



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

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Mr. Raymond Simon
Deputy Secretary
U.S. Department of Education
400 Maryland Avenue, SW
FB6, Room 7W310
Washington, DC 20202-0500

Dear Mr. Simon:

This **Final Audit Report** presents the results of our audit of the State Scholars Initiative cooperative agreement between the Center for State Scholars (Center) and the Department of Education (Department). The purpose of the audit was to determine if (1) the Department awarded the State Scholars Initiative Grant in accordance with applicable regulations and Department policy, and (2) the Office of Vocational and Adult Education (OVAE) provided adequate program management of the Center's grant.

BACKGROUND

The State Scholars Initiative (Scholars Initiative) Grant is designed to better prepare high school students academically by encouraging them to take more rigorous courses. The Scholars Initiative is managed jointly through a partnership (cooperative agreement) with the Center located in Austin, Texas and the Department of Education's Office of Vocational and Adult Education. The Scholars Initiative is authorized under the Carl D. Perkins Vocational and Technical Education Act of 1998, Section 114.

In June 2002, the Texas Business and Education Coalition (TBEC), at the request of Department officials, provided Department officials with an oral presentation on the Texas Scholars Program. The Texas Scholars Program encourages high school students to complete rigorous courses in math, science, and foreign language. The Texas Scholars Program also teaches local Scholars Coalitions how to fund local programs, which in turn provides mentors to students.

In August 2002, TBEC submitted a written proposal to the Department to operate the Scholars Initiative on behalf of the Federal government. OVAE treated this proposal as unsolicited. TBEC's proposal was to create a national program using the Texas Scholars Program as a model, and included the creation of a Center for State Scholars to help states systematically create self-sustaining, successful, localized versions of the Scholars Initiative.

Also in August 2002, the Department awarded the Center a four-year grant totaling \$9.6 million. The grant funds were to be used for administrative purposes and to provide start-up funds to participating states for their scholar programs. In November 2002, OVAE entered into a cooperative agreement with the Center to oversee and monitor the project to ensure that the Center complied with applicable regulatory requirements and the requirements of the cooperative agreement, and to ensure proper accountability for the grant funds by the Center and by each state participating in the pilot.

In June 2004, OVAE conducted a monitoring visit of the Center. This visit revealed several areas of concern, which resulted in the Department placing the Center on Special Conditions. These included, but were not limited to: (1) documentation that accounting policies and procedures in place must fully comply with all requirements in Parts 74 and 75 of the Education Department's General Administrative Regulations (EDGAR); (2) a full accounting, supported by contemporaneous documentation, for all expenditures of Federal funds by the Center during the first two years of the Scholars Initiative; (3) restricting draw downs of FY 2003 funds and FY 2002 carryover funds; and (4) providing assurance that the Center would repay all Federal funds expended in which it cannot provide satisfactory accounting and cannot show that the expenditures were allowable and allocable to the Federal grant.

During our recent audit of the Center for State Scholars (A06F0001), we determined that the Center did not properly account for and use over \$1.09 million of State Scholars Initiative funds in accordance with applicable Federal regulations and the requirements in the cooperative agreement with the Department. Additionally, we determined that the Center did not have the administrative capability to administer the grant during the first two years, and may not have the administrative capability to continue to administer this grant. In addition, the Center did not have adequate grant funds to cover the contract obligations incurred during the first two years of the grant. As a result, the Center was \$173,587 short in its ability to cover all of the participating States' contracted obligations with grant funds for the period in question.

AUDIT RESULTS

The Department did not award the State Initiative grant in accordance with applicable regulations and Department policy, and OVAE did not provide adequate program management of the Center's grant. Specifically, (1) the Department did not follow Department policy when it encouraged TBEC to submit an unsolicited proposal, and the panel review process was not in accordance with Department policy; and (2) OVAE did not provide consistent program management, and did not address financial problems expeditiously.

We received your comments disagreeing with the findings, but concurring with the recommendations in our draft report. The comments are summarized at the end of each finding along with the OIG's response, when applicable. The full text of your comments is included as an Attachment to the report.

FINDING No. 1 – Grant Awarding Policies Were Not Followed

The Department did not follow Department policy when it encouraged TBEC to submit an “unsolicited” proposal, and awarded the grant to the Center based on the unsolicited application/proposal from TBEC. Several documents in the OVAE program file indicated that the application was not genuinely unsolicited because it was completed with the Department's endorsement and involvement. In addition, the external panel review process was condensed into two days and the rush to review the unsolicited grant proposal gave the appearance that the selection was predetermined. It also appeared that the Department decided to fund this proposal and let the grantee know of its decision before the external review process began because TBEC officials incorporated the Center prior to the external panel review. Furthermore, the Official Grant File was missing required documentation, including two certifications (conflict of interest and a lobbying form).

Unsolicited Grant Proposal Was Encouraged

Department Directive C:GPA:1-102, *Discretionary Grant Planning, Review, and Award Procedures*, dated June 23, 1992, stated it is the policy of the Department that discretionary grants are awarded through an open and fair competitive process. The *Handbook for the Discretionary Grant Process* § 5.10.2, dated March 31, 2003, which superceded C:GPA:1-102, states that Department policy is not to encourage the submission of unsolicited applications. However, the Department encouraged TBEC to submit an unsolicited proposal when it could have opened the grant to competition since other states had similar scholar programs. Although the Department knew of other state scholars programs in Arkansas, Tennessee, and Virginia, TBEC was the only organization asked, by the Office of the Secretary, to provide a presentation to Department officials. In turn, TBEC was the only organization to submit an application for the State Scholars Initiative \$9.6 million grant, dated August 20, 2002.

While OVAE treated the TBEC original application as “unsolicited,” the following documents in the OVAE file indicate the Department was involved in the development of the final application—

- The Office of the Secretary invited TBEC to provide a presentation regarding the Texas Scholars Program to Department officials in June 2002.
- Decision Conference documents seeking the former Secretary's approval to develop and implement a State Scholars program (dated July 16, July 31, and August 9, 2002) identified that TBEC submitted an unsolicited proposal for a State Scholars Program that was received and reviewed by the Office of the Secretary. The former Secretary

approved this program on August 12, 2002, eight days prior to the date shown on TBEC's application found in the file.

- Additional documents from OVAE, identified in the OVAE file, stated, "TBEC submits refined unsolicited proposal for review and will require a resubmittal of TBEC proposal."

In March 2005, we notified the Department of its need to consider instructing the Principal Officers and other senior officials to be aware of the need to avoid circumstances where unsolicited proposals or applications – either in fact or appearance – are not genuinely unsolicited or are pre-selected.

On April 12, 2005, the Under Secretary issued a memorandum to all Department Principal Officers that stated, "Included under the Appendices of the *Handbook for the Discretionary Grant Process* is a definition of unsolicited application. That definition is:

Unsolicited Application. An application submitted to ED in writing and solely on the applicant's own initiative, without prior formal or informal solicitation by a federal government official.

