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SEP 30 2003

Control Number ED-OIG/A05-D0025

Ms. Nicole Kamp, Principal
The Shelby School
HC7 Box 191-T
Payson, AZ 85541

Dear Ms. Kamp:

This **Final Audit Report** presents the results of our audit of The Shelby School's (School) use of U.S. Department of Education (ED) funds for the period August 10, 2001, through August 30, 2002 (project period). The objective of our audit was to determine if the School expended ED funds according to the law and applicable regulations.

The School received $161,500 in Public Charter Schools Program (PCSP) funds during the project period. Our audit disclosed that the School generally expended PCSP funds in accordance with the law and applicable regulations. However, the School charged $5,456[1] to the grant for costs that were unallowable.

In response to the draft audit report, the School did not concur with our finding and recommendations. Based on the auditee's comments, we revised our finding and recommendations by eliminating some costs that we initially identified as being unallowable. The School's comments are summarized in the body of the report and included in their entirety as an attachment (See Attachment).

AUDIT RESULTS

Finding No. 1 The School Charged $5,456 in Unallowable Costs to the PCSP Grant

During the project period, the School charged $5,456 to the PCSP grant for costs that were unallowable. We judgmentally selected 25 costs totaling $72,348 from the 194 totaling $162,141 charged to the PCSP grant for the project period. We reviewed invoices and cancelled checks supporting these 25 costs and noted 9 were for mileage reimbursements to School employees for using their personal vehicles to perform School

[1] The School charged $162,141 to the PCSP grant even though it received only $161,500. Therefore, we only recommend recovery of $4,815 ($5,456 in unallowable costs less $641).

business. We requested documentation supporting the School's payment of the mileage reimbursement to School employees. However, the School's Principal stated that the School did not have supporting documentation for these expenses because it does not require employees to submit mileage documentation for use of their personal vehicles.

Pursuant to Office of Management and Budget (OMB), Circular A-122, *Cost Principles for Non-Profit Organizations*, Attachment A, Section A(2)(g), for a cost to be considered allowable, the specific cost must be adequately documented.

The School charged unallowable costs to the grant because School officials did not have policies and procedures to provide reasonable assurance that it maintained adequate documentation for mileage reimbursement payments made to School employees. If School officials had developed and implemented policies and procedures for gathering and maintaining written documentation before paying mileage reimbursements to School employees for use of a personal vehicle, the School would have support that PCSP funds were expended on costs related to the operations of the School.

Because School officials were unable to provide documentation for $5,456 of PCSP funds to pay for mileage reimbursements to School employees, the School could not provide evidence that ED funds were expended according to the law and applicable requirements.

Recommendations

We recommend that the Chief Financial Officer, Office of the Chief Financial Officer, in conjunction with the Deputy Under Secretary for the Office of Innovation and Improvement, instruct the School to

1.1 refund $4,815[2] to ED; and

1.2 develop and implement policies and procedures requiring School officials to gather and maintain written documentation before paying mileage reimbursements to School employees for use of a personal vehicle.

Auditee Comments

The School did not concur with our finding that the School charged unallowable costs to the PCSP grant. The School stated that the mileage reimbursements made to employees were necessary to allow teachers to attend seminars and other meetings. Attendance at these meetings and seminars educated School administrators about the requirements that apply to charter schools. The materials covered during these meetings and seminars were related to facilitating the implementation of the School and to establish its financial independence.

[2] The School charged $162,141 to the PCSP grant even though it received only $161,500. Therefore, we only recommend recovery of $4,815 ($5,456 in unallowable costs less $641).

OIG Response

We received the School's comments, but we still consider the mileage reimbursements to be unallowable. School administrators paid employees for their use of their personal vehicles for School business. The School provided a valid justification that mileage reimbursements were an allowable use of PCSP funds used for the initial implementation of the School. However, the School did not collect and maintain records supporting the basis for payments. Without adequate documentation, we do not have assurance that PCSP funds were expended in accordance with the law and applicable requirements.

BACKGROUND

The purpose of the PCSP is to provide grants for the planning, design, and initial implementation of charter schools created by members of the local community. Grants may be made for a period of up to three years. Funds may be used to plan and design the education program of the charter school and evaluate the effects of charter schools.

Charter schools are governed by the charter school legislation enacted in the Elementary and Secondary Education Act of 1965, as amended by the Improving America's Schools Act of 1994, Title X, Part C, Section 10304(f)(3), and the Charter School Expansion Act of 1998.[3] Charter schools that receive a grant directly from the federal government must also adhere to regulations listed in 34 C.F.R. Parts 75, 82, and 99.

The School received its charter from the Arizona State Board of Education and opened in July 2000. The School applied for a PCSP grant and received its award from ED on August 10, 2001. The grant provides the School with startup funding for a three-year period. For the project period (August 10, 2001, through August 30, 2002), the School received $161,500 in PCSP grant funds.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to determine if the School expended ED funds according to the law and applicable regulations. Our audit covered the award ED made on August 10, 2001 for $161,500 and costs charged for the project period.

To accomplish our objective, we

- interviewed the School's Principal;
- reviewed accounting records;
- reviewed lists of costs provided by the School and identified 194 totaling $162,141 charged to the PCSP grant for the project period;
- judgmentally selected 25 costs totaling $72,348. We selected costs with large dollar amounts and/or descriptions that in our opinion were inconsistent with the intent of the PCSP grant;

[3] The law was amended by the No Child Left Behind Act of 2001, Title V, Part B.

