requirements. The State catastrophic aid program assists school districts with costs for special education students in excess of 3 ½ times the estimated state average expenditure per pupil.

RSA 186-C:18, III states that the Department shall be liable for 80% of the cost above 3 ½ times the estimated state average expenditure per pupil and for all costs in excess of 10 times the estimated state average expenditure per pupil. RSA 186-C:18, VI (a) requires school districts to submit catastrophic costs to the Department by June 30th of each fiscal year. The school districts submit their costs through the Special Education Information System (SPEDIS). Per discussion with Department personnel, the Department does not require school districts to adhere to the deadline, and in fact, the Department gives districts until the end of July to submit their costs.

Recommendation:

The Department of Education should either work with the school districts to enforce compliance with the filing deadline in the statute or seek amendment to the statute to reflect current practice.

Auditee Response:

We concur with this observation. The Department is in the process of developing legislative action to change the date for the submission of the Catastrophic Aid expenditures from June 30, which is not practical, to July 31.

Observation No. 19 – Service Contracts Should Be Submitted For Governor And Council Approval

Observation:

The Department does not seek approval of the Governor and Council (G&C) for all service contracts in excess of \$2,500 in accordance with RSA 4:15. Examples include a contract with Southeastern Regional Education Service Center to conduct monitoring and program approval for fiscal year 2000 in the amount of \$384,449 and a contract with the University of New Hampshire to maintain the Special Education Information System for fiscal year 2000 in the amount of \$154,400.

Observation No. 19 – Service Contracts Should Be Submitted For Governor And Council Approval (Continued)

Observation (Continued):

With the development of the Department's Form 2 system in the 1970s, the Department adopted a policy to exempt projects authorized through the Form 2 system from G&C approval. The original intention of this policy was to make the disbursements to school districts more efficient due to the large volume of projects. Over time, the practice extended to include any contracts paid with the federal funds through the Form 2 system. The Department does not have the authority to exempt certain service contracts from the G&C approval process.

In the July 1999 performance audit of the Catastrophic Aid Program, we noted that a majority of the projects controlled by the Bureau of Special Education did not receive G&C approval. It was also noted that the Commissioner of Administrative Services, who was familiar with the Department's Form 2 system, reported that all contracts that could be competitively bid should go before G&C and that there are no rules governing what types of contracts are exempt from G&C approval.

Recommendation:

The Department should submit all service contracts exceeding \$2,500 to G&C for approval, and should work in concert with the Department of Administrative Services to establish formal policies and procedures regarding the exemption of certain grant awards from G&C approval.

Auditee Response:

We concur with the observation. A 1999 audit of the Bureau of Special Education pointed out the need to limit the use of the Form 2 process. The bureau now competitively bids all contracts and submits them to Governor and Council. We suggest that the requirements of issuing RFP's, reviewing them and issuing contracts may require additional staffing, as was noted in the 1999 audit.

Observation No. 20 - Tuition And Transportation Administrative Rules Should Be Revised To Be Consistent With Statute

Observation:

The Department does not use the rate set in administrative rule, Ed 1403, Tuition and Transportation Reimbursement, as the approved rate for transportation costs and the reporting dates outlined in the administrative rules differ from those in statute. For fiscal year 2000, the Department reimbursed school districts \$508,000 for transportation costs and \$3.4 million for tuition costs related to vocational programs.

Observation No. 20 - Tuition And Transportation Administrative Rules Should Be Revised To Be Consistent With Statute (Continued)

Observation (Continued):

Administrative rule Ed 1403 currently states that the approved transportation rate is one-half of the official IRS standard mileage rate or actual cost, whichever is less. However, the Department has continued to use a rate of \$.08/mile round trip, set in 1984 administrative rules that subsequently expired in 1990. The administrative rules were updated in 1996, and the approved transportation fare was changed in the Tuition and Transportation Reimbursement section.

RSA 188-E:9 requires the school districts to report tuition and transportation costs on forms prescribed by the Department (AV-1 form) to request reimbursement annually by September 30th and requires payment to be made annually by December 1st for the previous year. Conversely, Ed 1403 requires the forms to be submitted twice a year, by January 15th for the first semester and by June 30th for the second semester.

There should be consistency between the rules and the statute to provide clear guidance to school districts for submission of reimbursement requests and to enable the Department to enforce compliance with the mandated requirements.

Recommendation:

The Department should review requirements for tuition and transportation in both the statute and administrative rules. Based on that review, the Department should seek amendment where appropriate so that there is consistency between the statute and the rule.

Auditee Response:

The Department concurs with the observation and the recommendation. When the Administrative Rules were revised and readopted in 1996, several inconsistencies with RSA 188-E were apparently overlooked. Rule-making authority is a function of the State Board of Education. The Department will immediately make recommendations to the Board as to how Ed 1403 should be revised and recommends prompt action in starting the rule-making process.

Observation No. 21 - Administrative Rules Should Be Adopted As Required By Statute

Observation:

The Department of Education has not adopted all the administrative rules required by the State statutes.

**Observation No. 21 - Administrative Rules Should Be Adopted As Required
By Statute (Continued)**

Observation (Continued):

There are numerous laws, rules, and regulations that the Department must comply with. We reviewed the Department’s significant statutes that require the adoption of administrative rules and noted rules were never adopted or have expired and not been readopted for the following statutes.

STATUTE	DESCRIPTION OF RULE
RSA 21-N:9, II (a)	Organization of School Administrative Units
RSA 21-N:9, II (e)	Child Benefit Services Grants
RSA 21-N:9, II (h) RSA 193:1-b	Dual Enrollment Programs
RSA 21-N:9, II (k)	Vocational Rehabilitation Services
RSA 21-N:9, II (v)	Literacy Education/Dropout Prevention
RSA 21-N:9, II (w)	Exemption of Statewide Assessment
RSA 21-N:9, II(bb) RSA 186:11, XXXV	Master Teacher
RSA 186-C:18, V	Catastrophic Aid
RSA 198:44, II	Student Attendance Calculation

State departments adopt rules and regulations in order to communicate their policies, procedures, and practices to persons both inside and outside the agencies. Rulemaking allows for public and legislative oversight of Department operations. The lack of required rules could result in the Department functioning without the proper authority.

Recommendation:

The Department should adopt administrative rules as required by the statutes noted above. If the Department determines the adoption of rules is not necessary, it should seek to amend or repeal the statute.

Auditee Response:

We concur. The Department is in the process of promulgating rules in all areas where it believes the current law requires rulemaking. In those areas where the Department does not believe the adoption of rules continues to be necessary, it will seek either an amendment to or repeal of the authorizing statute.

Federal Compliance

Observation No. 22 - Procedures Should Be Developed To Minimize Time Between The Advancement Of Funds To And Disbursement Of Funds By Subrecipients

Observation:

The Department does not minimize the time elapsed between transfer of funds from the Department and disbursement of those funds by subrecipients.

Federal financial management standards require that "...procedures for minimizing the time elapsing between the transfer of funds from the US Treasury and disbursement by grantees and subrecipients must be followed whenever advance payment procedures are used." Standards further state that, "grantees must monitor cash drawdowns by their subgrantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees." Generally, the phrase "minimizing the time elapsing between transfer of funds" has been interpreted to mean no more than a three day balance of cash on-hand. Currently, the Department does not monitor the subrecipients' cash balances in order to determine whether the funds requested meet this three day balance limit.

The Department, through its Federal Funds Financial Management Manual, last updated in 1985, instructs subrecipients to make quarterly requests for funds, including an estimate of expenditures for up to four months beyond the request date. We noted that the Department generally grants the full amount of the requests.

The Department controls the disbursement of funds to subrecipients through its Form 2 system. This database application records award amounts and payments by project, grant and grant year. During our testing of 50 federal grant expenditures, we noted 26 were processed through the Form 2 system. Of those 26 expenditures, 15 (58%) were an advance of federal funds either in whole or in part. Total dollars tested were \$3.9 million, of which \$1.2 million (31%) was advanced to subrecipients.

This same observation was noted in our fiscal year 1992 audit of the Department. The Department in its response to the observation stated that it was modifying procedures to minimize the amount of time elapsing between the transfers of funds and was requesting federal grantor acceptance of the present method of funding. To date, it has done neither.

Observation No. 22 - Procedures Should Be Developed To Minimize Time Between The Advancement Of Funds To And Disbursement Of Funds By Subrecipients (Continued)

Recommendation:

The Department should implement procedures to minimize the time elapsing between the transfer of funds from the Department and disbursement of those funds by subrecipients. Consideration should be given to changing the advancement policy to one of reimbursement. Any policy on advances to subrecipients should be approved by the Department's federal awarding agency. The Department should update its Federal Funds Financial Management Manual to reflect current federal regulations and Department practices.

Auditee Response:

We concur with the audit observation that procedures should be developed to minimize timing of monetary advances to sub-recipients. The Department considered changing the advancement policy to one of reimbursement. A policy of reimbursement imposes undue financial hardship on smaller school districts that typically lack sufficient cash flow to self-fund and then wait for reimbursement. A more reasonable approach is to propose an update to the Federal Funds Financial Management Manual to reflect current federal regulations and Department practices and to seek approval on advances from the Department's Cognizant Agency. Our Administrator of Business Management is undertaking this task. Longer-term improvement will come with implementation of an integrated financial information management system. With new software systems, we will streamline the Form 2 payment process and have the option to move from quarterly payments to monthly payments, thereby minimizing the timing of advances.

Observation No. 23 - Vocational Rehabilitation Should Revise Standard Contract Language To Include Suspension And Debarment Certification Requirement

Observation:

The Bureau of Vocational Rehabilitation (VR) does not require companies with whom they contract to certify they are not suspended, debarred, or otherwise excluded from or ineligible for participation in federal assistance programs.

Federal regulation 34 CFR 80.35 states, "Grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, 'Debarment and Suspension.'" Executive Order 12549 sets a threshold of \$100,000 to require certification that the parties are not suspended or debarred.

