



CHIEF FINANCIAL OFFICER
STATE OF FLORIDA

TOM GALLAGHER

December 11, 2003

Mr. F. Philip Handy
Chairman, State Board of Education
325 West Gaines Street
Suite 1514
Tallahassee, Florida 32399

Dear Mr. Handy:

Enclosed are two reports covering School Choice Programs: (1) The Corporate Income Tax Credit Program and, (2) The McKay Scholarship Program and Opportunity Scholarship Program. Although there are some common issues to the three scholarship programs, two reports provide a better understanding of the distinctions between funding mechanisms.

The reports are organized according to: (1) Legislative Recommendations and, (2) State Board of Education/Department of Education Recommendations.

Overall, the Department of Education's failure to assign leadership to this program, combined with the absence of active participation in program management, has created a lack of accountability and has put the success of these vital school choice programs at risk. Most notably:

- Critical controls were not instituted which allowed for potential abuse or possible criminal activity. As a result, there are active criminal investigations being conducted
- There was a failure to adopt Administrative Rules, develop written procedures and perform other management actions, which were crucial for the success of these programs
- A changeover in management, specifically, the presence of three directors of the Office of School Choice in the last six months, has led to instability.

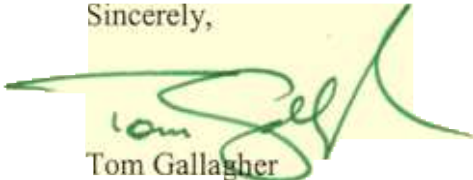
I believe these reports will assist you in your continued efforts to provide necessary accountability of taxpayer dollars and to strengthen the management of these important programs.

Mr. F. Philip Handy
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I am also encouraged that the Department of Education has recently appointed a permanent director to oversee the Office of School Choice.

If the Department of Financial Services can offer assistance in the implementation of any of these recommendations, please contact us.

Sincerely,



Tom Gallagher

TG/fe

cc: The Honorable Jeb Bush, Governor
The Honorable Jim King, President of the Senate
The Honorable Johnnie Byrd, Speaker of the House
The Honorable Jim Horne, Commissioner of Education
Dr. Jim Zingale, Executive Director, Department of Revenue
Members, State Board of Education



DEPARTMENT OF FINANCIAL SERVICES

TOM GALLAGHER
CHIEF FINANCIAL OFFICER

CORPORATE TAX CREDIT SCHOLARSHIP PROGRAM

December 10, 2003

CORPORATE TAX CREDIT SCHOLARSHIP PROGRAM

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SUMMARY

Overall the Corporate Tax Credit Scholarship Program does not have systems or processes in place to support accountability and Legislative intent. In order to accomplish objectives of any program, systems must be in place and operating effectively.

The Department of Financial Services has reviewed the processes essential for maintaining accountability and ensuring that program objectives are achieved. The purpose of our review was to evaluate and determine which systems need to be implemented, evaluate those that are currently in place, and provide recommendations to the State Board of Education and the Legislature to assist in establishing the framework for accountability. Recommendations for the adoption of Program rules are addressed to the State Board of Education as the body corporate authorized to adopt Section 1001.02(2)(n), Florida Statutes (2003).

ABOUT THE REPORT

This report should be read in conjunction with the report on the McKay and Opportunity Scholarship Programs. Although the three scholarship programs have some similar functions, the two reports provide a better understanding of the distinctions between funding mechanisms.

TERMS USED IN THE REPORT

1. State Board of Education (SBOE)
2. Department of Education (DOE)
3. Executive Office of the Governor (EOG)
4. Scholarship Funding Organization (SFO)
5. Department of Revenue (DOR)

LEGISLATIVE RECOMMENDATIONS

Eligibility Standards

LEGISLATIVE RECOMMENDATION NO. 1

The SFOs are authorized by Florida law to provide nonpublic school scholarships for students of low-income families and, therefore, have a fiduciary duty to act in the best interest of the State. These entities are entrusted with millions of dollars for this purpose and the State should have reasonable assurance that each SFO is capable of fulfilling their responsibilities prior to being determined eligible to receive funds under the Program. The following recommendations should be considered:

1. Each SFO should pass a fiscal sufficiency test. This would involve each SFO demonstrating that there is sufficient current and future expectation of revenue sources to properly administer scholarships.

