UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL
1999 BRYAN STREET, HARWOOD CENTER, SUITE 2630
DALLAS, TEXAS 75201-6817
PHONE (214) 880-3031 FAX (214) 880-2492

MAY 23 2002

MEMORANDUM

TO : Robert H. Pasternack
Assistant Secretary
Office of Special Education and Rehabilitative Services

FROM : Sherri L. Demmel
Regional Inspector General for Audit

SUBJECT: Final Audit Report ***ALLOWABILITY OF OFFICE OF SPECIAL EDUCATION AND REHABILITATIVE SERVICES' GRANT CHARGES BY PARTNERS RESOURCE NETWORK, INC., BEAUMONT, TEXAS***
Control Number ED-OIG/A06-B0028

Attached is our subject report presenting findings resulting from our audit of Partners Resource Network, Inc.

In accordance with the Department's Audit Resolution Directive, you have been designated as the action official responsible for resolution of the findings in this report.

If you have any questions or wish to discuss the contents of this report, please me at 214-880-3031. Please refer to the audit control number in all correspondence relating to this report.

Attachment

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MAY 23 2002

CONTROL NUMBER
ED-OIG/A06-B0028

Ms. Janice Meyer
Executive Director
Partners Resource Network, Inc.
1090 Longfellow Drive, Suite B
Beaumont, TX 77706-4819

Dear Ms. Meyer:

This **Final Audit Report** presents the results of our audit of grant costs incurred by Partners Resource Network, Inc. (PRN). The objective of our audit was to determine if the costs PRN charged to its two Office of Special Education and Rehabilitative Services' (OSERS') grants for the period July 1, 1997, through July 31, 2001, were allowable.

A draft of this report was provided to PRN. In its response, PRN disagreed with our recommendations that it be required to return $17,220 of unallowable consultant costs and pay $7,569 of imputed interest on excess cash. PRN said that the consultant had provided the contracted services and that excess cash did not exist. PRN's response included documentation that PRN said supported its statements. Based on our review of the documents, we dropped the recommendation that PRN pay the $7,569 of imputed interest. We did not change our recommendation regarding the consultant's costs. Regarding the other recommendations, PRN discussed the corrective actions it had taken. We have summarized PRN's comments after the recommendations. A copy of the response is enclosed with this report. The documents attached to the response have been provided to the Department of Education action official.

BACKGROUND

PRN, a non-profit corporation located in Beaumont, Texas, has received funding from the Department of Education since 1986. PRN received two OSERS grants, one from the Office of Special Education Programs and the other from the Rehabilitation Services Administration.

The Office of Special Education Programs awarded PRN a $2,112,000 grant to operate a Texas statewide parent training and information center for the five-year period from July 1, 1997, through June 30, 2002 (hereinafter referred to as the PATH project). PRN uses PATH grant funds to provide training and technical assistance to families of children with disabilities and young adults with disabilities regarding their educational rights, collaboration and communication between parents and professionals, and obtaining educational services. The Rehabilitation Services Administration awarded PRN a

$288,738 grant entitled Seeking Unlimited Recreational Experiences (SURE) for the three-year period from October 1, 1998, through September 30, 2001. The SURE grant was extended through September 30, 2002, with no additional funding. PRN uses SURE grant funds to work with community agencies to provide and promote recreational opportunities for children and adults with disabilities in East and Southeast Texas.

AUDIT RESULTS

We found that PRN could not adequately support $17,220 of consultant charges to the SURE grant and $45,500 of salary charges to the PATH grant. We concluded that the consultant charges are unallowable. Based on our analysis of the consultant's year-end reports and discussions with PRN and other officials, we determined that not all of the consultant's services were provided. We also determined that a conflict of interest existed between PRN's Executive Director and the consultant. We do not express an opinion on the allowability of the $45,500 of salary charges for the Co-Project Director of the PATH. Based on our discussions with PRN staff, we concluded that the Co-Project Director did work on the PATH, but because PRN had not maintained the required monthly time distribution records for this one employee, we could not determine if the $45,500 of salary charges were reasonable.

We also noted that PRN failed to have required Single Audits performed for two years and had not submitted any Single Audit reports to the Federal Audit Clearinghouse (Clearinghouse) at the time our fieldwork began. PRN also did not have written financial management policies and procedures, and maintained excess cash.

All citations to Title 34, Code of Federal Regulations (C.F.R.), in this report are to the July 1998 edition.

Standards for Financial Management Systems

Pursuant to 34 C.F.R. § 74.21(b), recipients' financial management systems must meet certain standards that include, in part, the following:

> (1) Accurate, current, and complete disclosure of the financial results of each federally-sponsored project . . . .
> (3) Effective control over and accountability for all funds, property, and other assets.
> (5) Written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants or payments by other means . . . .
> (6) Written procedures for determining the reasonableness, allocability, and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.
> (7) Accounting records including cost accounting records that are supported by source documentation.

