The Education Leaders Council's Drawdown and Expenditure of Federal Funds

FINAL AUDIT REPORT

ED-OIG/A03F0010
JANUARY 2006

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
Philadelphia, Pennsylvania

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January 31, 2006

Faye P. Taylor, CEO
Following the Leaders
1225 19th Street NW, Suite 240
Washington, DC 20036

Dear Ms. Taylor:

Enclosed is our final audit report, Control Number ED-OIG/A03F0010, entitled "The Education Leaders Council's Drawdown and Expenditure of Federal Funds." This report incorporates the comments that Following The Leaders (formerly the Education Leaders Council) 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:

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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.

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Sincerely,

Bernard Tadley

Bernard Tadley
Regional Inspector General for Audit

Enclosure

THE EDUCATION LEADERS COUNCIL'S
DRAWDOWN AND EXPENDITURE OF FEDERAL FUNDS

ED-OIG/A03F0010

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EXECUTIVE SUMMARY

The objectives of the audit were to determine if (1) federal funds drawn down by the Education Leaders Council (ELC) for the Following the Leaders (FTL) program were used for ELC's operations, and (2) expenditures allocated to the federally funded FTL program were reasonable, allocable, and allowable in accordance with regulations. The audit covered the period January 1, 2004, through December 31, 2004. We found that ELC: (1) drew down grant funds that could have been used to cover operating deficits in ELC's non-FTL activities, (2) charged indirect costs to the federal grants even though it did not have an approved indirect cost plan, and (3) charged questioned and unsupported costs to the federal grants.

The U.S. Department of Education's (Department) Fund for the Improvement of Education (FIE) supports nationally significant programs to improve the quality of elementary and secondary education at the state and local levels. The FIE also supports grants to entities that have been identified by the Congress in appropriations legislation. During the period July 1, 2002, to December 31, 2004, ELC received three FIE grants totaling $23,376,534 for the FTL project. In addition, for fiscal year 2005, Congress directed six grants, totaling $9,594,623 in awards, to ELC for the FTL project in various states.

Specifically, the audit disclosed that:

1. ELC did not comply with federal regulations concerning the drawdown of grant funds. ELC drew down and expended federal funds it was not entitled to. ELC overdrew the FTL Phase II (fiscal year 2003) grant by $495,326. The FTL Phase II grant overdraw could have covered ELC's reported accounting deficits for non-FTL activities in calendar year 2004. It appears that the grant overdraw occurred because of inadequate controls. For example, ELC did not maintain supporting documentation and failed to reinforce and follow established procedures.

2. ELC did not have an approved indirect cost plan. ELC's 2002 and 2005 cost policies specified that indirect costs were charged to the FTL grants using the Office of Management and Budget (OMB) Circular A-122's direct allocation method and that monthly timesheet activity was used to establish the rate for allocating the indirect costs. ELC believed that use of the OMB Circular A-122's direct allocation method to allocate indirect costs did not require prior approval. Because ELC did not have an approved indirect cost plan, $90,532 in indirect costs may not have been properly allocated to the grants.

3. ELC did not comply with cost principles contained in OMB Circular A-122. We found that 28.2 percent of the grant costs reviewed were either questioned or unsupported. In total, ELC charged $90,721 in questioned costs and $140,922 in unsupported costs to the FTL Phase II and III grants. It appears that the questioned and unsupported costs were the result of weak or non-existent internal controls. The questioned costs included $69,048 for ELC's annual conferences that should have been charged to ELC's annual conference cost center, $4,821 for meals and entertainment costs, and $4,501 for travel costs that do not appear to be FTL related. Also, included in the questioned amounts were costs for alcoholic beverages, advertising, fundraising, and interest that are specifically unallowable under applicable cost principles. In August 2005, after ELC had been apprised of the draft audit findings, ELC removed $74,990 of the questioned costs and $2,596 of the unsupported costs from the FTL Phase II and III grant expenses.

We recommend that the Department's Chief Financial Officer and Assistant Deputy Secretary for Innovation and Improvement require ELC to:

- Return to the Department $495,326, and any other grant funds, drawndown and not actually disbursed by ELC for FTL Phase II grant costs. Submit documentation in support of each drawdown request for grant funds, along with proof that the grant funds were disbursed for the purpose(s) of the drawdown request. In addition, determine the interest earned on federal funds and the amount of such interest to be remitted to the Department.

- Submit an indirect cost plan to the Department's Chief Financial Officer for negotiation and approval and refund the portion of the $90,532, and any other costs allocated to the FTL grants, on or after January 1, 2004, that are not in accordance with the indirect cost plan approved by the Department.

- Refund to the Department $15,732 for the questioned costs that remain charged to the FTL grants and any additional amounts identified by the Department.

- Provide adequate documentation to show that the unsupported expenditures of $138,327 that remain charged to the FTL grants are reasonable, allowable, and allocable to the grants, or refund the expenditures that the Department determines are not adequately supported. In addition, maintain adequate supporting documentation for all FTL grant expenditures.

- Provide all ELC officials and employees copies of OMB Circular A-122 and ELC's internal policies and procedures for determining allowable costs, travel, use of charge cards, and payroll; require ELC to maintain documentation that each officer and employee have reviewed the Circular and internal policies and procedures; and develop a process to ensure that the policies and procedures are complied with.

In December 2005, ELC changed its name to Following the Leaders.[1] A draft of this report was provided to ELC for review and comment. In its comments on the draft report, ELC did not disagree with our findings as a whole, however it did take issue with certain aspects of the findings. In addition, ELC did not disagree with our recommendations. We have incorporated ELC's comments, where appropriate, into the report and provide ELC's full response in Appendix E.

[1] In order to differentiate the FTL organization from the program, the report refers to the organization as ELC, its former name.

BACKGROUND

ELC is a non-profit organization, founded in 1995, that was located in Washington, DC. According to its mission statement, ELC was a school-reform group committed to leading educational change focused on improved academic achievement for all students. ELC reported that its membership base included state boards of education, state and local superintendents, governors, state and federal legislators, administrators, teachers, parents and other community leaders.

Administered by the Department's Office of Innovation and Improvement (OII), the Department's FIE supports nationally significant programs to improve the quality of elementary and secondary education at the state and local levels. In addition, the FIE supports grants to state and local education agencies, nonprofit organizations, for-profit organizations and other public and private entities that have been identified by the Congress in appropriations legislation. During the period July 1, 2002, to December 31, 2004, ELC received three FIE grants, totaling $23,376,534, for the FTL project. The first was a $3,501,000 unsolicited grant, awarded on July 1, 2002, (Award Number R215U020001) for FTL Phase I. The second was a $9,934,999 Congressionally directed grant, awarded on May 1, 2003, (Award Number U215K030213) for FTL Phase II. The third was a $9,940,535 Congressionally directed grant, awarded on June 25, 2004, (Award Number U215K040252) for FTL Phase III. In addition, for fiscal year 2005, Congress directed six grants, totaling $9,594,623 in awards, to ELC for the FTL project in various states.

ELC described the FTL project as a package of tools to assist states and school districts in meeting the requirements of the No Child Left Behind Act (NCLB). FTL provided technology resources and support to approximately 600 schools in 12 states. According to ELC, FTL helps teachers and administrators incorporate standards-based curriculum into their classrooms, and assists with the analysis and reporting of student performance data. FTL's service providers included Accountability Works, Achievement Technologies, The Princeton Review, and the Milken Family Foundation. Appendix A details ELC's objectives and measurable outcomes for FTL Phases II and III, as described in ELC's grant applications submitted to the Department.

Since 2003, major changes have occurred at ELC. Eight of ELC's board of directors and ELC's Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, and President have resigned. On October 1, 2004, ELC announced a planned merger with Accountability Works, one of its subcontractors, with the President of Accountability Works serving as ELC's Chief Executive Officer. In November 2005, ELC announced that ELC and Accountability Works would remain independent organizations. Additionally, in November 2005, ELC planned or implemented the following changes:(1) ELC would focus exclusively on its school-based initiative, (2) ELC would change its name to Following the Leaders to reflect the new focus, (3) a new Chief Executive Officer would be appointed, and (4) the organization's headquarters would move to Tennessee. According to ELC, the new organization's mission will be to serve as a catalyst for the application of technology to core instructional processes in order to raise student achievement and fulfill the goals of NCLB. To accomplish its mission, the new organization stated that it will assist schools and districts in the selection and implementation of technology-based resources and support services designed to help students achieve academic proficiency in core subjects.

On June 9, 2005, the Department designated ELC as a high-risk grantee with special conditions on its grants. The Department made this determination based upon the following: (1) ELC was not timely in filing its single audit covering fiscal year 2003, and there had been no significant single audit activity covering fiscal year 2004; (2) ELC had agreed that its fiscal accountability practices in the past have been problematic and that ELC is improving its practices to address these problems; and (3) ELC identified that it misspent approximately $272,000 in fiscal year 2002 funds, and single audits for fiscal years 2002 and 2003 have identified fiscal problems and questioned costs. The Department placed special conditions on the grants to ELC, which include: (1) grant funds must be deposited in and disbursed from a separate account and a clear and effective audit trail is required; (2) ELC will enter into a repayment agreement with the Department for the funds that it cannot account for properly; (3) ELC will be paid by the Department on a reimbursement basis; (4) ELC will institute appropriate fiscal controls; (5) ELC must make arrangements for the preparation of its fiscal year 2004 single audit and the fiscal year 2005 single audit will be filed timely; (6) ELC must have an approved indirect cost rate or direct cost allocation plan approved by the Department; and (7) ELC must promptly provide the Department with any requested records and information.

AUDIT RESULTS

The objectives of our audit were to determine if (1) federal funds drawn down by ELC for the FTL program were used for ELC's operations, and (2) expenditures allocated to the federally funded FTL program were reasonable, allocable, and allowable in accordance with regulations. We found that ELC drew down grant funds that could have been used to cover operating deficits in ELC's non-FTL activities, and that expenditures allocated to the FTL program were not reasonable, allocable, and allowable in accordance with regulations. Specifically, we found that ELC overdrew grant funds, did not have an approved indirect cost plan, and charged questioned and unsupported costs to federal grant funds.

ELC's General Comments:

ELC believes that it is now in full compliance with all regulations governing the use of federal funds. In addition, ELC noted that it was ELC's reporting of financial mismanagement and the overdraw of federal funds to the Department that resulted in our review of ELC's 2004 finances. ELC noted that throughout the period of our audit, ELC had not closed its 2004 accounting records. ELC was also completing its 2003 audit and reviewing and adjusting the 2004 and 2005 accounting records in order to make them accurate and to comply with regulations. ELC believed that many of the shortcomings identified by our audit would have been corrected as a result of its internal review process. ELC concurred with the findings concerning financial protocols, and noted that it had corrected many of the accounting entries. ELC believed its corrective actions were given minimal attention in the audit report.

OIG's Response:

The audit report noted that ELC had informed the Department that it had overdrawn grant funds and that ELC's accounting records for 2004 were not finalized. In response to ELC's statement that its 2004 accounting records were not finalized, the expenditures that we reviewed had been charged to the federal grants at the time our audit work was performed. Furthermore, we disagree with ELC's statement that the report gave minimal attention to the corrective actions taken by ELC. The report noted the corrective actions taken by ELC regarding drawdowns and indirect costs. Additionally, the report noted, in several places, the questioned and unsupported costs removed from the FTL Phase II and III grants by ELC.

FINDING NO. 1 - ELC OVERDREW FOLLOWING THE LEADERS PHASE II GRANT FUNDS

ELC overdrew the FTL Phase II grant by $495,326. As a result, ELC did not comply with regulations in 34 C.F.R. § 74.22 concerning the drawdown of grant funds. Regulations specify that:

- "Cash advances to a recipient organization are limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project." 34 C.F.R. § 74.22(b)(2).[2]

- "The timing and amount of cash advances are as close as is administratively feasible to the actual disbursements by the recipient organization for direct program or project costs and the proportionate share of any allowable indirect costs." 34 C.F.R. § 74.22(b)(3).

In March 2005, ELC informed the Department that it had overdrawn FTL Phase II grant funds by $272,674. ELC's calculated FTL Phase II overdraw amount was based on accrued expenses, not cash basis expenditures, and included a March 18, 2005, drawdown of $22,500. We initially calculated a cumulative FTL Phase II accrual basis overdraw of $273,520 as follows:[3]

Cumulative Drawdowns to March 18, 2005	$9,916,740
Less: Initial Accrual Basis Expenses for Calendar Years 2003 and 2004	($9,643,220)
Cumulative Accrual Basis FTL Phase II Grant Overdraw	$273,520

[2] Unless otherwise specified, all references to 34 C.F.R. Parts 74 and 75 are to the July 1, 2003, edition.
[3] The $846 difference between ELC's and our calculations ($272,674 versus $273,520) was due to expenses charged to the grant by ELC in calendar year 2002. The 2002 expenses were not allowable, as ELC did not receive Department approval to use grant funds for expenses incurred prior to February 1, 2003.

