



**U.S. DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL
75 Park Place, 12th Floor
New York, New York 10007**



September 8, 2004

**Control Number
ED-OIG/A02-E0007**

Honorable César Rey-Hernández
Secretary of Education
Puerto Rico Department of Education
Calle Teniente González, Esq. Calle Calaf – 12th Floor
Urb. Tres Monjitas
Hato Rey, Puerto Rico 00919

Dear Secretary Rey-Hernández:

This is our Final Audit Report entitled *Puerto Rico Department of Education's (PRDE) Administration of Contracts Awarded to Rock Solid Technologies (RST)*. The purpose of our audit was to determine whether PRDE properly administered contracts awarded to RST. Our specific objectives were to determine whether PRDE followed Federal and local laws in procuring services through its contracts with RST and ensured that contract requirements were met prior to payment of the contractor's invoices.

We found PRDE did not properly administer contracts awarded to RST and did not adequately manage its Title I and Technology Literacy Challenge programs. PRDE improperly charged \$3,354,545 to the U.S. Department of Education's (ED) Title I and Technology Literacy Challenge programs for two State-funded contracts unrelated to these programs that totaled \$7,354,545. These two contracts were awarded in 1999 and 2000 during PRDE's prior administration. The improper charges occurred because PRDE did not implement adequate controls to oversee RST's contract administration and to properly allocate contract charges. As a result, Title I and Technology Literacy Challenge students did not fully benefit from ED funding. None of the RST costs should have been charged directly to any ED grant because RST's services were related to maintaining PRDE's payroll systems, its human resource systems, and its school lunch program. We did not perform audit work to determine whether PRDE ensured that contract requirements were met prior to payment of the contractor's invoices because the contracts were State-funded.

We provided a draft of this audit report to PRDE. In its response, dated August 12, 2004, PRDE stated that its current administration was taking proactive steps to improve the weaknesses inherited from the prior administration. PRDE also stated it was working in close cooperation with ED to update its procedures. PRDE's response did not cause us to change our finding and recommendations. We have summarized PRDE's comments after the finding and have included PRDE's entire response as an Attachment.

BACKGROUND

RST is a software solutions company with offices in Austin, Texas and San Juan, Puerto Rico. RST began providing services to PRDE in April 1998, under the administration of the former PRDE Secretary. PRDE contracted with RST to work on the reengineering of PRDE's Computer Center applications and implement a human resources operating system to manage PRDE's employee payroll accounts. During our audit period, PRDE awarded 10 contracts to RST that totaled \$13,451,859, including two contracts awarded by the prior PRDE administration. All of the contracts awarded to RST were for State-funded services. The current administration continued to contract with RST because of RST's extensive knowledge of PRDE's human resources and payroll processing systems and because RST provided maintenance and support for PRDE's current operations.

In February 2002, the former Secretary and Associate Secretary of PRDE, as well as others, pled guilty to various felony charges involving extortion, program fraud, and money laundering of Federal funds. In August 2002, ED placed Special Conditions on PRDE's grants because of problems with PRDE's fiscal and program accountability. Additionally, in August 2003, PRDE's Internal Audit Office reported a payroll fraud case that involved the illegal appropriation of \$104,161 in state funds. According to PRDE's Internal Audit report, this occurred due to a lack of supervision and controls over processing payroll payment transactions. In September 2003, ED again placed Special Conditions on PRDE's grants due, in part, to unallowable payment of employees' salaries using Title I and other Federal program accounts.

AUDIT RESULTS

Finding: PRDE improperly charged \$3,354,545 to ED programs for professional services provided by RST

PRDE did not properly administer contracts awarded to RST and did not adequately manage its Title I and Technology Literacy Challenge programs. PRDE improperly charged \$1,000,000 to ED's Title I program and \$2,354,545 to the Technology Literacy Challenge program for two State-funded contracts unrelated to these programs that totaled \$7,354,545. This occurred because PRDE did not implement adequate controls to oversee RST's contract administration and to properly allocate contract charges. As a result, Title I and Technology Literacy Challenge students did not fully benefit from ED funding.

The regulations at 34 C.F.R. § 76.702¹ state that, "A State and a subgrantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds."

According to 34 C.F.R. § 80.20(a), "Fiscal control and accounting procedures of the State . . . must be sufficient to: . . . (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes." In addition, Office of Management and Budget (OMB) Circular No. A-87

¹ Unless otherwise specified, all regulatory citations are to the July 1, 2002 volume.

(1997), Attachment A, paragraph C.1 provides that to be an allowable cost, the cost must be allocable to a Federal award.

