



U.S. Department of Agriculture



Office of Inspector General  
Midwest Region

# Audit Report

Controls Over the Minnesota Department of  
Education's Use of Federal Funds

Report No. 27010-0019-Ch  
JUNE 2005

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Midwest Region

111 North Canal Street - Suite 1130

Chicago, IL 60606-7295



DATE: June 22, 2005

REPLY TO

ATTN OF: 27010-0019-Ch

TO: Ollice C. Holden  
Regional Administrator  
Food and Nutrition Service  
77 West Jackson, 20th Floor  
Chicago, IL 60603

ATTN: Adele Greco  
Senior Financial Specialist  
Financial Management

FROM: Edward R. Krivus /s/  
Regional Inspector General

SUBJECT: Controls Over the Minnesota Department of Education's  
Use of Federal Funds

This report presents the results of our audit of the controls over the Minnesota Department of Education's use of Federal funds. The Food and Nutrition Service's response to the official draft, dated June 15, 2005, is included in its entirety as exhibit B, with excerpts and the Office of Inspector General's position incorporated into the Findings and Recommendations section of the report.

Based on the information contained in the response, we have reached management decision on all recommendations and, therefore, no further correspondence with our office is necessary. If you have any questions, please contact me or have a member of your staff contact Dennis Boedigheimer, Assistant Regional Inspector General, at 312-353-1356.

# ***Executive Summary***

## ***Controls Over the Minnesota Department of Education's Use of Federal Funds Audit Report No. 27010-0019-Ch***

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### **Results in Brief**

We performed this audit at the request of the Food and Nutrition Service (FNS) to assess the Minnesota Department of Education's (State agency) use of Federal funds provided for State Administrative Expenses (SAE). The FNS request was based on the results of reviews conducted by the State's Office of Legislative Auditor and FNS' regional financial management staff covering fiscal years 1999 through 2004. The Legislative Auditor and FNS reviews identified the mismanagement of grant funds, and substantial problems with the State agency's accounting, expenditure, and reporting of both Federal SAE and program funds. FNS recommended changes to the State's accounting procedures and required adjusting entries that resulted in reimbursement of misspent funds.

This report presents the results of our audit of the adequacy of the State agency's controls over the use of Federal SAE funds. Our objective was to determine whether Federal SAE funds were used in accordance with regulations, and the extent of any improper claims. Our audit disclosed that the State agency is continuing to make corrections to its accounting system to ensure the proper use and reporting of Federal SAE funds. However, the State agency has not yet developed adequate procedures to ensure its professional service contracts adhere to Federal guidelines.

We determined that the State agency used Federal SAE funds to finance a State program initiative by contracting for computer enhancements unrelated to FNS' Child Nutrition Programs. We questioned 4 of the 12 contracts we reviewed for fiscal years 2000 through 2003, because the State agency did not correctly determine the allowability or properly allocate expenditures between Federal and State programs. As a result, the State agency used over \$235,000 of \$3 million in Federal SAE funds without a clear cost benefit to FNS' Child Nutrition Programs.

### **Recommendations In Brief**

We recommend that FNS issue a bill of collection to the State agency for \$235,120 in unallowable and unallocable costs charged for professional service contracts. We also recommend that FNS require the State agency to ensure their contracting procedures comply with Federal guidelines in determining the allowability and funding source for required costs. We also recommend that FNS require the State agency to establish appropriate contract criteria that includes a proper determination and allocation between Federal and State cost objectives.

**Agency Response** In its response to the official draft report, dated June 15, 2005, the FNS agreed with all recommendations and has collected the \$235,120 in unallowable and unallocable costs. We have incorporated applicable portions of the FNS response, along with our position, within the Findings and Recommendations section of the report. The FNS response is included in its entirety as exhibit B of this audit report.

**OIG Position** Based on FNS' response, we have reached management decisions for all Recommendations. Requirements for final action are listed under OIG Position for each recommendation within the Findings and Recommendations section of the report.

