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*Review of Project GRAD USA's Administration of Fund for  
the Improvement of Education Grants*

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**FINAL AUDIT REPORT**



**ED-OIG/A06H0002**

**July 2008**

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Our mission is to promote the efficiency, effectiveness, and integrity of the Department's programs and operations.



U.S. Department of Education  
Office of Inspector General

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UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL

Audit Services  
Chicago/Kansas City/Dallas Audit Region

July 21, 2008

Robert Rivera  
President and CEO  
Project GRAD USA  
1100 Louisiana St, Suite 450  
Houston, TX 77002

Dear Mr. Rivera:

Enclosed is our final audit report, Control Number ED-OIG/A06H0002, entitled *Review of Project GRAD USA's Administration of Fund for the Improvement of Education Grants*. This report incorporates the comments you provided in response to the draft report. 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 this audit:

Lawrence A. Warder  
Chief Financial Officer  
Office of the Chief Financial Officer  
U.S. Department of Education  
400 Maryland Avenue, SW  
Washington, D.C. 20202

Doug Mesecar  
Assistant Deputy Secretary  
Office of Innovation and Improvement  
U.S. Department of Education  
400 Maryland Avenue, SW  
Washington, DC 20202

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 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,

/s/

Gary D. Whitman  
Regional Inspector General  
for Audit

Enclosures

*The Department of Education's mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.*

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## EXECUTIVE SUMMARY

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The objectives of our audit were to determine whether Project GRAD<sup>1</sup> (PG) USA (1) properly accounted for and used Fund for the Improvement of Education (FIE) grant funds in accordance with relevant laws and regulations and (2) carried out the objectives specified in the 2005-2006 approved FIE grant application. Our audit covered the period from February 1, 2003, through September 1, 2006. PG USA received \$59,592,000 in FIE grant funds for the three-year period.

PG USA did not properly account for and use grant funds in accordance with relevant laws and regulations. Contrary to OMB Cost Principles and federal regulations, PG USA (1) charged \$13,826,871 as pre-award costs to the grants without evidence that the costs benefited the upcoming grant period; (2) paid and reimbursed sites for \$17,557,732 in unallowable and inadequately documented costs; and (3) did not adequately administer its contracts with sites or various vendors. As a result, PG USA and its sites

- (1) expended from \$3.3 to \$5.4 million per year from its next grant to pay for current operations in each current grant period, thus risking, without continued funding, the availability of funds for operating expenses during the upcoming grant period and for development of new sites. When no funding was awarded to PG USA after the 2005-2006 grant period, PG USA and at least one of the sites laid off approximately half their employees during the last half of that grant period;
- (2) did not have reasonable assurance that grant funds were used only for allowable purposes; and
- (3) could not provide reasonable assurance that it obtained fair and reasonable contract prices.

PG USA did not properly account for and use grant funds in accordance with relevant laws and regulations because it

- (1) identified 100 percent of all costs incurred or obligated during the dates of the pre-award period as pre-award costs, regardless of the grant period that benefited from the cost, and allowed the sites to do the same (PG USA converted every cost in the pre-award period to an upcoming grant period cost and charged no costs during the pre-award periods to the current, ongoing grant period);
- (2) did not require adequate documentation to be submitted before reimbursing sites for any payroll charged to the grant and concluded its sites were contractors that did not have to comply with OMB Circular A-122 provisions that define adequate support for payroll; and
- (3) was told by U.S. Department of Education (Department) officials to use contracts and referred by the Department to the applicable sections of the Code of Federal Regulations (C.F.R.), but the Department offered no additional guidance beyond approving the first site contract (the Department did not review subsequent contracts and performed no monitoring of PG USA beyond receiving yearly reports).

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<sup>1</sup> Graduation Really Achieves Dreams.

Although PG USA generally carried out the objectives specified in the approved 2005-2006 grant application, it did not perform adequate monitoring of sites. Specifically, PG USA did not complete the formal monitoring process outlined in the approved grant application, and it did not review required Single Audits from all applicable sites. As a result, PG USA and the Department did not have reasonable assurance that the funds allocated to these sites were used in compliance with the law, regulations, and the provisions of contracts, thus leaving Federal dollars at risk for potential misuse without detection.

We recommend that the Chief Financial Officer (CFO), in collaboration with the Assistant Deputy Secretary for the Office of Innovation and Improvement (OII), require PG USA to—

- Review the \$13,826,871 charged as pre-award costs, identify and provide support for those that meet the criteria of a pre-award cost; for the remaining costs, provide adequate documentation supporting their allowability in the appropriate grant period and return any amounts that cannot be supported or exceed the total grant award for the applicable period;
- Return \$1,484,888 in unallowable costs paid and reimbursed to sites;
- Provide documentation for \$16,072,844 in inadequately documented costs or return that amount, less any amount it can show is duplicated in the first recommendation, to the Department;
- Develop and implement policies and procedures that provide reasonable assurance that it and its sites will comply with Department and Federal procurement regulations; and
- Complete its monitoring process as soon as possible, ensuring financial aspects are addressed and financial personnel participate in all future monitoring.

In its comments to the draft of this report, PG USA did not concur with our findings and recommendations. PG USA disagreed that it (1) charged costs to the upcoming grant period that were not legitimate pre-award costs, (2) charged any more than \$206 in unallowable costs and a few thousand dollars in inadequately documented costs to the grant, (3) did not adequately administer its contracts with sites or various other vendors, and (4) did not perform adequate monitoring of sites. In addition, PG USA questioned the auditors' compliance with generally accepted government auditing standards (GAGAS).

The OIG has a strict internal quality assurance system that provides reasonable assurance that our audits adhere to GAGAS. After considering all documentation provided by PG USA with its comments, we revised the presentation of our findings and some of the recommendations for clarification purposes. Also, we determined that a fifth finding presented in the draft report was not a reportable condition and removed it as a finding, but included it as a part of the Other Matters section of this final report.

PG USA's comments and our responses to the comments are summarized at the end of each finding. The full text of PG USA's comments is included as Enclosure 4. Copies of the attachments that were included with the response are available upon request.

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## BACKGROUND

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The FIE is authorized under Part D, Subpart 1, of Title V of the No Child Left Behind Act of 2001. It provides authority for the Secretary of Education to support nationally significant programs to improve the quality of elementary and secondary education at the state and local levels and help all students meet challenging state academic content and achievement standards.

The FIE includes grants that are mandated by Congress in a statute that identifies the specific recipient(s), the amount of the award, and, in some cases, the project activities the recipient is to conduct. The Department's Office of Innovation and Improvement (OII) awarded PG USA five FIE grants as mandated by Congress in appropriations bills for fiscal years 2001 through 2005. The table below shows the grant periods, dates, and funding amounts for the individual awards PG USA received.

<b>Award Year</b>	<b>Grant Award Period</b>	<b>Award Amount</b>
2001-2002	April 16, 2001, to April 15, 2002	\$9,000,000
2002-2003	May 1, 2002, to April 30, 2003	\$18,000,000
2003-2004	June 20, 2003, to June 19, 2004	\$19,869,999
2004-2005	June 1, 2004, to May 30, 2005	\$19,882,000
2005-2006	April 20, 2005, to September 1, 2006	\$19,840,000
<b>Total</b>		<b>\$86,591,999</b>

PG USA is a private, not-for-profit organization that was first awarded FIE funds in 2001 to facilitate the implementation of the PG USA program (PG Program) in economically disadvantaged public school districts across the country. In each city it serves, PG USA uses a five-part school reform model across all grades, kindergarten through college. The five components of the PG Program include math, literacy, classroom management, social services, and The High School Program (scholarships). At the time of our audit, PG USA had implemented the PG Program through 12 sites: Houston, Texas; Newark, New Jersey; Los Angeles, California; Columbus, Ohio; Atlanta, Georgia; Knoxville, Tennessee; Akron, Ohio; Cincinnati, Ohio; Long Island, New York (formerly Roosevelt, New York); Brownsville, Texas; the Kenai Peninsula, Alaska; and Lorain, Ohio.

Each site is comprised of a local non-profit organization that partners with a local school district to run the PG Program. Some sites run the PG Program in several feeder patterns in one district. The process to become a site can take up to 18 months and starts when the local non-profit makes contact with PG USA asking to be allowed to become a PG site. After becoming a PG site, the local non-profit receives FIE funds as subawards through contracts signed by both the national PG office and the local non-profit. Each local non-profit is a subrecipient, as well as a contractor, of PG USA. (Pertinent terms are defined in Enclosure 1.)

In its 2005-2006 grant application, PG USA listed 4 goals and 16 objectives against which it could measure the program's performance. The 16 objectives were as follows:

1. Provide ongoing technical assistance in program implementation and organizational development through visits to local contractors on an as needed basis.
2. Offer targeted professional development opportunities to site and district staff through meetings and conferences.
3. Conduct Learning and Support Visits (LSVs) to each contractor.
4. Continue to develop and implement a collaborative target-setting process with contractors.
5. Add one new contractor and one new feeder, increasing the reach of the program from 135,000 students to 145,000 students.
6. Continue refinement of the PG USA New Site Handbook, improvements in the local board development process, enhancements of the new executive director development program, and the process of creating and executing a sustainable funding plan.
7. Continue the implementation of the program's 5 components in the 12 existing sites.
8. Specify the recommended elements within each of the three elements of the PG framework for an enriched high school model.
9. Launch a three-year pilot of district site evaluation model to be implemented by an outside evaluator in two sites.
10. Convene a research advisory panel consisting of nationally known, independent researchers in education and social sciences to provide input in evaluation procedures used by PG USA in both macro and micro assessment of the program's initiative.
11. Design a model for supporting reading across the curriculum at the secondary level.
12. Collaborate with Consistency Management & Cooperative Discipline (CMCD) to develop a process for customizing the secondary model to fit the specific needs of each site.
13. Conduct a contractor inventory and a program inventory to identify and codify best practices and strategies in parental involvement.
14. Provide staff with training on nationally recognized coaching model and work to develop a coaching model to support contractors.
15. Ensure a 10 percent increase in the number of PG USA schools meeting or exceeding Adequate Yearly Progress goals.
16. Increase the overall number of high school graduates by 5 percent in existing sites that have had four years or more of implementation of the high school component.

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## AUDIT RESULTS

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PG USA did not properly account for and use grant funds in accordance with relevant laws and regulations.<sup>2</sup> Specifically, PG USA (1) charged \$13,826,871 as pre-award costs to the grants without evidence that the costs benefited the upcoming grant period (FINDING NO. 1); (2) paid and reimbursed sites for \$17,557,732 in unallowable and inadequately documented costs (FINDING NO. 2); and (3) did not adequately administer its contracts with sites or various vendors (FINDING NO. 3). PG USA spent from \$3.3 to \$5.4 million per year more than what it was awarded in anticipation of receiving a grant for the next year. Using such a financing

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<sup>2</sup> Unless otherwise noted, references are to the July 1, 2003, edition of the regulations.



process, PG USA risked running out of money to operate its programs. When no funding was awarded to PG USA after the 2005-2006 grant period, PG USA and at least one of the sites laid off approximately half their employees during the last half of that grant period. PG USA also did not have reasonable assurance that grant funds were used only for allowable purposes or that it obtained fair and reasonable contract prices.

In addition, PG USA generally carried out the objectives specified in the approved 2005-2006 grant application. However, PG USA did not perform adequate monitoring of sites, complete the formal monitoring process outlined in the approved grant application (Learning and Support Visits), and review required Single Audits from all applicable sites (FINDING NO. 4). As a result, PG USA and the Department did not have reasonable assurance that FIE funds allocated to these sites were used in compliance with laws, regulations, and the provisions of contracts, thus leaving Federal dollars at risk for potential misuse without detection.

### **FINDING NO. 1 – PG USA Charged Pre-award Costs to the Grants without Evidence That the Costs Benefited the Upcoming Grant Period**

PG USA claimed and received reimbursement for approximately \$13.8 million charged as pre-award costs without documentation showing how the costs benefited the upcoming grant period. By definition, pre-award costs are exceptions to the rules of obligation. Pursuant to OMB Cost Principles and Department guidance,<sup>3</sup> preaward costs are costs incurred or obligated before the applicable period of performance but must benefit the applicable period of performance. By charging pre-award costs to the upcoming grant periods without showing how the costs benefited the upcoming period, PG USA and its sites risked, without continued funding, the availability of funding for operations of the upcoming grant period at the existing sites or for development of new sites. PG USA had to lay off approximately half its employees for the last half of the 2005-2006 grant period because no new FIE funding was provided.

#### **Current Period Operating Costs Charged As Pre-Award Costs for the Upcoming Grant Periods**

PG USA charged approximately \$13.8 million as pre-award costs without documentation showing how the costs benefited the upcoming grant period. These costs were operating expenses related to the performance of grant activities during the periods prior to the grant periods in which they were claimed and reimbursed as pre-award costs. We reviewed the national office expenditures charged to the 2005-2006 grant for costs incurred during PG USA's designated pre-award period. We also reviewed the expenditures that were incurred for 6 of the 12 sites<sup>4</sup> during PG USA's designated pre-award periods for the 2003-2004, 2004-2005, and 2005-2006 grant periods. PG USA—

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<sup>3</sup> OMB Circular A-122 *Cost Principles for Non-Profit Organizations*, revised May 10, 2004, and Department guidance cited on page 7 of this report.

<sup>4</sup>The sites reviewed were Akron, Atlanta, Brownsville, Newark, Los Angeles, and Houston.

- Charged the 2005-2006 grant for about \$806,479<sup>5</sup> of national office operating costs incurred during the 2004-2005 grant period. These routine operating costs included salaries, travel, and contracted services.
- Reimbursed four of the six sites \$13,020,392<sup>6</sup> for costs benefiting the current grant period using funds intended for the subsequent grant period. For example, in one reimbursement request, PG USA used 2004-2005 grant funds to reimburse the PG Los Angeles site over \$1.1 million for routine operating costs, including salaries, fringe benefits, equipment, supplies, and contracted services for January through May 2004. These costs were incurred during and for the performance of the 2003-2004 grant period and before the 2004-2005 site contract start date of June 1, 2004.

The following table shows the total amount of operating costs that benefited the period in which they were incurred or obligated but were claimed and reimbursed as pre-award costs in a subsequent period. (We did not identify any prior period costs at Akron, Ohio, or Brownsville, Texas.)

<b>Prior Period Costs by Site and Grant Period</b>				
	<u>2003-2004*</u>	<u>2004-2005*</u>	<u>2005-2006</u>	<u>Total</u>
PG USA	Not Reviewed	Not Reviewed	\$806,479	\$806,479
PG Atlanta	\$857,907	\$677,279	\$303,896	\$1,839,082
PG Newark	\$142,948	\$680,583	\$380,404	\$1,203,935
PG Los Angeles	\$1,561,613	\$1,227,814	\$473,014	\$3,262,441
PG Houston	\$2,519,657	\$2,835,799	\$1,359,478	\$6,714,934
<b>Totals</b>	\$5,082,125	\$5,421,475	\$3,323,271	\$13,826,871

\*Data was not available in a usable electronic form for PG USA for years prior to 2005-2006.

PG USA identified a pre-award period for the 2003-2004 grant as February 1, 2003, through June 20, 2003. In April 2003, PG USA provided budget and cost data for national office and site expenses consisting of salaries, fringe benefits, travel, supplies, and contracted services during February through May. The budgeted costs submitted as pre-award costs totaled over \$4.8 million, or 24 percent of the entire 2003-2004 grant period funding of \$19.8 million. Also, PG USA awarded contracts to the 12 subrecipient sites, with contract periods that approximated the grant periods, and allowed the sites to be reimbursed costs incurred during the same pre-award periods approved for PG USA.

<sup>5</sup> The 2005-2006 grant period began April 20, 2005. We included only the costs dated through March 31, 2005, and excluded costs dated from April 1 through 19, 2005 (except nine expenditures that had sufficient detail to be determined as costs from the prior period).

<sup>6</sup> For the sites during the three grant periods reviewed, we included costs with dates from before the grant/contract period start dates. We excluded costs invoiced in the first month of the grant period without sufficient data to determine when the costs were actually incurred.

### **Pre-award Costs Must Benefit the Upcoming Grant Period**

The grants to PG USA were individual awards, each stating the specific budget and performance periods in the respective Grant Award Notification. PG USA requested and received Department approval for pre-award costs, for more than 90 days before the beginning of the new grant period, for each of the three grant periods reviewed. PG USA included with the application for each upcoming grant its request for pre-award costs. PG USA provided budget and cost data to the Department containing routine operating costs incurred or to be incurred during the current grant period. These costs were allocable only to the grant period in which they were obligated, the current grant period, and should not have been considered as costs eligible for the upcoming application grant period.

By definition, pre-award costs are exceptions to the rules of obligation. Although the costs are incurred or obligated before the applicable period of performance, they must benefit the applicable period of performance.

OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, Appendix A, subpart C (28), amended September 30, 1999, states that, where a funding period is specified, a recipient may charge to the grant only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the Federal awarding agency. OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, states that pre-award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

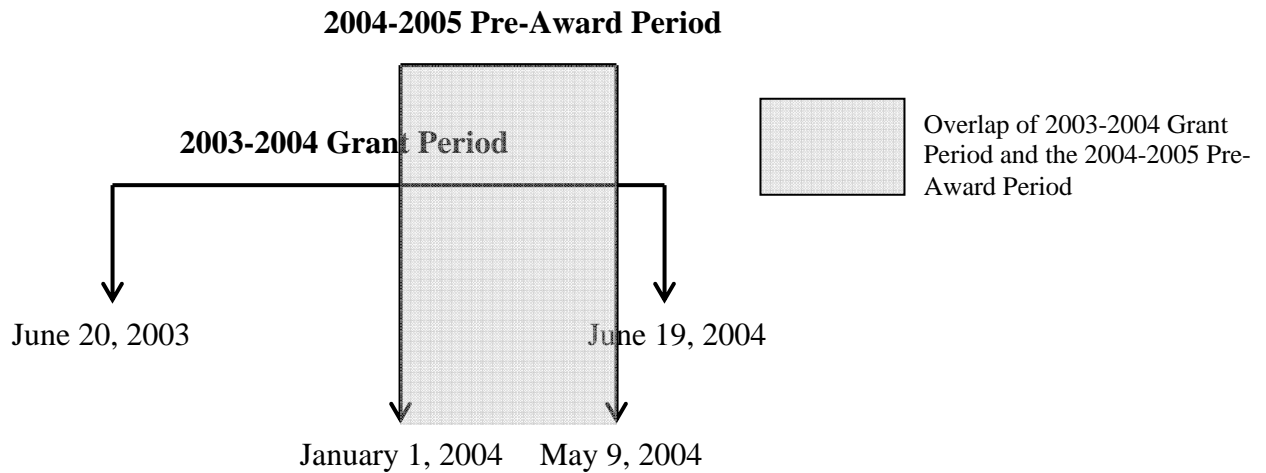
The Department's Grants Policy Bulletin #6, Attachment E, Pre-agreement (Pre-award) Costs, issued December 14, 1998, provides examples of legitimate circumstances in a grant project that might require granting approval for pre-agreement (pre-award) costs, including—

1. Engaging a consultant who otherwise would not be available during the award period to do work directly related to the project;
2. Obligating grant funds for buying equipment for the project before the beginning date in order to receive a concessionary price from a vendor; and
3. Traveling for Department-sponsored conferences that occur before the start of the project period.

### No Analysis of Which Period Benefited from the Cost

PG USA identified 100 percent of all costs incurred or obligated during the dates of the pre-award period as pre-award costs, regardless of the grant period that benefited from the cost (including costs from prior periods), and allowed the sites to do the same. PG USA converted all costs incurred during the pre-award period to costs of the upcoming grant period, and charged no costs that were incurred during the pre-award period to the current, ongoing grant period (that is, PG USA shifted the grant period to start with the pre-award period for all three grant periods reviewed). PG USA did not attempt to determine which costs were needed to continue the current period grant and which costs were in anticipation of the upcoming award.

Though PG USA was allowed to incur and charge pre-award costs for its grants, it still was required to determine which costs were allowable pre-award costs. To do so, PG USA needed to show which period would benefit from the costs it charged as pre-award costs. For example, as indicated in the diagram below, a PG site obligated or incurred costs during April 2004 for April office rental and deposits on conference facilities for June training. The 2003-2004 grant period was June 20, 2003, through June 19, 2004. The PG USA application for the 2004-2005 grant identified a pre-award period from January 1, 2004, through May 9, 2004. These two periods overlapped from January 1, 2004, through May 9, 2004.



