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June 14, 2005

Control Number
ED-OIG/A02-E0008

Richard P. Mills
Commissioner of Education
New York State Education Department
89 Washington Avenue
Albany, NY 12234

Dear Commissioner Mills:

This **Final Audit Report** presents the results of our audit, entitled *U.S. Department of Education Funds Disbursed for New York City Department of Education Telecommunication Services*. The objective of our audit was to determine if U.S. Department of Education (ED) funds disbursed for New York City Department of Education (NYCDOE) telecommunication services were for services that were excessive or erroneous. An additional objective was to ensure that the use of ED funds for telecom purposes was allowable.

In its May 20, 2005, response to our draft report, New York State Department of Education (NYSED) concurred with our recommendations and it is included as Attachment 1 to the report. NYSED referred to NYCDOE's response to the draft report. Because of the voluminous number of exhibits included in NYCDOE's response, copies are available upon request. We summarized NYSED's and NYCDOE's responses at the end of the respective findings.

BACKGROUND

NYCDOE oversees New York City's public school system, the largest public school system in the country. NYCDOE serves 1.1 million school children and is organized into 10 Regions, each of which includes approximately 120 schools.

According to a NYCDOE representative, NYCDOE began an ongoing project to regularly have phone bills reviewed, driven by the idea that it is good business practice.

Phone bills can be erroneous due to human error, computer error, misapplied rates, decentralized billing, tax and surcharge mistakes, tariff error, and duplicate billing. Auditing phone bills is a risk-free way to recover past overcharges and correct phone bills so that they result in future savings. Since May 2001, NYCDOE contracted with third party phone auditors. Their review of NYCDOE’s phone bills has resulted in refunds totaling over \$6.5 million for funds disbursed by NYCDOE for telecommunication services.

For the period July 1, 1999 through June 30, 2003, over \$7.2 million in ED funds have been charged by NYCDOE for telecommunication services.

AUDIT RESULTS

We sampled approximately \$2 million of the total \$7.2 million in telecommunication services transactions, and found that NYCDOE charged unsupported and unallowable costs to ED funds. Specifically, for the sampled items, we found that NYCDOE charged \$1.5 million in unsupported costs to ED grants. In addition, NYCDOE used about \$46,000 in ED funds for telecom purposes that were unallowable under ED grants. This includes \$8,795 of unallowable indirect costs charged to ED direct grants and \$36,901 of unallowable costs charged to ED grants for disconnected telecom services.

Finding 1 – Unsupported Costs Were Charged to ED Funds.

NYCDOE could not support expenditures for ED funds disbursed for telecommunication services because NYCDOE did not maintain an adequate archiving system to retrieve requested documents. We sampled 349 transactions totaling \$2,013,794 and found that NYCDOE could not provide support for 243 transactions totaling \$1,517,937, which represents 75 percent of the dollar amount of transactions within our sample.

Table 1
Distribution of Unsupported Telecommunication Funds¹

Year	Flow Through Funds	Direct Grants	Total
2000	72,166	30,543	102,709
2001	303,168	3,335	306,503
2002	78,946	11,718	90,664
2003	1,017,061	1,000	1,018,061
Total	\$1,471,341	\$46,596	\$1,517,937

¹ Refer to Exhibit 1 for grant distribution. Flow Through Grants refer to grants administered through the State Education Agencies whereas; Direct Grants are issued directly to the Local Education Agencies.

Per 34 CFR § 75.730, “A grantee shall keep records that fully show: . . . (b) How the grantee uses the funds; (c) The total cost of the project . . . (e) Other records to facilitate an effective audit.”

34 CFR § 76.702 states: “A State and a subgrantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.”

Pursuant to 20 USC § 1232f(a),

Each recipient of Federal funds under any applicable program through any grant, subgrant, cooperative agreement, loan, or other arrangement shall keep records which fully disclose the amount and disposition by the recipient of those funds, the total cost of the activity for which the funds are used, the share of that cost provided from other sources, and such other records as will facilitate an effective financial or programmatic audit. The recipient shall maintain such records for three years after the completion of the activity for which the funds are used.

34 CFR § 80.20(a) states “. . . Fiscal control . . . 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.” Further, (b)(6) states that “. . . Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc.”

