



DEPARTMENT OF EDUCATION
INCLUDING
DIRECT AID TO PUBLIC EDUCATION

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2014

Auditor of Public Accounts
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AUDIT SUMMARY

Our audit of the Department of Education and Direct Aid to Public Education for the fiscal year ended June 30, 2014, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and in Education's accounting system;
- matters involving internal control and its operation necessary to bring to management's attention; and
- instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

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AUDIT FINDINGS AND RECOMMENDATIONS

Structure Contract Management to Prevent the Circumventing of Commonwealth Requirements

During our audit, as required by the Code of Virginia §30-138(A) the Virginia Department of Education (Education) notified the Auditor of Public Accounts of a circumstance that suggested a reasonable possibility of a fraudulent transaction. Through our follow-up it appears that the employee in question was using Education's trusted relationship with one of its contractors to circumvent Commonwealth travel, procurement, and information technology requirements. The control environment at Education was enabling one of its employees to submit invoices directly to one of its contractors for payment. The contractor would make the payment and seek reimbursement from Education. Education would then reimburse these expenses under the terms of its contract. The structure of how this contract was managed and controlled did not prevent one of its employees from using the contract to circumvent Commonwealth requirements.

To ensure similar situations do not incur in the future, we recommend that Education evaluate how it has structured the management of each of its contracts. Education should structure its contracts so that employees cannot use them as an instrument to circumvent Commonwealth requirements.

Improve Information Security Policies and Procedures

Education does not properly manage certain aspects of their information security program. An agency's information security program is essential for establishing security baselines, best practices, and requirements for ensuring the protection of, and mitigate risks to agency information systems and data.

During our review, we noted the following weaknesses:

IT Systems/Data Backup and Restoration:

- Education does not have a documented process to backup and restore certain mission-critical IT systems. Education currently demonstrates that they monitor the IT Partnership's backup and restoration efforts. Additionally Education has demonstrated they have an internal process for backing up software applications and IT systems. However, the Commonwealth's Information Security Standard SEC 501-08 (Security Standard), Section CP-9, requires that an agency implement documented backup and restoration plans to support restoration of systems, data and applications in accordance with agency requirements.

IT Change Control:

- Education does not use proper change controls to guide the testing and implementation of internal database updates and patches. Specifically, Education should ensure that all required updates for the database are tracked through the SRTS change control tool and use this tool to maintain version control. Security Standard, Section CM – 3.d, requires that an agency retain and review a record of each configuration controlled change to a system.

IT Systems and Data Security:

- Education does not have an adequate IT Systems Hardening Policy. While Education has documented that the IT Partnership provides infrastructure-level hardening, the Partnership does not provide systems and data hardening at the software/application level. Security Standard, Section CM-6, requires that an agency document mandatory configuration requirements consistent with System Hardening Standards.
- Education does not scan all sensitive systems for vulnerabilities. Specifically, Education scans the Single Sign-on for Web Systems application but not the Oracle Financials or Teacher Licensure systems. While these systems are not public facing, they do include sensitive data which requires additional security controls. Security Standard, Section RA-5(2), requires that an agency scan each sensitive system for vulnerabilities at least once every ninety days.

Failure to implement these requirements can result in Education being unable to adequately address key aspects of the agency information security program for consistent management of system backup/restoration and IT systems hardening procedures. These procedures are essential for ensuring that IT systems are adequately protected from potential continuity and data hardening risks and vulnerabilities.

Education has not implemented these requirements as a result of a lack of dedicated resources. Specifically, Education does not have dedicated staff to adequately address these documentation and procedural requirements. We recommend that Education should dedicate the necessary resources to ensure that their information systems security policies and procedures are consistent with the Security Standard.

Improve Information Security Officer Designation

Education does not properly place the Information Security Officer (ISO) position within its organizational structure. Security Standard, Section 2.4.1, recommends that the ISO report directly to the agency head and should not report to the Chief Information Officer (CIO). Currently, the CIO also fulfills the responsibilities of the ISO.

Failure to properly place the ISO role within the organization prevents the position from being independent with regards to assessing the agency IT security controls of the IT environment and IT projects. Organizational independence is critical for an ISO to adequately assess security controls without competing priorities from the Information Technology Division.

Education has not implemented this organizational change as a result of a lack of dedicated resources. Specifically, Education has not dedicated staff to adequately separate the ISO and CIO role. We recommend that Education dedicate the necessary resources to ensure that the ISO is placed within the organizational structure to be able to objectively manage and evaluate the IT security program.

Improve IT Risk Management Documentation

Education does not properly manage certain aspects of their IT Risk Management documentation. An agency's IT Risk Management documentation is essential for protecting agency IT systems by identifying risks, vulnerabilities, and remediation techniques.