The April office rental benefited the grant period then running (2003-2004), was a routine operating cost supporting the performance of that period, should have been charged to 2003-2004 grant funds, and was not a pre-award cost benefiting the grant period to begin in June 2004. Conversely, the deposits on conference facilities to be used in June were to benefit the performance of the 2004-2005 grant period, were incurred during the pre-award period for the 2004-2005 grant, and were allowable pre-award costs for the 2004-2005 grant.

PG USA did not provide evidence showing it conducted such an analysis. Instead, it charged all costs incurred or obligated during the designated pre-award period as pre-award costs for the upcoming grant period.

## **Funding Limitations Circumvented and Continuation of Operations Jeopardized**

Charging \$13,826,871 in costs as pre-award costs circumvented the appropriations limitations imposed by Congress. Congress intended that PG USA use the appropriated funds only for current period operations and for legitimate pre-award costs that would benefit the upcoming grant period. Instead, PG USA spent from \$3.3 to \$5.4 million per year more than what it was awarded in anticipation of receiving a grant for the next year. Using such a financing process, if a new grant were not written into the law, PG USA risked running out of money to operate its programs.

During the pre-award periods, PG USA chose to charge operating costs that benefited the current period as pre-award costs for the upcoming period. As we describe on page 7 of this report, some of the costs PG USA incurred during the pre-award period each grant year could be allowable pre-award costs for the upcoming grant period. However, PG USA's practice of shifting costs incurred during the pre-award period to the next period's grant led to PG USA running out of funds early in the 2005-2006 grant period. Because PG USA was not awarded a 2006-2007 FIE grant, it had no pre-award period to charge the last few months of 2005-2006 operating costs. Officials of both PG USA and PG Houston stated that they had to lay off approximately half their workforce during the last half of the 2005-2006 grant period due to the lack of continued FIE funding.

### **Recommendations**

We recommend that the CFO, in collaboration with the Assistant Deputy Secretary for OII, require PG USA to—

- 1.1 Review the \$13,826,871 charged as pre-award costs and identify those that meet the criteria of a pre-award cost. For the eligible pre-award costs, provide adequate documentation to support their allowability. Further, for the remaining costs, PG USA must provide adequate documentation supporting the allowability of the cost as if it had been claimed in the appropriate grant period and return to the Department any amounts that cannot be supported or that exceed the total grant award for the applicable grant period; and
- 1.2 For expenditures not included in this audit, including the national office costs during the 2003-2004 and 2004-2005 grant periods and costs for the other six sites during grant periods 2003-2004, 2004-2005, and 2005-2006, review amounts charged as pre-award costs and identify those that meet the criteria of a pre-award cost. For the eligible pre-award costs, provide adequate documentation to support their allowability. Further, for the remaining costs, PG USA must provide adequate documentation supporting the allowability of the cost as if it had been claimed in the appropriate grant period and return to the Department any amounts that cannot be supported or that exceed the total grant award for the applicable grant period.

### **PG USA's Comments**

In its comments to the draft report, PG USA disagreed with our finding and recommendations. PG USA stated the pre-award costs were specifically included in the activities and budget for the

FIE grants approved by the Department, and the approval of the pre-award costs is entirely consistent with Department regulations, specifically 34 C.F.R. §§ 75.263 and 74.25(e)(1) and Grants Policy Bulletin #19. PG USA stated OIG did not mention these regulations in Finding No. 1. PG USA also said the draft report erroneously states that the pre-award period for the 2004-2005 grant ended on May 9, 2004, instead of May 31, 2004.

Additionally, PG USA stated that Finding No. 1 is not consistent with the examples of pre-award costs contained in Department guidance. PG USA further claimed that all three FIE grants are “a noncompeting continuous award” because the legislative appropriation required the FIE grant to fund “continued support” of PG USA. According to PG USA, nothing in the appropriations language imposed any limitations on the expenditure of the funds except that the funds had to be obligated before the end of the fiscal year.

### **OIG’s Response**

PG USA did not provide any additional documentation that would cause us to remove this finding or our recommendations. However, after reviewing both PG USA’s comments and our audit documentation, we clarified the finding and recommendation 1.1 to better explain (1) why the costs PG USA and its sites charged as pre-award costs could be unallowable and what actions need to be taken to show which costs were allowable pre-award costs, and (2) determine the amount of funds that would need to be returned when other costs are charged to the appropriate grant period.

PG USA asserts that we ignored regulations that state pre-award costs are allowable and provide the Secretary the authority to authorize them. While we do not cite all criteria relevant to this issue, we acknowledge in the finding that pre-award costs can be allowable. We also acknowledge that the Department has the authority to and did approve of PG USA charging pre-award costs to the grants. However, the specific costs PG USA and its sites charged as pre-award costs still must meet (1) the OMB Circular A-122 general principles and factors of allowability of costs, including being reasonable and allocable to the grant charged, and (2) the specific definition and criteria for pre-award costs in the Circular. The specific costs charged by PG USA as pre-award costs did not meet these requirements. Specifically, PG USA did not demonstrate that the costs charged as pre-award costs met the definition of being necessary to the period of performance or that they benefited the grants to which they were charged. Therefore, without evidence to the contrary, we must conclude that the costs are unallowable.

The FIE grants awarded to PG USA were not continuous awards. Each grant was a separate award with a specific grant period. A new appropriations bill was enacted each year, and each bill contained a new grant. Congress appropriates funds on the basis of fiscal years but allows the Department to set the period that grant funds are available for obligation. The Department sets the funding period. By regulation (34 C.F.R. §§ 75.250 and 75.251), the Department has established a system of budget periods and project periods to divide up the funding of grants. During our audit period, PG USA was awarded three FIE grants for three separate fiscal years, and Congress allowed the Department to set the performance and budget periods. The Department set start and end dates for each grant using the Grant Award Notification, while also allowing pre-award periods for each grant. For each of the three pre-award grant periods, PG USA considered all costs incurred during the pre-award periods to be valid pre-award costs, and, therefore, allocable

to the upcoming grant period. Contrary to the applicable guidance, PG USA made no determination as to which grant period benefited from the costs. PG USA essentially shifted the grant period to start at the beginning of the upcoming pre-award period and end when the next pre-award period began. The Department’s Grant Award Notification file for the 2004-2005 grant originally had the end of the pre-award period as May 31, 2004, but that date had been lined out and the date of May 9, 2004, had been written above the lined out date. Because it was to PG USA’s advantage, we used May 9, 2004, as the end of the pre-award period and did not question costs incurred during the period May 9 through May 31, 2004.

**FINDING NO. 2 – PG USA Paid and Reimbursed Sites for Unallowable and Inadequately Documented Costs**

PG USA paid and reimbursed sites \$17,557,732 in grant funds for costs that were either unallowable under Federal cost principles or were not adequately documented. Of the \$17,557,732, \$1,484,888 was not allowable under Federal cost principles and \$16,072,844 was not adequately documented to support that the costs were allowable under Federal cost principles. The following table presents a summary of unallowable and inadequately documented costs for the period February 1, 2003, through September 1, 2006.

<b>Grant Period</b>	<b>Universe of Costs</b>	<b>Sampled Costs</b>	<b>Unallowable Costs</b>	<b>Inadequately Documented Costs</b>
2003-2004	\$19,869,999	\$11,082,732	\$696,666	\$4,341,189
2004-2005	\$19,882,000	\$10,510,723	\$358,748	\$5,034,495
2005-2006	\$19,840,000	\$11,402,477	\$429,474	\$6,697,160
<b>Total</b>	<b>\$59,591,999</b>	<b>\$32,995,932</b>	<b>\$1,484,888</b>	<b>\$16,072,844</b>

**Unallowable Costs**

PG USA paid and reimbursed sites for \$1,484,888 in costs that were unallowable under Federal cost principles. The unallowable costs were for (1) contractual services which benefited multiple grant sources or were unallowed lobbying and public relations costs (\$40,235); (2) travel costs for the Chairman of the Board of PG USA to attend another entity’s board meeting (\$430); (3) legal fees that did not benefit the grant or were charged twice (\$27,082); (4) costs not equitably apportioned to the grant (\$331); (5) delivery of the Houston Chronicle newspapers to PG students’ households that were not allocated uniformly or treated consistently<sup>7</sup> (\$1,338,091); (6) PG Houston’s Single Audit (\$46,573), which did not meet A-133 requirements; and (7) costs that should have been charged to another grant (\$32,146).

OMB Circular A-122 gives detailed guidance concerning allowable grant costs. Both Attachment A and Attachment B of OMB Circular A-122 prescribe principles that PG USA must follow when determining what costs are allowable. Attachment A specifically states that, to be allowable,

<sup>7</sup> Three of the 15 Houston Chronicle invoices reviewed had a portion of the invoiced amount allocated to the FIE grant and a portion to other funding sources. The other 12 transactions were allocated entirely to the FIE grant. PG Houston had at least four other funding sources, some of which also benefited from the Houston Chronicle program. The Houston Chronicle expenses should have been allocated among the funding sources that benefited from the program.

costs must be reasonable, conform to policies and procedures, be consistently treated, and be adequately documented. Attachment B specifically prohibits certain lobbying, public relations, and legal costs (See Enclosure 3).

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, revised June 27, 2003, sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local governments, and non-profit organizations expending Federal awards. Subpart B-225 states that, “No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part . . . .”

### **Inadequately Documented Costs**

PG USA paid and reimbursed one site \$16,072,844 for costs that were not adequately documented. Nearly all (\$16,067,779) of the inadequately documented costs consisted of payments and reimbursements for salaries and fringe benefits. Although PG USA maintained time and effort (T&E) reports for personnel, it did not use the percentage of effort reported on the T&E reports to calculate payroll costs charged to the FIE grant. Instead, PG USA charged an estimated percentage of certain individuals’ time that would be charged to the grant, regardless of the number of hours actually worked on grant activities. PG USA never reconciled the actual with the estimated percentages to ensure the estimates were reasonable.

For example, PG Houston did not provide adequate documentation for any payroll charged to the FIE grant. Neither PG USA’s documentation nor the documentation provided by PG Houston accurately represented personnel effort expended directly (or only) for the FIE grant. Payroll documentation did not separate personnel effort by funding source, making it difficult, if not impossible, to track time worked on the FIE grant.<sup>8</sup>

According to OMB Circular A-122, to be allowable, costs must, among other requirements, be adequately documented. Adequate documentation for salaries consists of T&E reports that reflect an after-the-fact determination of the actual activity of each employee. T&E reports must account for the total activity for which employees are compensated, be signed by the employee or responsible supervisor, and must be prepared at least monthly. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

PG USA did not have policies and procedures that provided reasonable assurance that it and the sites complied with the requirements of OMB Circular A-122. PG USA officials stated they believed the process of using pre-determined percentages of certain personnel salaries was a fair representation of payroll costs to charge the grant, and, therefore, the T&E reports as prepared met OMB Circular A-122 requirements. PG USA also did not require adequate support for payroll expenses before reimbursing PG Houston. PG Houston officials stated they believe all

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<sup>8</sup> During our fieldwork, PG Houston provided T&E reports for one Houston Intermediate School District invoice and one PG Houston payroll charged to the grant. These reports were created after our site visit to PG Houston. The reports were not adequate to support payroll because they did not account for the total activity for which employees were compensated, and they did not show that the activities engaged in were specifically for the FIE grant. Because PG Houston receives funds from more than one funding source, the reports must reflect the activity for each funding source, not just by general program objective.



funds they receive can be used for the same goals and expenses and can be shifted among funding sources. PG Houston also believed that, because it was a contractor, the site did not have to comply with the payroll support requirements in OMB Circular A-122.

Unallowable costs charged to the grant constitute a debt to the Federal government and harms the Federal interest. When a grantee uses Federal funds for unallowable costs, those funds are not available to pay for items and services that will advance the program. Because PG USA did not provide documentation for payroll that accurately represented personnel effort expended directly (or only) for the FIE grant, Federal funds might have been used to pay PG USA employees who did not perform any work for the grants or might have been paid for time spent working on multiple programs. Also, PG USA did not have the information needed to correctly allocate personnel costs among multiple grants for employees working on multiple programs.

### **Recommendations**

We recommend that the CFO, in collaboration with the Assistant Deputy Secretary for OII, require PG USA to—

- 2.1 Return \$1,484,888 in unallowable costs paid and reimbursed to sites;
- 2.2 Provide adequate documentation to support the allowability of \$16,072,844 or return to the Department, less any amount it can show is duplicated in Recommendation 1.1, any amounts not supported; and
- 2.3 Develop and implement policies and procedures that provide reasonable assurance that documentation adequately supports expenses charged to Federal funds.

### **PG USA's Comments**

In its comments to the draft report, PG USA disagreed with all but \$206 in unallowable costs and “a few thousand” dollars in inadequately documented costs. It also disagreed with all of the recommendations.

PG USA stated that we failed to provide notice that the scope of the audit had expanded, and questioned our repeated requests for a management representation letter. PG USA also believed that we double-counted costs between findings.

PG USA also disagreed with our assessment that PG USA and PG Houston's salaries and fringe benefit figures are not adequately documented. PG USA asserted the T&E reports and other records provided adequately supported the reasonableness of the billing methodology, and there is no need for PG USA to recalculate its billings or provide additional documentation. PG USA also stated that PG Houston is a contractor providing services to PG USA, rather than a subgrantee and was required to comply with only certain sections of OMB Circulars A-122 and A-133.

PG USA stated it received no supporting documentation or explanation for some of the questioned costs and requested more information before commenting. PG USA acknowledged

that \$205.85 for a Texas Business and Education Coalition (TBEC) Board meeting was mistakenly charged to the FIE Grant and stated it will reimburse the Department. PG USA disagreed with our reasons for questioning the legal fees, costs related to flowers, and the Houston Chronicle costs.

### **OIG's Response**

PG USA did not provide any additional documentation that would cause us to remove this finding or our recommendations. However, after reviewing both PG USA's comments and our audit documentation, we clarified the finding and Enclosure 2 to better explain why the costs are unallowable and/or inadequately documented.

We informed PG USA in an email dated December 4, 2006, that the scope of the audit was expanding beyond the original 2005-2006 grant period. In an email sent to PG USA's CFO on January 22, 2007, we specifically stated that the official time period under review is now June 2003 through September 2006.

Throughout the audit, we informed PG USA of the findings related to the costs questioned in the report. For some of these costs, we requested documentation from PG USA more than once and never received the requested documentation. PG USA was provided time during the audit and during the 30-day comment period to request any clarification it needed to respond to the specific items of cost we identified as unallowable and inadequately documented.

PG USA admitted to using estimates when charging payroll to the FIE grants for both PG USA and PG Houston. The finding explains how the support provided for payroll (payroll, salaries, and fringe benefits) for both entities is inadequate. In addition, PG Houston is not a subgrantee. All the sites are subrecipients<sup>9</sup> that received a subaward from PG USA and, thus, must follow all regulations that apply to PG USA, including OMB Circular A-122. OMB Circular A-122 states that budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

Regarding the legal fees, we explained to PG USA that the FIE grant was charged twice for the same legal services: once through the liability insurance and once through the lawyers. Duplicate costs are unallowable. The trademark costs also are unallowable because the trademark was not incurred specifically for the award and is not necessary to the overall operation of the organization. Obtaining a trademark for "GRAD" solely benefited PG USA.

### **FINDING NO. 3 – PG USA Did Not Award and Administer Its Contracts in Compliance with Federal Regulations**

PG USA did not adequately award and administer either the site contracts or various licensing contracts. PG USA (1) did not execute site contracts timely, (2) did not competitively solicit bids for site contracts, and (3) did not conduct cost or pricing analysis for two education components. As a result, PG USA reimbursed sites for costs incurred before site contracts were executed and in

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<sup>9</sup> OMB Circular A-133, Subpart B §§ 210(b) & (d).

excess of agreed to amounts, leaving Federal funds vulnerable with no assurance the best bid or offer was chosen for each contract.

### **PG USA Did Not Execute Site Contracts Timely**

PG USA did not execute contracts with its sites in a timely manner and did not have full, legal recourse against the sites. Title 34 C.F.R. § 74.2, Federal Acquisition Regulations Subpart 2.101, and Black's Law Dictionary<sup>10</sup> state that a contract is a procurement contract under an award or subaward, and a procurement subcontract under a recipient's or subrecipient's contract. A contract is a mutually binding legal relationship obligating the seller to furnish the supplies or services and the buyer to pay for them. It gives each a legal duty to the other and also the right to seek a remedy for the breach of those duties. Its essential components are competent parties, subject matter, a legal consideration, mutuality of agreement, and mutuality of obligation. Execution of a contract includes the performance of all acts necessary to render the instrument complete and to give the instrument validity, including signing.

For site contracts and associated funding draw downs during the 2003-2004, 2004-2005, and 2005-2006 grant periods, PG USA drew down and distributed to the sites \$35,259,938 of \$47,784,236, or 74 percent of the total disbursed, prior to executing the contracts with the sites.<sup>11</sup> Also, PG USA reimbursed two sites a total of \$102,179 in excess of the contract not-to-exceed amounts. Because PG USA did not have executed contracts in place, it might not have been able to legally recover funds if problems were encountered with the sites. Although we did not identify any site funding issues requiring PG USA to seek legal recourse, the potential existed for Federal funds to have been misspent and grant services not supplied with no legal recourse available to PG USA. PG USA took no action on the two sites which received amounts in excess of their contract because the excess was expended on program activities.

### **PG USA Did Not Competitively Solicit Bids for the Site Contracts**

PG USA did not competitively solicit and award contracts to sites. No advertisement or formal solicitation was conducted to attract potential bidders or offerors to select sites and no competition existed at the sites to establish which local non-profit organization would implement the program. Instead, PG USA added seven sites (five sites were established at the time of the initial grant) by evaluating only interested parties that approached it. These interested parties heard of the PG Program by word of mouth or attended a presentation and pursued becoming a site.

According to 34 C.F.R. § 74.43, "All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition . . . . Awards must be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly establish all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient . . . ."

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<sup>10</sup> Sixth Edition 1990. St. Paul, Minnesota: West Publishing Company.

<sup>11</sup> The three contract periods approximately mirrored the three grant periods.

Without competition, PG USA does not have reasonable assurance that the new sites selected represent the best program quality and the most advantageous use of grant funding.

### **PG USA Did Not Perform Cost or Pricing Analysis for Two Education Components**

PG USA procured licenses for two education component programs,<sup>12</sup> totaling over \$2.6 million, without performing cost or price analysis or documenting required procurement data. PG USA did not document the basis for contractor selection, justification for lack of competition, or basis for award cost or price. Also, these agreements were executed (signed by both parties) on dates five to seven months after the contract-stated effective dates.

According to 34 C.F.R. § 74.45, “Some form of cost or price analysis must be made and documented in the procurement files in connection with every procurement action . . . .” Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability, and allowability.”

Pursuant to 34 C.F.R. § 74.46, procurement records and files for purchases in excess of the small purchase threshold (\$25,000) must include, at a minimum, the following—

- (a) Basis for contractor selection;
- (b) Justification for lack of competition when competitive bids or offers are not obtained;  
and
- (c) Basis for award cost or price.

Without performing cost or pricing analysis or recording required procurement data, PG USA could not support or ensure achieving a fair and reasonable price.

PG USA informed us that the procurement competition requirements did not apply to the selection of sites and continued to use the existing processes to attract, establish, and contract with new sites. PG USA obtained legal advice from its lawyers regarding some of its contracts; however, PG USA had no contracting expert/officer to ensure the procurement requirements were accomplished. PG USA sought guidance from Department officials on how to conduct the program because Federal regulations did not authorize PG USA to give subgrants to the sites. Department officials told PG USA to use contracts and referred it to the applicable sections of the C.F.R. but offered no additional guidance beyond approving the first site contract. The Department did not review subsequent contracts or monitor PG USA beyond the yearly reports to the Department.

### **Recommendations**

We recommend that the CFO, in collaboration with the Assistant Deputy Secretary for OII, require PG USA to—

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<sup>12</sup> Consistency Management & Cooperative Discipline (CMCD) and MOVE IT-Math, two of the five components of the PG model.

