



Report of the Vermont State Auditor

June 5, 2008

INTERNAL CONTROLS

Results of Review at the
Department of Education

Thomas M. Salmon, CPA
Vermont State Auditor
Rpt. No. 08-4

Mission Statement

The mission of the Auditor's Office is to be a catalyst for good government by promoting reliable and accurate financial reporting as well as promoting economy, efficiency, and effectiveness in state government.

This report is a work of the Office of the State Auditor, State of Vermont, and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from the State of Vermont or the Office of the State Auditor. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately. Please contact the Office of the State Auditor if you have questions about reproducing this report.

**THOMAS M. SALMON, CPA
STATE AUDITOR**



**STATE OF VERMONT
OFFICE OF THE STATE AUDITOR**

June 5, 2008

The Honorable Gaye Symington
Speaker of the House of Representatives

The Honorable Peter D. Shumlin
President Pro Tempore of the Senate

The Honorable James Douglas
Governor

Mr. William Talbott
Acting Commissioner of the Department of Education

Dear Colleagues,

As part of our audit of the Comprehensive Annual Financial Report (CAFR) for the fiscal year ending June 30, 2007, we reviewed internal controls over financial reporting, and compliance with laws and regulations at several State organizations, including the Department of Education (Department).

We found that the Department had implemented various entity-level controls, such as publishing, in conjunction with the Board of Education, its strategic plan. However, we also found internal control deficiencies in which improvements could be made. Specifically, establishment of a formal risk measurement and monitoring program and internal control evaluation mechanisms would allow management to determine the appropriateness of the existing risk level, while providing management the opportunity to identify and correct any control activity deficiencies. Two control activities, related to the statewide general education funding calculations, were collectively considered a significant deficiency. The improved spreadsheet controls should ensure accuracy of the statewide education payments calculations. The appropriately segregated duties over the calculation process should largely reduce the risk of error or fraud. The Department also had two deficiencies related to special education funding. First, lack of the audit selection criteria and second, untimely finalization and reporting of the audit results. Consistency of the selection criteria allows audits to focus at the risk areas imperative to the State. Timely audit completion and reporting of the results provide an effective monitoring mechanism for the use of State funds.

132 State Street • Montpelier, Vermont 05633-5101
Auditor: (802) 828-2281 • Toll-Free (in VT only): 1-877-290-1400 • Fax: (802) 828-2198
email: auditor@state.vt.us • website: www.auditor.vermont.gov

I would like to thank the management and staff of the Department of Education for their cooperation and professionalism. If you would like to discuss any of the issues raised by this audit, I can be reached at the phone number or email listed below.

Sincerely,

Thomas M. Salmon CPA

Thomas M. Salmon, CPA
State Auditor

Contents

Report

Introduction	1
Highlights	4
Background	6
Entity-Level Controls	7
Statewide General Education Funding and Related Control Activities	9
Special Education Control Activities	13
Conclusions	15
Recommendations	15
Management's Comments	16
Appendix I: Management's Comments	18

Figures

Figure 1: Simplified Illustration of the Statewide Property Tax Calculation, Collection and Distribution Process	11
--	----

Abbreviations

CAFR	Comprehensive Annual Financial Report
DOE	Department of Education
SAS	Statements on Auditing Standards
IT	Information Technology

Introduction

The Vermont Department of Education (DOE) provides continuous leadership to Vermont schools in assisting Vermont students with achieving an excellent education. It plays a major financial role in the administration of educational programs. Among other tasks DOE is responsible for the following:

- Administration of aspects of the statewide public education funding system, including calculations and distribution of general education payments to school districts and calculations of municipal remittances to the State. In performing its role, the Department of Education works with (1) school districts¹ that provide budget and student enrollment information to DOE; (2) the Department of Taxes, which provides DOE with homestead² and non-residential property tax rates; (3) municipalities, which bill their constituents, collect the tax and remit funds to schools and to the State; and (4) the Office of the State Treasurer, which collects municipal remittances³ of residential and non-residential property taxes owed to the State.
- Fiscal monitoring of supervisory unions, consisting of two or more school districts that receive federal and state grants.
- Administration of the federal and state special education finance programs.

¹ Unless otherwise indicated in this report, “school districts” means town school districts, union school districts, interstate school districts, joint contract districts, city school districts, unified union districts, and incorporated school districts.

² For the purposes of education funding, all real property is classified as either homestead or nonresidential (32 V.S.A. Chapter 135). A statewide education tax is imposed on these two classes of property at different rates. The homestead education tax rate in each municipality depends upon local per pupil spending. Both the homestead and nonresidential education tax rates are adjusted by the local common level of appraisal.