Although the Federal Acquisition Regulations (FAR) are not applicable to this grant, the Federal Government has defined an unsolicited proposal in FAR Subparts 2.1 and 15.6 as follows: "a valid unsolicited proposal must be independently originated and developed by the offeror; be prepared without government supervision, endorsement, direction, or direct government involvement; include sufficient detail to permit a determination that government support could be worthwhile and the proposed work could benefit the agency's mission responsibilities; and not be an advance proposal for a known agency requirement that can be acquired by competitive methods."

FAR § 15.604 allows for preliminary contact with agency personnel before preparing a detailed unsolicited proposal, however, this contact is limited. The contact can include (1) definition and content of an unsolicited proposal acceptable for formal evaluation; (2) requirements concerning responsible prospective contractors and organizational conflicts of interest; (3) guidance on preferred methods for submitting ideas/concepts to the Government; (4) agency points of contact for information regarding advertising, contributions, and other types of transactions similar to unsolicited proposals; (5) information sources on agency objectives and areas of potential interest; (6) procedures for submission and evaluation; and (7) instructions for identifying and marking proprietary information.

The Department did not follow its policy by encouraging the submission of an unsolicited application. In addition, because the Department was involved in the development of the proposal, the TBEC proposal did not appear to be genuinely unsolicited.

Panel Review Process Did Not Comply With Department Policy

According to the *Handbook*, § 4.5.10(6&7), before individuals begin to review applications, the competition manager will ensure that each reviewer understands conflict of interest and signs the

appropriate conflict of interest form, and will confirm that each reviewer who is receiving compensation under a purchase order has signed a Certification Regarding Lobbying, Debarment, Suspension and Other Responsibility Matters. In addition, the *Handbook*, § 4.5.8 Package for Application Reviewers, states that program officials should prepare and furnish to each reviewer an application review package at least two weeks in advance of the application review process whenever possible. To ensure the integrity of the competitive review process, the *Handbook* does not permit changes to the scope or objectives of a grant except in rare cases and unsolicited applications are not exempt from this requirement.

On August 21, 2002, OVAE sent the three external reviewers a letter that accompanied their packet of information. This letter stated that OVAE would hold a conference call on August 23, 2002 at 2:00 P.M. to discuss everyone's comments and scores. The external panel review forms were returned to OVAE on August 22, 2002, and August 23, 2002. The file contained a copy of the letter sent to the reviewer, the reviewers' handwritten and faxed notes of the review form, the reviewers' purchase order for payment, and the original grant application from TBEC, dated August 20, 2002. There was no evidence in the file that any of the reviewers completed the required conflict of interest form and Certifications Regarding Lobbying, Debarment, Suspension and Other Responsibility Matters.

In TBEC's original application, the Center was to be based within the TBEC organization. However, after OVAE officials reviewed this application, the Department recommended that TBEC separate itself from the Center and create a separate entity. OVAE officials stated that it was preferable for the entity to be a national entity in order for it to more effectively disseminate information about the program and to garner more support from business, education, and policy leaders across participating states. In addition, TBEC and Department officials stated that the program needed to distance itself from the "Texas" association. The Center was incorporated August 20, 2002, one day prior to the review packets being sent to the panel reviewers. The review panel did not review the grant application as it was altered by the Department, but instead reviewed the original version that proposed TBEC as the grant recipient and the Center as part of TBEC. OVAE officials stated that on some occasions the Department has allowed the substitution of a new grantee for the entity that submitted the project application and was selected. This has been done in instances where the Department has determined that project purposes or program goals were, for one or more reasons, better served by a new entity being named as the award recipient, rather than the entity that originally submitted the application. In these cases, the new entity had the same or better ability to carry out the original purposes of the approved application.

Changing grant recipients is a major change to a grant application, and in this case was a fundamental alteration of the grant proposal. Specifically, the grant proposal was substantially amended when the grant was awarded to the Center, which existed in name only, instead of to TBEC, which was an established organization. When the grant was awarded on August 28, 2002, the Center had only been incorporated for approximately one week, did not have any full-time employees, did not have an established infrastructure to administer the grant, and had only one part-time employee. The part-time employee was the grant Interim Executive Director (Interim Director) who was an employee of TBEC before the Center was created. After he became the Interim Director, he worked part-time for the Center and part-time for TBEC with

TBEC billing the Center for his services. A full-time director was not hired until October 2004, after the OVAE monitoring visit.

A recent OIG audit¹ of the Center determined that it did not have the administrative capability to administer the grant during award years 2002-2003 and 2003-2004 because the Center did not have adequate expertise, personnel, or accounting systems in place during the first two years of the grant.

Further, because critical parts of the Department's grant application internal control processes were either skipped or modified, the Department may have missed an opportunity to ensure up front that the grantee had all the necessary components to administer the Scholars Initiative and avoid problems that eventually came to the Department's attention a year and a half after the grant was awarded. The Department did not follow its policy and awarded the grant to what appeared to be a predetermined grantee. Grant proposals that appear not to be genuinely unsolicited, or where the selection is predetermined or appears to be predetermined, undermine the public's confidence in the integrity of the Department's grant-making process. Additionally, if competition is not used when awarding grants, the Department has no assurance that it is receiving the best capability or value for the money.

RECOMMENDATION

We recommend the Deputy Secretary in conjunction with the Assistant Secretary for OVAE—

- 1.1 Develop internal controls to ensure Department staff follows Department guidelines, policies, and the *Handbook for the Discretionary Grant Process* when processing grant applications.

Auditee's Comments to Finding 1: Grant Awarding Policies Were Not Followed

Unsolicited Grant Proposal Was Encouraged

The Deputy Secretary agreed that Department officials took special actions to recognize and better understand the important work of the Texas Business Education Coalition (TBEC) by inviting representatives of TBEC to the Department to give a presentation to Department officials on the Scholars Initiative administered in Texas, and may have discussed how such an Initiative may be expanded nationally. The facts relating to the initial request to TBEC for a presentation at the Department are not entirely clear. It is not clear whether the Department requested nothing more than to learn about the work in which TBEC was engaged and to decide if there were ways to incorporate the lessons learned in Texas with the Department's work. It is also quite possible that some of the TBEC officials may have misunderstood what was being requested. However, there was little guidance and policy on these subjects for grants, and as a result of the audit activity in this area, the Department has moved ahead in developing more information in this area, which should result in better administration in the future. Based on all

¹ ACN: A06F0001 – Center for State Scholars Initiative Grant.

of these factors, while some facts are unclear, it is understandable how a conclusion could be drawn that the grant was not unsolicited. Thus, the Deputy Secretary believes it is best to use the information in the audit report to look ahead and continues to work on improving the Department's policies and guidance in this area and to improving future communications about these subjects.

OIG's Response to Finding 1: Grant Awarding Policies Were Not Followed

Unsolicited Grant Proposal Was Encouraged

While we appreciate the Deputy Secretary's concerns, we have not changed the report. The evidence we gathered regarding the solicitation of this grant was from both TBEC and OVAE files and supports the conclusions in the report.