During the performance of our audit, ELC adjusted the FTL Phase II grant expenses, resulting in the FTL Phase II grant overdraw increasing to $495,326. ELC's adjustments, totaling $221,806, included removing from FTL Phase II grant expenses $74,170 for unallowable and unsupported expenses identified during the audit and charging a $148,000 expenditure initially posted to the FTL Phase II grant to the FTL Phase III grant. We calculated a cumulative FTL Phase II accrual basis overdraw of $495,326 as follows:

Cumulative Drawdowns to March 18, 2005	$9,916,740
Less: Revised Accrual Basis Expenses for Calendar Years 2003 and 2004 (as of September 2, 2005)	($9,421,414)
Cumulative Accrual Basis FTL Phase II Grant Overdraw	$495,326

Because ELC had not finalized its 2004 accounting records, the amount of FTL Phase II grant expenditures was subject to revision. Any revisions to FTL Phase II grant expenditures would affect the amount of the FTL Phase II grant overdraw.

The FTL Phase II grant overdraw could have covered ELC's operating deficits (i.e., expenses in excess of revenue) in 2004. ELC reported deficits of $501,595 for non-FTL cost centers in calendar year 2004.[4] As noted previously, ELC's accounting figures are on an accrual basis, not on a cash basis.

These instances of non-compliance appear to be the result of inadequate controls. For example, ELC did not maintain supporting documentation and failed to reinforce and follow established procedures. Regulations in 34 C.F.R. § 74.21(b)(5) and § 74.22(b)(1)(i) require grantees to maintain written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient. ELC had a written drawdown policy in place as of October 2002. The policy required (1) an accounting statement to be prepared to show the funds needed to meet invoices and payroll, (2) a drawdown for the expenses calculated, and (3) all funds from the draw to be used within three working days. ELC's former Director of Federal Programs prepared the policy, however, it appears that ELC's former management did not inform ELC employees of the policies and procedures regarding drawdowns. As a result, ELC employees were not knowledgeable of and did not follow the policies and procedures regarding drawdowns. In addition, ELC did not maintain supporting documentation for grant drawdowns during the period January 2004 through June 2004. We reviewed ELC's support for 24 drawdowns, totaling $1,543,470, of FTL Phase II grant funds during the period December 2003 to March 2005. We found that ELC did not maintain support for 11 of the drawdowns, totaling $1,298,924, made during the period January 2004 through June 2004.

[4] Amount reported by ELC as of September 2, 2005. A cost center is the segment of activity or area of responsibility for which costs are accumulated. ELC's non-FTL cost centers include general and administrative, communications and marketing, fundraising and development, the American Board for Certification of Teacher Excellence (ABCTE), Education Leaders Action Council, Charter School Leadership Council, annual conference, and board and committee meetings.

ELC's recent management has adopted a drawdown policy that requires (1) a weekly review of invoices, (2) ELC's finance department, along with the grant coordinator, to prepare and sign the drawdown requests (3) the drawdown requests to be forwarded to the Chief Executive Officer for final review, approval, and signature before the drawdowns occur, and (4) the issuance of checks once funds are transferred to ELC's checking account.

In addition to the overdrawn funds, ELC may have earned excess interest on the grant funds. The funds drawndown by ELC were deposited into a bank account established for federal funds. In general, the grant funds were transferred from this bank account into ELC's Operating and Sweep bank accounts to cover disbursements. ELC's Operating and Sweep bank accounts earned $721 of interest in 2004 and $619 of interest during the period January 2005 through June 2005. Regulations in 34 C.F.R. § 74.22(l) specify that interest earned on federal advances deposited in interest bearing accounts shall be remitted annually to the Department. However, recipients may retain interest amounts up to $250 per year for administrative expenses.

RECOMMENDATIONS:

We recommend that the Department's Chief Financial Officer and Assistant Deputy Secretary for Innovation and Improvement require ELC to:

1.1 Return to the Department $495,326, and any other grant funds, drawndown and not actually disbursed by the grantee for FTL Phase II grant costs.

1.2 Submit documentation (such as vendor invoices and timesheets) in support of each drawdown request for grant funds, along with proof that the grant funds were disbursed (such as cancelled checks or payroll reports) for the purpose of the drawdown request.

1.3 Provide a schedule detailing the adjustments to FTL Phase II grant expenses made by ELC to determine any revised overdraw amount.

1.4 Work with the Department to determine the interest earned on the federal funds and the amount of such interest to be remitted to the Department.

ELC's Comments:

ELC concurred that it did not comply at times with regulations concerning the drawdown of grant funds and that it had overdrawn grant funds. In addition, ELC has taken corrective actions, such as entering into a repayment plan with the Department to return the overdrawn funds.

ELC noted that, we reviewed 24 of the 63 FTL Phase II grant drawdowns, and that 10 drawdowns did not have proper documentation. ELC also noted that, due to adjustments and corrections to the 2004 accounting records, the overdraw amount had decreased from the $495,326 contained in the audit report to $476,169 (subject to further adjustments).

OIG's Response:

We acknowledge the corrective actions that ELC has taken. In response to ELC's comments concerning the number of FTL Phase II grant drawdowns, we note that between May 2003 and March 2005, ELC had made a total of 64 drawdowns (not 63 drawdowns noted by ELC). In addition, as noted in the audit report, our review of the FTL Phase II grant drawdowns was limited to the 24 drawdowns made during the period December 2003 through March 2005, and we found ELC did not maintain support for 11 (not 10 noted by ELC) of the 13 drawdowns made during the period January 2004 through June 2004.

In response to ELC's comments that the FTL Phase II overdraw had decreased from the amount contained in Finding 1, we have added Recommendation 1.3. Furthermore, based upon further review, we have added to this report information regarding ELC's interest earnings and Recommendation 1.4.

FINDING NO. 2 - ELC DID NOT HAVE AN APPROVED INDIRECT COST PLAN

ELC did not have an approved indirect cost plan. As a result, indirect costs may not have been properly allocated based upon the benefits provided to each activity of the organization. ELC believed that use of the OMB Circular A-122's direct allocation method to allocate indirect costs did not require prior approval from the Department. Thus, it did not submit a plan for approval. In January 2005, ELC contacted the OII program officer to discuss the use of the direct allocation method. However, the discussion did not cover ELC's actual methodology for applying the direct allocation method or if the Department's approval of a cost allocation plan was required.

Our review disclosed $90,532 in indirect costs that may not have been properly allocated to the FTL Phase II and III grants.[5] The indirect costs allocated to the FTL grants included $68,953 in rent costs, $19,422 in other indirect costs, and $2,157 in charges made with ELC's corporate American Express credit cards.

ELC's 2002 Cost Policy Statement noted that indirect costs are allocated under a direct allocation basis using salaries and wages as the allocation base. In addition, ELC's 2005 Finance Protocol Manual stated that joint costs are charged to the FTL grants using the OMB Circular A-122's direct allocation method and that monthly timesheet activity is used to establish the rate for allocating joint costs to the FTL grants. However, ELC used several methods to allocate indirect costs. For example, ELC allocated American Express charges to the FTL grants based upon one of the following allocations: 100 percent to FTL cost centers; 33 percent each to cost centers for FTL, ELC, and the American Board for Certification of Teacher Excellence (ABCTE); and 60 percent to ELC cost centers and 40 percent to FTL cost centers. The 40 percent allocation to the

[5] Questioned costs have been excluded from this amount.

FTL program was based on an analysis of payroll allocations for the period August 1, 2003, to December 31, 2003, that showed 42 percent of ELC's staff time being spent on FTL activities.

Under OMB Circular A-122, Attachment A, Paragraph D, *Allocation of Indirect Costs and Determination of Indirect Cost Rates*, there are three methods for calculating indirect cost rates: the simplified allocation method, the multiple allocation base method, and the direct allocation method.[6] In addition, under OMB Circular A-122, a non-profit organization which has not previously established an indirect cost rate with a federal agency is required to submit its initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award. Furthermore, regulations in 34 C.F.R. § 75.560(b) specify that grantees must have a current indirect cost rate agreement to charge indirect costs to a grant. To obtain an indirect cost rate agreement, a grantee must submit an indirect cost proposal to its cognizant agency and negotiate an indirect cost rate agreement.[7] The Department's first grant award, for FTL Phase I, was made to ELC on July 1, 2002.

The direct allocation method is used by some non-profit organizations that treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (1) general administration and general expenses, (2) fundraising, and (3) other direct functions, including projects performed under federal awards. Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated. This method is acceptable, provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data. Under the direct allocation method, indirect costs consist of general administration and general expenses and the indirect cost rates are computed using the simplified allocation method, which ELC did not use.

ELC's 2002 Cost Policy Statement was based on a model cost policy statement issued by the Department of Labor, Business Operation Center's Indirect Cost Rate Determination Guide. The Department's Office of the Chief Financial Officer, Indirect Cost Group provides a similar model cost policy statement to grantees requesting information on indirect costs. The model cost policy statement suggests that office space costs should be based on square footage, directly and indirectly as follows. The cost of office space occupied by staff whose salaries are directly charged is charged directly; the cost of space for staff whose salaries are charged on a mixed basis is allocated on a mixed basis in the same ratio as their salaries are allocated; the cost of space occupied by staff whose salaries are indirectly charged is charged indirectly; and the cost of space required for common areas is accounted for as an indirect cost.

[6] Unless otherwise specified, all references to the OMB Circular A-122 are to the revision effective on June 1, 1998.
[7] The Department is ELC's cognizant agency.

ELC's 2004 rent costs totaled $141,764, of this amount, $68,953 was allocated to the FTL grants. The 2004 rent costs charged to the FTL grants may not have been properly allocated for the following reasons: (1) ELC did not have an approved indirect cost plan, (2) ELC allocated total rent costs based upon a weighted average of timesheet activity allocated to the FTL grants, rather than on an individual employee basis, and (3) ELC did not exclude the cost of common areas from the rent costs allocated to the FTL grants.

In addition to rental costs, our review of the disbursements allocated to the FTL Phase II and III grants identified 20 disbursements for other indirect costs totaling $19,422. For the most part, ELC allocated 40 percent of the total amount of the payments to the FTL grants. For example, ELC allocated 40 percent of various payments for telecommunications, information technology services, and financial and accounting services to the FTL grants. Furthermore, our review of ELC's American Express credit card charges allocated to the FTL Phase II and III grants identified 13 charges for various indirect costs, totaling $2,157. For all of the American Express credit card charges, 40 percent of the total amount was allocated to the FTL grants.

ELC's lack of an approved indirect cost plan was also a finding in ELC's calendar year 2003 single audit report and was based upon the independent auditor's inquiries with the Department's Indirect Cost Group and Office of Inspector General to determine if prior approval of the cost allocation plan was necessary.

In July 2005, ELC notified us that they have begun working with the Department on the treatment of indirect costs.

RECOMMENDATIONS:

We recommend that the Department's Chief Financial Officer and Assistant Deputy Secretary for Innovation and Improvement require ELC to:

2.1 Submit an indirect cost plan to the Department's Office of the Chief Financial Officer for negotiation and approval.

2.2 Refund the portion of the $90,532, and any other costs allocated to the FTL grants, on or after January 1, 2004, that are not in accordance with the indirect cost plan approved by the Department.

ELC's Comments

ELC believed that prior approval was only required when applying for an indirect rate, and that prior approval was not required to allocate joint costs on a direct basis. In December 2005, ELC submitted an indirect rate proposal to the Department. ELC noted that, if approved, it would be owed funds for indirect costs from 2003 to present, and that these funds would reduce the amount of the overdraw of FTL Phase II grant funds.

OIG's Response:

We acknowledge the corrective action taken by ELC.

FINDING NO. 3 - ELC CHARGED QUESTIONED AND UNSUPPORTED COSTS TO THE FOLLOWING THE LEADERS GRANTS

In administering the FTL grants, ELC did not comply with the cost principles contained in OMB Circular A-122, *Cost Principles for Non-Profit Organizations*. Regulations in 34 C.F.R. § 74.27 specify that private non-profit organizations use the cost principles in OMB Circular A-122 for determining allowable costs. ELC is a private non-profit organization. We found that 28.2 percent of the costs we reviewed were either questioned (11.1 percent) or unsupported (17.2 percent). In total, our audit found that ELC charged $90,721 in questioned costs and $140,922 in unsupported costs to the FTL Phase II and III grants. In August 2005, after ELC had been apprised of the draft audit findings, ELC removed $74,990 in questioned costs and $2,596 in unsupported costs that were identified during our audit from the FTL Phase II and III grant costs.