³ 32 V.S.A. §5402 (c) requires that the Commissioner of Education determine a municipality’s net nonresidential education tax payment and net homestead education tax payment. According to this statute, twice a year (June and December) municipalities are required to pay to the State Treasurer 50 percent of the statewide nonresidential tax and 50 percent of the homestead education tax as determined by the Commissioner. In addition, 32 V.S.A. §5409 requires that municipalities that do not meet these dates be assessed an interest charge of 8 percent per annum of the amount due.

-
- Providing technical and financial assistance to school districts for eligible construction expenditures.
 - Compliance with federal regulations.

The Department of Education is overseen by the Vermont State Board of Education. The Board consists of voting and non-voting members, and is responsible for supervision over, and management of, the DOE and the public school system, except otherwise provided by law.

In consideration of the Department of Education's financial role and in accordance with our internal control audit obligations⁴ related to the State's fiscal year 2007 Comprehensive Annual Financial Report (CAFR), our objectives were to assess the Department's internal controls over financial reporting and compliance with laws and regulations related to its (1) entity-level controls⁵, (2) control activities⁶ associated with the administration of statewide general education funding, and (3) control activities associated with special education funding.

Auditing standards define three types of control findings⁷. First, a control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. According to auditing standards, the auditor must evaluate identified control deficiencies to determine whether these deficiencies, individually or in combination, are significant deficiencies or material weaknesses. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting

⁴ *Generally Accepted Auditing Standards* AU Section 150.02 (American Institute of Certified Public Accountants, Inc.). These standards require that auditors obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.

⁵ Entity-level controls can have a pervasive effect on the overall system of control activities and pertain to the organization as a whole. It encompasses the organization's control environment, risk assessment, information and communication, and monitoring activities.

⁶ Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives.

⁷ *Statements on Auditing Standards (SAS) 112, Communicating Internal Control Related Matters Identified in an Audit* (American Institute of Certified Public Accountants, Inc., May 2006).

principles such that there is more than a remote⁸ likelihood that a misstatement of the entity's financial statements that is more than inconsequential⁹ will not be prevented or detected. A material weakness is a significant deficiency, or a combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

⁸ SAS 112 states that the likelihood of an event is "more than remote" when it is at least reasonably possible.

⁹ The term "more than inconsequential" describes the magnitude of potential misstatement that could occur. A misstatement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements.

Highlights: Report of the Vermont State Auditor

Internal Controls: Review at the Department of Education

(June 2008, Rpt. No. 08-4)

Why We Did This Audit

As part of our audit of the State's fiscal year 2007 CAFR, we evaluated the internal controls over financial reporting and compliance with laws and regulations at the Department of Education due to its leading financial role in administering school funding. As part of our evaluation, we reviewed the design of the Department's entity-level controls, control activities related to statewide education funding and special education funding. We did not perform tests of effectiveness.

What We Recommend

We made a variety of recommendations related to several control areas. In particular, we recommended that DOE develop a formal risk assessment measurement and monitoring program, establish a committee responsible for monitoring and assessing internal controls, establish spreadsheet controls over the statewide general education funding calculations, and establish the audit selection criteria for the audits of special education expenditures.

Findings

The control areas at the Department of Education that we reviewed were largely designed appropriately. For example, DOE had implemented various entity-level controls, such as publishing, in conjunction with the Board of Education, its strategic plan.

We found two entity-level control deficiencies. First, DOE had not implemented a formal risk measurement and monitoring program. Through the risk assessment process, management determines how much risk is to be prudently accepted and strives to maintain risk within these levels. Such a process is important because managers can use risk assessments to determine the relative potential for loss in programs and functions and to design the most cost-effective and productive internal controls. Second, DOE does not have an ongoing mechanism to evaluate its internal controls. According to the State's internal control guide, management should establish procedures that monitor the effectiveness of control activities. Such monitoring provides management the opportunity to identify and correct any control activity deficiencies or problems and to minimize the impact of unfavorable events.

DOE's control activities related to the statewide general education funding calculation had two deficiencies. Collectively, these deficiencies are considered a significant deficiency. Namely,

1. *Spreadsheet Controls.* Critical spreadsheets are utilized to calculate the general education payments to school districts and municipal education tax payments to the State. Specifically, DOE does not have (1) a process of documentation supporting spreadsheet formula design and calculation process, (2) a process of formula logic check by anybody other than the spreadsheet developer, and (3) a review and approval controls. Because these spreadsheets are the basis for allocating about \$1 billion in State education payments to school districts and form the basis for recording revenues and expenditures in the State's financial reporting system, we believe that strong controls are needed.
2. *Segregation of Duties.* Segregation of duties is the division of key responsibilities among different people to reduce the risk of error or fraud. DOE has not properly segregated key functions related to the spreadsheet design and oversight controls.