Observation No. 23 - Vocational Rehabilitation Should Revise Standard Contract Language To Include Suspension And Debarment Certification Requirement (Continued)

Observation (Continued):

VR entered into three contracts over \$100,000 during fiscal year 2000, which were funded through the federal Vocational Rehabilitation program. Suspension/debarment certifications were not obtained from any of the contractors. Lack of effective procedures in this area could result in VR contracting with suspended or debarred parties, resulting in federal questioned costs. We determined that the three contractors noted above were not on the *List of Parties Excluded From Federal Procurement or Nonprocurement Programs*, issued by the General Services Administration, therefore the costs are not questioned.

Recommendation:

To comply with federal regulations, VR should revise its standard contract language to include a certification that the parties are not suspended, debarred, or otherwise excluded from or ineligible for participation in Federal assistance programs.

Auditee Response:

We concur. The Bureau of Vocational Rehabilitation has revised its standard contract language to include certification in contracts over \$100,000, demonstrating that the contractor is not suspended or debarred or otherwise excluded from or ineligible for participation in federal assistance programs. This will ensure we comply with federal regulations, thus eliminating the risk of contracting with suspended or debarred parties, which could result in questioned costs.

Observation No. 24 - Review Of Subrecipient Audit Reports Should Be More Timely

Observation:

For fiscal year 2000, the Department did not perform timely reviews of subrecipient audit reports in compliance with federal regulations. The Department disburses approximately 80% of all federal funds it receives to its subrecipients, primarily school districts. For fiscal year 2000, the Department disbursed approximately \$72 million in federal funds to subrecipients.

Review of subrecipient audit reports is a critical internal control and federal compliance function relied upon by the Department to ensure that its subrecipients are expending federal funds in accordance with federal guidelines. For the majority of the federal programs, the review of the subrecipient audit reports is the only formal annual monitoring performed by the Department.

Observation No. 24 - Review Of Subrecipient Audit Reports Should Be More Timely (Continued)

Observation (Continued):

Effective internal controls include a timely and thorough review of all subrecipient audit reports to ensure that subrecipients are in compliance with applicable laws and regulations. Federal regulation 34 CFR 80.26 (b) (3) states that agencies granting federal funds to subrecipients should review audit reports of subrecipients receiving more than \$300,000 in federal funds in a fiscal year. It also states that in this review agencies shall, “Ensure that appropriate corrective action is taken within six months after receipt of the audit report in instance of noncompliance with Federal laws and regulations.” Based on this requirement, the review process should be completed within a shorter period to ensure that corrective action is taken where necessary.

The Department’s internal audit section (comprised of an internal auditor and a secretary) is responsible for the review of approximately 200 subrecipient audit reports and 300 certification letters. The Department requires any subrecipient receiving less that \$300,000 to provide a letter certifying that fact. We tested the audit report review process during our audit period and of the 27 reports selected for testing, we noted the following issues:

- Two subrecipient audit report files could not be found. Per conversation with the internal auditor, Department program personnel will sometimes borrow the files for their own review and not sign them out or return them. There is no formal procedure to sign these files out.
- Fifteen of the 25 files tested (60%) were not completely reviewed within 60 days of the receipt of the report. The 60 days was a timeframe set by the LBA auditors and agreed to by the Department’s internal auditor as a reasonable timeframe for file review. While the majority of the reports received an initial review by the secretary within 60 days, the final review and approval by the internal auditor took much longer. The average length of time between receipt and completed review was 114 days. Dates ranged from one day to over 350 days between receipt and approval.
- Eight of the 25 reports tested contained findings of federal non-compliance. Of these eight, only four (50%) received a request for a Corrective Action Plan within six months of the Department’s receipt of the report as required by 34 CFR 80.26 (b) (3).

There are no formal procedures to ensure that a timely and thorough review of the audit reports is conducted. The tracking system (an Excel spreadsheet) used by the internal auditor to determine which audit reports were received and when they were approved is not kept current.

**Observation No. 24 - Review Of Subrecipient Audit Reports Should Be More Timely
(Continued)**

Recommendation:

The Department should implement procedures to ensure that all reviews of subrecipient audit reports are performed thoroughly, in a timely manner and that all federal non-compliance findings are followed up on within six months of receipt of the audit report. We suggest that, in order to adequately achieve this goal, the Department review the current staffing levels of this unit and determine whether additional staff resources are needed to assist the internal auditor in performing this critical function.

Auditee Response:

We concur that review of Subrecipient Audit Reports should be completed in more timely a manner. Steps are being enacted to accomplish this. We believe that we now have a better method of tracking the receipt and review of the audit reports with the implementation of a new MS Access database system that replaces the MS Excel spreadsheet procedure. This new system will assist in more timely completion of audit reports. Further, the Audit Section does not allow audit reports to leave their office, thereby ensuring no reports will be missing from the office. Other Department of Education personnel will review audit reports in the Internal Auditor's office. The Department will pursue adding auditing resources through budgetary additions in the biennial budget process.

**Observation No. 25 – Special Education Should Ensure Compliance With Federal
Maintenance Of Effort Requirements**

Observation:

Federal special education grants to school districts were approved without federally required maintenance of effort (MOE) documentation being remitted to the Department. Federal MOE guidelines require that federal dollars not be used to supplant previous levels of State or local expenditures.

We noted in previous audits that the Bureau of Special Education did not require school districts to supply MOE information as part of the grant application package. Since the 1992 audit, a section was added to the application package requiring school districts to report the amount of local funds expended in the previous year and budgeted in the current year, and to explain why any previous year amounts are greater than any current year amounts. However, of our sample of 25 subrecipients, three did not include adequate information to determine that the MOE requirement was met and funding was authorized without the required review and approval. This weakness in the control process over applications is explained in more detail in Observation No. 11.

Observation No. 25 – Special Education Should Ensure Compliance With Federal Maintenance Of Effort Requirements (Continued)

Observation (Continued):

The MOE requirement is federally mandated by 34 CFR 300.231, which states, “(a) *General*. ...funds provided to an LEA [local education agency] under Part B of the Act may not be used to reduce the level of expenditures for the education of children with disabilities made by the LEA from local school funds below the level of those expenditures for the preceding fiscal year. (b) *Information*. The LEA must have on file with the SEA [state education agency] information to demonstrate that the requirements of paragraph (a) of this section are met.”

Three school districts, Manchester, Nashua, and Oyster River, did not submit MOE documentation with their applications. In each of these applications, it was noted on the checklists that MOE documentation was missing, however, the funding applications were approved without the additional information being provided. The Department subsequently was able to provide documentation demonstrating that the school districts met the MOE requirements and as a result we are not questioning these grant award amounts. The total fiscal year 2000 award amount for these districts equaled \$2.4 million.

Recommendation:

The Department should require all necessary information be included with the application prior to final approval being given for each project. Final approval of the application and funding authorization should not be given without a completed checklist to ensure the review of all aspects of the application. The control over the checklists could be strengthened by requiring a checklist with final approval to be submitted with the approved budget before funding authorization is generated.

Auditee Response:

We concur with the observation. We also concur with the recommendation that the Department require all necessary information be included with the grant application before final approval for a project. The Bureau of Special Education has recently filled all of their consultant positions and this recommendation will be implemented immediately.

Observation No. 26 - Transfers Of Federal Expenditures Should Be Better Documented

Observation:

Transfers of federal expenditures were processed with inadequate supporting documentation. The Department does not have policies and procedures regarding the transfer of expenditures.

In testing a sample of expenditures, we noted that the Bureau of Business Management (BBM) processed two transfers of expenditures with little supporting documentation. Both transfers involved federal dollars, and the support consisted of a short memo from program personnel to BBM asking for an amount to be transferred. The expenditures transferred were then reimbursed with federal dollars. These amounts could not be linked to the original expenditure with the documentation available, and therefore it could not be determined if the costs were allowable under the federal program.

The Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, requires costs to be adequately documented in order to be allowable under federal awards. Support was subsequently provided for one of the two transfers, including invoices for the original expenditures. The other transfer involved expenditures for an educational program for individuals who have applied for assistance through the Department of Health and Human Services (DHHS). DHHS normally reimburses the Department of Education for these expenditures, but some of the bills were rejected due to the ultimate ineligibility of the individuals for DHHS services. These expenditures were then transferred to the Adult Education federal program. The Department was not able to provide any additional support to identify the original expenditures related to this transfer. As a result, we cannot determine whether the amount was an allowable cost under OMB Circular A-87 for the Adult Education federal grant, resulting in questioned costs as indicated below.

Questioned Costs : \$ 34,282

CFDA # 84.002 Adult Education – State Grant Program

Recommendation:

The Department should implement policies and procedures regarding the transfer of expenditures to ensure that adequate documentation supports each transfer. This documentation should enable the reviewer to identify the original expenditures associated with the requested transfer and the reason or propriety of the transfer. The Department should also contact the Federal awarding agency to determine a resolution of these costs.

Observation No. 26 - Transfers Of Federal Expenditures Should Be Better Documented (Continued)

Auditee Response:

We concur with the audit observation that transfer of expenditures (TE) should be better supported. A formal policy and procedure will be written regarding the transfer of expenditures to ensure that adequate supporting documentation is provided for each transfer. If invoices associated with the transfer of expenditure requests are not identified the TE will not be completed. The \$34,282 in question was expended for adult education services to DHHS clients in a program funded by DHHS and administered by the Bureau of Adult Education.

The clients receiving the services in question were ultimately determined by DHHS to be ineligible for this program. Therefore, under the federal regulations, DHHS funds could not be expended for these individuals. However, all of the individuals involved were eligible for services under the Workforce Investment Act of 1998, Title II – The Adult Education and Family Literacy Act. Section 211 (2). (d), (1), (2), (3), (4): “qualifying adult means an adult who is at least 16 years of age, is beyond the age of compulsory school attendance under the law of the State or outlying area, does not have a secondary school diploma or its recognized equivalent and is not enrolled in secondary school”. Therefore, a transfer of expenditures was authorized by the Bureau of Adult Education from the DHHS grant to the federal Adult Education and Family Literacy Act. Currently systems have been developed to prevent ineligible clients from being placed in this program so that further transfer of funds should not be needed.