Auditee's Comments to Finding 1: Panel Review Process Did Not Comply With Department Policy

The Deputy Secretary stated that it is the Department's understanding that the panel reviewing the application was experienced and was capable of reviewing one application thoroughly in two days; unlike many grant competitions where there can be hundreds of applications. Panel reviews are often done under very tight time frames, and when an application is submitted in August, and the funds must be awarded by a September 30th deadline for the obligation of funds, expedited reviews that do not compromise the quality or thoroughness of the review are understandable. While the draft audit report indicated concern about the change of the grantee from TBEC to the Center for State Scholars, the Department does not believe that the change was significant under all of the circumstances in this matter. Although TBEC's name was on the cover page of the August 2002 application, the application referred primarily to the Center for State Scholars as the entity operating the Initiative, awarding funds to selected State pilots, and supporting overall program development to allow the State Scholars Initiative to be expanded. Overall, from the information in the application it should have been reasonably clear to the reviewers that the Center would be a "start-up entity" that would need to develop its own infrastructure to carry out the Initiative. Moreover, the staff persons referenced in the application were actually the individuals involved in the Center's start-up and operation. In retrospect, whether the Initiative would have been administered more effectively by TBEC is certainly not clear in light of the questioned costs for expenditures incurred under the TBEC contract in the OIG's external audit of Center operations.

The draft audit report also indicated a concern that it appeared that the Department decided to fund the proposal and let the grantee know that before the external panel review process began, because TBEC officials incorporated the Center prior to the external panel review. We do not have sufficient facts to draw a conclusion about this part of the finding.

OIG's Response to Finding 1: Panel Review Process Did Not Comply With Department Policy

While we acknowledge the review panel had only one proposal to review, because it was a new program and new grantee we do not agree that the \$9.6 million grant proposal could be reasonably reviewed in two days. We also respectfully disagree with the belief regarding the significance of the change in grantee. The proposal reviewed by the panel did not identify the Center as a separate entity but as an integral part of TBEC. Specifically, the application stated, "the Center for State Scholars, **to be based at the Texas Business and Education Coalition (TBEC)**, will help states . . ." (emphasis added). The application included project personnel all of whom were associated with TBEC--the Executive Director of TBEC was the Center's Board of Advisors Co-Chair; TBEC's Outreach Director was the Center's Interim Project Director; and a member of TBEC's Coordinating Committee was the Center's Field Director. Therefore, it is reasonable to conclude that the panel members based their decision to award the grant to the Center because they believed it would be run through TBEC. However, as a new and separate entity, the Center had no structure and no full-time staff. Had OVAE provided this information to the external reviewers and allowed them sufficient time to consider it, they may have advised caution on this project, at the least, in place of accepting the proposal.

The two-day review process was not the only factor that led us to conclude that the selection was pre-determined. We also considered the following chronology of events:

- (1) August 12, 2002 – The former Secretary approved funding the Initiative based on the TBEC proposal.
- (2) August 20, 2002 – One day before the review packets were sent out to the external reviewers, Department officials contacted TBEC and asked that the Center be established as an independent non-profit corporation.
- (3) August 2002 (various dates) – TBEC officials worked with the White House, the Department, and contacts in the Office of the Arkansas Governor, and the Arkansas Department of Education to set up President Bush's announcement of the Initiative in Little Rock.
- (4) August 29, 2002 – President Bush announced the Initiative in Little Rock, Arkansas, less than one week after the external panel review.

Auditee's Comments to Finding 1: Other Related Issues

While the Department understands that two certifications were not in the "official grant file," we do not understand that there were problems or violations that occurred relevant to these certifications. In this case, there is no finding in the draft audit report of a conflict of interest or improper lobbying on the part of any of the reviewers who reviewed and selected the application for funding. However, as a result of this audit, the Department is also taking steps to improve its guidance on maintaining official grant files by adding guidance on this matter to the Department's *Handbook*.

The Department certainly agrees that having proper controls in place for processing grant applications and for ensuring that Department staff follows Department guidelines, policies, and the *Handbook* is important. The Department is also concerned, as you are, that grant proposals “that appear not to be genuinely unsolicited or where the selection is predetermined, undermine the public’s confidence in the integrity of the Department’s grant-making process.” The Department is continuing to work to improve its processing of grant applications and to strengthen the *Handbook* in various areas.

OIG’s Response to Finding 1: Other Related Issues

Department Directive C:GPA:1-102 requires “Certifications Regarding Lobbying, Debarment, Suspension and Other Responsibility Matters” and conflict of interest assurances and waivers. While we did not conclude that a conflict of interest or lobbying violations existed, we did determine that the required documents were not in the file. Without the required documents OVAE did not obtain assurances from panel members that conflicts of interest did not exist or that they were not involved in improper lobbying activities.

FINDING NO. 2 – Program Management Needs Improvement

OVAE program staff did not provide adequate program management of the Center’s grant, and grantee financial issues were not addressed expeditiously.

OVAE Provided Inconsistent Program Management

OVAE’s administration of the grant did not comply with the *Handbook* or EDGAR. Specifically, we found—

- The grant award notification did not contain the required attachments, including the cooperative agreement. *Handbook* § 5.9.1 states, “The award notification for the cooperative agreement must contain the appropriate special provisions and attachments including a copy of the actual agreement.” The cooperative agreement was not in place when the grant was awarded.²
- OVAE program staff acknowledged the Center’s concerns that deliverable dates outlined in the cooperative agreement were not realistic, and that the deliverable timeline was too short. They pledged to work with the Center to establish more reasonable due dates. However, deliverable due dates were not formally revised and OVAE staff recorded and measured the Center’s performance against the original deliverable due dates. *Handbook* § 1.1 states, “ED staff with discretionary grant related responsibilities will ensure that . . . the process is fair and objective.”

² The award notification was dated August 28, 2002, and the cooperative agreement was signed on November 5, 2002.

- OVAE officials gave approval for the Center to enter into a contract with TBEC for administration and management services that violated competitive contracting rules and was a conflict of interest. EDGAR § 74.43 states, “All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition.” EDGAR § 74.42 states, “No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. A conflict would arise when the employee, officer, or agent . . . has a financial or other interest in the firm selected for an award.” The contract for administration and management services was not competed and the Center’s Interim Director was also a TBEC employee at the time of contract award. Subsequent to that approval, OVAE cited the Center for entering into a non-approved contract with a sub-recipient. OVAE officials advised OIG auditors that in giving the Interim Director the authority “to enter into an agreement with TBEC to provide specific services, as appropriate,” OVAE was indicating that the Center’s Interim Director could incur certain reasonable start-up expenses on behalf of the Center. It was not OVAE’s intention to give multi-year contracting authority to an Interim Director. In addition, OVAE officials stated that by entering into the contract with TBEC, the Center altered its scope of work of the cooperative agreement without permission from the Department. However, the Center’s scope of work was not established until the Cooperative Agreement was signed in November 2002, and OVAE gave permission to the Center to contract with TBEC in October 2002. OVAE should have known that by giving approval for a part-time employee working for the Center and TBEC simultaneously to contract with the very company he worked for created a conflict of interest.