DOE's control activities related to special education funding had two

Highlights: Report of the Vermont State Auditor

Internal Controls: Review at the Department of Education

(June 2008, Rpt. No. 08-4)



deficiencies. One of the deficiencies related to a lack of documented formalized criteria utilized to select supervisory unions for audit. Appropriately developed and consistently applied audit selection criteria are important to ensure that selections are made on a basis that addresses the risk to the State. The second control deficiency related to the failure to finalize and report the results of special education audits in a timely manner. Timely finalization of the audits and reporting of the results is important for the audits to serve as an effective validation tool.

Background

Internal control can be broadly defined as a process, affected by an entity's governance structure, management, and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal control is a major part of managing an organization. Such controls comprise the plans, methods, and procedures used to meet missions, goals, and objectives. In addition, internal control serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud.

Scope and Methodology

As part of our audit of the State's fiscal year 2007 CAFR, we gained an understanding of internal controls at DOE. Our work was performed for the limited purpose of planning and performing this audit and would not necessarily identify all deficiencies in internal control over financial reporting. We considered the design of the Department's controls and whether they were in place and operational. We did not test the effectiveness of the controls.

To assess the Department of Education's entity-level controls, we used guidance developed by the U.S. Government Accountability Office¹⁰ to develop a set of questions that addressed the control environment, risk assessment, information and communication, and monitoring. We discussed these questions with the Department personnel, including DOE Deputy Commissioner, Chief Financial Officer and Assistant Division Director. We also reviewed applicable documentation, such as Vermont State Board of Education Fiscal Year 2008 Budget Recommendations and Annual Report, its internal control self-assessment and various human resources documents.

To assess the control activities associated with DOE's administration of the statewide general education funding, we reviewed the applicable Vermont statutes

¹⁰ *Internal Control Management and Evaluation Tool* (U.S. Government Accountability Office, GAO-01-1008G, August 2001).

and performed walkthroughs of major activities, such as calculations of the amounts owed to school districts and to the State. We inquired of the Education Finance Manager regarding the control activities established by DOE over the calculations, their authorization and approval procedures. We also gained an understanding of the IT controls by interviewing the Education Department's IT division personnel.

To obtain an understanding of the control activities associated with the policies and procedures of special education audits, we interviewed the Special Education Financial Manager, reviewed an example of a report and form that school districts are required to file in order to receive funding, and reviewed statistical results of past and on-going special education audits.

We performed this audit in accordance with generally accepted government auditing standards between August and December 2007 in Montpelier.

Entity-level Controls

In general, we found that entity-level controls of DOE were designed properly. Some improvements can be made to further strengthen such controls, which encompass its control environment, risk assessment, information and communication, and monitoring activities.¹¹

- *Control Environment.* The control environment sets the tone of an organization. It is the foundation for all other components of internal control. Among the factors that influence an evaluation of an organization's control environment are ethical values and integrity, management philosophy and operating style, commitment to competence, and structure.
- *Risk Assessment.* Risk assessment is the identification, analysis, and management of risks relevant to the achievement of the department's goals and objectives.
- *Information and communication.* For an entity to run and control its operations, it must have relevant and reliable financial and non-financial information, related to both internal and external events. Effective

¹¹ To guide our assessment of entity-level controls, we generally utilized the internal control frameworks and definitions promulgated by COSO and the U.S. Government Accountability Office. These concepts are also included in State guidance on internal controls, *Internal Control Standards: A Guide for Managers* (Department of Finance and Management).

communication must occur in a broad sense, flowing down, across, and up the organization.

- *Monitoring.* Internal control environments need to be monitored. Ongoing monitoring occurs in the course of operations, including regular management and supervisory activities.

DOE provided evidence that it had implemented important controls in these areas. For example,

- As part of establishing an ethical tone in the control environment, the DOE management team expressed clear expectations to all employees by providing a guide for new employees and the Statewide Code of Conduct, issued by the Department of Human Resources.
- With respect to risk assessment, DOE had established several expected risk assessment controls. For example, to mitigate the risk of the impact of legislative changes, DOE established a process of monitoring state and federal legislative changes. Also, DOE, in conjunction with the Board of Education, annually publishes a strategic plan, which defines the DOE's mission statement, outlines the DOE's five-year plan, expressed in five specific goals, and defines strategies for DOE to focus on each year. Although the current strategic plan does not address particular risks that the DOE might be facing, such plan may be viewed as one of the important starting points and a critical component of the effective risk assessment program.