2. New SFOs should demonstrate that they have processes in place to properly account for scholarship funds. For example, each SFO should demonstrate that they have financial systems and bank accounts in place to separately account for corporate contributions and administrative funds.
3. The SFO principals and nonpublic school officials need to pass a criminal background check. Other due diligence procedures for SFOs should include bankruptcy history, credit checks and lawsuit history. The results of this information should be sent to DOE to be included in their eligibility files.
4. In appropriate circumstances, SFOs should provide the State other financial assurances that accountability and legal requirements will be met.
5. The SFOs and nonpublic schools should have a state charter and be physically located within the State. We noted one SFO where the principal lives in Dallas, Texas. Based on phone conversations, it appears that there is no physical SFO operational within the State of Florida. As of October 20, 2003, this SFO has not received corporate contributions.
6. For program purposes, the types of nonpublic schools should be defined by statute. Currently, there are Internet schools, home schools and correspondence schools participating in the Program.
7. Other requirements deemed necessary for the benefit and protection of students.

LEGISLATIVE RECOMMENDATION NO. 2

Suspension or Permanent Removal of SFO Eligibility

The Legislature should consider the imposition of suspension or permanent removal of SFO eligibility when an SFO cannot demonstrate accountability of funds or there is material noncompliance with law.

The SFOs are private nonprofit corporations whose eligibility to receive corporate contributions and to provide scholarships is determined by DOE. Because SFOs have ongoing financial obligations, there are several issues that need to be addressed to provide DOE the legal authority to take enforcement action.

1. What actions can DOE take to protect scholarship funds if it is determined that these funds are in jeopardy?
2. If necessary, could DOE lawfully exercise some level of financial control over an SFO?

3. If DOE determines that an SFO should have its eligibility revoked, does DOE have the legal authority to reallocate corporate contributions to other SFOs?

Combining Scholarships

LEGISLATIVE RECOMMENDATION NO. 3

The Legislature should consider adding a statutory provision so that scholarships granted under the Corporate Tax Credit Program cannot be combined with the McKay or Opportunity Program scholarships. During the review, we noted examples where students received both McKay and Corporate Tax Credit scholarships.

Matching Scholarships to Funding

LEGISLATIVE RECOMMENDATION NO. 4

The Legislature should consider amending Section 220.187(4)(e), Florida Statutes (F.S.), and include a provision that each SFO shall demonstrate the matching of current funding received to pay scholarship obligations for the current or upcoming school year. This should replace the current statutory provision where funding shall be spent by fiscal year end.

In theory, SFOs are conduit or flow through organizations whereby assets should equal liabilities. This means that SFOs should identify applicants and secure corporate contributions accordingly. The corporate contributions received are booked as an asset and the liability should be to persons awarded scholarships. The SFOs should not be in the business of accumulating cash with no offsetting liability; however, by directing SFOs to disburse their cash balances prior to fiscal year end causes problems.

Most notably, the state fiscal year, school year and corporate tax year do not coincide. Also, SFOs tend to secure funding first, rather than have a pool of pre-approved applicants waiting for funds. Other issues include the unpredictability and timing of corporate contributions, which have caused some SFOs to perform actions that have the potential of reducing accountability.

For example, some SFOs have transferred funding unnecessarily to other SFOs prior to the June 30 deadline as a means of eliminating excess cash balances. Other examples including advancing funds to nonpublic schools prior to June 30 and delaying the receipt of corporate contributions until after the fiscal year end have not contributed to accountability and efficiencies in operations.

Time Period for Funding Availability

LEGISLATIVE RECOMMENDATION NO. 5

In conjunction with Recommendation No. 4, the Legislature should address the time period of funding availability. Currently, there is no provision in the statute to prevent an SFO from developing financing schemes with current corporate contributions or from granting scholarships for past or future periods.

In addition, some SFOs have managed irregular short-term cash flow patterns with the use of a line of credit. However, as noted later in this report, a line of credit should not be used as a means of financing an increase in the scholarship base with the anticipation that future corporate contributions will be greater to debt service the obligation.

SFO Funding Transfer Limitations

LEGISLATIVE RECOMMENDATION NO. 6

The Legislature should consider limiting scholarship funding transfers between SFOs. Funding transfers conflict with the current statute and increase the level of risk that funding may not be used for the appropriate purpose.

During the review, we noted that the SFOs transferred a total of \$10.27 million from one SFO to another. In two other instances, SFOs issued a total of \$1.7 million in checks on behalf of another SFO.

