



STATE OF NORTH CAROLINA

SPECIAL REVIEW

NORTH CAROLINA DEPARTMENT OF PUBLIC INSTRUCTION

RALEIGH, NORTH CAROLINA

APRIL 2006

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

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Office of the State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Dr. June Atkinson, Superintendent of Public Instruction-
North Carolina Department of Public Instruction

Pursuant to General Statute §147-64.6(c)(16), we have completed a special review of allegations concerning the Department of Public Instruction and the Reading First program. The results of our review, along with recommendations for corrective action, are contained in this report.

Copies of this report have been provided to the Governor, the Attorney General and other appropriate officials in accordance with North Carolina General Statute §147-64.6(c)(12) which requires the State Auditor to provide written notice of apparent instances of violations of penal statutes or apparent instances of malfeasance, misfeasance, or nonfeasance by an officer or employee.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

May 2, 2006

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INTRODUCTION

The Office of the State Auditor received allegations that the Department of Public Instruction's (DPI) Reading First Section Chief maintained a special fund outside of DPI with Upton Associates, Inc., a vendor for the Reading First program. Allegedly, unnecessary disbursements were made from this special fund, including payments to the Section Chief's children.

To conduct a special review of these allegations, we performed the following procedures:

- Interviews with current DPI employees;
- Interviews with individuals external to DPI including the Treasurer of Upton Associates and employees of the North Carolina Department of Administration-Division of Purchase and Contract;
- Examination of relevant documents and records at Upton Associates and DPI including review of invoices, purchase orders, travel reimbursement forms, check registers, and bank statements;
- Review of DPI's policies and procedures and North Carolina General Statutes applicable to DPI;

This report presents the results of our special review. The review was conducted pursuant to North Carolina General Statute §147-64.6(c)(16) rather than as a financial audit. The Department of Public Instruction is subject to financial audit procedures within the Office of the State Auditor's audit of the state's Comprehensive Annual Financial Report.

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FINDINGS AND RECOMMENDATIONS

1. DPI ALLOWED A VENDOR TO DEPOSIT AND HOLD STATE FUNDS IN ITS OWN BANK ACCOUNT.

The State Board of Education requires assessments at grades K, 1, and 2 that include documented, on-going individualized evaluations. These assessments are intended to document student development and progress in writing. During the summer and fall of 2003, DPI provided two two-day staff development workshops for primary teachers, literacy facilitators, and others in North Carolina. The registration fee for participants was \$225 for each workshop. Participants made separate hotel reservations.

DPI employed a business named Upton Associates, Inc. (Upton Associates) to manage the workshops, excluding the program content. Upton Associates manages meetings, conferences, and trade shows. Participants sent registration fees and made checks payable to Upton Associates. From May 23, 2003 through October 15, 2003 Upton Associates deposited \$81,930 from registration fees in its checking account with BB&T. Related workshop expenses of \$66,416 were subsequently paid by Upton Associates out of its account for hotels and meeting places at the direction of a K-2 Assessment Consultant, a DPI employee. The ending K-2 Assessment fund balance of \$15,514 on March 12, 2004 remained in the Upton Associates BB&T account.

Interviews with the Treasurer of Upton Associates and the Section Chief of Reading First substantiated that Upton Associates deposited the K-2 Assessment registration fees into their non-interest bearing checking account and paid the related workshop expenses from the same account. The Reading First Section Chief said she was following the directions of her supervisors when she began working with Upton Associates for the K-2 workshops and that they had used them for other workshops. The Upton Associates Treasurer confirmed they had managed other workshops in the past.

DPI's Cash Management Procedures for Workshops states, "The Cash Management Section will be responsible for receiving and processing the collection of funds for the North Carolina Department of Public Instruction." North Carolina General Statute §147-77, often referred to as the Daily Deposit and Reporting Act, requires institutions to daily deposit all funds belonging to the State of North Carolina in a bank, in the name of the State Treasurer. Further, DPI's Encumbering Funds Policy states, "...all unencumbered balances of current operations appropriations shall revert at the end of the fiscal year to the General Fund."