Observation No. 27 - Allocation Of Special Education Preschool Grant Funds Should Be Better Documented

Observation:

The Department exceeded the percentage federally allowed for administration in its 1998 special education preschool grant. We tested the 1998 grant for administration allowances, as this was the latest grant closed during our audit period.

Per federal regulations 34 CFR 301.24 (b) and 301.25 (a), each State may not use more than 5% of the federal grant award for administration. The 1998 preschool grant award was approximately \$1.48 million. Per review of the ledgers maintained by the Department, approximately 7% of the grant funds was spent on administration, resulting in an excess allocation of costs of \$24,159. The excess amount was used to fund one employee position, which is considered an administrative expense. The method used by the Department to track the percentage of grant funds used for administration is not documented. There is only one individual at the Department knowledgeable in the allocation of these administrative costs, and if this person were to leave state service it would be extremely difficult for the Department to duplicate the tracking. Additionally, this work is not approved or otherwise periodically monitored to review allocations and expenditure levels.

**Observation No. 27 - Allocation Of Special Education Preschool Grant Funds
Should Be Better Documented (Continued)**

Questioned Costs: \$ 24,159

CFDA #84.173 Special Education- Preschool Grants

Recommendation:

The Department should implement procedures to better document and monitor the percentages that are spent on each aspect of the grant to ensure that it meets the requirements in the future. Approvals of the allocations should be obtained and periodic review of the expenditures levels should be monitored to avoid exceeding federal allowable limits. The Department should also contact the Federal awarding agency to determine a resolution of the questioned costs.

Auditee Response:

We concur with the observation. Up until the reauthorization of Individuals with Disabilities Education Act (I.D.E.A.), the State was allowed to allocate from a total grant award, five percent for administrative cost. With reauthorization of I.D.E.A. in 1997, States are given the amounts to be used for entitlement, enrollment, poverty, discretionary, administrative cost and Sliver Grants. The administrative cost amount was less than the original five percent allocation and the bureau over expended in the first year. The Bureau of Special Education has changed its policies and procedures to review and monitor expenditures in order not to exceed the federal allowable limits. The Accountant III and the Program Assistant I within the bureau review and monitor the federal accounts to ensure compliance which is reported to the Program Specialist IV.

The bureau has sent a letter to Ruth Ryder of the Office of Special Education Programs, US Department of Education addressing the observation of over expenditure of administrative funds for FY 1998. We are awaiting a response to this letter.

**Observation No. 28 - Vocational Rehabilitation Should Ensure Compliance With
Federal Eligibility Regulations**

Observation:

Federal vocational rehabilitation eligibility regulations are not being consistently met. Federal vocational rehabilitation regulations require that customer eligibility determinations be made within 60 days and certifications of eligibility be documented.

- Federal regulation 34 CFR 361.41 (b)(1) requires that eligibility determination be made within 60 days of receipt of an application. In our review of 56 case files, we noted that four of the applicants were not determined eligible within 60 days, resulting in a delay in the customer's overall rehabilitation process.

Observation No. 28 - Vocational Rehabilitation Should Ensure Compliance With Federal Eligibility Regulations (Continued)

Observation (Continued):

In one of the four cases, the Case Management System (CMS) contained dates that showed that the determination was made the same day that the application was filed. However, per our review of the hard copies of the application and the certification of eligibility, the determination took 190 days. There was no evidence that an extended evaluation had been conducted. In the other three instances the amount of time in excess of the 60-day requirement ranged from three to 96 days.

- Federal regulation 34 CFR 361.42, requires that the determination of an applicant's eligibility for vocational rehabilitation services is based on established criteria. The Department requires that the counselor certify in writing the applicant's eligibility or ineligibility based on this criteria.

In our review of 56 case files, we noted four files did not contain a signed and dated certification of eligibility. Two of the four contained a typed name in place of a signature. One of the four also lacked evidence of the applicant's disability. This could result in the Department paying for customers to receive rehabilitation services when the customer is not actually eligible for those services.

Recommendation :

The Department should implement procedures to ensure federal eligibility compliance requirements are met. This could be accomplished via implementation of formal review procedures. CMS could also be programmed to notify the counselor when 60 days are about to expire to ensure that timely action is taken to certify the customer or to extend the evaluation.

Auditee Response:

We concur and will implement procedures to ensure compliance with the federal requirement that eligibility is determined within 60 days, as appropriate, and to assure that customers are certified eligible prior to the development of the IPE. Monitoring of eligibility compliance will be accomplished through implementation of a formal review process. Additionally, CMS status reports are available to Regional Leaders and Counselors to monitor those cases approaching the 60-day limit. The Agency will also investigate the possibility of programming the CMS to provide notification that the 60 days are about to expire to ensure that timely action is taken to determine eligibility for the customer.

Although not specific to the cases noted in this observation, we would like to note that there is a waiver proviso within the law and regulations that allows, in some instances, a customer and a counselor to agree to an extension of the time required to determine eligibility. This extension may be for a variety of issues in relation to the customer's circumstances, and if necessary would be done with joint agreement and documented within the case file.

Observation No. 29 - Vocational Rehabilitation Should Enhance Compliance With And Controls Over Customer Employment Plans

Observation:

Federal vocational rehabilitation regulations specific to an individual's plan for employment (IPE) are not being consistently met. Federal regulations require that IPEs contain certain information, and be developed and approved by both the customer and the vocational rehabilitation (VR) counselors.

In our review of 56 case files, we noted instances of noncompliance with federal requirements and failure to consistently apply the controls related to the IPE resulting in services being provided based on plans that were not sufficiently documented and approved, lacking either signatures, specific services or timelines to complete those services. Specifically, we noted the following instances of noncompliance.

- Federal regulation 34 CFR 361.45 (b)(1) and (b)(6) requires that the IPE and any amendments be signed by both the counselor and the customer. In our review, we noted seven instances where either the IPE or the amendment was not signed by both the counselor and the customer.
- Federal regulation 34 CFR 361.45 (b)(5) requires that the IPE be reviewed at least annually. In our review, we noted seven instances of case files that did not contain annual reviews when required.
- Federal regulation 34 CFR 361.46 (a)(3) requires that the IPE contain specific rehabilitation services to be provided to achieve rehabilitation objectives. In our review, we noted two instances of services provided to customers that were not specifically included in the IPE. In one case, the Department paid for dental work in the amount of \$3,148 and college tuition in the amount of \$3,390, neither of which were included in the IPE. In the second case, there was no IPE, yet the Department paid \$549 for an employment assessment.
- Federal regulation 34 CFR 361.46 (a)(4) states that the IPE contain timelines for each level of service provided and anticipated completion of rehabilitation objectives. In our review, we noted three instances where the IPE did not include a timeline for the services to be provided.

Observation No. 29 - Vocational Rehabilitation Should Enhance Compliance With And Controls Over Customer Employment Plans (Continued)

Recommendation:

The Department should implement procedures to ensure federal compliance requirements related to the IPEs are met, and controls are in place and operating as intended. This could be accomplished via implementation of formal review procedures. Also, the Case Management System (CMS) may be programmed to disallow approval of an IPE until all of the required elements are included, such as vocational goals and timelines. Additionally, as the system already contains information as to the date the IPE is developed, CMS could be programmed to notify the counselors that an annual review is due to ensure timely completion of the review.

Auditee Response:

We concur and will implement procedures to ensure that the federal compliance requirements related to the IPEs are met. An informal review process by supervisors is completed throughout the year. A formalized review process that will augment the current review activities will be put in place. The Agency will investigate the potential for programming the CMS to require needed elements prior to completing the IPE and to provide notification that an annual review is due to ensure timely completion of the review.

Observation No. 30 - The Department Should Require All Subrecipients To File General Assurances In Compliance With Federal Regulations

Observation:

The Department does not require all subrecipients to file general assurances in accordance with federal regulations. The Department provides federal funding through 45 different federal grants to 500 subrecipient entities. Most of these federal grants require the Department obtain assurances from subrecipients documenting their awareness of federal regulations for the grants.

For fiscal year 2000, the Department consolidated the various general assurances common to multiple federal programs into one packet. These assurances are required to be on file with the Department at the start of the fiscal year for every subrecipient receiving funds that year.

The Department requires the general assurances be on file for all school districts and administrative units, however, it does not require reporting agencies to file the general assurances. Reporting agencies are primarily non-profit organizations, private schools and summer camps.

**Observation No. 30 - The Department Should Require All Subrecipients To File
General Assurances In Compliance With Federal Regulations
(Continued)**

Recommendation:

The Department should implement procedures to ensure that all entities receiving federal funds have submitted a signed copy of the necessary assurances before receiving any federal funds.

Auditee Response:

We concur in part that the Department does not have on-file general assurances from all Reporting Agencies (RA's). The Department has in place a process for all SAU's and school districts to submit their signed general assurances before any funding can occur. This process is strictly enforced. However, the Department was in the process of implementing the general assurances for RA's. Unlike school districts, RA's can become active at any time during the fiscal year. Because of this, we eliminated the procedure of simply issuing a letter once a year. It is now the responsibility of each program manager to send out the general assurances for the RA's at the time applications are sent out. The new procedure requires that upon receipt of the signed general assurances, they are immediately sent to the internal auditor's office for recording and housing.

Auditor's Report On Management Issues

To The Fiscal Committee Of The General Court:

We have audited the accompanying financial statements of the New Hampshire Department of Education as of and for the year ended June 30, 2000 and have issued our report thereon dated December 7, 2001, which was qualified with respect to the lack of presentation of the financial position of the Department in the General, Special, Capital Projects, and Education Trust Funds and a limitation on the scope of our audit caused by the lack of documentation to support the amounts reported for fixed assets.