- compared payroll information, invoices, and canceled checks supporting the 25 PCSP costs to School accounting information.

We also relied, in part, on computer-processed data that the School maintained using QuickBooks© and Excel©. We compared the School's data with information from ED's Central Automated Processing System. We also compared the School's supporting documentation, consisting of invoices and canceled checks, with the School's computerized accounting records. Based on these comparisons, we concluded the data were sufficiently reliable to be used in meeting the audit's objective.

We performed our audit work between December 2002 and March 2003. We visited the School on December 6, 2002, and discussed the results of our audit with the School's Principal on March 25, 2003.

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

STATEMENT ON MANAGEMENT CONTROLS

As part of our audit, we did not assess the adequacy of the School's management control structure applicable to all ED awards because this step was not necessary to achieve our audit objective. Instead, we relied on testing of the School's compliance with the PCSP law and applicable regulations. Our testing disclosed a weakness in the School's management controls over ED awards. The School did not have mileage reimbursement polices and procedures to provide reasonable assurance that PCSP funds were expended according to the law. This weakness is discussed in the **AUDIT RESULTS** section of this report.

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 ED officials.

If you have 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 ED officials, who will consider them before taking final action on the audit.

Jack Martin
Chief Financial Officer
Office of the Chief Financial Officer
400 Maryland Avenue, SW, Room 4E313
Washington, DC 20202

Nina Shokraii Rees, Deputy Under Secretary
Office of Innovation and Improvement
U.S. Department of Education
400 Maryland Avenue, SW, Room 4W317
Washington, DC 20202

It is ED's policy 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.

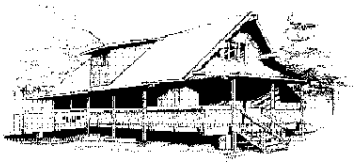
In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

Richard J. Dowd
Regional Inspector General
for Audit

Attachment

Attachment



THE SHELBY SCHOOL

July 17, 2003

Mr. Richard J. Dowd
U.S. Department of Education
Office of the Inspector General
111 North Canal Street Ste # 940
Chicago IL 60606-7204

Re: Permissibility of Costs Charged to PCSP Grant
(Control No. ED-OIG/A05-D0025)

Dear Mr. Dowd:

After reviewing your July 8 letter regarding our charges to the PCSP Grant for mileage reimbursement and for satellite television service, we do challenge your findings and recommendations for the reasons given below.

Before making our argument, though, we would like to express our appreciation generally for the PCSP funds. They did, in fact, serve their intended purpose of springboarding our school into a healthy and growing status. Although we disagree with some of your assertions and conclusion, we have not forgotten that we have been served.

Because your July 8 letter, like your March letter, offers the conclusion that we have violated the Act ("The School charged unallowable costs . . .") but never explains why, response is somewhat difficult. But we will do our best. Our challenges are as follows:

1. We are disappointed about your finding that the supposed mischarges were the result of our reliance on our "own interpretation" of the law, our failure to review the budget, and our failure to contact a program official. In fact, we reviewed the budget regularly, but it was sometimes too general to answer our questions. When the audit team visited our school, we spoke with them about our consistent inability to find a program official who was particularly interested in our questions or was able to interpret the law for us. They knew from this discussion that our decisions, whether "right" or "wrong", were not the result of a maverick attitude on our part, and it is very disappointing that you are now suggesting that that was the case.

2. You acknowledge that the purpose of the funds was, inter alia, to facilitate "implementation of the charter school" and the establishment of "financial independence". The essential prerequisite to obtaining those goals was the education of the school administrators about the many, sometimes incomprehensible, requirements that applied to charter schools. This education required the attendance at seminars put on by charter officials and meetings with our advisors who were experienced in this area. The mileage

charges which you challenge made it possible for the administrators to get to those seminars and meetings.

3. You also acknowledge that the purpose of the funds was, inter alia, to facilitate the "planning and design of the educational programs". You state that this general goal encompasses "acquiring necessary equipment and educational materials and supplies, and . . . acquiring or developing curriculum materials." The purchase of the monthly satellite television service enabled our teachers to design educational programs which included the wealth of educational material that can be obtained through cable and nowhere else. And in our mountainous setting, satellite is the only way to get that material. This satellite material is as valuable to the curricula we have developed as any of the books, the purchase of which you approved.

4. In your letter, you quote the "allowable activities" listed in 20 USCA §7221c(f)(3)(B)(i)-(iii). We believe the mileage charges and satellite service are encompassed by these, as discussed above. But even if they do not fall within those sections, they do fall within 20 USCA §7221c(f)(3)(B)(iv), which you failed to quote and which allows use of PCSP funds for "other initial operational costs that cannot be met from State or local sources." Arizona provides for neither the mileage nor the satellite service.

5. If you decide, despite the above, that our expenditures were inappropriate, our request is that, rather than reclaiming the money, you return it to the general fund allocated to us so that we can use it for other expenditures as to which you have no problem. That way, the students will not be deprived in any way.

Thank you, and call me with any further questions.

Sincerely,

Nicole Kamp
School Director

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