Thus, allowing Upton Associates to deposit registration fees in its bank account and not reverting balances to the general fund at year-end violated DPI's Cash Management

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Policy as well as state law. Moreover, this arrangement compromised DPI's ability to control and account for these funds. Further, the revenue, expenditures, and resulting fund balance associated with this activity was never reported in the state's accounting system.

RECOMMENDATION

DPI should make arrangements to have the remaining fund balance transferred from Upton Associates' bank account to DPI's general fund bank account as soon as possible. DPI should take corrective action to ensure compliance with its Cash Management Procedures for Workshops and General Statute §147-77 when contractors assist with the management of DPI workshops.

2. DPI DID NOT OBTAIN A WRITTEN CONTRACT WITH UPTON ASSOCIATES SPECIFYING FEES AND SERVICES.

For the two K-2 Assessment workshops in 2003, it appears there were no written contracts. We requested copies of contracts from the Treasurer for Upton Associates and various DPI employees, however, none were provided to us. The Upton Associates Treasurer said agreements were made by telephone.

For the Reading First workshops, DPI issued purchase orders through E-procurement. For purchases up to \$5,000, DPI's E-procurement Policy states,

Upon approval a purchase order (with contractual terms and conditions attached) is issued and transmitted to the provider electronically. The contract document is not required. The justification document for a sole source request is not required.

Because the purchase orders were less than \$5,000, a written contract or sole source documentation was not required. However, the Reading First purchase orders did not adequately specify the terms and conditions of the agreement between DPI and Upton Associates. The purchase orders did not indicate essential payment information such as how the billing amount would be determined. Further, the purchase orders lacked adequate detail to determine the actual services provided by Upton Associates.

RECOMMENDATION

DPI should ensure purchase orders for small purchases less than \$5,000 provide adequate details regarding fees and services.

3. EXCESS RECEIPTS FROM THE K-2 ASSESSMENT WORKSHOPS WERE INAPPROPRIATELY TRANSFERRED TO THE READING FIRST PROGRAM.

The federal No Child Left Behind Act of 2002 established Reading First (CFDA 84.357) as a program designed to provide professional development for teachers who teach

FINDINGS AND RECOMMENDATIONS (CONTINUED)

reading and writing. In January 2004, a K-2 Reading Consultant was promoted to Section Chief of the new Reading First program. She was responsible for getting the program up and running, including writing the state's Reading First program guidance. The new Section Chief was one of the consultants Upton Associates contacted about the K-2 Assessment workshops. When the consultant was promoted to Section Chief, she continued using Upton Associates to manage the Reading First workshops. The Section Chief directed Upton Associates to pay Reading First expenditures totaling \$8,793 from the K-2 Assessment funds, leaving an ending fund balance of \$6,721 on July 6, 2005.

DPI's External Conference Policy states, "Registration fees collected and not used to defray expenses of the particular conference may not be used for other programs and must revert to the general fund." The \$15,514 ending fund balance from the K-2 Assessment workshops (Finding 1) on March 12, 2004, was never reverted to the general fund and was used to pay Reading First program expenses.

RECOMMENDATION

DPI should transfer the \$15,514 K-2 Assessment fund balance that existed on March 12, 2004, to the general fund to ensure compliance with its External Conference Policy.

4. DPI SPLIT PURCHASES FROM A VENDOR TO APPARENTLY AVOID COMPETITIVE BIDDING REQUIREMENTS.

According to DPI's purchasing via E-procurement policy, contracts over \$5,000 and up to \$10,000 require an informal Request for Proposal and contracts over \$10,000 and up to \$25,000 require a formal Request for Proposal.

