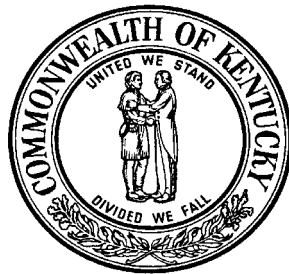


**INDEPENDENT ACCOUNTANT'S REPORT
ON APPLYING AGREED-UPON PROCEDURES
TO THE KENTUCKY DEPARTMENT OF EDUCATION**



**CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS
www.auditor.ky.gov**

**105 SEA HERO ROAD, SUITE 2
FRANKFORT, KY 40601-5404
TELEPHONE (502) 573-0050
FACSIMILE (502) 573-0067**

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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Kentucky Department of Education
Kentucky Board of Education Audit Committee
Capital Plaza Tower
500 Mero Street
Frankfort, KY 40601

INDEPENDENT ACCOUNTANT'S REPORT
ON AGREED-UPON PROCEDURES

We have performed the procedures enumerated below, which were agreed to by the Kentucky Department of Education (KDE), solely to assist KDE in identifying policy, control and processing weaknesses within KDE and making recommendations to ensure that new policies and procedures are properly designed and implemented. The KDE's management is responsible for processing all transactions at KDE. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below, either for the purpose for which this report has been requested or for any other purpose.

The procedures and associated findings are as follows:

KDE Purchasing Practices With Outside Vendors

1. Procedure -

Determine, from the population of transactions with outside vendors for fiscal years 2003 and 2004 from the report generated at KDE, a representative sample to test for the following attributes: a) Files contained complete supporting documentation for the purchase; b) Files displayed evidence of delivery to the requestor of the ordered goods or services; c) Files contained evidence of appropriate supervisory and vendor approvals; d) Total dollar amount of the transaction matched the amount in MARS; and e) Transactions appear normal and consistent with other purchases, i.e., not unusual in the circumstances.

Finding: We noted exceptions in which the activities as prescribed in the KDE Policy and Procedure Manual were not followed as described.



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2. Procedure -

Evaluate the effectiveness and efficiency of KDE's purchase approval process with outside vendors for fiscal years 2003 and 2004. Determine that the manual approval controls are operating as required (not approvals within MARS), i.e. approval levels, approval request procedures, and the flow of documents.

Finding: We evaluated KDE's purchase approval process and determined that manual approval controls are sufficient to process purchase transactions effectively; however, KDE did not uniformly and consistently apply those procedures.

3. Procedure -

Review a sample of sole source contracts within KDE for fiscal years 2003 and 2004. Determine if they were appropriate per the requirements governing sole source contracts and competitive bidding procedures.

Finding: We noted exceptions with sole source contracting procedures required by Finance and Administration Cabinet policy and procedures and the KDE Policy and Procedure Manual.

4. Procedure -

Determine whether the institution of a policy regarding the communication to the Division of Financial and Materials Management within three days of receipt of goods or services has strengthened the purchasing process and made administrative procedures at KDE operate more efficiently.

Finding: We noted that the policy had not been fully implemented within the purchasing process or the KDE Policy and Procedure Manual, thus the efficiency of such process is undeterminable.

KDE Transactions With Education Cooperatives

5. Procedure -

Prepare a MARS report of all expenditure transactions between the KDE and the Education Cooperatives (Cooperatives) for fiscal years 2003 and 2004. Determine, from the population, a representative sample to test for the following attributes: a) Files contained complete supporting documentation for the transactions; b) Files contained evidence of appropriate supervisory approvals; c) Total dollar amount of the transaction matched the amount in MARS; and d) Transactions appear normal and consistent with other transactions, i.e., not unusual in the circumstances.

Finding: We noted exceptions in which the activities as prescribed in the KDE Policy and Procedure Manual were not followed as described.

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6. Procedure -

Review a sample of transactions occurring at the end of fiscal years 2003 and 2004 with Cooperatives to determine that monies were spent according to applicable agreements.

Finding: We noted exceptions in which the monies were not spent within the timeframe allotted in the applicable agreements.

7. Procedure -

Perform reconciliation between KDE records and Cooperative records for fiscal years 2003 and 2004 to determine agreement in amount sent to each Cooperative. As part of this, utilize the certified public accountants (CPA) reports from each Cooperative that are sent to the Auditor of Public Accounts (APA).

Finding: We performed a reconciliation between KDE records and Cooperative records and there were variances. The CPA reports that were submitted to the APA could not be utilized due to timeliness of the reports and detail of information contained in the reports.

8. Procedure -

Review and document how KDE distributes funds to the Cooperatives for fiscal years 2003 and 2004. Identify any variances from funds distribution requirements of Memorandums of Agreement and/or Federal Cash Requests by testing sampled distributions for compliance.

Finding: We noted variances where KDE distributed funds to the Cooperatives but not in the form of a Memorandum of Agreement and/or Federal Cash Requests.