Except as discussed in the preceding paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States 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.

In planning and performing our audit of the financial statements of the New Hampshire Department of Education as of and for the year ended June 30, 2000, we noted issues related to the operation of the Department that merit management consideration but do not meet the definition of a reportable condition as defined by the American Institute of Certified Public Accountants, and were not an issue of noncompliance with laws, rules, regulations, contracts, or grants.

The issues that we believe are worthy of management consideration but do not meet the criteria of reportable conditions or noncompliance are included in Observations No. 31 and No. 32 of this report.

This auditor's report on management issues is intended solely for the information and use of the management of the Department of Education and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

Office of Legislative Budget Assistant
Office Of Legislative Budget Assistant

December 7, 2001

Management Issues

Observation No. 31 - The Department Should Consider Recommending Revisions To Statutory Adequacy Grant Formula

Observation:

Fiscal year 2000 was the first year of the education adequacy grants and as such the Department had no experience with interpreting and administering the statutory adequacy calculations. Now that the Department has gained experience and knowledge, it should consider recommending revision to the mechanics of the calculation and to the law establishing the formula. Specifically, consideration should be given to the areas noted below.

- In calculating the cumulative 3rd grade (two part test) and 6th grade (four part test) results from the educational improvement and assessment tests, the Department used a simple average of the six parts of the 3rd and 6th test results combined to determine which school districts fell within a 40-60% achievement range. Those districts where 40-60% of the students achieved a performance rating at the basic level or above are used as the group of districts which determine the average base per pupil cost figure. While the statute does not specify how to determine the 40-60% range, we believe that a weighted average formula, based on the number of 3rd and 6th graders tested would be more equitable. Using a weighted average would give equal weight to both grades rather than skewing the weight in favor of the 6th grade test as it is a four part test rather than the 3rd grade two part test.
- Part of the adequacy grant formula gives additional weight factors to school districts with pupils eligible to receive free or reduced-price meals. The higher the percentage of pupils eligible to receive free or reduced-price meals the larger the weight factor given. When the Department calculated the percentage factor for each school district it appropriately used all grades K-12 as required by the statute, rather than just elementary grades K-8. This lowered the percentage for each school district. To provide consistency the statute should require only elementary grades be used in determining free or reduced-price meals weight as these are the only grades used in applying the weight factor.

Consideration should also be given when reviewing the free or reduced-price meal weight factor, to using the individual town factor rather than the overall factor for each school district. In cooperative districts where there are multiple towns, the percentage of pupils receiving free or reduced-price meals in one town may far exceed the percentage in another town within the same district. The use of a district average may give one town more weight than it would otherwise receive if it were a separate district.

Recommendation:

We recommend that the Department work with the legislature to propose and implement changes to the law that further refine the components used in calculating educational adequacy.

Observation No. 31 - The Department Should Consider Recommending Revisions To Statutory Adequacy Grant Formula (Continued)

Recommendation (Continued):

As the Department gains expertise and knowledge, it should continually review its statutory interpretations with the assistance of the legislature and Attorney General, when appropriate.

Auditee Response:

The Department concurs with the recommendations made by the auditors. The Department will continue its practice of making recommendations for improving Adequacy cost and aid calculations to the legislature as well as seeking clarifying language in existing statutes when necessary. Furthermore, the Department has an ongoing statutory duty to provide assistance to the Adequate Education and Education Finance Commission established in RSA 198:49.

Observation No. 32 - Internal Audit Procedures Related To Subrecipient Monitoring Should Be Enhanced

Observation:

There are no formal policies in place regarding the investigation of variances between the amounts recorded by the Department as paid to subrecipients and the audited amounts reported by subrecipients. The internal auditor compares the expenditures reported by the Department as paid to subrecipients to the amounts reported by the subrecipients in their audit reports. The internal auditor's review of the differences in these two amounts is informal and undocumented.

The Bureau of Business Management supplies the internal auditor with a database containing the expenditures for the fiscal year by subrecipient. The internal auditor then enters that information, as well as the audited amounts reported by the subrecipients, into a spreadsheet. The spreadsheet compares the recorded amounts to the audited amounts, and the internal auditor considers the variances and makes a determination, not based on any set threshold, as to which variances should be investigated. The internal auditor does not document the investigation or the resolution of the variances noted.

The internal auditor's primary responsibility is subrecipient monitoring, including the review and evaluation of subrecipient audit reports. Many of the Department's program staff rely on the internal auditor to satisfy federal subrecipient monitoring requirements. The main focus of the subrecipient monitoring has been the review of audit reports. The review of expenditure variances is another tool used by the internal auditor to monitor subrecipients and, as such, should be documented.

Observation No. 32 - Internal Audit Procedures Related To Subrecipient Monitoring Should Be Enhanced (Continued)

Recommendation:

The internal auditor should establish procedures for investigating variances between recorded amounts and audited amounts reported by subrecipients. These procedures should establish a set of criteria for the variances to be investigated, and those investigations should be documented to evidence the resolution.

Auditee Response:

We concur with the observation and recommendation. The Department will establish procedures for investigating variances between recorded amounts and audited amounts reported by subrecipients. The internal auditor will establish a set of criteria for investigating variances. Investigations will be documented and include evidence of the resolution. Timely completion of investigations may require increasing the staff of the internal auditor. The Department will pursue adding auditing resources through budgetary additions in the biennial budget process.

Independent Auditor's Report

To The Fiscal Committee Of The General Court:

We have audited the accompanying financial statements of the New Hampshire Department of Education as of and for the year ended June 30, 2000. These financial statements are the responsibility of the Department of Education's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the fourth paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States 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 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 more fully discussed in Note 1, the financial statements referred to above are not intended to present the financial position of the Department of Education in the General, Special, Capital Projects, and Education Trust Funds.

As discussed in Note 4, the Department does not have complete financial records to support the amounts reported for fixed assets. Accordingly, we were unable to examine sufficient evidential matter to support such amounts.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had our audit not been limited in scope as discussed in the fourth paragraph, and the matter discussed in the third paragraph, the financial statements referred to above present fairly, in all material respects, certain financial activity of the Department of Education as of and for the year ended June 30, 2000, in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the financial statements referred to in the first paragraph. The accompanying supporting schedules on pages 73 through 77 are presented for the purpose of additional analysis and are not required parts of the financial statements of the Department of Education. Such information has been subjected to the auditing procedures applied in our audit of the financial statements referred to in the first paragraph and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 7, 2001 on our consideration of the Department of Education's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, regulations, contracts, and grants.

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

December 7, 2001

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**COMBINED STATEMENT OF REVENUES AND EXPENDITURES
BUDGET AND ACTUAL – GENERAL, SPECIAL, CAPITAL PROJECTS,
AND EDUCATION TRUST FUNDS
FOR THE YEAR ENDED JUNE 30, 2000**

	<u>General Fund</u>		
	<u>Budget</u>	<u>Actual</u>	<u>Favorable/ (Unfavorable) Variance</u>
<u>Revenues</u>			
<u>Unrestricted Revenues</u>			
Miscellaneous Fees	\$ -0-	\$ 47,288	\$ 47,288
Total Unrestricted Revenues	\$ -0-	\$ 47,288	\$ 47,288
<u>Restricted Revenues</u>			
State Education Property Tax	\$ -0-	\$ -0-	\$ -0-
U.S. Department Of Education	-0-	-0-	-0-
U.S. Department Of Agriculture	-0-	-0-	-0-
Social Security Administration	-0-	-0-	-0-
U.S. Department Of Labor	-0-	-0-	-0-
U.S. Dept Of Health & Human Serv.	-0-	-0-	-0-
Teacher Certification Fees	-0-	-0-	-0-
State Agency Grants	-0-	-0-	-0-
Apprenticeship Training	-0-	-0-	-0-
Other	-0-	66,619	66,619
Total Restricted Revenues	\$ -0-	\$ 66,619	\$ 66,619
Total Revenues	\$ -0-	\$ 113,907	\$ 113,907
<u>Expenditures</u>			
Education Adequacy Grants	\$ -0-	\$ -0-	\$ -0-
Grants To Locals	-0-	-0-	-0-
Building Aid	19,000,000	18,944,900	55,100
Catastrophic Aid	15,978,187	15,247,931	730,256
Other Program Costs	9,787,945	8,017,847	1,770,098
Salaries And Benefits	4,199,463	3,914,034	285,429
Court-Ordered Placements	4,740,317	4,043,201	697,116
Other	1,531,148	1,416,059	115,089
Kindergarten Aid	-0-	-0-	-0-
Total Expenditures	\$ 55,237,060	\$ 51,583,972	\$ 3,653,088
Excess (Deficiency) Of Revenues Over (Under) Expenditures	\$ (55,237,060)	\$ (51,470,065)	\$ 3,766,995