> According to 34 C.F.R. § 74.27, the cost principles for determining allowable costs for a private non-profit organization are contained in Office of Management and Budget (OMB) Circular Number A-122 (1998).

Consultant Services Not Provided

We determined that $17,220 for consultant services that PRN charged to the SURE grant was not adequately documented. We also determined that not all of the consultant's services were provided. Further, we determined that a conflict of interest existed between PRN's Executive Director and the consultant, and that PRN did not have written standards of conduct addressing conflicts of interest relating to the award and administration of contracts.

The principles in Attachment A, paragraph A.2.g of OMB Circular A-122 state that for a cost to be allowable that it be adequately documented. Attachment A, paragraph A.4.a of the circular further states:

> A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received.

In addition, pursuant to the procurement standards contained in 34 C.F.R. § 74.42:

> The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. 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, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award.

PRN entered into a consultant contract for each year of the SURE grant. The annual fee for each contract was $5,760 ($5,700 in the final grant year) and was paid in advance at the beginning of each year. A conflict of interest existed between PRN's Executive Director and the consultant because they are husband and wife. PRN's Executive Director selected her husband to be the consultant, signed the annual consultant contracts, and approved the advance payments to the consultant. According to the contracts, the consultant was to be paid $30 an hour for providing approximately three to four hours of work each week. The contracts required the consultant to provide a written report on his activities at the end of each 12-month period. PRN could not provide support for the hours the consultant spent on the contracts or that all of the steps under the contracts were provided.

For the first 12-month period, the consultant's contract listed seven deliverables in addition to the written report. In the report, which was slightly over one page, the consultant stated that he did not complete four of the seven deliverables. The remaining three deliverables involved holding meetings to advise PRN's Executive Director and the SURE Project Director and

developing a plan for the use of student interns. PRN provided no documentation of the frequency or extent of the meetings. The consultant did provide a two-page document that he had prepared at the beginning of the contract period that was a plan for the use of student interns and intern job descriptions. The SURE project never implemented the plan.

For the second 12-month period, the consultant's contract listed six deliverables in addition to the written report. The report consisted of a one-page document. Two deliverables involved meeting periodically to advise PRN's Executive Director and the SURE Project Director on various activities. PRN provided no documentation that these meetings had occurred. PRN also could not provide documentation of the consultant's involvement in the remaining four contract deliverables, which involved developing Partners Ranch[1] and raising funds for its operation. For example, two of the deliverables involved securing a consultant to perform a feasibility study of Partners Ranch and working with that consultant to develop a fund raising plan. The consultant who performed the feasibility study stated that the PRN Executive Director and the SURE consultant initially contacted him regarding performing the study, but that he had no contact with the SURE consultant thereafter.

For the third 12-month period, the consultant's contract listed six deliverables in addition to the written report. The report for the third year was not due at the time of our fieldwork (about one month remained in the contract period). Two deliverables involved meeting periodically with PRN's Executive Director and the SURE Project Director on various activities. Again, PRN could provide no documentation that these meetings occurred. The remaining four deliverables involved various Partners Ranch activities. For example, one deliverable was to maintain the membership of Partners Ranch Steering Committee and arrange for periodic meetings. Six of 11 Steering Committee members stated that there had been no contact with the consultant and no meetings for approximately one year. Another deliverable was to establish communication with development officers for agencies providing similar programs. PRN's Executive Director provided a list of five such agencies. The consultant told us that he and his wife visited the agencies usually during vacations and obtained pamphlets from them.

Salary Charges Not Documented

The Co-Project Director for the PATH grant, who is the husband of PRN's Executive Director, had not submitted monthly time distribution records since March 2000. PRN maintained such records for the salary charges of the Co-Project Director prior to March 2000, and for all other employees who worked on the PATH and SURE grants during the period of our audit.

Requirements for compensation for personal services are listed in OMB Circular Number A-122, Attachment B, paragraph 7m(2):

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[1] Partners Ranch is owned by PRN and consists of 26 undeveloped acres adjacent to the PRN Executive Director's residence. PRN planned to develop and use Partners Ranch for recreational activities for children and adults with disabilities. At the time of our fieldwork, Partners Ranch was not operational.

> Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:
> (a) The reports must reflect an *after-the-fact* determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.
> (b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.
> (c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.
> (d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

The Co-Project Director was budgeted to work on the PATH project at a 60 percent full-time equivalency rate. PRN charged the PATH grant approximately $45,500 of salary and fringe benefits for the Co-Project Director from April 2000 through June 2001, without after-the-fact time distribution records. Based on interviews with PRN officials, we determined that the Co-Project Director did work on the PATH project during this time period, but due to the lack of records we could not determine the extent of work that was performed and do not express an opinion on the allowability of the $45,500 of charges.