We did not determine the specific cause for each questioned and unsupported cost charged to the grants because officials and employees responsible for incurring most of the questioned and unsupported costs were no longer employed by ELC. The management of ELC is responsible for establishing and maintaining effective internal control over compliance with requirements applicable to federal grants. It appears that the questioned and unsupported costs were the result of weak or non-existent internal controls established and maintained by the management of ELC. For example, ELC had weak or non-existent internal controls to ensure that ELC's policies regarding the reasonableness, allocability, and allowability of grant costs were followed and that grant expenditures were supported with adequate documentation. Furthermore, in 2002, ELC's former Director of Federal Programs created a cost policy statement, the purpose of which was to determine the reasonableness, allocability, and allowability of costs in accordance with the provisions of the applicable federal cost principles and terms and conditions of awards, however the policy does not describe the process for making these determinations. These policies covered direct and indirect costs, travel costs, and unallowable costs such as fundraising, entertainment, alcoholic beverages, advertising costs, and fines and penalties. Recent ELC management did not locate these policies until late April 2005, after the start of our audit and following our request for such policies. In addition, the recent Director of Federal Programs noted that he was never informed of these policies by former ELC management. ELC's recent management has adopted policies that cover items such as allowable costs, use of company credit cards, travel, and payroll.

During the period January 1, 2004, to December 31, 2004, 382 disbursements, totaling $5,212,117, were issued from ELC's operating account.[8] These disbursements were allocated to both the FTL grants and ELC's other cost centers. We judgmentally selected transactions, totaling $1,474,712, for review. Of the transactions we selected, $820,190 (55.6 percent) was allocated to the FTL Phase II and III grants. A table summarizing our selections and the questioned and unsupported costs identified is provided in Appendix D.

ELC Charged QuestionedCosts to the FTL Grants.

ELC charged $90,721 in questioned costs to the FTL Phase II and III grants. The questioned amount consists of $80,455 charged to the FTL Phase II grant and $10,266 charged to the FTL Phase III grant. Of the total questioned amount, ELC removed $74,990 from the FTL grant costs, consisting of $71,865 from the FTL Phase II grant and $3,125 from the FTL Phase III grant. As a result, $15,732 of costs remained questioned. A complete listing of the questioned costs is provided in Appendix B. The questioned costs included amounts spent on the following:

Meals and Entertainment

ELC allocated 40 percent ($4,821) of $12,052 in charges for meals and entertainment. The charges consisted of a December 2003 Holiday Party, a February 2004 breakfast meeting for ten guests, a May 2004 reception and dinner, and a January 2004 dinner for 11 guests. Entertainment costs such as social activities, meals, rentals, and gratuities are unallowable under OMB Circular A-122, Attachment B, paragraph 14, *Entertainment costs*. The amount allocated to the FTL grants included $1,630 for alcoholic beverage charges. Costs for alcoholic beverages are unallowable under OMB Circular A-122, Attachment B, paragraph 2, *Alcoholic beverages*. Additionally, in 2002, ELC had prepared a cost policy that stated that entertainment and alcoholic beverage costs are unallowable charges to federal awards.

In August 2005, ELC removed from the FTL Phase II and III grant expenses the $2,640 for the December 2003 Holiday Party, $304 for the January 2004 restaurant charge, and $1,643 for the May 2004 reception and dinner charge. ELC noted that the February 2004 breakfast meeting expense was for an ELC board meeting. The breakfast meeting cost does not represent a reasonable expense because the $583 (of which, 40 percent, or $233, was allocated to the FTL Phase II grant) was for ten people, resulting in a cost of $58 per attendee. By comparison, the Government Services Administration's (GSA) 2004 per diem meals and incidental expenses (M&IE) rate for Washington, DC was $51, of which $10 was for breakfast.

[8] From the $5,212,117, we excluded seven payments totaling $3,000,000. We included one $20,000 payment made in 2003, to arrive at a population of $2,232,117 from which we selected transactions for review. The Objective, Scope and Methodology section contains addition information on the selection of items for review.

Travel Costs

ELC charged the FTL grants for $4,501 in travel costs not allocable to the FTL Phase II or III grants. This amount consisted of $2,304 for costs to attend an Alliance for School Choice retreat and $2,197 for airfare costs. Under OMB Circular A-122, Attachment A, Subparagraph A.4, a cost is allocable to a grant award if it is incurred specifically for the award, benefits both the award and other work and can be distributed in a reasonable proportion to the benefits received, or is necessary for the overall operation of the organization. In addition, OMB Circular A-122, Attachment B, paragraph 55, *Travel costs*, states travel costs are allowable when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization. The travel did not fit the definition of an allocable or allowable cost, as detailed below.

- In August 2004, ELC's former Chief Executive Officer traveled to Teton Village, Wyoming to attend an Alliance for School Choice retreat. The Alliance for School Choice works to promote, implement, and enhance K-12 educational choice. School choice is not an FTL related activity. Registration, lodging, airfare and rental car costs totaled $5,761, of which $2,304 (40 percent) was allocated to the FTL Phase II and III grants. The travel costs were questioned because the trip does not appear FTL related or necessary for the administration of ELC. Additionally, in 2002, ELC had prepared a travel policy that stated that travel costs are limited to those allowable under Federal Travel Regulations. The lodging costs incurred were $269 per night plus tax and a resort fee of $11 per night, whereas the GSA lodging rate was $115 per night. The excess lodging allocated to the FTL grants was $282 for four nights. Furthermore, ELC allocated $347 in airfare costs to the FTL Phase III grant for the former Chief Executive Office's husband to attend the retreat. In addition, $800 for the conference registration fee for the former Chief Executive Officer and her husband was allocated to the FTL Phase II grant. In August 2005, ELC removed from the FTL Phase II and III grant expenses the $2,304 of questioned charges related to the Alliance for School Choice retreat.

- Six charges for airfare totaling $4,708, of which $2,197 was allocated to the FTL Phase II grant, do not appear FTL related or necessary for the operations of ELC. The airfare was for trips to Alberta, Canada for ELC's former Chief Executive Officer and former Director of Communications and roundtrip airfare from Hawaii to Washington, DC for ELC's former President. Alberta, Canada and Hawaii are not among the states participating in the FTL program. In August 2005, ELC noted that it intended to remove the $1,701 in charges for airfare to Canada and that the $496 in airfare from Hawaii was under review. ELC noted that one of its staff members resided in Hawaii and that the travel charge might therefore be FTL related.

2003 and 2004 Annual Conferences

The FTL grants were charged $61,696 for ELC's 2003 annual conference and $7,352 for ELC's 2004 annual conference. The annual conference costs are questioned because they contain charges specifically unallowable under OMB Circular A-122, Attachment B, *Selected Items of Cost* and do not fully comply with the general cost principles contained in OMB Circular A-122, Attachment A.

Selected Items of Questioned Cost

The FTL Phase II grant was charged $61,696 for ELC's 2003 annual conference held in Nashville, Tennessee in September 2003. These costs include $60,000 for the conference center's charges ($20,000 was paid in November 2003 and $40,000 was paid in February 2004), $508 for audio-visual services paid in April 2004, $1,063 for photography services and $125 for ELC's "Rebel With a Cause" jacket presented as an award, both paid in March 2004.[9] Our review of the conference center expenses allocated to the FTL grants for lodging, banquet, room service, and other charges disclosed unreasonable and unallowable charges. For example:

- ELC's total banquet charges were $73,567, of which $39,800 (54.1percent) was paid from the FTL Phase II grant. An undetermined amount of banquet charges incurred by ELC was unreasonable. ELC's banquet charges exceeded the GSA M&IE rate of $46 per day.[10] For example, on one day, ELC charged 30 lunches at $26 per person, 50 reception charges at $35 per person, and 80 deluxe hosted bar packages at $13 per person. On another day, ELC charged 340 dinners at $59 per person, 225 continental breakfasts at $16 per person, and 63 bottles of wine at $32 each. Included in the banquet charges was $2,415 (54.1 percent of total) for alcoholic beverage costs, including service charges and taxes, consisting of $822 for the reception and $1,593 for the dinner. Alcohol is an unallowable cost under OMB Circular A-122 Attachment B, paragraph 2, *Alcoholic beverages*, and ELC's own 2002 cost policy.

- ELC's 2002 travel policy stated that travel costs are limited to those allowable under Federal Travel Regulations. ELC paid $159 per night plus tax for lodging when GSA's maximum per diem rate for Nashville, Tennessee in 2003 was $103 per night, consisting of the GSA rate plus a 25 percent conference lodging allowance. ELC's total lodging cost was $19,076, whereas using the GSA rate with a 25 percent conference lodging allowance results in lodging costs of $12,269. The excess lodging amount is $6,807, of which $3,683 (54.1 percent) was paid from the FTL Phase II grant.

- The conference center's invoices included $3,977 in total interest charges due to late payments by ELC, of which $2,152 (54.1 percent) was paid from the FTL Phase II grant. Interest is unallowable under OMB Circular A-122, Attachment B, paragraph 23, *Interest, fundraising, and investment management costs*.

[9] The conference center's invoices totaled $110,985, consisting of banquet costs of $73,567, room costs of $23,663, audio-visual costs of $10,819, a net credit of $1,040 for miscellaneous costs and credits, and interest charges of $3,977. The $60,000 (54.1 percent of the conference center's total costs) charged to the FTL Phase II grant in ELC's general ledger was classified as lodging. As a result, for purposes of our review, we treated 54.1 percent of all conference center costs as having been charged to the FTL Phase II grant. In addition, we note that among the calendar year end 2003 adjusting entries was an adjustment for $12,000. It is possible that all or a portion of the adjustment was a reduction in the conference center expenses charged to the FTL Phase II grant.

[10] The $46 M&IE rate consists of $7 for breakfast, $12 for lunch, $18 for dinner, and $9 for incidental expenses.

- Excluding telecommunications, business center, and parking charges, ELC's total room service charges were $2,272, of which $1,229 (54.1 percent) was paid from the FTL Phase II grant. We were unable to determine if all the room service charges were reasonable and necessary based upon the invoices obtained, the length of stay, and the meals provided at conference. However, $261 of the room service charges paid from the FTL Phase II grant was unreasonable and questionable. These costs include $57 for meals where meals were already provided during ELC's conference; $106 in unnecessary laundry service charges given the length of stay; $6 for in-room movies because entertainment costs are unallowable under OMB Circular A-122, Attachment B, paragraph 14, *Entertainment costs*; $6 for golf shop purchases because goods or services for personal use are unallowable under OMB Circular A-122, Attachment B, paragraph 18, *Goods or services for personal use*; $67 for meals charged after the close of the conference; and $19 for purchases of bottled water from the guestrooms.

In August 2005, ELC removed the $61,696 of 2003 annual conference costs charged to the FTL II grant.

The FTL Phase III grant was charged $7,352 for ELC's 2004 annual conference held in Orlando, Florida in December 2004. These costs, which were paid in October and November 2004, include $4,915 for advertising and $2,220 for the printing and mailing of postcards. In addition, in September 2004, $217 was charged for "Rebel With a Cause" jackets presented as awards. OMB Circular A-122 specifies that selected items of cost are unallowable, for example:

- ELC charged $4,915 to the FTL Phase III grant for the image, placement, and purchase of an advertisement for the annual conference. Advertising is unallowable under OMB Circular A-122, Attachment B, paragraph 1, *Advertising and public relations costs*. Additionally, ELC's 2002 cost policy stated that advertising costs (other than for recruitment of staff or for the disposal of property) are unallowable charges to federal awards.

- ELC allocated $217 to the FTL Phase III grant for "Rebel With a Cause" jackets that were presented as awards. However, the cost of memorabilia, gifts and souvenirs is unallowable under OMB Circular A-122, Attachment B, paragraph 1, *Advertising and public relations costs*. In August 2005, ELC removed this cost from the FTL Phase III grant expenses.

