

Washington State Auditor's Office
Special Investigation Report

Seattle School District No. 1
King County

Investigation Period
September 1, 2005 through August 31, 2009

Report No. 1008301

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WASHINGTON
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STATE AUDITOR



**Washington State Auditor
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September 17, 2012

Board of Directors
Seattle School District No. 1
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Report on Governmental Special Investigation

Attached is the official report on misappropriation at Seattle School District No. 1. On October 25, 2011 the District notified the State Auditor's Office of a potential loss of public funds. This notification was submitted to us under the provisions of state law (RCW 43.09.185).

This report contains the results of our investigation of the former Program Manager's unallowable activities at the District from September 1, 2005 through August 31, 2009. The purpose of our investigation was to determine if a misappropriation had occurred.

Our investigation was performed under the authority of state law (RCW 43.09.260) and included procedures we considered necessary under the circumstances.

Questions about this report should be directed to Sarah Walker, Fraud Manager, at (509) 454-3621.

BRIAN SONNTAG, CGFM
STATE AUDITOR

Investigation Summary

**Seattle School District No. 1
King County
September 1, 2005 through August 31, 2009**

INVESTIGATION SUMMARY

On October 25, 2011, the Seattle School District Accounting Manager reported a suspected loss to the State Auditor's Office related to the District's small works roster program, as required by state law.

At the District's request, we initiated an investigation and determined that between September 1, 2005 and August 31, 2009 the Seattle School District incurred unnecessary costs of approximately \$1.3 million due to a lack of adequate internal controls and supporting documentation.

The District established corrective measures to address issues described in this report.

BACKGROUND

In February 2011, our Office issued a Special Investigation Report on the District's Regional Small Business Development Program (RSBDP). We found the District paid \$1,519,965 for services with a questionable public purpose and \$280,005 for services it did not receive and for services that benefitted a private company. In October 2011, the King County Prosecuting Attorney filed criminal charges against the former RSBDP Program Manager and two other individuals who, according to Prosecutor's Office documents, billed the District for "little or no work".

On October 25, 2011, as required by state law (RCW 43.09.185), the District's Accounting Manager reported a suspected loss of public funds to our Office. We met with District management the next day to discuss the suspected loss.

At this meeting, the District stated it had paid \$83,430 on nine separate invoices to a vendor for cleaning at Garfield High School during the final stages of the renovation of the school. These invoices were approved for the Small Works Roster Program by a staff member not associated with the program. The work associated with these invoices was authorized by the Small Works Roster Program manager. The District asked our Office to examine all Small Works Roster Program invoices for which the former Program Manager had authorized the purchase order or had approved the vendor invoice. The former RSBDP Program Manager also managed the Small Works Roster Program.

This investigation focused solely on the Small Works Roster Program. School districts may use a small works roster in lieu of other procedures to award public works contracts with an estimated cost of \$300,000 or less. Our RSBDP investigation did not include Small Works Roster payments, which focused on consulting contracts awarded by the Program Manager.

During the period of this investigation, the Small Works Program and the RSBDP Program were managed by the same individual. All references to “Small Works Roster Program Manager”, “RSBDP Program Manager and “Program Manager” are to this one person.

INVESTIGATION RESULTS

We asked the District for a list of purchase orders initiated by the program manager or his staff between 2005 and 2009. From this list, we identified 26 vendors to include in our investigation, based on research into whether they were legitimate vendors. We requested and analyzed all payment vouchers and invoices for these vendors. Based on this work, we requested the District arrange interviews with five vendors. Three vendors met with us and answered our questions and we identified exceptions which we discuss in this report. Of the other two vendors, one met with us but declined to answer questions and the other declined to meet with us.

District-approved payments

The Seattle School District incurred unnecessary costs of \$1,279,310 due to a lack of adequate internal controls. These costs were authorized by the small works program manager who was a part of our previous report. Many of the invoices lacked adequate supporting documentation.