9. Procedure -

Determine if any Cooperative acted as fiscal agent for KDE under a general services agreement for fiscal years 2003 and 2004. Determine the provisions of that agreement are being fulfilled.

Finding: We found that the Kentucky Educational Development Corporation acted as fiscal agent for KDE under a general services agreement for the fiscal year ended June 30, 2003 and the provisions of the agreement appear to have been fulfilled.

10. Procedure -

Review KDE policy and procedures as they relate to Cooperative transactions for fiscal years 2003 and 2004 to ensure that controls implemented since past problems are in place.

Finding: We noted that controls exist for Cooperative transactions and adherence to all controls was not always achieved.

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We were not engaged to, and did not, conduct an audit, the objectives of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Kentucky Department of Education and is not intended to be and should not be used by anyone other than this specified party.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen
Auditor of Public Accounts

September 2, 2004

APPENDIX A

FINDINGS AND RECOMMENDATIONS

An agreed-upon procedures engagement was performed utilizing two preliminary draft reports from the Internal Auditor at KDE. The reports, entitled Preliminary Draft Report on the Review of the Purchasing Process at the Kentucky Department of Education FY 02 and Summary Draft Report on the Review of the Kentucky Department of Education Transactions with Educational Cooperatives FY 02, were incorporated into our procedures as necessary. The findings from performing the agreed upon procedures are listed below:

Agreed-Upon Procedure 1

FY 2003

1. 16 instances, for transactions totaling \$2,030,396.22, in which the files displayed no evidence of delivery of the ordered goods/services to the requestor.
2. 22 instances where the proper approvals, as outlined in the policy and procedure manual approval matrix, were not obtained.
3. One instance in which no Department Purchase Requisition (DPR)/purchase request was provided; thus whether proper approvals were obtained could not be determined.
4. One occurrence, in which the amount as provided in the FY 03 KDE Purchasing Transactions report, did not agree to the supporting documentation.

For the test on purchasing transactions for FY 04, we used a list of 539 contracts, totaling \$16,179,026.98. From this list, a sample of 25 transactions totaling \$3,255,147.49 was selected for testing. We found:

FY 2004

1. Two instances in which no vendor invoice was provided in the supporting documentation.
2. 14 instances, for transactions totaling \$3,113,892.93, in which the files displayed no evidence of delivery of the ordered goods/services to the requestor.
3. 22 instances in which the proper approvals were not obtained.
4. One occurrence in which no DPR/purchase request was provided, thus whether proper approvals were obtained could not be determined.
5. One instance in which no attributes could be tested on the transaction because the document was not located. KDE personnel provided a printed copy of the contract and invoice; however, the DPR/purchase request and/or vendor invoice could not be reviewed.

KDE Comment Procedure 1

FY 2003 #1 and FY 2004 #2:

In the instances of no receipts, 14 of the 16 instances in fiscal year 03 and 12 of the 14 instances in fiscal year 04 had electronic receipts entered into the MARS Financial system that matched up with the purchase order, however, our MAP procedure did not document the use of electronic receipts instead of paper or email receipt certifications. Two other instances in each fiscal year consisted of a payment against a copier rental agreement and a payment of lease agreement for the School and Community Nutrition office location. A certificate of receipt has not been required for payments of rental and lease agreements in the past, but is not specified in the MAP procedure. The MAP procedure has been updated to document the appropriate procedure and allow for exceptions to the normal practices.

FINDINGS AND RECOMMENDATIONS
(Continued)

KDE Comment Procedure 1 (Continued)

FY 2003 #2 and FY 2004 #3:

In all 22 instances in FY 03 and FY04 that were cited as not having the proper approvals, the MAP procedure or approval matrix required a signature, but our documentation had the person's initials or a stamp that is used by the Division of Financial and Materials Management for approval. The intent of the procedure is to have adequate notice of approval. As the referenced forms of notice are adequate for to meet the intent of the procedure, the MAP manual has been updated to provide these methods as alternative acceptable forms of approval.

FY 2003 #2:

On the one occurrence in FY 03 where no DPR was provided, the FFA Camp made this purchase. FFA purchasing is decentralized and they have a different internal requisitioning form that is maintain at the FFA site.

FY 2003 #4:

On the one occurrence in FY 03, where the supporting documentation was different from the Purchasing Transaction Report, there is no clear explanation why the second line item on the invoice (a credit for discount) did not reference the contract number on the transaction report. Both line items of the invoice and contract are showing on the report, however, line 2 did not show the contract number in the reference field. Thus, the invoice documentation, which matches the PD system document, does support the transactions showing on the report. This was a system error, which could not be controlled by the agency.

FY 2004 #1:

The two instances in FY 04 where no vendor invoice was provided are both associated with a long-term lease agreement and we don't require the vendor to send an invoice for the monthly charge. This is an exception to the normal processing that was not documented in our MAP procedure, but has been updated accordingly. A Gary Freeland Memo from the Division of Administrative Services not only authorizes payment, but also acts as the invoice and receipt based on actual knowledge of continued occupancy of facilities.