Pursuant to the selected items of cost contained in OMB Circular A-122, Attachment B, paragraph 29, *Meetings and Conferences*, to the extent that meetings and conference costs are identifiable with a particular cost objective, they should be charged to that objective. Therefore, the 2003 annual conference costs should have been charged to ELC's annual conference cost center, as ELC reported $90,455 of annual conference income in excess of expenses in 2003. The annual conference revenue reported in 2003 was sufficient to cover ELC's 2003 annual conference costs charged to the FTL Phase II grant. In addition, the 2004 conference costs should have been charged to the annual conference cost center, as ELC reported revenue in 2004 for the annual conference.

Compliance With General Cost Principles

ELC's treatment of annual conference costs did not comply with general cost principles. Under general cost principles, the annual conference costs should have been charged to ELC's annual conference cost center. Under OMB Circular A-122, Attachment A, Section B, paragraph 1, direct costs are those that can be identified specifically with a particular final cost objective. Costs identified specifically with other cost objectives of the organization are direct costs of those objectives and are not to be assigned to other awards directly or indirectly. In addition, under paragraph 4, the costs of activities, such as meetings and conferences (except those held to conduct the general administration of the organization), performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs. Also, ELC's 2002 cost policy stated that the cost of activities performed as a service to members, clients, or the general public are classified as direct costs, and that such activities include meetings and conferences, except those held to conduct the general administration of ELC.

Similarly, allocability is among the general criteria for determining the allowability of costs. Under OMB Circular A-122, Attachment A, Section A, paragraph 4, a cost is allocable to a grant award if it is incurred specifically for the award, benefits both the award and other work and can be distributed in a reasonable proportion to the benefits received, or is necessary for the overall operation of the organization. ELC did not include the annual conference as being either a specific objective or measurable outcome of the FTL project in the FTL Phase II and III grant applications submitted to the Department. (Appendix A details ELC's objectives and measurable outcomes for FTL Phases II and III as detailed in ELC's grant applications submitted to the Department.) Given the amount of the conference programming devoted to FTL related matters, ELC's charges to the FTL grants were not reasonable. ELC charged 54.1 percent of the 2003 conference center costs and 40 percent of the audio-visual and award costs to the FTL Phase II grant. However, it appears that only 27 percent (approximately) of the 2003 conference's programming may have been devoted to FTL related matters.

In general, ELC intended to allocate 90 percent of 2004 conference costs to the FTL Phase III grant when the costs were paid in 2004 and 2005. However, it appears that only 66 percent (approximately) of the 2004 conference's programming may have been devoted to FTL related matters. ELC believes that approximately 90 percent of the 2004 conference was FTL related, because the overall purpose of the FTL program is to support the implementation of NCLB and the FTL grant application noted ELC would disseminate information through speeches and other methods. The difference in the percentage (i.e., 66 percent versus 90 percent) of the 2004 annual conference that was FTL related is mainly due to seven conference sessions, that while they appear to be related to NCLB, do not appear to be FTL related. These conference sessions include (1) *General Session: No Child Left Behind: Real Progress So Far?*, (2) *Reading for All Students: Research-Based Practices*, (3) *General Session: The President's Next Term*

Agenda, (4) *Virtual Schools: A New Reality?*, (5) *Using Research-Based Practices to Improve School Discipline: What Works in the Real World*, (6) *Charter Schools: Promoting Growth and Trimming Chaff*, and (7) lunch with the K12 Chancellor for the Florida Department of Education. ELC did not maintain documents, such as presentation materials or session handouts, to support its contention that the sessions were FTL related.

Printing Costs

The FTL Phase II grant was charged $5,148 for two payments for printing costs. These costs are questioned because they were not allocable to the FTL program. For one payment made in March 2004, of which $2,575 was charged to the FTL Phase II grant, the invoices were specifically for printing ELC and ABCTE related items, and should have been charged directly to ELC's communications and marketing and ABCTE cost centers, respectively. For the second payment, made in February 2004, of which $2,573 was charged to FTL Phase II grant, the invoices indicated that the services were for ELC, ABCTE and annual conference matters. As such, these costs should have been directly charged to ELC's cost centers for communications and marketing, ABCTE, and annual conference, respectively. In August 2005, ELC removed the $2,573 in costs for the February 2004 payment from FTL Phase II grant expenses.

Interest, Delinquency and Late Payment Fees

ELC charged $1,294 for interest, delinquency, and late payment fees to the FTL Phase II and III grants. Interest costs are unallowable under OMB Circular A-122, Attachment B, paragraph 23, *Interest, fundraising, and investment management costs*. In addition, when grant funds are available for the payment of expenses, incurring interest, delinquency, or late payment fees is not a prudent expenditure of federal grant funds. In August 2005, ELC removed from FTL II grant expenditures $1,164 of American Express credit card delinquency charges.

Professional Communication Services

Portions of three payments for professional communication services were questioned because not all activities were fully allocable to the FTL program. The payments were made in September, October, and December 2004, and $50,700 was charged to FTL Phase III grant funds. We were unable to determine the allowable amount because the invoices did not contain sufficient information to permit us to do so. While each invoice contained FTL related activities, the questioned activities included:

- The June 23, 2004, invoice for $16,200 indicated work performed on the message and mission of the new ELC, annual conference planning, soliciting additional business support, and ABCTE. The costs for these services should have been determined and charged to ELC's communications and marketing, annual conference, fundraising and development, and ABCTE cost centers, respectively. The consultant's contract called for services in the following three areas: communicate with ELC/FTL target audiences, media relations, and long-term strategies. Under media relations activities, the consultant was to counsel ELC on how to handle inaccurate media eruptions, create a strategic media plan for building relationships and delivering news to education writers, and monitoring news coverage to respond immediately to any negative news and to see opportunities and trends in media reports. The initial contract covered the period May and June 2004 and was for $16,200, of which 60 percent was for communications with target audiences and 40 percent was for media relations.

- The July 31, 2004, and September 21, 2004 invoices, totaling $16,200, indicated work on the annual conference and daily scans of news coverage. The October 15, 2004, invoice for $10,200 indicated work on the annual conference. In addition, the November 9, 2004, invoice for $8,100 indicated work on the annual conference and ELC's communications plan. The costs for these services should have been determined and charged to ELC's respective cost centers, such as the annual conference and communications and marketing cost centers.

In addition, portions of six payments, totaling $93,211, made in September 2003 through March 2004 for professional communication services may have been over charged to the FTL Phase II grant. Based upon our review of the information contained in seven of the consultant's invoices, totaling $81,721, for the period June 2003 through December 2003, $42,153 in costs were allocable to the FTL Phase II grant. However, based upon information contained in ELC's accounting records, $62,806 in costs for these invoices may have been charged to the FTL Phase II grant. As a result, up to $20,653 in costs for the seven invoices may have been over charged to the FTL Phase II grant. We were unable to determine the specific amount for each invoice that was charged to the FTL Phase II grant because ELC's accounting records did not contain sufficient information to permit us to do so. The amount that may have been over charged consists of the following:

- The June 2003 invoice indicated that approximately 45.3 percent ($5,753) of the total amount of $12,700 was attributable to FTL. It appears that ELC charged the full amount of the invoice to the FTL Phase II grant when it disbursed payments in September 2003 and February 2004. As a result, $6,947 may have been over charged to the FTL Phase II grant.

- The November 2003 invoice indicated that approximately 65.9 percent ($6,408) of the total amount of $9,727 was attributable to FTL. It appears that ELC charged the full amount of the invoice to the FTL Phase II grant when it disbursed payments in December 2003 and February 2004. As a result, $3,319 may have been over charged to the FTL Phase II grant.

- The December 2003 invoice indicated that approximately 70.9 percent ($5,488) of the total amount of $7,737 was attributable to FTL. It appears that ELC charged $6,447 to the FTL Phase II grant when it paid the invoice in March 2004. As a result, $959may have been over charged to the FTL Phase II grant.

- The four invoices for July 2003 through October 2003 indicated that $24,504, of the total amount of $51,557 was attributable to FTL. It appears that ELC charged

$33,932 of the four invoices to the FTL Phase II grant when it disbursed payments in September 2003, November 2003, and March 2004. As a result, $9,428 may have been over charged to the FTL Phase II grant.

Under OMB Circular A-122, Attachment A, Section 4, a cost is allocable to a particular cost objective in accordance with the relative benefits received. As a result, costs not allocable to the FTL grants should have been charged to the respective cost centers or treated as an indirect cost.

ELC Charged Unsupported Costs to the FTL Grants.

ELC charged $140,922 in unsupported costs to the FTL Phase II and III grants. The unsupported amount consists of $40,010 charged to the FTL Phase II grant and $100,912 charged to the FTL Phase III grant. Of the total unsupported amount, ELC removed $2,596 from the FTL grant costs, consisting of $1,182 from the FTL Phase II grant and $1,413 from the FTL Phase III grant. As a result, $138,327 of unsupported costs remained. Under OMB Circular A-122, Attachment A, Section A, *Basic Considerations*, one of the factors affecting the allowability of costs is that the costs must be adequately documented. Regulations in 34 C.F.R. § 75.730 specify that a grantee shall keep records related to grant funds that fully show how the grantee uses the funds and maintain records to facilitate an effective audit. In addition, regulations in 34 C.F.R. § 74.53(b) note that financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or annual financial report. In general, to be allowable, both direct and indirect costs must be adequately supported by source documentation that shows the purposes and circumstances of the cost's incurrence. A complete listing of the unsupported costs is provided in Appendix C. The unsupported costs that ELC charged to the FTL Phase II and III grants include:

American Express Charges

The unsupported costs include $18,363 for 85 American Express credit card charges allocated to the FTL Phase II and III grants. At the start of the audit, we requested documentation supporting ELC's American Express charges. At that time, ELC's supporting documentation consisted mainly of the monthly American Express billing statements. In April 2005, ELC requested documentation, such as receipts, directly from American Express. In July 2005, ELC provided receipts for some of the selected charges. However, most of the charges remain unsupported because ELC did not provide documentation that indicated the purpose and circumstance for the cost incurrence. Of the unsupported American Express credit card charges allocated to the FTL grants, $1,487 (16 charges) was for restaurants in the Washington, DC area, $14,019 (56 charges) was for travel costs, and $2,857 (13 charges) was for other costs. Although ELC's 2002 travel policy stated costs incurred for travel are to be supported by auditable travel vouchers, travel vouchers were not prepared. In August 2005, ELC removed from the FTL Phase II and III grants six restaurant charges totaling $1,322 and three charges for other costs totaling $1,274. As a result, $15,767 of unsupported American Express credit card charges remained allocated to the FTL Phase II and III grants.

Payroll

Payroll costs of $60,685 allocated to the FTL Phase II and III grants were unsupported. For the 45 timesheets with allocations to FTL that we reviewed, 18 were not signed by the employee, 10 were signed but not dated, and 10 were signed and postdated in January 2005. OMB Circular A-122, Attachment B, paragraph 7, *Compensation for personal services*, states that time 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.

Professional Services

In September through December 2004, ELC made three disbursements for professional communication services, totaling $50,700, that were charged to FTL Phase III grant. ELC provided invoices detailing the activities performed by the consultant, however, as noted above under unallowable expenses, not all activities performed under the contract and detailed in the invoices were fully allocable to FTL. We were unable to determine the unallowable amount because the invoices did not contain sufficient information as to the time expended on each activity to permit us to determine the allowable portion. As a result, the payments were also deemed to be unsupported.

Miscellaneous Disbursements

The FTL Phase II and III grants were charged $11,175 for seven disbursements ($1,200 for accounting services, $5,890 for auditing services, $2,132 for technology services, $1,245 for design/printing services, $40 for a board member's travel costs, and $668 for newswire services). These amounts were unsupported because no invoices or receipts were provided supporting the payments.

RECOMMENDATIONS:

We recommend that the Department's Chief Financial Officer and Assistant Deputy Secretary for Innovation and Improvement require ELC to:

3.1 Refund to the Department $15,732 for the questioned costs that remain charged to the FTL grants ($8,590 for the FTL Phase II grant and $7,141 for the FTL Phase III grant).

3.2 Provide accounting records and other supporting documents showing how ELC charged each of the seven invoices, totaling $81,721, for professional communication services for the period June 2003 through December 2003, and require ELC to refund to the Department the portion of the $20,653 deemed over charged to the FTL Phase II grant by the Department.

3.3 Specify all of the 2003 and 2004 annual conference income and expenses credited and charged to the FTL Phase II and III grants and refund to the Department any amounts deemed unallowable by the Department.

3.4 Provide adequate documentation to show that the unsupported expenditures of $138,327 that remain charged to the FTL grants ($38,828 for the FTL Phase II grant and $99,499 for the FTL Phase III grant) are reasonable, allowable, and allocable to the grant(s), or refund the expenditures that the Department determines are not adequately supported.