Thirteen Reading First purchase orders ranging from \$4,664 to \$5,000 were issued to Upton Associates from November 21, 2003 through August 12, 2005. The thirteen Reading First purchase orders issued to Upton Associates totaled \$64,506. We noted two instances where two separate Reading First purchase orders were issued on the same day. We also noted four instances where two or three separate purchase orders were issued within the same month. The Section Chief said she did not know what the bidding limits were and she was just following the way it had been done in the past.

Program guidance for Reading First outlines the required number of workshops per year to ensure program compliance. Based on the number of workshops held from November 2003 through June 2005, and the actual costs associated with these workshops, the estimated cost for the required number of workshops would here exceeded \$25,000 per year, requiring a formal Request for Proposal. A former DPI employee said they tended to by-pass the bidding requirements because it took too long to get a contract and they had too many workshops during the year. Avoiding the bidding requirements is a violation of North Carolina General Statute §143-133 which says, "No bill or contract shall be divided for the purpose of evading the provision of this Article."

RECOMMENDATION

DPI should implement procedures to ensure compliance with its Purchasing Via E-Procurement Policy and state law. DPI should also evaluate the continued use of a vendor to manage the workshops for Reading First.

5. THE READING FIRST SECTION CHIEF RECEIVED UNAUTHORIZED TRAVEL REIMBURSEMENTS FROM K-2 FUNDS CONTROLLED BY UPTON ASSOCIATES.

Our review of disbursements from the K-2 funds at Upton Associates revealed a number of travel reimbursements to the Reading First Section Chief. There were no approved travel authorizations to support these travel reimbursements. The Section Chief apparently initiated her own travel reimbursements from the K-2 funds. The unauthorized reimbursements included:

- A \$438.00 travel advance for a business trip to Miami in December 2004. There was no documentation associated with the payment. The Section Chief said she forgot to repay it. As of October 1, 2005 it had not been repaid.
- \$231.84 for two trips from her home in Rocky Mount to workshops in High Point (and return) at a rate of 36 cents per mile. The Section Chief's duty station is Raleigh.
- \$110.92 for mileage reimbursement at a rate of 36 cents per mile for travel between Raleigh and Raeford, Rocky Mount and Weldon, and Rocky Mount and Tarboro during December 2003 and January 2004. Because she did not determine whether a state vehicle was available, the Section Chief should not have been reimbursed for mileage. In addition, the reimbursement rate was incorrect. The correct mileage rate was 23 cents per mile.
- \$327.94 for hotels located in the Raleigh area. There was no written approval for these reimbursements. The Section Chief said in one instance she worked late and decided to stay over. In another instance she said she had a plane to catch early the next morning.

The above instances constitute noncompliance with DPI's Employee Travel Advances Policy, Transportation by Personal Vehicle Policy, and General Guidelines for Lodging. Additionally, these instances violated state travel policies published in the Office of State Budget and Management's *Budget Manual*.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

DPI's Staff Travel Policy states, "Mileage is measured from the closer of duty station or point of departure to destination (and return)...DPI abides by the motor fleet rate of 23 cents per mile when a state-owned vehicle is available and the employee chooses to use his/her own vehicle." The duty station of Raleigh is closer to High Point than the Section Chief's home in Rocky Mount.

The Section Chief said she did not check to see if a state vehicle was available prior to travel because she did not know this was required. She said at that time she did not know about the motor pool. Because the Section Chief did not determine whether a state vehicle was available, she should not have been reimbursed for mileage. In addition, the reimbursement exceeded the amount the Section Chief was entitled to receive based on her duty station, even if the use of a personal vehicle had been authorized.

See Appendix A for a detailed list of questioned travel costs.

RECOMMENDATION

The Section Chief should reimburse DPI for the travel advance and unauthorized travel reimbursements, totaling \$1,108.70. Supervisors and division heads should ensure they provide adequate oversight, including authorization and approvals, for travel reimbursements. As part of that oversight, they should provide training for employees on proper travel procedures.