FY 2004 #4:

On the one occurrence in FY 04 where no DPR was provided, the payment to the vendor was authorized by a Contract Lease End Extended Agreement for the Commissioner's car signed by the Director of Financial and Materials Management. The Director of Financial and Materials Management, having full knowledge that the lease was extended and the Commissioner was in possession of the car, waived the need for a DPR.

FY 2004 #5:

There is no explanation for the missing document in fiscal year 04. Our control procedure requires a sign-out card, including the date and person's name, be put in place of any document that is removed from the files. A sign-out card was in the file in this instance, but the person who signed out the document could not produce the document. Documents can get misplaced or misfiled. In light of the high volume and number of documents processed and maintained by KDE, we feel adequate controls are currently in place to secure the maintenance and use of purchasing records.

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 2

The Preliminary Draft Report on the Review of the Purchasing Process at the Kentucky Department of Education FY 02 provides a recommendation that was a significant component of testing for efficiency and effectiveness under Procedure 2:

I [Internal Auditor] recommend that KDE institute a policy regarding the receipt of goods or services that requires the employee receiving the goods, within three business days, to submit evidence of receipt (certificate of receipt, receiving report, signed copy of the invoice denoting receipt, packing slip, etc.) or an e-mail notification to the Division of Financial and Materials Management (F&MM) and not be considered complete until such documentation has been sent in accordance with the documented delivery process.

Procedure 2 relied on Procedure 1 for sampled transactions and incorporated Procedure 1 test results, in part, for assessing effectiveness and efficiency. Three Procedure 1 transactions were not used, leaving 47 purchase transactions tested for Procedure 2. The Procedure 2 test results support the conclusion in Procedure 4.

In addition to the attributes below, auditors examined the transactions for any unusual processes or occurrences. Auditors also tracked processing time from initiation of the request, through final receipt of invoice.

The following additional attributes and test results were included in Procedure 2:

| Attribute | Compliance |
|---|-------------------|
| Certificate of Receipt / Receiving Report, signed copy of invoice, packing slip, email, etc. indicated receipt of goods and date. | 18 of 47 or 38% |
| Evidence indicates employee receiving the goods or services submitted evidence of receipt or an email to F&MM noting receipt to F&MM within 3 days. | 1 of 47 or 2% |
| Penalties were not applied (Applies to IFB, RFP, RFQ, RFI)* per FAP 111-10-00(17) | 47 of 47 or 100% |

* Information obtained from the FAC Controller by the APA indicates KDE's total penalty liability for FY 03 and FY 04 was \$21.76, indicating no material penalties were assessed for failure to timely pay vendors.

KDE is using manual controls to process purchase transactions effectively; however there is room for improvement in approval processing, Management Advisory Policies (MAP) implementation, and tracking of receipt of goods. Test results and observations follow.

1. Agency DPR forms are used per agency MAP. When properly used, agency DPR forms offer substantive hardcopy documentation of original approvals and submittals and provide an effective means of tracing purchase requisitions.
2. KDE did not incorporate the FY 02 internal audit report recommendation in its MAP regarding implementation of the three-day processing recommendation. Only one transaction fully complied with the recommendation.

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 2 (Continued)

3. KDE's F&MM did not track when notice of receipt of goods was received so it was not possible for auditors to fully assess implementation of the FY 02 internal audit report recommendation.
4. KDE prepared Certificates of Receipt in response to the FY 02 internal audit report recommendation in order to verify dates of receipt of goods and services. These were available for 38% of the transactions tested.
5. Per Finance and Administration Cabinet (FAC), KDE paid a total of \$21.76 in penalties for late payment to vendors during the FY 03 and FY 04; however, no penalties were associated with the transactions tested. The average amount from all state agencies reporting penalties for FY 03 and FY 04 was \$1576.00 and \$1060.00 respectively.

Recommendation

We recommend:

- KDE update its MAP to include the FY 02 internal audit report recommendation regarding receipt of goods and services; and
- KDE implement the FY 02 internal audit recommendation to ensure receipt of goods or services is reported to F&MM within three days.

Agency Comment Procedure 2

Out of the 47 transactions examined by the APA, in addition to the 18 transactions found in compliance to indicate a receipt of goods and date, another 26 transactions had electronic receipts in the MARS system evidencing receipt that were not counted as compliant. These transactions are primarily for technology purposes and the entry into the MARS system automatically generates a simultaneous email to the Division of Financial and Materials Management to evidence receipt. This would bring the total to 44 out of 47 transactions with evidence of receipt of goods. Although not in compliant with the technical wording of the policy this is in furtherance of the intent.

