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OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES
Sacramento Audit Region

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Dr. John E. Deasy
Superintendent
Los Angeles Unified School District
333 S. Beaudry Ave.
Los Angeles, CA 90017

Dear Superintendent Deasy:

This final audit report, “Los Angeles Unified School District’s Internal Controls Over Nonpayroll Purchases Using U.S. Department of Education Funds,” presents the results of our audit. The purpose of the audit was to determine whether Los Angeles Unified School District (LAUSD) designed internal controls that would provide reasonable assurance that nonpayroll purchases using U.S. Department of Education (Department) funds were in accordance with applicable Federal requirements. The audit covered nonpayroll purchases charged to Department programs from July 1, 2012, through June 30, 2013.

BACKGROUND

LAUSD is the second largest school district in the nation, based on an enrollment of more than 640,000 students in kindergarten through grade 12 at more than 900 schools and 187 public charter schools. The district administers numerous Department grant programs such as Title I, Grants to Local Educational Agencies; Special Education Grants to States; 21st Century Community Learning Centers; and Title II, Improving Teacher Quality State Grants. LAUSD charged more than \$151 million of nonpayroll purchases to Department programs from July 1, 2012, through June 30, 2013 as listed below.

**Nonpayroll Purchases Charged to Department Grant Programs
From July 1, 2012, through June 30, 2013**

Department Grant Program	Number of Transactions	Total Nonpayroll Purchases
Title I, Grants to Local Educational Agencies	67,935	\$81,807,699
Special Education Grants to States	739	18,292,808
21st Century Community Learning Centers	2,457	13,947,803
Title II, Improving Teacher Quality State Grants	3,742	7,226,974
School Improvement Grants	1,542	6,412,565
Career and Technical Education-Basic Grants to States	4,277	5,296,005
All Other Department Programs	11,777	18,414,145
Total Nonpayroll Purchases	92,469	\$151,397,999

AUDIT RESULTS

LAUSD designed internal controls that provided reasonable assurance that district personnel used Department funds for nonpayroll purchases during our audit period in accordance with applicable Federal requirements. LAUSD had written policies and procedures that helped ensure that the district's nonpayroll purchases were allowable, if followed. The district also established approval procedures over various types and amounts of transactions. In addition to its own system of controls, LAUSD was also subject to oversight, monitoring, and audits from multiple entities, including the California Department of Education (CDE) and the district's own inspector general.¹ Our internal control assessment covered transactions that district personnel made using either a purchase order or a procurement card (referred to as purchase card throughout the remainder of this report). We also analyzed multiple nonpayroll purchases the district made during our audit period using funds it received from the Department.

We provided a draft of this report to LAUSD for comment on April 11, 2014. LAUSD's controller informed us on April 28, 2014, that the district does not have any comments.

Purchase Order Transactions

We determined that the district's policies and procedures over procurement and accounting processes for purchase order transactions were appropriate to provide reasonable assurance that nonpayroll purchases using Department funds were allowable. Specifically, the policies and procedures addressed control mechanisms such as requiring (1) specific approvals for different purchase thresholds for tangible (supplies, equipment) and intangible (professional services) items; (2) the unit or school making the purchase to confirm receipt with the accounts payable department before vendors could be paid; and (3) a three-way document match of the purchase order, invoice, and receipt before the accounts payable department approved payments.

¹ LAUSD is also required by Office of Management and Budget Circular A-133 to have an annual Single Audit, as are all non-Federal entities with annual expenditures of \$500,000 or more in Federal awards. LAUSD's Single Audits are conducted by independent public accountants.

For seven judgmentally selected nonpayroll transactions, we reviewed purchase orders and other documents generated from LAUSD's accounting system and external documents, such as invoices, to gain an understanding of the purchasing process and determine whether district personnel followed controls. We verified that personnel obtained approvals from the initiating unit or school and Procurement Services Division and the district received goods and services before it paid the vendors. We determined that LAUSD personnel were following the policies and procedures applicable to these seven purchase order transactions, and the purchases they made using Department funds were allowable under Department programs.