These conditions occurred because OVAE did not follow EDGAR or *Handbook* guidance, separated the Center from the original grant applicant (TBEC), established deliverable due dates without allowing adequate time for organizational start-up activities, gave erroneous and conflicting guidance to the Center, and did not limit the number of individuals involved in providing program management to Center employees. Instead of one program officer being assigned to this grant, OVAE assigned three different program officers during the two-year period. Additionally, OVAE officials, at times, interacted directly with the Center staff without the knowledge of the program officer assigned to manage the grant or overturned prior approvals given by the program officer, thereby giving inconsistent direction. Together, these conditions appeared to reduce the Center’s potential for progress and contributed to its inability to meet deadlines for deliverables.

Financial Issues Were Not Addressed Expeditiously

OVAE program staff did not fully address financial problems when they first surfaced and did not take aggressive corrective action at the earliest possible point. Although OVAE was aware of problems as early as January 2003 and frequently reminded the Center that deliverables were coming due or were overdue, they did not perform an on-site visit to address these problems until June 2004. Our review disclosed—

- OVAE program correspondence shows repeated requests, beginning in January 2003, for the Center to conform financial reporting to specified formats. *Handbook* § 1.1 states, “ED staff with discretionary grant related responsibilities will ensure that . . . Structures are in place for monitoring and holding grantees accountable for their activities.”
- OVAE program documents show that program staff were concerned, in September 2003, about a “possible funding problem” and discussed the issue with other Department staff, but did not request comprehensive data and an explanation from the Center. Nor did they conduct a site-monitoring visit because of these specific concerns at that time. OVAE officials stated that they requested Center officials to come to Washington to discuss the concerns, however, neither Center documents nor OVAE officials could substantiate that a meeting took place. OVAE officials believed that the possible funding problem was merely a question concerning the timing and availability of appropriated funds, not a concern as to how funds were being used by the Center. *Handbook* § 6.4.2 states, “. . . every program principal office shall – 1. Establish monitoring procedures that promote grantee – a. Progress in achieving Department program goals and objectives; b. Adherence to laws, regulations and assurances governing the Department program; and c. Conformity with the approved applications, Department reporting or other requirements.”
- The Year Two cooperative agreement required the Center to fund more states than it was capable of funding – 18 states for the two years at \$300,000, for a total of \$5.4 million. ED awarded the Center only \$4.8 million for the two years. Selecting more than six states per year would require more funds than awarded. OVAE program staff should have realized at this point that it was mathematically impossible to select and support more than six states per year without increasing funds or reducing the amount of pass-through funds provided to each state. *Handbook* § 1.1 states, “ED staff with discretionary grant related responsibilities will ensure that . . . the process is fair and objective.”

OVAE program staff believed the level of monitoring they were providing was sufficient and did not give adequate consideration to the cumulative nature of program deficiencies. In addition, OVAE officials stated that the minute OVAE felt there was a problem, a monitoring team was sent to the Center. However, problems went undetected and uncorrected, Federal funds were inefficiently and inappropriately expended, and progress toward program goals was reduced. If OVAE officials had taken appropriate action when they first became concerned, they may have prevented or been able to mitigate problems with the Center’s operations and spending.

RECOMMENDATIONS

We recommend that the Deputy Secretary direct the Assistant Secretary for OVAE to—

- 2.1 Develop and implement internal controls that ensure OVAE staff follows the guidance provided in EDGAR and the *Handbook* to effectively monitor and manage their grant programs.
- 2.2 Limit the number of program officers assigned to a grantee and the number of personnel giving directions to a grantee to better provide consistent guidance.

Auditee's Comments to Finding 2: Program Management Needs Improvement

OVAE Provided Inconsistent Management

The Deputy Secretary stated that unfortunately, due to the negotiations between the Center and the Department that preceded the final cooperative agreement, OVAE was unable to attach a copy of the cooperative agreement to the grant award notification (GAN). In addition, although the draft audit report does not make note of this, the GAN itself stated that the award was being made subject to the grant application and to applicable EDGAR regulations. Therefore, under the terms of the GAN, the Center was required to meet the goals, objectives, and purposes of the project as contained in the approved application. Ultimately, these application goals, objectives, and purposes formed the critical elements of the final cooperative agreement signed by the Department and the Center. In addition, in the draft audit report there was concern that deliverable dates were not formally revised, and OVAE staff recorded and measured the Center's performance against the original deliverable due dates. If OVAE staff mistakenly failed to formally revise the deliverable due dates or to hold the Center accountable for original deliverable due dates that had been changed, it was through an oversight that was unintentional.

In addition, the Deputy Secretary stated that in the draft audit report, OIG expressed concern that OVAE officials gave approval for the Center to enter into a contract with TBEC for administration and management services that violated competitive contracting rules and was a conflict of interest. The Deputy Secretary stated that OVAE officials did not believe that they gave approval for contracting with TBEC in an inappropriate manner. The Center appeared to alter its scope of work by entering into two contracts with TBEC, which appeared to be inappropriate. In fact, as the OIG's external audit of the Center's operations uncovered, both TBEC and the Center had very little documentation and information about the actual services performed pursuant to the contracts and the costs associated with those services, which could have justified the administrative services expenses.

The draft audit report also includes concerns about the contract violating competitive contracting rules and being a conflict of interest. The Deputy Secretary responded that clearly, under the terms of the grant award the Center was expected to be aware of, and to be in full compliance

with, the 34 C.F.R. Part 74 procurement regulations, notwithstanding the content of the October 17, 2002 memorandum. Additionally, no conflict of interest presented itself in this case because the President of the Center's Board of Directors and the Executive Director of TBEC signed the contract for services.

OIG's Response to Finding 2: OVAE Provided Inconsistent Management

Even though the GAN contained statements regarding the applicable regulations, it did not contain important grant deliverable information contained in the cooperative agreement; and as noted in various documents in the OVAE program file, the Center had trouble meeting said deliverables. OIG acknowledges that the program officer adjusted some deadlines. However, OVAE officials identified in the early stages of the grant that deadlines were unreasonable and timelines were too short, yet they were never adjusted as directed.

While OVAE officials may not believe they gave approval to the Center to enter into a contract with TBEC, several factors led us to conclude otherwise. The October 17, 2002, memo represented OVAE's response to questions posed by the Interim Executive Director of the Center. The Interim Executive Director asked, "Can the Center for State Scholars still enter into an agreement with TBEC to provide administrative services such as opening and maintaining a bank account, ordering checks, establishing an accounting system, and other start-up administrative functions, as agreed to previously?" OVAE responded, "The Interim Executive Director has the authority to enter into agreement with TBEC to provide specific services as appropriate." Additionally, OVAE stated that a full-time Executive Director should have been hired by November 12, 2002. However, OVAE allowed the Interim Executive Director, an employee of TBEC, to stay in his position for over two years without hiring a full-time Executive Director. Furthermore, Department and OVAE officials were present at the Center's board meetings when the TBEC contract was discussed; therefore, they should have known of the contract as well as the extent of the contract. The scope of work was not altered as outlined in the funded proposal because that proposal had the Center based out of TBEC; therefore, no contract would have been necessary. OVAE allowed the Center to enter into a contract with TBEC, which was not competed, and OVAE knew the Center's Interim Director was also a TBEC employee at the time of contract award. Even though the Center's Interim Executive Director did not sign the contract, he was a major decision-maker in the development of the contract and its requirements.