Section 220.187(2)(b), F.S., provides that a taxpayer may not contribute more than \$5 million to any single SFO. In theory, the \$5 million limit can be exceeded since the identity of scholarship funds with respect to individual contributors cannot be distinguished within a single bank account. Additionally, the transfers conflict with Section 220.187(4)(d), F.S., where each SFO should accept contributions based only on the amounts needed to fill scholarships.

Each SFO has a fiduciary duty to ensure that accountability for funding is maintained. When an SFO transfers corporate contributions to another SFO, there is a risk that the exercise of fiduciary duty may not be maintained by the SFO receiving the funds. Funding transfers also increase the risk that scholarship funds can be credited to inappropriate bank accounts and not be detected by annual financial audits.

Tax Credit Allocations

LEGISLATIVE RECOMMENDATION NO. 7

The Legislature should consider establishing a mechanism to restore unused tax credit allocation when corporations contribute less than the DOR pre-approved amounts.

The DOR pre-approves tax credits on a first come, first serve basis. Corporations receive this pre-approval and contribute funding to the specific SFO. In some instances corporations have contributed less than the amount pre-approved by the DOR. This reduces tax credit allocation for other corporations that may be willing to contribute and could eventually limit the effectiveness of the Program.

Phase-out of a Student's Scholarship

LEGISLATIVE RECOMMENDATION NO. 8

The Legislature should consider a scaled phase-out of a student's scholarship if the student was a participant in the program and becomes ineligible due to a slight increase in the parent's salary.

For those students who qualify for a scholarship in year 1, but fail to qualify in year 2 because the parent's income has slightly exceeded the income threshold according to the National School Lunch Program, the Legislature may consider a scaled phase-out provision of the scholarship. We noted a few instances where students did not qualify in the second year of the Program because a parent received a minimal pay increase.

Auditor General's Use of Audit Reports

LEGISLATIVE RECOMMENDATION NO. 9

The Legislature should address the Auditor General's use of audit reports, unless it is determined that the single audit provision should be included in Section 220.187, F.S. If the single audit provision is included in the statute, then the Auditor General provision should be removed to avoid redundancy in law.

Section 220.187(4)(f), F.S., requires that for each SFO that receives corporate contributions, the SFO must provide to the Auditor General an annual financial and compliance audit of its accounts and records conducted by an independent certified public accountant and in accordance with rules adopted by the Auditor General. The statute directing the Auditor General's receipt of the audit reports needs clarification as to purpose.

Program Performance and Accountability

LEGISLATIVE RECOMMENDATION NO. 10

There are Legislative considerations of the Program that could affect performance and accountability. First, there are some inherent limitations to the corporate tax credit funding mechanism. These include:

- Time and effort is needed to solicit contributions from corporations.
- Funding streams may be irregular and unpredictable.
- Funding may not match the demand for scholarships.

In addition, although the SFOs that we visited appear to be frugal and pay close attention to administrative costs, it is questionable as to whether some SFOs have enough administrative resources to properly administer the scholarships.

STATE BOARD OF EDUCATION (SBOE) RECOMMENDATIONS

Administrative Rules

SBOE RECOMMENDATION NO. 1

The SBOE should adopt administrative rules for the effective administration of the Corporate Tax Credit Program. Lack of rules has contributed to possible criminal actions currently being investigated by this Department and other law enforcement entities.

Section 220.187(7), F.S., requires that DOE must 1) enter into a cooperative agreement with DOR; 2) submit annually a list of qualified scholarship funding organizations to DOR; 3) determine eligibility of nonpublic schools; and

4) determine eligibility of expenditures. Section 220.187(7)(e), F.S., provides that DOE adopt rules necessary to determine eligibility of SFOs and to identify qualified students. Section 120.54(1)(a), F.S., provides that agency rule making is not a matter of agency discretion.

In addition, DOE needs to establish by rule a formal process for determining SFO and nonpublic school eligibility including proper authorizations and evidential matter supporting conclusions. Eligibility determinations should be memorialized by a final order.

Florida Single Audit Act

SBOE RECOMMENDATION NO. 2

The Corporate Tax Credit Program meets the requirements of “State Financial Assistance” and is therefore subject to the Florida Single Audit Act. We recommend that DOE comply with Florida law and classify the program accordingly.