KDE agrees with the APA finding that our MAP procedures needed to be updated to document the process for receipt of goods and services, and to require evidence of receipt to be sent from the receiver to the Division of Financial & Materials Management within three business days of the receipt of goods. It should be noted that KDE did adopt this policy, as recommended in the 2002 internal audit report. On April 21, 2003 written instructions were issued to the staff of the Materials Management Branch to implement John Heeb's recommendations. However, inadvertently we did not simultaneously update our MAP manual. We have now updated the MAP manual procedures to comply with the recommendation. We will encourage receiving the certificate of receipt electronically (using email) in order to document the timing of the receipt in the Division of Financial and Materials Management.

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 3

Procedure 3 included tests sufficient to determine if sampled KDE sole source contracts were appropriate and complied with requirements. We assumed the population provided by KDE included all available sole source MARS fields and transactions. The population for FY 03 and FY 04 consisted of 69 contracts and totaled \$1,682,374.93.

Auditors tested 24 (35%) of KDE's sole source transactions. Of the 24 transactions tested, 17 were non-personal service contracts and 7 were personal service contracts. Overall dollar coverage of the sample was \$1,073,195.24 (64%). The sample included testing of manual controls documentation and did not include an examination of MARS automated controls.

The transactions tested consisted of FAC approved sole source contracts that were classified by KDE under FAP 111-10-00 Competitive Bidding Exceptions: Sole Source, and FAP 111-43-00 (3) Personal Service Contract Exemptions for Sole Source Contracts and Emergency Conditions.

Tests performed were sufficient to ensure controls were functioning properly and appropriate for sole source contracts and noncompetitive bid procedures, pursuant to Agreed Upon Procedure 3. The controls and procedures tested included those required by Kentucky laws, regulations, FAC policies and procedures, Kentucky Department of Education Agency Management Advisory Procedures, and House Bill 269 budget restrictions.

Testing revealed errors present in 11 of 23 attributes tested. Some attributes were not applicable to all sample items. Auditors also noted other general issues related to the sole source contract files examined.

KDE has taken significant steps to clarify requirements related to sole source contracting through its MAP and to ensure efficiency, effectiveness, and compliance with laws and policies. However, significant weaknesses related to the specific attributes tested and general conditions were observed:

Findings

1. For the non-personal sole source service contracts tested, KDE did not consistently provide FAC written justification clearly substantiating the fact that the sole source item is the only item that will meet the needs of the agency.
2. Contract number C-04181571 appeared to be improperly classified as a sole source contract.
3. For 24 of the 24 sole source transactions tested, the agency failed to fully use the MAP approval matrix and obtain full signatures and/or initial authorizations, although all documents tested showed some form of approval.
4. All personal service contracts documentation for the 7 tested transactions contained a description of the needed service and sole source justification. HB 269 was made effective in March 2003 and required open competition and careful scrutiny of sole source personal service contracts. KDE entered into 7 personal service contracts that were designated as sole source for the two-year period tested and all occurred on or after July 1, 2003. A June 30, 2004 memorandum from FAC Secretary Rudolph currently directs all Executive Branch Agencies to continue the processes implemented by HB 269 and requires continued open competition for all personal service contracts.

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 3 (Continued)

Recommendation

We recommend:

- KDE follow FAC policies by fully and clearly justifying sole source contract purchases in its written requests to FAC in a consistent manner.
- Any potential misclassifications noted be reviewed by KDE and FAC for proper authorization type classification;
- KDE review its MAP approval matrix and incorporate practicable procedures for approval signatures and initialing of documents;
- Requisite approval documents be standardized and include clear signature lines for all approval levels; and
- KDE use open competition for all personal service contracts.

Agency Comments Procedure 3

Finding 1. KDE sole source contracts were approved by FAC based upon the documentation that was submitted with the special authority contracts. KDE will follow FAC policies by fully and clearly justifying sole source contract purchases in a consistent manner.

Finding 2. The contract C-04181571 was originally submitted to FAC as a competitive bidding exception- other goods and services, which the auditors agreed that was the proper cited authority. We were advised by FAC that the cited authority should be a different authority and when the contract was approved by FAC the cited authority was changed by FAC. This is reflected in the file. The auditor's finding should be addressed with FAC instead of KDE, since FAC superseded KDE's initial submission.

Finding 3. In the instances cited of not having proper approvals, the MAP procedure or approval matrix required a signature to evidence approval. In all cases, notice of approval was obtained, but the evidence of approval was through initials or a stamp that is used in the Division of Financial and Materials Management for approval rather than specific required signature. The intent of the procedure is to provide appropriate notice of approval, which is being received. Accordingly, the MAP procedure and approval matrix has been modified to additionally provide for these alternative methods of approval.

Finding 4. During FY 2004 KDE did not issue any sole source personal service contracts and all PSCs have been competitively bid. KDE will continue to use open competition for all personal services contracts.

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 4

Testing was done in Procedure 1 and Procedure 2 to conclude that the recommendation from the FY 02 Internal Auditor's report was not fully implemented at KDE.

Agency Comment Procedure 4

KDE's response to Procedure 4 is the same as previous response to Procedure 2.

