

**DEPARTMENT OF EDUCATION
INCLUDING
DIRECT AID TO PUBLIC EDUCATION
AND
VIRGINIA SCHOOLS FOR DEAF AND BLIND**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2005**



AUDIT SUMMARY

Our audit included the Department of Education, Direct Aid to Public Education, the Virginia School for the Deaf and Blind in Staunton, and the Virginia School for the Deaf, Blind, and Multi-Disabled in Hampton. Our audit for the year ended June 30, 2005, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no matters involving internal control and its operation that we consider material weaknesses; and
- no instances of noncompliance or other matters that required reporting.

The Department of Education is the designated fiscal agent for the Comprehensive Services Act and we issue a separate report on this entity.

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DEPARTMENT OVERVIEW

The Department of Education has four functional areas, described in more detail below.

- Direct Aid to Public Education
- Central Office Operations
- Virginia School for the Deaf and Blind in Staunton; Virginia School for the Deaf, Blind, and Multi-Disabled in Hampton
- Comprehensive Services Act for At-Risk Youth and Families

The Department of Education (Department) provides funding to localities for elementary and secondary public education through the Direct Aid to Public Education program. During fiscal year 2005, the Department transferred over \$5.4 billion in state and federal funds to local school divisions. State dollars make up the majority of these funds, which support the Standards of Quality.

The Department's Central Office supervises the public school systems; provides training and technical assistance; and monitors the compliance with laws and regulations of 132 operational school divisions. The Department assists school divisions, colleges, and universities in helping teachers and other staff improve their skills, and it licenses and certifies school personnel. The Department also serves as the pass-through agency for state and federal funds, and determines the allocation of state money to local school divisions through direct aid to local school divisions.

The Department also maintains operational control over the two schools for the deaf and blind. The schools provide comprehensive instructional programs and services to children with serious auditory and visual impairments and multi-disabilities that local school divisions cannot serve. The State Board of Education is the governing body of the Virginia Schools for the Deaf and Blind Foundation (Foundation). The Foundation promotes the growth, progress, and welfare of the Schools for the Deaf and Blind.

The Department is the designated fiscal agent for the Comprehensive Services Act for At-Risk Youth and Families (CSA). Central Office staff process pool fund payments to localities for services performed assisting at-risk youth. We issue a separate report for CSA.

FINANCIAL INFORMATION

The Department primarily receives General Fund appropriations, which account for over 82 percent of total funding. The Department also receives federal grants and collects fees for teacher licensure. The Schools for the Deaf and Blind receive funds from local school divisions, federal grants, and income from the Foundation.

The following table summarizes budget and actual operating activity for fiscal year 2005 by the Department's functional areas, and we provide more detailed financial information for each area in this report.

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Direct aid to public education	\$5,451,881,789	\$5,585,525,553	\$5,468,157,432
Central office operations	106,985,974	125,089,025	92,054,149
Virginia School for the Deaf and Blind in Staunton	7,150,588	8,042,933	7,559,927
Virginia School for the Deaf, Blind and Multi-Disabled in Hampton	<u>6,601,888</u>	<u>6,704,621</u>	<u>6,455,619</u>
Total	<u>\$5,572,620,239</u>	<u>\$5,725,362,132</u>	<u>\$5,574,227,127</u>

Direct Aid for Public Education

The Department acts as a pass-through agency for state and federal funds and determines the allocation of funds to local school divisions. Over \$5.4 billion in state and federal funding goes to local school divisions primarily for public education and local school functions. The following table summarizes these expenses by fund. General funds make up over 85 percent of this funding.