During our review, we noted the following weaknesses:

Business Impact Analysis/IT Data and Systems Sensitivity Classification:

- Education does not properly classify IT systems and data sensitivity. While Education does identify the sensitivity of a system in regards to confidentiality, integrity, and availability, it does not define the level of sensitivity, in regards to low, medium, or high. Security Standard, Section 4.2.3, requires an agency to identify the sensitivity-level of a system or data on the basis of low, medium, or high.
- Education does not properly determine the potential impact of risks identified in their risk management documentation. While Education does define the magnitude of potential impacts, it does not document what those specific impacts may be, such as monetary, political, and reputational damages. Security Standard, Section 4.2.3, requires that an agency determine potential damages as a result of a compromise of sensitive data.
- Education does not define specific regulatory requirements for applicable data, such as HIPAA and FERPA requirements. While Education does educate and train employees on what data regulatory requirements are and has the ability to produce sanitized documents, Education has not identified these requirements according to each sensitive system. Security Standard, Section 2.2.8.2, requires that a data owner define protection requirements for data based on regulatory requirements for their respective system.
- Education does not properly identify roles and responsibilities over IT systems. Education has documented a prime contact and application lead for applications, but has not clearly defined what roles these fulfill or other required roles. Security Standard, Section 2, describes critical roles and responsibilities within an agency with respect to IT systems. Specifically, the roles of System Owner, Data Owner, Data Custodian, and System Administrator must be defined for each sensitive IT system.

IT Risk Assessments:

- Education did not complete an IT Risk Assessment for the Oracle Financials system or the Teacher Licensure system. Security Standard, Section 6.2, requires that an agency conduct and document an IT risk assessment of all sensitive IT systems as needed but not less than once every three (3) years.

Failure to implement these requirements can increase the likelihood of Education being unable to adequately address risks, vulnerabilities, and remediation techniques for sensitive IT

systems. Additionally, failure to consistently identify information across IT Risk Management documents can result in inconsistent management of IT resources, based on sensitivity and risk.

Education has not implemented these requirements as a result of a lack of dedicated resources. Specifically, Education has not dedicated staff to adequately address these documentation requirements. We recommend that Education dedicate the necessary resources to ensure that their IT Risk Management documentation is consistent for the entire agency and IT Risk Assessments are developed to address all sensitive IT systems.

DEPARTMENT OVERVIEW

Education has three functional areas, described in more detail below:

- Direct Aid to Public Education
- Central Office Operations
- Comprehensive Services Act for At-Risk Youth and Families

Education provides funding to localities for elementary and secondary public education through the Direct Aid to Public Education program. During fiscal year 2014, Education transferred over \$6.8 billion in state and federal funds to local school divisions. State funds make up approximately 86.3 percent of these funds, which support the Standards of Quality and other state programs.

Education's Central Office assists the 136 local public school systems by providing training, technical assistance, and monitoring their compliance with laws and regulations. Education helps teachers and other staff improve their skills by assisting school divisions, colleges, and universities in developing educational programs, and provides certain licensing and certification to school personnel. Education also serves as the pass-through agency for state and federal funds and determines the allocation of state money to local school divisions.

Education 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 will include CSA in the 2014 Agencies of Secretary of Health and Human Resources audit report.

FINANCIAL INFORMATION

Education primarily receives General Fund appropriations, which represent its share of state sales tax and other state tax revenues. Education also receives federal grants and collects fees for teacher licensure.

The following table summarizes budget and actual operating activity for fiscal year 2014 by Education's functional areas, and we provide more detailed financial information for each area in this report.

<u>Program Area</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Direct Aid to Public Education	\$6,814,837,283	\$6,840,449,624	\$6,815,120,445
Central Office Operations	<u>94,932,511</u>	<u>100,793,459</u>	<u>91,040,672</u>
Total	<u>\$6,909,769,794</u>	<u>\$6,941,243,083</u>	<u>\$6,906,161,117</u>

Source: Commonwealth Accounting and Reporting System

Direct Aid to Public Education

Education acts as a pass-through agency for state and federal funds and determines the allocation of funds to local school divisions. Essentially \$6.8 billion in state and federal funding went to local school divisions primarily for public education and local school functions. The following table summarizes these expenses by fund.

