



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL  
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MAR 30 2004

Mr. Doug Hulce, Superintendent  
Magdalena Municipal Schools  
P.O. Box 24  
Magdalena, NM 87825

Dear Mr. Hulce:

This **Final Audit Report (ED-OIG/A06-D0027)** presents the results of our audit of Magdalena Municipal Schools' (Magdalena) administration of the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) grant for the period September 15, 2000, through September 30, 2003. Our objective was to determine whether Magdalena properly accounted for and used the GEAR UP grant funds in accordance with 1) the Higher Education Act of 1965, as amended (HEA), 2) Education Department General Administrative Regulations (EDGAR), 3) GEAR UP grant terms, and 4) the cost principles in Office of Management and Budget (OMB) Circular A-87.

We provided a draft of this report to Magdalena. In its response to our draft report, Magdalena officials provided additional support and we reduced the amount of unallowable costs to \$929.75 and the amount of unsupported costs to \$4,333.05. We have summarized Magdalena's comments in the body of the report and have included the response as Attachment B.

### BACKGROUND

GEAR UP is a discretionary grant program designed to increase the number of low-income students who are prepared to enter and succeed in postsecondary education. Signed into law as Title IV, Part A, Sections 403 and 404 of the HEA, GEAR UP provides five-year, competitive grants to States and partnerships for services at high-poverty middle and high schools.

GEAR UP grantees serve an entire cohort of students beginning no later than the seventh grade and follow the cohort through high school. Funds are also used to provide college scholarships to low-income students who are part of the same cohort.

In fiscal year 1999, 164 five-year GEAR UP partnership grants were awarded with first year funding ranging from \$70,000 to \$3,843,000 and averaging \$460,000. The maximum annual Federal contribution is \$800 per student served. The total fiscal year GEAR UP funding for 1999, 2000, 2001, 2002, and 2003, respectively, was \$120 million, \$200 million, \$295 million, \$285 million, and \$293 million.

The U.S. Department of Education (Department) awarded Magdalena a five-year GEAR UP partnership grant totaling \$1,108,255. The award amounts were—

Year One	September 15, 2000 – September 14, 2001	\$ 173,597
Year Two	September 15, 2001 – September 14, 2002	\$ 197,597
Year Three	September 15, 2002 – September 14, 2003	\$ 221,597
Year Four	September 15, 2003 – September 14, 2004	\$ 245,867
Year Five	September 15, 2004 – September 15, 2005	<u>\$ 269,597</u>
	Total	\$1,108,255

Magdalena administers the GEAR UP partnership grant by providing services to students through academic enrichment classes, remediation courses, after school activities, and summer enrichment programs.

## AUDIT RESULTS

Magdalena did not properly account for and use GEAR UP partnership grant funds in accordance with all applicable regulations, grant terms, and cost principles. Specifically, Magdalena awarded GEAR UP scholarships to ineligible students (\$16,500), charged the grant for fund-raising costs (\$929.75), used grant funds for expenditures that were not adequately supported (\$4,333.05), and did not establish a separate trust fund to safeguard GEAR UP scholarship funds (\$112,500). Details of the unallowable and unsupported expenditures are discussed in Attachment A.

### **Unallowable Expenditures**

Magdalena should not have awarded a total of \$16,500 in GEAR UP grant funds for Year 2003 scholarships to 18 graduating seniors. As noted in its grant proposal application, Magdalena currently serves a cohort of students in kindergarten through 10<sup>th</sup> grade. The 12<sup>th</sup> grade students were ineligible to receive the scholarships because GEAR UP scholarships should be awarded only to students within the eligible cohort.

According to 34 C.F.R. § 694.2 (2001), “A Partnership, or a State that chooses to use a cohort approach in its GEAR UP early intervention component, must . . . (a) Provide services to at least one entire grade level (cohort) of students . . . beginning not later than the 7<sup>th</sup> grade; (b) Ensure that supplemental appropriate services are targeted to the students with the greatest needs; and (c) Ensure that services are provided through the 12<sup>th</sup> grade to those students.”

According to 34 C.F.R. § 694.10(a) and (b), the scholarships are awarded under the eligibility requirements of Section 404E the Higher Education Act of 1965, as amended (HEA). Section 404E(d)(4) of the HEA describes eligible scholarship recipients as students who participated in the early intervention component required under Section 404D of the HEA.

Magdalena also used \$929.75 of grant funds for unallowable fund-raising costs. OMB Circular A-87, *Attachment B, Paragraph 21.a* (1997) states, “Costs of organized fund raising . . . are unallowable . . . regardless of the purpose for which the funds will be used.”