Agreed-Upon Procedure 5

For the test on purchasing transactions for FY 03 and FY 04 with the Cooperatives we used a list of 275 transactions totaling \$21,851,464.49 and a list of 244 transactions totaling \$17,221,195.06, respectively. From these lists, 28 transactions were tested, totaling \$4,175,772.41 from FY 03 and 18 transactions; totaling \$2,665,015.16 from FY 04. We found:

- 13 instances in which someone other than the Division Director of the program office signed the request for payment.
- The KDE document known as the "Gary Freeland Memo" was not signed by the Division Director of the originating office, but signed by someone else.
- One instance where no supporting documentation was included in the agreement; thus, whether adequate supporting documentation existed or if proper approvals were obtained could not be determined.
- Two instances in which the proper approvals were not obtained.

Agency Comments Procedure 5

KDE has reviewed our policies and procedures to make sure they accurately reflect the process and authorizations that the Department's management requires for approvals. The procedures and approval matrix have been updated accordingly. As such, upon review by the Division of Financial and Materials Management, if it is determined that the proper approval signatures are not on the documents to be processed, the documents are being returned to the originator to obtain the required approvals.

In the one instance where no supporting documentation was included in the file for a Personnel MOA transaction, the original documentation, including the invoice and other supporting papers, was on file in the Division of Budgets. KDE has changed this procedure to have all original documentation submitted to the Division of Financial and Materials Management for record storage, rather than the Division of Budgets.

For the two instances where proper approvals were not obtained, these were cases similar to the items in procedure #1 where the documentation had an electronic signature or initials rather than the full signatures as required in the procedures manual. As electronic signatures or initials provide an appropriate approval, the MAP manual has been updated to reflect these alternative forms of approval, in addition to signatures.

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 6

A report of Cooperative transactions with KDE in FY 03 and 04 was created using the vendor numbers supplied by KDE. From this report, 35 transactions from 9 Cooperatives were tested for compliance with any applicable agreements. The list of transactions was provided to KDE and the Cooperatives in order to request the applicable agreements, supporting documentation, and remaining balances. The request for remaining balances was sent to the Cooperatives on August 5, 2004.

During our fieldwork, we determined the transactions with Southeast/South Central Cooperative were really transactions with Eastern Kentucky University (EKU). The error occurred because KDE uses the same vendor number for EKU and the Southeast/South Central Cooperative. Due to exceptions found with EKU transactions, we have included them in our report even though EKU is not a Cooperative.

The following table illustrates the results of testing selected transactions with the Cooperatives and EKU. These transactions had remaining balances per the Cooperative and these monies have not been returned to KDE per the applicable agreement.

| Educational Cooperative | Expenditure Description | Amount Received Per KDE | Remaining Balance Per Cooperative | Master Agreement Period |
|---|---|--------------------------------|--|--------------------------------|
| Kentucky Valley Educational Cooperative | Deaf and Blind Transportation Reimbursement | \$ 44,175.50 | \$ 44,175.50 | N/A |
| Ohio Valley Educational Cooperative | M-04144824-Teacher Academy (History) | \$ 50,000.00 | \$ 5,644.10 | 05/01/04 through 06/30/04 |
| Ohio Valley Educational Cooperative | M-04145143-Teacher Academy (Math) | \$ 50,000.00 | \$ 9,089.69 | 05/01/04 through 06/30/04 |
| Eastern Kentucky University | M-02441574-Mountain Writing Project | \$ 118,800.00 | \$ 36,660.28 | 02/15/03 through 06/30/04 |
| Eastern Kentucky University | M-02441431-Writing Project | \$ 118,800.00 | \$ 22,953.30 | 02/15/03 through 06/30/04 |
| Eastern Kentucky University | M-02234471-Middle School Academic Achievement | \$ 400,000.00 | \$114,778.28 | 08/01/02 through 06/30/03 |
| Eastern Kentucky University | M-03079727-Teacher Academy (Wellness) | \$ 58,000.00 | \$ 12,769.05 | 04/14/03 through 06/30/04 |
| Eastern Kentucky University | M-02244850-KIDS Project | \$ 717,608.00 | \$ 93,643.89 | 07/01/02 through 06/30/04 |

FINDINGS AND RECOMMENDATIONS
(Continued)

| Educational Cooperative | Expenditure Description | Amount Received Per KDE | Remaining Balance Per Cooperative | Master Agreement Period |
|--|---|--------------------------------|--|--------------------------------|
| Eastern Kentucky University | M-03169484- Coordinated School Health Program | \$ 109,311.76 | \$ 9,333.09 | 07/15/03 through 06/30/04 |
| Green River Regional Educational Cooperative | M-04145114- Teacher Academy (TECI) | \$ 50,000.00 | \$ 17,909.43 | 05/01/04 through 06/30/04 |
| Totals | | \$2,439,728.26 | \$465,341.74 | |

All of these expenditures were based on a Master Agreement except for the one with the Kentucky Valley Educational Cooperative. The Kentucky Valley Educational Cooperative had not spent \$44,175.50 that was provided to reimburse their school districts for the transportation of students to the School for the Deaf and the School for the Blind. The statutory requirements related to this reimbursement can be found in KRS 157.280 and 702 KAR 5:120. Even though there is no Master Agreement, it is questionable why the money was not remitted to the appropriate schools or school districts on a more timely basis.