Auditee's Comments to Finding 2: Financial Issues Were Not Addressed Expeditiously

The Deputy Secretary stated that the draft audit report expressed a concern that OVAE officials did not take timely actions when financial reports failed to conform to specified formats, and contained errors or potential problems. However, he stated that OVAE officials did try to work with Center officials on deadlines and provided technical assistance and feedback on submissions. OVAE officials conducted frequent program monitoring through a variety of methods, including telephone conferences, e-mails, written feedback on deliverables, attendance at Center Board meetings, and on-site reviews. Clearly, as soon as it became evident in May

2004 that there was an *actual* funding problem, OVAE officials took immediate steps to send a monitoring team and to institute detailed, strict special grant conditions on the Center.

The Deputy Secretary concurred that OVAE can limit the number of program officers assigned to a grantee and the number of personnel giving directions to a grantee to better provide for consistent guidance. However, reassignments of project officers are sometimes necessary and cannot be avoided, such as, when a project officer leaves the Department or when there are serious concerns about a project officer's workload.

OIG's Response to Finding 2: Financial Issues Were Not Addressed Exeditiously

While we cited OVAE's June 2004 monitoring visit and the resulting special conditions in the background section of the report, we wish to emphasize that OVAE had financial concerns at the Center as early as January 2003 and those financial concerns continued throughout the grant period with the Center's late and incomplete submission of deliverables. However, OVAE did not conclude until May 2004 that there was a funding problem. The purpose of monitoring is to avoid grantees having actual funding problems, and officials should be more proactive instead of only taking action when there is an actual funding problem.

OTHER MATTERS

OVAE did not contact the OIG after discovering indicators of potential fraud, waste, and abuse at the Center. These issues came to OVAE's attention during a monitoring visit, a subsequent external audit, and upon receipt of draft board minutes from a meeting after the monitoring visit occurred.

Department Directive OIG 1-102, dated November 13, 2003, states, "Any Department employee having information indicating fraud, waste, abuse, or mismanagement involving Department programs and operations should bring this information to the immediate attention of the nearest OIG/IS office or the OIG Hotline. Appropriate information would include that pertaining to fraud, waste, abuse, or mismanagement by another employee in the performance of his/her official duties or by any person or entity that receives or administers Department funds (e.g., contractors, grantees, or consultants)."

During their monitoring visit in June 2004, OVAE became aware of several problems at the Center, including inadequate or non-existent support for expenses, financial records and financial management policies; a non-approved contract with a sub recipient;³ and budgetary issues. In July 2004, an audit by Eastman Corporate Audit Services identified several issues with the Center, including but not limited to: (1) the majority of invoices were not approved; (2) Time-

³ OVAE considered the contract between the Center and TBEC to be non-approved; however, during our review of the OVAE file, we found a memo giving the Interim Executive Director the authority to enter into an agreement with TBEC to provide specific services as appropriate.

and-Effort sheets were not being properly tracked per government regulations; (3) controls over States' expenditures were not in place; and (4) budgets from participating States were not final and payments to States versus State budgets were not compared and reviewed. OVAE officials considered these as common problems for novice grantees. However, they did take some actions when the problems were identified. They placed Special Conditions on the Center based on the monitoring visit results, they assisted the external auditors with the subsequent audit, and they have assisted the Center with the implementation of the Special Conditions.

In addition, OVAE received draft board minutes of a meeting on July 9, 2004 in which a board member directed a Center employee to "clean up the mess retroactively." These minutes also included a statement that this employee should "continue to work with ED [Department of Education] to resolve retroactive issues so that a paper trail will keep [the] inspector general off [of] ED's back." OVAE officials informed us that they did not consider these statements as serious matters when they reviewed the minutes.

We believe the matters detailed above were indicators of potential fraud, waste, and abuse that should have been brought to the OIG's attention. By not involving the OIG and dismissing problems found at the Center, OVAE officials left Department program funds vulnerable to fraud, waste, and abuse.

Since we brought this matter to OVAE's attention, they have been diligent in bringing other indicators of fraud, waste, and abuse to our attention.

Auditee's Comments to Other Matters

The Deputy Secretary stated, while OVAE was very concerned about the monitoring visit's and the financial management audit's findings, OVAE staff, in consultation with OGC, determined that an appropriate and effective way to address such concerns was by imposing special conditions, including placing the Center on reimbursement, requiring a detailed accounting for all Federal spending, and increasing technical assistance, monitoring, and oversight, all effective tools that were available to the Department for addressing the challenges presented by the Center's apparent failures. The draft report suggests that OVAE should have contacted OIG after these matters came to OVAE's attention as a result of OVAE's monitoring visit, the Eastman Chemical financial management audit, and the draft Board minutes, suggesting that the problems uncovered were indicators of potential "fraud, waste, and abuse" at the Center. Further, the draft audit report states that the matters of which OVAE became aware during its on-site review and of which mention is made in the Center's July 9, 2004 Board minutes were "indicators" of potential fraud, waste, and abuse and should have been brought to the OIG's attention.

OIG's Response to Other Matters

Although the OIG acknowledges that imposing special conditions, including putting the Center on reimbursement and increasing technical assistance and monitoring were all tools that the Department had at its disposal, we stand by our position that the Department did not bring any of

the Center's problems to our attention. We also stand by our position that the serious matters pointed out in this audit report were clear indicators of potential fraud, waste, abuse, and mismanagement and we have not changed our report. Bringing matters to the OIG's attention does not apply only to instances of suspected or actual fraud. Department officials also have an obligation to bring to our attention any circumstances of potential fraud, waste, abuse, or mismanagement of Federal funds. Department Directive OIG 1-102, dated November 13, 2003, states, "Any Department employee having information indicating fraud, waste, abuse, or mismanagement involving Department programs and operations should bring this information to the immediate attention of the nearest OIG/IS office or the OIG Hotline."

Our audit of the Center's State Scholars Initiative Grant resulted in questioned costs of over \$1 million, and questioned whether the Center was capable of administering the grant and whether it would remain financially solvent in the future. The Department's monitoring visit in June 2004 did not question the over \$1 million that the Center could not adequately account for and these issues would not have come to light without our review. By not bringing any of these matters to our attention, the Department's program funds were vulnerable to misuse and the taxpayers' interests were not protected. Additionally, if these matters had been brought to our attention earlier, perhaps the Center's performance on this Initiative could have been improved to the point where it remained the grantee on this project. As it stands now, the Center is no longer the grantee on this Initiative and the Department had to start over to find another grantee to continue this effort.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to determine if (1) the Department awarded the State Scholars Initiative Grant in accordance with applicable regulations and Department policy, and (2) OVAE provided adequate program management of the Center's grant.