### **Unsupported Expenditures**

Magdalena did not provide adequate documentation for expenditures totaling \$4,333.05 for tuition charges, student incentives, hotels, and airline tickets. OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments, Attachment A, Paragraph C.1.b. & j.* (1997) states, “. . . To be allowable under Federal awards, costs must . . . Be allocable to Federal awards . . . [and] . . . Be adequately documented.”

### **GEAR UP Scholarship Funds Need to be in a Trust Fund**

Magdalena had not set up a trust fund for \$112,500 in scholarships awarded to eligible students during the first three years of the GEAR UP grant program. The scholarships were to be delivered to students after they completed high school and began their postsecondary education. According to Magdalena's Performance Reports, the funds for scholarships had already been placed in a trust fund. However, we found that Magdalena had not established an irrevocable trust fund to safeguard the GEAR UP grant scholarship funds.

The Department requires a grantee to establish a separate trust fund that meets the requirements of state law for trust funds. Because a grantee cannot enter into a binding written agreement with itself, the agreement must be written with a separate trust entity in order to satisfy the obligation requirement. State law will vary on the details, but essentially, there must be a group of people who serve as trustees for the trust funds who manage those funds (expend the funds and receive income to the trust) as required by the trust agreement.

We concluded that the above conditions occurred because Magdalena did not establish a formal system of management controls to safeguard GEAR UP scholarship funds in an irrevocable trust and to ensure that GEAR UP grant funds were adequately documented and used only to provide services to the cohort of eligible students.

## **RECOMMENDATIONS**

We recommend that the Chief Financial Officer, in collaboration with the Assistant Secretary for Postsecondary Education, instruct Magdalena to—

1. Refund to the Department \$16,500 for scholarships awarded to ineligible students.
2. Refund to the Department unallowable costs of \$929.75 for fund-raising costs.

3. Provide sufficient documentation to support costs of \$4,333.05 or refund that amount to the Department.
4. Deposit GEAR UP grant scholarship funds of \$112,500 into a separate trust fund.
5. Establish a formal system of management controls to ensure GEAR UP grant funds are adequately documented and used only to provide services to the cohort of eligible students.

### **MAGDALENA'S COMMENTS TO THE DRAFT REPORT**

Magdalena provided additional documentation to support some of the unallowable and unsupported costs identified in the draft report. The documentation included receipts and identification of the students in the cohort of eligible students for the following unallowable or unsupported costs: football equipment of \$1,719.00, room charges, hotels, meals, and recreation charges for teachers and students of \$6,474.81.

Magdalena agreed that charges for the hotel of \$1,776.00 and airline tickets of \$1,293.00 were inappropriate. They stated that the hotels charges were refunded and the airline tickets were cancelled.

Magdalena also agreed to refund \$16,500 for scholarships awarded to non-cohort students. Magdalena has established a GEAR UP Scholarship Trust Fund in the amount of \$112,500 and established a formal system of management controls to ensure GEAR UP funds are only used to provide services to the cohort of eligible students.

### **OIG'S RESPONSE**

After reviewing Magdalena's response, we reduced the amount of unsupported costs by \$6,474.81 and unallowable costs by \$1,719.00. We accepted the following documentation as adequate support: hotel receipts, meal receipts, travel reimbursement requests, and receipts for student recreation activities for unsupported costs of \$6,474.81.

We also accepted the documentation provided to support the charges for football equipment of \$1,719.00. In the grant application, Magdalena identified after school incentives including tutoring and extension activities. In Magdalena's response, they stated that students were tutored for one hour and then participated in a sports/club activity for one hour. Therefore, Magdalena demonstrated to us that the purchase of the football equipment was used as an incentive activity for eligible GEAR UP students. Additionally, we discussed this expenditure with Department GEAR UP program officials and they agreed that Magdalena could use sports activities as an incentive on this grant. We made the corresponding adjustments to the figures in this report.

Although the hotel receipt for the refund of \$1,776.00 was provided, this amount was not reimbursed to the GEAR UP fund. Furthermore, the \$1,293.00 spent on travel was not reimbursed to the GEAR UP fund and no documentation of airline receipts was provided.

We did not verify that Magdalena has established the scholarship trust fund as described in their response. That verification should be provided to the Department officials identified in the Administrative Matters section.

### **OBJECTIVE, SCOPE, AND METHODOLOGY**

The objective of our audit was to determine whether Magdalena properly accounted for and used the GEAR UP grant funds from September 15, 2000, through September 30, 2003, in accordance with the HEA, as amended; EDGAR; GEAR UP grant terms; and the cost principles in OMB Circular A-87.