- 3.1 Disburse grant funds only after a contract has been executed;
- 3.2 Competitively solicit and award additional or new sites; and
- 3.3 Develop and implement policies and procedures that provide reasonable assurance that it complies with the cost and pricing analysis and procurement records requirements.

### **PG USA's Comments**

PG USA generally agreed with the first and third sub-findings, but disagreed with the second sub-finding. PG USA agreed that its contract record keeping procedures could be improved and provided the procedures it will follow for all future grant awards.

PG USA stated it follows a comprehensive New Site Development process that ensures "open and free competition" for potential contractor sites. According to PG USA, its New Site Development Handbook provided a detailed, step-by-step process that each prospective site had to follow to become a part of the PG network and to be awarded funds. PG USA said it talked with hundreds of prospective sites and advertised the New Site Development process on its website and "at widely attended education reform venues across the country like GEAR UP (Gaining Early Awareness & Readiness for Undergraduate Programs) and NCAN (National College Access Network)." PG USA strongly believes that a traditional bidding process involving a request for proposals would not have provided the best vehicle to ensure "that the new sites selected represent the best program quality and the most advantageous use of grant funding."

### **OIG's Response**

PG USA did not provide any additional documentation that would cause us to remove this finding or our recommendations. However, after reviewing both PG USA's comments and our audit documentation, we edited the finding to improve its clarity.

PG USA did not provide documentation to substantiate that all potential sites heard of the PG Program and had the opportunity to apply. PG USA stated the New Site Development Handbook was advertised on the PG USA website; however, this is not adequate advertising, since prospective sites must know about the PG Program to know to look for the New Site Development Handbook on the website. PG USA also stated the handbook was advertised at GEAR UP and NCAN venues. However, PG USA did not provide documentation, such as literature given out by PG USA or an agenda of what was discussed at these venues to support this assertion. Placing the New Site Development Handbook on the PG USA website is not sufficient evidence that PG USA solicited bids in an open and free competition.

In addition to PG USA not soliciting competing bids, PG USA did not compare one site to another to select the sites offering the best value to the PG program. PG USA acknowledged in various interviews throughout the audit that interested sites made the first contact with PG USA, and the New Site Development Handbook was used after this initial contact to guide a potential site regarding the next steps in the PG process. Although PG USA states that a traditional bidding process would not be effective, it would need to either provide a sole source justification or go through the normal competitive bid process.

**FINDING NO. 4 – PG USA Did Not Adequately Monitor Sites’ Performance**

In the 2005-2006 grant application, PG USA listed 4 goals and 16 objectives against which it could measure the program’s performance.<sup>13</sup> One objective included in the grant application was the requirement to conduct Learning and Support Visits (LSV) at each contractor. Although PG USA generally carried out the 16 objectives, it did not complete the formal monitoring process (the LSVs) outlined in the approved grant application. In addition, PG USA did not review required Single Audits from all applicable sites.

A grantee is responsible for monitoring each project, program, subaward functions, or activity supported by the grant.<sup>14</sup> PG USA did not adequately monitor 10 of the 12 sites’ performance. PG USA’s method to formally monitor the sites was not complete and did not include a review of vital financial areas. In addition, PG USA did not have personnel with financial or accounting backgrounds as part of the review team.

PG USA had a number of processes to review the sites. Three of the processes were (1) reviewing grant expenditures before money is released to the sites, (2) conducting LSVs, and (3) reviewing a site’s Single Audit report. However, during our three-year audit period, four sites were not subjected to any LSVs or Single Audits. Another six sites either did not have a LSV or an acceptable Single Audit during the three-year period.

Sites	2003 Allocated PG USA Funds	2003 Single Audit?	2004 Allocated PG USA Funds	2004 Single Audit?	2005 Allocated PG USA Funds	2005 Single Audit?	LSV?	All Monitoring Complete?
Atlanta	\$1,736,830	N	\$825,648	N	\$1,040,622	N	N	N
Columbus	\$1,388,827	N	\$1,092,665	N	\$763,436	N	N	N
Houston	\$6,313,267	Y*	\$6,608,240	Y*	\$4,150,805	Y*	N	N
Los Angeles	\$2,297,960	Y	\$2,213,825	Y	\$1,964,714	Y	N	N
Lorain	\$0	**	\$244,939	**	\$677,781	N	Y	N
Newark	\$1,360,037	N	\$2,183,107	Y	\$1,353,698	N	Y	N
Cincinnati	\$591,670	N	\$182,771	**	\$599,774	N	Y	N
Knoxville	\$770,098	N	\$825,928	N	\$894,881	N	N	N
Brownsville	\$197,244	**	\$822,503	N	\$1,253,281	N	Y	N
Kenai Peninsula	\$80,613	**	\$586,957	Y	\$571,390	Y	Y	Y
Akron	\$598,236	Y	\$331,240	Y	\$468,203	Y	Y	Y
Roosevelt	\$407,559	N	\$468,720	**	\$502,187	N	N	N

\*PG Houston’s Single Audits did not comply with OMB Circular A-133 because the FIE funding represented a Type A program, but was excluded from Single Audit coverage for at least the last three years. For the last two years, the Single Audit was paid with FIE funds.

\*\*Site did not meet A-133 dollar threshold for that year and no Single Audit needed.

As a result of not adequately monitoring the performance of its sites, PG USA put Federal dollars at risk for potential misuse without detection, and PG USA and the Department did not have

<sup>13</sup> See Background Section, page 4 for list of objectives.

<sup>14</sup> According to 34 C.F.R. § 75.701, “A grantee shall directly administer or supervise the administration of the project.”

reasonable assurance that the PG sites complied with laws, regulations, and the provisions of contracts that could have a direct and material effect on the Federal program.

### **Support Visits Not Completed at 6 of 12 Sites**

As of the date we completed our fieldwork, PG USA had performed LSVs at only 6 of the 12 sites. Between its inception in 2001 and the beginning of the formal site visits in the fall of 2004, PG USA orally communicated with the sites. Before the formal review process, PG USA did not require the sites to define specific targets to meet the overall goals and did not formally visit the sites to monitor their progress. Because the LSV process began with the newer sites, some of the more established sites operated up to five years without a formal LSV. When the LSV process was initiated in the fall of 2004, PG USA set up a target setting process for all sites. As of September 25, 2007, PG USA had provided evidence that all sites had set their targets for 2005-2006 and had plans to set their targets for 2006-2007 by November 1, 2007.

According to 34 C.F.R. §§ 75.701 and 74.51(a), a grantee shall directly administer or supervise the administration of the project. The grant recipients are responsible for managing and monitoring each project, program, subaward, function, or activity supported by the award.

### **Single Audits Not Performed or Reviewed**

Single Audits that included a review of PG USA's FIE funds were performed, as required by the Single Audit Act, on only 3 of the 12 sites (Los Angeles, Akron, and Kenai Peninsula). However, 9 of the 12 sites did not have one or more Single Audits performed that followed A-133 requirements, with some sites going three years without an audit. PG USA did not review the three sites' Single Audits that were performed.

We have concluded, based on OMB Circular A-133 and the relationship between PG USA and its sites, that PG USA's sites are subrecipients of Federal awards. According to OMB Circular A-133, Subpart B, non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of A-133. Federal agencies shall apply the provisions of A-133 to non-Federal entities, whether they are recipients expending Federal awards received directly from Federal awarding agencies or are subrecipients expending Federal awards received from a pass-through entity (a recipient or another subrecipient). The Circular specifically states the form of the agreement, i.e. subgrant or contract, does not control but that judgment should be exercised in determining whether an entity is a subrecipient or vendor. Characteristics indicative of a Federal award received by a subrecipient are when the organization: (1) determines who is eligible to receive what Federal financial assistance; (2) has its performance measured against whether the objectives of the Federal program are met; (3) has responsibility for programmatic decision making; (4) has responsibility for adherence to applicable Federal program compliance requirements; and (5) uses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

The contracts between PG USA and the sites provide that the sites implement the PG Program by such activities as (1) securing and training a high-quality consulting staff to monitor and support implementation; (2) training all teachers in all components; (3) developing processes with principals to monitor and review results; (4) provide adequate materials in a timely fashion to support teacher training and program implementation; and (5) prepare reports on enrollment and staffing data, performance outcome measures, and financial matters. The contracts also required either (a) the services of an independent auditor to issue a report on compliance with, and internal control over compliance with, requirements applicable to major Federal programs or (b) compliance with Federal regulations, including having records available for audit.

PG USA is a recipient and the sites are subrecipients of the FIE earmark funds. As a recipient, OMB Circular A-133<sup>15</sup> states PG USA must advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts and ensure subrecipients expending the threshold amount have met audit requirements. Subrecipients must submit either a copy of the audit report to the recipient or written notification that an audit was conducted. According to OMB Circular A-133, PG USA must ensure eligible sites receive Single Audits, and PG USA must ensure these sites follow Federal regulations by submitting evidence of these Single Audits to PG USA. PG USA did not enforce the clauses requiring compliance with OMB Circular A-133 that was included in all site contracts or review any Single Audits when they were completed.

Not all monitoring was completed because the first round of LSVs took longer to complete than PG USA officials anticipated, which in turn pushed back the second round of visits. PG USA also believed that sites were exempt from Federal requirements and a Single Audit was a choice left up to each individual site.

Without completing formal monitoring visits and not including a review of vital financial areas, PG USA and the Department cannot ensure that the use of FIE funds allocated to these sites complied with laws, regulations, and the provisions of contracts that could have a direct and material effect on the Federal program, thus leaving Federal dollars at risk for potential misuse without detection. We reviewed expenditures for six of the sites and visited the largest of these sites (PG Houston). We reviewed expenditures for the 2003-2004, 2004-2005, and 2005-2006 grant periods. Our review disclosed unallowable and inadequately documented expenditures. (See Finding No. 2 and Enclosure 2.)

## **Recommendations**

We recommend that the CFO, in collaboration with the Assistant Deputy Secretary for OII, require PG USA to—

- 4.1 Complete the LSVs as soon as possible, ensuring financial aspects are addressed;
- 4.2 Ensure financial personnel participate in all future LSVs; and
- 4.3 Obtain and review the required OMB A-133 Single Audits for all sites that have not completed a Single Audit for fiscal years 2003, 2004, and 2005.

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<sup>15</sup> Subpart C §§ 300, 320(e) and Subpart D § 400(d).



## **PG USA's Comments**

PG USA disagreed with the finding and one recommendation. According to PG USA, we ignored many types of ongoing review processes used by PG USA and focused solely upon the LSV process.

PG USA stated that the contracts with the sites list specific services the sites are expected to deliver and, based on these contracts, PG USA consistently and routinely monitored PG sites in a number of ways: the New Site Development Process; frequent visits to sites to provide support and monitor activity; and highly specialized programmatic training and monitoring visits of the major programs, including professional development/coaching and "Walk and Talks." PG USA also used third-party evaluations and internal tracking of data to monitor sites.

According to PG USA, all PG sites except Houston and Long Island have participated in an LSV. The LSV is a process that PG has been developing to provide an on-site, 360-degree review of each contractor site. It was piloted in Los Angeles in January 2002 and revised throughout 2002 and 2003. During the period cited in the report (2003-2006), first-generation LSVs were conducted in Knoxville and Columbus. The LSV process, in its current form, was conducted in 6 of 12 sites between November 2004 and October 2005. PG USA stated that all sites are scheduled for LSVs this school year, which, as the OIG auditors recommend, will include staff from the PG USA financial team.

PG USA stated that it takes its fiduciary responsibility very seriously. It reviews every item for which a site requests reimbursement prior to the release of any funds to that site, and no funds are disbursed without appropriate support. PG USA stated that requests from the sites are reviewed and approved by the CFO and President.

## **OIG's Response**

PG USA did not provide any additional documentation that would cause us to remove this finding or our recommendations. However, after reviewing both PG USA's comments and our audit documentation, we edited the finding to improve its clarity.

The six formal LSVs provided by PG USA were the only comprehensive reviews of the sites that looked at various aspects of the PG program. According to an email from PG USA staff, "[v]erbal reviews, which were prototypes for LSV have been done with other, older sites" and the LSVs, in their current form, began in the fall of 2004. Before the formalized LSV process, PG USA staff visited the sites and kept handwritten notes. PG USA acknowledged that without a formal written process it was hard to get the sites to make appropriate changes. However, once the LSV was formalized and the reports and recommendations were in writing, the sites were more willing to make changes. Because PG USA could not provide documentation of these oral communications during our review, OIG evaluated PG USA's monitoring of the sites using the six formal LSVs.

According to PG USA, the LSV process was piloted as early as January 2002. PG USA provided no documentation to support this assertion, and we have no indication of what PG USA reviewed during these LSVs.

We acknowledge that PG USA has a system in place to review reimbursement requests from sites. However, PG USA needs to improve its review of costs and understanding of allowable and unallowable costs (see Finding No. 2). Furthermore, PG USA should ensure that sites complete their Single Audits and review those audits for internal control weaknesses and questioned costs.

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## OTHER MATTERS

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### **PG USA's Performance Reports Need Sufficient Information to Allow for an Adequate Assessment of the Program's Performance**

PG USA's performance reports did not contain sufficient information for either the Department or PG USA to adequately assess PG USA's performance. PG USA's first four grant applications and accompanying yearly reports to the Department did not assess PG USA's progress against measurable objectives. PG USA introduced measurable objectives in the fifth grant application and assessed the PG Program against these measurable objectives in the fifth yearly report (2005-2006) to the Department. In the 2005-2006 grant application, PG USA listed 4 goals and 16 objectives. We examined the 16 stated objectives. Most of the objectives are focused on processes (or services) and outputs (or products). Only 2 were focused on outcomes: (1) ensure a 10 percent increase in the number of PG schools meeting or exceeding Adequate Yearly Progress (AYP) objectives; and (2) increase the overall number of high school graduates by 5 percent at the existing PG contractors with 4 years or more of implementation of the high school component.

The two objectives were stated in the grant application and on the Grant Performance Report Project Status Chart as percentages; however, they measure only a change in absolute numbers without taking into consideration any other reasons for the change. PG USA assumes that any change in the absolute numbers can be tied directly to the PG program. However, a change in the number of graduates from year to year can be attributed to an increase in eleventh graders who then graduate, or an increase in the population of twelfth graders the year of graduation, or an increase in the total population of ninth through twelfth graders the year of graduation. All these factors are not a result of the PG program, but can result in an increase in the number of graduates in a given year. We acknowledge that the objectives were approved by the Department; however, we feel these objectives do not completely show how the PG USA program is performing.

We suggest that PG USA and the Department ensure that any future performance reports contain information sufficient to allow the Department and PG USA to adequately assess the program's performance.

### **PG USA's Indirect Cost Rate Agreement**

PG USA's grant applications stated that all costs would be charged as direct costs, and the accompanying budgets showed no provision for indirect costs. During the audit, PG USA staff did not indicate to us that they had requested and agreed to an indirect cost rate. However, on March 27, 2008, the Department provided us with an Indirect Cost Rate Agreement it established

with PG USA. The letter transmitting the Agreement to PG USA states that the rates agreed upon should be used to compute indirect costs for grants, contracts, and applications funded by the Department and other Federal agencies. The rates were agreed to in May 2006 and covered the period July 1, 2004, through December 31, 2006. During the three-year period, PG USA did not charge any indirect costs to the FIE grants. Instead, it charged all costs as direct costs. If any of the direct costs were included in PG USA's indirect cost allocation pool, they would not be allowable direct costs. Because neither PG USA nor the Department could provide us with PG USA's negotiated indirect cost rate and cost allocation plans during our audit, we could not make a determination of whether PG USA charged costs as direct when they should have been included in the indirect cost allocation pool.

We suggest that PG USA, if it continues to receive multiple grants, negotiate an indirect cost rate with the appropriate Federal agency as provided in Attachment A of OMB Circular A-122. In addition, we suggest that the Department require PG USA to provide evidence that it did not charge costs as direct when those costs were included in the cost allocation pool for the period July 1, 2004, through June 30, 2006.

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## OBJECTIVES, SCOPE, AND METHODOLOGY

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The objectives of our audit were to determine whether PG USA (1) properly accounted for and used grant funds in accordance with relevant laws and regulations and (2) carried out the objectives specified in the approved 2005-2006 grant application. Our audit covered the period from February 1, 2003, through September 1, 2006.

To accomplish our objectives, we performed the following procedures.

- Reviewed contracts between the sites and PG USA for the 2003-2004, 2004-2005, and 2005-2006 grant periods.
- Reviewed the contracts for two licensing agreements.<sup>16</sup>
- Reviewed PG USA's expenditures for the period January 15, 2005, through September 1, 2006.
- Reviewed the expenditures for six PG sites (Houston, Akron, Atlanta, Brownsville, Newark, and Los Angeles) for the 2003-2004, 2004-2005, and 2005-2006 grant periods.
- Reviewed PG USA's grant applications and budget narratives for the 2003-2004, 2004-2005, and 2005-2006 grant periods.
- Reviewed the yearly reports to the Department submitted by PG USA for the 2003-2004, 2004-2005, and 2005-2006 grant periods.
- Reviewed the available A-133 Single Audit reports for PG USA and the sites.
- Reviewed both PG USA's and PG Houston's written policies and procedures for procurement and purchasing, payroll, general accounting procedures, and travel.
- Reviewed the employee handbooks for both PG USA and PG Houston.

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<sup>16</sup> Consistency Management & Cooperative Discipline (CMCD) and MOVE IT-Math, two of the five components of the PG model.

- Randomly selected 105<sup>17</sup> of 2,582 expenditures for the 2005-2006 grant period and reviewed supporting documentation for each of the selected expenditures.
- Judgmentally selected 1,499 of 3,469 expenditures recorded in the 7 budget categories for the 2003-2004, 2004-2005, and 2005-2006 grant periods. The 1,499 expenditures reviewed included 749 PG USA payroll and fringe benefits expenditures, 142 PG Houston payroll and fringe benefits expenditures, 473 pre-award costs from both PG USA and the sites, and 135 other PG USA and site expenditures. The expenditures reviewed accounted for \$33,044,358, or 55 percent, of the \$59,591,999 expended by PG USA and its sites.
- Reviewed 100 percent of payroll and fringe benefits expenditures for both PG USA and PG Houston for the 2003-2004, 2004-2005, and 2005-2006 grant periods.
- Reviewed 100 percent of the costs PG USA recorded during the pre-award period for the 2005-2006 grant year (\$859,293 of the total \$6,473,632 PG USA costs reviewed) and judgmentally selected 6 of the 12 sites to review the costs (\$37,289,674 reviewed for all 6 sites) they recorded during the pre-award periods. We chose to review expenditures for the sites for the 2003-2004, 2004-2005, and 2005-2006 grant periods because of questions related to reimbursements to the sites for Single Audits. We judgmentally selected six sites to review. The six sites were selected based on the following: Brownsville, Houston, Los Angeles, and Newark were selected because they were consistently the four sites with the largest amount of allocated funding; Akron was selected because it had a Single Audit during the 2003-2004 grant period; and Atlanta was selected because we noticed potential questions with its 2003-2004 costs, including reimbursed costs for another grant and prior period costs.
- Reviewed the 16 objectives set forth in PG USA's 2005-2006 grant application and evidence PG USA maintained to support performance of the objectives.
- Interviewed various PG USA and PG Houston employees.
- Interviewed Department officials.

We also relied, in part, on computer-processed data related to FIE grants contained in PG USA's accounting system. We verified the completeness of the data by comparing electronic FIE expenditures provided by PG USA to electronic drawdown files taken from the Department's Grant Administration and Payment System (GAPS) to ensure we reviewed all money drawn down by PG USA for each grant period. We also compared the total drawdown amounts for each grant period (provided by both GAPS and PG USA) and ensured that these amounts matched the grant amounts awarded by the Department. We verified the authenticity of the data by comparing the electronic FIE expenditures from our samples to source documentation (including, but not limited to, invoices, payroll registers, receipts, and travel expense reports) provided by both PG USA and the sites. Based on these tests, we concluded that the data were sufficiently reliable to use in meeting our objectives.

We conducted our work at PG USA, one PG USA site, and our offices from October 2006 through February 2007. We discussed the results of our audit with PG USA officials on August 3, 2007, and provided an official draft report on August 27, 2007.

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<sup>17</sup> Fifteen from each of the seven budget categories: salary, fringe benefits, travel, equipment, supplies, contractual, and other.