<u>Fund</u>	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual Expenses</u>
General	\$5,342,473,570	\$5,233,272,453	\$5,214,334,626
Federal	870,905,000	915,905,000	913,832,311
Lottery Proceeds	462,000,000	532,700,000	529,701,699
Literary Fund	135,990,713	144,438,573	144,438,573
Federal Stimulus (ARRA)	-	10,655,598	10,285,119
Commonwealth Transportation	2,173,000	2,173,000	1,709,861
Special	895,000	895,000	818,256
Trust and Agency	<u>400,000</u>	<u>400,000</u>	<u>-</u>
Total	<u>\$6,814,837,283</u>	<u>\$6,840,439,624</u>	<u>\$6,815,120,445</u>

Source: Commonwealth Accounting and Reporting System

General Fund appropriations make up approximately 77 percent of the Direct Aid expenses. The General Fund original budget decreased \$10 million primarily as a result of increased Lottery and Literary Fund forecasts, which in turn reduced spending in the General Fund. The original budget for Federal increased \$45 million because Education needed additional appropriations to cover the projected amount of reimbursement requests from school divisions.

The Lottery Proceeds original budget increased \$70 million due to an increase in the forecast of lottery profits. The Federal Stimulus (ARRA) fund original appropriation increased as a result of appropriating \$10 million for all remaining ARRA funds Education received under the Statewide Data Systems and School Improvement grants.

While localities did not take advantage of all of the federal funding available (stimulus and non-stimulus) in fiscal year 2014, some of these funds are still available into fiscal year 2015. After December 2014, most federal stimulus funding will not be available.

The following table shows Direct Aid transfer payments by program:

<u>Program</u>	<u>Expenses</u>	<u>Percent</u>
State Education Assistance Programs	\$5,880,677,420	86.3%
Financial Assistance for Cultural and Artistic Affairs	926,570,598	13.6%
Federal Education Assistance Programs	<u>10,325,596</u>	<u>0.1%</u>
Total	<u>\$6,817,573,614</u>	<u>100.0%</u>

Source: Commonwealth Accounting and Reporting System

The majority of the expenses under the State Education Assistance Programs are transfer payments to localities for several different programs, of which the Standards of Quality funding makes up 88 percent. Funding for the Standards of Quality is comprised of roughly 24 percent from Education's net revenue from the state sales and use tax and the remaining portion funded with other General Funds. Lottery profits from special state revenue sharing make up another nine percent of the State Education Assistance expenses. The Federal Education Assistance Program includes various federal programs supported by stimulus and non-stimulus funds.

As noted above, localities did not take advantage of all federal funding available in fiscal year 2014, especially stimulus funds. All stimulus funding ends by the end of fiscal year 2015. The following chart shows the amounts Education allocated and the amounts localities spent during fiscal year 2014. Localities must obligate and spend any remaining funds before the program ends.

<u>Federal Stimulus Program</u>	<u>Appropriated</u>	<u>Expenses</u>
School Improvement Grant*	\$10,313,921	\$ 9,933,443
Statewide Data Systems*	<u>351,676</u>	<u>351,676</u>
Total Stimulus Funds	<u>\$10,665,597</u>	<u>\$10,285,119</u>

**Localities have until September 30, 2014, to obligate and December 31, 2014, to spend the remaining funds.*

The Standards of Quality set minimum standards for programs and services each local school board must provide. Education 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 Code of Virginia. 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 funding formulas of the Direct Aid programs appropriated in the Lottery Service Area of the Appropriation Act.

Education calculates most state payments using the Average Daily Membership (ADM) for each school division and the total agency appropriation. Local divisions receive these payments twice per month throughout the fiscal year. At the beginning of the fiscal year, Education makes a preliminary calculation of 24 equal installment payments for each school division. After each school division reports its actual ADM as of March 31, Education adjusts the remaining installment payments to reflect each school division's actual ADM. The following table shows expenses in Direct Aid over the last four fiscal years from Education.

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Direct aid to localities expenses*	\$6,522,526	\$6,802,658	\$6,786,402	\$6,815,120
Total students**	1,208,902	1,214,688	1,222,554	1,229,235
Per pupil expenses***	\$5,395	\$5,600	\$5,551	\$5,544
Total teachers****	98,792	96,512	96,179	96,647

*Dollars in thousands

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

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

****Reported from the Instructional Personnel Report for corresponding school years

In fiscal year 2014, total Direct Aid expenses increased about \$28 million from fiscal year 2013 levels due the addition of a new supplement and strategic compensation program to direct aid to public education accounts.

Central Office Operations

<u>Fund</u>	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual Expenses</u>
General	\$52,375,428	\$ 52,643,555	\$51,151,867
Federal	37,570,811	39,984,246	35,622,575
Special	3,164,000	3,164,000	1,536,163
Federal Stimulus (ARRA)	-	3,179,386	1,457,471
Indirect Cost Recoveries	1,298,690	1,298,690	941,703
Commonwealth Transportation	243,919	243,919	243,919
Trust and Agency	<u>279,663</u>	<u>279,663</u>	<u>86,974</u>
Total	<u>\$94,932,511</u>	<u>\$100,793,459</u>	<u>\$91,040,672</u>

Source: Commonwealth Accounting and Reporting System

Central Office's expenses were approximately \$9.7 million less than budgeted. Federal expenses were less than budgeted due to the timing of requests for reimbursements from the localities. Localities have three years to spend their funding, so the timing of reimbursement requests can vary over the span of the program. In addition, Education received a new, multi-year federal stimulus grant totaling \$15.1 million in fiscal year 2011 to cover costs related to the development and administration of a longitudinal data system expansion. However, Education has only spent \$6.6 million of the grant through fiscal year 2014.