3.5 Maintain supporting documentation for all FTL grant expenditures; require consultants to provide invoices detailing the work performed, the time spent, and the associated costs of each activity performed; and ensure employees sign and date their timesheets.

3.6 Provide all officials and employees copies of OMB Circular A-122 and ELC's internal policies and procedures for determining allowable costs, travel, use of charge cards, and payroll; ensure that the officials and employees comply with the policies and procedures; and require ELC to maintain documentation that each officer and employee had reviewed such circular and internal policies and procedures.

ELC's Comments:

In regards to the $15,732 of questioned costs, ELC noted that $192 in first class airfare has been corrected; costs of $11,828 will be approved on the belief that Department officials, who understand the programmatic nature of the FTL grant activities, will find that these costs were allocable to the grants; travel costs of $2,718 will be approved on the belief that ELC could not obtain GSA rates; and clarification from the Department is needed regarding items totaling $993.

In response to the unsupported costs identified in the audit report, ELC noted that it had undertaken the following actions and will provide the results to the Department:

- ELC contacted all former employees and requested that they certify the purpose of each trip taken and charged to ELC's credit cards. The results of the effort were being reviewed and will be incorporated into the 2004 accounting adjustments.
- ELC noted that it was alerted to deficiencies in timesheet records in 2004, when the 2003 audit was being completed. In response, ELC put in place timesheet requirements, but in some instances, only electronic copies of the timesheets were maintained. As a result, some dates and/or signatures were missing. ELC contacted all employees to request that they certify the timesheet records where they were missing. ELC will adjust its accounting records based on this exercise.
- ELC disagreed with our assessment of the reasonableness of certain vendor invoices. ELC took issue with the notion that only detailed activity reports showing how vendors spent their time could support the reasonableness of the charges.

In regards to the recommendations made in the draft report, ELC noted that they will work with the Department to resolve the questioned and unsupported costs and will provide documentation during the audit resolution process. ELC believes that it is now in full compliance with requirements concerning supporting documentation of grant expenditures. In addition, ELC noted that it had provided officials and employees with copies of OMB Circular A-122 and its operating protocols and that each employee had reviewed the documents.

OIG's Response:

We acknowledge the corrective actions taken by ELC in response to the audit recommendations.

ELC commented on some, but not all, of the costs questioned in the audit report. ELC believes that Department officials who understand the programmatic nature of the FTL grant activities will approve questioned costs of $11,828. We disagree with ELC's assessment because these costs include items that are clearly not allowable and allocable to the FTL grants. This amount includes $130 in interest and late payment charges that are specifically unallowable under OMB Circular A-122; $2,575 in printing costs that were for ELC and ABCTE related items and therefore not allocable to the FTL program; and $1,988 for updates to ELC's website that are not allocable to the FTL grant (other invoices from the vendor were specifically for work on ELC's FTL websites). The remaining $7,135 consists of costs from ELC's 2004 annual conference. While the Department may conclude that the annual conference costs were allocable to the FTL grants, we were unable to reach such a conclusion, because ELC did not maintain documents, such as presentation materials or session handouts, to support its contention that the conference sessions in question were FTL related.

ELC believes that the Department would approve the $2,718 in questioned travel costs because ELC would have been unable to obtain government pricing. We note that only the excess hotel charges of $288 were questioned because they exceeded the applicable GSA rate by 94 percent. The remaining travel costs were questioned because they were either not reasonable or not allocable to the FTL program. The questioned travel and travel related costs include $233 for a breakfast meeting for ten people; the total cost of the breakfast meeting was $583 or $58 per person. To offer a comparison, we noted in the audit report that the GSA per diem rate allocated $10 for breakfast. As a result, the $58 per person charge for breakfast exceeds that which would be incurred by a prudent person and is therefore a questioned cost. Also included in questioned travel costs was $2,197 in airfare charges that did not appear FTL related or necessary for the operations of ELC. In August 2005, ELC informed us that they intended to remove the $1,701 of airfare costs to Alberta, Canada and that $496 in airfare from Hawaii to Washington, DC was under review. If ELC now contends that the trips to Alberta, Canada and from Hawaii to Washington, DC were FTL related, ELC did not provide information to support its revised position to us.

ELC noted that it needs clarification from the Department on $993of questioned costs. These costs were questioned because they were either not reasonable or allocable to the FTL program. These questioned costs include $600 for a forfeited deposit to a hotel for ELC's annual retreat; $60 for American Express credit card membership reward program fees (this amount is in addition to the fees already removed from the grant charges by

ELC); $26 for legal fees that are not FTL related (this amount is in addition to the legal fees already removed from the grant charges by ELC); and $307 in payroll charges.

ELC commented on some, but not all, of the unsupported costs contained in the audit report. We note that ELC's actions to have employees certify their travel charges and timesheets indicate that these costs were unsupported at the time of our audit. ELC noted that it was alerted to deficiencies in its time sheet records in 2004, when the 2003 audit was being completed. However, we note that a similar issue was raised in ELC's 2002 single audit, issued in May 2003. In ELC's 2002 single audit, the auditor recommended that personnel activity reports supporting the actual amount of time spent for each cost center be maintained. ELC concurred with the finding and recommendation and noted that it had adopted a policy of completing timesheets.

In regards to ELC taking issue with the notion that only detailed activity reports showing how vendors spent their time could support the reasonableness of the charges. ELC provided no comments that address the issue raised in the audit report. The audit report noted that the consultant's invoices in question contained activities that were allowable, questionable, or not fully allocable to the FTL program, and that we were unable to determine the allowable amount because the invoices did not contain sufficient information as to the time expended on each activity.

In order to facilitate the audit resolution process, we have revised the report's appendices to provide additional information on the questioned and unsupported costs discussed in this finding.

OTHER MATTERS

ELC's Financial Position

ELC's current financial position is a cause for concern. As a result, we suggest that the Department's Chief Financial Officer regularly monitor ELC's financial condition. Our concern is due to the following conditions:

- ELC's net assets have steadily decreased during the period from calendar year end (CYE) 2001 to September 2, 2005. At CYE 2001, ELC's net assets were negative $25,033, and by September 2, 2005, ELC's net assets declined to negative $547,000.[11] ELC's increasing negative net assets were the result of recurring operating deficits during the intervening periods. Significantly decreasing net assets may indicate problems with a non-profit entity's financial solvency.

- The current ratio (current assets divided by current liabilities) measures an entity's ability to cover its current obligations from current assets. ELC's current ratio was 1:1.62 as of CYE 2003, 1:1.27 as of CYE 2004, and 1:15.07 as of September 2, 2005. ELC's current ratios indicate that its current assets are less than its current liabilities. Current ratios of less than 1:1 may raise concerns regarding an entity's liquidity. As

[11] Amounts as of September 2, 2005, are approximate amounts, reported by ELC that have not been audited.

of September 2, 2005, ELC reported current liabilities of $427,000 and current assets of $28,000, of which $23,000 was cash or cash equivalents.

- The Department's grants constitute the majority of ELC's revenue. In calendar year 2004, the federal grants constituted approximately 93 percent of ELC's total revenue. This percentage has increased from calendar 2002, when the federal grants constituted approximately 70 percent of ELC's total revenue. In 2004, the most recent calendar year, ELC reported $737,000 in revenue from sources other than federal grants. Of this amount, $200,000 was a non-cash contribution resulting from the forgiveness of a note payable. An organization that relies heavily on few sources of income is more at risk financially than an organization with multiple revenue sources.

- ELC's current financial position does not reflect the resolution of findings with questioned costs for this audit or ELC's CYE 2002 and CYE 2003 single audit reports. These single audit reports contain findings with questioned costs totaling approximately $726,000. ELC will be liable for the portion of the questioned costs disallowed by the Department.

In its comments on the audit report, ELC noted that it has submitted a turnaround plan to the Department to address the issues pertaining to ELC's fiscal health

ELC's 2004 Accounting Records

Under OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*, ELC's calendar year 2004 single audit report was due on September 30, 2005. As of September 30, 2005, ELC's accounting records for calendar year 2004 were not finalized, and the 2004 single audit had not begun. In September 2005, ELC had retained an independent public accounting firm to perform the 2004 single audit. In its comments on the audit report, ELC noted that it was ready to schedule the 2004 single audit.

OBJECTIVE, SCOPE AND METHODOLOGY

The objectives of our audit were to determine if (1) federal funds drawn down by ELC for the FTL program were used for ELC's operations and (2) expenditures allocated to the federally funded FTL program were reasonable, allocable, and allowable in accordance with regulations. The audit covered the period January 1, 2004, through December 31, 2004.

To accomplish the audit objectives, we reviewed applicable criteria contained in the Education Department General Administrative Regulations (34 C.F.R. Parts 74 and 75) and OMB Circular A-122, *Cost Principles for Non-Profit Organizations*.[12] We reviewed ELC's grant applications for FTL Phase I, II, and III for the fiscal year 2002, 2003, and 2004 grant awards, respectively; single audit reports for CYE 2002 and 2003; and

[12] See footnotes 2 and 6.

policies and procedures concerning the drawdown and expenditure of grant funds. We obtained and reviewed accounting reports from ELC's finance system, bank statements and cancelled checks, payroll reports and timesheets, and vendor invoices and other documents supporting expenditures. We interviewed ELC's current Chief Executive Officer, Chief Policy Officer, contract Chief Financial Officer, and Director of Federal Programs.

To achieve the audit's objectives, we relied upon computer-processed data contained in ELC's Fast Fund accounting system, ELC's accounting system of record, as of May 17, 2005. We assessed the completeness and accuracy of this data. As part of this assessment, we compared bank statements and cancelled checks to transactions contained in ELC's accounting system. We also compared judgmentally selected computer-processed data to source records. Based upon this preliminary assessment, we concluded that data used was sufficiently reliable for the assignment's objectives.

To determine if the federal funds drawn down by ELC for the FTL program were used for ELC's operations, we reviewed ELC's audited financial statements for calendar years 2002 and 2003, accounting reports from ELC's finance system for calendar year 2004, and compared the grant expenditure amounts to grant drawdowns contained in the Department's Grants Administration and Payment System.

To determine if the costs charged to the federal grants were reasonable, allocable, allowable and adequately supported in accordance with applicable regulations and OMB Circular A-122, we selected expenditures for review. During the period January 1, 2004, to December 31, 2004, ELC made 382 disbursements totaling $5,212,117, from its Operating Account. These disbursements were allocated to both the FTL grants and ELC's other cost centers. The disbursements consisted of nine payments to American Express totaling $195,510, 48 disbursements for payroll and payroll taxes totaling $721,078, 318 payments for other expenses totaling $1,295,529, and 7 payments to Achievement Technologies, Incorporated totaling $3,000,000. The 2004 payments to Achievement Technologies, Incorporated were excluded from our review as they will be included in our audit of ELC's subcontracting activities (Control Number A03-F0003).

From the remaining population, totaling $2,212,117, of payments made in 2004, we judgmentally selected transactions as follows:

- We reviewed the November 2003 through December 2004 American Express statements and judgmentally selected 129 charges, totaling $62,136. Of the total selected, 125 charges, totaling $32,237 (51.9 percent), were allocated to the FTL Phase II and III grants. Charges were selected based upon the type and location of the vendors, location of travel, charge type, and amount.
- We judgmentally selected six pay periods representing payroll charges of $157,162. Of the total payroll charges selected, $70,341 (44.8 percent), were allocated to the FTL Phase II and III grants.
- For the other expenses, we selected all payments of $1,000 or greater (excluding three payments for retirement plan contributions), that resulted in 143 payments totaling

$1,235,414 being selected. Of the total selected, 86 payments, totaling $697,612 (56.5 percent), were allocated to the FTL Phase II and III grants.

In addition, we judgmentally selected one $20,000 payment that was made in 2003 and allocated to the FTL Phase II grant, because it was for ELC's 2003 annual conference. Because portions of the selected expenditures were based upon the audit team's judgment, there is no assurance that the selections are representative of the entire population and, therefore, should not be projected over the unselected expenditures. A table summarizing our selections is provided in Appendix C. Due to concerns about ELC's charging of questioned expenditures, we have referred this matter to our Office of Investigations for further review.

We assessed the system of internal control, policies, procedures and practices applicable to ELC's drawdown and expenditure of federal funds. For purposes of the audit, we assessed and classified the significant controls into the following categories: (1) drawdown of federal funds and (2) expenditure of federal funds. Because of inherent limitations, a study and evaluation made for the limited purposes described above would not necessarily disclose all material weaknesses in internal controls. However, our assessment disclosed significant internal control weaknesses that adversely affected ELC's ability to administer the federal grant funds. These weaknesses resulted in ELC overdrawing grant funds, charging questioned and unsupported costs to the grants, and not having an approved indirect cost plan. These weaknesses and their effects are fully discussed in the Audit Results section of the audit report.