To accomplish our objectives, we—

- Reviewed OVAE's official grant file on the Center for State Scholars.
- Reviewed OVAE's July 2004 monitoring report of the Center.
- Interviewed former and current OVAE officials, including both the current and former Assistant Secretary; Assistant Deputy Secretary; Division Director, Discretionary Programs and Innovation Group; Branch Chief, Effective Practices and Dissemination Group; Division of High School, Postsecondary and Career Education (DHSPCE); and a former Program Analyst, Effective Practices and Dissemination Group, DHSPCE.
- Interviewed an external panel member who reviewed the TBEC proposal, a former Office of the Secretary official, and an Office of the General Counsel official.
- Reviewed the Center's Board of Director's minutes for the meeting held July 2004.

Our review of OVAE's official grant file included documentation of TBEC's presentation to the Secretary and the Department, various decision documents pertaining to the unsolicited TBEC

proposal and its approval by the Secretary, TBEC's grant application, the review panels' Unsolicited Proposal Review Forms, the Center's Articles of Incorporation and Bylaws, the Center's financial information related to Grants and Payments System draw downs, and various other correspondence between the Center and OVAE officials. We also reviewed applicable laws, regulations, handbooks, and Department policies and directives for unsolicited grant applications, the panel review process, and the requirement to notify the IG.

For purposes of the audit, we obtained an understanding of OVAE's procedures for processing unsolicited grant applications and classified the management controls significant to the review's objectives into the following areas:

- OVAE's evaluation of the unsolicited grant proposal
- The expert review panels' evaluation of the grant application
- Official grant file documentation

Because of inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the internal controls. However, our assessment disclosed internal control weaknesses that adversely affected OVAE's ability to award the unsolicited grant to the Center for State Scholars in accordance with applicable regulations and internal policies for unsolicited grant applications. Specifically, we determined the Department needs to improve its internal controls related to unsolicited grant proposals, as well as its desire to notify the OIG of potential program problems. These weaknesses and their effects are discussed in the AUDIT RESULTS section of this report.

We conducted our fieldwork at Department offices in Washington D.C. from January 24, 2005, through January 28, 2005. We held an exit conference with Department officials on May 17, 2005.

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

ADMINISTRATIVE MATTERS

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). ED policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 days of the issuance of this report. The CAP should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report. An electronic copy of this report has been provided to your Audit Liaison Officer.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

If you have any questions, please call Sherri Demmel, Regional Inspector General for Audit, at 214-661-9526.

Sincerely,

//signed//

Helen Lew
Assistant Inspector General
for Audit Services

Attachment

October 28, 2005

MEMORANDUM

TO: Sherri L. Demmel
Regional Inspector General for Audit

FROM: Ray Simon /signed/
Deputy Secretary

SUBJECT: Final Comments on Draft Audit Report, “*AUDIT OF STATE SCHOLARS INITIATIVE COOPERATIVE AGREEMENT BETWEEN THE CENTER FOR STATE SCHOLARS AND THE DEPARTMENT OF EDUCATION*” Audit Control Number ED-OIG/A06F0006

We appreciate the opportunity to provide comments on behalf of the Department on the draft “Audit of the State Scholars Initiative Cooperative Agreement Between the Center for State Scholars (Center) and the Department of Education,” Control Number ED-OIG/A06-F0006. Previously, the Office of Vocational and Adult Education (OVAE) provided preliminary comments on this draft report, and we hope you found those comments helpful. These comments follow further consideration of the draft audit report and discussions between representatives of your office and the Office of the General Counsel (OGC) on a number of the technical comments.

In general, we found the draft report to be helpful as we continue to strengthen our processes for administering discretionary grants including those that are unsolicited. While we do not always agree with all of the discussion in the draft report, the findings and recommendations show areas in which administrative clarifications or improvements will be helpful. As you know, even before the draft report was issued, the Department took significant steps to improve administration in these areas. OVAE placed very substantial special conditions on the Center’s grants, took careful steps to closeout the relationship with the Center at the end of September under a voluntary termination, and took steps to continue the State Scholars Initiative (the Initiative) after holding a grant competition and selecting a highly-qualified grantee, the Western Interstate Commission for Higher Education, to carry out the next phase of the Initiative.

Additionally, as you note in your draft report, on April 12, 2005, the Under Secretary provided clear guidance that should improve the understanding of Department employees of unsolicited grants, and improve the Department’s consideration of unsolicited grant applications. We appreciate the preliminary notification made by OIG in March 2005 on this matter that helped in the preparation of the Under Secretary’s guidance.

Finding No. 1: Grant Awarding Policies Were Not Followed

Unsolicited Grant Proposal Was Encouraged

We agree that Department officials took special actions to recognize and better understand the important work of the Texas Business Education Coalition (TBEC) by inviting representatives of TBEC to the Department to give a presentation to Department officials on the Scholars Initiative administered in Texas, and may have discussed how such an Initiative may be expanded nationally. As the draft report recognizes, there were other State scholars programs, however, it is not clear that any of the others had the capacity and experience to administer a scholars initiative of national scope.

The facts relating to the initial request to TBEC for a presentation at the Department are not entirely clear. It is not clear whether the Department requested nothing more than to learn about the work in which TBEC was engaged and to decide if there were ways to incorporate the lessons learned in Texas with the Department's work. It is also quite possible that some of officials with TBEC may have misunderstood what was being requested.

Moreover, as you know, at that time, there was little guidance or policy on what constituted an “unsolicited application.” For example, there was no applicable definition for an “unsolicited grant proposal.” The Department’s *Handbook for the Discretionary Grant Process (the Handbook)* was in the process of being developed and went into effect in March of 2003, six months after the State Scholars grant was awarded to the Center. Moreover, while the Education Department General Administrative Regulations (EDGAR) outline requirements for considering, reviewing, selecting and funding an unsolicited grant application, the regulations are silent on the pre-submission procedures for unsolicited proposals. As your report notes, there were regulations on some of these topics in the Federal Acquisition Regulations that applied to contracts. However, there was little guidance and policy on these subjects for grants, and as a result of the audit activity in this area, we have moved ahead in developing more information in this area, which should result in better administration in the future.

Based on all of these factors, while some facts are unclear, it is understandable how a conclusion could be drawn that the grant was not unsolicited. Thus, we believe it is best to use the information in your report to look ahead and continue to work on improving the Department’s policies and guidance in this area and to improving future communications about these subjects.

Panel Review Process Did Not Comply With Department Policy

The draft report also indicates that the external reviewers of the proposal did not have a sufficient period of time to review the proposal, such as two weeks, which has become part of Department guidance for reviewing competitive grants. It is our understanding that the panel reviewing the application was experienced and was capable of reviewing one application thoroughly in two days, unlike many grant competitions where there can be hundreds of applications. Panel reviews are often done under very tight time frames, and when an application is submitted in August, and the funds must be awarded by a September 30th deadline for the obligation of funds, expedited reviews that do not compromise the quality or thoroughness of the review are understandable.