The Florida Single Audit Act provides uniform state audit requirements for nonstate entities receiving state financial assistance. Subject to the requirements of Section 215.97, F.S., and EOG Rule 27D-1, Florida Administrative Code, certain nonstate entities that receive state financial resources are required to have their financial statements and state financial assistance audited in accordance with Chapter 10.650 Rules of the Auditor General. Section 215.97 (2)(p), F.S., defines state financial assistance as state resources provided to nonstate entities to carry out a state project. EOG Rule 27D-1.002 further describes tax credits as a type of state financial assistance.

The application of Section 215.97, F.S., indicates that the SFOs are authorized by statute to carry out a public purpose (i.e., to fund scholarships for students of limited financial means). A state financial resource is transferred to eligible SFOs by corporate contributions authorized by state law. State Program requirements and funding occur simultaneously when the SFOs receive this funding. Under the enabling statute for the Corporate Tax Credit Program, DOE is responsible for managing the Program requirements, while DOR is responsible for the administration of the tax credit allocation.

Program Management

SBOE RECOMMENDATION NO. 3

To provide reasonable assurance that program funding is being used for the purpose as prescribed by law, DOE should establish a program management function. Program managers monitor and perform other verification procedures necessary as a means of concluding whether program objectives are being met. The adoption of written policies and procedures are critical for the effective management of scholarship programs.

Program management is the establishment and operation of a system to provide reasonable assurance that program objectives are fulfilled. Within this framework the system should provide for accountability and compliance with law. After nearly two years of program activity, DOE has not established a program management function.

With respect to the Corporate Tax Credit Program, program management should include, but is not limited to the following functions:

1. Procedures and actions to ensure legal compliance and accountability of funding.
2. Procedures and actions to ensure eligibility determinations of students, nonpublic schools and SFOs.
3. The DOE's use of financial audit reports (single audit) as a component of program management.
4. The DOE's requirement for SFOs to submit monthly reports on funding and students.
5. Verification of school attendance for scholarship recipients.
6. On an exception basis, perform site visits of SFOs and nonpublic schools.
7. Perform reconciliation's of tax credits, SFOs, schools and students.
8. Perform database crosschecks for public school enrollments and other scholarship programs to prevent multiple payments per student.

There was confusion as to who is responsible for program management. According to statute, DOE and DOR share responsibility in administering the Corporate Tax Credit Scholarship Program. The DOE administers the program aspects such as eligibility determinations, program monitoring, and ensuring that all funding is being used for the purpose as prescribed by law. The DOR administers the allocation of corporate tax credits and performs tax audits within the purview of their statutory authority. Section 220.187(7), F.S., requires that DOE and DOR enter into a cooperative agreement to assist in the administration of the Program. The law further delineates the responsibilities of DOE and DOR. It was not until approximately one year after the Program began did DOE and DOR enter into this required written agreement. Eight months later, DOE agreed to receive DOR's corporate tax data.

SBOE RECOMMENDATION NO. 4

Establish a Database

The DOE must establish a database with relevant program, SFO, school, student and funding data. Contrary to information provided by DOE, prior to October 2003, no system existed for tracking funding by student.

For those students who participate in the McKay, Opportunity and Corporate Tax Credit Programs, DOE must develop a database that maintains program funding by nonpublic schools, parents, and students. As part of this process, SFO information regarding nonpublic schools should be periodically reported to DOE. In turn, DOE should perform procedures on the data to en-

sure that funding represents legitimate SFOs, nonpublic schools and students. The information can also be compared against the public school student database to ensure that the State is not paying for a student to attend both a public and private school.

Section 1002.42(2)(a), F.S., provides that DOE shall maintain a database of private schools within the State. For the McKay, Opportunity and Corporate Tax Credit Programs, the database should be an integral part of program management and will assist DOE in assessing program needs.

DOE Operating Procedures SBOE RECOMMENDATION NO. 5

Within the context of rules, DOE should establish and implement written operating procedures to meet legal compliance and accountability requirements.

Written operating procedures are used to describe the day-to-day tasks which are necessary for program personnel to accomplish the program objectives. Operating procedures provide structure and consistency within the Program.

Nonpublic School Eligibility SBOE RECOMMENDATION NO. 6

In conjunction with Recommendation No. 1, DOE should establish a formal process to ensure that all participating nonpublic schools have met the statutory eligibility requirements. This will increase the probability that Legislative intent is achieved.