We conducted on-site fieldwork at ELC's offices in Washington, DC during the period March 30, 2005, through April 28, 2005 . On August 16, 2005, we held an exit conference with ELC's management. We conducted the audit in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

APPENDIX A – FTL OBJECTIVES AND MEASURABLE OUTCOMES

FTL Phase II (FY 2003 Grant)
Objective 1 – Help state education agencies (SEAs), local education agencies (LEAs), schools, classrooms, and families achieve adequate yearly progress (AYP). Measurable Outcomes – • All teachers in FTL schools will be using a standards-based accountability system, including web-based applications to track student progress against the state's academic standards. • The SEA will have a usable database of instructional resources for use by every teacher in the state. • States will begin to adopt reforms and other practices to professionalize the teaching profession. • Parents in FTL schools will have access to a daily progress report detailing the progress of their child toward meeting state standards and achieving AYP. • School and LEA leaders will have access to information on the progress of teachers, schools and LEAs in meeting standards and AYP. • Schools and LEAs will identify the assistance the schools and teachers need to close achievement gaps and increase academic performance.
Objective 2 – Help states determine the real costs of NCLB and optimize state, local and federal resources to increase student academic success. Measurable Outcomes – • Participating states will undergo an analysis of the actual costs of implementing the requirements of NCLB in their state. • States will receive technical assistance regarding NCLB that allow for more flexible administration and oversight of education programs. • States will receive guidance regarding the effective use of existing resources to optimize educational opportunities for students. • The Department will be provided with information needed to determine ongoing budgetary needs for successful implementation of NCLB.
Objective 3 – Create state and local-based change agents. Measurable Outcomes – • Each participating states will have a project leader appointed within 60 days of notification that the state will participate. • Each LEA added under FTL Phase II will host an event to generate awareness of the FTL program and the policies of NCLB.

FTL Phase III FY 2004 Grant)
Objective 1 – Improve student achievement through the use of FTL tools, project leaders, and practices via student-teacher interaction. Measurable Outcomes – • Provide access and support for FTL tools to students. • Provide professional development and support for FTL tools to teachers. • Provide professional development and support on FTL practices to teachers. • Analyze FTL's progress in helping students achieve proficiency against state standards and implement recommendations for improving FTL. • Analyze FTL's progress in helping schools reach their state AYP goals.
Objective 2 – Enhance educational network to support student achievement through use of FTL tools, project leaders, and practices. Measurable Outcomes – • Provide school and LEA administrators guidance in analyzing student achievement and implementing improvements. • Provide student achievement data and other information materials to parents. • Engage the Supplemental Services Coalition to introduce services to LEAs and SEAs. • Provide SEAs with FTL progress reports on FTL efforts in their LEAs and schools.
Objective 3 – FTL will continue to evaluate and improve its tools, project leaders, and practices. Measurable Outcome – • Analyze cost of implementation of a sample of FTL school-based sites to determine the expected cost range for implementation. • Develop a comparison of FTL school-based service providers with other potential service providers. • Evaluate effectiveness of project leaders and implement recommendations for improvement.Develop a knowledge sharing capability to disseminate best practices across FTL. • Disseminate best practices and lessons learned about NCLB implementation to the broader education community and public through publications and speeches.
Objective 4 – To promote the policy and ideas of NCLB in schools and LEAs participating in FTL. Measurable Outcome – • Analyze school and LEA leader understanding of NCLB goals as reflected in their diagnostic, instructional and data analysis activities.

APPENDIX B
FINDING NO. 3 – SCHEDULE OF QUESTIONED COSTS

Questioned Amount	Amount Removed by ELC	Amount to be Resolved FTL Phase II	Amount to be Resolved FTL Phase III	Description	Criteria
$2,370	$2,344	$26	--	ELC allocated 40 percent ($3,375) of a March 2004 payment (check 3611) for legal fees (Webster, Chamberlain and Bean, invoice 7640 dated October 6, 2003, and invoice 8660 dated January 12, 2004) to the FTL Phase II grant. Of this amount, $2,370 was not allocable to the FTL grants and should have been charged to ELC's general and administrative cost center. In August 2005, ELC removed $2,344 of the questioned charges from the FTL Phase II grant.	Pursuant to OMB Circular A-122, Attachment A, Section A, paragraph 4, a cost is allocable to a grant award if it is incurred specifically for the award, benefits both the award and other work and can be distributed in a reasonable proportion to the benefits received, or is necessary for the overall operation of the organization.
$1,988	--	$1,988	--	ELC allocated 100 percent of the June 2004 payment (check 3672) for updates to ELC's website (Summerhouse Studios, invoice 04-000136 dated April 15, 2004) to the FTL Phase II grant. The amount was questioned because it was not allocable to the FTL program. We noted that other invoices (invoice 04-000143 dated April 15, 2004, and invoice 04-000121 dated February 4, 2004) were specifically for work on ELC's FTL websites.	
$288	--	$288	--	ELC charged the FTL Phase II grant $288 for excess lodging costs in February 2004 (one night for $96 in excess lodging costs, charged on February 11, 2004) and March 2004 (two nights for $192 in excess lodging costs, charged on March 4, 2004). ELC charged $169 per night (excluding taxes) for lodging in Houston, Texas at the Houstonian Hotel. This rate is 94 percent above the 2004 GSA rate of $87 per night.	Pursuant to OMB Circular A-122, Attachment A, Section A, paragraph 3, a cost is reasonable if it does not exceed that which would be incurred by a prudent person. In addition, ELC's 2002 travel policy stated that costs incurred for travel were limited to those allowable under Federal Travel Regulations.

Questioned Amount	Amount Removed by ELC	Amount to be Resolved FTL Phase II	Amount to be Resolved FTL Phase III	Description	Criteria
$307	--	$423	($116)	Our review disclosed payroll expenses that were not allocable to the FTL grants because amounts in the payroll allocations did not agree with employees' timesheets and amounts that were charged to the FTL Phase II grant, that should have been charged to FTL Phase III grant. The questioned payroll expenses included: • For the pay period ended April 2, 2004, 48.2 percent of the gross pay for the Director of Communications should have been allocated to the FTL Phase II grant. However, 56.9 percent was allocated. As a result, $136 was over allocated to the FTL Phase II grant. • For the pay period ended June 30, 2004, a total of $287 of gross pay for the Member Services Coordinator and Chief Operating Officer was over charged to the FTL Phase II grant and under charged to the FTL Phase III grant. • For the pay period ended September 15, 2004, 39.2 percent of the gross pay for the Chief Executive Officer should have been allocated to the FTL Phase III grant. However, 43.5 percent was allocated. As a result, $171 was over allocated to the FTL Phase III grant.	Pursuant to OMB Circular A-122, Attachment A, Section A, paragraph 4, a cost is allocable to a grant award if it is incurred specifically for the award, benefits both the award and other work and can be distributed in a reasonable proportion to the benefits received, or is necessary for the overall operation of the organization.
$192	--[13]	$192	--	In January 2004, ELC reimbursed a board member for first-class airfare costs to attend ELC's December 2003 board meeting. ELC allocated 40 percent of the payment (check 3513) to the FTL Phase II grant. We estimated the questioned amount of $192 based upon the average difference (57.5 percent) between first-class airfare and coach airfare for two comparable trips on the same airline. In August 2005, ELC informed us that they intended to remove the charges for first class airfare.	Pursuant to OMB Circular A-122, Attachment B, paragraph 55, the difference between first-class air accommodations and less than first-class air accommodations is unallowable.

[13] In the comments to the draft report, ELC noted that this questioned cost had been corrected.

Questioned Amount	Amount Removed by ELC	Amount to be Resolved FTL Phase II	Amount to be Resolved FTL Phase III	Description	Criteria
$600	--	$600	--	ELC allocated to the FTL Phase II grant 40 percent ($600) of a November 4, 2003, hotel charge ($1,500 in total to Nemacolin Woodlands Resort and Spa) for a forfeited deposit for ELC's annual retreat.	Pursuant to OMB Circular A-122, Attachment A, Section A, paragraph 3, a cost is reasonable if it does not exceed the which would be incurred by a prudent person and whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or performance of the award. In addition, pursuant to OMB Circular A-122, Attachment A, Section A, paragraph 4, a cost is allocable to a grant award if it is incurred specifically for the award, benefits both the award and other work and can be distributed in a reasonable proportion to the benefits received, or is necessary for the overall operation of the organization.
$25	$25	--	--	ELC allocated to the FTL Phase II grant 40 percent ($25) of a January 2004 charge for flowers. In August 2005, ELC removed the charge from the FTL Phase II grant expenses.	
$130	$70	$60	--	ELC charged the FTL Phase II grant $130 (100 percent) for American Express credit card membership reward program fees charged on January 1, 2004, ($70) and March 16, 2004, ($60). In August 2005, ELC removed $70 of the charges from the FTL Phase II grant expenses.	
$9	$9	--	--	ELC allocated to the FTL Phase II grant 40 percent ($9) of a March 2004 charge for a Sports Illustrated magazine subscription. In August 2005, ELC removed the charge from the FTL Phase II grant expenses.	

Questioned Amount	Amount Removed by ELC	Amount to be Resolved FTL Phase II	Amount to be Resolved FTL Phase III	Description	Criteria
$4,821	$4,588	$233	--	See discussion of Meals and Entertainment. The questioned cost to be resolved is a February 5, 2004, charge of $583 (40 percent or $233 was allocated to the FTL Phase II grant) from the Jefferson Hotel for a breakfast meeting for ten guests.	See criteria noted in Finding No. 3.
$4,501	$2,304	$2,197	--	See discussion of Travel Costs. The questioned costs to be resolved include: • A November 11, 2003, charge of $1,241 (40 percent or $496 was allocated to the FTL Phase II grant) from Expedia for roundtrip airfare between Honolulu, Hawaii and Washington, DC for ELC's former President • Airfare to Alberta, Canada for ELC's former Director of Communications, consisting of a January 14, 2004, charge of $1,147 (40 percent or $459 was allocated to the FTL Phase II grant); a February 5, 2004, charge of $148 (100 percent was allocated to the FTL Phase II grant); and February 8, 2004, charge of $375 (100 percent was allocated to the FTL Phase II grant). All charges were from Northwest Airlines. • Airfare to Alberta, Canada for ELC's former Chief Executive Officer, consisting of a January 15, 2004, charge of $1,011 (40 percent or $404 was allocated to the FTL Phase II grant) from Northwest Airlines; and a February 5, 2004, charge of $786 (40 percent or $315 was allocated to the FTL Phase II grant) from America West Airlines.	

Questioned Amount	Amount Removed by ELC	Amount to be Resolved FTL Phase II	Amount to be Resolved FTL Phase III	Description	Criteria
$61,696	$61,696	--	--	See discussion of 2003 Annual Conference.	See criteria noted in Finding No. 3.
$7,352	$217	--	$7,135	See discussion of 2004 Annual Conference. The questioned costs include: • An October 2004 payment (check 3777) to KSA Plus Communications (invoice 0502-26, dated September 21, 2004) for the purchase of an image ($234) and the placement of an advertisement in Education Week ($2,593) and the printing and mailing of postcards ($2,220) for the annual conference (100 percent was allocated to the FTL Phase III grant). • A November 2004 payment (check 3827) of $2,320 (90 percent or $2,088 was allocated to the FTL Phase III grant) to Editorial Projects in Education (invoice 17686, dated August 30, 2004) for the purchase of an advertisement in Education Week.	
$5,148	$2,573	$2,575	--	See discussion of Printing Costs. The questioned costs to be resolved are from a March 2004 payment (check 3592) to Kwik Kopy Printing for $6,437 (40 percent or $2,575 was allocated to the FTL Phase II grant). The payment, for the printing of ELC and/or ABCTE related items, was for the following invoices: • Invoice 36421, dated September 5, 2003, for $102. • Invoice 36474, dated September 10, 2003, for $1,101. • Invoice 36512, dated September 12, 2003, for $778. • Invoice 36521, dated September 12, 2003, for $540. • Invoice 36736, dated October 3, 2003, for $2,713. • Invoice 36776, dated October 3, 2003, for $180. • Invoice 37047, dated October 27, 2003, for $564. • Invoice 37088, dated October 29, 2003, for $111. • Invoice 37097, dated October 29, 2003, for $349.	