Although DOE had implemented some good entity-level controls, DOE had two control deficiencies. First, having implemented a process to monitor the impact of legislative changes and having created a strategic plan, the Department had not implemented a process to formally measure and monitor risks. According to the State's internal control guide, after risks are identified, they should be evaluated in terms of likelihood and impact.¹² In addition, the guide contains an example of a simple evaluation scale that can be used by departments. This methodology provides an example of the use of common criteria to define what constitutes high, medium or low risk area and should result in consistent assessment of risk and enable DOE to prioritize proposed actions.

¹² *Internal Control Standards: A Guide for Managers* (Department of Finance and Management). Likelihood is defined as the probability that an unfavorable event would occur if there were no (or limited) internal controls to prevent or reduce the risk. Impact is a measure of the magnitude of the effect to a department if the unfavorable event were to occur.

Second, DOE did not have an internal audit function or an ongoing mechanism to evaluate its internal controls. Although DOE participated in an annual statewide internal control self-assessment process sponsored by the Department of Finance and Management, DOE had not implemented an ongoing mechanism to evaluate internal controls. According to the State's internal control guide, management should establish procedures, which monitor the effectiveness of control activities and the use of control overrides. Such monitoring gives management the opportunity to identify and correct any control activity deficiencies or problems and to minimize the impact of unfavorable events.

DOE also did not employ two common mechanisms that can assist in preventing and detecting fraud, particularly from internal sources. Specifically, DOE does not conduct background checks on employees with a high level of fiscal responsibility nor provides a formal mechanism for staff to report suspected fraud or for dealing with whistleblowers. Because we found that the State as a whole lacked these mechanisms, we will be addressing these issues on a statewide rather than on an organization-by-organization basis.

Statewide Education Funding and Related Control Activities

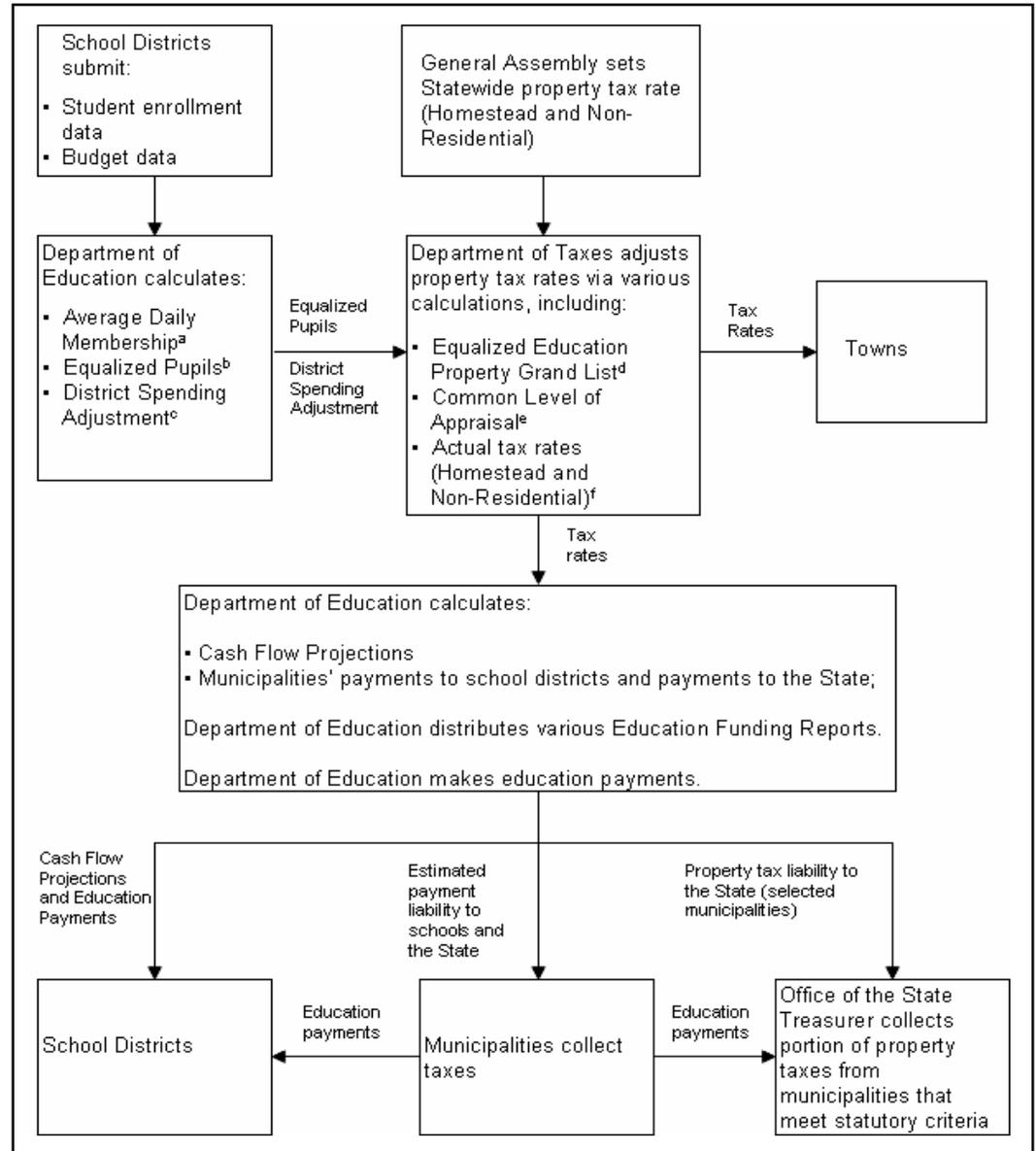
Several revenue sources support the State's expenditures to fund public education. The statewide property tax is the most significant of these revenues, totaling \$879 million in FY 2007. The School Finance Team within the Department of Education plays a significant role in administering statewide education funding. Specifically, this group calculates equalized pupils and district spending adjustments, two significant inputs to the development of property tax rates. DOE also determines the allocation of the statewide property taxes, collected by municipalities, to various school districts, and the amounts municipalities owe to the State. Calculations are performed utilizing multiple Excel spreadsheets.