Information concerning the Indirect Cost Agreement came to our attention after the completion of our field work and issuance of the draft report. We reviewed the information and noted the agreement as discussed in the Other Matters section of this report.

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

## Enclosure 1: Definitions<sup>18</sup>

“*Award* means financial assistance that provides support or stimulation to accomplish a public purpose. Awards include grants and other agreements in the form of money or property, in lieu of money, by the Federal Government to an eligible recipient. The term does not include –

- (1) Technical assistance, which provides services instead of money;
- (2) Other assistance in the form of loans, loan guarantees, interest subsidies, or insurance;
- (3) Direct payments of any kind to individuals; and
- (4) Contracts which are required to be entered into and administered under procurement laws and regulations.”

“*Contract* means a procurement contract under an award or subaward, and a procurement subcontract under a recipient's or subrecipient's contract.”

“*Federal award* means Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities.”<sup>19</sup>

“*Recipient* means an organization receiving financial assistance directly from ED to carry out a project or program. The term includes public and private institutions of higher education, public and private hospitals, and other quasi-public and private non-profit organizations such as, but not limited to, community action agencies, research institutes, educational associations, and health centers. The term may include commercial organizations, foreign or international organizations (such as agencies of the United Nations) which are recipients, subrecipients, or contractors or subcontractors of recipients or at the discretion of the Secretary . . . .”

“*Subaward* means an award of financial assistance in the form of money, or property in lieu of money, made under an award by a recipient to an eligible subrecipient or by a subrecipient to a lower tier subrecipient. The term includes financial assistance when provided by any legal agreement, even if the agreement is called a contract, but does not include procurement of goods and services nor does it include any form of assistance which is excluded from the definition of ‘award’ as defined in this section.”

“*Subrecipient* means the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided. The term may include foreign or international organizations (such as agencies of the United Nations) at the discretion of the Secretary.”

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<sup>18</sup> 34 C.F.R. § 74.2, Definitions, unless otherwise noted.

<sup>19</sup> Definition from OMB Circular A-133, Subpart A, § 105.

## Enclosure 2: Unallowable/Inadequately Documented Costs

February 1, 2003–September 1, 2006

Description of Cost Questioned	Unallowable Costs	Inadequately Documented Costs	Total Amount	OMB Circulars A-122 and A-133 (A-133 noted in cells)	Potentially Duplicated in Finding 1
Salaries		\$3,814,176	\$3,814,176	B-8.m (1), (2)	\$351,454
Fringe Benefits		\$703,337	\$703,337	B-8.m (1), (2)	\$51,826
Contractual services benefiting multiple grants or costs not allowed <sup>20</sup>	\$40,235		\$40,235	A-A(4.a); B-17; B-25(a & b); B-1.d (1), (2), & (3)	
Board Chairman's travel to another entity's Board Meeting	\$430		\$430	A-A(2.a-g)	\$224
Travel of Board Chairman		\$5,065	\$5,065	A-A(2.g)	
Shoecraft Legal Fees charged to the grant twice	\$19,393		\$19,393	B-10	\$12,448
Trademark Legal Fees for trademark that did not benefit the grant	\$7,689		\$7,689	A-A(4.a)	
Flowers to PG staff and individuals that were not equitably apportioned to all activities	\$331		\$331	A-A(4.a); B-13	\$201
<i>Subtotal PG USA Costs</i>	<i>\$68,077</i>	<i>\$4,522,578</i>	<i>\$4,590,655</i>		<i>\$416,152</i>
PG Houston Salaries and Fringe Benefits		\$11,550,266	\$11,550,266	B-8.m (1), (2)	\$3,474,534
Houston Chronicle delivered to PG households	\$1,338,091		\$1,338,091	A-A(4.a);	\$1,057,691
Costs of PG Houston's Single Audits.	\$46,573		\$46,573	A-133: 4. Policy; A-.105; B-.200(a):.225 & .230(a)	\$20,000
PG Houston costs charged to wrong grant	\$7,146		\$7,146	A-A(4.a); A-A(4.b)	
PG Atlanta costs charged to wrong grant	\$25,000		\$25,000	A-A(4.a); A-A(4.b)	
<i>Subtotal Site's Costs</i>	<i>\$1,416,811</i>	<i>\$11,550,266</i>	<i>\$12,967,076</i>		<i>\$4,552,225</i>
<b>Total Finding 2</b>	<b>\$1,484,888</b>	<b>\$16,072,844</b>	<b>\$17,557,732</b>		<b>\$4,968,337</b>

<sup>20</sup> Includes lobbying and public relations costs.

### **Enclosure 3: Selected Portions of OMB Circulars A-122 and A-133**

OMB Circular A-122; Attachments:

A-A(2) – “Factors affecting allowability of costs. To be allowable under an award, costs must meet the following general criteria: a. Be reasonable for the performance of the award and be allocable thereto under these principles. b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items. c. Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the organization. d. Be accorded consistent treatment. e. Be determined in accordance with generally accepted accounting principles (GAAP). f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally-financed program in either the current or a prior period. g. Be adequately documented.”

A-A(4.a) – “A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it: (1) Is incurred specifically for the award; (2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received; or (3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.”

A-A(4.b) – “Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the ‘award’.”

B-1.d (1), (2) & (3) – Defines the only allowable public relations costs as “(1) Costs specifically required by the Federal award; (2) Costs of communicating with the public . . . considered necessary as part of the Federal award; or (3) Costs of conducting general liaison with news media and government public relations officers . . . to keep the public informed.”

B-8.m (1), (2) & (3) – “(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency. (See subparagraph E.2 of Attachment A.) (2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards: (a) The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards. (b) Each report must account for the total activity for which



employees are compensated and which is required in fulfillment of their obligations to the organization. (c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports. (d) The reports must be prepared at least monthly and must coincide with one or more pay periods. (3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2), must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (FLSA) (29 CFR Part 516). For this purpose, the term ‘nonprofessional employee’ shall have the same meaning as ‘nonexempt employee,’ under FLSA.”

B-10 – States that certain legal costs may be allowed but only to the extent that the costs are reasonable in relation to the activities required and the costs are not otherwise recovered from the Federal Government or a third party, either directly or otherwise.

B-13 – Morale costs are allowed as long as they are equitably apportioned to all activities of the non-profit organization.

B-17 – The grantee is not allowed to charge to the grant expenses related to costs of organized fund raising.

B-25.a&b – Unallowed charges included expenses related to lobbying activities, including any attempt to influence or modify legislation.

OMB Circular A-133:

4. Policy – “Federal agencies shall apply the provisions of the sections of this Circular to non-Federal entities, whether they are recipients expending Federal awards received directly from Federal awarding agencies, or are subrecipients expending Federal awards received from a pass-through entity (a recipient or another subrecipient).”

Subpart A-105 – “Federal award means Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities. It does not include procurement contracts, under grants or contracts, used to buy goods or services from vendors . . . .”

Subpart B-200(a) – “Non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part.”

Subpart B-230(a) – “Unless prohibited by law, the costs of audits made in accordance with the provisions of this part are allowable charges to Federal awards . . . .”

## **Enclosure 4: PG USA's Comments**



September 25, 2007

The Honorable John P. Higgins, Jr.  
Inspector General  
United States Department of Education  
Office of Inspector General 400  
Maryland Avenue, SW  
Washington, DC 20202-1500

Re: Draft Audit Report, Control No. ED-OIG/A06H0002; Review of Project GRAD USA's  
Accountability of Fund for the Improvement of Education Grant

Dear Mr. Higgins:

Project GRAD USA (hereinafter "GRAD") is in receipt of Draft Audit Report No. ED-OIG/A06H0002 ("Draft Audit Report") issued by the Dallas Audit Region of the Office of Inspector General ("OIG") of the Department of Education. In this audit, the OIG reviewed the funds expended by GRAD under the Fund for Improvement of Education Grant awarded by the Department in fiscal year 2005. For your information and convenience, we have attached a copy of the Draft Audit Report as Attachment C to this letter.

GRAD profoundly disagrees with the findings and recommendations of the Draft Audit Report, and we are concerned that the OIG auditors failed to adhere to generally accepted government auditing standards in performing this audit. Accordingly, we request that your office review the Draft Audit Report and our attached response thereto. We believe that you will agree that the Draft Audit Report needs to be withdrawn, the findings of the report need to be revised, and a new draft audit report that complies with generally accepted government auditing standards must be issued.

A summary of our response to each of the audit findings is attached as Attachment A. Our detailed comments in response to each of the findings of the Draft Audit Report are set forth in Attachment B. For your general information, we have also included as Attachment D two reports that provide a general description of the work performed by GRAD. Also, for the

John P. Higgins, Jr.  
September 25, 2007  
Page 2

convenience of you and your staff, we have included an extra copy of this letter and its attachments.

Please direct any questions to our attorney, Kevin Vincent of the law firm of Baker Botts L.L.P. He can be reached at 202.639.7719 or kevin.vincent@bakerbotts.com. We look forward to hearing from you.

Sincerely,

Robert Rivera President  
and CEO Project GRAD  
USA

attachments

cc: O. Kevin Vincent, Baker Botts L.L.P.  
    Sherri L. Demmel, Regional Inspector General for Audit

Attachment A  
**Summary of Comments on Draft Audit Report No. ED-OIG/A06H0002**

The Draft Audit Report is replete with errors and omissions so significant that the only viable option is for the Inspector General to order that the Draft Audit Report be replaced with a new report that complies with generally accepted government auditing standards. To do anything else would violate the letter and spirit of the FIE Grant and applicable laws and regulations.

The express terms of the FIE Grant and Department of Education regulations provided for the reimbursement of GRAD's pre-award costs but the OIG auditors ignored the relevant grant provisions and regulations to conclude that GRAD's pre-award costs are not allowable. The regulations cited in the Draft Audit Report do not support the auditors' Finding No. 1 that the costs are unallowable. The OIG auditors are improperly attempting to change Department policy by challenging a grantee's incurred costs. The auditors' desired policy would have defeated, however, the very purpose of the FIE Grant -- providing "continued support" to Project GRAD schools and students.

In Finding No. 2, the OIG auditors have raised every conceivable challenge, no matter how strained, to the costs incurred by GRAD. The explanations provided in the Draft Audit Report for questioning each item of cost are either incorrect on their face, or in many instances, nonexistent. The overall goal of the audit, therefore, appears to be to maximize the total dollars the auditors could challenge as unallowable or unsupported, rather than to conduct an examination of GRAD's incurred costs in accordance with generally accepted government auditing standards. Even though the auditors question more than \$25 million of GRAD's incurred costs, GRAD can identify only \$206 in unallowable costs.

Although, as with all grantees, GRAD can make changes that will improve its practices, Finding No. 3 -- that GRAD's administration of contracts was inadequate -- is mistaken. GRAD's contract administration procedures are extensive and more than adequate. Contrary to the OIG auditors' conclusion that GRAD failed to obtain competition before awarding contracts to the sites, GRAD used its New Site Development process to competitively select new sites.

In Finding No. 4, the auditors ignored the many types of ongoing review processes employed by GRAD, misleadingly choosing to focus upon the LSV process. Moreover they erroneously failed to recognize that all but two of the Project GRAD sites have undergone the LSV process. GRAD monitored all sites for programmatic results on a continuous basis. GRAD's monitoring procedures and activities were discussed with the auditors, and the documentation for the monitoring processes was made available to the auditors, but they did not understand, or ignored, the significance of GRAD's processes. The auditors' errors and omissions result in their erroneous conclusion that GRAD did not adequately monitor the performance of the sites and illustrate that the auditors failed to comply with generally accepted government auditing standards in conducting their audit.

In the final Finding of the Draft Audit Report, the OIG auditors incorrectly assert that GRAD was required to meet its AYP goal in the first two grant periods. The auditors focus on the shortcoming on the AYP goal without any consideration of the other factors that prove the success of Project GRAD.

Attachment B

**Detailed Response to Audit Findings**

***Response to Finding No. 1 -- PG USA Used Current Period Funds for Costs from Prior Grant Periods -- The Department of Education Expressly Authorized GRAD's Use of Grant Funds for Costs Incurred in the Pre-award Period***

The express terms of the Fund for Improvement of Education ("FIE") Grant, the legislation appropriating funds for the FIE Grant, the applicable regulations issued by the Department of Education, the grant application and proposed budgets submitted by GRAD, and written communications from the grant officer to GRAD, all provided for the reimbursement of costs incurred by GRAD prior to the effective date of the grant award. The limitation that the OIG auditors seek to impose on the pre-award costs incurred by GRAD have no basis in statute, regulation or the terms of the FIE Grant.

Instead Finding No. 1 appears to be a product of the OIG auditors' disagreement with the Department's policy of reimbursing pre-award costs incurred by grantees. Whether or not the OIG's opposition to the Department's policy of reimbursing pre-award costs has any merit, that opposition is not a valid basis for retroactively denying pre-award costs incurred in good faith by GRAD in reliance on the Department's written assurances that the costs would be reimbursed. It would be unfair and improper to penalize GRAD simply because the OIG disagrees with the Department's policy.

The express terms of the FIE Grant and regulations made GRAD's pre-award costs allowable.

Each of three grants examined by the OIG auditors included the following language in Attachment E to the Grant:

PREAGREEMENT (PREAWARD) COSTS

The costs identified below that have been incurred by the grantee in anticipation of receiving this grant are allowable only if the costs are specifically included in the approved activities and budget and were incurred from January 15, 2005 to April 20, 2005.

All approved project costs for the period identified above.

Specific approved items listed below (omit cost per item)

See Exhibit [B-1] (Attachment E of Grant No. U215K050030 for the 2005-2006 grant period).<sup>2</sup>  
In none of the grants examined by the auditors did the Department check the line to indicate that

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<sup>1</sup>As explained further in response to Finding No. 2, the inclusion of audit findings regarding the grants for the 2003-2004 and 2004-2005 grant periods violated generally accepted government auditing standards because the auditors notified GRAD that they were examining only the 2005-2006 grant period and never informed Project GRAD that they had expanded the scope of the audit to include the two prior years until the release of the Draft Audit Report.

only specific items were allowable, nor did the Department list any specific allowable costs during the pre-award periods. Rather, and as shown above, in each grant the Department expressly stated that all approved project costs were allowable during the pre-award period.

The approval of pre-award costs in Attachment E of the grants is entirely consistent with Department regulations. Education Department General Administrative Regulation ("EDGAR") Sections 75.263 and 74.25(e)(1) expressly authorize grantees to "[i]ncur pre-award costs 90 calendar days prior to award or more than 90 calendar days with the prior approval of the" Department. 34 CFR § 74.25(e)(1); *see* 34 CFR § 75.263.<sup>3</sup> The Department's Grants Policy Bulletin #19 entitled "Part 75 Amendments (Expanded Authorities) -- Updated" explains in its section on Preaward Costs that EDGAR 74.25(e)(1) expanded a prior waiver issued by the Department to permit all grantees to recover "expenditures for allowable items and activities of a project up to 90 days before the beginning of **either a new award or a noncompeting continuation award** without prior ED approval." Exhibit [B-2] (GPOS Bulletin # 19 issued Mar. 22, 1999) at p. 5 of 15 (emphasis in original).

All of the pre-award costs incurred by GRAD satisfied the criteria imposed by Attachment E of the FIE Grant and EDGAR Sections 75.263 and 74.25(e)(1). GRAD did not seek or obtain reimbursement for any costs incurred prior to the beginning of the pre-award period specified in Attachment E, and the auditors made no finding that costs prior to the pre-award period had been paid. The pre-award costs paid to GRAD were specifically included in the activities and budget for the FIE Grant that were approved by the Department. The auditors did not identify in Finding 1 any pre-award costs paid to GRAD for purportedly unallowable items. Instead, in Finding 1 the OIG auditors have questioned and recommend reversal of the Department's policy decision reflected in Attachment E of the FIE Grant and EDGAR Sections 75.263 and 74.25(e)(1) to allow grantees to recover pre-award costs incurred prior to the award period stated in the grant.

The OIG auditors violated generally accepted government auditing standards by ignoring the relevant grant provisions and regulations.

Interestingly, the OIG auditors do not cite in the Draft Audit Report the express provisions of the FIE Grant or the regulations most relevant to Finding 1. Attachment E is not mentioned in the Draft Audit Report. Nor does the Draft Audit Report mention either EDGAR Sections 75.263

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<sup>2</sup> The language of Attachment E in the two prior grants is identical except that the 2003-2004 grant specified a period of February 1, 2003 to June 20, 2003, and the 2004-2005 grant specified a pre-award period of January 1, 2004 to May 31, 2004. The Draft Audit Report erroneously states on page 3 of 23 that the pre-award period for the 2004-2005 grant ended on May 9, 2004.

<sup>3</sup> The bulk of the pre-award costs paid to GRAD were incurred within 90 days prior to the award date of the grants, and thus would have been allowable under the regulations even without the written approval of the Department provided in Attachment E to the Grant. Although the Draft Audit Report questions the "Department approval for pre-award costs, for more than 90 days before the beginning of the new grant period," the Draft Audit Report recommends that GRAD pay back essentially all of the costs incurred during the 90-day period prior to the award date, and not just the costs incurred more than 90 days prior to the award date. Purportedly "[t]o be conservative," the auditors are willing to allow GRAD to retain some, but not all, of the costs incurred during a nineteen-day window prior to the award date of the 2005-2006 Grant. Draft Audit Report at p. 5 n.7.

and 74.25(e)(1) or Grants Policy Bulletin #19.<sup>4</sup> The Draft Audit Report fails to mention that the express provisions of the grant and Department regulations allowed GRAD to recover these pre-award costs. Instead, the Draft Audit Report simply acknowledges that "PG USA requested and received Department approval for pre-award costs," see Draft Audit Report at page 5, without referencing how the Department conveyed its approval to GRAD. The inference from the Draft Audit Report is that the Department's approval of pre-award costs may have been obtained by GRAD in some sort of "side letter" or even orally, instead of in the very terms of the FIE Grant as well as the regulations that authorize the grant<sup>5</sup>

The Draft Audit Report's omission of any reference to the most relevant grant provisions and regulations calls into question the auditors' compliance with generally accepted government auditing standards ("GAGAS"). The Inspector General Act of 1978 requires OIG auditors to comply with the GAGAS issued by the Comptroller General when conducting audits. 5 U.S.C. App. § 4(b)(1)(A). The Comptroller General's publication Government Auditing Standards (commonly, and hereinafter, referred to as the "Yellow Book") sets forth the generally accepted government auditing standards that should be followed by OIG auditors.

Even viewing the Draft Audit Report in the light most favorable to the OIG, the omission of any reference to the most relevant regulations and grant provisions in Finding No. 1 would lead to the conclusion that the OIG auditors failed to meet the generally accepted government auditing standards that they use competence and professional judgment in performing their audit work. Yellow Book §§ 3.31 & 3.43. Auditors with "a general knowledge of the environment in which the audited entity operates and the subject matter under review" would not have overlooked Attachment E to the FIE Grant. *Id.* § 3.43.b. Similarly, had the OIG auditors been "exercising reasonable care . . . in accordance with applicable professional standards as required by the standard of professional judgment, *id.* § 3.32, they could not have omitted any citation to EDGAR Sections 75.263 and 74.25(e)(1) or Grants Policy Bulletin #19 from their audit report. These omissions, coupled with the numerous other factual errors in the Draft Audit Report,<sup>6</sup> indicate that, at the very least, the OIG auditors failed to exhibit competence and professional judgment in performing their work.

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<sup>4</sup> Although it is not cited in the Draft Audit Report, the text of Grants Policy Bulletin #19 was incorporated in the FIE grant award package provided by the Department to Project GRAD. *See* Exhibit [B-3] (Department's letter to PG USA dated April 21, 2005 forwarding documents inadvertently omitted from the award package). The document entitled "Part 75 Amendments (Expanded Authorities)" is Grants Policy Bulletin #19, and the relevant provision on Preaward costs quoted above is on the final page of the document. The prior grant award packages also included provisions that explained the Department's policy of permitting grantees to recover pre-award costs.