While the draft audit report indicates concern about the change of the grantee from TBEC to the Center for State Scholars, we do not believe that the change was significant under all of the circumstances in this matter. Although TBEC's name was on the cover page of the August 2002 application, the application referred primarily to the Center for State Scholars as the entity operating the Initiative, awarding funds to selected State pilots, and supporting overall program development to allow the State Scholars Initiative to be expanded. In the "management plan" section, the application provided that as early as September 1, 2002, the Center would be established and staff interviews would begin. Overall, from the information in the application it should have been reasonably clear to the reviewers that the Center would be a "start-up entity" that would need to develop its own infrastructure to carry out the Initiative. Moreover, the staff persons referenced in the application were actually the individuals involved in the Center's start-up and operation. These individuals included Joe Randolph, Drew Scheberle, and John Stevens. (In retrospect, whether the Initiative would have been administered more effectively by TBEC is certainly not clear in light of the questioned costs for expenditures incurred under the TBEC contract in the OIG's external audit of Center operations.)

The draft audit report also indicated a concern that it appeared that the Department decided to fund the proposal and let the grantee know that before the external panel review process began, because TBEC officials incorporated the Center prior to the external panel review. We do not have sufficient facts to draw a conclusion about this part of the finding. Early incorporation of the Center seemed like an appropriate step so that if the application were approved, the Center would be better able to administer the program on a timely basis while incurring a minimal amount of cost. In fact, if TBEC had not taken steps to incorporate the Center early in the process, this might have jeopardized the Center's early ability to administer the grant once Federal funds had been awarded.

Other Related Issues

The draft audit report indicated a concern that the official grant file was missing two required certifications. While we understand that two certifications were not in the "official grant file," we do not understand that there were problems or violations that occurred relevant to these certifications. In this case, there is no finding in the draft audit report of a conflict of interest or improper lobbying on the part of any of the reviewers who reviewed and selected the application for funding. However, as a result of this audit, we are also taking steps to improve Department guidance on maintaining official grant files by adding guidance on this matter to the Department's *Handbook*.

Recommendation: The Deputy Secretary, in conjunction with the Assistant Secretary for OVAE, should-

- 1.1 Develop internal controls to ensure Department staff follows Department guidelines, policies, and the *Handbook for the Discretionary Grant Process* when processing grant applications.

We certainly agree that having proper controls in place for processing grant applications and for ensuring that Department staff follows Department guidelines, policies, and the *Handbook* is important. We are also concerned, as you are, that grant proposals “that appear not to be genuinely unsolicited or where the selection is predetermined, undermine the public’s confidence in the integrity of the Department’s grant-making process.” We are continuing to work to improve Department’s processing of grant applications and to strengthen the *Handbook* in various areas.

Finding No. 2: Program Management Needs Improvement

OVAE Provided Inconsistent Management

The draft audit report expresses a concern that the cooperative agreement was not in place at the time the grant was awarded. Unfortunately, due to the negotiations between the Center and the Department that preceded the final cooperative agreement, OVAE was unable to attach a copy of the cooperative agreement to the grant award notification (GAN). OVAE engaged in negotiations with the Center on the scope of work, program requirements, and the structure of the grantee organization, all of which resulted in delays to the signing of the cooperative agreement until November 2, 2002. In addition, although the draft audit report does not make note of this, the GAN itself stated that the award was being made subject to the grant application and to applicable EDGAR regulations. Therefore, under the terms of the GAN, the Center was required to meet the goals, objectives, and purposes of the project as contained in the approved application. Ultimately, these application goals, objectives, and purposes formed the critical elements of the final cooperative agreement signed by the Department and the Center.

In addition, in the draft audit report there was concern that deliverable dates were not formally revised, and OVAE staff recorded and measured the Center’s performance against the original deliverable due dates. Generally, OVAE officials adjusted the deadlines for project deliverables when OVAE concluded that it was in the best interests of the Initiative, the Department, and the Center to do so. Such adjustments were noted in the file. For example, there was a concern about the Center missing the deadline for the selection of pilot States, which was originally set as December 16, 2002. The Center explained that the delay was caused by the Center’s reluctance to move forward with the States’ selection without the Board of Directors being assembled. OVAE officials discussed these concerns with Center officials and agreed with the Center about the importance of having the Board of Directors in place prior to the pilot selection process taking place. Therefore, OVAE approved an extension of the deadline from December 16, 2002, to March 1, 2003. Apparently, in this case, the Project Officer did not adjust the due dates in the first cooperative agreement, which was an administrative oversight.

In other cases, following discussions with Center staff, OVAE concluded that the delays were not reasonable or excusable, so some deadlines remained unchanged and submissions were considered overdue. For example, the Center failed to submit monthly reports in November and December of 2002, and did not submit them until January 15, 2003. OVAE staff concluded that the Center had failed to provide acceptable justifications for the delays, and the deadlines were not extended.

It is regrettable that the Center missed a number of deadlines and that program officials had to spend a great deal of time reminding and alerting Center staff of applicable deadlines as well as working with them on rescheduling deadlines. If OVAE staff mistakenly failed to formally revise the deliverable due dates or to hold the Center accountable for original deliverable due dates that had been changed, it was through an oversight that was unintentional.

In the draft audit report, OIG expressed concern that OVAE officials gave approval for the Center to enter into a contract with TBEC for administration and management services that violated competitive contracting rules and was a conflict of interest. OVAE officials did not believe that they gave approval for contracting with TBEC in an inappropriate manner. In the October 17, 2002 memo, OVAE provided the future “Executive Director” of the Center the authority to hire advisors and consultants, as appropriate. However, OVAE did not intend an “Interim Director” to have unlimited, multi-year contracting authority. At that time, OVAE had a clear expectation that the Center would soon hire a full-time Executive Director to carry out key responsibilities, as was reflected in the “Deliverables and Timeline” section of the cooperative agreement, in which the second deliverable was for the Center to hire an Executive Director by November 12, 2002, approximately one month after the October 17, 2002 memo was written.

The Center appeared to alter its scope of work by entering into two contracts with TBEC, which appeared to be inappropriate. Under its approved budgets for the years in question, the Center was required to use most of its grant funds on financial support of pilots/partnerships, following the start-up period. It was not authorized to utilize a large portion of the grant award for extensive contractual administrative services. OVAE was not asked by the Center to provide nor did it provide written approval to changes in the scope of work, approved budget, or the terms and conditions of the grant award. Clearly, the tremendous shifts in costs and the significant administrative cost overruns when compared to the approved budgets, occurred primarily as a result of the contracts with TBEC, the breadth of services TBEC provided, the lack of contract oversight by the Center, and in many cases, the lack of required documentation to support TBEC’s activities.

In fact, as the OIG’s external audit of the Center’s operations uncovered, both TBEC and the Center had very little documentation and information about the actual services performed pursuant to the contracts and the costs associated with those services, which could have justified the administrative services expenses. This was one of the serious concerns expressed by OVAE officials when they first learned of the contracts with TBEC and the expenses connected with those contracts. These concerns were later reiterated by OVAE officials following their monitoring visit and the Eastman Chemical financial audit. In sum, although the Center had a continuing obligation to inquire and obtain written permission from OVAE about which specific services were permitted, OVAE was never asked to review a specific contract for services entered into between TBEC and the Center.