## ***Abbreviations Used in This Report***

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CFR	Code of Federal Regulations
FNS	Food and Nutrition Service
FY	Fiscal Year
NSLP	National School Lunch Program
OIG	Office of Inspector General
OMB A-87	Office Management and Budget Circular A-87
SAE	State Administrative Expense
SCHIP	State Child Health Insurance Program
USDA	United States Department of Agriculture

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# ***Background and Objectives***

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## **Background**

The Child Nutrition Act of 1966 (Act) requires an annual allocation of Federal funds to each State for its administrative costs incurred in connection with the programs authorized under the Richard B. Russell National School Lunch Act [42 U.S.C. 1751 et seq.] or under this Act [42 U.S.C. 1771 et seq.].<sup>1</sup> The Food and Nutrition Service (FNS) determines the allocation amounts and monitors a State's draw of Federal funds to ensure it does not exceed its allocation. The Act also provides a State the option of using up to 20 percent of its fiscal year (FY) allocation for obligation and expenditure to be used in the next fiscal year. However, any allocations that the State did not obligate or expend must be returned to FNS for reallocation to States that demonstrate a need for additional State Administrative Expense (SAE) funds.

Federal Regulations<sup>2</sup> stipulate that SAE funds shall be made available to State agencies and describe the proper use and reporting of those funds. A State's allocated amount, based in part on its SAE Plan, is made available through a letter of credit. The use of Federal SAE funds requires compliance with the Uniform Administrative Requirements for Grants and Cooperative Agreements 7 CFR 3016 and the Office of Management and Budget Circular A-87, which describe the establishment of indirect cost rates and the allowability of certain direct costs.

The Minnesota Department of Education is the current State agency that has direct responsibility for Federal SAE fund usage. In addition to annual Federal SAE allocations, FNS provided grant funds for specific projects. Special grants must be used only for expenses associated with the specific grant objective.

During FYs 2000 through 2003, the State agency received Federal SAE funds in regular allocations, a reallocation in FY 2000, and also received special grant funds. The State agency received regular allocations and reallocations totaling over \$10.9 million, with over \$3 million (28 percent) expended for professional service contracts and amendments. In addition, the State agency received Team Nutrition and Provision 2 and 3 grants totaling \$700,000<sup>3</sup>.

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<sup>1</sup> The Child Nutrition Act authorizes SAE funding and includes the Special Milk Program (7 CFR part 215) and the School Breakfast Program (7 CFR part 220). The Richard B. Russell National School Lunch Act includes the National School Lunch Program (7 CFR part 210), the Child and Adult Care Food Program (7 CFR part 226) and the Food Distribution Program (7 CFR part 250).

<sup>2</sup> 7 CFR 235, State Administrative Expense Funds.

<sup>3</sup> The Team Nutrition grant covered two years with \$100,000 provided in fiscal year 2000 and an additional \$200,000 provided in fiscal year 2001. The Provision 2 and 3 grants were a one-time award of \$400,000 in fiscal year 2001.

The State agency's mismanagement of both the Team Nutrition and Provision 2 and 3 grants was the subject of a report issued by the State's Office of the Legislative Auditor. The State's Legislative Auditor reported that during fiscal year 2001 the State agency misspent grant funds by charging: payroll costs for employees who did not work on the grant, travel expenses unrelated to the grants, and unallowable professional contracted services. In total, the Legislative Auditor questioned \$350,000 out of \$600,000<sup>4</sup> provided through two specialized grants. FNS collected the misspent grant funds and recommended changes to the State's accounting procedures.

**Objective**

The objective of the audit was to determine whether State Administrative Expense funds were used in accordance with regulations and the extent of any improper claims.

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<sup>4</sup> The State's Legislative Auditor only audited the 2001 grant awards totaling \$600,000.



# **Findings and Recommendations**

## **Section 1: State Agency's Use of Federal SAE Funds**

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The Minnesota Department of Education (State agency) charged a Federal award for a State program initiative, for which the costs and benefits had not been correctly identified or allocated to State programs. The State agency's use of Federal State Administrative Expense (SAE) funds did not comply with Federal cost principles identified in the Office of Management and Budget's (OMB) Circular A-87 and attachments. As a result, we questioned over \$235,000 in Federal SAE funds charged to the Federal award but used for a State mandated project.

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### **Finding 1**

#### **Unallowable Costs Were Charged to Finance the State's Child Health Insurance Program**

The State agency used Federal SAE funds for computer enhancements for the specific purpose of complying with the State's Child Health Insurance Program (SCHIP).<sup>5</sup> The State agency followed Minnesota State contracting procedures, however, these procedures do not address compliance with Federal requirements for SAE funds. As a result, the State used \$160,120 in Federal SAE funds to pay three contracts during fiscal years 2001 through 2003 that did not benefit FNS' Child Nutrition Programs.