Purchase Card Transactions

We determined that the district's policies and procedures over procurement and accounting processes for purchase card transactions were appropriate to provide reasonable assurance that nonpayroll purchases that district personnel made using Department funds were allowable. LAUSD schools and departments had several types of purchase cards, including separate cards for office supplies and instructional materials, travel, and fuel that personnel used to make nonpayroll purchases. The district required personnel who had a purchase card to sign the card agreement and its assurances, take a training class, and pass a test before they could use the card. Purchase card approvers are either department heads or school principals. Purchase card users must reconcile their purchases to monthly statements that credit card companies send to LAUSD's credit card unit and identify the specific programs that the costs were charged to. The purchase card approver reviews and approves these reconciliations and checks the appropriateness and accuracy of amounts charged to Department programs. In addition, LAUSD's purchase cards are restricted at the time of the transaction to specific types of purchases that would be appropriate based on authorized merchant category codes. For example, personnel cannot use a purchase card designated for office supply purchases at merchants in the travel industry, such as airlines or hotels. We reviewed the reconciliation process for two judgmentally selected nonpayroll purchases using purchase cards and concluded that LAUSD adhered to its policies and procedures and properly accounted for the two purchases.

Nonpayroll Purchases Analyses

We also analyzed and assessed actual expenditures for multiple nonpayroll purchases that LAUSD personnel made using Department funds. We performed vendor level analyses for four cost types: professional and consultant services, subagreements for services, material and supplies, and noncapitalized equipment. We identified the cost types based on factors such as the total amount of expenditures, the existence of high-dollar or high-volume vendors, or a large proportion of total payments made to specific vendors at the end of the fiscal year. For these cost categories, we reviewed the vendors for each cost type and determined that the vendors appeared to supply educational goods or services associated with the cost type.

When we had concerns regarding specific purchases under the four cost types, we asked for more information from LAUSD officials and obtained reasonable responses. We did not find any unusual or questionable charges to Department grant programs. For example, we were concerned that about \$14.7 million of special education purchases charged to subagreements for services had no vendor information. This amount accounted for more than half of the \$27.6 million LAUSD charged to the subagreements for services for our audit period. LAUSD's deputy controller explained that the subagreements for services costs charged to the special education program represented allocations of

funds to certain charter schools. LAUSD's explanation for the allocations to the charter schools appeared to be reasonable.

Oversight and Monitoring Controls

In conjunction with LAUSD's system of internal controls, other entities provide supplemental controls such as oversight, monitoring, and audit activities that can detect errors and identify appropriate corrective actions. These supplemental controls can result in improved internal controls going forward. Program offices within the CDE perform periodic monitoring reviews of LAUSD's administration of Department grant programs. In addition, the LAUSD inspector general conducts various audits of district operations. We concluded that the activities that these entities performed are an appropriate oversight mechanism, especially in detecting and resolving errors that can lead to enhanced internal controls.

A finding from the independent public accountant's recent Single Audit report covering LAUSD's fiscal year 2012–2013 (July 1, 2012–June 30, 2013) illustrates how external audits can identify errors and lead to enhanced controls. In this case, the independent public accountant determined that LAUSD staff had erroneously charged more than \$84,000 to the Federal Teacher Incentive Fund grant program as a result of training stipend overpayments. The error occurred because district accounting personnel used incorrect payroll information to calculate the stipends. LAUSD reported to the independent public accountant that it implemented monitoring and review procedures, including a monthly tracking system for the program expenditures, biweekly budget meetings, and a review process for budget reports. Although we did not verify that the corrective actions were implemented, the actions should improve controls over the Federal Teacher Incentive Fund grant program expenditures and help ensure that errors of this type do not occur in the future.

OBJECTIVE, SCOPE, AND METHODOLOGY

The purpose of our audit was to determine whether LAUSD designed internal controls that would provide reasonable assurance that nonpayroll purchases using Department funds were in accordance with applicable Federal requirements. We modified our original audit objective to limit our review to LAUSD's system of internal controls because we determined that extending the audit to transaction testing was not necessary based on our risk assessment and conclusion on the district's design of its system of internal controls. The audit covered nonpayroll purchases charged to Department programs from July 1, 2012, through June 30, 2013.

To achieve our revised objective, we performed the audit steps below to assess LAUSD's internal controls over nonpayroll purchases using Department funds and external oversight of its nonpayroll purchases. We also obtained LAUSD's expenditure data for our audit period and performed assessments of its nonpayroll purchases.

