Department of Education Administration

July 1, 2003 to October 31, 2005

Richard L. Fair
State Auditor
The Honorable Jon S. Corzine
Governor of New Jersey

The Honorable Richard J. Codey
President of the Senate

The Honorable Joseph J. Roberts, Jr.
Speaker of the General Assembly

Mr. Albert Porroni
Executive Director
Office of Legislative Services

Enclosed is our report on the audit of the Department of Education, Administration for the period of July 1, 2003 to October 31, 2005. If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fáir
State Auditor
April 17, 2006
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Department of Education Administration

Scope

We have completed an audit of the Department of Education (DOE), Administration for the period July 1, 2003 to October 31, 2005. Administration encompasses all activities of DOE except for the Marie H. Katzenbach School for the Deaf and state aid funding. Our audit included financial activities accounted for in the state's General Fund.

The prime responsibility of the Department of Education is to ensure that every New Jersey student has an equal opportunity to receive a thorough and efficient education. Annual revenue and expenditures of the administrative component of the department were $865 million and $120 million, respectively. The major component of revenue was federal grants.

Objectives

The objectives of our audit were to determine whether financial transactions were related to the department's programs, were reasonable, and were recorded properly in the state's accounting systems. We also tested for resolution of the significant condition noted in our prior report dated April 23, 2001.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the department. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial
transactions. We also read the budget message, reviewed financial trends, and interviewed department personnel to obtain an understanding of the programs and the internal control.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample transactions were sorted and transactions were judgmentally selected for testing.

To ascertain the status of the finding included in our prior report relating to our current scope, we identified corrective action, if any, taken by the department and walked through the system to determine if the corrective action was effective.

Conclusions

We found that the financial transactions included in our testing related to the department's programs, were reasonable, and were recorded properly in the accounting systems. In making this determination, we noted an internal control weakness meritng management's attention. We also found that the department has resolved the significant issue noted in our prior report.
Revolving Funds

The annual appropriation act specifies that funds are available during the current fiscal year and for one month thereafter for expenditures applicable to said fiscal year. Unless otherwise provided all unexpended balances lapse into the State Treasury. Revolving fund account balances are carried forward into the next fiscal year. A revolving fund is defined as a fund established to finance (1) state activities of a business or commercial nature or (2) the operation of an intergovernmental service agency or enterprise, which generates receipts (income) from the sale of commodities or service. Such receipts are available for the continuing operation of the activity or enterprise.

The department maintains various revolving funds. One revolving fund is used for the print shop and office supplies. The department also utilizes this fund to pay for interdepartmental postage and telephone charges which are subsequently recovered from other organizational units within the department. Since fiscal year 1993, the unexpended balance in this fund has increased from $58,000 to $1.4 million. Our review disclosed the following:

- At the fiscal year ending June 30, 2005 approximately $743,000 in unexpended state balances which should have lapsed to the State Treasury were improperly credited to the fund.

- An additional $764,000 was credited from four special purpose accounts to cover potential lawsuits. Settlements would normally be funded through the Department of the Treasury’s interdepartmental tort claims account. A reserve was placed on this fund by the state’s budget bureau to prevent
the department from spending these funds without prior approval.

- Approximately $1.1 million was expended out of the revolving fund for items such as a department vehicle, travel expenses, official receptions, furniture and computers. These costs, while reasonable and necessary, should have been paid out of the department’s direct state services appropriations. Furthermore, the department allocated $568,000 of these costs to various federal programs. Our review of selected transactions disclosed that these costs are administrative in nature and would have been recovered through the department’s indirect cost rate. Administrative costs are a factor of the department’s indirect cost rate calculation.

Another revolving fund is used as a clearing account for certain employee salaries which are allocable to federal programs. At the end of the fiscal year 2005, federal programs were assessed $1.4 million for salaries, fringe benefits, and an additional 20 percent of salaries for operating expenses. Since only $1.3 million was actually expended out of the account, the department was able to increase available funds by $100,000. As of July 31, 2005 this revolving fund had an unexpended balance of $356,000.