Figure 1 illustrates the processes involved in the statewide property tax administration. Department of Taxes (DOT), State Treasurer's Office (STO) and all of the state's municipalities also are involved in administration of the statewide property tax system. DOT calculates property tax rates and provides the rates to

municipalities. STO collects amounts remitted by municipalities to the State.¹³
Municipalities collect property taxes from town homeowners.

¹³ Municipalities remit collected statewide property taxes directly to school districts to cover budgeted education expenditures. Some municipalities collect property taxes in excess of education spending amounts. In such cases, municipalities remit the excess funds to the State Treasurer's Office for reallocation to other school districts.

Figure 1: Simplified Illustration of the Statewide Property Tax Calculation, Collection and Distribution Process



^aThe Average Daily Membership (ADM) is a count of resident and state-placed students who receive an elementary or secondary education at public expense, performed in accordance with 16 V.S.A. § 4001 (1).

^bPer 16 V.S.A. §4001, Equalized Pupils means the long-term weighted ADM multiplied by the ratio of the statewide long-term ADM to the statewide long-term weighted ADM.

^cThe District Spending Adjustment is the ratio of the district's education spending plus excess spending per equalized pupil for a year to the base education payment for the school year.

^dThe Equalized Education Property Grand List means one percent of the aggregate fair market value of all nonresidential and homestead property adjusted in accordance with 32 V.S.A. § 5401.

^eThe Common Level of Appraisal is the ratio of the aggregate value of local education property grand list to the aggregate value of the equalized education property tax grand list.

^fThe actual tax rate is calculated for each municipality by dividing the statewide residential (taking into account district spending adjustment) and non-residential tax rates by the municipality's most recent common level of appraisal.

Many of the activities we reviewed had adequately designed controls. However, control exceptions were also identified, including incomplete controls over key spreadsheets and lack of segregation of duties. Collectively, we consider these exceptions to be a significant deficiency.

Spreadsheet Controls

According to a PricewaterhouseCoopers LLP whitepaper on spreadsheet controls, strong operational controls over key spreadsheets are essential for any organization to prevent and deter errors.¹⁴ Such controls include, but are not limited to process documentation, access controls, logic checks of formulas. Numerous field studies conducted on spreadsheets used in organizations have demonstrated that the vast majority of spreadsheets contain a high rate of error.¹⁵ According to Raymond R. Panko, Ph.D., a KPMG study showed that 91 percent of spreadsheets examined had errors serious enough to affect decisions.

DOE utilized multiple spreadsheets to calculate inputs to the property tax rate calculated by DOT and to determine education payments to school districts and had established some controls over their key spreadsheets. These controls included maintenance of a naming convention to ensure version control and the use of analytical procedures as a detective control to find errors in the spreadsheet. However, DOE did not employ controls that are important to ensure the integrity of the spreadsheets.