Failure to Complete and Submit Single Audits

PRN had not completed the required Single Audits for the fiscal years ended on June 30, 1999 and 2000, which were due at the Clearinghouse by March 31, 2000 and 2001, respectively. Although the Single Audits for 1997 and 1998 were completed, PRN had not submitted them to the Clearinghouse at the time we began our audit (PRN had provided a copy of its 1998 Single Audit report to the OSERS' PATH grant official). After we advised PRN of the requirement, PRN submitted the 1997 and 1998 Single Audit reports to the Clearinghouse.

OMB Circular Number A-133, Subpart B § 200(a) states:

> Non-Federal entities that expend $300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part.

Subpart C § 320(d) further states:

> All auditees shall submit to the Federal clearinghouse designated by OMB the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section . . . .

In addition, Attachment C to the Grant Award Notification directed PRN to submit its Single Audit reports to the Clearinghouse. Single Audit reports are required by OMB Circular Number A-133 § 320(a) to be submitted within the earlier of 30 days of the receipt of the auditor's report or nine months after the end of the audit period.

No Written Financial Management Policies and Procedures

PRN did not have formal written policies and procedures governing its financial management system. PRN provided a seven-page document that it had given to its Single Auditor that identified some of the system's checks and balances. This document did not include the written procedures required by 34 C.F.R. Part 74.

Pursuant to 34 C.F.R. § 74.22(b)(1):

> Recipients are paid in advance, provided they maintain or demonstrate the willingness to maintain – (i) Written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient; and (ii) Financial management systems that meet the standards for fund control and accountability as established in § 74.21.

Written procedures are also required covering procurement standards that include: (1) standards of conduct in 34 C.F.R. § 74.42, and (2) procurement standards in 34 C.F.R. § 74.44.

Excess Cash

PRN maintained excess cash during a portion of our audit period. PRN's practice was to make draw downs generally once a month. This practice resulted in excess cash for short periods of time. For example, during a three-month period from February through April 2001, PRN made monthly draw downs of $35,000, $33,000, and $30,000. PRN took from five to nine days to expend the funds.

The regulations at 34 C.F.R. § 74.22(b) state:

> (2) 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.
> (3) 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.

RECOMMENDATIONS

We recommend that the Assistant Secretary of OSERS require PRN to:

1. Strengthen its management controls to ensure that all costs are adequately documented and allowable, required audits are completed and submitted timely, written policies and procedures are developed and followed, and draw downs are timed as close as possible to actual disbursements.

2. Establish written standards of conduct governing the performance of employees engaged in the award and administration of contracts, including specific standards to prevent conflicts of interest.

3. Follow the standards of conduct and terminate the existing consultant's contract, and discontinue contracting in the future with individuals and entities in which a real or apparent conflict of interest exists.

4. Return to the Department of Education $17,220 of unallowable consultant costs identified during our audit and any additional payments made to the consultant since our audit that were charged to the SURE grant.

5. Provide documentation to support the accuracy of the $45,500 of unsupported salary costs charged to the PATH grant or return the charges to the Department.

PRN'S COMMENTS TO THE DRAFT REPORT AND OIG'S RESPONSE

PRN described the actions it had taken to address recommendation numbers one through three. Regarding recommendation number four, PRN did not agree that the $17,220 of consultant payments should be returned, although PRN did agree to discontinue the consultant's contract. Regarding recommendation number five, PRN provided monthly time sheets that were prepared after our fieldwork as support for the $45,500 of salary costs.

PRN disagreed it had maintained excess cash during the first year of the PATH grant and provided copies of bank statements that showed it generally had made monthly draw downs of grant funds. Based on our review of the bank statements, we dropped a recommendation that PRN pay the Department of Education $7,569 of imputed interest on excess cash. We calculated the imputed interest based on Department records that showed PRN had drawn down $365,000 of the $400,000 award for the first year of the PATH project at the beginning of that year. The $365,000 actually included a number of smaller drawdowns during the year.

Our analysis of the school's comments and documentation provided did not convince us to make any other changes to the recommendations. PRN's comments to our final recommendations are summarized below followed by OIG's response.

PRN's Comments to Recommendation Numbers 1-3. PRN said that: 1) an experienced individual had been hired to review bank statements, invoices, and payroll activities to ensure all costs are adequately documented and allowable; 2) all work for the 1998-99 and 1999-00 required audits had been done and the written reports would be completed in April 2002 and submitted to the Department and the Audit Clearinghouse; 3) formal written policies and procedures were being developed and would be completed by June 1, 2002; and 4) more frequent draw downs of grant funds were being made to avoid excess cash. PRN also said that it would include in the written policies and procedures standards of conduct governing the performance of employees engaged in the award and administration of contracts, including standards related to conflicts of interest. PRN stated that the consultant's contract was discontinued and no additional payments would be made to the consultant.