Our audit found:

- The District made one payment for products it did not receive.
- The District did not obtain price quotations from more than one vendor, as required by District policies and state law.
- The District did not obtain a signed contract with the vendor.
- Some purchase orders were generated after vendors submitted invoices.
- Invoices did not provide enough detail to demonstrate the District was charged only for work performed.
- In some instances, the District did not require sufficient documentation to support that services had been rendered or that the vendor worked the number of hours it billed.
- In some instances, the District paid wage rates or prices that were substantially higher than prevailing rates.

Without adequate documentation, we are unable to determine the validity of some or all of the charges billed by these vendors, as shown in the following table:

Vendor 1	\$2,500	Security cameras
Vendor 2	\$83,430	Cleaning services
Vendor 3	\$127,981	Security surveillance systems
Vendor 4	\$24,837	Moving services
Vendor 5	\$13,449	Video cabling
Vendor 6	\$95,882	Demolition work
Vendor 7	\$82,085	Cleaning services
Vendor 8	\$200,039	Miscellaneous construction work
Vendor 9	\$176,600	Miscellaneous construction work
Vendor 10	\$156,143	Cleaning services
Vendor 11	\$201,105	Miscellaneous construction work
Vendor 12	\$11,305	Cleaning services
Vendor 13	\$86,323	Miscellaneous construction work
Vendor 14	\$17,631	Moving services
Total	\$1,279,310	

Vendor 1: In January 2006, the District paid \$2,500 for two high-resolution infrared security cameras for Cleveland High School. Based on our review of documentation and interviews with District staff, we determined these cameras were not installed at the school. This vendor did not charge the District for installation services.

Vendor 2, 3 and 4: Between July 2006 and March 2010, the District paid \$236,248 to three companies owned by an individual we identified in the prior investigation as having billed the District for services he never provided. They are:

Vendor 2: The District paid this company \$83,430 for clean-up work at several schools. The vendor's billing rate was \$50.74 per hour. The District approved invoices for labor rates that are substantially higher than the prevailing wages for this type of work. The Department of Labor & Industries prevailing wage rate for janitorial work during this time period was approximately \$18 per hour.

Vendor 3: The District paid this company \$127,981 to purchase and install security equipment at several schools and the Building for Excellence (BEX) warehouse. The only working system we found is at Cleveland High School. Employees stated the system is not fully functional. We observed camera systems at the BEX warehouse and Cleveland High School. The BEX warehouse system consisted of a rebuilt computer with a video card, floppy disk drives, computer monitor, and several cameras and was not operational. The Cleveland High School system consisted of the same type of equipment as the BEX warehouse and according to staff, breaks down frequently.

District staff went to the locations where this vendor installed security equipment to determine its cost. Staff noted, for example, the cost of the BEX equipment was approximately \$5,500. The District approved invoices totaling \$36,500 for this equipment, a markup of 660 percent.

Vendor 4: The District paid a vendor \$24,837 for moving furniture out of an elementary school. The lump-sum invoice did not include sufficient details to support the amount charged, such as number of workers and hours worked, wage rates and dates of services.

Vendor 5: The District paid a vendor for video surveillance cabling and conduit. This vendor, a District employee at the time, billed the District for:

- \$14,505 for 5,850 feet of video cable, 700 feet of conduit, and fittings.
- \$975 for installation of these items.

Our research of the cost of these materials determined they are available for \$1,054. The District paid this vendor \$14,505 for these materials, more than 1,376 percent more than our estimate, or \$13,449.

Vendor 6: The District paid a vendor \$95,882 for demolition work at South Shore School. This vendor declined to answer our questions about his one-page invoice.

We noted the following concerns with regards to the payment. For this single invoice:

- The District allowed the vendor to bill \$65 per hour. This is substantially higher than the prevailing wage rate for a demolition laborer during this time period, which was approximately \$35 per hour.
- The District approved a 40 percent markup on the base labor rates. The markup on labor appears excessive.
- The District approved for 172 regular hours, 540 time and a half hours, and 180 double time hours. Considering only 172 regular hours were charged, the number of overtime hours charged is very high and not supported by invoice detail to validate so many hours at high rates of pay.
- The number of workers, or the number of hours worked per day is not specified.