Federal Regulations<sup>6</sup> for the use of SAE funds requires the State agency to correctly identify the proper Federal funding source and ensure that all costs are allowable. However, we determined the State's contracting procedures did not include either the determination whether costs charged were allowable or an identification of a proper funding source. For a cost to be allowable under a Federal award, the cost must be reasonable, necessary, and allocated to a cost objective based on the relative benefits received.

During fiscal years 2001 through 2003, the State agency did not ensure that three professional service contracts, charged to Federal SAE funds, were allowable. The three contracts included computer enhancements to implement the SCHIP in order to identify and enroll children in the State's health insurance program. Although the SCHIP used school lunch program eligibility data, the cost objective was not to benefit FNS' Child Nutrition Programs. The State agency, without determining the allowability of costs, improperly charged \$160,120 in contracting costs to Federal SAE funds.

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<sup>5</sup> In Minnesota, their SCHIP was called the Express Lane Eligibility Initiative.

<sup>6</sup> 7 CFR 235.6 (b) with reference to OMB Circular A-87 (Revised 5/10/04), specifically Attachment A (C)(1) and (3) – General Principles for Determining Allowable Costs.

The State agency also did not identify a proper funding source for the State's health insurance initiative. Joint guidance published prior to the initiative by the U.S. Departments of Agriculture (USDA), Education, and Health and Human Services recommended that States seek funding for the health insurance initiative from several different sources, none of which mentioned USDA as a Federal fund source. The State agency chose to use Federal SAE funds based on potential future benefits of expanding direct certifications and verifying eligibility for the National School Lunch Program (NSLP). However, for this benefit to become a reality, the State would first need Federal approval to directly certify against Minnesota's Department of Human Services' data. Although it has been more than 3 years, the State has neither received Federal approval nor made additional direct certifications.

State agency officials explained that a former State official handled the contracting and funding for the SCHIP and reportedly relied on the potential future benefits to the NSLP as the rationale for using Federal SAE funds for SCHIP expenditures. Current State agency officials did speculate about whether the expense was explicitly approved by FNS. However, an FNS regional official stated they did not approve the use of Federal SAE funds for the State's SCHIP expenditures.

Since the State agency's contracting procedures did not require a determination of whether certain costs were allowable under a Federal award, they improperly identified the State's SCHIP initiative as necessary in the administration of FNS' Child Nutrition Programs. We determined that additional procedures are needed to ensure the allowability of expenditures and the identification of a proper funding source in accordance with Federal regulations. Since the State agency could not show any direct benefit to FNS' Child Nutrition Programs, we questioned the amounts paid for all three contracts totaling \$160,120 in Federal SAE funds.

## **Recommendation 1**

Issue a bill of collection to the State agency for \$160,120 in unallowable costs charged for professional service contracts used to finance a State initiative that was unrelated to FNS' Child Nutrition Programs.

### **Agency Response.**

In its response dated June 15, 2005, FNS agreed with our recommendation and sent a bill of collection to the State agency on May 13, 2005, for \$160,120. On May 26, 2005, the State agency mailed a check for this amount to the FNS lockbox, which was received on June 6, 2005.

**OIG Position.**

We accept FNS' management decision. Follow internal agency procedures in forwarding Final Action correspondence to the OCFO.

**Recommendation 2**

Require the State agency to ensure its contracting procedures include the establishment of appropriate cost objectives for each professional service or consulting contract so that allowability as a Federal expenditure can be properly determined.

**Agency Response.**

In its response dated June 15, 2005, FNS agreed with our recommendation and the State agency will be developing additional written contracting procedures. These procedures, with an estimated completion date of September 15, 2005, will require that future contracts establish cost objectives for each professional service or consulting contract in enough detail so that the appropriateness of expenditures using Federal funds can be properly determined.

**OIG Position.**

We accept FNS' management decision. For Final Action, FNS needs to notify the OCFO that it reviewed and agreed with the State agency's additional contracting procedures.

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**Finding 2**

**State Agency Did Not Allocate A Contracted Service Between Federal and State Programs**

The State agency entered into a professional service contract that affected both Federal and State programs, but paid the entire contracted amount from Federal SAE funds. Due to the lack of established criteria for professional service contracts, there was not enough detail in the description of work for a determination to be made as to which Federal or State programs benefited from this expenditure. The State agency was reimbursed \$75,000 in Federal SAE funds for a contract that does not distinguish between Federal and State program expenses.