According to OMB Circular A-87 § C.1.j, to be allowable under Federal awards, costs must be adequately documented. Section C.1.b, states, costs must be allocable to Federal awards under the provisions of this Circular. Section C.3.a, establishes, “A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received.”

NYCDOE did not implement adequate controls to maintain documentation of Federal expenditures. Contributing factors include the following:

- Due to a major NYCDOE reorganization in 2003, all district offices archived all documentation in over 28,000 boxes without adequately inventorying the contents. Therefore, original documentation was not readily available. Although a recent re-inventorying of records was underway at the time of our audit, few supporting documents were provided at the conclusion of fieldwork.
- Data prior to the 2003 reorganization should have been previously archived, but as NYCDOE lacked internal controls regarding archiving and record keeping, this data was also unavailable. Internal controls were inadequate because they lacked complete procedures to ensure proper and effective record retention.

Since NYCDOE did not provide the supporting documents, we were unable to determine if the telecommunication services were properly charged to ED grants. As NYCDOE was unable to provide 75 percent of the dollar amount of transactions within our sample, we question the propriety of the balance not tested during our audit, totaling over \$5.1 million of telecommunication services charged to ED funds.

Recommendations

We recommend that the ED Chief Financial Officer, through NYSED, require NYCDOE to:

- 1.1 Provide sufficient documentation to support \$1,517,937 charged to ED grants for telecommunication services, or return this amount to ED, including the indirect costs attributable to unsupported services, as discussed in Finding 2.
- 1.2 Provide sufficient documentation to support for the untested transactions totaling \$5,193,191 charged to ED grants for telecommunication services, or return this amount to ED, including the indirect costs attributable to unsupported services.
- 1.3 Establish and implement internal controls for proper record keeping and allocation of telecommunication charges to ED grants.

NYSED Comments

NYSED agreed with the recommendations.

However, regarding Recommendation 1.2, NYSED stated that they would request additional sampling be conducted by ED to determine a more accurate disallowance rate.

OIG Response

We considered NYSED's response to Recommendation 1.2, but our position remains the same. Although afforded sufficient time, NYCDOE was unable to produce supporting documentation for 75 percent of the dollar value of transactions sampled. Expansion of our sampling would not produce alternative results.

NYCDOE Comments

NYCDOE concurred with Finding 1. NYCDOE concurred with two of three recommendations of this finding.

NYCDOE did not agree with Recommendation 1.2. NYCDOE stated it disagreed that it should be required to provide invoices for the entire universe of telecommunication services charged to ED grants, and stated that controls in its budget and accounting systems provided the necessary on-line approvals to charge transactions to a particular fund source. As the audit found only \$46,000, or 2.2 percent, as unallowable, NYCDOE

considered due diligence was applied in accordance with restrictions governing ED grants.

OIG Response

We considered NYCDOE's response to Finding 1, but our position remains the same. Because NYCDOE was unable to produce documentation supporting 75 percent of the dollar value of transactions sampled, the records are not available to substantiate its response. Since sufficient documentation was not provided for a substantial part of our sample, we could not determine the allowability of the costs or evaluate NYCDOE's due diligence applied in charging ED grants for telecommunication services.

Finding 2 – Unallowable Indirect Costs Were Charged to ED Direct Grant Funds

NYCDOE disbursed ED direct grant funds for telecommunication services that were unallowable as they were already considered within the indirect cost rates charged to the grants. Of the 349 transactions sampled, NYCDOE provided supporting documentation for 106 transactions totaling \$495,858. Of the supporting documentation provided, we determined that NYCDOE charged direct grants \$7,596 for 27 telecommunication service transactions when those services were already included within the indirect cost rates charged to the grants.

According to OMB A-87, Attachment B, Section 10, "Costs of telephone, mail, messenger, and similar communication services are allowable." However, as per Attachment A, C.1.f., "A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost."

NYCDOE's internal controls were not adequate to ensure that indirect costs are not directly charged to direct grants. We determined that direct charges of \$7,596 were unallowable. The indirect costs associated with this amount are also unallowable. Based on the application of the indirect cost percentage,² we calculated unallowable indirect costs to be \$1,198. In total, we determined that \$8,795 was unallowable.