<sup>5</sup> Although GRAD's entitlement to pre-award costs is established by the terms of the FIE Grant and the applicable Department regulations, GRAD also received numerous written assurances from Department officials that confirmed that GRAD could recover its pre-award costs. *See* Exhibit B-4] (Correspondence between GRAD and the Department dated April 20, 2004, February 24, 2004 (Department email stating "you will get your preaward costs approved"); April 16, 2003, May 22, 2002 (regarding Potential Meeting); May 22, 2002 (regarding questions on FIE award); May 8, 2002. GRAD relied upon these repeated assurances from the Department before incurring the pre-award costs. All of this correspondence was made available to the OIG auditors.

<sup>6</sup> See the errors identified in footnotes 2, 15, 16, 17, 19, 22, 23, 24, 25, 28, 30, 31, 33, 34, 35.



More troubling to GRAD is our perception that the OIG auditors failed to conduct their audit work in accordance with the principle of objectivity. Yellow Book § 2.04. Project GRAD believes that the omission from the Draft Audit Report of references to the regulations and grant provisions that expressly provided for the payment of pre-award costs, as well as the omission of numerous other facts that support Project GRAD's positions, were not the result of mere oversight on the part of the OIG auditors. Project GRAD instead believes that the auditors intentionally omitted relevant information from the Draft Audit Report that detracted from their purported Findings questioning the costs incurred by GRAD. Indeed, the OIG auditors acknowledged to GRAD during the audit that the auditors would only be writing up in their audit report findings that questioned costs incurred by GRAD, and not any conclusions by the auditors that GRAD had properly incurred costs. GRAD anticipated that the Draft Audit Report would include only negative findings, but is dismayed that the Draft Audit Report does not even discuss the factual information presented to the auditors that contradicts their negative findings:

The principle of objectivity required the auditors to "maintain[] an attitude of impartiality" in conducting their audit and to use "intellectual honesty" in writing the audit report. *Id.* § 2.10. The Draft Audit Report was supposed to be written "in an unbiased manner and in the proper context. This means presenting the audit results impartially and fairly." *Id.* § A.8.02.b. The auditors were required to "conduct[] their work with an attitude that is objective [and] fact-based .. with regard to audited entities." *Id.* § 2.08. By omitting any reference to the most relevant regulations and grant provisions for Finding No. 1, the OIG auditors failed to present a "complete" report of their findings in accordance with GAGAS. The Yellow Book explains that "[b]eing complete means that the report contains sufficient, appropriate evidence needed to satisfy the audit objectives and promote an understanding of the matters reported. It also means the report states evidence and findings **without omission of significant relevant information related to the audit objectives.**" *Id.* § A8.02.c (emphasis added). The OIG auditors failed to meet these standards.

The regulations cited in the Draft Audit Report do not support the audit finding.

Although the OIG auditors failed to reference the most relevant grant provisions and regulations, they did choose to cite several regulations to support their purported finding that the pre-award costs paid to GRAD are unallowable. An examination of the regulations cited by the auditors shows, however, that Project GRAD was fully compliant with the referenced regulations and that the regulations do not provide any basis for finding GRAD's costs unallowable. Instead of citing the directly relevant EDGAR regulations on pre-award costs, 34 CFR §§ 75.263 & 74.25(e)(1), the auditors cited several EDGAR provisions of only general relevance. *See* Draft Audit Report at p. 3 n.2 citing 34 C.F.R. §§ 74.5, 75.701, 75.702, 75.703, and 75.707. The Draft Audit Report fails to explain how these provisions have any bearing on the audit finding and in any event GRAD was in substantial compliance with these regulations.

The Draft Audit Report also asserts that GRAD violated OMB Circulars A-110 and A-122. The excerpts from the OMB Circulars paraphrased in the Draft Audit Report show, however, that Project GRAD complied with these regulations. As permitted by OMB Circular A-110, Appendix A, Subpart C(28), GRAD charged to the FIE Grant the "pre-award costs authorized by the Federal awarding agency." *See* Draft Audit Report at p. 4. Likewise, the costs incurred by

Project GRAD were allowable under the Pre-agreement costs principle of OMB Circular A-122, Appendix B.36 because GRAD received "the written approval of the awarding agency" for the costs. *Id.*

Even though the OIG auditors did not choose to cite the relevant provision of the Department's Grant Policy Bulletin #19 on Pre-award Costs, they managed to find, and rely heavily in the Draft Audit Report on, an earlier bulletin issued by the Department. *See* Draft Audit Report at p. 4 discussing Grants Policy Bulletin #6, issued Dec. 14, 1998. The gist of Finding No. 1 in the Draft Audit Report is that pursuant to Grants Policy Bulletin #6, pre-award costs are allowable only if they can be "considered site startup costs." *See* Draft Audit Report at 6. That is not what Grants Policy Bulletin #6 states. Even if it did, Grants Policy Bulletin #6 was superseded by the subsequent guidance in Grants Policy Bulletin #19 and cannot negate the policy allowing the recovery of pre-award costs stated in EDGAR Sections 75.263 and 74.25(e)(1).

The OIG auditors essentially read the term "pre-award costs" to mean only "startup costs." The only support they provide for their interpretation limiting the term "pre-award costs" to startup costs are the three examples of costs that are listed on page 4 of the Draft Audit Report. Even the discussion in the Draft Audit Report makes it clear, however, that the three listed items from Grants Policy Bulletin #6 are only "examples" of allowable pre-award costs and not an exhaustive list of the types of costs that are allowable. *See* Draft Audit Report at p. 4 ("The Department's Grants Policy Bulletin #6 . . . provides examples of legitimate . . . preagreement (pre-award) costs, including --"). The actual definition of pre-agreement costs in Cost Principle 36 of OMB Circular A-122 makes no mention of startup costs. OMB Circular A-122, Appendix B, § 36. Cost Principle 36 in OMB Circular A-122 is derived from the Federal Acquisition Regulation ("FAR") cost principle on precontract costs, which has identical language. *Compare* 48 C.F.R. 31.205-32 with OMB Circular A-122, Appendix B, § 36. The federal boards of contract appeals routinely apply the FAR 31.205-32 cost principle on precontract costs, and none of these cases equate the term with "startup" costs. *See, e.g., In re MIG Corp.*, 05-1 BCA ¶ 32979, ASBCA No. 54451, 2005 WL 1271522 (A.S.B.C.A., May 25, 2005) (where a board of contract appeals found that certain "startup" costs incurred by a contractor did not qualify as "precontract costs" under FAR 31.205-32 but that standby equipment costs could be allowable as precontract costs).

The OIG auditors' reliance on Grants Policy Bulletin #6 instead of the directly relevant and more recent Grants Policy Bulletin #19 may reflect their recognition that the more recent bulletin directly contradicts their rationale for Finding No. 1.<sup>8</sup> Grants Policy Bulletin #19 emphasizes that pre-award costs are recoverable under "either a new award **or** a noncompeting **continuation**

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GRAD was never provided a copy of Grants Policy Bulletin #6 by the Department or by the OIG. We have contacted the Department to request a copy of the bulletin and have been told it is not available to the public. To the extent that anything in Grants Policy Bulletin #6 supports the audit findings, as a non-public document it is not a regulation that is binding upon grantees. Accordingly, whether or not Grants Policy Bulletin #6 states policy that remains in effect within the Department, it cannot be used as a basis for demanding a refund from GRAD as recommended in the Draft Audit Report. In any event, as explained above, the provisions of Grants Policy Bulletin #6 quoted in the Draft Audit Report do not in fact support Finding No. 1.

<sup>8</sup> As explained above, if the OIG auditors deliberately chose to ignore Grants Policy Bulletin #19 as we suspect, then the OIG auditors violated the generally accepted government auditing standard that requires objectivity.

**award.**<sup>9</sup> Obviously, a grantee with a continuation award will not have startup costs, so the guidance in Grants Policy Bulletin #19 would be incorrect if the OIG's interpretation were correct that only startup costs are recoverable as pre-award costs.

The OIG may not change Department policy by challenging a grantee's incurred costs.

We believe that the OIG auditors' decision to ignore Grants Policy Bulletin #19, as well as EDGAR Sections 75.263 and 74.25(e)(1), reflects the OIG's stated position that the Department's policy decision to give expanded authorities to grantees, including the authority to recover pre-award costs without prior approval, was ill-advised. Grants Policy Bulletin #19 updated and reiterated the Department's policy of allowing grantees these Expanded Authorities. *See* Exhibit [B-2]. The OIG subsequently conducted an audit of the Department's administration of grants using these Expanded Authorities. *See* Exhibit [B-5] (Final Audit Report EDOIG/A07-B0016 dated 2002 entitled "The Department's Management Controls Over Discretionary Grants Need To Be Strengthened To Ensure Grant Accountability"). The first bullet in the Audit Results section of this 2002 audit report concluded that "[t]he Department's oversight of grantees was not sufficient to balance their discretionary authority under 34 C.F.R. §§ 74.25 [and] 75.263." *Id.*<sup>10</sup> Notwithstanding the criticism of the policy in the OIG's 2002 audit report, however, the Department ° has not chosen to revise its policy on Expanded Authorities including pre-award costs; the OIG and the rest of the Department apparently remain in disagreement regarding the wisdom of this policy.

It appears that, because the OIG disagrees with the policies stated in Grants Policy Bulletin #19 and EDGAR Sections 75.263 and 74.25(e)(1), the OIG auditors chose to ignore these policies and regulations when they conducted their audit. That violated the auditors' duty to follow the principles of objectivity and impartiality mandated by generally accepted government auditing standards. *See* Yellow Book §§ 2.04, 2.08, 2.10, A.8.02.b, A.8.02.c.

The OIG is, of course, entitled to disagree with Department policy. In fact, the Inspector General has the authority under the Inspector General Act "to recommend" changes in the Department's policies. *See* 5 U.S.C. App. § 4(a)(3). If the OIG continues to believe that the Department's policy on pre-award costs is ill-advised, it can certainly issue a new audit report to the Department that recommends changes to that policy going forward. But the OIG lacks the authority to disregard duly promulgated regulations and Department policy in conducting its audits. It also certainly lacks any authority to recommend that a grantee repay costs that were properly paid to the grantee in accordance with such regulations and policies.

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<sup>9</sup> The Draft Audit Report correctly states that the Department "awarded PG USA five FIE grants as mandated by Congress in Appropriations Bills for fiscal years 2001 through 2005." Draft Audit Report at p. 2. All three FIE grants reviewed by the OIG auditors can therefore be considered "a noncompeting continuation award."

<sup>10</sup> The 2002 OIG Audit Report specifically noted in its Background section that the Department's "Expanded Authorities" regulations, including 34 C.F.R. §§ 74.25 and 75.263 "allowed grantees to . . . [o]bligate funds up to 90 days before the effective of a budget period without prior approval." The fact that these provisions have been the subject of scrutiny and criticism by the OIG in the past supports the conclusion that the OIG auditors did not simply overlook these provisions in conducting the present audit.

Stated differently, if the OIG wants to change Department policy, it can do so by recommending changes to the Secretary of Education. It is improper, however, for the OIG to try to change Department policy by seeking to punish grantees who in good faith rely upon the policy.

The OIG auditors' desired policy would have defeated the purpose of the FIE Grant.

The OIG auditors cite one relevant regulation in Finding No. 1 in their apparent effort to change the Department's policy on pre-award costs. OMB Circular A-122, Appendix B(36) does state that pre-award costs are allowable "where such costs are necessary to comply with the proposed delivery schedule or period of performance." The OIG auditors failed to recognize how their strained interpretation of the meaning of pre-award costs, however, would have precluded Project GRAD from meeting the agreed delivery schedule and period of performance of the FIE Grant.

The legislative appropriation for the FIE program in Fiscal Year 2005 required the Department to award a grant to "Project GRAD-USA Inc., Houston, TX, for continued support and expansion of the program focusing on school reform." H. Rep. 108-792; Pub. 1. No. 108-447.<sup>11</sup> The critical language here is "continued support," which appropriately characterizes the work that GRAD performs. The OIG auditors essentially contend that GRAD should have interrupted the "continued support" mandated by Congress for the schools and schoolchildren served by Project GRAD, in order to adhere rigidly to an arbitrary award period created for the administrative convenience of the Department.

Project GRAD's mission is to provide continued support to schools and schoolchildren throughout the school year.

The legislative appropriation required the FIE Grant to fund "continued support" of Project GRAD. The legislative language itself recognizes the continuing nature of GRAD's work. GRAD's mission "is to ensure a quality public education for students in economically disadvantaged communities, so that high school graduation and college attendance rates dramatically increase." Exhibit B-6 (Annual Report) at p. 2. GRAD's approach is to partner with school districts in at-risk feeder patterns (elementary and middle schools feeding into a high school) to add value to their academic programs through added personnel, in some cases, as well as other resources; added training and coaching; and added monitoring and assessing. This means that when GRAD partners with a school district, it plans to support the on-going school program over a number of school years to impact graduation and college attendance rates.

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<sup>11</sup>The Fiscal Year 2003 and 2004 Appropriations laws had identical language. Nothing in this appropriations language imposed any limitations on the expenditure of the funds except that the funds had to be obligated before the end of the fiscal year. The FIE grant funds paid to Project GRAD were obligated at the time of the award of the grant during each respective fiscal year. Accordingly, the OIG auditors' accusation that the payment of pre-award costs "circumvented the appropriations limitations imposed by Congress and did not meet Federal fiscal regulations" is specious. Draft Audit Report at p. 6. The OIG auditors perhaps included this statement as a make weight "throwaway" line because they do not bother citing the alleged appropriations language or regulations that were "circumvented."

Indeed, the first goal set forth in its approved grant proposal for 2005-2006 -- as in previously approved grant proposals — bears out the need for Project GRAD to apply its added value support across one or more school years:

- Goal #1: Continued support of Project GRAD contractor sites, which includes
  - o technical assistance in program implementation—roll-out of programs during the school year;
  - o targeted professional development for site and district staff--as needed during the school year;
  - o setting, supporting, and monitoring of targets based on annual program implementation and student performance.

The other three goals stated in each grant likewise required GRAD to provide support throughout the school year and across multiple school years.

All of GRAD's goals and objectives require implementation, support, and measurement of a complex set of components within the context of the school year. For example, if a program of K-8 mathematics support is to be implemented, teaching plans for a school year must be developed; coaches must be hired—usually from teacher ranks; teachers and coaches must have initial training before beginning to teach; and on-going coaching, monitoring, and imbedded professional development must occur to ensure an impact on state tests at the end of the school year. High-stakes standardized tests generally are administered late in the second semester of tested years. Meaningful measurement for these components requires multiple school years to accomplish. Thus, implementation of Project GRAD does not involve a finite multi-week or even multi-month program. Although much of Project GRAD works within the context of the school year, which typically begins in late August and ends in May or June, GRAD provides an ongoing program of support throughout the calendar year and from year to year.

GRAD applied the Grant funding for continued support.

When GRAD applied for FIE grant funding each year, it was not requesting funds for a discrete program to begin on the "award date" of the grant or even funding for the next school year. As stated in the legislation and as Goal # 1 in the grant applications, GRAD was requesting funding for continued support of its ongoing program. In effect, the delivery schedule mandated by the legislation and proposed by GRAD and accepted by the Department, required continued support of GRAD's ongoing program.

The OIG auditors place exclusive focus on the stated "award period" for each grant without recognizing the lack of correlation of the award period to the actual program funded by the legislative appropriation and the FIE Grant. The "award date" of each grant was an arbitrary date dictated by the date that Congress passed the Department of Education appropriation in each fiscal year and then the length of time it took the Department to process the grant application

after GRAD was notified of its award.<sup>12</sup> Both the Department and GRAD fully understood the arbitrary nature of the award period. Accordingly, GRAD submitted with its grant application proposed budgets that showed level expenditures during both the pre-award period and the stated award period of the grant, and the Department readily approved these budgets. GRAD and the Department also discussed in numerous oral and written communications prior to the "award" of each grant the start date of the pre-award period so that GRAD could prepare its budgets. The Department thus was fully aware that GRAD was using the FIE Grant to provide continued support to GRAD's program.<sup>13</sup>

The restrictions on the use of the grant funding advocated by the OIG auditors would have placed GRAD in an impossible dilemma when it received a grant award in the middle of school semester, as happened in April 2005. If the grant's objective is to support implementation of a component within the partner school, which involves staffing, April is too late for hiring for a school year that will end in May or June. It is also too late to have an impact on students' overall annual growth, because April is testing and/or spring break, and then followed by the natural winding down of the school year in May or June. That left GRAD with two choices:

- It could be guilty of stop-start implementation, losing whole semesters, which is disruptive to the partner school and unproductive in terms of adding value (the course advocated by the OIG auditors); or
- It could seek pre-award approval to enable partner schools to begin programs as the second semester begins or continue existing Project GRAD components into the second semester of the school year (the course that GRAD and the Department sensibly chose).

The stopping and starting of components would have proven to be not only impractical and disruptive, but also unproductive and, hence, a waste of resources. Because Project GRAD is designed to provide added value to the entire school year and to multiple school years, the only sensible choice for effective implementation and continued support of the Project GRAD program, as mandated by Congress and the FIE Grant, was to obtain permission to use funding in the pre-award period.

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<sup>12</sup> "Award date" is actually somewhat of a misnomer as that term is used in the FIE Grants. In one sense, Project GRAD was "awarded" the FIE Grant when Congress passed the Department of Education appropriations each year. Furthermore, the Department issued a letter each year notifying Project GRAD that it had been "identified as the recipient of a grant" in the appropriations act and informed Project Grant of the precise amount of the grant award. The notification for fiscal year 2005 was issued by the Department on January 25, 2005, see Exhibit [B-7], although the subsequent notice of award and "award date" did not occur until April 20, 2005. For these reasons, the April 20 date could be considered the "administrative start date" rather than the actual "award date" for the 2005-2006 FIE Grant.

<sup>13</sup> After receiving the written notification from the Department of the precise amount of the grant and confirming the start date of the pre-award period, GRAD incurred the pre-award costs questioned by the OIG auditors. Thus it would be unfair to require GRAD to pay back these costs after GRAD specifically relied upon the Department's assurances in incurring the costs.

***Response to Finding No. 2 -- PG USA Paid and Reimbursed Unallowable and Unsupported Expenditures -- With the Exception of One \$206 Charge, the Costs Reimbursed to GRAD Were Allowable Costs and Were Supported by the Records Made Available to the Auditors***

In Finding No. 2, the OIG auditors appear to have raised every conceivable challenge, no matter how strained, to the costs incurred by GRAD. The explanation provided by the OIG auditors in the Draft Audit Report for questioning each item of cost is either incorrect on its face, or in most instances, nonexistent. Moreover, the summary of questioned costs in Enclosure 2 is replete with errors. The overall goal of the audit, therefore, appears to have been to maximize the total dollars the OIG auditors could challenge as unallowable or unsupported, rather than to conduct an examination of GRAD's incurred costs in accordance with GAGAS.

The OIG auditors improperly expanded the scope of the audit to challenge costs from the 2003-2004 and 2004-2005 grant periods.

In accordance with generally accepted government auditing standards, at the beginning of this audit the OIG auditors notified GRAD in writing of the scope of the planned audit. *See* Yellow Book § 6.07.a ("Auditors should communicate the following additional information under GAGAS: a. the nature, timing, and extent of planned testing and reporting"). The written notification provided to GRAD clearly indicated that the scope of the audit was limited to the 2005-2006 FIE Grant. *See* Exhibit [B-8] (Oct. 12, 2006 OIG letter stating "We will need access to all records pertaining to the administration of the FIE grant at Project GRAD USA for the period of April 20, 2005 to September 1, 2006."); Yellow Book § 7.09 ("The scope defines the subject matter that the auditors will assess and report on, such as a particular program or aspect of a program, the necessary documents or records, **the period of time reviewed**, and the locations that will be included.") (emphasis added). The Yellow Book explains that under generally accepted government auditing standards, the "[s]cope is the boundary of the audit." Yellow Book § 7.09. The OIG auditors therefore violated GAGAS by questioning costs in the Draft Audit Report from the 2003-2004 and the 2004-2005 grant periods in addition to the 2005-2006 grant period, without notifying GRAD that OIG had expanded the scope of the audit.