6. CERTAIN EXPENDITURES FROM K-2 FUNDS DID NOT APPEAR REASONABLE AND NECESSARY FOR PROGRAM OPERATIONS.

Our review documented \$6,035.65 of expenditures from K-2 funds that appeared unnecessary. Examples of these expenditures included:

- \$870 to the Section Chief's children of which \$700 lacked documentation. The Section Chief said her children put meeting packets together and unloaded boxes for meetings.
- \$2,559.44 for 80 rolling totes used by participants to hold workshop materials.
- \$80.25 for items from Bath and Body Works.
- \$80.94 for two computer wrist rests and a cordless mouse. The Section Chief said one of the wrist rests wore out but the other one and the mouse is in her office.

See Appendix B for a detailed list of questioned expenditures.

RECOMMENDATION

Management should ensure the reasonableness and necessity of each expenditure for the Reading First program.

7. DPI's DUTY STATION REPORT SUBMITTED TO THE OFFICE OF STATE BUDGET AND MANAGEMENT CONFLICTS WITH MANAGEMENT'S UNDERSTANDING OF EMPLOYEE DUTY STATION.

The Section Chief, her Supervisor, and the Division Director said some employees of the Reading First program have their home designated as their duty station. These employees are located throughout the state and each serves a particular region. However, they are not assigned to a regional office.

North Carolina General Statute §138(6)(a)(1) states, "...any designation of an employee's home as his duty station by a department head shall require prior approval by the Office of State Budget and Management on an annual basis."

However, DPI's Designation of Duty Station Report for 2005 indicates all employees have Raleigh as their duty station. The Director of Human Resources said in an email to the Office of State Budget and Management on September 23, 2005, "...all workstations at DPI are designated as Raleigh-based as indicated by location of the position on PD118."

RECOMMENDATION

DPI should establish a clear understanding between employees, their supervisors, and human resources about official duty stations to avoid incorrect travel reimbursements. DPI should submit an updated Designation of Duty Station Report to the Office of State Budget and Management for approval according to North Carolina General Statute §138(6)(a)(1).

Appendix A
Department of Public Instruction - Reading First Program
Questioned Travel Costs

Check #	Check Date	From Account	Payee	Questioned Amount	Description	Audit Question/Issue/Concern
4001	12/01/04	Upton Associates	The Section Chief	\$ 438.00	Travel advance for Miami trip	Not repaid
3030	08/18/03	Upton Associates	The Section Chief	111.60	Travel reimbursement from home to High Point	Violates travel policies - overpayment
Not Provided	12/15/03	Upton Associates	The Section Chief	120.24	Travel reimbursement from home to High Point	Violates travel policies - overpayment
3655	07/01/04	Upton Associates	The Section Chief	110.92	Mileage reimbursement	Use of incorrect reimbursement rate - overpayment
3585	08/01/04	Upton Associates	The Section Chief	197.12	Reimbursement for 3 nights, Radisson Hotel, RTP, NC	Duty Station Raleigh-Violates travel policies - overpayment
3955	11/15/04	Upton Associates	The Section Chief	66.12	Reimbursement for Comfort Suites, Raleigh, NC	Duty Station Raleigh-Violates travel policies - overpayment
4433	06/16/05	Upton Associates	The Section Chief	64.70	Reimbursement for Comfort Suites, Durham, NC	Duty Station Raleigh-Violates travel policies - overpayment

Total \$ 1,108.70

Appendix B
Department of Public Instruction - Reading First Program
Questioned Costs - Miscellaneous