Recommendation

We recommend that the ED Chief Financial Officer, through NYSED, require NYCDOE to:

- 2.1 Return \$8,795 in telecommunication services charged to direct grants inclusive of its applicable indirect cost rates.
- 2.2 Establish internal control procedures to ensure telecom services are properly allocated to ED grants prior to payment.

² Refer to Exhibit II for illustration of direct grants and applicable indirect cost rates.

NYSED Comments

NYSED concurred with our recommendations.

NYCDOE Comments

NYCDOE concurred with Finding 2 and the recommendations. NYCDOE agreed to return \$8,795 inclusive of its applicable indirect cost rates.

Finding 3 – Unallowable Costs Were Charged to ED Grant Funds

NYCDOE disbursed ED grant funds for telecommunication services that were unallowable as the services were disconnected. We analyzed the supporting documentation provided for the 106 transactions from our sample of 349 questioned items. We determined that NYCDOE charged ED grant funds \$36,901 for phone lines that were unallowable as they were disconnected.

Analysis of the supporting documentation provided by NYCDOE, disclosed three transactions totaling \$36,901 were charged to the Title I grant. These charges included a total of 137 telephone numbers³ that were disconnected according to third party auditors contracted by NYCDOE.

NYCDOE apportioned its telecommunication services among many grants using estimates. We cannot determine which phone lines were charged to Title 1 grants. There may be additional disconnected phone lines, which were not included in our sample. Consequently, we cannot ascertain what portion of the \$7.2 million charged to ED funds was proper.

According to OMB A-87, C.1.a. “To be allowable under Federal awards, costs must meet the following general criteria: Be necessary and reasonable for proper and efficient performance and administration of Federal awards.”

As per 34 CFR § 76.702, “A State and a subgrantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.”

34 CFR § 80.20(a) states, “. . . Fiscal control . . . 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.”

For the period of our audit, July 1, 1999 through June 30, 2003, NYCDOE did not have adequate internal controls in place to verify existing phone lines within its 1,200 schools

³ These telephone numbers were billed as “working telephone numbers” or, WTN’s.

prior to payment of telecom invoices. As a result, NYCDOE disbursed \$36,901 in ED grant funds for telecommunication services when those services did not exist.

Recommendation

We recommend that the ED Chief Financial Officer, through NYSED, require NYCDOE to:

- 3.1 Return \$36,901 paid for disconnected phone lines.
- 3.2 Prepare and provide to ED the results of a complete analysis of the \$7.2 million NYCDOE charged ED grant funds for telecommunication services as additional phone lines may have been disconnected.
- 3.3 Establish internal control procedures to ensure telecom services exist and are properly allocated to ED grants prior to payment.

NYSED Comments

NYSED concurred with our recommendations.

NYCDOE Comments

NYCDOE concurred with Finding 3. NYCDOE concurred with two of three recommendations of this finding.

NYCDOE agreed to return \$36,901 paid for disconnected phone lines. NYCDOE agreed with the intent of Recommendation 3.2, but stated that the \$7.2 million charged to ED grants for telecommunication services included charges other than recurring telephone costs. NYCDOE stated it will analyze those recurring charges associated with telephone lines (Object Code 402) to insure those lines are inspected.

OIG Response

We considered NYCDOE's response to Finding 3 and the related recommendations, but our position remains the same. As NYCDOE apportioned its telecommunication services among many grants using estimates, we cannot determine if other telephone costs, for example, recurring data lines expenses, were also disconnected.

OBJECTIVES, SCOPE, AND METHODOLOGY

The primary objective of this audit was to determine if ED funds disbursed for NYCDOE telecommunication services were for services that were excessive or erroneous. An additional objective was to ensure that the use of ED funds for telecom purposes was allowable.

To accomplish our audit objectives, we interviewed officials from NYCDOE, reviewed NYCDOE’s Standard Operating Procedures for Telecommunications, and reviewed ED documentation regarding the allowability of charges for telecommunication services. We also obtained electronic data files extracted by NYCDOE from the Financial Accounting Management Information System (FAMIS).

To achieve our audit objectives, we assessed the reliability of computer-processed data extracted by NYCDOE from FAMIS and found the data sufficiently reliable for meeting our audit objectives. We tested the accuracy and completeness of the data by comparing details of selected transactions with files that we created from the extract. Based on these tests, we conclude that the data are sufficiently reliable to support the findings, conclusions, and recommendations and using the data would not lead to an incorrect or inaccurate conclusion.