First, the Department of Education did not have formal written policies and procedures descriptively supporting the various spreadsheets formula design and calculation processes. According to the State internal control guidance, proper documentation of policies and procedures is critical to the daily operations of a department. It is a key training tool that helps to ensure adequate and consistent understanding of the key inputs, formulas and outputs, which among other things would allow the less experienced employees to have unambiguous guidance to the process design and its implementation. Written documentation is also critical to ensure that formulas in the spreadsheet are updated in accordance with the applicable statutory provisions and makes errors or omissions less likely.

Second, DOE did not implement a process to require someone other than the user/developer of the spreadsheets to inspect the logic of formulas within the spreadsheets and to document the results of this review. Third, there was no

¹⁴ "The Use of Spreadsheets: Considerations for Section 404 of the Sarbanes-Oxley Act," PricewaterhouseCoopers, LLP, 2004.

¹⁵ "Controlling Spreadsheets," Raymond R. Panko, Ph.D., ISACA, Information Systems Control Journal, Volume 1, 2007.

documented review that demonstrated that changes to the general education payments calculations were tested and approved, independent of the developer of the changes. The lack of a documented independent review of logic in the spreadsheet formulas and changes to the spreadsheet increases the risk of errors in which inappropriate formulas are created and improper results generated.

Segregation of Duties and Review and Approval Process

While the School Finance division had assigned certain responsibilities related to the various calculations to a financial analyst, we found that it was primarily the School Finance manager who was responsible for key aspects of the process. He designed the calculation spreadsheets, created formulas, changed and updated the spreadsheets, authorized school payments and prepared the supporting schedules for recording revenue and expenditures in VISION. As previously discussed, the Department of Education did not have a formal documented independent review and approval process of calculations of the statewide education funding and education payments to schools.

According to the State's internal control guide, segregation of duties is the division of key functions and responsibilities among different people to reduce the risks of errors. Different personnel should perform the functions of initiation, authorization and record keeping. No one individual should control or perform all key aspects of a transaction or event.

The Department of Education was not following this guide and had a single staff member that performed all key aspects of the education funding transactions.

Special Education Control Activities

Generally, we found that DOE had good controls over the grant application and disbursements processes for special education grants to school districts and some controls over monitoring appropriateness of expenditures by these grant recipients. However, improvements could be made over the process of validating the appropriateness of spending by school districts. Appropriate controls for this activity are important due to the significance of Federal and State spending for special education. In particular, for FY2007, special education grants to school districts consisted of, (1) approximately \$23 million in Federal Grants, and (2) approximately \$100 million in State Grants.

We found that there was appropriate segregation of duties in the grant application and disbursements processes, including an independent manager review of the

calculation of the grant amount and disbursement to schools. Additionally, the Special Education Finance group monitored the appropriateness of grant recipient expenditures through annual audits of a sample of supervisory unions. This group based their audit approach on the DOE Audit Protocol and Guidelines. This guide details the audit framework and establishes processes and requirements for requesting audit information, conducting field work, determining sample sizes, reviewing time studies and reporting audit results. The annual audits served as a control to ensure validity of the school district expenditure reports and to verify the information for accurate and allowable costs. Audits of fiscal years 2005 and 2006 covered approximately 21 percent and 4 percent of expenditures by supervisory unions, respectively.

Although the annual audits are a key monitoring control, the methodology and criteria for selecting supervisory unions for audit is not formally documented and the finalization and reporting of the results of these audits has been significantly delayed. In planning its audits, DOE subjectively varies the number, frequency and audit selection criteria from year to year, which may lead to haphazard selection methodology and less effective audits. Well-defined audit selection criteria can minimize inconsistencies and ensure continuity of audit processes, and can also increase overall audit effectiveness. Moreover, appropriately developed and consistently applied audit selection criteria are important to ensure that selections are made on a basis that addresses the risks to the State and enables the design of the most cost-effective and productive audits. Furthermore, the group that performs these audits is limited to two staff and therefore has limited resources to devote to this function which makes the use of techniques that improve audit efficiencies particularly important.

In addition, as of November 2007, we found that the audits of supervisory unions for the fiscal years 2005-2006 had not been finalized and the fiscal year 2007 audit cycle had not commenced. We understand that the fiscal year 2007 audit cycle has been cancelled to allow for completion of the 2005 and 2006 audits. In order for the audits to function as a validation control, timely finalization of the audits and reporting of the results is important. Moreover, the audits exposed deficiencies in the school districts' financial management of the grants. For example, the audits found errors in the allocation of time for professionals who were not 100 percent dedicated to special education. Usually these errors resulted in significant over-reimbursements of school district expenditures. Such findings point to the need for audit reports to be issued timely in order for weaknesses to be corrected as soon as practicable.