Section 1002.42, F.S., establishes minimum requirements for all private schools. Sections 220.187, 1002.38 and 1002.39, F.S., provides additional eligibility requirements for the Corporate Tax Credit, McKay and Opportunity Programs, respectively. Prior to October 2003, DOE could not demonstrate how these requirements were being met.

Currently, DOE has chosen to use a sworn compliance form as a means of updating the private school database and determining school eligibility. This form encompasses the requirements noted above with some additional statutory requirements. The DOE should also implement a process to spot check and confirm reported compliance through requests for supporting documentation. Additionally, DOE should institute other control mechanisms to ensure all schools are in compliance.

SBOE RECOMMENDATION NO. 7

Program Agreements

In order to facilitate the program management function and to implement provisions of the Florida Single Audit Act, DOE should enter into written agreements with each SFO. Accordingly, all terms and conditions should be included as a means of enforcing accountability. The agreements should include, but not be limited to the following:

1. Description of the allowable uses of program funds.

2. SFO and scholarship recipient responsibilities.
3. Deliverables. Note: a deliverable for education has two primary purposes; 1) did the student receive an education and if so, 2) was it a quality education. The first can be achieved through attendance records and the second achieved through a testing mechanism.
4. State single audit requirements.
5. Required information to be sent to DOE to assist in the program management function.
6. The suspension or permanent removal of SFO eligibility when SFO actions are not in accordance with law. Note: because SFOs have ongoing financial obligations and there is a public interest, a mis-managed SFO may have to be placed under control by DOE. The real possibility of this outcome will need to be addressed by the Legislature to specify how DOE could accomplish this responsibility.

Reconcile Tax Credit Allocation Funding and Scholarships

SBOE RECOMMENDATION NO. 8

The DOE should reconcile tax credit funding to students.

To provide subsequent accountability and to develop an expectation for the current funding levels, DOE should reconcile pre-approved tax credits to funding for each SFO, school and student. In addition, this will be useful in developing information reports and will provide a basis to measure program outcomes.

School Attendance

SBOE RECOMMENDATION NO. 9

Each SFO should establish a process to corroborate and document school attendance. Currently, most SFOs rely on the honor system whereby it is up to each nonpublic school to notify the SFO when students are not attending. SBOE Recommendation No. 4 will facilitate the attendance verification.

SPECIFIC SBOE REQUIREMENTS FOR SFOs

Student Eligibility

SBOE RECOMMENDATION NO. 10

Although most SFOs that we visited have processes in place to determine student eligibility, we noted that some improvements are needed. We recommend that DOE require each SFO to formalize their processes by including written procedures, corroborating evidence and signed approvals.

The overall objective of a student eligibility process is to conclude and support, through evidential matter, that each participating student met the statutory requirements to receive a scholarship. Eligibility files, whether in man-

ual or electronic format, should corroborate the existence of a student, parent (s), and household income. The eligibility process should address, but not be limited to, the following:

1. Each file should contain corroborating evidence of the parent/guardian and student relationship. In some instances this relationship was not established. Moreover, parents and students have different last names and students are not always listed as dependents on parents' tax returns.
2. The number of individuals residing in a household should be corroborated. For example, we noted instances where the tax return was used to corroborate income; however, the number of individuals living in the house exceeded the number of dependents on the tax return. According to the income eligibility guidelines for the National School Lunch Program, each household member can provide an income allowance of \$5,809.
3. We noted instances where all income was not identified. This occurs when spouses file separate tax returns and only the income of one parent is used to substantiate eligibility. In other instances, income levels were not corroborated because tax returns were not signed and W-2 information was not included in the file.
4. Evidential matter supporting eligibility should occur prior to a student receiving a scholarship. In some instances, income tax returns were provided after the fact.
5. If an SFO contracts with a third party to determine eligibility, then the SFO should have a clear understanding as to the contractor's methodology in determining income eligibility. Most SFOs were not certain as to how the contractor corroborated this information.
6. The Legislature may want to consider what constitutes income when students live in foster homes.

Maintain Funding Identity

SBOE RECOMMENDATION NO. 11

Each SFO should establish accounting processes and bank accounts to maintain funding identity. We noted one SFO where the receipt, transfer and subsequent disbursement of funds was conducted in such a way as to not maintain funding identity.