Vendor 7: The District paid a vendor \$107,875 for clean-up work at Cleveland High School and for moving services at Columbia School. One of the company's owners declined our offer to meet with him to discuss invoices related to this work. The District approved invoices for labor rates of \$65 per hour for janitorial services that are substantially higher than Department of Labor & Industries prevailing wage rates for this type of work, which were approximately \$18 per hour.

We found a difference of \$62,125 between the vendor's billing rate and prevailing wage rate. We also found an invoice totaling \$19,960 that lacked crucial details, such as the number of workers, hours worked, and labor rate to support the amount paid.

Vendors 8 and 9: The District paid two vendors (8 and 9) owned by the same individual \$376,639 for painting, striping, concrete work, moving, seal coating, and trench digging. We asked this vendor how he learned of the contracting opportunities, since the projects were not competitively procured. The vendor at first did not remember who contacted him, but later stated the Small Works Program Manager notified him of the contracting opportunities.

The District approved an invoice for \$32,000 from Vendor 9 for the removal and disposal of five portable buildings from E.C Hughes School, despite a quote from the District's maintenance department of \$12,000 for this work.

The vendor subcontracted this work to another company for \$9,000. When the subcontractor learned the portables were still full of desks and other equipment, the vendor had to hire two other subcontractors to remove the contents of each portable. The vendor told us he paid these two other subcontractors a total of \$6,000 to \$10,000. The vendor charged the District more than \$20,000 for the work done by these subcontractors. The vendor told us that he was not on-site while this work was performed. According to the vendor, he paid between \$15,000 and \$19,000 total to the three subcontractors for this work; the District approved invoices totaling approximately \$50,000 related to the removal of the portable buildings. In our judgment, the amount of markup is excessive.

The District paid invoices submitted by Vendors 8 and 9, despite the lack of adequate details to support the amount paid.

Vendor 10: The District paid a vendor \$87,000 for cleaning and renovation work at various schools. The vendor also received an additional \$125,000 from the general contractor for miscellaneous clean-up work at Garfield High School. The District Accounting Department initially rejected an invoice for \$125,000 from this vendor. The vendor told us someone on the District staff told him to submit his final invoice to the general contractor. The vendor could not recall specifically who told him this.

We asked this vendor to provide timecards supporting amounts shown on the invoices. The vendor provided us with timecards for employees who worked on District activities from July 21, 2008 to September 7, 2008. We totaled the number of hours per day for all employees, and compared it to the number of hours shown on the invoices submitted to the District for payment. We found the District paid invoices for more hours than supported by the employees' timecards. For example, between September 1, 2008 and September 7, 2008, the vendor billed the District for 529 hours, and the total number of hours per timecards was 251.5 hours.

The District approved invoices for labor rates that are substantially higher than Department of Labor & Industries prevailing wage rates for this type of work, which were approximately \$18 per hour. Invoices submitted by the vendor charged the District \$30 to \$52 per hour, plus a 25 percent markup on all charges. The vendor told us he pays his workers \$18 per hour.

We question the difference between the vendor's billing rate and prevailing wage rate. This difference is \$68,960. We also question instances in which the District paid invoices for more hours than supported by the vendor's employees' timecards. This represents \$87,183.

Vendors 11 through 14: The District approved and paid invoices totaling \$316,364 without obtaining enough detail to show it was charged appropriately and benefitted from the services.

CONTROL WEAKNESSES

The Program Manager reported directly to the Executive Director of Facilities. The Executive Director did not adequately supervise the program manager. As a District manager, the Executive Director was responsible for establishing an internal control system to help ensure resources are guarded against waste, loss and public misuse. This did not occur.