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

Special Fund			Capital Projects Fund			Education Trust Fund			Combined Total (Memo Only)		
Budget	Actual	Favorable/ (Unfavorable) Variance	Budget	Actual	Favorable/ (Unfavorable) Variance	Budget	Actual	Favorable/ (Unfavorable) Variance	Budget	Actual	Favorable/ (Unfavorable) Variance
\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ 47,288	\$ 47,288
<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 47,288</u>	<u>\$ 47,288</u>
\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ 417,974,904	\$ 417,974,904	\$ -0-	\$ 417,974,904	\$ 417,974,904	\$ -0-
92,949,404	69,285,971	(23,663,433)	-0-	-0-	-0-	-0-	-0-	-0-	92,949,404	69,285,971	(23,663,433)
19,484,338	17,772,502	(1,711,836)	-0-	-0-	-0-	-0-	-0-	-0-	19,484,338	17,772,502	(1,711,836)
5,122,759	3,840,286	(1,282,473)	-0-	-0-	-0-	-0-	-0-	-0-	5,122,759	3,840,286	(1,282,473)
3,940,781	1,853,341	(2,087,440)	-0-	-0-	-0-	-0-	-0-	-0-	3,940,781	1,853,341	(2,087,440)
919,845	454,975	(464,870)	-0-	-0-	-0-	-0-	-0-	-0-	919,845	454,975	(464,870)
651,725	732,608	80,883	-0-	-0-	-0-	-0-	-0-	-0-	651,725	732,608	80,883
1,448,870	1,101,515	(347,355)	-0-	-0-	-0-	-0-	-0-	-0-	1,448,870	1,101,515	(347,355)
365,934	242,505	(123,429)	-0-	-0-	-0-	-0-	-0-	-0-	365,934	242,505	(123,429)
337,289	175,265	(162,024)	-0-	-0-	-0-	-0-	-0-	-0-	337,289	241,884	(95,405)
<u>\$ 125,220,945</u>	<u>\$ 95,458,968</u>	<u>\$ (29,761,977)</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 417,974,904</u>	<u>\$ 417,974,904</u>	<u>\$ -0-</u>	<u>\$ 543,195,849</u>	<u>\$ 513,500,491</u>	<u>\$ (29,695,358)</u>
<u>\$ 125,220,945</u>	<u>\$ 95,458,968</u>	<u>\$ (29,761,977)</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 417,974,904</u>	<u>\$ 417,974,904</u>	<u>\$ -0-</u>	<u>\$ 543,195,849</u>	<u>\$ 513,547,779</u>	<u>\$ (29,648,070)</u>
\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ 824,792,297	\$ 824,792,297	\$ -0-	\$ 824,792,297	\$ 824,792,297	\$ -0-
96,079,271	75,948,940	20,130,331	-0-	-0-	-0-	-0-	-0-	-0-	96,079,271	75,948,940	20,130,331
-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	19,000,000	18,944,900	55,100
-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	15,978,187	15,247,931	730,256
17,122,770	10,865,060	6,257,710	-0-	-0-	-0-	-0-	-0-	-0-	26,910,715	18,882,907	8,027,808
10,303,579	8,245,102	2,058,477	-0-	-0-	-0-	-0-	-0-	-0-	14,503,042	12,159,136	2,343,906
-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	4,740,317	4,043,201	697,116
7,722,918	3,506,920	4,215,998	2,090,543	828,755	1,261,788	169,500	28,550	140,950	11,514,109	5,780,284	5,733,825
-0-	-0-	-0-	6,153,983	3,474,656	2,679,327	950,000	-0-	950,000	7,103,983	3,474,656	3,629,327
<u>\$ 131,228,538</u>	<u>\$ 98,566,022</u>	<u>\$ 32,662,516</u>	<u>\$ 8,244,526</u>	<u>\$ 4,303,411</u>	<u>\$ 3,941,115</u>	<u>\$ 825,911,797</u>	<u>\$ 824,820,847</u>	<u>\$ 1,090,950</u>	<u>\$ 1,020,621,921</u>	<u>\$ 979,274,252</u>	<u>\$ 41,347,669</u>
<u>\$ (6,007,593)</u>	<u>\$ (3,107,054)</u>	<u>\$ 2,900,539</u>	<u>\$ (8,244,526)</u>	<u>\$ (4,303,411)</u>	<u>\$ 3,941,115</u>	<u>\$ (407,936,893)</u>	<u>\$ (406,845,943)</u>	<u>\$ 1,090,950</u>	<u>\$ (477,426,072)</u>	<u>\$ (465,726,473)</u>	<u>\$ 11,699,599</u>

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**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**BALANCE SHEET
NONEXPENDABLE TRUST FUNDS
JUNE 30, 2000**

	<u>John Nesmith</u>	<u>Special Teachers Competence</u>	<u>Harriet Huntress</u>	<u>Hattie Livesey</u>
<u>Assets</u>				
Investments	\$ 233,474	\$ 155,659	\$ 23,042	\$ 11,451
Total Assets	<u>\$ 233,474</u>	<u>\$ 155,659</u>	<u>\$ 23,042</u>	<u>\$ 11,451</u>
<u>Liabilities And Fund Balance</u>				
Due To General Fund	\$ 12,646	\$ 10,855	\$ -0-	\$ -0-
Total Liabilities	<u>\$ 12,646</u>	<u>\$ 10,855</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Fund Balance	<u>\$ 220,828</u>	<u>\$ 144,804</u>	<u>\$ 23,042</u>	<u>\$ 11,451</u>
<u>Liabilities And Fund Balance</u>	<u>\$ 233,474</u>	<u>\$ 155,659</u>	<u>\$ 23,042</u>	<u>\$ 11,451</u>

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

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND BALANCE
NONEXPENDABLE TRUST FUNDS
FOR THE YEAR ENDED JUNE 30, 2000**

	<u>John Nesmith</u>	<u>Special Teachers Competence</u>	<u>Harriet Huntress</u>	<u>Hattie Livesey</u>
<u>Revenues</u>				
Interest and Dividends	\$ 12,165	\$ 5,637	\$ 864	\$ 430
Net Increase In Fair Value	<u>6,477</u>	<u>9,696</u>	<u>1,331</u>	<u>661</u>
Total Revenues	<u>\$ 18,642</u>	<u>\$ 15,333</u>	<u>\$ 2,195</u>	<u>\$ 1,091</u>
<u>Expenses</u>				
Client Services	\$ 12,646	\$ -0-	\$ -0-	\$ -0-
Personnel Development	-0-	6,878	-0-	-0-
Consultants	<u>-0-</u>	<u>3,977</u>	<u>-0-</u>	<u>-0-</u>
Total Expenses	<u>\$ 12,646</u>	<u>\$ 10,855</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Net Income	<u>\$ 5,996</u>	<u>\$ 4,478</u>	<u>\$ 2,195</u>	<u>\$ 1,091</u>
Fund Balance - July 1, 1999	<u>\$ 214,832</u>	<u>\$ 140,326</u>	<u>\$ 20,847</u>	<u>\$ 10,360</u>
Fund Balance - June 30, 2000	<u>\$ 220,828</u>	<u>\$ 144,804</u>	<u>\$ 23,042</u>	<u>\$ 11,451</u>

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

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2000**

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Department of Education have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

A. Financial Reporting Entity

The Department of Education is an organization of the primary government of the State of New Hampshire. The accompanying financial statements report certain financial activity of the Department. The financial activity of the Department is accounted for in the General, Special, Capital Projects, Education Trust, and Fiduciary Funds in the State of New Hampshire's Comprehensive Annual Financial Report (CAFR). Assets, liabilities, and fund balances are reported by fund for the State as a whole in the CAFR. The Department, as an organization of the primary government, accounts for a portion of the General, Special, Capital Projects and Education Trust Funds and those assets, liabilities, and fund balances as reported in the CAFR that are attributable to the Department cannot be determined. Accordingly, the accompanying financial statements are not intended to show the financial position of the Department in the General, Special, Capital Projects, and Education Trust Funds and the changes in these fund balances are not reported on the accompanying financial statements.

B. Basis Of Presentation - Fund Accounting

The State of New Hampshire and the Department use funds and account groups to report on their financial position and the results of their operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fund is a separate accounting entity with a self-balancing set of accounts. An account group is a financial reporting device designed to provide accountability for certain assets and liabilities that are not recorded in the funds because they do not directly affect net expendable available financial resources.

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Basis Of Presentation - Fund Accounting (Continued)

Governmental Fund Types

General Fund

The General Fund accounts for all financial transactions not specifically accounted for in any other fund. By law, and with certain exceptions, all revenues of governmental funds are paid daily into the State Treasury. All such revenues, other than certain designated revenues, are credited to the General Fund. Annual expenditures that are not allocated by law to other funds are charged to the General Fund.

Special Fund

The Special Fund, one of the State's Special Revenue Funds, is used to account for specific revenue sources that are legally restricted to expenditures for specific purposes. The State allocates to the Special Fund expenditures and revenues of programs that, by statute, operate primarily from specific program revenues or from federal grants-in-aid.

Capital Projects Fund

The Capital Projects Fund is used to account for certain capital improvement appropriations which are or will be primarily funded by the issuance of state bonds or notes, other than bonds and notes for highway or turnpike purposes, or by the application of certain federal matching grants.

Education Trust Fund

The Education Trust Fund is also one of the State's Special Revenue Funds. The Education Trust Fund was established in fiscal year 2000 to distribute adequate education grants to school districts. Funding for the grants comes from a variety of sources, including the statewide property and utility taxes, incremental portions of existing business and tobacco taxes, sweepstakes funds, and tobacco settlement funds. Only the statewide property tax was credited through the Department of Education in fiscal year 2000.

Fiduciary Fund Types

Nonexpendable Trust Fund

Transactions related to assets held in a trustee or agency capacity are accounted for in the fiduciary fund category. The principal of the nonexpendable trust funds is held in perpetuity, whereas the earnings on the principal are used to support the fund's purpose.

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Basis Of Presentation - Fund Accounting (Continued)

Account Groups

General Fixed Assets

General fixed assets acquired for use by the Department for the performance of its operations are reflected in the General Fixed Assets Account Group at the time of acquisition. As of June 30, 2000, the Department had recorded in the General Fixed Assets Account Group the cost of general fixed assets based on available historical cost records. Donated fixed assets are recorded at fair market value at the time donated.

C. Measurement Focus And Basis Of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All government funds are accounted for using the flow of current financial resources measurement focus and reported on a modified accrual basis of accounting. Accordingly, the State of New Hampshire accounts for its financial transactions relating to the General, Special, Capital Projects, and Education Trust Funds on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when measurable and available to finance operations of the fiscal period. "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures are recognized in the period in which obligations are incurred as a result of the receipt of goods or services. Nonexpendable trust funds are accounted for using the accrual basis of accounting. The financial statements of a nonexpendable trust fund include a balance sheet and a statement of revenues, expenses and changes in fund balance.