**Recommendation**

We recommend the department discontinue the practice of using revolving funds for other than their intended purpose and return unexpended balances to the State Treasury.
March 28, 2006

Mr. Richard L. Fair, State Auditor
Office of Legislative Services
Office of the State Auditor
125 South Warren Street
P.O. Box 067
Trenton, NJ 08625-0067

Dear Mr. Fair:

Subject: Response to OLS Audit Report of the Department of Education Administration

The New Jersey Department of Education (DOE) has received and reviewed the findings and recommendations contained in the Office of Legislative Services (OLS) Audit Report of the Department of Education Administration for the period July 1, 2003 to October 31, 2005. We are pleased to have the opportunity to respond to the audit report. We take seriously our responsibility to appropriately spend and properly account for state and federal appropriations as well as other funds we may receive, and we appreciate the suggestions that we receive to improve our process and procedures. The findings and recommendations on page 3, along with our responses are as follows:

Finding, Page 3 – Revolving Funds

The department maintains various revolving funds. One revolving fund is used for the print shop and office supplies. The department also utilizes this fund to pay for interdepartmental postage and telephone charges which are subsequently recovered from other organizational units within the department. Since fiscal year 1993, the unexpended balance in this fund has increased from $58,000 to $1.4 million. Our review disclosed the following:

- At the fiscal year ending June 30, 2005 approximately $743,000 in unexpended state balances which should have lapsed to the State Treasury were improperly credited to the fund.

- An additional $764,000 was credited from four special purpose accounts to cover potential lawsuits. Settlements would normally be funded through the Department of Treasury’s interdepartmental tort claims account. A reserve was placed on this fund by the state’s budget bureau to prevent the department from spending these funds without prior approval.

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Approximately $1.1 million was expended out of the revolving fund for items such as a department vehicle, travel expenses, official receptions, furniture and computers. These costs, while reasonable and necessary, should have been paid out of the departments’ direct state services appropriations. Furthermore, the department allocated $568,000 of these costs to various federal programs. Our review of selected transactions disclosed that these costs are administrative in nature and would have been recovered through the department’s indirect cost rate. Administrative costs are a factor of the department’s indirect cost rate calculation.

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**Recommendations**

We recommend the department discontinue the practice of using revolving funds for other than their intended purpose and return unexpended balances to the State Treasury.

**Department Responses**

The findings and recommendations involve the use of revolving funds by the department. These funds were established with the approval of the State Comptroller to serve the following purposes:

1. Account for charges for publications sold to the public;
2. Account for internal services (such as postage and printing) and supplies provided to the department;
3. Accumulate and account for charges to federal grants for departmental administration, which the department considers to be direct costs to the grants;
4. Accumulate charges for department-wide costs such as telephone, security, and building maintenance, which are then billed back to state and federal accounts as appropriate so that expenses are recorded as part of program activities.

In addition, the revolving fund has been used to address certain contingencies, such as lawsuit settlements, repair and replacement of computers or other equipment, and similar unforeseen expenses.

With this as background, I would like to address each of the specific findings.

- The unexpended state balances credited to the revolving fund reflected state program costs for department-wide costs as noted above. While the expenses may be budgeted in
one program, the department also believes that the expenses may be allocable to the various state programs. Had the expenses been covered by transfer rather than the accounting methods actually used, the funds would not have lapsed to the Treasury.

- As indicated above, the Department’s revolving fund has been used to cover settlement costs for lawsuits. The Department is unclear whether it is responsible for authorizing the Attorney General to settle lawsuits against the Department and for identifying the funds for such settlement, or whether authorization and identification of funds is the responsibility of the Tort Claims Fund. The Department has acted on the understanding that the actions are its responsibility, not that of the Tort Claims Fund. When the Department has identified funds to cover potential lawsuits and deposited such funds in the revolving fund, the Department has notified the state budget bureau so that the funds can be placed in reserve, to be released only if needed for settlement.

In response to this audit, the department will seek clarification from the Treasurer, State Comptroller, and Attorney General regarding the question of authorizing settlements and identifying funds. If it is determined that these actions are the responsibility of the department, we will request that a separate account be established and request that funds be transferred to that account as needed and identified.

- Regarding the expenditure of funds for the revolving fund for items such as a department vehicle and computers, I would comment that on at least one documented occasion the department was directed by the Office of Management and Budget to use the revolving fund balances for the purchase of computers. A copy of the relevant correspondence is included with this response.

Finally, the practice of using the revolving funds as a clearing account for expenses allocable to federal program is long standing. It is our understanding that the practice is appropriate when a reasonable cost basis and method of allocation can be established. In the instance cited, the revolving fund was newly established and assessments to federal grants were made on the basis of estimated costs rather than actual expenditures. These estimated costs included certain information technology applications that are still under discussion. If funds are not required, they will be returned to the federal government.