We obtained an extract from NYCDOE’s FAMIS for all Federally funded telecommunications services from July 1, 1999 through June 30, 2003. From the extract, only ED funded transactions were included in our population.

We then classified the transactions based on whether they related to a targeted assistance or school-wide school, as this differentiation determines how funds may be spent. NYCDOE did not readily have a year-by-year list of targeted assistance and school-wide schools. To expedite receipt of this required information, we assisted NYCDOE in compiling the data.

Subsequently, we stratified each of the classifications on an annual basis, and selected transactions for sampling, as follows:

<u>Targeted Assistance</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>Total</u>
\$20-\$499	25	25	25	25	100
\$500-\$99,999	25	25	25	25	100
Judgmentally Selected	3	0	15	0	18
	<u>53</u>	<u>50</u>	<u>65</u>	<u>50</u>	<u>218</u>
<u>School-Wide</u>					
\$999 and Below	19	27	29	22	97
\$1,000 and Above	10	8	13	3	34
	<u>29</u>	<u>35</u>	<u>42</u>	<u>25</u>	<u>131</u>
Total	<u>82</u>	<u>85</u>	<u>107</u>	<u>75</u>	<u>349</u>

All transactions in the stratified sample were randomly selected, with the exception of 18 targeted assistance transactions, which were judgmentally selected. Three from 2003 were selected because of their high dollar value, and 15 from 2001 relate to a credit and associated debits. In total, for our four-year audit period of July 1, 1999 through June 30, 2003, we sampled 349 transactions equaling \$2,013,794.

We conducted the fieldwork at NYCDOE offices and schools during the period January 2004 to October 2004. Our audit was performed in accordance with generally accepted governmental auditing standards appropriate to the scope of the review described above.

ADMINISTRATIVE MATTERS

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.

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:

Jack Martin
Chief Financial Officer
U.S. Department of Education
400 Maryland Avenue, SW
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.

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 information contained therein is not subject to exemptions in the Act.

Sincerely,

/s/

Daniel P. Schultz
Regional Inspector General
for Audit

Exhibit 1

New York City Department of Education Unsupported Telecommunication Funds
 Flow Through and Direct Grant Distribution
 For the Period of July 1, 1999 through June 30, 2003

Flow-Through Grants

CFDA ⁴ No.	Description	2000	2001	2002	2003	Total
84.010	Title I	\$45,147	\$284,121	\$40,742	\$160,364	\$530,374
84.027	Special Education	8,091	5,663	14,138	10,013	37,905
84.048	Vocational Education		1,259	1,150	1,895	4,304
84.173	Special Education – Preschool	12,260	8,358	15,363	230	36,211
84.186	Safe and Drug Free Schools	6,446	93	895	14,888	22,322
84.213C	Even Start		500	6,658	10,000	17,158
84.281	Eisenhower Prof. Development		2,000			2,000
84.298A	Innovative Programs	222	88			310
84.318X	Education Technology		1,086		806,187	807,273
84.367A	Improving Teacher Quality				13,484	13,484
	Total	\$72,166	\$303,168	\$78,946	\$1,017,061	\$1,471,341

Direct Grants

CFDA No.	Description	2000	2001	2002	2003	Total
84.165A	Magnet Schools Assistance	\$15,258		\$2,523		\$17,781
84.184F	Safe and Drug Free Schools	4,940				4,940
84.215E	Fund for the Improv. of Ed.			1,500		1,500
84.287A	21 st Cent. Comm. Learn. Centers			5,500	\$1,000	6,500
84.290U	Bilingual Ed. – Comprehensive	6,385	\$3,335	195		9,915
84.303A	Technology Innovation Chal.	3,960		2,000		5,960
	Total	\$30,543	\$3,335	\$11,718	\$1,000	\$46,596

⁴ CFDA is the acronym for the Catalog of Federal Domestic Assistance.