OIG's Response. We agree that these actions should improve management controls when completed.

PRN's Comments to Recommendation Number 4. PRN disagreed that the consultant's services were not provided and that the $17,220 should be returned. PRN said "After this matter was brought to PRN's attention by the OIG auditors, adequate documentation was requested from, and provided by, the consultant regarding his time spent on the SURE grant." PRN provided copies of the consultant's monthly time sheets for the period October 1998 through September 2001. PRN said the time sheets were prepared from the consultant's personal calendar and "reconciled against the calendars and time sheets [of] other staff." PRN also provided copies of two reports submitted to PRN by the consultant and various grant documents it submitted to the Department that addressed the consultant's duties.

PRN stated that while the consultant did not provide all of the contracted services in the first year, the consultant did provide "alternative services at the direction of the Executive Director." For the second year, PRN contends that all deliverables were provided. For the third year, PRN stated "Final status cannot be determined until September 30, 2002 because PRN has been given a no-cost extension to complete objectives for 00-01."

OIG's Response. PRN's comments and the documents provided did not convince us to change our recommendation. During our audit fieldwork, we reviewed the monthly time sheets that were available for the period October 1998 through March 2000 (no time sheets were available after March 2000). The time sheets included only the total hours the consultant worked each month as a PRN employee on the PATH grant. The time sheets did not contain any hours that this individual worked as a consultant on the SURE grant. The consultant's hours shown on the time sheets could not have been recorded by the consultant or reviewed by PRN's Executive Director on a contemporary basis. The hours were recorded and reviewed over two years after the fact for some of the months. PRN also did not provide copies of the consultant's personal calendars or the results of its reconciliation against the calendars and time sheets of other staff to support the hours.

We had reviewed the consultant's reports and grant documents during our audit fieldwork and concluded that they do not support the services were provided. The consultant was paid at the beginning of the third year for services to be provided during that year. At the time of our fieldwork, only about one month remained in that year and PRN could not support that the contracted consultant services for the year were provided.

PRN's Comments to Recommendation Number 5. Regarding the $45,500 of unsupported salary costs charged to the PATH grant, PRN said "Since the time of the field work of the OIG auditors, the Co-Project Director has submitted time sheets for April 2000 to present." PRN provided copies of these monthly time sheets that covered the period April 2000 through June 2001. PRN stated that the records met the documentation requirements of OMB Circular Number A-122.

OIG Response. We did not change our recommendation. We agree that the time sheets would meet the OMB Circular Number A-122 requirements if the time sheets had been completed within a reasonable period of time after each month ended. At the time of our fieldwork in August 2001, PRN had not required the Co-Project Director of the PATH project to submit monthly time sheets since March 2000. The time sheets PRN provided with its response were prepared and reviewed several months and, in a few cases, over a year, after the work was performed. PRN did not provide the Co-Project Director's calendar or any other documentation that would show how the Co-Project Director was able to determine the work hours that were recorded on the time sheets.

OBJECTIVE, SCOPE AND METHODOLOGY

The objective of our audit was to determine if PRN grant charges were allowable. Our audit covered the period from July 1, 1997, through July 31, 2001.

To accomplish our objective, we obtained background information about PRN. We interviewed OSERS and PRN officials and individuals identified in the consultant's reports. We reviewed PRN's accounting records, bank statements, documentation for expenditures, and records of services provided to recipients. We tested the allowability of non-salary charges by selecting a judgmental sample of 33 expenditure transactions, which totaled $32,383, that were charged to the two OSERS grants during our audit period. We tested the allowability of salary charges by selecting a judgmental sample of 11 PRN employees from a universe of 70 employees whose salary costs were charged to the two grants during our audit period. All transactions selected in the samples were reviewed. There is no assurance that these judgmental samples were representative of the universe of transactions and should not be projected over the unsampled transactions.

We relied on computer-processed data obtained from the Department's Grants Administration and Payment System and from PRN to accomplish our audit objective. We performed limited tests of the data to verify reliability by comparing the data to information in PRN's accounting records. Based on the results of these tests, we concluded that the computerized data was sufficiently reliable to formulate conclusions associated with the objective of our audit.

We performed fieldwork during August 2001, at PRN in Beaumont, Texas. We conducted an exit meeting on September 13, 2001. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

STATEMENT ON MANAGEMENT CONTROLS

As part of our review, we assessed PRN's management controls, policies, procedures, and practices applicable to the scope of the audit. We assessed the level of control risk for determining the nature, extent, and timing of our substantive tests. For the purposes of this report, we assessed and classified the significant management controls into the following categories: (1) use of grant funds, (2) documentation of grant charges, and (3) cash management.