Check #	Check Date	From Account	Payee	Questioned Amount	Description	Audit Question/Issue/Concern
2947	07/31/03	Upton Associates	Daughter	\$ 300.00	Payment to daughter	No documentation
2970	07/31/03	Upton Associates	Accents in Advertising	1,922.34	400 tote bags for K-2 with set-up	Unnecessary
3107	10/14/03	Upton Associates	Getitquick.com	89.60	8 25' twisstop phone cords	Unnecessary
3107	10/14/03	Upton Associates	Getitquick.com	35.10	2 gel computer wrist rests	Unnecessary
3221	12/15/03	Upton Associates	Daughter	300.00	Payment to daughter	No documentation
3222	12/15/03	Upton Associates	Son	100.00	Payment to son	No documentation
3955	11/15/04	Upton Associates	The Section Chief	44.94	Cordless Mouse and wristrest	Unnecessary
4365	05/20/05	Upton Associates	Acudata	2,559.44	80 rolling totes	Unnecessary
4433	06/16/05	Upton Associates	The Section Chief	80.25	Items from Bath & Body Works	Unnecessary
4444	06/23/05	Upton Associates	Oriental Trading	433.98	Gold "Winner" Medals	Unnecessary
4465	07/06/05	Upton Associates	Daughter	120.00	Putting packets together for meeting	Unnecessary
4466	07/06/05	Upton Associates	Son	50.00	Unloading boxes of materials for meeting	Unnecessary

Total \$ 6,035.65

RESPONSE FROM THE NORTH CAROLINA DEPARTMENT OF PUBLIC INSTRUCTION



PUBLIC SCHOOLS OF NORTH CAROLINA

STATE BOARD OF EDUCATION Howard N. Lee, *Chairman*

DEPARTMENT OF PUBLIC INSTRUCTION June St. Clair Atkinson, Ed.D., *State Superintendent*

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April 26, 2006

The Honorable Leslie W. Merritt, Jr., CPA, CFP
Office of the State Auditor
2 S. Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Mr. Merritt:

We have received the confidential draft of your Special Review of allegations concerning the Department of Public Instruction (DPI) and the Reading First Program. The specific allegations were that the Reading First Section Chief maintained a special fund outside of DPI with Upton Associates, Inc., a vendor for the Reading First program. Allegedly, unnecessary disbursements were made from this special fund, including payments to the Section Chief's children. We appreciate the opportunity to respond to the report. After review of the Findings and Recommendations in the Special Review Report, we offer the following responses:

1. DPI ALLOWED A VENDOR TO DEPOSIT AND HOLD STATE FUNDS IN ITS OWN BANK ACCOUNT.

Recommendation: DPI should make arrangements to have the remaining fund balance transferred from Upton Associates' bank account to DPI's general fund bank account as soon as possible. DPI should take corrective action to ensure compliance with its Cash Management Procedures for Workshops and General Statute 147-77 when contractors assist with the management of DPI workshops.

DPI's Response: DPI concurs with the finding. DPI has requested that Upton Associates return the remaining fund balance, along with a detailed accounting of the collections and disbursements. Those funds will be deposited into the DPI general fund bank account as soon as received. In addition, DPI will ensure that staff is aware that the DPI Cash Management Section is responsible for receiving and processing the collection of funds for DPI. Staff will receive communications and additional training in the correct procedures for cash collections.

OFFICE OF THE STATE SUPERINTENDENT

JUNE ST. CLAIR ATKINSON, Ed.D., *State Superintendent* | jatkinson@dpi.state.nc.us
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AN EQUAL OPPORTUNITY/AFFIRMATIVE ACTION EMPLOYER

2. DPI DID NOT OBTAIN A WRITTEN CONTRACT WITH UPTON ASSOCIATES SPECIFYING FEES AND SERVICES.

Recommendation: DPI should ensure purchase orders for small purchases less than \$5,000 provide adequate details regarding fees and services.

DPI's Response: DPI concurs with the finding. DPI has already initiated procedures to ensure that small purchases less than \$5,000 provide adequate details regarding fees and services. DPI employees have been instructed to include complete details regarding the services to be provided by purchases of services in amounts less than \$5,000. In addition, the DPI Purchasing and Contracts Section have been instructed to return any requests that do not provide adequate details regarding the services and fees.