Recommendation

We recommend KDE consider sending deaf and blind transportation reimbursements directly to the schools or school districts that incur the expenses to prevent instances where the Cooperative may not remit the reimbursements on a timely basis.

We also recommend that KDE not make payments based on a Master Agreement until detailed invoices are provided. The terms of the Master Agreements clearly indicate that payments should be made on a cost reimbursement basis. The invoices accepted and reimbursed in our sample were not detailed and KDE could not determine what services had been provided. In addition, for two of the Master Agreements with the Ohio Valley Educational Cooperative the payment method specified in the agreement was that the Cooperative would be paid in full as soon as the agreement was approved. KDE should avoid using this payment method in future Master Agreements.

Agency Comment Procedure 6

KDE will explore sending Deaf and Blind Transportation Reimbursements directly to the schools or school districts that incur the expenses to prevent instances where the Cooperative may not remit the reimbursements on a timely basis.

KDE has reviewed and discussed the terms of Master Agreements. Instructions have been forwarded in email dated September 30, 2004 to KDE staff responsible for preparation of Master Agreements directing the use of the standardized phrase "any unencumbered funds at the close of the contract period must be returned to the Kentucky Department of Education" in all contracts.

KDE currently requires and is receiving invoices for all Master Agreements before payment is made. However, KDE has notified staff in writing to closely scrutinize submitted invoices and if necessary to request more detailed invoices/expenditure reports prior to sending payments to vendors.

FINDINGS AND RECOMMENDATIONS

(Continued)

Agreed-Upon Procedure 7

To perform Procedure 7, a report was extracted from MARS of KDE expenditures to Cooperatives for FY 03 and FY 04. KDE personnel provided the vendor numbers for the Cooperatives. To obtain Cooperative data from the same period, a request was made to the Cooperatives to report the amount of money they recorded as being a receipt from KDE.

- One Cooperative did not provide any data for FY 03 and FY 04.
- Four Cooperatives only provided a statement of the amount received and no additional detailed information.
- Four Cooperatives provided sufficient detailed information to reconcile the amounts.

FY 03 Amounts

| Educational Cooperative | Cooperative Submitted | KDE Submitted | Differences |
|--|---------------------------------|-------------------------|--------------------|
| Badgett Regional Cooperative | \$ 93,198.00 | \$ 131,101.00 | (\$ 37,903.00) |
| Green River Regional Educational Cooperative | \$ 421,932.00 | \$ 474,882.00 | (\$ 52,950.00) |
| Kentucky Educational Development Corporation | \$ 7,503,297.91 | \$ 7,926,305.96 | (\$ 423,008.05) |
| Kentucky Valley Educational Cooperative | \$ 2,112,719.42 | \$ 589,169.22 | \$ 1,523,550.20 |
| Ohio Valley Educational Cooperative | \$ 1,793,149.67 | \$ 1,318,122.42 | \$ 475,027.25 |
| West Kentucky Educational Cooperative | \$ 990,502.29 | \$ 944,853.35 | \$ 45,648.94 |
| Eastern Kentucky University | Nothing Provided by Cooperative | \$ 2,661,200.73 | (\$2,661,200.73) |
| Northern Kentucky Cooperative | \$ 8,270,779.65 | \$ 7,069,895.87 | \$ 1,200,883.78 |
| Central Kentucky Education Cooperative | \$ 818,842.65 | \$ 735,933.94 | \$ 2,908.71 |
| | | | |
| FY 03 Totals | \$ 22,004,421.59 | \$ 21,851,464.49 | |

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 7 (Continued)

FY 04 Amounts

| Educational Cooperative | Cooperative Submitted | KDE Submitted | Differences |
|--|---------------------------------|-------------------------|--------------------|
| Badgett Regional Cooperative | \$ 168,381.00 | \$ 138,801.00 | \$ 29,580.00 |
| Green River Regional Educational Cooperative | \$ 982,129.75 | \$ 950,730.75 | \$ 31,399.00 |
| Kentucky Educational Development Corporation | \$ 617,339.00 | \$ 619,439.00 | (\$ 2,100.00) |
| Kentucky Valley Educational Cooperative | \$ 634,384.00 | \$ 720,282.50 | (\$ 85,898.50) |
| Ohio Valley Educational Cooperative | \$ 1,401,476.01 | \$ 1,298,105.17 | \$ 103,370.84 |
| West Kentucky Educational Cooperative | \$ 2,667,048.86 | \$ 1,212,806.11 | \$ 1,454,242.75 |
| Eastern Kentucky University | Nothing Provided by Cooperative | \$ 3,599,096.72 | (\$ 3,599,096.72) |
| Northern Kentucky Cooperative | \$ 8,978,015.50 | \$ 7,858,645.61 | \$ 1,119,369.89 |
| Central Kentucky Education Cooperative | \$ 846,580.38 | \$ 823,288.20 | \$ 23,292.18 |
| | | | |
| FY 04 Totals | \$ 16,295,354.50 | \$ 17,221,195.06 | |

Badgett Regional Cooperative:

- \$30,000 reported in FY 03 as a KDE expenditure was reported as a receipt in FY 04 by the Cooperative.
- Remaining amounts unreconciled were \$5,260 and \$420 for FY 03 and FY 04 respectively.