Because of inherent limitations, a study and evaluation made for the limited purposes described above would not necessarily disclose all material weaknesses in management controls. However, our assessment disclosed weaknesses related to the use of grant funds, documentation of grant charges, and cash management. These weaknesses are discussed in the AUDIT RESULTS section of this report.

ADMINISTRATIVE MATTERS

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 U.S. Department of Education official, who will consider them before taking final Departmental action on the audit:

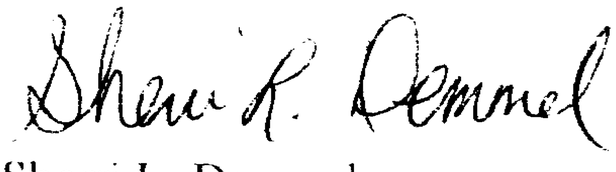
Dr. Robert H. Pasternack, Assistant Secretary
Office of Special Education and Rehabilitative Services
U.S. Department of Education
Mary E. Switzer Building, Room 3006
330 C Street, SW
Washington, DC 20202

Office of Management and Budget Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, we request receipt of your comments within 30 days.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available, if requested, 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 or wish to discuss the contents of this report, please contact me at 214-880-3031. Please refer to the control number in all correspondence related to this report.

Sincerely,



Sherri L. Demmel
Regional Inspector General for Audit

Enclosure

PARTNERS

resource network, inc.

Enclosure

March 14, 2002

Sherri L. Demmel
Regional Inspector General for Audit
U.S. Department of Education
Office of Inspector General
1999 Bryan Street, Suite 2630
Dallas, Texas 75201-6817

Dear Ms. Demmel,

Re: Draft Audit Report (Control Number ED-OIG/A06-B0028) dated February 12, 2002

We appreciate that on March 14, 2002, in a telephone conversation with Janice Meyer, Sherri Demmel agreed to allow an additional day for preparation of these comments. Ms. Demmel stated that this letter will be accepted without penalty with a post mark date of March 15, 2002. In addition, the Board of Directors and the management staff of PRN wish to express appreciation for the professional manner in which the field work for this audit was performed.

On the following pages, we will specifically address the OIG findings regarding the following: 1) consultant charges of $17,220, 2) salary charges of $45,500, 3) Single Audits, 4) written financial management policies/procedures, and 5) excess cash.

Note: Text from your report appears below in regular type. Our corresponding responses follow in italics.

AUDIT RESULTS

We found that PRN could not adequately support $17,220 of consultant charges to the SURE grant and $45,500 of salary charges to the PATH grant. We concluded that the consultant charges are unallowable. Based on our analysis of the consultant's year end reports and discussions with PRN and other officials, we determined that not all of the consultant's services were provided. We do not express an opinion on the allowability of the $45,500 of salary charges for the Co-Project Director of the PATH Project. Based on our discussions with PRN staff, we concluded that the Co-Project Director did work on the PATH, but because PRN had not maintained the required monthly time distribution records for this one employee, we could not determine if the $45,500 of salary charges were reasonable

Documentation to support the $17,220 of consultant charges to the SURE grant and $45,500 of salary charges to the PATH grant are enclosed. Documentation is enclosed to verify that the only services not provided by the consultant were the result of the deletion of a specific objective of the grant and a subsequent assignment of alternative services to the consultant.

1090 LONGFELLOW DR • SUITE B • BEAUMONT TEXAS 77706-4889 • 409 898 3681 • FAX 409 898 4869 • 1-800-866-4726

We also noted that PRN failed to have required Single Audits performed for two years and had not submitted any Single Audit reports to the Federal Audit Clearinghouse at the time our fieldwork began.

Documentation is enclosed to show that all work has been completed for the Single Audit Reports for 98-99 and 99-00 and that the written reports will be available no later than April 30, 2002. The Single Audit reports for 96-97 and 97-98 had been submitted previously to the Federal Audit Clearinghouse but without the required cover sheets, and therefore, they were not acknowledged on the Clearinghouse web site. They were re-submitted, with cover sheets, during the OIG audit visit in August 2001.

PRN also did not have written financial management policies and procedures,

A PRN accounting manual will be completed by June 1, 2002, and a copy will be mailed to The OIG Office

and maintained excess cash.

Documentation is enclosed showing that we made monthly draws and did not maintain excess cash as alleged.

All citations to Title 34, Code of Federal Regulations (C.F.R.), in this report are to the July 1998 edition.