Exhibit II

New York City Department of Education Supported Telecommunication Funds
 Charges to Direct Grants and Applicable Indirect Cost Rates
 For the Period July 1, 1999 through June 30, 2003

Direct Grant Charges

CFDA No.	Description	2001	2002	2003	Total
84.165A	Magnet Schools Assistance	\$456	\$772	\$57	\$1,285
84.215E	Fund for the Improv. of Ed.	418	87		505
84.215X	Fund for the Improv. of Ed.			619	619
84.287B	21 st Cent. Comm. Learn. Centers	1,800			1,800
84.290U	Bilingual Ed. – Comprehensive	2,229			2,229
84.303A	Technology Innovation Chal.		1,004		1,004
84.364A	Literacy through School Lib.			154	154
Supported Charges to Direct Grants		\$4,903	\$1,863	\$830	\$7,596
Indirect Cost Rates		16.1%	16.1%	13.1%	
Indirect Cost Rates Applied		789	300	109	\$1,198
Unallowable Charges to Direct Grants		\$5,693	\$2,163	\$939	\$8,795⁵

⁵Amounts are rounded.



THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, NY 12234

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May 20, 2005

Control Number
ED-OIG/A02-E0008

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:

The New York State Education Department has the following response to recommendations contained in the draft audit report entitled U.S. Department of Education Funds Disbursed for New York City Department of Education Telecommunication Services, received April 25, 2005:

Recommendation #1

The Education Department (ED) Chief Financial Officer through New York State Education Department (NYSED) require NYCDOE to:

- 1.1 Provide sufficient documentation to support \$1,517,937 charged to ED grants for telecommunication services, or return this amount to ED, including the indirect costs attributable to unsupported services, as discussed in Finding 2.
- 1.2 Provide sufficient documentation to support for the untested transactions totaling \$5,193,191 charged to ED grants for telecommunication services, or return this amount to ED, including the indirect costs attributable to unsupported services.
- 1.3 Establish and implement internal controls for proper record keeping and allocation of telecommunication charges to ED grants.

We agree with this recommendation.

- 1.1 We will work with the NYCDOE to ensure that all additional supporting documentation is made available to the ED to support the \$1,517,937 charged to ED grants.
- 1.2 We will work with the NYCDOE to ensure that they are diligent in pursuing the missing documentation. We do not think it is possible to provide invoices for all telecommunications services charged to ED grants. We will request that the ED conduct additional sampling based on existing documentation to determine a more accurate disallowance rate.
- 1.3 We are working with the NYCDOE to ensure that proper internal controls are established for proper record keeping and the allocation of telecommunication charges to ED grants. We will work with the NYCDOE to ensure they receive training on internal controls.

Recommendation #2

The ED Chief Financial Officer through NYSED require NYCDOE to:

- 2.1 Return \$8,795 in telecommunication services charged to direct grants inclusive of its applicable indirect cost rates.
- 2.2 Establish internal control procedures to ensure telecom services are properly allocated to ED grants prior to payment.

We agree with this recommendation.

- 2.1 We agree with the recommendation and will work with the NYCDOE to ensure that the \$8,795 charged to direct grants inclusive of its applicable indirect rates is returned to the ED.
- 2.2 We are working with the NYCDOE to ensure that proper internal controls are established in order that telecommunication services are properly allocated to ED grants prior to payment.

Recommendation #3

The ED Chief Financial Officer through NYSED require NYCDOE to:

- 3.1 Return \$36,901 paid for disconnected phone lines.
- 3.2 Prepare and provide to ED the results of a complete analysis of the \$7.2 million NYCDOE charged ED grant funds for telecommunication services as additional phone lines may have been disconnected.
- 3.3 Establish internal control procedures to ensure telecom services exist and are properly allocated to ED grants prior to payment.

- 3.1 We agree with the recommendation and will work with the NYCDOE to ensure that the \$36,901 paid for disconnected phone lines is returned to the ED.
- 3.2 We will work with the NYCDOE to ensure that a complete review of recurring charges associated with telephone lines is conducted. In particular we will ensure there is an analysis and review of contract vendors and lines charged to community school districts that no longer exist.
- 3.3 We are working with the NYCDOE to ensure that proper internal controls are incorporated in the NYCDOE Telecommunications Chapter of its Standard Operating Procedures Manual. We will work with the NYCDOE to ensure they receive training on internal controls.

Also attached is NYC's response to the audit. The response shows the NYCDOE is committed to making the necessary improvements.

The Department has established a work group to identify improvement opportunities for NYCDOE's operations and processes related to grants management. The Department looks forward to working with the ED to improve the grants management process.

Sincerely,



Theresa E. Savo