Budget and Expense Analysis for 2005 – Direct Aid to Public Education

	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual Expenses</u>
General funds	\$4,681,326,289	\$4,661,628,624	\$4,646,504,200
Special funds	795,000	795,000	621,816
Commonwealth transportation fund	2,173,000	2,173,000	2,173,000
Trust and agency funds	196,495,400	196,495,400	131,854,700
Federal funds	<u>571,092,100</u>	<u>724,433,529</u>	<u>687,003,716</u>
Total	<u>\$5,451,881,789</u>	<u>\$5,585,525,553</u>	<u>\$5,468,157,432</u>

The difference in Direct Aid to Public Education's budgeted and actual spending of General Funds reflects the fact that the Average Daily Membership, while higher than last year, was less than initially estimated; however, the majority of the variance is due to the difference between the actual sales tax collected and paid to school divisions and the amount appropriated based on the Department of Taxation's revenue estimates. (NOTE: The sales tax appropriation is a "sum sufficient" appropriation.) The variance between budgeted and actual spending of Trust and Agency Funds results from the method of processing disbursements from the Literary Fund. While the Direct Aid to Public Education appropriation includes the use of Literary Funds, the Treasury Department makes the actual disbursements and records the disbursement as an expense in Treasury's budget. We issue a Separate Report on the Literary Fund. Finally, the increase between the original and final budget in federal funds is a combination of executive and legislative actions to increase federal fund appropriations for additional federal funds anticipated for several federal programs including Title I, No Child Left Behind, and the school lunch program.

The majority of the expenses under the Direct Aid program are transfer payments to localities for several different programs. Standards of Quality funding makes up approximately 60 percent of all aid sent to local school divisions, with another 21 percent from special state revenue sharing, which consists of a portion of net revenue from the state sales and use tax and lottery profits. The following table shows Direct Aid transfer payments by program.

Direct Aid to Public Education Expenses by Program

Standards of quality	\$3,278,588,507	60 %
Sales tax and direct lottery	1,144,650,367	21 %
Categorical aid	570,983,272	10 %
Public school employee benefits	239,147,886	5 %
Nutritional services	165,811,691	3 %
Other	<u>68,975,709</u>	<u>1 %</u>
Total	<u>\$5,468,157,432</u>	<u>100 %</u>

The Standards of Quality set minimum standards for programs and services each local school board should provide. The Department allocates funds to each locality based on demographic and census information gathered from local school divisions, following the provisions outlined in the Appropriation Act and federal grant agreements. Sales and use tax disbursements go to each school division using census data of school-age children within the school divisions. The school divisions receive lottery profit allocations based on the number of students reported for each school division in the spring multiplied by the per pupil amount determined by the General Assembly.

The Department calculates most state entitlement payments based on the average daily membership (ADM) for each school division and the total departmental appropriation. At the beginning of the fiscal year, the Department makes a preliminary calculation of 24 equal installment payments for each school division. After each school division reports its actual average daily membership as of March 31, the Department adjusts the remaining installment payments to reflect each school division's actual average daily membership. The following table shows expenditures in direct aid over the last five fiscal years. In 2005, total direct aid increased nearly \$649 million over 2004 levels due to increased average daily membership and increased per-pupil appropriations.

Costs per Pupil for Fiscal Years 2001-2005

	<u>Fiscal Year 2001</u>	<u>Fiscal Year 2002</u>	<u>Fiscal Year 2003</u>	<u>Fiscal Year 2004</u>	<u>Fiscal Year 2005</u>
Direct aid to localities expenses*	\$4,365,937	\$4,426,272	\$4,588,903	\$4,819,436	\$5,468,157
Total students**	1,130,446	1,143,018	1,156,471	1,165,905	1,175,734
Per pupil expenses***	3,862	3,872	3,968	4,134	4,651
Total teachers****	89,934	89,171	91,083	92,634	94,693

*Dollars in thousands

**Final March 31, unadjusted average daily membership (ADM)

***Direct Aid to localities expenditures divided by total students

****Estimate based on localities' annual school reports as of December 14, 2005

In February 2004, the Department became aware and notified the General Assembly of a pending fiscal year 2005 budget shortfall. Several factors led to this situation, including revised estimates for the state's share of localities' retirement costs; a software translation error in special education student counts for two localities; and a Departmental coding error that undercounted teachers at 56 of the state's 2,019 schools. The Department requested and received a legislative adjustment to receive and spend fiscal 2006 funds in late 2005. The original shortfall estimate was \$12.1 million, but the final figure was less than \$8.9 million. The Department and the localities have taken appropriate corrective action to prevent recurrence.