Standards for Financial Management Systems

Pursuant to 34 C.F.R. § 74.21(b), recipients' financial management systems must meet certain standards that include, in part, the following:

> (1) Accurate, current, and complete disclosure of the financial results of each federally-sponsored project
> (3) Effective control over and accountability for all funds, property, and other assets.
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> (6) Written procedures for determining the reasonableness, allocability, and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award
> (7) Accounting records including cost accounting records that are supported by source documentation.

According to 34 C.F.R. § 74.27, the cost principles for determining allowable costs for a private non-profit organization are contained in Office of Management and Budget (OMB) Circular Number A-122 (1998)

Consultant Services Not Provided

We determined that $17,220 for consultant services that PRN charged to the SURE grant was not adequately documented.

After this matter was brought to PRN's attention by the OIG auditors, adequate documentation was requested from, and provided by, the consultant regarding his time spent on the SURE grant. He states that the data for this documentation was based on the consultant's personal calendar. His data was satisfactorily reconciled against the calendars and time sheets other staff. The consultant's time sheets for October 1998 September 2001 are enclosed in Attachment A.

We also determined that not all of the consultant's services were provided.

In 98-99, the four deliverables concerning student interns were not provided because an objective was deleted from the SURE grant. See Attachment B, Consultant Report for 98-99 and Attachment C, page 2 of the April 1999-March 2000 SURE Performance Report. In lieu of these four deliverables, the consultant provided alternative services at the direction of the Executive Director. In 99-00, all deliverables were provided. See Attachment D, Consultant Report for 99-00. The activities of the SURE Project for 00-01 were not completed at the time of the audit visit, and therefore a determination of final status was not possible at that time. Final status cannot be determined until September 30, 2002 because PRN has been given a no-cost extension to complete objectives for 00-01. See Attachment E, revised Grant Award Notice.

Further, we determined that a conflict of interest existed between PRN's Executive Director and the consultant, and that PRN did not have written standards of conduct addressing conflicts of interest relating to the award and administration of contracts.

The principles in Attachment A, paragraph A.2 g of OMB Circular A-122 state that for a cost to be allowable that it be adequately documented. Attachment A, paragraph A.4 a of the circular further states.

> A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received.

In addition, pursuant to the procurement standards contained in 34 C.F.R. § 74.42:

> The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. 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, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award.

Since 1994, there has been an on-going precedence within PRN wherein the Executive Director has selected her husband as a consultant, awarded contracts to her husband, and approved payments to her husband. This practice was not cited by previous auditors as being in conflict with 34 CFR 74.42. PRN is a small agency and has no administrative staff other than the Executive Director authorized by the Board of Directors to perform the functions mentioned, e.g., select consultants, sign contracts, and approve payments. . The relationship between PRN's Executive Director and the consultant (husband and wife) has been known by Project Officers for the PATH Project since their marriage in 1993. However, when the OIG auditors pointed out the problem, it was ceased immediately. See Attachment F, Memorandum of September 4, 2001.

PRN entered into a consultant contract for each year of the SURE grant. The annual fee for each contract was $5,760 ($5,700 in the final grant year) and was paid in advance at the beginning of each year. A conflict of interest existed between PRN's Executive Director and the consultant because they are husband and wife. PRN's Executive Director selected her husband to be the consultant, signed the annual consultant contracts, and approved the advance payments to the consultant. According to the contracts, the consultant was to be paid $30 an hour for providing approximately three to four hours of work each week. The contracts required the consultant to provide a written report on his activities at the end of each 12-month period. PRN could not provide support for the hours the consultant spent on the contracts or that all of the steps under the contracts were provided.

Documentation for hours the consultant spent on the SURE grant is provided in Attachment A. The consultant reports in Attachments B and D indicate the steps of the contracts that were provided.

For the first 12-month period, the consultant's contract listed seven deliverables in addition to the written report. In the report, which was slightly over one page, the consultant stated that he did not complete four of the seven deliverables. The remaining three deliverables involved holding meetings to advise PRN's Executive Director and the SURE Project Director and developing a plan for the use of student interns. PRN provided no documentation of the frequency or extent of the meetings. The consultant did provide a two-page document that he had prepared at the beginning of the contract period that was a plan for the use of student interns and intern job descriptions. The SURE project never implemented the plan.

The consultant report in Attachment B indicates that in 98-99, all but four deliverables were met. The exceptions were for implementation of the student intern program, which was deleted from the grant at the end of 1999 and therefore, never implemented. See Attachment C. The timesheets in Attachment A indicate the occurrence of meetings with the Executive Director and project director and other relevant individuals. The remainder of the consultant's time in year one was spent on three major activities: 1) on-going planning and evaluation meetings with the Executive Director (deliverable 1), 2) identifying a group of community leaders to support the development of Partners Ranch, and 3) identifying ways to generate funding for the continuation of the programs after the end of federal funding. The last two were not specified in

the contract. However, the consultant pursued these activities at the direction of the Executive Director.