According to Federal requirements, certain costs, such as professional services or consulting contract costs, are only allowable subject to the adequacy of the contractual agreement for the service. The agreement must include enough detail, such as a description of the service and an estimate of time required, in order to determine whether the costs were properly allocated and therefore allowable.<sup>7</sup> However, we determined that the State entered into one contract that did not contain enough detail to determine the proper allocation of costs.

In fiscal year 2001, the State agency entered into a contract for \$400,000 that included \$325,000 for computer maintenance and support, and \$75,000 for other unspecified enhancements. Although computer maintenance and support is an allowable expense, the contract language contained other enhancements that were not defined or allocated between Federal and State programs. Based on the contracting language, and lack of other supporting documentation, State agency officials have been unable to identify the specific program benefits received from the unspecified enhancements. Therefore, we question \$75,000 of unspecified enhancements because we cannot determine what part, if any, was for allowable Federal expenditures.

We questioned State agency personnel on several different occasions, in an attempt to obtain support for the \$75,000 in computer enhancements. Although State agency personnel provided a list of potential computer enhancements, there was nothing to tie that list to the contract amount. A State agency official explained that there was a large turnover of staff, particularly in management, and it was difficult to try to assemble exactly what happened for that particular contract.

Since the original contract did not support a proper allocation of cost between Federal and State benefits, the State agency needs to ensure all future contracts meet Federal requirements before claiming them as Federal SAE fund expenses. State agency officials informed us that they now require greater scrutiny in their review of contracted services, and we reviewed a current contract evidencing allocation between Federal and State funding sources based on the cost objectives. However, without established written criteria for the allocation of contracted costs, there is reduced assurance that State and Federal programs will be consistently charged based on the relative benefits received.

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<sup>7</sup> 7 CFR 235.6 (b) with reference to OMB Circular A-87 (Revised 5/10/04), specifically Attachment B, 32 (b)(8) – Selected Items of Cost

### **Recommendation 3**

Issue a bill of collection to the State agency for \$75,000 in contract costs that were not allocated between Federal and State programs.

#### **Agency Response.**

In its response dated June 15, 2005, FNS agreed with our recommendation and sent a bill of collection to the State agency on May 13, 2005, for \$75,000. On May 26, 2005, the State agency mailed a check for this amount to the FNS lockbox, which was received on June 6, 2005.

#### **OIG Position.**

We accept FNS' management decision. Follow internal agency procedures in forwarding Final Action correspondence to the OCFO.

### **Recommendation 4**

Require the State agency to establish written contract criteria in accordance with Federal requirements that includes a definition of terms, a description of the service, an estimate of the time required and an allocation of expenditures between Federal and State programs.

#### **Agency Response.**

In its response dated June 15, 2005, FNS agreed with our recommendation and the State agency will develop additional written contracting procedures, with an estimated completion date of September 15, 2005. The procedures will require that terms used in the contract are defined; services being contracted for are described in detail; and significant work product milestones with timeframes as well as the date of full completion of the contracted product are clearly stated. If an allocation of costs between Federal and State programs are applicable, then the procedures will require a description of how the allocation will be fairly made.

#### **OIG Position.**

We accept FNS' management decision. For Final Action, FNS needs to notify the OCFO that it reviewed and agreed with the State agency's additional contracting procedures.

## ***Scope and Methodology***

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We performed our fieldwork from November 2004 through March 2005 at the FNS Regional office in Chicago, Illinois and the State agency's office in Roseville, Minnesota. This audit was a special request by FNS based on concerns raised by their own reviews. In addition, an audit report from the Minnesota Office of the Legislative Auditor uncovered mismanagement of funds in two FNS grants for fiscal years 2001 and 2002. The FNS financial management review, performed in May 2004, identified substantial problems in the State agency's accounting, expenditure, and reporting of both Federal SAE and program funds for fiscal years 1999 through 2004.

Our review included fiscal years 2000 through 2002, from which we selected the third quarter of fiscal year 2001 due to the highest amount of SAE outlays being recorded in this period. We judgmentally selected 24 of the 468 total transactions valued at \$523,511 of the total \$905,256 for the third quarter. Our sample accounted for 58 percent of the overall universe value for this quarter and included direct salary, contract for professional service, and indirect cost expenditures. Based on results of our testing, we expanded our sample selection to include 12 of the total 46 professional service contracts and amendments the State entered into during fiscal years 2000 through 2003. The value of the 12 contracts we reviewed represented \$2.5 million of the \$3 million paid for professional service contracts and amendments.