Ohio Valley Educational Cooperative:

- \$35,000 reported in FY 03 as a KDE expenditure was reported as a receipt in FY 04 by the Cooperative.
- Remaining unreconciled amount \$14,424 in FY 03 was associated with a vendor address within MARS of 'XX'.
- Cooperative records included additional amounts received from KDE that the MARS report did not have as expenditures from KDE. The Cooperative had classified the receipts in the following categories: 4C's, Postsecondary Education, and Adult Education.
- \$183,000 reported in FY 04 as a KDE expenditure should have been reported as a receipt in FY 05 for the Cooperative as the date of all these transactions were after June 30, 2004, but before the Commonwealth's final FY 04 close.
- Remaining unreconciled amount of \$26,162 in FY 04 was associated with a vendor address within MARS of 'XX' and \$1,044.48 that is unexplained.

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 7 (Continued)

FY 04 Amounts

West Kentucky Educational Cooperative:

- KDE had expenditures for FY 03 in the amount of \$15,000 that didn't appear on the Cooperative General Ledger. On the Cooperative General Ledger there appeared \$61,988.94 in receipts that didn't appear on the FY 03 KDE expenditure report. For a net difference of \$46,988.94.
- Remaining unreconciled amount of \$1,340 in FY 03 was associated with different vendor addresses within MARS of '02' '03' and '10' and not included in the total above.
- KDE had expenditures for FY 04 in the amount of \$210,647.36 that didn't appear on the Cooperative General Ledger. On the Cooperative General Ledger there appeared \$1,664,890.11 in receipts that didn't appear on the FY 04 KDE expenditure report. For a net difference of \$1,454,242.75.

Central Kentucky Educational Cooperative:

- \$4,970.94 reported in FY 03 as a KDE expenditure was reported as a receipt in FY 04 by the Cooperative.
- KDE had expenditures for FY 03 in the amount of \$375 that didn't appear on the Cooperative Deposit Detail. On the FY 03 Cooperative Deposit Detail there appeared \$81,576.70 in receipts that were FY 02 KDE expenditures. For a net difference of \$81,201.70.
- KDE had expenditures for FY 04 in the amount of \$1,169 that didn't appear on the Cooperative Deposit Detail. On the FY 04 Cooperative Deposit Detail there appeared \$19,310.24 in receipts that were not on the FY 04 KDE expenditure report. For a net difference of \$18,141.24.

Agency Comment Procedure 7

The following information will explain and reconcile the majority of the unreconciled amounts listed on pages 11-12. (Expenditure reports on file in agency.)

Badgett Regional Cooperative - 2003

- | | |
|--|-----------------|
| • <i>Payment for Teacher Academy on 12/20/02</i> | 5,000.00 |
| • <i>Payment for Anita Whitehead on 12/6/02 for "other" expenses (RSC 8)</i> | 130.00 |
| • <i>Payment for Claudia Crumx on 11/13/02 for "other" expenses (RSC 2)</i> | 130.00 |
| TOTAL | 5,260.00 |

Badgett Regional Cooperative - 2004

- | | |
|--|--------|
| • <i>Payment for Denise Bailey on 5/17/04 for travel</i> | 420.00 |
|--|--------|

Ohio Valley Education Cooperative - 2003

- | | |
|---|-----------|
| • <i>Miscellaneous payment from School and Community Nutrition program for Head Start program</i> | 14,424.00 |
| • <i>The additional amounts recorded by OVEC were set by agencies other than KDE, such as WFDC and Council on Post Secondary Education.</i> | |

Ohio Valley Education Cooperative - 2004

- | | |
|---|-----------|
| • <i>Miscellaneous payments from School and Community Nutrition program for Head Start program.</i> | 26,162.00 |
|---|-----------|

FINDINGS AND RECOMMENDATIONS
(Continued)

Agency Comment Procedure 7 (Continued)

West Kentucky Education Cooperative - 2003

- *Payment from KSB on 12/17/02 “to collaborate with WKEC”* 15,000.00
- *The \$61,988.94 may have come from other state agencies, but not enough information given to know for sure.*

West Kentucky Education Cooperative - 2004

- *Unable to reconcile without seeing the cooperative’s ledger*

Central Kentucky Education Cooperative - 2003

- *Payment for travel on 8/26/02 for invoice 136* 375.00
- *Unable to reconcile without seeing the cooperative’s ledger*