For the second 12-month period, the consultant's contract listed six deliverables in addition to the written report. The report consisted of a one page document. Two deliverables involved meeting periodically to advise PRN's Executive Director and the SURE Project Director on various activities. PRN provided no documentation that these meetings had occurred. PRN also could not provide documentation of the consultant's involvement in the remaining four contract deliverables, which involved developing Partners Ranch and raising funds for its operation. For example, two of the deliverables involved securing a consultant to perform a feasibility study of Partners Ranch and working with that consultant to develop a fund raising plan. The consultant who performed the feasibility study stated that the PRN Executive Director and the SURE consultant initially contacted him regarding performing the study, but that he had no contact with the SURE consultant thereafter.

The Consultant Report in Attachment D indicates that in 99-00, all deliverables were met. The timesheets in Attachment A indicate the occurrence of meetings with the Executive Director, SURE staff, and potential members of the PRN Steering Committee. Regarding the feasibility study, the consultant fulfilled his contractual responsibility by making the arrangements for the study, including initial communication with the feasibility consultant. The feasibility study was conducted in August and November 2000. The OIG auditors were provided with a copy of the two-part Feasibility Report and Recommendations. The follow-up on the results and recommendations was the responsibility of the project director, not the consultant. The consultant's activities in regards to contact with development officers for similar programs was not limited to visiting and obtaining pamphlets during vacations, as stated in the report. He told the OIG auditors about visiting children's camps during his vacations to underscore his commitment to the SURE grant. The list of agencies and their representatives provided to the OIG auditors and the data on file on various programs (also reviewed by the auditors) are sufficient documentation of that deliverable 6 being met.

For the third 12-month period, the consultant's contract listed six deliverables in addition to the written report. The report for the third year was not due at the time of our fieldwork (about one month remained in the contract period). Two deliverables involved meeting periodically with PRN's Executive Director and the SURE Project Director on various activities. Again, PRN could provide no documentation that these meetings occurred. The remaining four deliverables involved various Partners Ranch activities. For example, one deliverable was to maintain the membership of Partners Ranch Steering Committee and arrange for periodic meetings. Six of 11 Steering Committee members stated that there had been no contact with the consultant and no meetings for approximately one year. Another deliverable was to establish communication with development officers for agencies providing similar programs. PRN's Executive Director provided a list of five such agencies. The consultant told us that he and his wife visited the agencies usually during vacations and obtained pamphlets from them.

For 00-01, The timesheets in Attachment A indicate the occurrence of meetings with the Executive Director and project director and other relevant individuals. The remaining four

For 00-01, The timesheets in Attachment A indicate the occurrence of meetings with the Executive Director and project director and other relevant individuals. The remaining four deliverables are still pending, due to the no-cost extension to the SURE grant, mentioned above.

It should be noted that in the original grant application, the consultant was specifically identified by name as the individual to perform the duties in his contract for 98-99. Therefore, the hiring of the individual, his proposed duties, the amount of time (0.10 FTE), and the basis for payment ($30.00 per hour) were all in accordance with the specifications of the original grant application and therefore had previous approval by the DOL. See page 5 of the grant proposal enclosed, Attachment G. (It should be noted that the duties specified in the consultant contracts for all three years significantly exceeded the scope of those specified for the staff position in the original proposal, at no increase in cost to the project.) The only change that was made was to designate the individual as a consultant rather add to his FTE. The reason for this change was that the individual's involvement, although continual, was not needed on a daily, consistent FTE-type basis as is usual for an employee. The consultant was only contracted for sixteen hours per month. His role was to provide primary ***leadership*** *for the development and implementation of a program using university student interns as adjunct staff for recreational activities, and he did so. The key word is leadership. At four hours per week, the position was not budgeted for performing the multitude of tasks and activities necessary to "make it all work". In the second and third years, the services specified on his contracts are alternatives to the deleted intern program and are reflective of the needs of the grant. In all three years, his job was to lay groundwork, establish infrastructure, and provide direction for the actions of other employees.*

Salary Charges Not Documented

The Co-Project Director for the PATH grant, who is the husband of the Executive Director, had not submitted monthly time distribution records since March 2000. PRN maintained such records for the salary charges for the Co-Project Director prior to March 2000, and for all other employees who worked on the PATH and SURE grants during the period of our audit

Requirements for compensation for personal services are listed in OMB Circular Number A-122, Attachment B, paragraph 7m(2)

> Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards
> (a) The reports must reflect an *after-the-fact* determination of the actual activity of each employee. Budget estimates (i e , estimates determined before the services are performed) do not qualify as support for charges to awards
> (b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.
> (c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.
> (d) The reports must be prepared at least monthly and must coincide with one or more pay periods

Since the time of the field work of the OIG auditors, the Co-Project Director has submitted time sheets for April 2000 to present. Copies for April 2000 - June 2001 are enclosed in Attachment H. This documentation meets the requirements for payment of salary for all the following: PRN requirements for all employees, OMB Circular Number A-122, Attachment B, paragraph 7m(2) cited above, and the Texas Pay Day Law. Note: Review of these time sheets will reveal that a significant amount of sick leave has been used by the Co-Project Director during this time period. This behavior has been limited to the past three years of his employment with PRN and is the result of his on-going struggles with the effects of a serious medical condition that severely limits his energy and stamina.