To accomplish our audit objectives we:

- Reviewed regulations, policies, and procedures governing Federal SAE funds;
- Interviewed FNS Regional Office and State agency officials to determine what controls are in place to monitor Federal SAE funds;
- Reviewed the results of State audits to identify issues that concern the State agency's use and recording of Federal SAE funds;
- Reviewed the indirect cost rate and how its used; and,
- Reviewed the State agency's procedures for budgeting, documenting, and claiming SAE by testing the validity of the claims made on the Federal Financial Status Report.

This audit was conducted in accordance with Generally Accepted Government Auditing Standards.

## **Exhibit A** – Summary of Monetary Results

Exhibit A – Page 1 of 1

<b>FINDING NUMBER</b>	<b>DESCRIPTION</b>	<b>AMOUNT</b>	<b>CATEGORY</b>
1	Federal SAE Funds Used To Finance State Program Initiative	\$ 160,120	Questioned Costs: Recovery Recommended
2	Contract Costs Not Properly Allocated Among Federal and State Programs	\$ 75,000	Questioned Costs: Recovery Recommended
		\$ 235,120	

# Exhibit B – FNS' Response to the Draft Report

Exhibit B - Page 1 of 2



United States  
Department of  
Agriculture

June 15, 2005

Food and  
Nutrition  
Service

Midwest Region

77 W. Jackson Blvd.  
20<sup>th</sup> Floor  
Chicago, IL  
60604-3591

Mr. Edward R. Krivus, Regional Inspector General  
Office of Inspector General  
Midwest Regional Office  
111 North Canal Street, Suite 1130  
Chicago, Illinois 60606-1130

Dear Mr. Krivus:

We have received the Official Draft Report entitled, "Controls Over the Minnesota Department of Education's Use of Federal Funds," Audit Report No. 27010-19-Ch. We address each recommendation below.

**Recommendation No. 1** – Issue a bill of collection to the State agency for \$160,120 in unallowable costs charged for professional service contracts used to finance a State initiative that was unrelated to FNS' Child Nutrition Programs.

FNS agrees with this recommendation.

**State Agency Response:** FNS sent a bill of collection to the State agency on May 13, 2005 for \$160,120. On May 26, 2005, the State agency mailed a check for this amount to the FNS lockbox, which was received on June 6, 2005.

**Recommendation No. 2** - Require the State agency to ensure its contracting procedures include the establishment of appropriate cost objectives for each professional service or consulting contract so that allowability as a Federal expenditure can properly determined.

FNS agrees with this recommendation.

**State Agency Response:** The State agency will be developing additional written contracting procedures. These procedures will require that future contracts establish cost objectives for each professional service or consulting contract in enough detail so that the appropriateness of expenditures using federal funds can be properly determined.

The estimated completion date will be September 15, 2005.

**Recommendation No. 3** – Issue a bill of collection to the State agency for \$75,000 in contract costs that were not allocated between Federal and State programs.

FNS agrees with this recommendation.

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## **Exhibit B – FNS' Response to the Draft Report**

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Exhibit B - Page 2 of 2

**State Agency Response:** FNS sent a bill of collection to the State agency on May 13, 2005 for \$75,000. On May 26, 2005, the State agency mailed a check for this amount to the FNS lockbox, which was received on June 6, 2005.

**Recommendation No. 4** – Require the State agency to establish written contract criteria in accordance with Federal requirements that includes a *definition of terms*, a description of the service, an estimate of the time required and an allocation of expenditures between Federal and State programs.

FNS agrees with this recommendation.

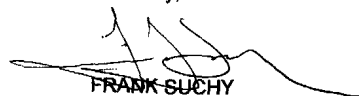
**State Agency Response:** The State agency will develop additional written contracting procedures. The procedures will require that terms used in the contract are defined; services being contracted for are described in detail; and significant work product milestones with timeframes as well as the date of full completion of the contracted product are clearly stated. If an allocation of costs between Federal and state programs are applicable, then the procedures will require a description of how the allocation will be fairly made.

The estimated completion date will be September 15, 2005.

FNS has reviewed and also agrees with Exhibit A of the Official Draft Report.

If you have any additional questions, please contact Adele Greco at 312-886-4652.

Sincerely,



FRANK SUCHY  
Chief  
Fiscal/State Systems  
Financial Management

Attachment

cc: Elvira Jarka, RD, SNP, MWRO  
Leo Dohogne, Chief, GM, FM, MWRO

Informational copies of this report have been distributed to:

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