To accomplish our objective, we—

- Reviewed Magdalena's Single Audit Report for the year ended June 30, 2002;
- Reviewed Magdalena's GEAR UP grant application and budget narrative;
- Reviewed Magdalena's GEAR UP grant Performance Report;
- Reviewed Magdalena's School Board Minutes, dated May 20, 2003;
- Reviewed written policies and procedures for purchasing and requisitions;
- Judgmentally selected and reviewed expenditures of financial budgets for Years 2000-01 through 2003-04. Those included payroll transactions, purchase orders, invoices, cancelled checks, receipts, and other supporting documents. We reviewed all expenditures greater than \$1,000 and most of the expenditures greater than \$500. The reviewed expenditures accounted for 45 percent of the total expended by Magdalena for Year 2000-01, 21 percent of the total for Year 2001-02, 45 percent of the total for Year 2002-03, and 23 percent for the completed portion of Year 2003-04; and
- Interviewed various Magdalena employees, school board members, and Department officials.

To achieve our audit objective, we relied, in part, on computer-processed data related to Magdalena's financial budget systems. We verified the completeness of the data by comparing source records to the computer-generated data, and verified the authenticity by comparing computer-generated data to source documents. Based on these tests, we concluded that the data were sufficiently reliable to be used in meeting the audit's objective.

We conducted our fieldwork at the Magdalena Municipal School District Offices in Magdalena, New Mexico on October 6 – 9, 2003. We discussed the results of our audit with Magdalena officials in an exit conference held on November 14, 2003. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the audit described above.

**STATEMENT ON MANAGEMENT CONTROLS**

We obtained a sufficient understanding of management controls for planning the audit and determining the nature, timing, and extent of tests to be performed. As part of our review, we relied on substantive testing of expenses charged to the GEAR UP grant to test management controls. Our testing disclosed instances of non-compliance with federal regulations, grant terms, and cost principles that led us to conclude that weaknesses existed in controls over GEAR UP grant funds. These weaknesses and their effects are 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 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 officials, who will consider them before taking final Departmental action on the audit:

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

Sally L. Stroup  
Assistant Secretary for Postsecondary Education  
U.S. Department of Education  
1990 K Street, N.W.  
Washington, DC 20006

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,

**/Signed/**

Sherril L. Demmel  
Regional Inspector General  
for Audit

Attachments

**Unallowable and Unsupported GEAR UP Grant Expenditures  
September 15, 2000 – September 30, 2003**

<b>GEAR UP Budget Award Year</b>	<b>Expenditure Item</b>	<b>Cost</b>	<b>Reason Disallowed</b>	<b>Criteria*</b>
<b>Year One 2000-2001</b>	Fund raising - candles	\$ 929.75	Fund raising activity	<b>2</b>
<b>Year Two 2001-2002</b>	Hotel stay	\$ 1,776.00	Not reimbursed to GEAR UP fund	<b>1</b>
	Airline tickets	\$ 1,293.00	Not adequately documented, and not reimbursed to GEAR UP fund	<b>1</b>
<b>Year Three 2002- 2003</b>	T-shirts for students	\$ 265.25	Not adequately documented as to which students were in the cohort	<b>1 &amp; 3</b>
	Student incentives	\$ 120.00	Not adequately documented	<b>1</b>
	Tuition for computer aided drafting class at a university	\$ 351.52	Not all students were in the cohort	<b>3</b>
	Tuition for basic automotive class at a university	\$ 527.28	Not all students were in the cohort	<b>3</b>
<b>Total</b>		<b>\$ 5,262.80</b>		

**\*Criteria:**

1. “To be allowable under Federal awards, costs must . . . be adequately documented.” OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments, Attachment A, Paragraph C.1.j* (1997).
2. “Costs of organized fund raising, including financial campaigns, solicitation of gifts and bequests, and similar expenses incurred to raise capital or obtain contributions are unallowable, regardless of the purpose for which the funds will be used.” OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments, Attachment B, Paragraph 21.a* (1997).
3. “A Partnership, or a State that chooses to use a cohort approach in its GEAR UP early intervention component, must . . . Provide services to at least one entire grade level (cohort) of students . . . beginning not later than the 7<sup>th</sup> grade.” 34 C.F.R. § 694.2(a) (2001).

**BOARD OF EDUCATION**  
COLLEEN GRAYSON, President  
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MARY ANNE RAEL, Member

## MAGDALENA MUNICIPAL SCHOOLS

PO Box 24

Magdalena, New Mexico 87825

Phone: 505-854-2241 Fax: 505-854-2531

DOUG HULCE, Superintendent  
JOE B. MAREZ, Mid-High Principal  
KITTY MARTIN, Elementary Principal  
JUDY TANNER, Director of SPED  
Human Resources, and Federal Programs

### ATTACHMENT B

February 18, 2004

Ms. Sherri Demmel  
Regional Inspector General for Audit  
U.S. Department of Education  
Office of Inspector General  
1999 Bryan Street, Harwood Center, Suite 2630  
Dallas, Texas 75201-6817

Dear Ms. Demmel:

In connection with your examination of Magdalena Municipal Schools' (MMS) Administration of the GEAR UP Grant Fund, we acknowledge that we are responsible for the fair representation of documents, records, and other information provided for your review. In that connection, we confirm that to the best of our knowledge and belief:

- There are no irregularities involving management or employees who have or had a significant role in MMS' compliance with the Department's requirements contained in the Higher Education Act of 1965, as amended, and 34 CFR Part 694, GEAR UP.
- There are no irregularities involving any persons, outside consultants for example, that could have a material influence on the compliance with the requirements contained in the Higher Education Act of 1965, as amended, and 34 CFR Part 694, GEAR UP.
- There are no material transactions that have not been properly recorded in the accounting records related to compliance with the Department's requirements contained in the Higher Education Act of 1965, as amended, and 34 CFR Part 694, GEAR UP.
- We have furnished all documents and reports requested during the course of the audit and they are accurate and complete.
- We have complied or disclosed any noncompliance with all laws and regulations pertaining to the Higher Education Act of 1965, as amended, and 34 CFR Part 694, GEAR UP.



Doug Hulce, Superintendent

Magdalena Municipal School  
Response to  
Draft Audit Report

**Response to Recommendations**

1. Magdalena Municipal Schools agrees to refund **\$16,500** for scholarships awarded to non-cohort students.
2. Magdalena Municipal Schools agrees to refund **\$2,190.55** unallowable expenditures. Please see page 2 and the attached documentation for the rationale for our arrival at this figure.
3. A GEAR UP Scholarship Trust Fund, account number \_\_\_\_\_ in the amount of \$112,500 has been set up at Wells Fargo Bank.
4. Magdalena Municipal Schools has established a formal system of management controls to ensure GEAR UP grant funds are adequately documented and used only to provide services to cohort students.

Magdalena Municipal School  
Response to  
Draft Audit Report

**First Year of GEAR UP Program 2000-2001**

1. 929.75 spent on fundraising to buy candles for resale – Unallowable Expenditure

**Second Year of GEAR UP Program 2001-2002**

1. \$1,776.00 spent for hotel stay at the National GEAR UP Conference in Washington DC Oct. 5-9, 2001. After the attacks September 11, 2001, the Conference was cancelled and rescheduled for July 2002.—The receipt for the refund from the hotel provided (See attached)
2. \$1,293 spent on travel for four people to attend the National GEAR UP Conference in Washington DC. GEAR UP program personnel, a representative from our partners (Maternal and Child Health of Socorro), and external evaluator were scheduled to attend the National GEAR UP Conference Oct. 5-9, 2001. After the attacks September 11, 2001, the Conference was cancelled and rescheduled for July 2002, and all airline tickets with an arrival into Reagan National Airport in Washington DC were cancelled. The tickets were never reissued.
3. \$1,719.00 spent on football equipment, the equipment purchased with GEAR UP funds (\$123.00 each) was used by the 14 cohort students, and continues to be used by GEAR UP students annually. The equipment was purchased as an incentive for cohort students participating in the after school GEAR UP tutorial program in which cohort students were tutored for 1 hour and then participated in a sport/club activity for an hour (see page 11 Magdalena's grant application: *Continuum of Special Services*). – Receipt provided (See attached)
4. \$1,290.00 spent on hotel stay for the National GEAR UP Conference—Receipts provided (see attached)

**Third Year of GEAR UP Program 2002-2003**

1. \$450.00 spent on meals for teacher training – Missing per diem documentation provided (see attached)
2. \$265.00 spent on Renaissance T-Shirts for non-cohort students – Unallowable Expenditure
3. \$360.00 spent on housing expenses for FFA students at the National FFA Convention. A total of \$1,590 was spent for housing and conference registration. GEAR UP contributed \$540.00, and \$1,050 was spent from the district operational account. The total spent for each student was \$270. The GEAR UP contribution = 2 students x \$270.00 = \$540.00. (See attached)
4. \$120.00 spent on Renaissance incentives for non-cohort students – Unallowable Expenditure
5. \$3,191.08 spent on a hotel stay by teachers—Receipts provided (See attached)
6. \$156.00 spent on Putt-Putt golf for students participating in Mid-School School on Wheels— Receipts provided (See attached)
7. \$425.43 spent on hotel stay by teachers— Receipts provided (See attached)
8. \$351.52 spent on tuition for CAD for non-cohort students – Unallowable Expenditure
9. \$527.28 spent on tuition for Basic Automotive Class for non-cohort students – Unallowable Expenditure
10. \$157.50 spent on meals for teacher training – Missing per diem documentation provided (see attached)

**Fourth Year of GEAR UP Program 2003-2004**

1. \$425.43 spent on hotel stay by consultants— Receipts provided (See attached)

**TOTAL AMOUNT OF UNALLOWABLE EXPENDITURES:      \$2,190.55**