Central Office Operations

2005 Budget and Expense Analysis for 2005 – Central Office

	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual Expenses</u>
General funds	\$ 53,509,200	\$ 55,783,907	\$52,562,353
Special funds	2,812,340	3,972,340	2,241,233
Commonwealth transportation fund	218,904	218,904	147,149
Trust and agency	193,613	193,613	191,123
Federal trust funds	<u>50,251,917</u>	<u>64,920,261</u>	<u>36,912,291</u>
Total	<u>\$106,985,974</u>	<u>\$125,089,025</u>	<u>\$92,054,149</u>

The variance between budgeted and actual spending of General Funds is due to staffing vacancies as well as lower-than-expected costs for the Standards of Learning tests and state accreditation activities. The variances in the budget and actual federal spending occur because the Department compiles the estimates of federal awards up to two years in advance. The Department does not receive notification of actual award amounts or new programs until the beginning of the fiscal year, which is after the approval of the original budget. The Department requested appropriation increases in federal funds in anticipation of additional federal funds for administration of the No Child Left Behind Act, but these did not materialize.

As illustrated below, Central Office's largest category of expense is contractual services. The largest contractual provider to the Department, Harcourt Brace, administers, grades, and evaluates Standards of Learning tests and other tests associated with the implementation of the No Child Left Behind Act. The Department paid \$24.6 million in fiscal year 2005 to this vendor for these services. In October 2005, the Department switched vendors to Pearson Educational Measurement under a six-year contract totaling \$139.9 million.

Central Office Operations Fiscal 2005 Expenditures Analysis

Contractual services	\$54,043,354
Personal services	22,514,681
Transfer payments	12,655,408
Continuous charges	1,506,222
Equipment	842,528
Supplies and materials	<u>491,956</u>
Total	<u>\$92,054,149</u>

Virginia Schools for the Deaf and Blind

The Virginia School for the Deaf and Blind in Staunton (School in Staunton) and the Virginia School for the Deaf, Blind, and Multi-Disabled in Hampton (School in Hampton) provide comprehensive instructional programs and services to children with serious auditory and visual impairments and multiple disabilities that local school divisions cannot serve.

At the direction of the General Assembly, the Virginia Board of Education is considering whether to consolidate the schools for the deaf, blind, and multi-disabled at one of the present school sites, or to construct a new consolidated school at a third, undecided site. The General Assembly has authorized \$61.5 million for the effort; however, construction estimates for both options were significantly higher due to rising material costs. The Board has not taken additional actions, pending legislative guidance.

Budget and Expense Analysis for Fiscal 2005
Virginia School for the Deaf and Blind at Staunton

	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual Expenses</u>
General funds	\$6,222,486	\$6,564,582	\$6,516,236
Special funds	449,102	749,351	465,909
Federal trust funds	<u>479,000</u>	<u>729,000</u>	<u>577,782</u>
Total	<u>\$7,150,588</u>	<u>\$8,042,933</u>	<u>\$7,559,927</u>

Budget and Expense Analysis for Fiscal 2005
Virginia School for the Deaf, Blind, and Multi-Disabled at Hampton

	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual Expenses</u>
General funds	\$6,139,263	\$6,240,966	\$6,240,220
Special funds	265,500	265,750	171,193
Federal trust funds	<u>197,125</u>	<u>197,905</u>	<u>44,206</u>
Total	<u>\$6,601,888</u>	<u>\$6,704,621</u>	<u>\$6,455,619</u>

Personal service costs account for the majority of expenses at both schools. The table below shows fiscal year 2005 operating expenses for the Schools for the Deaf and Blind broken down by type of expense.