Conclusion

DOE has implemented a myriad of internal controls related to entity-level controls, statewide general education funding related activities and special education funding activities. Such controls improve the likelihood that the DOE is positioned to achieve reliability in its financial operations, and compliance with laws and regulations. Nevertheless, there were a number of areas in which improvements can be made. These improvements are expected to further enhance the Department's controls and ensure compliance with laws and regulations, and the reliability of its financial reporting.

Recommendations

Entity-level Controls

We recommend that the Commissioner of Education:

- Develop a formal risk assessment measurement and monitoring program, which includes risk assessments in major operational areas.
- Establish a committee, comprised of financial and program managers within the Department, that is responsible for monitoring and assessing internal controls related to significant operational areas. This committee should also monitor and follow-up corrective action plans.

Statewide General Education Funding Related Control Activities

We recommend that the Commissioner of Education:

- Establish spreadsheet controls over calculations of the general education funding and payments, including (1) formal documentation of the process, (2) formulas logic tests, and (3) review and approval controls.
- Segregate fundamental functions of initiation, authorization and record keeping within the School Finance Group and establish processes for management review, approval and sign off on key transactions.

Special Education Control Activities

We recommend that the Commissioner of Education:

- Establish and document selection criteria for audits of supervisory unions special education expenditures.

-
- Require that DOE staff complete supervisory unions audits related to special education expenditures within an appropriate prescribed time frame.

Management's Comments

On April 23, 2008, the Department of Education's Chief Financial Officer provided comments on a draft of this report (see Appendix I for a reprint of these comments). In general, DOE's comments addressed the actions that it planned to take in response to our findings. The following summarizes DOE's comments.

- *Risk Assessment and Internal Control Evaluations.* The DOE Chief Financial Officer indicated the Department will establish a risk assessment measurement and monitoring program during monthly management meetings. In addition, he noted that these meetings will also be the mechanism used to monitor and assess internal controls, and to follow up with the corrective action plans. The Department plans to introduce these early in FY 2009.
- *Statewide Education Funding.* The DOE Chief Financial Officer noted some of the actions that DOE had taken with respect to validating the education funding spreadsheets. For instance, the formula results for 12 to 15 districts were reviewed and manually recalculated. However, this control is limited because the review was done by the same person who performed the initial calculations. The Chief Financial Officer also noted that he spot checked many of the spreadsheet functions. Notwithstanding such activities, DOE agreed to implement additional spreadsheet controls. Specifically, DOE stated that it plans to (1) create a notebook documenting data origin, data checks, and file names and (2) maintain a log sheet to document file updates that will be used to document the spreadsheet review. Moreover, in December 2006, DOE hired a Financial and Systems Analyst who has been given the primary responsibility of maintaining the spreadsheets in fiscal year 2008. During fiscal year 2008, the School Finance Manager has been performing oversight and review of the spreadsheets.
- *Special Education.* The DOE Chief Financial Officer has confirmed the Department's intent to formalize the audit selection criteria for the special education audit group and noted that draft criteria have been developed. DOE plans to implement new criteria for the next audit cycle. The Chief Financial Officer reiterated the Department's commitment to ensure prompt completion of the audits and stated that the audit protocols will be reviewed to ensure that the audits can be completed in a timely manner. In addition, he noted that the goal will be completion of each audit within one year from the due date of the school

districts' final expenditure reports. These reports are required to be submitted by August 1 each year.

- - - - -

In accordance with 32 V.S.A. §163, we are also providing copies of this report to the Secretary of the Agency of Administration, Commissioner of the Department of Finance and Management, and the Department of Libraries. In addition, the report will be made available at no charge on the State Auditor's web site, <http://auditor.vermont.gov/>.

Appendix I: Management Comments



State of Vermont
Vermont Department of Education
120 State Street
Montpelier, VT 05620-2501

April 23, 2008

Thomas M. Salmon, CPA
Vermont State Auditor
132 State Street
Montpelier, VT 05633-5101

Re.: Response to Internal Controls Review

Dear Tom:

We have reviewed the draft report of the Internal Controls Review and note there are three areas needing the department's attention. We have carefully reviewed our processes since reading the report and offer the attached response including corrective actions.