Most of Central Office Operation expenses are for contractual obligations associated with the Standards of Learning testing contract with NCS Pearson, Inc. In fiscal year 2014, NCS Pearson, Inc. received \$47.6 million in combined state and federal funds. Education renewed the contract with NCS Pearson, Inc. through June 30, 2017. Payroll and other personal services costs consist of roughly 28 percent of the total expenses for the Central Office Operation in fiscal year 2014. The table on the following page shows Central Office Operation expenses by each major object.

<u>Major Object</u>	<u>Amount</u>
Contractual Services	\$60,287,445
Personal Services	25,477,413
Transfer Payments	2,997,660
Continuous Services	1,825,622
Supplies and Materials	231,703
Equipment	<u>220,829</u>
Total	<u>\$91,040,672</u>

Source: Commonwealth Accounting and Reporting System



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

December 12, 2014

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John C. Watkins
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Department of Education, including Direct Aid to Public Education (Education)** for the year ended June 30, 2014. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives

Audit Objectives

Our audit's primary objective was to evaluate the accuracy of Education's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2014. In support of this objective, we evaluated the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System and in Education's accounting system, reviewed the adequacy of Education's internal control, tested for compliance with applicable laws, regulations, contracts, and grant agreements.

Audit Scope and Methodology

Education's management has responsibility for establishing and maintaining internal control and complying with applicable laws, regulations, contracts, and grant agreements. 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, regulations, contracts, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and 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.

- Sub-recipient monitoring of federal awards
- Contractual services expenses
- Payroll expenses
- Financial assistance and incentives payments
- Appropriations
- Information System Security

We performed audit tests to determine whether Education'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, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Education's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that Education properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in Education's accounting records. Education 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 or Education, as referenced.

We noted certain matters involving internal control and its operation and compliance with applicable laws, regulations, contracts and grant agreements that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

Exit Conference and Report Distribution

We discussed this report with management on January 30, 2015. Management's response to the findings identified in our audit is included in the section titled "Agency Response." We did not audit management's response and, accordingly, we express no opinion on it.

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.



AUDITOR OF PUBLIC ACCOUNTS

GDS/clj



COMMONWEALTH of VIRGINIA

Steven R. Staples, Ed.D.
Superintendent of Public Instruction

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February 9, 2015

Ms. Martha Mavredes
Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218-1295

Dear Ms. Mavredes:

I appreciate the opportunity to respond to the findings of the audit completed by the Auditor of Public Accounts of the Department of Education (DOE), including Direct Aid to Public Education, for the year ended June 30, 2014. I am pleased that the audit found that the department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in the agency accounting system. The audit did identify matters involving internal control and instances of noncompliance with applicable laws and regulations in the areas of contract management and information security, and the report contains several recommendations for improvement that will focus the work of agency management and staff that will implement them.

Regarding the finding on structuring contract management to prevent the circumventing of Commonwealth requirements, the Department of Education does believe this to be an isolated, contained incident. In response to the finding, agency contracts will be reviewed, and for reimbursement-based contracts, procedures will be discussed with contract administrators and contract modifications will be issued as necessary. Language will be added to the DOE Administrative Manual prohibiting reimbursement-based contracts. We plan to complete these actions by July 31, 2015.

Regarding the findings on information security, staff will give priority to addressing the specific findings and recommendations outlined in the report. A part-time information security specialist began employment with the agency in February 2015, and the report findings and recommendations will be a priority assignment for this staff person. In addition, I have appointed the Deputy Superintendent for Finance and Operations to the Information Security Officer role in response to a related finding.

Ms. Martha Mavredes
February 9, 2015
Page Two

Thank you again for the opportunity to provide an agency response to the audit report. The Department of Education is committed to focusing available staff resources to address the very important findings and recommendations identified as needing attention.

Sincerely,

A handwritten signature in black ink, appearing to read 'S.R. Staples', with a long horizontal line extending to the right.

Steven R. Staples, Ed.D.
Superintendent of Public Instruction

SRS/kd

DEPARTMENT OF EDUCATION

Steven R. Staples
State Superintendent of Public Instruction

Board Of Education Members
As of June 30, 2014

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