Bank Accounts Should Comply With 220.187(4)(e), Florida Statutes

SBOE RECOMMENDATION NO. 12

The SFOs typically operate with two to three bank accounts including an administrative account, scholarship account and, in some instances, an investment account. Section 220.187(4)(e), F.S., requires that each SFO spend 100% of the corporate contributions on scholarships. Additionally, all interest earnings must be spent on scholarships. To accomplish the requirements

of Section 17.57, F.S., and to ease administrative burden, some SFOs have set-up their scholarship banking in trust accounts. The bank provides the benefit of writing scholarship checks and the burden of reconciliation is lessened because the checks are debited immediately from the trust account. We recommend the following practices when using these types of accounts:

1. Upon issuance, the checks are automatically debited to the account so there is no float. Although there is no clearing pattern for the trust account, the bank needs to periodically provide a listing of their clearing pattern for cleared and un-cleared checks on their account. This can be included in the bank reconciliation process and would be used to identify any stale checks.
2. The benefit of having the bank issue the checks should be measured against the lost interest earnings on the account.

In addition, these accounts could be in violation of Section 220.187(4)(e), F.S., due to the tradeoff between lost interest earnings and the ease of administrative burden.

Establish Written Procedures and Prohibitions on Related Party Transactions.

SBOE RECOMMENDATION NO. 13

Each SFO should establish written procedures and prohibitions on certain related party transactions.

Related parties increase the risk that program objectives may not be achieved. In addition, there could be a legal compliance issue. We noted where one SFO is affiliated with two schools to which all of the SFO's scholarship funds are directed. This appears to violate Section 220.187(2)(b), F.S., where a taxpayer cannot direct funding to a specific child as beneficiary. In addition, we noted some instances where parents of students were also employees of the schools where the students attended.

Check Endorsements

SBOE RECOMMENDATION NO. 14

Each SFO should establish a system to ensure that checks are endorsed in accordance with law.

Each SFO should establish a system of review and follow-up of cleared scholarship checks to ensure that parents and schools are in compliance with law. Periodically selecting a sample of schools and reviewing endorsements on checks that have cleared the bank account can accomplish this process. Schools that are not complying with law should be officially notified and reminded to comply with the statute.

During the review, we noted various scenarios of check endorsements that were not in compliance with statute. In addition, the Legislature may consider providing additional statutory language prohibiting a restrictive power of attorney where a school can endorse checks on behalf of parents.

Monitoring Student and Funding Information

SBOE RECOMMENDATION NO. 15

Each SFO should provide periodic information transfers to DOE to track students and funding and to prevent possible “double dipping” between SFOs and other scholarship programs. We noted several instances where students received scholarships in both the McKay and Corporate Tax Credit Programs.

Other Issues

SBOE RECOMMENDATION NO. 16

We reviewed the six funded SFOs authorized by DOE. We were able to conclude that five SFOs maintained processes to accomplish program objectives and that program funding was used to pay scholarships. However, during our FloridaChild review, the following irregularities were noted:

1. We were unable to attest to the validity of the information maintained in the financial system. FloridaChild’s financial system is maintained in Austin, Texas. Applicant information is entered and transferred online via the Internet to the financial system. Information is live and historical records to indicate an audit trail seems not to exist. In addition, our analysis indicates that the information is not always complete and does not always agree with the banking records.
2. We are unable to attest to the validity of the eligibility process. In the second year of the program, eligibility of the applicants was only verified on a sample basis. Coupled with the online application process, this increases the risk of phantom students.
3. FloridaChild has not maintained a system of budgeting and cash management. FloridaChild has borrowed \$5.2 million on a line of credit with SunTrust Bank. This is to maintain and expand a scholarship base that cannot be maintained on current cash projections. The most significant problem is that future corporate contributions are obligated to pay the liability. This affects the period of funding availability where current corporate contributions should match to current obligations. This also violates the securing of corporate contributions to meet current needs. The scholarship base should not be leveraged.
4. FloridaChild has received \$1.85 million in funds from other SFOs in order to fund the scholarship base. This violates the law where each SFO secures funds for the current need.
5. Other SFOs wrote \$1.7 million in checks to fund the FloridaChild scholarship base. These other SFOs are relying on whether FloridaChild has conducted proper eligibility requirements and there is a satisfactory system of internal control to account for the disbursement of these funds.

6. FloridaChild employs the honor system of attendance reporting from private schools prior to disbursing funds.
7. FloridaChild did not perform bank reconciliations in the second year of the program.
8. FloridaChild charges a \$15 dollar application fee to the parent in order to cover their administrative costs.
9. FloridaChild sent a letter to each school requesting 2% of the scholarship funding awarded be provided as a donation to fund administrative expenses.