At no point during the audit did the OIG auditors inform GRAD that they were expanding the scope of the audit to review the costs incurred in the prior grant periods. During the course of the audit, the OIG auditors did request from GRAD access to documents from prior years, and GRAD provided the auditors the requested documents in the spirit of cooperation and good faith. Because the costs incurred in prior years are often relevant in determining the allowability or reasonableness of the costs incurred in the period that is being audited, the auditors' request for additional documents did not alert GRAD that the OIG was expanding the scope of the audit. GRAD only learned that the OIG auditors had expanded the scope of the project to include the prior years at the conclusion of the audit when on July 31, 2007, three days before the exit conference for the audit, the OIG auditors provided to GRAD "For Discussion Purposes Only --Finding Point Sheets" questioning costs from the 2003-2004 and 2004-2005 grant periods as well as the 2005-2006 grant period.

Because the 2005-2006 grant totaled less than \$20 million, GRAD was shocked to learn at the conclusion of the audit that the OIG was questioning more than \$30 million in costs. Due to the short period of time that GRAD was given to prepare, the lack of good faith shown by the OIG

auditors in questioning costs from years that were outside the scope of the audit,<sup>14</sup> the patently erroneous conclusions that the OIG auditors used to recommend that GRAD pay back almost \$14 million in Finding No. 1, and the biased nature of the other findings, GRAI) saw no point in presenting a substantive response to the OIG auditors during the exit conference. Now that GRAD has had an opportunity to prepare a detailed rebuttal to the OIG auditors' erroneous conclusions, the OIG must rescind the Draft Audit Report. A new audit report should be issued only if it complies with generally accepted government accounting standards.

The fact that the OIG auditors produced an audit report that questions \$31,384,745 in incurred costs in the audit of a grant that totaled \$19,840,000 is indicative of the OIG auditors' objective for this audit report. *See* Draft Audit Report at p. 21 (Total Amount column, final entry).<sup>15</sup> The OIG auditors must recognize that if this audit report goes final, the headline of any article in the press will read "OIG Questions \$31 Million Paid to Project GRAD." Yet after reviewing the Draft Audit Report, Project GRAD can see a legitimate basis for the OIG to question only \$206 (not \$206 thousand just \$206) of Project GRAD's costs as unallowable, and only a few thousand dollars of GRAD's costs as unsupported. It is grossly irresponsible for the OIG auditors to inflate the total costs questioned in order to make the audit more attractive to the press or the public. The objective of this audit report appears to be to make GRAD seem unworthy of receiving any federal grant funding in the future, rather than reporting on whether GRAD "accounted for and used grant funds in accordance with relevant laws and regulations" as claimed in the Draft Audit Report. Such an objective is clearly inconsistent with generally accepted government auditing standards and leaves the Inspector General little choice but to rescind this Draft Audit Report

GRAD's rebuttal to each item identified as unallowable or unsupported in Enclosure 2 of the Draft Audit Report follows below.

#### Prior Period Costs (\$13,826,871)

This total is for the costs questioned in Finding No. 1 that are addressed above. As also explained above, the inclusion of these costs in Enclosure 2 of the Draft Audit Report results in a double-counting of the actual costs questioned by the OIG auditors.

#### Salaries (\$3,814,176)

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<sup>14</sup> The OIG auditors further exhibited their lack of good faith by threatening to question all \$60 million received by Project GRAD under the FIE Grants from 2003 through 2006 unless Project GRAD prepared a management representation letter demanded by the OIG auditors that is not required by any statute, regulation or provision of the FIE Grants. *See* Exhibit B-9 (email from Sherri L. Demmel dated August 22, 2007).

<sup>15</sup> Besides reflecting an improper expansion of the scope of the audit, the total of \$31,384,745 also is based on an impermissible "double-counting" of the costs questioned by the OIG auditors. As shown in the "Duplicated in Finding 1" column, of Enclosure 2, almost \$5 million of the costs questioned in Finding 2 were also questioned in Finding 1. Draft Audit Report at p. 21. The OIG auditors clearly understood that they were questioning costs totaling \$26,416,408 that had been paid to Project GRAD. Yet the OIG auditors simply added together the amounts questioned in Findings 1 and 2 to produce their bottom line Total Amount of \$31,384,745 in the Draft Audit Report. The only rationale that Project GRAD can see for the inclusion of that figure in the Draft Audit Report is that \$31,384,745 in questioned costs makes Project GRAD look worse than \$26,416,408.



The Draft Audit Report incorrectly asserts that Project GRAD USA's salaries and fringe benefit figures are unsupported. GRAD provided all Time & Effort ("T&E") Reports, ADP payroll ledgers, job descriptions, organizational charts and human resource documents for all GRAD staff, as requested by the OIG auditors. GRAD's accounting and payroll staff additionally spent several hours as requested by OIG auditors to explain in detail how hours charged to the FIE Grant were calculated and accounted for.

The OIG auditors contend that GRAD was required to use the percentage of effort reported on the T&E Reports to calculate payroll costs charged to the Grant rather than the approximations actually used by GRAD. Although the OIG auditors had access to all of GRAD's T&E Reports, the Draft Audit Report fails to cite even one example where the approximations used by GRAD resulted in an overstatement of the actual time spent by GRAD as reflected in the T&E Reports. GRAD's T&E Reports and other records adequately support the reasonableness of the billing methodology followed by GRAD. There is no need for GRAD to recalculate its billings.

#### Fringe Benefits (\$703,337)

The response regarding Salaries above applies here also.

#### Lobbying and Public Relations Costs (\$40,235)

Enclosure 2 of the Draft Audit Report lists as unallowable "Contractual services" of \$40,235. GRAD received no supporting documentation from the OIG to determine the makeup of this figure but the description indicates that this amount was for "lobbying and public relations costs." However, GRAD took great care to determine if contracted services were lobbying or public relations in nature and to the extent it was determined either were applicable, the expenses were not paid with federal funding. GRAD segregated all costs for lobbying and public relations and paid such costs utilizing other funding sources.

#### Chairman of the Board's unallowed travel to another entity's Board Meeting (\$430)

GRAD received no supporting documentation from the OIG auditors to determine the makeup of the \$430 figure included in Enclosure 2. However, GRAD did review its source documents and found expenses totaling \$205.85 for a TBEC Board meeting that was mistakenly charged to the FIE Grant.<sup>16</sup> GRAD will reimburse the Department for this erroneous charge of \$205.85.

#### Chairman of the Board travel (\$5,065)

The Draft Audit Report provides no explanation as to why the OIG challenged this amount as unsupported. GRAD has source documents for this travel and documentation to support expenses totaling \$5,065 reimbursed to the Chairman of the Board and charged to the FIE Grant. The documentation for part of these costs was provided to the OIG auditors during their audit, and GRAD located documentation for the remainder after the auditors' visit, but the auditors

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<sup>16</sup> The OIG auditors perhaps mistakenly recorded the amount for the travel to TBEC as \$430.

never followed up with GRAD to request additional information. If the auditors had asked any questions about the documentation for these costs, GRAD would have answered the auditors' questions.

Shoecraft Legal Fees (\$19,393)

Enclosure 2 cites cost principle 10 in OMB Circular A-122 as the basis for making unallowable the costs incurred by GRAD in the *Shoecraft* litigation. The cited cost principle makes unallowable costs incurred in the defense of "criminal, civil or administrative proceeding[s] .. . commenced by the Federal Government, or a State, local or foreign government." OMB Circular A-122, Appendix B, §10.b(1). It also applies to costs incurred "in connection with patent infringement litigation," *id.* at § 10.h, but does not apply to non-patent litigation between private parties.<sup>7.17</sup> No government was a party to the *Shoecraft* litigation, and the litigation did not involve claims of patent infringement, so cost principle 10 is wholly inapplicable to the costs incurred by GRAD in connection with the *Shoecraft* case.

The Shoecrafts had contended that they were employees of Project GRAD USA, during a period in which the FIE Grant was the primary cost objective of Project GRAD. Had the Shoecrafts prevailed on their arguments, additional costs resulting from the litigation would have been allocable to the FIE Grant. The costs incurred by GRAD in successfully defending against the Shoecrafts' claims therefore benefited the Government as well as Project GRAD. Accordingly, the attorneys' fees incurred in the *Shoecraft* litigation are expressly allowable as "professional services costs" pursuant to OMB Circular A-122, Appendix B, §37.

Trademark Legal Fees (\$7,689)

The OIG auditors also contend that "Trademark Legal Fees" totaling \$7,689 are unallowable. GRAD reasonably incurred legal fees to obtain advice regarding its trademarks, because trademarks are necessary to preserve the integrity of the GRAD "brands." If other organizations could use the name "Project GRAD" and other names trademarked by GRAD for inferior programs that do not adhere to GRAD's rigid standards, that would damage GRAD's reputation and make it difficult for GRAD to convince additional school systems to adopt the Project GRAD model. Since expansion is one of the stated objectives of the FIE Grant, trademark legal fees were therefore "incurred specifically for the award" in accordance with OMB Circular A-122, Appendix A, §A.4.a(1).<sup>18</sup> Thus, contrary to the findings of the OIG auditors, these costs were allowable and allocable to the FIE Grant pursuant to OMB Circular A-122, A-A.4.a.

Flowers to PG staff (\$472)

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The OIG auditors presumably made the mistake of assuming that cost principle 10 applied to all legal fees without actually reading the cost principle, and did not realize that cost principle 37 instead applied to these costs. GRAD would have expected that the OIG auditors had a better understanding of the cost principles applicable to Department grants.

<sup>18</sup> Alternatively, the trademark legal fees were allowable to the FIE Grant because they benefit the award as well as other work, *id.* §A.4.a(2) or because they were "necessary to the overall operation of the organization." *Id.* §A.4.a(3).

Although this amount is trivial, the OIG auditors are seeking to disallow a cost to reward employees "for meeting AYP," even though elsewhere in the Draft Audit Report the OIG auditors stress that one of the objectives of the FIE Grant was "meeting or exceeding" AYP, and the OIG auditors criticize Project GRAD for falling short of this objective. Draft Audit Report at p. 14. Regardless, the cost principle cited in the Draft Audit Report -- cost principle 13 -- is not applicable to the costs questioned here. The cited cost principle applies to "costs of employee information publications, health or first-aid clinics and/or infirmaries, recreational activities, employee counseling services," and similar costs, not to costs for purchasing flowers. OMB Circular A-122, Appendix B, §13.a.

PG Houston Payroll (\$11,550,266)

The Draft Audit Report states incorrectly that Project GRAD "Houston did not provide support for any payroll charged to the [FIE] grant." Draft Audit Report at p. 8. In fact, as acknowledged in footnote 10 of the Draft Audit Report, Project GRAD Houston did provide timesheets and personnel records to the OIG auditors for their review. Rather than discuss the support provided by Project GRAD Houston for its payroll costs, however, the OIG auditors chose to disregard the information provided by Project GRAD Houston.<sup>19</sup>

As a contractor providing services to Project GRAD USA, rather than a subgrantee, Project GRAD Houston was required to comply with only certain sections of OMB Circulars A-122 and A-133. See OMB Circular A-133, Appendix B, §210(a) ("The payments received for goods or services provided as vendor would not be considered Federal awards"). The contract between GRAD and Project GRAD Houston therefore required Project GRAD Houston to comply with only the portions of OMB Circular A-122 that were applicable to vendors. The OIG auditors interpret certain provisions of OMB Circular A-122 to require T&E reports for grantees and subgrantees, but whether or not that is the case, Project GRAD Houston as a contractor vendor was not required to maintain T&E reports for its own personnel.

Nevertheless, in an effort to demonstrate to the OIG auditors that the work performed by Project GRAD Houston personnel was properly allocable to the FIE Grant, Project GRAD Houston prepared T&E reports for all personnel charged to the grant, and these after-the-fact T&E reports were provided to the OIG auditors.<sup>20</sup> Project GRAD Houston's T&E reports provide a reasonable estimate of the actual work performed by each employee during the period of the grant. The OIG auditors, however, want to reject as inadequate the T&E reports provided by Project GRAD Houston because the timesheets do not break out "each funding source" for Project GRAD Houston. Draft Audit Report at p. 8 n.10. For this reason, the OIG auditors question as unsupported all of the payroll costs charged by Project GRAD Houston to the FIE Grant, even though Project GRAD Houston explained to the OIG auditors that approximately 95 percent of Project GRAD Houston employees worked exclusively on the FIE Grant objectives

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<sup>19</sup> Footnote 10 erroneously states that the timesheets were created after the fact, although the timesheets for Houston Independent School District ("HISD") employees were in fact contemporaneous documents. HISD was a subcontractor to Project GRAD Houston in performing services under the FIE Grant.

<sup>20</sup> Project GRAD Houston has recently implemented the Time Track II system for tracking its employees' time, and as a result, will be able to produce contemporaneous T&E reports for all future awards.

and the OIG auditors did not dispute the reasonableness of Project GRAD Houston's allocations for the small majority of its employees whose work benefited multiple cost objectives.

Project GRAD Houston has provided adequate support for the payroll costs charged to the FIE Grant, and Project GRAD USA does not believe further documentation is necessary to substantiate these costs.

#### Houston Chronicle Costs (\$1,338,091)

Project GRAD Houston has developed an innovative program in conjunction with the *Houston Chronicle* to promote family literacy and ultimately college access for participants in Project GRAD. From the inception of the program in 1999 to the present, the *Houston Chronicle* has provided a coherent college-focused literacy delivery system to the teachers, children and families served by Project GRAD.

Beyond providing news and entertainment that engage students and their families with the world around them, these subscriptions ensure that every child has access to reading materials at home. Project GRAD Houston teachers have the ability to use the newspaper in their lessons and homework assignments -- helping assure that students are reading outside of class.

- Building family literacy -- which encompasses working on the literacy of parents in concert with working on the literacy of their children is a proven tool for improving the general academic foundation of students in underserved populations, among them those from second-language learning populations.
- Newspapers, typically written at a level no higher than eighth grade and having as their subject matter immediate, practical information, are a good tool for building family literacy. They become an even better source when delivered directly to households every day.

As a reading supervisor stated: "Having the *Houston Chronicle* in their home ensures that every Project GRAD student will have the opportunity to read daily. I know that they'll be gaining valuable information that helps them with their assignments."

Newspaper readership is part of a comprehensive drive to improve reading, math skills and knowledge of current events. Because the GRAD families frequently have limited access to reading materials, providing a newspaper brings quality literacy experiences into their homes. In home visits, GRAD staff consistently report a dearth of available literature and reading material beyond the daily newspaper.

Under this program, the *Houston Chronicle* education staff makes available the following educational support services to Project GRAD teachers and families.

- Teacher training on use of the newspaper in the classroom
- Teacher training on use of the newspaper for homework assignments for GRAD students
- Presenting the Parent/TAAS Workshop in Parent University sessions
- Online Resources for teachers (previously hard copy curriculum guides)
- Training parents to use the newspapers to support literacy in their homes

A copy of some of the training materials provided by the *Houston Chronicle* education staff in connection with this innovative program is included as Exhibit B-10. The exhibit includes representative copies of advertisements encouraging Project GRAD families to participate in the program, activities for students and their families published in the paper, teacher guides, student guides, lesson calendars, online tools for teachers, and an index to the *Chronicle in Education* "Lesson of the Week."

A critical component of Project GRAD Houston's Success For All reading program is the Parent Reading Night called Raising Readers. This evening workshop helps parents and children work and play together to learn about reading. GRAD consultants and GRAD Parent and Community Engagement Coordinators use the home newspapers as a readily available resource for this program.

The *Houston Chronicle* consistently supports the college-bound focus of Project GRAD. From using GRAD success stories as the story topics for practice tests to sending letters into the homes of GRAD parents, the *Chronicle* has proven to be a steadfast partner in the quest for a more educated citizenry. A letter from Mr. Ed Vaughn (at that time a Manager at the *Chronicle*) to new GRAD parents in the Reagan feeder pattern on August 21, 2000 clearly articulates their belief that the newspaper enriches the lives of students and their families:

"Educators all agree that students who read from a variety of materials are better students. Families who read the newspaper and discuss it are enriched. News in the paper ranges from serious community issues such as transportation and clean air to fun subjects like sports and comics. The newspaper is the best way to become an informed citizen... allowing you to make up your own mind, be an informed voter, and participate in our democracy."

Because the *Chronicle* often reports on issues of interest to college-bound students and their families, the newspaper becomes one more voice in the chorus of GRAD voices focused on instilling a hope and a belief in the power of a college education for the children in the GRAD schools. The *Houston Chronicle* subscriptions are an integral component of the educational services delivered by Project GRAD Houston. The costs for these subscriptions are therefore clearly allowable under the FIE Grant.

#### PG Houston Single Audit Costs (\$46,573)

Project GRAD Houston can identify costs totaling \$26,573 from its outside auditor that were charged to the FIE Grant, but Project GRAD Houston is unable to identify the remaining \$20,000 questioned in Enclosure 2 of the Draft Audit Report. GRAD therefore needs additional information from the OIG to respond to this purported finding of the audit.

#### PG Houston Charges Intended for Another Grant (\$7,146)

Enclosure 2 questions as unallowable \$7,146 because "PG Houston charged money intended for one grant to the" FIE Grant. The OIG auditors did not explain to Project GRAD Houston or to Project GRAD USA when these costs were incurred, what grant year they were charged to the FIE Grant, or which other grant should have been allocated these costs. Project GRAD Houston

is unable to locate this charge of \$7,146. GRAD therefore needs additional information to respond.

PG Atlanta Charges (\$25,000)

Enclosure 2 questions as unallowable \$25,000 because "PG Atlanta charged money intended for one grant to the" FIE Grant. The OIG auditors did not explain to GRAD when these costs were incurred, what grant year they were charged to the FIE Grant, or which other grant should have been allocated these costs. GRAD is unclear as to the precise charges questioned by the OIG auditors and therefore needs additional information to respond.

***Response to Finding No. 3 -- PG USA Did Not Have Adequate Contract Administration --GRAD Performed Extensive Contract Administration Over All Project GRAD Sites, But Will Make Changes to its Contract Administration Procedures to Better Document its Full Compliance With Applicable Federal Regulations.***

Although, as with all grantees, GRAD can make changes that will improve its contract administration practices, GRAD's contract administration procedures are extensive and more than adequate.

GRAD used its New Site Development process to competitively select new sites

The Draft Audit Report erroneously states that "PG USA did not competitively solicit and award contracts to sites. No advertisement or formal solicitation was conducted to attract potential bidders or offerors to select sites and no competition existed at the sites to establish which local non-profit organization would operate the program." Draft Audit Report at p. 10.

In actuality, GRAD required prospective sites to follow a clearly established process that detailed all requirements that a site needed to fulfill in order to be eligible to become a Project GRAD site. GRAD follows a comprehensive New Site Development process that ensures "open and free competition" for potential contractor sites. The procurement model followed by GRAD to select among prospective contractor sites was developed in order to ensure "to the maximum extent practical, open and free competition" as required by the Department's regulations. 34 C.F.R. § 74.43. The Draft Audit Report implies that GRAD only worked with a handful of prospective sites and that no process existed for identifying sites best equipped to implement a quality program for the most advantageous use of funds. This assessment is not accurate. In fact, due to the large number of inquiries from interested communities and districts across the country, a critical part of the New Site Development process is to ensure that only contractor sites that meet the preconditions for success in operating the Project GRAD program were awarded contracts.

The process to become a Project GRAD site requires, at a minimum, one year of extensive buy-in from teachers, principals, school superintendents, school board members, and community and business leaders. In addition, GRAD requires extensive structural and programmatic elements that enable GRAD to succeed in a new community including the establishment of a locally-based 501(c)(3) organization that brings together school district, community, and business leaders in support of implementing Project GRAD. GRAD strongly believes that a traditional bidding process involving a request for proposals would not have provided the best vehicle to ensure "that the new sites selected represent the best program quality and the most advantageous use of grant funding" as the OIG auditors erroneously assumed. Draft Audit Report at p. 10.

The Project GRAD New Site Development Handbook provides a detailed, step-by-step process that each prospective site had to follow in order to become a part of the Project GRAD network and to be awarded funds. The Handbook is a compilation of strategies that ensure strong community and school support for Project GRAD in a new site. In addition, it provides detailed planning tools for ensuring that a strong infrastructure is established for the local 501(c)(3) organization. Although it is not mentioned in the Draft Audit Report, the New Site Development

Handbook was made available to the OIG auditors during the audit and a copy of the Handbook is attached to this submission as Exhibit B-11.<sup>21</sup>

To ensure a fair and open procurement process, the Handbook requires that each prospective Project GRAD site follow a four-stage process as GRAD considers whether or not to expand to that particular community:

- In the **Exploratory Phase**, GRAD's objectives are to provide the site with an understanding of Project GRAD; assemble a working group of key stakeholders, including administrators, district personnel, potential funders, and community leaders; and prepare a preliminary budget.