LAUSD's Internal Controls Over Nonpayroll Purchases

We interviewed LAUSD fiscal and accounting officials and staff to gain an understanding of the district's organization and internal control structures; reviewed the district's policies, procedures, and guidance for purchasing nonpayroll goods and services using Department funds; and reviewed district accounting records and contract documents. We also interviewed LAUSD staff responsible for administering the Title I program to gain an understanding of additional controls over nonpayroll purchases using Department funds and reviewed their policies and procedures that also cover the Title II and Title III programs.²

We gained an understanding of LAUSD's use of an automated financial system to manage purchases of nonpayroll goods and services and charge the costs to the funding source (programs). The system is also used to account for other transaction information such as the type of expenditure, amount, vendor, transaction date, and type of transaction.

We reviewed LAUSD's procurement manuals that were in effect during our audit period. We also reviewed documentation generated by LAUSD's accounting system and external documents such as invoices and contract documents for seven transactions to gain an understanding of the purchasing process. We gained an understanding of LAUSD's controls over the use of various types of purchase cards used to make nonpayroll purchases and reviewed accounting documents used for the reconciliation process for two nonpayroll purchases made using purchase cards. In total, we reviewed nine transactions totaling \$827,555 of the \$151,397,999 of nonpayroll purchases charged to the Department programs during our audit period to assess the district's implementation of applicable internal control policies and procedures. The nine transactions are not representative of LAUSD's total nonpayroll purchases using Department funds and therefore the results cannot be projected. To determine whether the nine transactions were allowable, we reviewed the requirements under Office of Management and Budget Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments."

We judgmentally selected the nine transactions; each represented larger transactions in the different procurement approval thresholds in LAUSD's current procurement manual. We also considered the different Department programs and payment methods when selecting the transactions. The transactions included three Title I transactions totaling \$352,310, of which two were purchase card transactions totaling \$12,136; two Title II transactions totaling \$247,807; one 21st Century Community Learning Center transaction for \$134,593; one Career Technical Education transaction for \$64,941; one School Improvement Grants transaction for \$24,999; and one special education transaction for \$2,905. The number of transactions and purchase totals for each of the programs during the fiscal year are listed in the table in the Background section.

External Oversight of Nonpayroll Purchases

We interviewed CDE personnel responsible for program oversight, an LAUSD inspector general official who oversees internal audits, and personnel at LAUSD's independent public accountant who perform the annual Single Audit to gain an understanding of the oversight, monitoring, and audit activities performed. We also reviewed their reports to evaluate oversight, monitoring, and audit

² For this report, the Title III program refers to the English Language Acquisition State Grants.

activities related to LAUSD's policies, procedures, and processes for nonpayroll purchases using Department funds.

Analyses of Nonpayroll Purchases

We analyzed the electronic file provided by LAUSD that contained all nonpayroll purchases during our audit period to identify and further analyze cost types with at least one of the factors described in the Audit Results under the "Nonpayroll Purchases Analyses" section. We then analyzed the vendors in four cost types: professional and consultant services, subagreements for services, material and supplies, and noncapitalized equipment and contacted LAUSD to clarify any transactions or vendors that appeared unusual.

We relied on computer-processed data contained in the LAUSD accounting system to identify the universe of nonpayroll purchases related to Department grant programs. LAUSD provided us an electronic file with all nonpayroll purchases from July 1, 2012, through June 30, 2013, using Federal funds, and we extracted the more than \$151 million of nonpayroll purchases charged to Department grant programs during our audit period.³ We verified the completeness of the data in the electronic file by comparing expenditure amounts to those reported to the Department for the special education and 21st Century Community Learning Center programs. We also verified the authenticity of selected data by comparing the costs recorded in the file for our sample to source documentation that LAUSD provided. Based on our assessment, we concluded that LAUSD's accounting records were sufficiently reliable for the purposes of our review.

We performed fieldwork from July 2013 through March 2014, including a site visit at the school district offices in Los Angeles, California. We held an exit conference with LAUSD officials on March 14, 2014. We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our audit objective.

³ The electronic file of nonpayroll purchases was created by LAUSD one day after the end of the fiscal year. Thus, the file does not reflect all year-end adjustments.

ADMINISTRATIVE MATTERS

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.

If you have any questions regarding the information in this report, please contact Beverly Dalman, Assistant Regional Inspector General for Audit, at (916) 930-2393, or myself at (916) 930-2399.

Sincerely,

/s/

Raymond Hendren
Regional Inspector General for Audit

Electronic cc:

Kevin Chan, Director, Audits & Investigations Division, CDE