Fiscal 2005 Operating Expenses by Type
Virginia Schools for the Deaf and Blind

	<u>Staunton</u>	<u>Hampton</u>	<u>Total</u>	<u>Percentage</u>
Personal services	\$6,106,999	\$5,078,846	\$11,185,845	79.8 %
Contractual services	631,479	651,135	1,282,614	9.2 %
Supplies and materials	407,091	364,088	771,179	5.5 %
Continuous charges	189,145	301,557	490,702	3.5 %
Equipment	204,308	39,859	244,167	1.7 %
Other	<u>20,905</u>	<u>20,134</u>	<u>41,039</u>	<u>0.3 %</u>
Total	<u>\$7,559,927</u>	<u>\$6,455,619</u>	<u>\$14,015,546</u>	<u>100.0 %</u>

The Schools also had capital expenditures of \$1.7 million during fiscal year 2005. This amount includes over \$1.3 million for boilers and almost \$300,000 sprinklers installations at the School in Staunton. These are not new capital projects but rather represent the continuation of ongoing projects.

The School in Staunton serves 140 students including 105 residential students at an average per-pupil cost of \$53,999. The School in Hampton serves 66 students including 42 residential students at an average per-pupil cost of \$96,812. Hampton's per-pupil costs were significantly higher this year than last year because of its declining enrollment. As existing students graduate and leave, the school is not replacing these students, because of the uncertainty over the future of the school. During the same period, however, Staunton's student census increased 28.4 percent. Overall, the number of students served by the Schools for the Deaf and Blind increased by 7.3 percent over the prior year.

Virginia Schools for the Deaf and Blind
Cost per Pupil for Fiscal Years 2004 and 2005

	<u>Staunton</u>		<u>Hampton</u>	
	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>
Operating Expenses	\$7,572,312	\$7,559,927	\$6,336,655	\$6,455,619
Total Students	109	140	83	66
Per Pupil Expenses	\$ 69,471	\$ 53,999	\$ 76,345	\$ 97,812

The Foundation supports and aids the Schools in the existing and future enterprises involving the Schools. The Foundation administers gifts, grants, bequests, and devices consistent with their terms and for the benefit of the Schools for the Deaf and Blind. The State Board of Education approves the Foundation's budget and acts as its governing board. The Assistant Superintendent of Finance serves as the Secretary/Treasurer of the Foundation, oversees the actions of the Foundation investor, and reports financial activities to the Board of Education.

Annually, the Schools receive income from the Foundation's investments, which they must spend in accordance with a plan submitted to the Foundation's board. At December 31, 2004, the market value of the Foundation's investment portfolio was \$2,733,425, having earned \$194,163 during calendar year 2004. The Board approved calendar year 2004 disbursements to the School in Staunton of \$26,336 and to the School in Hampton of \$16,317.

OTHER ISSUES

The No Child Left Behind Act of 2001

The No Child Left Behind Act of 2001 (Act) is a federal program intended to help close the achievement gap between disadvantaged and minority students and their peers, and to hold schools accountable for results. The Act requires that states create and administer annual assessment tests in reading and math in grades three through eight. States must disaggregate test results data for students by poverty levels, race, ethnicities, disabilities, and limited English proficiency. The Act prescribes up to 37 performance targets; each school in every division must meet some or all of those targets. Schools must meet further standards for being safe and drug free. Divisions and schools that do not make adequate yearly progress toward state specific proficiency goals will first receive assistance, then be subject to corrective action and ultimately, restructuring. Schools that meet or exceed objectives will be eligible for academic achievement awards.

To address concerns that complying with the Act might cost more than the federal revenue it brought the state; the Department joined a consortium of state departments of education, sponsored by the Council of Chief State School Officers (CCSSO) to develop a coordinated approach for analyzing the costs of the Act for multiple states. The CCSSO contracted with a consultant to develop the model framework for states and local divisions to use to determine the activities and costs to implement the Act. The study addressed both the state agency and local school divisions' costs to implement the Act.