In the **Development Phase**, GRAD's activities include the following: expanding the level of agreement to proceed with Project GRAD implementation by focusing on building relationships with the identified feeder pattern and most critical supporters; establishing a local plan for Project GRAD implementation, including a three-year implementation budget; obtaining initial stakeholder agreement to implement Project GRAD; and assisting in the development of a local Project GRAD budget.

- In the **Approval Phase**, GRAD approves the local Project GRAD proposal and obtains final approval from stakeholders to proceed with local Project GRAD implementation. GRAD helps local stakeholders by providing consultation in establishing a local 501(c)(3) organization, providing support for hiring and training the executive director of the local Project GRAD site, coordinating development of a strategic plan for the rollout of components and provision of ongoing technical assistance and support, and documenting shared expectations in a memorandum of understanding between Project GRAD USA and the local Project GRAD site.
- Finally, in the **Start-up Phase**, GRAD coordinates and manages the rollout of components, provides ongoing training for the local executive director, attends local board meetings as appropriate, and monitors overall effectiveness of program implementation.

GRAD talked with hundreds of prospective sites and advertised the New Site Development process on [www.projectgrad.org](http://www.projectgrad.org), see Exhibit B-12, and at widely attended education reform venues across the country like GEAR UP (Gaining Early Awareness & Readiness for Undergraduate Programs) and NCAN (National College Access Network).<sup>22</sup> Over the past five years, GRAD worked with many communities including those in Mississippi, rural West Virginia, Alaska, rural New Hampshire, Iowa, the San Francisco Bay Area, as well as Philadelphia, Charleston, West Virginia, New Orleans, Dallas, San Antonio, Knoxville, Laredo, Boston, and the cities of Cincinnati, Akron, Lorain, Dayton, Springfield, Toledo, Youngstown and Cleveland in Ohio. Additionally, we have had numerous inquiries from across the country

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The omission of any mention of the Handbook is another example of how the OIG auditors violated generally accepted government auditing standards by failing to write a complete report. Yellow Book § A.8.02.C.

<sup>22</sup> The OIG auditors erroneously found that "[n]o advertisement ... was conducted" to select new sites. Draft Audit Report at p. 10.



including Arizona (Phoenix); California (East North Hollywood, Los Angeles and San Diego); Delaware; Florida (Orlando and Tampa); Idaho (Pocatello); Indiana (Indianapolis); Michigan (Benton Harbor and Detroit); Minnesota (Red Lake); Missouri (Kansas City); North Carolina (Monroe & Wilmington), New York, (Brooklyn, Harlem, & Upstate); Pennsylvania (Chester); Tennessee (Memphis); Washington DC; and Wisconsin (Milwaukee).

The seven sites that became Project GRAD contractors since the time of the initial grant followed GRAD's New Site Development process and competed among many prospective communities to meet the various requirements necessary. For each of the seven sites that were added, GRAD included the new site in the proposed budget that GRAD submitted to the Department with its FIE Grant application. GRAD also clearly explained the New Site process to the Department in each of the FIE Grant applications.

GRAD believes that the New Site Development strategy provided an open and competitive process and that by implementing this approach, GRAD ensured that the new sites selected represented the best program quality and the most advantageous use of grant funding.

Project GRAD USA will improve its procedures to better document compliance with procurement requirements in future awards.

Although GRAD's site selection and contract procedures are in substantial compliance with the requirements imposed by the Department's regulations, GRAD recognizes that its contract record keeping procedures can be improved. The files made available to the OIG auditors include procurement records that document the basis for the selection of the contractor for each site as well as for the licenses for the Consistency Management & Cooperative Discipline ("CMCD") and MOVE IT-Math components of Project GRAD, the basis for the contract price negotiated for each contract, the justification for the lack of competition for the licenses for the proprietary CMCD and MOVE IT-Math components, and an explanation of the competitive New Site Development process used for selecting new sites. Because these files are voluminous and do not specifically reference each requirement of the regulations, GRAD understands that it may have been difficult for the OIG auditors to confirm GRAD's compliance with the regulatory requirements.<sup>23</sup>

Specifically, GRAD will adhere to the following procedures for all future grant awards:

- GRAD will disburse grant funds only after an executed contract has been awarded.
- GRAD will continue to adhere to not-to-exceed limitations in contracts.<sup>24</sup> If the scope of a contract needs to be expanded, GRAD will negotiate an increased not-to-exceed limitation with the contractor.

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<sup>23</sup> The OIG auditors' conclusion that the Department "performed no monitoring of PG USA beyond the yearly reports to the Department," Draft Audit Report at p. 11, however, is simply untrue. Project GRAD made available to the OIG auditors documentation of the many actions taken by the Department in monitoring Project GRAD's performance of the FIE Grant.

<sup>24</sup> During the 2005-2006 grant period, there were no instances in which not-to-exceed limitations were exceeded.

- GRAD will maintain a procurement file for each contract above \$25,000 that shows compliance with the specific requirements of 34 C.F.R. § 74.46.
- GRAD will create and maintain in the procurement file a summary document describing the cost and pricing analysis performed for each contract that exceeds \$25,000.
- GRAD will create and maintain in the procurement file a document explaining the justification for lack of competition for each noncompetitive contract award.

***Response to Finding No. 4 -- PG USA Did Not Perform Adequate Monitoring of Sites -- The Draft Audit Report Omits Significant Relevant Information That Shows That GRAD Performed Adequate Monitoring of All Sites***

The OIG auditors' analysis in Finding No. 4 of the Draft Audit Report is completely flawed. The auditors entitles this section of the report "PG USA Did Not Perform Adequate Monitoring of Sites." They supports this title by asserting that "PG USA did not perform adequate monitoring for 10 of the 12 sites." The Draft Audit Report then claims that GRAD had only "three formal processes" for monitoring the sites: "(1) reviewing grant expenditures before money is released to the sites, (2) conducting Learning and Support Visits (LSV), and (3) reviewing a site's Single Audit report." Next the auditors state that GRAD "did not perform an LSV at six sites." Draft Audit Report at p. 12. All of these assertions by the OIG auditors are wrong.

The OIG auditors ignored the many types of ongoing review processes employed by GRAD on a continuous basis, misleadingly choosing to focus solely upon the LSV process. Moreover they erroneously failed to recognize that all but two of the Project GRAD sites have undergone the LSV process. As explained below, GRAD monitored all sites for programmatic results on a continuous basis during and before the grant period and continues that monitoring today. GRAD's monitoring procedures and activities were discussed with the auditors, and the documentation for the monitoring processes was made available to the OIG auditors, but they apparently did not understand, or chose to ignore, the significance of GRAD's processes. The OIG auditors' errors and omissions result in their erroneous conclusion that GRAD did not adequately monitor the performance of the sites and again illustrate that the auditors failed to comply with generally accepted government auditing standards in conducting their audit.<sup>25</sup>

GRAD provides regular programmatic monitoring and support to the Project GRAD sites.

The contractor site agreements set forth GRAD's broad goal for children to commit to fulfill their academic potential, graduate from high school, and plan for a college degree. Further, they list the specific services that contractor sites are expected to deliver:

- Securing and training a high quality consulting staff to monitor and support implementation;
- Providing professional development for teachers and key staff for program components;
- Developing processes with principals by which to monitor and review results, proactively solve problems, and build ownership for the Project GRAD model; and

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<sup>25</sup> The Draft Audit Report asserts at page 12 that "[b]etween its inception in 2001 and the beginning of the formal site visits in the fall of 2004, PG USA used verbal communication with the sites." While technically correct --GRAD certainly had verbal communications both orally and in writing with the sites at all times -- the OIG auditors presumably meant to say that GRAD had only oral communications with the sites without documented site visits from 2001 through 2004. If that is what the auditors meant, their conclusion is completely false as shown below.

- Providing adequate materials in a timely fashion to support teacher training and program implementation.

Based on these contracts with the sites, GRAD consistently and routinely monitors Project GRAD sites programmatically in a number of ways:

- First, GRAD follows a New Site Development Process, which generally lasts about two years following the announcement of a contractor site's initial implementation. Intense monitoring is a key to this process, attending to initial program implementation and staffing, constituency building, and initial fund development. *See* Exhibit B-13 (New Site Implementation Check List).
- Following that initial period of site development, GRAD staff members continue to make frequent visits to contractor sites to provide support and to monitor activity. These visits also include meetings with partner school district superintendents and attendance at school board meetings to check their perspective on results. GRAD personnel also attend contractor board meetings, where a Project GRAD USA staff member serves as an ex officio member of the board of each Project GRAD site. For example, one GRAD staff member has attended most of the board meetings at Ohio sites for the last two years, thus providing continuity of monitoring. *See* Exhibit B-14 (summary of travel during the 2005-2006 grant period). Conference calls also provide a significant and cost-effective method of monitoring sites. GRAD staff members, who offer expertise in component implementation, participate in regular calls with site coaches and site executive directors to troubleshoot issues and share best practices.
- Highly specialized programmatic training and monitoring visits are also built into the major programs of GRAD. During the grant period, a full program of professional development/coaching and "Walk and Talks" -- specialized monitoring visits -- is delivered in conjunction with the implementation of the GRAD Mathematics program at the sites. *See* Exhibit B-15. Walk and Talk reports are produced for each school at each site by GRAD staff after on-site, classroom-level monitoring. GRAD coaches, along with local site coaches, make observations at each school and rate the teachers' level of implementation. The follow-through piece is the set of recommendations for helping teachers to achieve the next highest level of implementation. These recommendations are the basis for the follow-up support provided by the GRAD coaches for each school following the Walk and Talk events. Similarly, all sites rolling out or maintaining CMCD participate in annual "Walk-Abouts" -- the specialized monitoring visits for CMCD. Both of these monitoring mechanisms yield reports. *See id.* (example of Walk and Talk reports). Additionally, sites implementing Campus Family Support received monitoring and support visits. *See* Exhibit B-16 (sample CFS monitoring reports).

Goals and specific targets are established for each Project GRAD site.

The Draft Audit Report erroneously asserts that "[b]efore the formal [LSV] review process, PG USA did not require the sites to define specific targets to meet the overall goals nor did it formally visit the sites to monitor their progress." Draft Audit Report at p. 12. The facts are

quite different and reveal that GRAD engages in an extensive process to set goals starting with the inception of each site.<sup>26</sup>

To specify and update its goals and to support contractor sites in setting targets customized to the local needs, GRAD embarked on the following process for implementing a target-based management system, holding sites responsible for performance: In October 2004, GRAD began discussions about formalizing updated national goals for 2005-2007. With input from the contractors, the goals were presented in January 2005, with direction for setting annual site-specific targets designed to meet national goals. The goals were the following:

- All schools will improve Adequate Yearly Progress (AYP) performance.
- All partner high schools will improve their graduation and college entrance results.
- Sites will develop and maintain positive constituencies by actively building stakeholder relationships.
- Sites will achieve financial sustainability by ensuring a diversity of funding, with a mix of national, district, and local sources.
- Sites will achieve and maintain site efficiency and effectiveness through judicious deployment of personnel and resources.

By June 2005, GRAD USA was working with sites to help them with updated target-setting and reporting procedures. Since that time, updates on progress toward meeting targets and provision of support for that activity have been integral aspects of GRAD's frequent communications with the contractor sites. All sites, whether they had had the last generation LSV or not, completed targets for 2005-2006; and all sites except Columbus completed end-of-year reports on them. This information was shared with the OIG auditors, but is not reflected in their report. Further, since this is an on-going process, by November 1, 2007, GRAD will have completed reports from all sites on their 2006-2007 targets.

GRAD initiates frequent discussions with executive directors of the sites to check on progress in meeting targets in all areas, collects data on outcomes of targets, and visits sites to monitor progress and to provide technical assistance. An example of how this works is the use of the Walk and Talk reports. Every site's targets related to mathematics are set to achieve a high level of implementation of the program at every grade level in order to ensure high mathematics achievement of all students, thus contributing to Adequate Yearly Progress. Not only are the Walk and Talk reports the basis for support, but also, they feed back into the adjustment of targets and the strategies for accomplishing them in the particular site.

All but two sites have received Learning and Support Visits (LSVs).

The OIG report erroneously states that "PG USA performed LSVs at only 6 of the 12 sites."<sup>27</sup> In fact, all Project GRAD sites except Houston and Long Island have at some point in their

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<sup>26</sup>The numerous visits that GRAD performs at the sites in addition to the LSVs are discussed above.

<sup>27</sup> The OIG auditors apparently did not realize that the six LSV reports they reference are simply the latest ??? of the LSV format and that prior LSVs were conducted using different format for the LSV reports.

implementation participated in an LSV. The LSV is a process that GRAD has been developing to provide an on-site, "360-degree" review of each contractor site. It was piloted in Los Angeles in January 2002, and revised through visits to Newark in October 2002, Cincinnati in November of 2002; and Columbus, in December 2003. During the period cited in the report (2003-2006), first-generation LSVs were conducted in Knoxville in April 2004, Atlanta, May 2004, and Columbus, September 2004.

The Learning and Support Visit process, in its current form, was conducted in six of 12 sites between November 2004, and October 2005. Sites completing the latest version of the LSV are the following: Cincinnati; Lorain; Newark; Akron; Brownsville; and Kenai. This leaves 5 sites without the current format of an LSV. However, when you take into consideration the LSVs done in the earlier form, all sites but Houston and Long Island had completed at least one LSV, with three in the earlier format taking place earlier in 2004.<sup>28</sup>

All sites are scheduled for LSVs this school year, which as the OIG auditors recommend, will include staff from the GRAD financial team:

- Fall: Houston, Los Angeles, Atlanta, Knoxville, Newark, Long Island
- Spring: Akron, Cincinnati, Lorain, Kenai, Brownsville, Philadelphia

While the Draft Audit Report points out that representatives of the financial group within GRAD have not directly participated in the actual on-site LSV, discussions with members of the financial staff preceded each LSV in order to formulate the questions on goals. The LSV team is typically an interdisciplinary group including staff members with years of experience managing organizations with large budgets. The LSV targets related to financial matters follow:

- # 4: "Sites will achieve financial sustainability by ensuring a diversity of funding, with a mix of national, district, and local sources."
- # 5: "Sites will achieve and maintain site efficiency and effectiveness through judicious deployment of personnel and resources."<sup>29</sup>

GRAD has performed a rigorous review of the funding provided to each site.

GRAD takes its fiduciary responsibility very seriously and reviews every item for which a site requests reimbursement, prior to the release of any funds to that site. All sites are subjected to the same scrutiny. All requests are received via an invoice showing items for which the site is requesting reimbursement. GRAD reviews each request for proper timeframe for the grant period requested and adequate support showing the purpose for which funds have been spent.

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<sup>28</sup>The LSV for Long Island has been delayed because Long Island is transitioning to a new school district partner and a new executive director. In contrast, Project GRAD Houston has yet to receive a formal LSV because the Project GRAD USA staff are intimately familiar with Project GRAD Houston's performance. Because GRAD's staff and president are located in Houston, they have ample opportunity to conduct monitoring of Project GRAD Houston's work. As a result, conducting a formal LSV at Project GRAD Houston has taken a lower priority to completion of the LSVs at the other sites.

<sup>29</sup>The Draft Audit Report ignores the fact that two of the five LSV goals relate to financial issues and instead states merely that the LSVs "touch[] only briefly on the funding of the sites." Draft Audit Report at p. 13.

Additionally, individual items are verified to assure that they fall into the proper budget categories allocated for the respective site.

No funds are disbursed without appropriate support. If an item requires additional support, GRAD contacts the site is contacted by phone or email. If the site is not able to supply the required support in a timely manner, the expenditure in question is deducted from the total request and the remaining supported amount is reimbursed.

GRAD provides an explanation to the sites as to why any item are not being reimbursed. By doing this, we are bringing to their attention what unallowable expenses are being requested or why a certain portion cannot be reimbursed, thus reinforcing the sites' awareness so they will not request the same type of expenditure in the future. If the site can later provide adequate supporting documents to GRAD, the site would be allowed to resubmit this item on a separate request. This process gives USA an audit trail for items rejected and then resubmitted.

After reviews and processing, the request is submitted to GRAD's chief financial officer ("CFO") with a breakout of any items not reimbursed or questioned. The CFO reviews and either approves for reimbursement or returns to the processor with additional input, explanation or suggestion as needed. Once it is approved by the CFO, the reimbursement must then be approved by GRAD's president and then funds are requested for reimbursement to the site. At that time, GRAD's staff notifies the site by email as to the amount being reimbursed, along with the explanation reflecting items not reimbursed. Every request is unique to the site requesting reimbursement per the budget approved, but each is reviewed with the most in-depth examination and scrutiny to assure judicious distribution of funds entrusted to GRAD's administration.

Third-party evaluations and internal data tracking are additional monitoring tools used by GRAD.

The formal evaluations discussed in further detail in response to Finding No. 5 provide further monitoring of Project GRAD sites. Project GRAD Houston received third-party evaluations from 1995-2004 and was participating in a pilot study of graduation conducted by American Institutes for Research ("AIR") during the period of the FIE Grant. The Project GRAD sites in Atlanta, Columbus, Newark, and Houston were included in the Manpower Demonstration Research Corporation ("MARCO") evaluation report, which was completed in July 2006. Project GRAD Los Angeles was part of the initial study by MARCO, but was not included in the final report because of the difficulty of getting complete data from the district. Not only was Project GRAD Newark included in the MARCO study, but also, Dr. Blame Opine conducted two studies of Newark for 1998-03 and a second for 2003-04. Additionally, Dr. Opine conducted a study of the initial implementation in 2002-03 of Project GRAD at Maynard Elementary in Knoxville, a special case where a school in danger of state take-over was rehabilitated through fast-track implementation of Project GRAD. In June of 2007, Eric Hettinger completed an evaluation of the four Ohio sites, Cincinnati, Columbus, and Lorain. Further, he is completing a three-year study of Project GRAD Knoxville this month. GRAD has involved nine of its sites in rigorous, third-party evaluations, which measure their success in meeting the complex array of goals of GRAD.

Finally, GRAD annually tracks contractor sites' success in closing the achievement gap with their district on state high stakes test. *See* response to Finding #5 below and Exhibit B-17 at pp. 9, 24 & 28.

The OIG auditors violated generally accepted government auditing standards by ignoring GRAD's extensive monitoring efforts.

As shown above, Project GRAD USA uses its personnel and other resources vigorously in monitoring contractor site programmatic progress, contrary to the limited picture presented in the OIG report. The OIG auditors omitted any reference to the many monitoring tools used by GRAD to devote exclusive focus on single audits and the LSV process, and even then the auditors misleadingly failed to reference the earlier versions of the LSVs performed at the sites. These errors and omissions by the OIG auditors violated generally accepted government auditing standards.

As with their conclusions in Finding No. 1, the auditors conclusions in Finding No. 4, violate the standards of competence and professional judgment mandated by GAGAS. Yellow Book §§ 3.31 & 3.43. The OIG auditors failed to "exercis[e] reasonable care . . . in accordance with applicable professional standards" in reviewing GRAD's monitoring procedures as required by the standard of professional judgment. *Id.* § 3.32. The auditors failed to present their findings regarding monitoring "in the proper context" and in an "objective [and] fact-based" manner as required by GAGAS. *Id.* §§ 2.08 & A.8.02.b. Once again, the OIG auditors failed to present a complete report of their findings "without omission of significant relevant information related to the audit objectives" in accordance with generally accepted government auditing standards. *Id.* § A8.02.c.