Questioned Amount	Amount Removed by ELC	Amount to be Resolved FTL Phase II	Amount to be Resolved FTL Phase III	Description	Criteria
$1,294	$1,164	$7	$123	See discussion of Interest, Delinquency and Late Payment Fees. The questioned costs to be resolved include: • A January 2004 payment (check 3516) to Verizon that included $17 (40 percent or $7 was allocated to the FTL Phase II grant) for a late payment fee indicated on the bill dated January 4, 2004. • A June 5, 2004, American Express credit card delinquency charge of $29 (40 percent or $12 was allocated to the FTL Phase III grant). • A July 2004 payment (check 3681) to Verizon that included $43 (40 percent or $17 was allocated to the FTL Phase III grant) for a late payment fee indicated on the bill dated June 4, 2004. • A July 2004 payment (check 3696) to K3 Communications (invoice 1005, dated June 25, 2004) that included a late payment fee of $94 (100 percent was allocated to the FTL Phase III grant).	See criteria noted in Finding No. 3.
$90,721	**$74,990**	**$8,590**	**$7,141**	**Totals**	

Note: Amounts subject to rounding.

<table>
<tr><th>Questioned Amount</th><th>Amount to be Resolved FTL Phase II</th><th>Amount to be Resolved FTL Phase III</th><th>Description</th><th>Criteria</th></tr>
<tr><td colspan="5">The portions of the following costs were questioned as noted in the discussion of Professional Communication Services.</td></tr>
<tr><td>$50,700</td><td>--</td><td>$50,700</td><td>We were unable to determine the questioned amount because the invoices did not contain sufficient information to permit us to do so. The following KSA Plus Communications' invoices (paid in September, October, and December 2004 with checks 3752, 3777, and 3840, respectively) contained activities not allocable to the FTL program:
• Invoice 0411-29, dated June 23, 2004, for $16,200 (100 percent allocated to the FTL Phase III grant), indicated work performed on the message and mission of the new ELC, annual conference planning, soliciting additional business support, and ABCTE.
• Invoice 0501-3, dated July 31, 2004, for $8,100, and invoice 0502-26, dated September 21, 2004, for $8,100 in services (both 100 percent allocated to the FTL Phase III grant), indicated work on the annual conference and daily scans of news coverage.
• Invoice 0503-13, dated October 15, 2004, for $11,100 (of which, $10,200 was allocated to the FTL Phase III grant), indicated work on the annual conference.
• Invoice 0504-11, dated November 9, 2004, for $8,100 (100 percent allocated to the FTL Phase III grant), indicated work on the annual conference and ELC's communications plan.</td><td>See criteria noted in Finding No. 3.</td></tr>
</table>

Questioned Amount	Amount to be Resolved FTL Phase II	Amount to be Resolved FTL Phase III	Description	Criteria
$20,653	$20,653	--	Up to $20,653 in costs for FitzGerald Communications may have been over charged to the FTL Phase II grant. We were unable to determine the specific amount because ELC's accounting records did not contain sufficient information. The questioned amount consisted of the following: • Invoice 130311, dated June 30, 2003, indicated that approximately 45.3percent ($5,753) of the total amount of $12,700 was attributable to FTL. It appears that ELC charged the full amount of the invoice to the FTL Phase II grant when it disbursed payments in September 2003 (check 3343) and February 2004 (check 3536). As a result, $6,947 may have been over charged to the FTL Phase II grant. • Invoice 130723, dated November 30, 2003, indicated that approximately 65.9 percent ($6,408) of the total amount of $9,727 was attributable to FTL. It appears that ELC charged the full amount of the invoice to the FTL Phase II grant when it disbursed payments in December 2003 (check 3486) and February 2004 (check 3536). As a result, $3,319 may have been over charged to the FTL Phase II grant. • Invoice 130808, dated December 31, 2003, indicated that approximately 70.9 percent ($5,488) of the total amount of $7,737 was attributable to FTL. It appears that ELC charged $6,447 to the FTL Phase II grant when it paid the invoice in March 2004 (3587). As a result, $959 may have been over charged to the FTL Phase II grant. • The four invoices (130392, 130476, 130558, and 130639) for July 2003 through October 2003 indicated that $24,504, of the total amount of $51,557 was attributable to FTL. It appears that ELC charged $33,932 of the four invoices to the FTL Phase II grant when it disbursed payments in September 2003 (check 3343), November 2003 (check 3426), and March 2004 (check 3587). As a result, $9,428may have been over charged to the FTL Phase II grant.	See criteria noted in Finding No. 3.
$71,353	**$20,653**	**$50,700**	**Totals**	

Note: Amounts subject to rounding.

APPENDIX C
FINDING NO. 3 – SCHEDULE OF UNSUPPORTED COSTS

Unsupported American Express Charges						
Charge Date	**Vendor**	**Charge Type/Location**	**Total Amount**	**FTL Allocation**	**Unsupported FTL Phase II Grant**	**Unsupported FTL Phase III Grant**
November 11, 2003	American Airlines	Airfare to Dallas, TX	$1,312	40%	$525	
November 13, 2003	Hertz Car Rental	San Diego, CA	$179	100%	$179	
November 13, 2003	Residence Inn	La Jolla, CA	$330	100%	$330	
December 16, 2003	St. Gregory Hotel	Washington, DC	$714	40%	$285	
December 6, 2003	St. Gregory Hotel	Washington, DC	$379	40%	$151	
December 6, 2003	St. Gregory Hotel	Washington, DC	$182	40%	$73	
January 22, 2004	Action Without Borders	Membership Organization	$50	40%	$20	
January 8, 2004	Marriott Hotel	Boston, MA	$456	100%	$456	
January 13, 2004	MacNair Travel Mgmt	Travel Services	$1,013	100%	$1,013	
January 27, 2004	Hertz Car Rental	Phoenix, AZ	$125	100%	$125	
January 27, 2004	Courtyard	Phoenix, AZ	$173	100%	$173	
February 3, 2004	Ricky's Taxi Services	Springfield, VA	$84	40%	$34	
February 4, 2004	Taxi Service	Baltimore, MD	$57	40%	$23	
January 18, 2004	America West Airlines	Airfare to Los Angeles, CA	$138	40%	$55	
February 6, 2004	Bertucci's Restaurant	Washington, DC	$69	40%	$28	
March 1, 2004	Nooshi Restaurant	Washington, DC	$66	40%	$26	
February 11, 2004	Houstonian Hotel	(Restaurant) Houston, TX	$338	100%	$127	
February 11, 2004	Houstonian Hotel	Houston, TX	$198	100%	$198	
February 21, 2004	Desmond Great Valley	(Lodging) Malvern, PA	$288	40%	$115	
March 9, 2004	Bertucci's Restaurant	Washington, DC	$56	40%	$23	
March 19, 2004	Georgetown Seafood	Washington, DC	$45	40%	$18	
March 22, 2004	Sorriso	(Food and Beverage) Washington, DC	$81	40%	$32	
March 28, 2004	Hertz Car Rental	Miami, FL	$267	100%	$267	
March 22, 2004	American Airlines	Airfare to Miami, FL	$1,359	100%	$1,359	
March 26, 2004	Aqua Hotel and Lounge	Miami, FL	$19	100%	$19	

Charge Date	Vendor	Charge Type/Location	Total Amount	FTL Allocation	Unsupported FTL Phase II Grant	Unsupported FTL Phase III Grant
April 6, 2004	Gentner	Audio Conference	$465	40%	$186	
April 6, 2004	Gentner	Audio Conference	$555	40%	$222	
April 6, 2004	Gentner	Audio Conference	$984	40%	$394	
April 12, 2004	Georgetown Seafood	Washington, DC	$50	40%	$20	
April 14, 2004	MWI Connections	Membership	$10	40%	$4	
April 29, 2004	Starbucks	Washington, DC	$11	40%	$4	
April 5, 2004	US Online.com	(U.S. Airways) Airfare to Colorado Springs, CO	$1,162	40%	$465	
April 20, 2004	America West Airlines	Airfare to San Jose, CA	$457	40%	$183	
April 25, 2004	Northwest Airlines	Airfare to Minneapolis, MN	$643	40%	$257	
May 14, 2004	Expedia E-Packages	Travel	$512	40%		$205
May 17, 2004	OU CCE Registration	College/University	$150	40%		$60
May 21, 2004	California Pizza Kitchen	Washington, DC	$68	40%		$27
May 25, 2004	Seattle's Best Coffee	Orlando, FL	$8	40%		$3
May 25, 2004	Seattle's Best Coffee	Orlando, FL	$9	40%		$4
May 27, 2004	Allied Telecom Group	Electronics	$575	40%		$230
May 27, 2004	Staples	(Office Supplies) Washington, DC	$293	40%		$117
June 2, 2004	Trans National Com	Professional Services	$683	40%		$273
May 21, 2004	Houstonian Hotel FD	Houston, TX	$380	40%	$152	
May 21, 2004	Houstonian Hotel FD	Houston, TX	$198	40%	$79	
June 3, 2004	Harry's Tap Room	Arlington, VA	$63	40%	$25	
May 8, 2004	Courtyard	Brighton, MI	$89	40%		$36
June 8, 2004	Take Out Taxi Arlington	(Food and Beverage) Falls Church, VA	$158	40%	$63	
June 18, 2004	Avis Rent-A-Car	Miami, FL	$161	40%	$64	
June 29, 2004	Staples	(Office Supplies) Phoenix, AZ	$193	40%	$77	
July 30,2004	Orbitz LLC	(U.S. Airways) Airfare to Columbia, SC	$298	40%		$119
July 14, 2004	Ortanique	(Food and Beverages) Washington, DC	$292	100%		$292
July 20, 2004	MacNair Travel Mgmt	(American Airlines) Airfare to Los Angeles, CA	$793	100%		$793
July 23, 2004	Expedia ESR Hotel	Travel/Lodging	$288	100%		$288

Charge Date	Vendor	Charge Type/Location	Total Amount	FTL Allocation	Unsupported FTL Phase II Grant	Unsupported FTL Phase III Grant
August 4, 2004	MacNair Travel Mgmt	(U.S. Airways)Airfare to New York, NY	$257	100%		$257
July 19, 2004	American Airlines	Airfare to Los Angeles, CA	$462	100%		$462
July 23, 2004	America West Airlines	Airfare to Los Angeles, CA	$165	100%		$165
July 26, 2004	Holiday Inn	Los Angeles, CA	$47	100%		$47
July 27, 2004	Holiday Inn	Los Angeles, CA	$124	100%		$124
July 27, 2004	Holiday Inn	Los Angeles, CA	$124	100%		$124
July 27, 2004	Holiday Inn	Los Angeles, CA	$124	100%		$124
July 27, 2004	Holiday Inn	Los Angeles, CA	$124	100%		$124
July 27, 2004	Holiday Inn	Los Angeles, CA	$139	100%		$139
July 27, 2004	Holiday Inn	Los Angeles, CA	$124	100%		$124
July 27, 2004	Holiday Inn	Los Angeles, CA	$139	100%		$139
July 23, 2004	American Airlines	Airfare to Washington, DC	$841	100%		$841
July 23, 2004	Hotels.com	Lodging	$386	40%		$154
August 6, 2004	Orbitz LLC	(Frontier Airlines) Airfare to Denver, CO	$287	39%		$111
August 13, 2004	Hertz Car Rental	Anchorage, AK	$646	100%		$646
August 16, 2004	Expedia ESR Hotel	Travel/Lodging	$549	100%		$549
August 26, 2004	Hotel Lucerne	New York, NY	$161	100%		$161
August 20, 2004	Old Ebbitt Grill	Washington, DC	$54	40%		$22
August 27, 2004	Georgetown Seafood	Washington, DC	$51	40%		$20
September 30, 2004	Marriott	Jackson, MS	$183	100%		$183
September 28, 2004	Lincoln Suites Downtown	Washington, DC	$500	100%		$500
November 2, 2004	MacNair Travel Mgmt	(Southwest Airlines) Airfare to Orlando, FL	$177	100%		$177
November 3, 2004	MacNair Travel Mgmt	(Northwest Airlines)Airfare to Orlando, FL	$310	90%		$279
		Totals	**$23,496**		**$7,847**	**$7,920**

Note: Amounts subject to rounding

Unsupported Payroll									
Pay Period Ending	**Total Payroll**	**Total Timesheets**	**FTL Allocation**	**Timesheets with FTL Allocations**				**Unsupported FTL Phase II Grant**	**Unsupported FTL Phase III Grant**
				Total	**Not Signed**	**Signed But Not Dated**	**Signed and Postdated**		
March 24, 2004	$42,313	10	$14,086	9	5	2	1	$11,888	
April 2, 2004	$18,940	11	$6,744	9	5	--	3	$6,743	
June 30, 2004	$34,108	9	$13,483	9	5	2	2	$8,310	$5,171
September 15, 2004	$29,900	10	$13,093	7	2	2	2		$12,923
September 30, 2004	$18,650	7	$11,498	6	1	2	2		$10,639
December 15, 2004	$13,250	5	$11,437	5	--	2	--		$5,011
Totals	**$157,162**	**52**	**$70,341**	**45**	**18**	**10**	**10**	**$26,941**	**$33,744**

Note: Amounts subject to rounding.