D. Budgetary Data

General Budget Policies

The statutes of the State of New Hampshire require the Governor to submit a biennial budget to the Legislature for adoption. This budget, which includes annual budgets for each year of the biennium, consists of three parts. Part I is the Governor's program for meeting all expenditure needs as well as estimating revenues to be received. There is no constitutional or statutory requirement that the Governor propose, or the Legislature adopt, a budget that does not resort to borrowing. Part II is a detailed breakdown of the budget at the Department level for appropriations to meet the expenditure needs of the government. Part III consists of draft appropriation bills for the appropriations made in the proposed budget.

The operating budget is prepared principally on a modified cash basis and adopted for the governmental and proprietary fund types with the exception of the Capital Projects Fund.

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Budgetary Data (Continued)

General Budget Policies (Continued)

The Capital Projects Fund budget represents appropriations for individual projects, that extends over several fiscal years. Fiduciary-type funds are not budgeted.

The New Hampshire biennial budget is composed of the initial operating budget, supplemented by additional appropriations. These additional appropriations and estimated revenues from various sources are authorized by Governor and Council action, annual session laws, and existing statutes which require appropriations under certain circumstances. As shown on the Schedules of Budgetary Components - General Fund on page 73, Special Fund on page 74, Capital Projects Fund on page 75, and Education Trust Fund on page 76, the final budgeted amount includes the initial operating budget plus supplemental appropriation warrants, balances brought forward, and transfers.

Budgetary control is at the department level. All departments are authorized to transfer appropriations within their departments with the prior approval of the Joint Legislative Fiscal Committee and the Governor and Council. Additional fiscal control procedures are maintained by both the Executive and Legislative Branches of government. The Executive Branch, represented by the Commissioner of the Department of Administrative Services, is directed to continually monitor the State's financial system. The Legislative Branch, represented by the Joint Legislative Fiscal Committee, the Joint Legislative Capital Budget Overview Committee, and the Office of Legislative Budget Assistant, monitors compliance with the budget and the effectiveness of budgeted programs. Unexpended balances of appropriation at year end will lapse to undesignated fund balance and be available for future appropriations unless they have been encumbered or are legally defined as non-lapsing accounts. Capital Projects Fund appropriations are scheduled to lapse two years from the date appropriated unless extended or designated as non-lapsing by law.

A Combined Statement Of Revenues And Expenditures - Budget And Actual - General, Special, Capital Projects, And Education Trust Funds is presented as part of the Department of Education's financial statements.

Variances - Favorable/(Unfavorable)

The variance column on the Combined Statement Of Revenues And Expenditures - Budget And Actual - General, Special, Capital Projects, And Education Trust Funds highlights differences between budget and actual revenue and expenditures. For revenue, these variances are caused by actual revenue exceeding budget generating a favorable variance or actual being less than budget generating an unfavorable variance. The Special Fund unfavorable revenue variance of \$29.8 million is due to federal funds received being less than estimated as a direct result of federal expenditures being less than estimated. For expenditures, a favorable variance results from actual expenditures being less than the amount budgeted for the fiscal year. The favorable expenditure variances represent a

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Budgetary Data (Continued)

Variances - Favorable/(Unfavorable) (Continued)

combination of ending available balances and unliquidated encumbrances. Unfavorable expenditure variances represent actual expenditures for the reporting period exceeding the amounts budgeted for the fiscal year.

Encumbrances

Contracts and purchasing commitments are recorded as encumbrances when the contract or purchase order is executed. Upon receipt of goods or services the encumbrance is liquidated and the expenditure and liability are recorded. The Department's unliquidated encumbrance balances at June 30, 2000 in the General, Special, and Capital Projects Funds were \$1,051,739, \$2,558,588, and \$320,596, respectively.

E. Fixed Assets – General

General fixed assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisition costs are reflected as expenditures in governmental funds, and the related assets are reported in the General Fixed Assets Account Group. All purchased fixed assets are valued at cost where historical records are available and at an estimated historical cost where no historical records exist. Donated fixed assets are valued at their estimated fair market value on the date received. Interest costs incurred during construction are not capitalized. Assets in the General Fixed Assets Account Group are not depreciated.

F. Interfund And Intrafund Transactions

The State accounts for interfund and intrafund transactions as described below.

Reimbursements - Various departments charge user fees for such services as centralized data processing, accounting and auditing, purchasing, personnel, and maintenance. In addition, the Department of Administrative Services charges rent to those departments that are housed in state-owned buildings. These fees and rent are not considered material and are recorded as revenue by the servicing department and as expenditures by the user department.

G. Interpretation Of Combined Total (Memo Only) Columns

Total columns have been included in the Combined Statement of Revenues and Expenditures - Budget and Actual - General, Special, Capital Projects And Education Trust Funds. The total columns include interfund activity and are presented only to facilitate financial analysis. Data in these columns do not present financial activity in conformity with generally accepted accounting principles. Intra-agency eliminations have not been made in the aggregation of this data.

NOTE 2 – NONEXPENDABLE TRUST FUNDS

The State Treasurer is the custodian for four trust funds at the Department of Education: (1) John Nesmith Trust Fund; (2) Special Teachers Competence Fund; (3) Harriet Huntress Trust Fund; and (4) Hattie Livesey Trust Fund. These funds are reported as Nonexpendable Trust Funds in the State of New Hampshire's Comprehensive Annual Financial Report and are maintained by the Department of Education's Business Administrator.

John Nesmith Trust Fund

The John Nesmith Trust Fund was established by RSA 186-B:8 and is to be used for the aid, support, maintenance, and education of the indigent blind in the State of New Hampshire. Disbursements from the fund are authorized by the Department of Education's Office Of Blind Services.

Special Teacher Competence Fund

Pursuant to RSA 186:7-a, the Special Teacher Competence Fund is "...a permanent fund [from which] the proceeds of the sale of the state lands affected under the authority of a joint resolution approved June 28, 1867 and the annual income thereof may be used by the state board of education for any activity calculated to increase the professional competence of the teachers of New Hampshire." Disbursements from the funds are authorized by the Director of the Division of Program Support at the Department.

Harriet Huntress Trust Fund

The Harriet Huntress Trust Fund was established to provide aid to needy pupils who are students in New Hampshire schools. Disbursements from the fund are authorized by the Department of Education's Business Administrator. There were no disbursements from this fund during fiscal year 2000.

Hattie Livesey Trust Fund

The Hattie Livesey Trust Fund was established for the purpose of providing loans or gifts to assist worthy pupils who are students of New Hampshire schools. Disbursements from the fund are authorized by the Department of Education's Business Administrator. There were no disbursements from this fund during fiscal year 2000.

NOTE 3 – INVESTMENTS

The following statutory requirements and Treasury policies have been adopted to ensure reasonable rates of return on investments while minimizing risk.

The State Treasurer, under the authority of RSA 11:1, acts as custodian of the Department's nonexpendable trust fund investments. In accordance with RSA 11:5, all trust funds in the custody of the Treasurer are invested and reinvested in legal instruments allowable under RSA 6:8.

NOTE 3 – INVESTMENTS (Continued)

In accordance with GASB Statement No. 3, investments are classified as to risk by the three categories described below:

- Category 1 Insured or registered in the State’s name, or securities held by the State or its agent in the State’s name.
- Category 2 Uninsured and unregistered, with securities held by the counterparty’s trust Department or agent in the State’s name.
- Category 3 Uninsured and unregistered, with securities held by the counterparty, or by its trust Department or agent but not in the State’s name.

The Department’s investments at June 30, 2000, summarized by type and risk category, are shown in the following schedule.

	Categories			Fair Value
	1	2	3	
Pooled Investments:				
U.S. Government Obligations	-0-	-0-	56,594	\$ 56,594
Uncategorized:				
Open-ended Mutual Funds				367,032
Total Investments				\$ 423,626

NOTE 4 - GENERAL FIXED ASSETS ACCOUNT GROUP (Unaudited)

Equipment is recorded at historical cost if known, estimated cost if historical cost is unknown, or fair market value at the date of acquisition if the asset is donated.

The following is a schedule of equipment balances and activity reported by the Department of Education to the Department of Administrative Services for the fiscal year ended June 30, 2000. Equipment purchases are funded through budgeted appropriations. Currently, the Department does not have complete financial records to support the amounts included the General Fixed Assets Account Group.

Balance, July 1, 1999	\$ 3,759,353
Additions	538,725
Deletions	(405,808)
Balance, June 30, 2000	\$ 3,892,270

NOTE 5 - EMPLOYEE BENEFIT PLANS

New Hampshire Retirement System

The Department of Education, as an organization of the State government, participates in the New Hampshire Retirement System (Plan). The Plan is a defined benefit plan and covers substantially all full-time employees of the Department. The Plan qualifies as a tax-exempt organization under Sections 401 (a) and 501 (a) of the Internal Revenue Code. RSA 100-A established the Plan and the contribution requirements. The Plan, which is a cost-sharing, multiple-employer Public Employees Retirement System (PERS), is divided into two membership groups. Group I consists of employees and teachers. Group II consists of firefighters and police officers.

Group I - Members contributing through age 60 qualify for a normal service retirement allowance based on years of creditable service. The yearly pension amount is $1/60$ (1.67%) of average final compensation (AFC), multiplied by years of creditable service. AFC is defined as the average of the three highest salary years. At age 65 the yearly pension amount is recalculated at $1/66$ (1.5%) of AFC multiplied by years of creditable service. Members in service with ten or more years of creditable service who are between ages 50 and 60 are entitled to a retirement allowance with appropriate graduated reduction based on years of creditable service. In addition, any Group I member who has completed at least 20 years of creditable service that, when combined with his or her age equals at least 70, is entitled to retire and have benefits commence immediately at a reduced service retirement allowance.