PRDE paid RST \$14,496,446 for the 10 contracts reviewed. All costs associated with the 10 contracts should have been charged to PRDE's State account codes or to indirect cost codes because RST's costs were primarily associated with PRDE's computer systems for payroll, human resources, and the school lunch program. However, under the prior administration, PRDE improperly charged \$3,354,545 as direct costs to ED's Title I and Technology Literacy Challenge programs. This occurred because PRDE's Program Office identified on its "Allocation of Funds" form that Federal funds could be charged for RST's contracts. PRDE justified the charges by claiming that a great portion of the payroll processed by PRDE was for Federally funded employees. However, PRDE should not have charged any direct costs to ED's programs because the portion of payroll PRDE claimed it processed for Federally funded employees was already charged through indirect costs. For the 10 contracts reviewed, PRDE charged a total of \$2,576,666 as indirect costs.

Recommendations:

We recommend that the Assistant Secretary for the Office of Elementary and Secondary Education require PRDE to

- 1.1 Return to ED \$3,354,545 in questioned costs; and
- 1.2 Establish controls to ensure contract related expenditures are properly allocated to Federal and State accounts.

PRDE's response

In general, PRDE agreed with our finding and recommendations. PRDE stated that its current administration was taking proactive steps to improve the weaknesses inherited from the prior administration. PRDE also stated it was working in close cooperation with ED to improve current procedures, and in some cases, institute new procedures that will ensure that Federal funds are spent in accordance with Federal requirements, including assuring that contract expenditures are properly allocated to Federal and State accounts. Finally, PRDE stated it had been working diligently to design and implement changes to improve the contracting process consistent with State law and Federal grants management requirements. This work included extensive site visits and technical assistance by ED since September 2003, when PRDE and ED formalized their collaborative efforts through the Cooperative Audit Resolution and Oversight Initiative (CAROI), a collaborative method to provide alternative and creative approaches to resolve audit findings, as well as their underlying causes.

OIG's reply

We considered PRDE's response, but did not change our finding and recommendations. PRDE's effort to improve current procedures through the CAROI process may be considered by ED's Assistant Secretary for the Office of Elementary and Secondary Education, as part of the audit

resolution process. However, PRDE must return to ED the \$3,354,545 PRDE improperly charged to ED's Title I and Technology Literacy Challenge programs.

OTHER MATTERS

In our audit reports of PRDE's administration of contracts awarded to National School Services (ED-OIG/A01-A0004 and ED-OIG/A02-B0012) and R.V. Research and Management Group, Inc. (ED-OIG/A02-B0025), we reported that PRDE did not competitively bid contracts. Puerto Rico's procurement regulations governing PRDE, require that any acquisition of goods, works and services in excess of \$25,000 must use formal competitive procedures.

Although the contracts PRDE awarded RST were State funded, PRDE could not provide evidence that the contracts awarded to RST during PRDE's prior administration were competitively bid. PRDE also did not maintain in its procurement records evaluations conducted prior to awarding the contracts. RST's contracts executed during the current administration were not competitively bid because RST had extensive knowledge of PRDE's human resources and payroll processing systems and because RST continued to provide maintenance and support for PRDE's current operations.

Lack of competition in its procurement transactions with RST prevented PRDE from assuring that the highest quality of services and products were received at competitive prices or that certain vendors were not given preferential treatment or were arbitrarily excluded.

PRDE's response

PRDE recognized the importance of upgrading its procurement and contracting processes. PRDE stated it had been working diligently, in cooperation with ED, to design and implement changes to improve the inefficient and outdated contracting system inherited from the prior administration. However, PRDE disputed the Draft Audit Report's statement that "PRDE overpaid RST \$1,066,163 in State funds for two of the contracts reviewed." PRDE provided evidence that the payment vouchers were cancelled prior to the issuance of payment to RST. Therefore, no improper overpayment in State funds took place.

OIG's reply

PRDE provided documentation confirming its assertion that no improper overpayment in State funds took place. As a result, we removed the Draft Audit Report's statement that "PRDE overpaid RST \$1,066,163 in State funds for two of the contracts reviewed."

OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of our audit was to determine whether PRDE properly administered contracts awarded to RST. Our specific objectives were to determine whether PRDE followed Federal and local laws in procuring services through its contracts with RST and ensured that contract requirements were met prior to payment of the contractor's invoices.

The period of our audit was from May 1, 1999 through June 30, 2003. To achieve the audit objectives, we interviewed officials from PRDE's Budget Division and Office of Information Systems and Technological Support to Teachers. We also reviewed 10 contracts between PRDE and RST for services rendered from May 1, 1999 through June 30, 2003, as well as payment vouchers, invoices, and supporting documentation for the 10 contracts. We performed our fieldwork at PRDE's offices in Hato Rey, Puerto Rico from January 21, 2004 through April 29, 2004, the date of our exit conference.

We did not rely on any computer-processed data for any conclusions reached during this audit.

Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

STATEMENT ON MANAGEMENT CONTROLS

As part of this audit, we assessed the system of management controls applicable to PRDE's processing of invoices submitted by RST. Based on previous knowledge gained through our prior audits (ED-OIG/A01-90006, ED-OIG/A01-90007, ED-OIG/A01-A0004, ED-OIG/A02-B0012, ED-OIG/A02-B0025, ED-OIG/A02-C0017, ED-OIG/A02-D0014, and ED-OIG/A02-D0020) and ED's designation of PRDE as a "high-risk" grantee under 34 C.F.R. § 80.12, we determined the level of control risk, that is the risk that material errors, irregularities, or illegal actions may occur, to be high. We found that PRDE did not charge the RST costs to the proper accounts. This weakness and its effects are fully disclosed in the AUDIT RESULTS section of the report.

ADMINISTRATIVE MATTERS

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Departmental action on this audit:

Raymond J. Simon
Assistant Secretary
Office of Elementary and Secondary Education
Federal Office Building 6
400 Maryland Avenue, SW, Room 3W315
Washington, DC 20202

It is the policy of the U.S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be greatly appreciated.

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent the information contained therein is not subject to exemptions in the Act.

Sincerely,

/s/

Daniel P. Schultz
Regional Inspector General
for Audit

Attachment

Attachment



Estado Libre Asociado de Puerto Rico
DEPARTAMENTO DE EDUCACIÓN

OFICINA ASUNTOS FEDERALES

August 12, 2004

Daniel P. Schultz
Regional Inspector General for Audit
U.S. Department of Education
Office of Inspector General
75 Park Place, Room 1207
New York, NY 10007

Dear Mr. Schultz:

On July 12, 2004, the United States Department of Education, Office of Inspector General, issued Draft Audit Report Control Number ED-OIG/A02-E0007. This Draft Audit Report presented the results of OIG's audit of *Puerto Rico Department of Education's (PRDE) Administration of Contracts Awarded to Rock Solid Technologies (RST)*. PRDE appreciates the opportunity to respond to the Office of Inspector General's (OIG) July 12, 2004 draft audit report.

PRDE has the following response to the finding contained in the draft audit report.

Response

The draft audit finding states that PRDE "improperly charged \$1,000,000 to ED's Title I program and \$2,354,545 to the Technology Literacy Challenge program" The draft audit report recognizes that these "two contracts were awarded in 1999 and 2000 during PRDE's prior administration" (page 1 of the Draft Audit Report). The audit report states that "under the prior administration, PRDE improperly charged \$3,354,545 as direct costs to ED's Title I and Technology Literacy Challenge programs" (page 3 of the Draft Audit Report). As ED is aware, PRDE's current administration is taking proactive steps to improve the weaknesses inherited from the prior administration, including the ones addressed in this draft audit report as discussed further below.

As PRDE has stated in recent responses to Draft Audit reports, PRDE is working in close cooperation with the U.S. Department of Education (ED) to improve current procedures and in some cases institute new procedures that will ensure that federal funds are spent in accordance with federal requirements, including assuring that contract expenditures are properly allocated to Federal and State accounts. This work has included extensive site visits and technical assistance

P.O. BOX 149759, SAN JUAN, PUERTO RICO 00916-9759 • TEL: (787) 759-8910 • FAX: (787) 751-6192

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Attachment

by ED since September 2003, when PRDE and ED formalized their collaborative efforts through the Cooperative Audit Resolution and Oversight Initiative (CAROI) process.

PRDE's current administration inherited a burdensome, lengthy, and inefficient contract process; in cooperation with ED, including the ongoing receipt of valuable technical assistance from ED through CAROI, PRDE has been working diligently to design and implement changes to improve the contracting process consistent with state law and federal grants management requirements.

In addition, PRDE has collaborated with ED to develop an action plan to continue to modernize and improve its procurement process in a manner that is consistent with federal program and grants management requirements. PRDE looks forward to continuing this process during the upcoming August 2004 CAROI meetings in Puerto Rico.

Finally, after research into the issue of the alleged overpayment of State funds, PRDE respectfully disputes the Draft Audit Report's conclusion that "PRDE overpaid RST \$1,066,163 in State funds for two of the ten contracts reviewed." Because OIG observed two payment vouchers for these contracts, it incorrectly concluded that two disbursements took place for each contract. In fact, investigation into this issue by PRDE's Finance Department yielded information and evidence establishing that these payment vouchers were cancelled prior to the issuance of payment to RST, and each contract was paid with State funds only once. Therefore, no improper overpayment in State funds took place. This issue was recently discussed over the phone and in person with OIG auditors in Puerto Rico and additional documentation was provided in order to confirm this conclusion.

Conclusion

PRDE recognizes the important task before it in upgrading its procurement and contracting processes and has been working intensively toward this goal. As mentioned previously, PRDE's current administration inherited an outdated contracting system and has made the task of upgrading the system one of its top priorities. PRDE will continue to upgrade its contracting and procurement system with the assistance of the U.S. Department of Education and looks forward to continuing this work during the August 2004 CAROI meeting.

If you have any questions, please feel free to contact me.

Sincerely,



Heana I. Fas Pacheco
Director