Unsupported Professional Services and Miscellaneous Disbursements						
Date	**Check Number**	**Total Payment**	**Unsupported FTL Phase II Grant**	**Unsupported FTL Phase III Grant**	**Payee**	**Description**
September 16, 2004	3752	$16,200	--	$16,200	KSA Plus Communications	See discussion of unsupported Professional Services in Finding No. 3 and questioned costs detailed in Appendix B.
October 25, 2004	3777	$13,900	--	$8,100		
December 7, 2004	3840	$27,300	--	$26,400		
November 12, 2004	3812	$7,015	--	$5,890	Draper and McGinley	Unsupported payment because of missing invoices (27043 and 27239).
September 21, 2004	3759	$1,650	--	$1,245	Summerhouse Studios	Unsupported payment because of missing invoices (04-000152, 04-000163, 04-000164, and 04-000168). (75 percent of the payment was allocated to the FTL Phase III grant.)
June 2, 2004	3650	$1,500	$600	--	Financial and Accounting Consultant	Unsupported payments because of missing invoices for May and June 2004. (40 percent of the each payment was allocated to the FTL Phase II grant.)
June 24, 2004	3671	$1,500	$600	--		

Date	Check Number	Total Payment	Unsupported FTL Phase II Grant	Unsupported FTL Phase III Grant	Payee	Description
March 30, 2004	3601	$5,331	$2,132	--	Shared Technologies Fairchild Telecom	Unsupported payment because of missing invoices (136228, 142403, 146554, 147815, 147817, 148515, and 148975). (40 percent of the payment was allocated to the FTL Phase II grant.)
January 20, 2004	3513	$1,426	$40	--	Board Member	Unsupported payment because of missing receipt for a $100 airfare change fee. (40 percent of the payment was allocated to the FTL Phase II grant.)
February 25, 2004	3553	$1,670	$668	--	U.S. Newswire	Unsupported payment because of missing invoices (116456, 116652, 117795, and 118732). (40 percent of the payment was allocated to the FTL Phase II grant.)
	Totals	**$77,492**	**$4,040**	**$57,835**		

Note: Amounts subject to rounding.

APPENDIX D – SUMMARY OF SELECTIONS AND QUESTIONED AND UNSUPPORTED COSTS

Population	Amount and Number of Payments	Amount Selected and Count	FTL Amount and Count	FTL Questioned Amount and Percent	FTL Questioned Count	FTL Unsupported Amount and Percent	FTL Unsupported Count	Total FTL Questioned and Unsupported Amount and Percent
American Express	$195,510 (9 payments)	$62,136 (129 charges)	$32,237 (125 charges)	$11,768 (36.5%)	33 charges	$18,363 (57.0%)	85 charges	$30,131 (93.5%)
Payroll	$721,078 (48 payments)	$157,162 (52 timesheets)	$70,341 (45 timesheets)	$307 (0.4%)	5 timesheets	$60,685 (86.3%)	38 timesheets	$60,992 (86.7%)
Other Expenses[14]	$1,315,529 (319 payments)	$1,255,414 (144 payments)	$717,612 (87 payments)	$78,647 (11.0%)	19 payments	$61,875 (8.6%)	10 payments	$140,522 (19.6%)
	$2,232,117 (376 payments)	**$1,474,712**	**$820,190**	**$90,721 (11.1%)**		**$140,922 (17.2%)**		**$231,644 (28.2%)**

Note: Amounts subject to rounding.

[14] Includes a payment of $20,000 paid in 2003.

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December 21, 2005

On behalf of Following the Leaders, Inc., we submit the following response to ED-OIG audit number A03F0010, The Education Leaders Council's Drawdown and Expenditure of Federal Funds, dated November, 2005.

In December of 2005, The Education Leaders Council (ELC) re-framed its organizational mission and changed its name to Following the Leaders (FTL). A new Chief Executive Officer, Faye P. Taylor, assumed leadership of the organization. Ms. Taylor replaced Mr. Theodor Rebarber who was the CEO from October, 2004 until December 2005. During his tenure, Mr. Rebarber worked diligently to correct operational and financial difficulties that ELC had encountered primarily during the first six months of 2004.

FTL is now re-organized and in full compliance with all federal regulations governing the use of federal funds awarded by the United States Congress for the Following the Leaders program. The comments provided herein address serious shortcomings that were identified by ELC under Mr. Rebarber's leadership and were reported to the U.S. Department of Education (Department) immediately. It was ELC's reporting of financial mismanagement and the overdraw of federal funds which in turn resulted in the Inspector General's review of ELC's 2004 finances.

It is important to note that throughout the entire period of the OIG's audit, ELC had not closed its 2004 accounting records. When Mr. Rebarber assumed leadership of ELC in late 2004, the 2003 audit was underway but not yet complete. We set to work completing the 2003 audit and reviewing and adjusting the 2004 (and 2005) accounting records as needed to make them accurate and to comply with federal regulations. It is our position that many of the shortcomings identified by the Department would have been and were corrected as a result of this internal review process. Thus, while we concur with the findings concerning financial protocols, we have long since corrected many of the accounting entries, a fact which is given minimal attention in this report.

Following the Leaders

The OIG's report has identified three findings:

1. *ELC did not comply with federal regulations concerning the drawdown of grant funds. ELC overdrew Following the Leaders Phase II Grant Funds.*

Auditee response: We concur that ELC did not comply at times with federal regulations concerning the drawdown of grant funds and that, as a result, ELC overdrew federal funds. Specifically, weak internal controls resulted in a lapse of enforcement of both the "three day rule" (34 CFR section 74.22(b)(3) for expending federal funds and of ELC's process for matching invoices to drawdowns it had submitted. The OIG reviewed 24 drawdowns. There were, in fact 63 total FTL II drawdown requests; of these 63, 10 did not have proper documentation. All ten of these draws were submitted to the Department between January and June of 2004.

The OIG report concludes that ELC overdrew $495,326 in federal funds as a result of weak financial controls. At the time OIG completed its review, that number was accurate in our opinion. Based upon ongoing adjustments and corrections to our 2004 records, the overdraw has actually dropped $476,169 (this amount might be adjusted further pending completion of the 2004 independent audit and could drop significantly pending review of our indirect cost proposal). We have completed negotiations with the Department about a repayment plan and timetable and continue to work closely with the Department to meet our obligations. It is also worth noting that we have prepared a repayment plan that would allow us to address additional re-payment amounts identified during audit resolution.

The OIG report contains two corrective recommendations under finding 1:

- *Return overdrawn funds to the Department:* as noted, we have negotiated a repayment plan to return funds.
- *Submit documentation in support of each drawdown request:* we have assembled this information and will review it with the Department upon request.

2. *ELC did not have an approved indirect cost plan.*

ELC allocated indirect expenses using the direct allocation method permitted under OMB Circular A-122. ELC did not believe that prior approval was required to allocate allowable joint costs on a direct basis. ELC was of the opinion that prior approval was only required when applying an indirect rate (as stated in OMB A-122).

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ELC did not apply an indirect rate to general and administrative expenses and thus believed no prior approval was required.

In December, 2005, ELC did submit an indirect rate proposal (as required under Special Conditions put in place by the Department in June of 2005). That proposal was based on the most recent audited financial statements. If approved, FTL will in fact be owed substantial funds for the indirect portion of general and administrative costs from 2003 to the present. These funds would significantly reduce the overdraw.

The OIG report contains two corrective recommendations under finding 2:

- *Submit an indirect cost plan to the Department:* this has been done.
- *Refund any costs allocated to FTL grants not in accordance with the approved plan:* as noted above, we expect that approval of the plan will actually result in a reduction of the overdraw of federal funds.

3. *ELC did not comply with cost principles contained in OMB Circular A-122. ELC charged unallowable and unsupported costs to the Following the Leaders grants.*

The audit concludes that ELC charged $15,732 in unallowable and $138,327 in unsupported costs to Phase II and III of the Following the Leaders appropriations.

Unallowable Costs: Of the 12 items that comprise the $15,732:

- 1 item has since been corrected ($192)
- 4 items we believe will be approved by the Department staff who understand the programmatic nature of the grant activities ($11,828): these items pertain to activities charged to the grant that OIG did not believe could reasonably be allocated
- 3 items we disagree with and believe will be approved by Department personnel ($2,718): these items pertain to OIG's assumption that ELC should have been able to obtain government pricing on travel and travel-related costs. ELC's travel policy called for compliance with government regulations but did not specify compliance with GSA rates. It is our firm belief that it is not possible – and therefore not reasonable - for a non-profit organization of ELC's size to expect to obtain rates available to the federal government through its large purchasing power.
- 4 items we need clarification on from the Department ($993)

Unsupported Costs:

The OIG audit has questioned costs based on an assessment of appropriate documentation that focuses on credit card charges for travel, timesheet records, and vendor invoice detail. We look forward to reviewing and resolving these issues with the Department and offer brief comments in response here.

- Travel receipts and records: In response to concerns raised by OIG, ELC completed undertook to contact all former employees and ask them to certify the purpose of each trip taken and charged to the company credit card. The results of that effort are being reviewed and will be incorporated into our final 2004 accounting adjustments.
- Timesheets: ELC was alerted to deficiencies in timesheet records in 2004 when the 2003 audit was being completed. The organization put in place new timesheet requirements, but in some instances has maintained only an electronic copy of the timesheets which means that some dates and/or signatures are lacking. ELC undertook another exercise to contact all employees to get certification of timesheet records where they were missing. We adjusted our accounting records based on this exercise and look forward to reviewing the results with the Department.
- Vendor invoice detail: we disagree with OIG's assessment of the reasonableness of certain vendor invoices. We believe that the value of certain contracts can be demonstrated in a variety of means; however, OIG consistently relied on the notion that only detailed activity reports showing how time was spent by vendors could support the reasonableness of those charges. We will review these items with the Department to reach closure.

The OIG report contains six corrective recommendations under finding 3:

- *Refund unresolved unallowable costs:* As noted above, we have projected our finances assuming an overdraw amount that is greater than the $476,169 currently booked and will work with the Department to resolve potentially unallowable items.
- *Provide documentation on vendor services:* We will provide this during audit resolution.
- *Specify 2003 and 2004 annual conference income and expenses:* We will provide this during audit resolution.
- *Provide adequate documentation on unsupported costs:* We will provide this during audit resolution.
- *Maintain supporting documentation for all FTL grant expenditures and require consultants detail work performed:* We believe that we are in full

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compliance with documentation requirements and will re-confirm this with the Department during audit resolution.

- *Provide all officials and employees copies of OMB Circular A-122 and require confirmation of receipt and review:* completed: OMB Circular A-122 has been provided to all employees; a form indicating receipt and review was also circulated, signed by each employee and returned; finally, our finance manual, which details operating protocols that conform with federal regulations, also has been provided to all employees.

Other Matters: The OIG report also refers to ELC's fiscal health and completion of the 2004 audit. We have submitted a turnaround plan to the Department that we believe will allow FTL to continue operations and meet the re-payment agreement schedule. That plan calls for repayment of overdrawn funds over a three year period. We are ready to schedule the 2004 audit and will do so as soon as practicable.

The audit report also referred to Special Conditions imposed on ELC in June of 2005. The OIG audit refers to seven items from these conditions (page 4 of the OIG audit). These seven items and their status are as follows:

1. *deposit and disperse federal funds from a separate account and maintain a clear audit trail:* completed
2. *enter into a repayment agreement with the Department:* completed
3. *operate on a reimbursement basis:* implemented and ongoing
4. *institute appropriate fiscal controls:* completed
5. *make arrangements for the 2004 audit and file 2005 timely:* bids were solicited and a firm has been retained for the 2004 audit; we expect to complete 2005 on time
6. *submit an indirect rate "direct allocation proposal":* submitted and under review
7. *promptly provide documents requested by the Department:* has been done consistently

December 21, 2005

Meave G. O'Marah, consulting Chief Financial Officer on behalf of Following the Leaders (formerly Education Leaders Council)

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