Group II - After attaining the age of 45, members with 20 years of creditable service qualify to receive a retirement allowance at a rate of 2.5% of AFC for each year of creditable service, not to exceed 40 years. Members in service at age 60 qualify to receive a prorated retirement allowance.

Members of both groups are entitled to disability allowances and also death benefit allowances subject to various requirements and rates based on AFC or earnable compensation. All covered Department employees are members of Group I.

The Plan is financed by contributions from the members, the State and local employers, and investment earnings. During fiscal year 2000, Group I and II members were required to contribute 5% and 9.3%, respectively, of gross earnings. The State funds 100% of the employer cost for all of the Department's employees enrolled in the Plan. The annual contribution required to cover any normal cost beyond the employee contribution is determined every two years based on the Plan's actuary.

The Department's payments for normal contribution costs for fiscal year 2000 amounted to 3.94% of the covered payroll for its Group I employees. The Department's contributions for fiscal year 2000 were \$370,411 equal to the required employer contributions for the period. The Plan does not make separate measurements of assets and pension benefit obligation for individual employers. The New Hampshire Retirement System Comprehensive Annual Financial Report contains detailed information regarding the Plan as a whole, including

NOTE 5 - EMPLOYEE BENEFIT PLANS (CONTINUED)

New Hampshire Retirement System (Continued)

information on payroll, contributions, actuarial assumptions and funding method, and historical trend data. The New Hampshire Retirement System operates on a fiscal year ending June 30.

Post-employment Health Care Benefits

In addition to the benefits described above, the Department, as an organization of the State government, provides post-employment health care benefits, in accordance with RSA 21-I:30, to all retired employees and their spouses on a non-contributory basis, as authorized by State statute.

During fiscal year 2000, the State paid for the full cost of health insurance premiums for the retired employees and spouses on a pay-as-you-go basis. The cost of the health insurance for Department employees and spouses is a budgeted amount and is paid from an appropriation made to the administrative organization of the New Hampshire Retirement System. Accordingly, the cost of health insurance benefits for retired Department of Education employees and spouses is not included in the Department's financial statements.

NOTE 6 – LITIGATION

Claremont School District, et. al. verses Governor, et. al.

For the last several years, the State has been involved in ongoing litigation initiated against the State by five school districts who challenged the constitutionality of the State's statutory system of financing the operation of elementary and secondary public schools primarily through local property taxes. On December 17, 1997, the New Hampshire Supreme Court ruled in favor of the Plaintiffs and found that property taxes in support of education are State taxes and that such taxes must be proportional and reasonable throughout the State, and that the current system failed to meet this standard. The Supreme Court further held that a constitutionally adequate public education is a fundamental right, and that the legislative and executive branches must develop and adopt specific criteria implementing appropriate guidelines for such an education.

During the 1998 legislative session, the legislature passed a law defining the components of what constitutes an adequate education and further established commissions to study the costs of providing a constitutionally adequate education. On April 29, 1999, the State Legislature produced a law that determined the cost of an adequate education for the biennium beginning July 1, 1999, and committed the expenditure of that amount of money. Also included in this law are two study commissions: one charged with reviewing New Hampshire's tax structure and the other with reviewing the costs and delivery of an adequate education.

NOTE 6 – LITIGATION (Continued)

Claremont School District, et. al. verses Governor, et. al. (Continued)

In August 1999, the Plaintiffs filed motions in the Supreme Court challenging various aspects of the new system. In October, the Supreme Court struck down the statewide property tax included in the funding plan. The court held that the phase-in of the tax in certain communities was unconstitutional. The court held that the Plaintiffs' other claims were premature and dismissed them without prejudice. In November 1999, the Legislature reenacted the statewide property tax without the phase-in.

On September 5, 2001, the Plaintiffs filed a motion in the Supreme Court challenging the adequacy of the State's compliance with the Court's prior rulings and seeking an Order requiring the Legislature to enact a new school funding system by June 3, 2002. The Attorney General's Office filed an objection to the Plaintiffs motion and asked the Court to close the case. On December 4, 2001, the Supreme Court dismissed the Plaintiffs' claims seeking to require the Legislature to enact a new school funding system. The only pending request is the Plaintiffs' challenge to the definition of an adequate education. It is not possible to predict the outcome of this case at this time or the potential fiscal impact on the State.

Town of New London, Town of Newbury, et. al. verses State

This case was filed on October 24, 2000, in Merrimack County Superior Court and is a constitutional challenge to the statewide education property tax and the educational funding distribution system. The Petitioners are communities that are members of a cooperative school district and are also "donor" communities under the statewide education property tax. They allege that based on the distribution system enacted by the Legislature, they are treated differently than "donor" communities that are not members of a cooperative school district. They also argue that if the distribution system is found to be constitutional, then they should be allowed to renegotiate their cooperative school district allocation formulae.

The trial originally scheduled for November 13, 2001 was converted to a hearing on a Motion to Dismiss. On December 11, 2001, the Merrimack County Superior Court granted the motion to dismiss.

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**SCHEDULE OF BUDGETARY COMPONENTS
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2000**

	<u>Operating Budget</u>	<u>Supplemental Appropriations Warrants</u>	<u>Balances Brought Forward</u>	<u>Net Transfers In (Out)</u>	<u>Budget</u>
<u>Revenues</u>					
<u>Unrestricted Revenues</u>					
Miscellaneous	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-
Total Unrestricted Revenues	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-
<u>Restricted Revenues</u>					
Foundation Aid	\$ 56,000,000	\$ -0-	\$ -0-	\$ (56,000,000)	\$ -0-
Court Ordered Placements	1,900,000	-0-	-0-	(1,900,000)	-0-
Other	-0-	-0-	-0-	-0-	-0-
Total Restricted Revenues	\$ 57,900,000	\$ -0-	\$ -0-	\$ (57,900,000)	\$ -0-
Total Revenues	\$ 57,900,000	\$ -0-	\$ -0-	\$ (57,900,000)	\$ -0-
<u>Expenditures</u>					
Foundation Aid	\$ 73,500,000	\$ -0-	\$ -0-	\$ (73,500,000)	\$ -0-
Building Aid	19,000,000	-0-	-0-	-0-	19,000,000
Catastrophic Aid	16,500,000	-0-	-0-	(521,813)	15,978,187
Other Program Costs	9,520,650	-0-	267,295	-0-	9,787,945
Salaries And Benefits	4,139,899	72,758	-0-	(13,194)	4,199,463
Court-Ordered Placements	3,400,000	-0-	2,718,504	(1,378,187)	4,740,317
Other	896,741	6,454	627,953	-0-	1,531,148
Total Expenditures	\$ 126,957,290	\$ 79,212	\$ 3,613,752	\$ (75,413,194)	\$ 55,237,060
Excess (Deficiency) Of Revenues					
Over (Under) Expenditures	\$ (69,057,290)	\$ (79,212)	\$ (3,613,752)	\$ 17,513,194	\$ (55,237,060)

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**SCHEDULE OF BUDGETARY COMPONENTS
SPECIAL FUND
FOR THE YEAR ENDED JUNE 30, 2000**

	<u>Operating Budget</u>	<u>Supplemental Appropriations Warrants</u>	<u>Balances Brought Forward</u>	<u>Net Transfers In (Out)</u>	<u>Budget</u>
<u>Revenues</u>					
<u>Restricted Revenues</u>					
U.S. Department Of Education	\$ 65,509,057	\$ 26,675,026	\$ 1,675,231	\$ (909,910)	\$ 92,949,404
U.S. Department Of Agriculture	18,919,024	561,429	3,885	-0-	19,484,338
Social Security Administration	4,853,091	261,671	7,997	-0-	5,122,759
U.S. Department Of Labor	2,125,000	1,728,640	87,141	-0-	3,940,781
U.S. Dept. Of Health & HS	616,423	244,724	59,126	(428)	919,845
Teacher Certification Fees	604,274	47,451	-0-	-0-	651,725
State Agency Grants	238,367	1,210,503	-0-	-0-	1,448,870
Apprenticeship Training	202,500	163,434	-0-	-0-	365,934
Other	<u>326,560</u>	<u>10,729</u>	<u>-0-</u>	<u>-0-</u>	<u>337,289</u>
Total Restricted Revenues	<u>\$ 93,394,296</u>	<u>\$ 30,903,607</u>	<u>\$ 1,833,380</u>	<u>\$ (910,338)</u>	<u>\$ 125,220,945</u>
Total Revenues	<u>\$ 93,394,296</u>	<u>\$ 30,903,607</u>	<u>\$ 1,833,380</u>	<u>\$ (910,338)</u>	<u>\$ 125,220,945</u>
<u>Expenditures</u>					
Grants To Locals	\$ 68,351,173	\$ 27,651,307	\$ 450,980	\$ (374,189)	\$ 96,079,271
Other Program Costs	13,448,143	2,326,848	1,816,668	(468,889)	17,122,770
Salaries And Benefits	10,038,678	243,210	-0-	21,691	10,303,579
Other	<u>5,434,106</u>	<u>682,294</u>	<u>1,695,469</u>	<u>(88,951)</u>	<u>7,722,918</u>
Total Expenditures	<u>\$ 97,272,100</u>	<u>\$ 30,903,659</u>	<u>\$ 3,963,117</u>	<u>\$ (910,338)</u>	<u>\$ 131,228,538</u>
Excess (Deficiency) Of Revenues Over (Under) Expenditures	<u>\$ (3,877,804)</u>	<u>\$ (52)</u>	<u>\$ (2,129,737)</u>	<u>\$ -0-</u>	<u>\$ (6,007,593)</u>

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**SCHEDULE OF BUDGETARY COMPONENTS
CAPITAL PROJECTS FUND
FOR THE YEAR ENDED JUNE 30, 2000**