The cost study found that total projected federal revenues should cover total estimated costs for the Department to implement the Act for the measurement period of the study. Because of the 2014 requirement for 100 percent student proficiency and the U.S. Department of Education continuing to make implementation decisions by granting waiver requests and responding to other national issues, the study results presented could and most likely will change over time.

The cost study also reviewed costs for local school divisions and estimated the cost of implementing the Act ranged from \$238 to \$267 million per year for the school years 2003 through 2004, and 2007 through 2008. This represents a local dollar per pupil figure per year of between \$204 and \$219. When balanced against new revenues, this results in an unfunded per pupil cost of approximately \$53 per year. As the 2014 requirement for 100 percent proficiency approaches, it is likely that Virginia's local school divisions could increase costs at a faster rate and need additional resources to assist schools and students.

The Act's provisions may present other risks for school divisions. For example, parents with children in schools that fail to meet state standards for at least two consecutive years, or have children who are victims of violent crime or who attend schools that are persistently dangerous may transfer their children to a better-performing public school, including a public charter school, within their district. Students from low-income families in schools that fail to meet state standards for at least three years are eligible to receive supplemental educational services including tutoring, after-school services, and summer school. These actions may result in additional costs for localities and school divisions. At this early stage of implementing the Act, the Commonwealth cannot determine the effect of these variables.

The Department has requested the US Department of Education accept 13 proposed waivers to the Department's implementation of the Act. To date, the U.S. Department of Education has approved three waivers, two have approval with modifications while one has approval as a trial program in four localities; denied five; and two remain under study.

Standards of Learning

The Board of Education established the Standards of Learning and adopts revisions on a rotating schedule. The SOL's are the minimum content requirements for students in the following subjects: English; mathematics; science; history/social science; computer/technology; visual and performing arts; foreign language; health; physical education; and driver education. The Standards of Learning set targets and expectations for both teachers and students. The Board also approved a review schedule for all Standards of Learning in each subject area at least once every seven years.

Governor's Schools

The Virginia Governor's School program is a state and local supported program that includes summer residential, summer regional, and academic-year programs serving more the 7,500 gifted students. The program presently offers 16 academic-year Governor's Schools; seven summer residential Governor's Schools; and 20 summer regional Governor's Schools. The academic-year Governor's Schools provide subjects including arts, government and international studies, global economies and technology, mathematics, science, and technology. The summer residential Governor's Schools provide gifted high school juniors and senior educational experience in visual and performing arts, humanities, mathematics, science, technology, medicine, life science, engineering, and marine science. The summer regional Governor's Schools, serving gifted elementary and middle school students, provide educational experiences in the arts, science, and humanities.

Charter Schools

Charter Schools are public, nonsectarian, nonreligious, or non-home-based alternative schools located within a public school division. Virginia's five charter schools served 555 students in fiscal 2005, 80 percent of them in grades 9 through 12.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

November 16, 2005

The Honorable Mark R. Warner
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Education including the Direct Aid to Public Education, the Virginia School for the Deaf and Blind in Staunton, and the Virginia School for the Deaf, Blind, and Multi-Disabled in Hampton** for the year ended June 30, 2005. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions on the Commonwealth Accounting and Reporting System and the Department's Oracle Financials System, review the adequacy of the Department's internal controls, and test compliance with applicable laws and regulations, and review corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

- Contractual services expenditures
- Payroll expenditures
- Appropriations
- Network Security

We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Department's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses. We confirmed investment portfolio balances for the Virginia Schools for the Deaf and Blind Foundation with outside parties.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and the Department's Oracle Financials System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System and the Department's Oracle Financials System.

We noted no matters involving internal control and its operation that we consider necessary to be reported to management. The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management on December 14, 2005.

AUDITOR OF PUBLIC ACCOUNTS

LCR:sks
sks:29

DEPARTMENT OF EDUCATION

Jo Lynne DeMary
State Superintendent of Public Instruction

BOARD MEMBERS
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