These irregularities are being referred to the Office of Fiscal Integrity.



DEPARTMENT OF FINANCIAL SERVICES

TOM GALLAGHER
CHIEF FINANCIAL OFFICER

MCKAY AND OPPORTUNITY SCHOLARSHIP PROGRAMS

December 10, 2003

MCKAY AND OPPORTUNITY SCHOLARSHIP PROGRAMS

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SUMMARY

Overall, the McKay and Opportunity Scholarship Programs do not have systems in place to support accountability and Legislative intent. In order to accomplish objectives of any program, systems must be in place and operating effectively.

The Department of Financial Services has reviewed the processes essential for maintaining accountability and ensuring that program objectives are achieved. The purpose of the review was to evaluate and determine which systems need to be implemented, evaluate those that are currently in place, and provide recommendations to the State Board of Education and the Legislature to assist in establishing the framework for accountability.

ABOUT THE REPORT

This report should be read in conjunction with the report on the Corporate Tax Credit Program. Although the three scholarship programs have some similar functions, the two reports provide a better understanding of the distinctions between funding mechanisms.

TERMS USED IN THE REPORT

1. Department of Education (DOE)
2. Scholarship Funding Organization (SFO)
3. Department of Revenue (DOR)

LEGISLATIVE RECOMMENDATIONS

Private School Eligibility

LEGISLATIVE RECOMMENDATION NO. 1

The Legislature should consider an increase in the eligibility standards for private schools that participate in the McKay and Opportunity Programs.

Section 1002.42, Florida Statutes (F.S.), establishes minimum requirements for all private schools. Sections 220.187, 1002.38 and 1002.39, F.S., provides additional eligibility requirements for the Corporate Tax Credit, McKay and Opportunity Programs, respectively. Prior to October 2003, DOE did not have a process for determining whether private schools met the eligibility requirements to participate in the Programs.

Currently, DOE has chosen to use a sworn compliance form as a means of determining school eligibility and updating the private school database. This form encompasses the requirements noted above with additional statutory requirements. Participating private schools complete the form for submission to DOE.

For nonpublic schools participating in the three scholarship Programs, each private school must demonstrate fiscal soundness by being in operation for one school year or must provide DOE other assurances that the school's financial obligations can be met. In addition, each school must comply with anti-discrimination provisions of the U.S. Code, health and safety laws and other requirements pertaining to private schools. The Legislature may want to consider the following additional requirements, which are deemed necessary for the benefit and protection of students:

1. Private school personnel need to pass criminal background checks and the results should be filed with DOE.
2. Private schools should have a state charter and be physically located within the State.
3. For program purposes, the types of nonpublic schools should be defined by statute. Currently, there are internet schools, home schools and correspondence schools participating in these Programs.

Combining Scholarships

LEGISLATIVE RECOMMENDATION NO. 2

The Legislature should consider adding a statutory provision specifying that scholarships granted under the Corporate Tax Credit Program cannot be combined with the McKay or Opportunity Program scholarships. During the review, we found numerous examples where students received either the McKay or Opportunity combined with the Corporate Tax Credit scholarships (90% of the exceptions noted were McKay).

STATE BOARD OF EDUCATION (SBOE) RECOMMENDATIONS

Administrative Rules

SBOE RECOMMENDATION NO. 1

The State Board of Education should promulgate administrative rules for the effective administration of the McKay and Opportunity Scholarship Programs. Lack of rules has contributed to possible criminal actions currently being investigated by this Department and other law enforcement entities.

Sections 1002.38(8) and 1002.39(8), F.S., provide that the State Board of Education may adopt administrative rules. Section 120.54(1)(a), F.S., provides that agency rule making is not a matter of agency discretion.

Program Management

SBOE RECOMMENDATION NO. 2

To provide reasonable assurance that program funding is being used for the purpose as prescribed by law, DOE should establish a program management function. Program managers monitor and perform other verification procedures necessary as a means of concluding whether program objectives are being met. The adoption of written policies and procedures are critical for the effective management of voucher programs.

Program management is the establishment of a system to provide reasonable assurance that program objectives are fulfilled. Within this framework the system should provide for accountability and compliance with law. After nearly two years of program activity, DOE has not established a program management function.