Moreover, the OIG auditors failed to "obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions" that GRAD performed inadequate monitoring of the sites as required by the generally accepted government auditing standards. *Id.* § 7.55; *see also* § 7.68 ("Auditors should determine the overall sufficiency and appropriateness of evidence to provide a reasonable basis for the findings and conclusions, within the context of the audit objectives."); § 8.14 ("In the audit report, auditors should present sufficient, appropriate evidence to support the findings and conclusions in relation to the audit objectives."). As explained in the Yellow Book:

Evidence is not sufficient or not appropriate when (1) using the evidence carries an unacceptably high risk that it could lead to an incorrect or improper conclusion, (2) the evidence has significant limitations, given the audit objectives and intended use of the evidence, or (3) the evidence does not provide an adequate basis for addressing the audit objectives or supporting the findings and conclusions. **Auditors should not use such evidence as support for findings and conclusions.**

*Id.* § 7.70.b (emphasis added). In Finding No. 4, the OIG auditors ignored these standards. -28-

The Yellow Book does not allow auditors to dispense with the requirement of obtaining sufficient and appropriate evidence when doing so will preclude the auditors from reaching their desired conclusions:

The concept of sufficient, appropriate evidence is integral to an audit. Appropriateness is the measure of the quality of evidence that encompasses its relevance, validity, and reliability in providing support for findings and conclusions related to the audit



objectives. In assessing the overall appropriateness of evidence, auditors should assess whether the evidence is relevant, valid, and reliable.

*Id.* § 7.56; *see* § A7.01 ("An integral concept for performance auditing is the use of sufficient, appropriate evidence based on the audit objectives to support a sound basis for audit findings, conclusions, and recommendations."). In focusing only on LSVs and single audits without any consideration of the other monitoring tools used by GRAD, or even the full extent of the LSVs actually performed by GRAD, the OIG auditors failed to obtain sufficient and appropriate evidence for their purported audit findings. By publishing their conclusion in Finding No. 4 that GRAD did not perform adequate monitoring anyway, the OIG auditors violated generally accepted government auditing standards.

***Response to Finding No. 5 -- PG USA Did Not Deliver All Services and Products Specified in the Approved Grant Application -- This Finding is Wrong and the Draft Audit Report Omits Significant Relevant Information That Shows That GRAD Delivered Substantially All Services and Products Specified in the Approved Grant Application***

To provide context for evaluating this finding, it is important to begin with the wording of its title: "PG USA Did Not Deliver All Services and Products Specified in the Approved Grant Application." Finding No. 5 addresses the degree to which GRAD met its two quantitative goals on adequate yearly progress ("AYP") and graduation. These goals, however, are not services and products, but measures of the success of services and products delivered by Project GRAD in impacting students. Thus the conclusion that services and products were not delivered by GRAD is not supportable.

Indeed, when the four goals and sixteen objectives listed in GRAD's 2005-2006 grant application are examined, one finds that GRAD fully accomplished thirteen of its stated sixteen objectives.<sup>30</sup> On the other three objectives, although falling short, GRAD made significant progress, including on the objective for AYP, where GRAD aimed for a 10% improvement in

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<sup>30</sup> The Draft Audit Report inaccurately indicates that there were only "two objectives defined in the grant application submitted to the Department," Draft Audit Report at p. 14, and makes no mention of the other 14 objectives included in the application. The OIG auditors will presumably contend that they fairly ignored 12 objectives where GRAD fully accomplished its goals because they were not "measurable objectives." That contention would ignore, however, that GRAD's success in achieving all of its objectives are measurable in a qualitative, if not a quantitative, manner, as shown in Exhibit B-18.

AYP, but made an 8% improvement instead. See Exhibit B-18 (Chart showing FIE Grant Goals/Objectives and Outcomes for the period April 20, 2005 to September 1, 2006).<sup>31</sup>

GRAD used a reasonable methodology to calculate AYP.

GRAD used the following methodology to calculate AYP:

- **Data:** In order to ensure the use of the cleanest data possible, GRAD used data published on state websites as its official data source. This, of course, places a restriction upon what data are available. At the time of our end-of-grant report, data for Tennessee and New Jersey were not yet posted for 2005- 2006. That meant that the possible time period for measurement of this target was change in Project GRAD sites from 2003-2004 to 2004-2005. The OIG auditors checked this with the Department, who corroborated this method of using the latest available posted data at the time of the audit.
- **Pool of Project GRAD Schools Measured:** GRAD included in the measurement of progress for this target all Project GRAD schools—elementary, middle, and high—which had begun implementation before 2003-2004, in order to have any actual impact to measure, since GRAD rolls out components over a multi-year period. Indeed, some of the schools measured had not completed the roll-out of the entire program. For example, we measured Akron and Cincinnati; however, in 2005-2006 both changed the literacy program which they supported. The universe of schools in the Project GRAD model is dynamic because of the continuous evolution of the program, a fact which seems to have been lost on the auditors.
- **Results:** GRAD set the objective of increasing the number of schools reaching AYP by 10% over the period. In actual numbers rather than percentages, that meant moving from 102 schools reaching AYP to 112 reaching AYP. During the period measured, the result was an 8% gain (as opposed to an initially reported 6% gain, which was due to a mathematical error). What this means is that instead of reaching the objective of 112 schools achieving AYP, GRAD had 110 schools achieving AYP.<sup>32</sup>

<b>Objective</b>	<b>Achievement</b>
112 schools reaching AYP	110 schools reaching AYP

AYP, which reflects test scores, graduation, and attendance, is one indicator of success, which GRAD takes seriously. However, while GRAD did not meet its 10% target that year, it made progress in a period when districts across the country reported difficulty in continuing to meet AYP standards, as reported in the September 20, 2006 edition of **Education Week**. Discussing

<sup>31</sup> Although the OIG auditors chose to ignore the fact that GRAD successfully accomplished 13 of its 16 objectives, the OIG auditors placed great emphasis on GRAD's failure to fully accomplish its objective for LSVs as shown in Finding No. 4. The Draft Audit Report's exclusive focus on GRAD's shortcomings with no mention of GRAD's successes provides a misleading and incomplete assessment of GRAD's performance in violation of generally accepted government auditing standards.

<sup>32</sup> Nowhere in the Draft Audit Report do the OIG auditors mention the absolute number of schools that correlate to the AYP percentage goals. GRAD believes that it is no accident that the Draft Audit Report obscures the fact that GRAD achieved AYP at 110 schools and fell only two schools short of its goal of 112 schools.

then-released data, this article explained that because performance targets have risen over time, nationally the percent of schools making AYP dropped from 75% to 71% and the percentage of schools rated as needing improvement increased from 13% to 17%.

GRAD reported its methodology for calculating AYP and its AYP calculations to the Department. *See* Exhibit B-19 (GRAD's Final Grant Performance Report dated Nov. 30, 2006); Exhibit B-20 (Grant Performance Report for the period Apr. 20, 2005 to Sep. 1, 2006).<sup>33</sup> Although the OIG auditors implicitly criticize the methodology GRAD used to calculate AYP, GRAD received no response from the Department indicating that its AYP target was stated incorrectly in the grant application, nor did GRAD receive feedback from the Department indicating that GRAD had employed an incorrect method in measuring and reporting on the target.

The OIG auditors' methodology and conclusions regarding AYP are flawed.

The Draft Audit Report states that the OIG auditors analyzed AYP data from :2003 to 2006 for eleven Project GRAD sites to determine whether the sites achieved the 10 percent objective for AYP. The OIG auditors found that "[a]11 11 sites did not meet this objective in at least one of the three years, with some sites not meeting the objective all three years." Draft Audit Report at p. 15. As a consequence of this finding, the OIG auditors concluded: "Over the past three grant periods, PG USA received approximately \$60 million despite the fact that PG USA did not meet the objective of increasing the number of schools meeting or exceeding AYP objectives by 10 percent, as stated in the grant application." *Id.* at p. 16.

There are at least three serious deficiencies in the OIG auditors' analysis of GRAD's objective for AYP:

- First, and most egregiously, the OIG auditors are applying an objective to years in which it was not a stated objective.<sup>34</sup>
- Second, they are applying the objective to all schools each year, some of which were just beginning roll-out of GRAD and would not have had any impact to measure, thus demonstrating a lack of understanding of how the GRAD program is implemented.
- Finally, to dismiss, out of hand, GRAD's success and value because it reached an 8% improvement in AYP rather than a 10% improvement (110 schools rather than 112

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<sup>33</sup> Because GRAD disclosed that it fell short of the AYP goal in its end-of-the year report to the Department, GRAD is highly skeptical of the OIG auditors' assertion that the "Department informed us that it was not aware that PG USA had not met one of its two stated objectives." Draft Audit Report at p. 16. GRAD has not discussed this contention with the Department but assumes that the Department's representatives simply disagreed with the auditors' conclusion that the AYP shortcoming indicated that GRAD failed to deliver all services required by the FIE Grant. GRAD assumes that the OIG auditors are misconstruing their actual communications with the Department.

<sup>34</sup> The OIG auditors' examination of the change in AYP in the prior years instead of just the change from the 2004-2005 to the 2005-2006 period, is another consequence of the auditors' decision to expand the scope of the audit beyond that announced at the beginning of the audit. As explained above, the auditors' decision to expand the scope of the audit to prior years without prior notice to GRAD is also objectionable.

schools reaching AYP) during a finite one-year period belies an understanding of the complexity of the work involved in improving the academic achievement of the underserved populations with whom GRAD works.

The OIG auditors apparently failed to review GRAD's grant applications for the 2003-2004 and 2004-2005 grant periods, because the Draft Audit Report mistakenly assume that the AYP objective applied to all three periods examined by the OIG auditors. In fact,, the objective of improving the number of GRAD schools meeting AYP by 10% was not an objective set forth in the 2003-2004 or 2004-2005 FIE Grants. Indeed, the AYP objective was set for the first time in GRAD's 2005-2006 grant application because this was the first time when the Department required quantitative targets. Yet once again, the OIG auditors' flawed conclusions regarding AYP reveal their noncompliance with the generally accepted auditing standards of competence, professional judgment, reasonable care, objectivity, completeness, sufficiency, appropriateness, relevance, validity, and reliability. Yellow Book §§ 2.08, 3.31, 3.32, 3.43, 7.55, 7.56, 7.68, 7.70.b, 8.14, A7.01, A8.02.b & A8.02.c.

GRAD surpassed its objective for graduation rates.

GRAD's objective related to graduation, which was also included in its 2005-2006 grant application for the first time, was to increase the overall number of high school graduates by five percent at the existing Project GRAD contractors that had four or more years of implementation of the high school component. GRAD surpassed this objective. The Draft Audit Report asserts that GRAD's graduation objective does "not correlate to how the PG program is actually performing." Draft Audit Report at p. 15. The OIG auditors' objection here relates to the use of absolute numbers in the objective.

GRAD used the following method for calculating graduation results:

- For graduation measurements, GRAD's best source of data is state websites, which post graduation rates and counts for schools. Though usually lagging a year behind, this source of rates works well when comparing graduation results across a single state. Indeed, in our third-party quasi-experimental study of the four Ohio sites, completed in June, 2007, the Ohio state website was the source for all of the graduation rate data.
- However, across sites in different states, the problem is, as acknowledged by the OIG auditors and pointed out in the September 2005 GAO Report, "No Child Left Behind Act: Education Could Do More to Help States Better Define Graduation Rates and Improve Knowledge about Intervention Strategies," that states calculate graduation rates in a variety of ways. Graduation rates posted on state websites cannot be compared across states.
- Knowing this, GRAD attempted to calculate a simple rate of new ninth graders versus graduates; however, GRAD has not been able to get uniform data from state websites providing an annual count of new ninth graders (generally the number is total ninth graders).
- Therefore, a count, in the context of total school population is collected on the sites for internal use as suggested in the Draft Audit Report as a partial solution. *See Exhibit B-2 at p.11* (graduation data sample -- While these contextual numbers could not be fed into

the format provided in the grant for quantitative data, it is very much a part of the GRAD assessment of progress.

- Contrary to the OIG auditors' statement that GRAD "feels that this is the best tool at its disposal to analyze graduation data," Draft Audit Report at p. 15, it is simply an indicator that GRAD uses until available funding allows us to contract for quasi-experimental third-party studies of all of the contractor sites.

GRAD surpassed its objective no matter what universe of schools we considered. The actual target for graduation was to reach a 5% increase in the number of graduates from the baseline year before implementation to the 2004-2005 year, when data was posted, in GRAD contractor schools that had had four years or more of implementation of the high school component. (Even then, Tennessee's counts were not posted in time for the report, and we relied upon the proprietary data released only to the partner district for their results.) In the baseline year, the total graduates in all GRAD schools was 3373. For a 5% increase in the total population we would have needed an increase to 3543. For 2005, we found that we increased the graduation numbers to 3584, in all of our high schools, thus surpassing the objective by 1.3%.

Alternatively, however, if GRAD had limited the contractor schools to the objective as stated and thus had included only the schools that had had four years or more of implementation of the high school component, we would have had a baseline number of 2900 which would have required an increase to 3045 for a 5 % increase. The actual increase was to 3176 for a 9.5 % increase.

<b>Objective</b>	<b>Achievement</b>
5% increase (3045)	9.5% increase (3176)

Other measures show GRAD's success in improving graduation rates.

Even if one disregards the reported results on the graduation objective for 2005-2006, GRAD has other evidence which shows success in the area of graduation. Recent third-party quasi-experimental studies demonstrate GRAD's success in improving graduation rates:

- In the June 2007 study of the four Ohio sites, the researcher demonstrated that graduation rates have improved across all Project GRAD high schools in the state since the inception of GRAD; and that the graduation rate gains in Lorain and Akron were the largest and most statistically significant. See Exhibit B-22 (Report on "Educating Ohio's Children" dated June 29, 2007).
- GRAD is very much aware of the need nationally to find the best methods of calculating graduation rate and has entered into the national discussion on this topic by contracting with the American Institutes of Research (AIR) to produce a pilot study of Houston schools in which three of the major recommended methods of calculating graduation rate were employed. These recommendations came from the 2005 "National Institute of Statistical Sciences/Education Statistics Services Institute Task Force on Graduation, Completion, and Dropout Indicators, Final Report," for the National Center for Educational Statistics. The draft of the resulting study was shared with the OIG auditors; and it indicated gains in graduation rates over comparison schools in Houston, some of

which were statistically significant—a point which is down-played in the OIG report.<sup>35</sup> See Exhibit B-23 (sample findings from AIR study. GRAD plans to employ these calculation methods across the country as funding becomes available.

Multiple independent studies prove GRAD's overall success.

The OIG auditors' conclusion from their misleading analysis of the two quantitative objectives in the FIE Grant is that GRAD has not proven its success. The discussion in the Draft Audit Report implies that the only measures of GRAD's success would be these two objectives.

GRAD has a record of studying its results on a number of measures of aspects of an extremely complex model both internally and externally through third-party evaluations, as funding permits. Within these studies, as well as within the objectives reported on in the grant, many success stories may be found. When one evaluates a complex model which rolls out over a number of years affecting students from Kindergarten through college entrance, one must address a wide array of measures, some more appropriate for newer sites and some more appropriate for longer-lived sites:

- As pointed out earlier, thirteen (13) of sixteen (16) objectives reported on for this grant indicate complete success, with the others indicating great progress. Among these objectives was improvement of graduation numbers, a success corroborated by two recent external studies as discussed in the last section.
- Additionally, fairly recently completed third-party quasi-experimental evaluations have pointed out other types of successes:
  - MDRC findings
    - Students at Project GRAD schools outperformed students in similar comparison schools on national tests and showed as much improvement on high-stakes state achievement tests as students in comparison schools.
    - At Jefferson Davis High School in Houston, the initiative's flagship school, the program had a statistically significant positive impact on the proportion of students who completed on time the core academic curriculum required for college.
  - Bettinger's Ohio Study (Exhibit B-22): In addition to statistically significant improvements in graduation, this study found the following:
    - Fourth grade math scores have increased in GRAD schools relative to comparison schools.
    - Fourth grade reading and sixth grade math show some improvement.

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<sup>35</sup> The Draft Audit Report misleadingly states that "sometimes this increase was statistically significant and sometimes it was not" -- a statement that reveals a misunderstanding of statistics. Draft Audit Report at p. 16. The auditors imply with this statement that the findings of statistically insignificant increases in certain graduation rate data negate the findings of statistically significant increases in graduation rates in other data.

- Student disciplinary rates have fallen in Project GRAD schools relative to comparison schools.
- Teacher attendance has also improved relative to comparison schools.
- Most Project GRAD sites have been involved in rigorous evaluations, as of September 2007, nine sites have been involved in rigorous evaluation on a number of objectives important to the model, some more than one.
  - MDRC elementary and secondary studies included Houston, Newark, Atlanta, and Columbus (final report dated July 2006)
  - Bettinger, Ohio: Columbus, Lorain, Cincinnati, and Akron (Exhibit B-22 (final report completed June 2007))
  - Bettinger, Knoxville (final due by end of September, 2007)
  - AIR, Houston (final due October, 2007)
- GRAD has been a subject of the following major third-party evaluations:  
Eric Bettinger. **Educating Ohio's Children: An Evaluation of Project GRAD Ohio**, June 29, 2007 (Exhibit B-220

American Institutes for Research. **A Pilot Study of Project GRAD Houston**, October 11, 2006.

MDRC. **Striving for Student Success: The Effect of Project GRAD on High School Student Outcomes in Three Urban School District**, July, 2006.

MDRC. **Charting a Path to Graduation: The Effect of Project GRAD on Elementary School Student Outcomes in Four Urban School Districts**, July, 2006.

Kwame Opuni. **Program Evaluation Reports for GRAD Houston**, September, 1995; October, 1996; October, 1997; November, 1998; December, 1999; March, 2001; March, 2002; October, 2002; November, 2002; April, 2004.

Kwame Opuni. **Preliminary Evaluation of the Newark Initiative, 1998-2003**, December, 2003; **Project GRAD Newark 2003-04 Program Evaluation Report**, February, 2005.

Kwame Opuni. **The Maynard Study, 2002-03, First Year Formative Report, Project GRAD Knoxville**, April, 2004.

- Also, GRAD has been included positively as a promising model in several reviews of research:

The Education and Economic Development Coordinating Council At-Risk Committee. **At-Risk Student Intervention Implementation Guide**, 2007.

Communities In Schools and National Dropout Prevention Center Network. **Dropout Risk Factors and Exemplary Programs: A Technical Report**, May, 2007.

Comprehensive School Reform Quality Center. **Report on Middle School and High School Comprehensive School Reform Models**, October, 2006.

Internally, GRAD annually tracks contractor sites' success in closing the achievement gap with their districts on state high stakes mathematics and literacy tests using data reported on state websites. See Exhibit B-17 at pp. 9, 24 & 28.

### *Conclusion*

Project GRAD USA has cooperated fully with the OIG audit from the beginning of the audit, and will continue to do so. In this spirit, GRAD has provided the audit team on-site access to all of the documents and information requested in the audit, including many documents outside the scope of the audit.

The OIG auditors claim that that the "objectives of our audit were to determine whether Project GRAD: (1) properly accounted for and used grant funds in accordance with relevant laws and regulations, and (2) delivered the services and products specified in the approved grant application." Draft Audit Report at p. 1. After reviewing the findings of the Draft Audit Report, however, it appears that the OIG auditors' actual objectives were to: (i) reverse the policy of the Department that allows grantees to recover pre-award costs; and (ii) to paint a picture that falsely portrays Project GRAD as an organization unworthy of receiving grant awards from the Federal Government in the future. The OIG auditors' apparent actual objectives in conducting this audit were improper and in violation of generally accepted government auditing standards. Regardless of the auditors' motives, however, the numerous omissions and factual errors in the Draft Audit Report dictate that the Office of Inspector General direct that the Draft Audit Report be rewritten completely.

The OIG auditors' disregard of fundamental facts that weigh against the audit findings after these facts were specifically brought to their attention by GRAD, coupled with the auditors' failure to reference regulations directly on point to the audit issues, point to the conclusion that the OIG auditors lacked competence and exhibited bias in conducting the audit.

Generally accepted government auditing standards require "avoidance of any conduct that might bring discredit to auditors' work, including actions that would cause an objective third party with knowledge of the relevant information to conclude that the auditors' work was professionally deficient." Yellow Book § 2.15. Any objective third party reading the Draft Audit Report in the light of this response from GRAD would have to conclude that the OIG auditors' work was deficient. Those deficiencies in the Draft Audit Report dictate that it be replaced with a new report prepared in accordance with GAGAS.

For the reasons set forth in this response, Project GRAD USA requests that the Draft Audit Report be revised immediately to comply with generally accepted government auditing



standards. Because of the numerous factual errors and violations of GAGAS in the Draft Audit Report, as well as the highly prejudicial potential impact to GRAD of the conclusions and recommendations in the draft report, the Inspector General should prohibit any circulation of the Draft Audit Report outside of the OIG until the report is rewritten in accordance with generally accepted government auditing standards.