Including these administrative costs in the department’s indirect cost rate would require a major change in the process and structure of the state’s budget, notably the inclusion of all such expenses in the direct state services appropriation for each department. Moreover, the department is currently in the process of negotiating a five-year, fixed indirect cost rate with the United States Department of Education, so a change at this time would be difficult. Nevertheless, we will discuss these changes with the Office of Management and Budget.
Mr. Richard L. Fair  
Page 4  
March 28, 2006

We believe that the department’s revolving funds are being used appropriately. We also concur that alternative methods of charging for particular expenses may be preferable to those used in the past, and we will actively review these alternatives with the State Comptroller.

Because of the structure of revolving funds, unexpended balances are inevitable. The department is reviewing past deposits and will make adjustment to balances as appropriate, with funds being returned to the State or Federal Treasuries as necessary.

We trust that our responses satisfy the concerns raised in the audit report. Should you have any questions or need further information, please contact me at 984-5593.

Sincerely,

Ray Montgomery, Director  
Office of Compliance Investigation

RM/RKG/response to OLS audit of DOE admin.  
Enclosure

c: Lucille E. Davy  
Isaac R. Bryant  
Penelope Lattimer  
Yut’she Thomas  
David Corso  
Robert Goertz  
Charles Pefiall
TO: Vito A. Gagliardi, Sr., Commissioner  
Department of Education

FROM: Charlene Holzbaur, Director  
Office of Management and Budget

DATE: June 13, 2001

SUBJECT: Reserved Funds

I am writing in response to your May 30, 2001 request to release equipment funds in the Department’s Office of Information Technology from reserve.

Your staff has provided documentation indicating a need to replace 35 computers that will not support the Windows 2000 operating system. These computers will be replaced with new machines at a cost of $1,370 each. OMB has reviewed the requirements of this project; however, your request to release equipment funds held in reserve has not been approved.

OMB concurs that the Department should begin the migration to the Windows 2000 operating system from the Windows 95 environment, which will not be supported by Microsoft in the near future. However, equipment account balances are needed to address other shortfalls in the Department’s budget. In fiscal 2001, almost $380,000 carried forward into the Department’s Administrative Services Revolving Fund. This account currently has significant balances that can be utilized to support projects such as this.

ag

c:  Peter Lawrance
    Bruce Perelli
    Mary Byrne
    Jeff Osowski
    Steve Blaustein
    Barbara Breeden
    Jack Longworth
May 30, 2001

TO: Charlene Holzbaur, Director
Office of Management and Budget

FROM: Vito A. Gagliardi, Sr.
Commissioner

SUBJECT: Release of Reserved Funds

It has come to my attention that the Office of Management and Budget (OMB) has placed $511,543 in the Department of Education’s (DOE) equipment accounts in reserve. Given the current fiscal constraints facing the state, I can understand why this occurred and I am willing to make adjustments in our spending pattern to comply with this crisis. However, I am requesting that $48,000 in the Office of Information Technology (OIT) account be released.

The Office of Information Technology, in support of the Department of Education’s mission statement, develops and maintains the department’s systems for decision-making purposes and for collecting information from school districts to satisfy state and federal reporting requirements. In addition, the OIT develops and maintains the department’s office automation systems (Microsoft Software for instance) to ensure that all staff have the resources to perform their job functions effectively and efficiently.

Microsoft has stated that it will discontinue support for Windows 95 effective December 31, 2001. Based on this announcement of discontinuance of support for the Windows 95 desktop operating system, DOE initiated the process of migrating to Windows 2000 Professional/MS Office 2000. As an integral part of our migration strategy, we have identified the minimum PC system requirements for running the Windows 2000 Professional operating system. Our plan calls for upgrading (where feasible) memory/storage on PCs which do not meet the associated requirements for supporting the Windows 2000 environment. PCs that can’t be upgraded are replaced.
Based on our overall computing environment, we have been cycling out the desktop PCs which do not meet the requirements associated with running Windows 2000 Professional/MS Office 2000. In addition to what has already been completed during this fiscal year, we planned to replace an additional 35 PCs (approximately $48,000) prior to the end of the current fiscal year and another 115 PCs would be deployed during the first few months of the next fiscal year to ensure that we can continue to adequately support the needs of the business.

With the OMB removal of the unexpended FY 01 funding being utilized to update the department’s PC technology, we may find ourselves next year in a position of conducting our business on unsupported software and equipment. We respectfully request that DOE OIT’s state 77 funds be restored to enable our department to continue to complete the FY 01 portion of its planned migration project.

VAG/BAB/mm:C.Holzbaur.OMB
c: Peter Lawrance
   Bruce Perelli
   Mary Byrne
   Annette Garcia
   Jeff Osowski
   Jack Longworth
   Steve Blaustein
   Barbara Breeden