With respect to the McKay and Opportunity Programs, program management includes, but is not limited to the following:

1. Procedures and actions to ensure legal compliance and accountability of funding.
2. Procedures and actions to ensure eligibility determinations of students, and private schools.
3. Verification of school attendance.
4. On an exception basis, perform site visits of private schools.
5. Perform database crosschecks for public school enrollments and other scholarship programs to prevent multiple payments per student.

Establish a Database

SBOE RECOMMENDATION NO. 3

The DOE must establish a database with relevant program, SFO, school, student and funding data. Contrary to information provided by DOE, prior to October 2003, no system existed for tracking funding by student.

For those students who participate in the McKay, Opportunity and Corporate Tax Credit Programs, DOE must develop a database that maintains program funding by nonpublic schools, parents, and students. As part of this process, SFO information regarding nonpublic schools should be periodically reported to DOE. In turn, DOE should perform procedures on the data to ensure that funding represents legitimate SFOs, nonpublic schools and students. The information can also be compared against the public school student database to ensure that the State is not paying for a student to attend both a public and private school.

Section 1002.42(2)(a), F.S., provides that DOE shall maintain a Database of private schools within the State. For the McKay, Opportunity and Corporate Tax Credit Programs, the database should be an integral part of program management and will assist DOE in assessing program needs.

SBOE RECOMMENDATION NO. 4

Student Eligibility

Within the context of administrative rules, DOE should establish a formal process for determining student eligibility and approving scholarships.

The overall objective of a student eligibility process is to conclude and demonstrate through evidential matter that each participating student met the statutory requirements. The DOE did not have sufficient evidential matter to support the validity of this process.

School Attendance

SBOE RECOMMENDATION NO. 5

The DOE should establish a process to document and report school attendance. Currently, the private schools are on the honor system whereby it is up to each private school to notify DOE when students are not attending. The DFS and DOE are aware of instances where private schools have deposited scholarship checks when the student was actually enrolled in the public school system. Recommendation No. 3 will facilitate the attendance verification process.

Operating Procedures

SBOE RECOMMENDATION NO. 6

Within the context of rules, DOE should establish written operating procedures to meet statutory and accountability requirements.

Entities and programs that operate within the framework of written procedures generally show a high success rate in accomplishing objectives. Written operating procedures are used to describe the day-to-day tasks which are necessary for program personnel to accomplish the program objectives. Operating procedures provide structure and consistency within an organization.

Written Agreements

SBOE RECOMMENDATION NO. 7

Upon DOE's approval of any private school's eligibility to participate in the programs, DOE should enter into a written agreement with the private school. This will reduce confusion and provide a clearer understanding regarding each party's responsibilities.

In order to facilitate the program management function, DOE should enter into written agreements with private schools that participate in the program. Accordingly, all terms and conditions should be included as a means of enforcing accountability. The agreements should at a minimum contain:

1. DOE and private school responsibilities.
2. Deliverables. Note: a deliverable for education has two primary purposes; 1) did the student receive an education and if so, 2) was it a quality education. The first can be achieved through attendance records and the second achieved through a testing mechanism.
3. Certain required information to be sent to DOE to assist in the program management and to develop information reports.

4. The suspension or permanent removal of the private school eligibility to participate in the program if the school is not financially sound or there are unlawful activities.

Data Uploads in FLAIR

SBOE RECOMMENDATION NO. 8

The DOE should establish internal controls for the web-interface and data uploads to the State's accounting system (FLAIR). Currently, DOE's system will accept invalid data. Upon reviewing disbursement detail that was loaded to FLAIR, we noted a state warrant made out to an address (not a payee) and parents receiving scholarship checks under different social security numbers. During the review, we noted that parent names and social security numbers were input by either the private schools or the parents. There were no controls in place to ensure that the data was valid.

Monitoring State Warrants

SBOE RECOMMENDATION NO. 9

The DOE should establish a system of review and follow-up of cleared scholarship checks to ensure that parents and schools are in compliance with law. Periodically selecting a sample of schools and reviewing endorsements on a sampling of cleared checks can accomplish this process. Schools that are not complying with the statute should be officially notified and sanctions imposed.

During the review, we noted a very high percentage of State warrants that were not endorsed in accordance with law (90% of the exceptions noted were McKay). Additionally, some of these warrants were endorsed directly by parents with no indication of a private school endorsement. Also, various other scenarios of check endorsements not in compliance with statute were found.

The Legislature may consider providing additional statutory language prohibiting a restrictive power of attorney where a school can endorse checks on behalf of parents.