3. EXCESS RECEIPTS FROM THE K-2 ASSESSMENT WORKSHOPS WERE INAPPROPRIATELY TRANSFERRED TO THE READING FIRST PROGRAM.

Recommendation: DPI should transfer the \$15,514 K-2 Assessment fund balance that existed as of March 12, 2004 to the general fund to ensure compliance with their External Conference Policy.

DPI's Response: DPI agrees with the finding and recommendation. The \$15,514 balance will be transferred from the Reading First Program to the general fund immediately.

4. DPI SPLIT PURCHASES FROM A VENDOR TO APPARENTLY AVOID COMPETITIVE BIDDING REQUIREMENTS.

Recommendation: DPI should implement procedures to ensure compliance with its Purchasing Via E-procurement Policy and State Law.

DPI should evaluate whether they want to continue having a vendor manage the workshops for Reading First. If so, they should determine the estimated costs for the vendor (including postage, printing, faxing, etc.) for a year then submit a Request for Proposals form, one time, for the entire year.

DPI's Response: DPI agrees with the finding. DPI has already initiated procedures to ensure compliance with its Purchasing Via E-Procurement Policy and State law requiring either informal or formal Requests for Proposals. The DPI Purchasing & Contracts Section has been instructed to research requests for services in amounts just under \$5,000 and to research a sample of all requests under \$5,000 to ensure that requests are not being split to avoid bidding requirements. In addition, the DPI Purchasing and Contracts Section has recently obtained a reporting mechanism listing contracts by vendor that will be used to facilitate researching multiple contracts with the same vendor.

5. THE READING FIRST SECTION CHIEF RECEIVED UNAUTHORIZED TRAVEL REIMBURSEMENTS FROM K-2 FUNDS CONTROLLED BY UPTON ASSOCIATES.

Recommendation: The Section Chief should reimburse DPI for the travel advance and unauthorized travel reimbursements, totaling \$1,108.70. Supervisors and division heads should ensure they provide adequate oversight, including authorization and approvals, for travel reimbursements. As part of that oversight, they should provide training for employees on proper travel procedures.

DPI's Response: DPI concurs with the finding and recommendation. The former Section Chief will be required to reimburse the travel advance and unauthorized travel reimbursements. Additional training in travel reimbursement policies and procedures will be provided to the new Section Chief as well as all other DPI staff, including supervisors and division heads.

6. CERTAIN EXPENDITURES FROM K-2 FUNDS DID NOT APPEAR REASONABLE AND NECESSARY FOR PROGRAM OPERATIONS.

Recommendation: Management should ensure the reasonableness and necessity of each expenditure for the Reading First program.

DPI's Response: DPI agrees with the finding. DPI has provided recent training and will continue to provide training to staff as to the reasonableness and necessity of expenditures for all Federal and State programs.

7. DPI'S DUTY STATION REPORT SUBMITTED TO THE OFFICE OF STATE BUDGET AND MANAGEMENT CONFLICTS WITH MANAGEMENT'S UNDERSTANDING OF EMPLOYEE DUTY STATION.

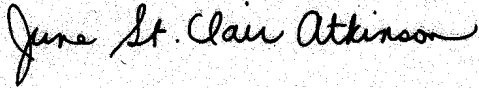
Recommendation: DPI should determine the appropriate duty stations for its employees and submit them to the Office of State Budget and Management for approval according to North Carolina General Statute 138 (6)(a)(1.)

DPI's Response: DPI concurs with the finding. The DPI Personnel Division is correcting DPI's Designation of Duty Station Report for all employees that should have their home designated as their duty stations. The revised report will be submitted to the Office of State Budget and Management for their approval.

The Honorable Leslie W. Merritt, Jr., CPA, CFP
April 26, 2006
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If you have any questions regarding our responses or corrective actions, please contact Larry McLamb at 807-3611.

Sincerely,



June St. Clair Atkinson

JSA/LEM/sh

- c Dr. Janice Davis
- Dr. Elsie Leak
- Philip Price
- Vanessa Jeter
- Larry McLamb

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