I want to commend your staff for their professional manner and expertise. This process has been informative and instructive and will help us improve our systems. Please let me know if you need additional information.

Sincerely,

A handwritten signature in blue ink that reads "Bill Talbott".

Bill Talbott, CFO

The logo for the State of Vermont, featuring a stylized green mountain range and the word "VERMONT" in a serif font.

Appendix I: Management Comments

Department of Education Response to Internal Controls Review

April 21, 2008

Entity-level Controls

We recommend that the Commissioner of Education:

1 - Develop a formal risk assessment measurement and monitoring program, which includes risk assessments in major operational areas.

2 - Establish a committee, comprised of financial and program managers within the Department, that is responsible for monitoring and assessing internal controls related to significant operational areas. This committee should also monitor and follow up corrective action plans.

Response to recommendations

The Commissioner and Chief Financial Officer will establish these processes with the department's management team at its monthly meetings to be effective at the beginning of or early in the FY 2009 fiscal year.

Statewide General Education Funding Related Control Activities

We recommend that the Commissioner of Education:

1 - Establish spreadsheet controls over calculations of the general education funding and payments, including (1) formal documentation of the process, (2) formulas logic tests, and (3) review and approval controls.

2 - Segregate fundamental functions of initiation, authorization and record keeping within the School Finance Group and establish processes for the management review, approval and sign off on the key transactions.

Response to recommendations.

The following steps will be taken by the department to meet these recommendations:

- a. Create a notebook containing documentation of data origin, data checks, and file names into which data are inserted. Each file will have its own page with a brief, explanatory paragraph stating the purpose.
- b. A log sheet will be created that will be a check-off page with date and initials of person updating files.
- c. Reference to statutory citations for new formulas modifying the funding formula have always been inserted in the top sections of each affected column of the spreadsheet when those changes have a significant impact to a number of districts or are new and impact all districts.

Appendix I: Management Comments

- d. Significant statutory changes will be duly noted in the log sheet of the impacted file.
- e. When a spreadsheet had been modified due to statutory changes, each new formula was checked and recalculated on paper via calculator. Only then was the formula incorporated into the final spreadsheet.
- f. Each spreadsheet was reviewed and tested cell by cell for differing categories of districts. Multiple districts in each category were tested and reviewed (generally for a total of 12 to 15 districts). Each formula in each cell for any given district was reviewed and recalculated by hand throughout the spreadsheet.
- g. There was a vacancy in the Financial and Systems Analyst position for most of FY2006 through the first half of FY2007. The spreadsheet determining the FY2007 calculations that were audited was done in June of 2006 and modified as budgets that had previously failed were approved. A Financial and Systems Analyst was hired in mid to late December of 2006, midway through the fiscal year. At that point, the spreadsheets had been completed, cash flows had gone out, and two of three payments from the Education Fund had been made as well as one of the two billings having been sent to towns. The Chief Financial Officer had occasionally been consulted during that time period and he spot checked many of the spreadsheet functions.
- h. In FY2008, the Financial and Systems Analyst has primarily responsible for maintaining the spreadsheet for the FY2008 payments, with oversight and review from the School Finance Manager.
- i. Review documentation will be included in the log sheet as described above in b.
- j. All formulas have been worked through by hand in the past. New formulas are worked through and carefully scrutinized to ensure the results are as expected. They are then incorporated into the spreadsheet.
- k. The log sheet will refer to relevant statutory language that explains the changes to the formulas.
- l. The reviewer's initials and date will be entered.
- m. As noted above in response g, there was a vacancy in the Financial and Systems Analyst position for the first half of FY2007. A Financial and Systems Analyst was hired in mid to late December of 2006, midway through the fiscal year. Currently, the School Finance Manager and the Financial and Systems Analyst review one another's work for logic and accuracy. There are no other staff available to provide additional review.
- n. In FY2008, the Financial and Systems Analyst has primarily been responsible for maintaining the spreadsheet, with oversight and review from the School Finance Manager.

Special Education Control Activities

We recommend that the Commissioner of Education:

- 1 - Establish and document selection criteria for audits of school district

Appendix I: Management Comments

special education expenditures.

2 - Require that DOE staff complete school district audits related to special education expenditures within an appropriate prescribed time frame.

Response to recommendations.

The department is working on selection criteria for prioritizing which supervisory unions will be audited for each fiscal year. The first draft has been produced and, after appropriate review, the process will be refined and implemented for the next audit cycle. The department will be reviewing the special education audit protocols to ensure that the audits can be completed in a timely manner. The goal will be to have all audits completed within one year of the date the final reports for that year are due.