	<u>Operating Budget</u>	<u>Supplemental Appropriations Warrants</u>	<u>Balances Brought Forward</u>	<u>Net Transfers In (Out)</u>	<u>Budget</u>
<u>Revenues</u>					
Total Revenues	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-
<u>Expenditures</u>					
Kindergarten Aid	\$ -0-	\$ 5,000,000	\$ 1,153,983	\$ -0-	\$ 6,153,983
Other	<u>-0-</u>	<u>650,000</u>	<u>1,440,543</u>	<u>-0-</u>	<u>2,090,543</u>
Total Expenditures	<u>\$ -0-</u>	<u>\$ 5,650,000</u>	<u>\$ 2,594,526</u>	<u>\$ -0-</u>	<u>\$ 8,244,526</u>
Excess (Deficiency) Of Revenues Over(Under) Expenditures	<u>\$ -0-</u>	<u>\$ (5,650,000)</u>	<u>\$ (2,594,526)</u>	<u>\$ -0-</u>	<u>\$ (8,244,526)</u>

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**SCHEDULE OF BUDGETARY COMPONENTS
EDUCATION TRUST FUND
FOR THE YEAR ENDED JUNE 30, 2000**

	<u>Operating Budget</u>	<u>Supplemental Appropriations Warrants</u>	<u>Balances Brought Forward</u>	<u>Net Transfers In (Out)</u>	<u>Budget</u>
<u>Revenues</u>					
<u>Restricted Revenues</u>					
State Education Property Tax	\$ -0-	\$ 417,974,904	\$ -0-	\$ -0-	\$ 417,974,904
Total Revenues	<u>\$ -0-</u>	<u>\$ 417,974,904</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 417,974,904</u>
<u>Expenditures</u>					
Education Adequacy Grants	\$ -0-	\$ 824,792,297	\$ -0-	\$ -0-	\$ 824,792,297
Kindergarten Aid	-0-	950,000	-0-	-0-	950,000
Other	-0-	169,500	-0-	-0-	169,500
Total Expenditures	<u>\$ -0-</u>	<u>\$ 825,911,797</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 825,911,797</u>
Excess (Deficiency) Of Revenues					
Over (Under) Expenditures	<u>\$ -0-</u>	<u>\$ (407,936,893)</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ (407,936,893)</u>

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
(CASH BASIS)
FOR THE YEAR ENDED JUNE 30, 2000**

<u>Federal Catalog Number</u>	<u>Federal Grantor/ Federal Program Title</u>	<u>Expenditures</u>
<u>Department Of Agriculture</u>		
10.553	School Breakfast Program	\$ 2,209,642
10.555	National School Lunch Program	11,499,609
10.556	Special Milk Program For Children	199,469
10.558	Child And Adult Care Food Program	2,652,215
10.559	Summer Food Service For Children	316,019
10.560	State Administrative Expenses For Child Nutrition	310,980
10.574	Team Nutrition Grants	30,040
10.665	Schools And Roads - Grants To States	<u>554,530</u>
	Total	\$ 17,772,504
<u>Department Of Labor</u>		
17.249	Employment Services And Job Training Pilots - Demonstration & Research	<u>\$ 1,866,795</u>
	Total	\$ 1,866,795
<u>Department Of Education</u>		
N/A	Common Core Data Survey	\$ 20,881
84.002	Adult Education - State Grant Program	1,234,726
84.010	Title I Grants To LEAS	17,273,418
84.011	Migrant Education - Basic State Grant	216,841
84.013	Title I Program For Neglected And Delinquent Children	265,377
84.027	Special Education - Grants To State	17,993,796
84.029	Special Education - Personnel Development And Parent Training	44,344
84.048	Vocational Education - Basic Grants To States	4,855,390
84.126	Vocational Rehabilitation Grants To States	8,925,643
84.162	Immigrant Education	31,411
84.169	Independent Living - State Grants	254,272
84.173	Special Education - Preschool Grants	1,410,848
84.177	Independent Living Services For Older Individuals Who Are Blind	202,654
84.185	Byrd Honors Scholarships	165,000
84.186	Safe And Drug-Free Schools And Communities - State Grants	1,850,863
84.187	Supported Employment Services For Individuals With Severe Disabilities	244,840
84.194	Bilingual Education Support Services	102,582

(Continued)

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF EDUCATION**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
(CASH BASIS)
FOR THE YEAR ENDED JUNE 30, 2000
(Continued)**

<u>Federal Catalog Number</u>	<u>Federal Grantor/ Federal Program Title</u>	<u>Expenditures</u>
<u>Department Of Education (Continued)</u>		
84.196	Education For Homeless Children And Youth	97,425
84.213	Even Start - State Educational Agencies	604,744
84.215	Fund For The Improvement Of Education	41,901
84.216	Capital Expenses	1,675
84.243	Tech-Prep Education	472,549
84.265	State Vocational Rehabilitation Unit In-Services Training	57,533
84.276	Goals 2000 - State And Local Education Systemic Improvements Grants	1,539,714
84.281	Eisenhower Professional Development State Grants	1,588,026
84.293	Foreign Language Assistance	27,475
84.298	Innovation Education Program Strategies	1,331,119
84.318	Technology Literacy Challenge Fund	2,021,234
84.323	Special Education - State Program Improvement Grants For Children With Disabilities	84,527
84.332	Comprehensive School Reform Demonstration	232,150
84.340	Class Size Reduction	3,320,872
84.342	Preparing Tomorrow's Teachers To Use Technology	45,340
	Total	\$ 66,559,170
<u>Department Of Health And Human Services</u>		
93.938	Cooperative Agreements To Support Comprehensive School Health Programs To Prevent The Spread Of HIV And Other Important Health Problems	\$ 225,128
	Total	\$ 225,128
<u>National Corporation For Community Services</u>		
94.004	Learn And Service America - School And Community Based Programs	\$ 196,857
	Total	\$ 196,857
<u>Social Security Administration</u>		
96.001	Social Security - Disability Insurance	\$ 3,482,744
96.006	Supplemental Security Income	523,470
	Total	\$ 4,006,214
	Total All Programs	\$ 90,626,668

APPENDIX A

Current Status Of Prior Financial Audit Findings

The following is a summary, as of December 7, 2001, of the status of the observations contained in the audit report of the Department of Education for the fiscal year ended June 30, 1992. A copy of the prior report can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House Room 102, Concord, NH 03301-4906.

	Status
Internal Controls	
Recurring Reportable Conditions	
1. Manual Federal Ledger System (<i>see current year observation No. 3</i>)	● ○ ○
New Reportable Conditions	
2. Equipment Inventory	● ● ●
3. Division Of Vocational Rehabilitation Equipment Lien Policy	● ● ●
4. Building Aid Calculation Error	● ● ●
5. Overstatement Of Accounts Payable	● ● ●
6. Control Over Cash Receipts	● ● ●
7. Lack Of Cross-Training – Foundation Aid	● ● ●
8. Accounting For Trust Funds	● ● ●
State Compliance	
9. Research And Demonstration Unit	● ● ●
10. Biennial Report Not Filed Timely	● ● ●
Federal Compliance	
11. Subrecipient Cash Management (<i>see current year observation No.22</i>)	○ ○ ○
12. Underallocation Of Indirect Costs	● ● ●
13. National School Lunch Program AIMS Reviews	● ● ●
14. Chapter 1 On-Site Review Tracking System	● ● ●
15. Improper Amounts Used On State Per Pupil Expenditure (SPPE) Survey	● ● ●

(Continued)

APPENDIX A

**Current Status Of Prior Financial Audit Findings
(Continued)**

	Status
Federal Compliance (Continued)	
16. Untimely Submission Of Special Education Annual Performance Report	● ● ●
17. Lack Of Special Education Non-Supplanting Documentation (<i>see current year observation No. 25</i>)	● ○ ○
18. Understatement Of Vocational Education Financial Status Report	● ● ●
19. Financial Management Of Vocational Education Programs	● ● ●
20. Vocational Rehabilitation Client Database System	● ● ●
21. Vocational Rehabilitation Individual Written Rehabilitation Program (IWRP) Documentation	● ● ●
22. Determination Of Vocational Rehabilitation Similar Benefits	● ● ●
23. Error In Vocational Rehabilitation RSA-2 Annual Report	● ● ●
24. Vocational Rehabilitation Case Closure Procedures	● ● ●
25. Errors In Annual Report Of Vending Facilities Program	● ● ●

Status Key

Fully Resolved	● ● ●
Substantially Resolved	● ● ○
Partially Resolved	● ○ ○
Unresolved	○ ○ ○

APPENDIX B

Current Status Of Prior Performance Audit Findings

The following is a summary of the status of the observations, as of December 7, 2001, contained in the performance audit report of the Department of Education's Special Education Catastrophic Aid Program, dated July 1999. A copy of the report can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House Room 102, Concord, NH 03301-4906 or it can be viewed at www.gencourt.state.nh.us/lba. The table below represents the Department's evaluation of the status of the observations in the performance report and have not been verified by this Office.

	Status (Per the Department)		
Staffing			
1. Inadequate Staffing At The Bureau Of Special Education	○	○	○
Rule Making			
2. Lack Of Administrative Rules (<i>see current year observation No. 21</i>)	●	●	○
Compliance			
3. Insufficient Review Of Special Education Expenditures (<i>see current year observations No. 4 and 15</i>)	●	○	○
4. Projects Not Being Submitted For Governor And Council Approval (<i>see current year observation No.19</i>)	●	○	○
5. Rates Not Being Appropriately Set For Non-Approved In-State Facilities	●	●	○
6. Student Placements At Some Non-Approved Facilities Exceed Limit	●	●	●
Information Management			
7. SPEDIS Oversight Needs Improvement (<i>see current year observation No.4</i>)	●	●	○
8. Update The Legislature On The SPEDIS Conversion	●	○	○
Foundation Aid Formula			
9. Weighted Funding Formula Not Placement Neutral	●	●	●

Status Key

Fully Resolved	● ● ●
Substantially Resolved	● ● ○
Partially Resolved	● ○ ○
Unresolved	○ ○ ○

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