The draft audit report also includes concerns about the contract violating competitive contracting rules and being a conflict of interest. Clearly, under the terms of the grant award the Center was expected to be aware of, and to be in full compliance with, the 34 CFR part 74 procurement

regulations, notwithstanding the content of the October 17, 2002 memorandum. Additionally, no conflict of interest presented itself in this case because the President of the Center's Board of Directors and the Executive Director of TBEC signed the contract for services. The President of the Center's Board had full fiscal and programmatic authority to act on behalf of the Center and in the Center's best interest. Drew Scheberle, the individual who arguably could have had a conflict of interest by working for TBEC and the Center, did not sign the contract. Finally, any authority given to the Center in the October 17, 2002 memorandum was the authority to enter into contracts "as appropriate," as stated in the memorandum. Thus, the Center would *not* have had the authority to enter into a contract that was not "appropriate" under applicable Federal requirements (e.g., if the contract would violate EDGAR provisions, including those pertaining to procurement).

Financial Issues Were Not Addressed Expeditiously.

The draft audit report expressed a concern that OVAE officials did not take timely actions when financial reports failed to conform to specified formats, and contained errors or potential problems. However, OVAE officials did try to work with Center officials on deadlines and provided technical assistance and feedback on submissions. When repeated attempts by OVAE to address the deliverable deficiencies failed, the Assistant Secretary wrote a letter to the Chairman of the Board of Directors on March 8, 2004, in which she expressed concerns about the deliverables. The letter resulted in a meeting between the Assistant Secretary and representatives of the Center's Board of Directors, and ultimately, the Department placed the Center on a cost reimbursement arrangement to ensure that proper controls would be in place.

OVAE officials conducted frequent program monitoring through a variety of methods, including telephone conferences, e-mails, written feedback on deliverables, attendance at Center Board meetings, and on-site reviews. Clearly, as soon as it became evident in May 2004 that there was an *actual* funding problem, OVAE officials took immediate steps to send a monitoring team and to institute detailed, strict special grant conditions on the Center. These strict requirements and special conditions were in place prior to the Center being authorized to draw down FY 2002 carryover funds or any new FY 2003 funds. Additionally, on October 4, 2004, OVAE program staff met with the Interim Executive Director, a representative of the Chairman of the Board, and the Center's accountant to review the special conditions.

Finally, OVAE conducted a monitoring visit and placed strict special conditions on the Center's grant. The monitoring visit resulted in a meeting with the representatives from the Center's Board, a financial management audit by the Eastman Chemical Company, and an 8-page draft report, as a result of which immediate changes were developed by the Center to its financial management policies and internal controls. Moreover, based on the findings of its monitoring team, OVAE decided to impose special conditions and notified the Center that it would not negotiate a new cooperative agreement until all special conditions had been met. More specifically, under the special conditions, the Center had to demonstrate to OVAE that it had in place accounting policies and procedures that complied fully with all requirements contained in Parts 74 and 75 of EDGAR. Additionally, to ensure appropriate financial accounting, one of the special conditions required that the Center submit quarterly reports to OVAE on the Center's administration of the Initiative, the expenditures incurred by the Center,

and a description of the Center's progress on each significant aspect of the Initiative. Moreover, following the monitoring visit and the financial management audit, OVAE staff remained in frequent contact with the Center to answer technical questions, authorize monthly drawdowns based on detailed written requests by the Center, and review the Center's operating budget.

Recommendations: The Deputy Secretary to direct the Assistant Secretary for OVAE to-

- 2.1 Develop and implement internal controls that ensure OVAE staff follows the guidance provided in EDGAR and the *Handbook* to effectively monitor and manage their grant programs.

We concur that OVAE can develop and implement internal controls that ensure that OVAE staff follows the guidance provided in EDGAR and the *Handbook* to effectively monitor and manage grant programs.

- 2.2 Limit the number of program officers assigned to a grantee and the number of personnel giving directions to a grantee to better provide consistent guidance.

We concur that OVAE can limit the number of program officers assigned to a grantee and the number of personnel giving directions to a grantee to better provide for consistent guidance. However, reassignments of project officers are sometimes necessary and cannot be avoided, such as, when a project officer leaves the Department or when there are serious concerns about a project officer's workload.

Other Matters

The draft audit report indicates that OVAE officials should have contacted the OIG earlier, after discovering the problems at the Center. More specifically, the draft report suggests that OVAE should have contacted OIG after these matters came to OVAE's attention during OVAE's monitoring visit, the Eastman Chemical financial management audit, and in the draft Board minutes, suggesting that the problems uncovered were indicators of potential "fraud, waste, and abuse" at the Center. Further, the draft audit report states that the matters of which OVAE became aware during its on-site review and of which mention is made in the Center's July 9, 2004 Board minutes were "indicators" of potential fraud, waste, and abuse and should have been brought to the OIG's attention. The audit report further states, that "by not involving the OIG and dismissing the problems found at the Center, OVAE officials left Department program funds vulnerable to fraud, waste, and abuse."

Department officials have been working with OIG officials to determine more specifically when program and other Department officials should contact OIG on particular types of matters. We support these efforts and know that they will result in improved understanding by program officials of the appropriate times for referrals to OIG.

At the time in question, OVAE took prompt and decisive administrative actions in order to protect and safeguard Department funds and the Initiative itself. OVAE also took specific and detailed steps to assist the Center in correcting the mismanagement and accountability failures uncovered by OVAE. Of course, had OVAE believed that fraud was being contemplated or suggested, it would have reported the matter to the OIG, but that was not the case.

In this case, OVAE officials, based on the information known to them, determined that there were no elements within the financial management or other programmatic shortfalls at the Center that constituted “fraud.” Primarily, OVAE identified accountability deficiencies such as failures in recordkeeping, financial management, and staying within approved budgets, and first undertook a monitoring visit to the Center. The monitoring visit was a detailed examination of the Center’s fiscal records and programmatic progress. The monitoring visit resulted in a meeting with representatives from the Center’s Board, a financial management audit by in-house auditors of the Eastman Chemical Company who issued an 8-page draft report, and immediate changes to the Center’s policies and internal controls.

Further, in consultation with OGC, OVAE undertook the development of strict special conditions to be placed on the Center’s Initiative grant, notified the Center that it would not negotiate or enter into a third year cooperative agreement until all special conditions had been met, and provided intensive technical assistance to the Center to assist the Center in meeting the special conditions. Imposing these special conditions and stating that it would not sign a third year cooperative agreement gave the Department increased leverage over the Center with which to compel compliance with all applicable requirements and ensure fiscal accountability.

In short, while OVAE was very concerned about the monitoring visit’s and the financial management audit’s findings, OVAE staff, in consultation with OGC, determined that an appropriate and effective way to address such concerns was by imposing special conditions, including placing the Center on reimbursement, requiring a detailed accounting for all Federal spending, and increasing technical assistance, monitoring, and oversight, all effective tools that were available to the Department for addressing the challenges presented by the Center’s apparent failures. These appear to have been reasonably effective ways to address the problems uncovered. As the draft audit report indicates, since the OIG has shared these issues and concerns with OVAE, OVAE has been diligent in appropriately bringing to the OIG’s attention information of potential fraud, waste, or abuse, and has sought to act more proactively to contact OIG at the earliest time when a program office discovers that a grantee has significant fiscal problems.