Central Kentucky Education Cooperative - 2004

- *Payment for membership dues from Fran Hardin on 7/16/03* 1,169.00
- *Receipts in the amount of \$19,310.24 on the cooperative’s ledger may have come from other state agencies.*

Agreed-Upon Procedure 8

From the 35 transactions reviewed for Procedure 6, we documented how KDE distributed funds to the Cooperatives in FY 03 and FY 04. The following table illustrates our findings:

| Type of Disbursement | Number of Transactions | Dollar Amount |
|--|-------------------------------|----------------------|
| Federal Cash Requests | 10 | \$ 1,223,711.00 |
| Master Agreements | 19 | 2,352,673.11 |
| Deaf and Blind Transportation Reimbursements | 3 | 246,508.59 |
| Flexible Spending Account | 3 | 1,984,088.64 |
| Totals | 35 | 5,806,981.34 |

In FY 03 and FY 04, KDE used Federal Cash Requests for the following programs:

- Exceptional Children Services
- Individuals with Disabilities Education Act, Part B (IDEA-B)
- Migrant Education

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 8 (Continued)

In FY 03 and FY 04, KDE used Master Agreements for the following types of projects/activities:

- Payroll Services for Contracted KDE Employees
- Middle School Academic Achievement
- KIDS Project
- Community Service Work Project
- Writing Projects
- Teacher Academies
- Kentucky Virtual Leadership Network
- Coordinated School Health Program
- Regional Migrant Center

In addition, KDE is distributing funds to the Cooperatives for deaf and blind transportation reimbursements and flexible spending accounts. KRS 157.280 states that school districts shall be reimbursed for providing transportation of a child to the Kentucky School for the Deaf and the Kentucky School for the Blind. Northern Kentucky Cooperative for Educational Services (NKCES) is the third party administrator for the flexible spending accounts of 20 school districts. For each employee in those districts who waived state health insurance, KDE pays up to \$234 per month. These amounts are sent to NKCES on a monthly basis in the form of a check. By June 1 of each year, NKCES should wire any remaining balance from the preceding year to the Kentucky State Treasurer. On May 27, 2004, NKCES sent back \$1,877,275 to the Kentucky State Treasurer's Office. From the information provided by KDE, NKCES is the only Cooperative that acts as the flexible spending administrator.

Agency Comment Procedure 8

KDE agrees with the results of the review of activities illustrated in Procedure 8. The tables accurately reflect the four different types of transactions from KDE to Cooperatives. KDE will continue to follow accepted procedures when disbursing funds to Cooperatives for Federal Cash Requests, Master Agreements, and payment to Cooperatives as third party administrators for the flexible spending allocations for employees waiving their state health insurance. KDE will, however, review the circumstances of Deaf and Blind Transportation reimbursement being paid to Cooperatives on behalf of multiples of school districts instead of those payments being made directly to the local school district. In either event, notice has been and will continue to be made to vendors that unencumbered funds at the close of the grant period must be refunded to the Kentucky State Treasurer.

Agreed-Upon Procedure 9

From the 35 transactions reviewed for Procedure 6, we found that Kentucky Educational Development Corporation (KEDC) acted as fiscal agent for KDE under a general services agreement for the fiscal year ended June 30, 2003. Master Agreement Number M-02252802 established that KEDC would provide payroll services for specified KDE leadership personnel due to the expiration of budget bill language on June 30, 2002. The reason cited for a fiscal agent for payroll services was due to the General Assembly not enacting a budget for the FY 03. This agreement was deemed necessary to continue employees under the salary schedule of the KDE leadership and technical staff that was provided for under subsequent budget language. It should be noted that the General Assembly did not enact a budget for FY 05 but KDE did not enter into an agreement with KEDC to act as fiscal agent.

FINDINGS AND RECOMMENDATIONS
(Continued)

Agreed-Upon Procedure 9 (Continued)

The Master Agreement required payment to be made by Electronic Fund Transfer two days prior to payroll disbursement. The two transactions that were tested contained invoices dated 06/25/04 and KDE paid the amounts electronically on 06/26/04. The payment provisions of the agreement were fulfilled for the tested transactions.

Agency Comment Procedure 9

As the APA notes above, extenuating circumstances require the KEDC general services agreement. The agreement with KEDC was an unavoidable situation due to the legislature's failure to enact a budget. KDE and KEDC established appropriate controls in that situation that prevented potential for fraud, embezzlement or misappropriation of funds and the terms of the agreement were appropriately fulfilled.

Agreed-Upon Procedure 10

Testing was done in Procedures 5 through 9 that incorporated policies and procedures associated with Cooperative transactions. Controls are in place, but as concluded in Procedures 5 through 9, controls can continue to be strengthened.

Agency Comment Procedure 10

The KDE agrees that adequate controls are in place to control expenditures with the Educational Cooperatives. As opportunities are identified for strengthening our policies in this area, KDE will update the procedures manual accordingly.