Additionally, the Program Manager did not have experience in awarding and managing construction contracts and managing personnel. He did not receive training or instruction on how to do so.

In addition, District program staff stated, although they had concerns about the program, they did not bring them forward due to fears of reprisal. We found many District employees were unaware of the District's whistleblower and anti-retaliation policies or did not trust the policies during this period of time.

Between 2005 and 2009, the District paid invoices that lacked necessary details supporting the amounts paid. As a result of our RSBDP report, the District established new procedures for the Accounting Department. Staff now reviews invoices to ensure they are supported with adequate detail.

RECOMMENDATION

The District established corrective measures to address issues described in this report. We recommend the District continue to:

- Obtain invoices with sufficient detail and documentation to support charges before paying vendor invoices, and that clearly demonstrate the benefit to the District.
- Obtain price quotations from more than one vendor when required by state law and District policy.
- Prepare and sign written contracts with vendors.
- Provide training to managers and staff about effective internal controls.
- Ensure that persons hired meet the experience requirements identified in the position description.

DISTRICT RESPONSE

Seattle Public Schools appreciates the thorough and professional investigation performed by the State Auditor's Office. When the District first learned of the potential loss of funds, it was quickly reported to your office with the District's request that you conduct a complete investigation.

The conduct described in the investigative report and the resulting financial consequences are extremely serious and unacceptable. The District will adopt each of the recommendations you have made. It is our obligation to ensure we take the necessary measures to prevent this from happening ever again.

This audit follows the investigation by your office of the Regional Small Business Development Program (RSBDP), which was supervised by the same individual who supervised the District's Small Works Program from 2005-2009. As with that investigation, your audit has identified a number of the same factors as were present in the activities of the RSBDP program. We agree that the District failed on several fronts – lack of employee oversight, operation outside normal accountability channels, failure of internal controls, and lack of an adequate means for employees to raise their concerns.

The management issues with the Small Works Program (SWP) were first identified in September 2009. At that time all work under the SWP was suspended, and thorough procedures established for the program. An independent audit was conducted to assure the new procedures would be effective. When the SWP resumed in 2010, management of the SWP activities was transferred to the District's regular Purchasing and Capital Departments in order to assure that normal District procedures were followed. Since that time, the District's SWP program has performed completely consistently with statutes, Board Policies and staff procedures.

The District is committed to addressing all recommendations made in your report in a prompt manner. We have already made progress in several areas:

- **Ethics Program, Whistleblower and Anti-Retaliation Programs**– The School Board has established a formal ethics program, naming the head of the Seattle Ethics and Elections Commission as the District's Ethics Officer. Training is provided to employees on both ethics and rights and protections provided to whistleblowers. We will vigorously enforce these protections.
- **Internal Auditor** – An internal auditor has been appointed, to conduct independent audits at the School Board's direction.
- **Insurance Claim** - We have made a preliminary claim with our insurance pool for coverage regarding the loss of funds. These additional amounts will be added to the claim. We will pursue this claim to ensure the District is compensated in accordance with its coverage.
- **Recovery of Funds** - Legal counsel has been retained to assess and pursue recovery of losses and investigation costs.
- **Internal Controls** – Departmental performance measurement reporting requirements have been instituted in the last year and new review procedures are being developed to address the recommendations. This will help ensure that programs and associated personal service contracts receive adequate oversight, invoices are adequate and properly reviewed, and staff is trained to comply with these requirements. Training on contract compliance requirements has been developed and delivered to both central and school based staff.

These measures represent only some of the work that we have done to address the problems identified in your report. The School Board will oversee, guide and direct as necessary the response to assure continued compliance. We look forward to continuing to work closely with your office on these efforts as we seek to ensure a situation like this never happens again.

STATE AUDITOR'S OFFICE REMARKS

We thank the District for notifying us in a timely manner and for its assistance and cooperation during the investigation.



ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments and fraud, whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our Web site and through our free, electronic subscription service.

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