All employees are required to submit time sheets before receiving their payroll check. A memo to this effect was distributed in September 2001. See Attachment I.

The Co-Project Director was budgeted to work on the PATH project at 60 percent full time equivalency rate. PRN charged the PATH grant approximately $45,5000 of salary and fringe benefits for the Co-Project Director from April 2000 through June 2001, without after the fact time distribution records. Based on interviews with PRN officials, we determined that the Co-Project Director did work on the PATH Project during this time period, but due to the lack of records, we could not determine the extent of work that was performed and do not express an opinion on the allowability of the $45,500 of charges.

Documentation to support the salary charges of $45,500 for the Co-Project Director are enclosed in Attachment H.

Failure to Complete and Submit Single Audits

PRN had not completed the required Single Audits for the fiscal years ended on June 30, 1999 and 2000, which were due at the Clearinghouse by March 31, 2000 and 2001, respectively. Although the Single Audits for 1997 and 1998 were completed, PRN had not submitted them to the Clearinghouse at the time we began our audit (PRN had provided a copy of its 1998 Single Audit report to the OSERS' PATH grant official). After we advised PRN of the requirement, PRN submitted the 1997 and 1998 Single Audit reports to the Clearinghouse

OMB Circular Number A-133, Subpart B § 200(a) states

> Non-Federal entities that expend $300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part

Subpart C § 320(d) further states

> All auditees shall submit to the Federal clearinghouse designated by OMB the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section

In addition, Attachment C to the Grant Award Notification directed PRN to submit its Single Audit reports to the Clearinghouse. Single Audit reports are required by OMB Circular Number A-133 § 320(a) to be submitted within the earlier of 30 days of the receipt of the auditor's report or nine months after the end of the audit period

As indicated in the Draft Audit report, upon advisement by the OIG auditors in August 2001, PRN immediately sent the missing cover sheets for the 97 and 98 audit reports, copies of the two audit reports to the Clearinghouse.

At the time of the OIG audit, PRN had obtained a letter of engagement from the auditing firm, Borel, McCellan, and Applegate, PLLC dated January 4, 2001. See Attachment J. The Executive Director had initiated activities with their representative, EDITED *regarding the 98-99 and 99-00 audit reports, but the work on the audits was only in the early stages. There were several reasons for PRN's delay in completing these audits:*

1. *There was tremendous difficulty hiring an auditor. The accountant who had performed our previous audits (through June 1998) moved to another state, and his firm did not replace him. He was the only CPA with that firm qualified to perform OMB Circular Number A-133 audits. The firm notified us in February 2000 they would no longer provide that service. See Attachment K. An immediate search began for a new auditor, with little success. None of the contacted firms were willing to perform an audit for the amount in PRN's budget. Very few firms in Southeast Texas perform audits for non-profits, or they limit the number they perform, and competition was overwhelming with all the other non-profits who had previously been served by the same previous auditor.*

2. *Data generated by PRN's accounting software program was presented in a format that was difficult to utilize. In September 1999 PRN converted the accounting software program from a DOS version to a Windows version. In the process, the program "batched" a great deal of transactions by accounting codes, and as a result, the General Ledger provided only summary data each month, noted as "balance from conversion". Thus normal closing and adjustment activities were extremely time consuming because original invoices and cancelled checks had to be referenced often for clarification. The situation was noted by the OIG auditors.*

3. *In June 1998, PRN's bookkeeper resigned to attend college. The replacement was immediate, but the salary was not enough to hire a trained accountant. The new bookkeeper (promoted from Secretary) required significant on the job training. In spite of the training, several mistakes were made in account coding during her first few months. Discovering and correcting these mistakes months after the fact was time-consuming and complicated by the software conversion above-mentioned, which caused further delay.*

4. *The Executive Director's usual diligence in meeting all reporting deadlines was distracted due to her preoccupation with her mother's illness with cancer and subsequent death in January 2000.*

At present, all work for the Single Audits for fiscal years ending June 30, 1999 and June 30, 2000 has been completed and turned over to the auditor. She has completed her "investigation" for both years and is currently writing the two audit reports. See letter from EDITED *in Attachment L. The reports should be complete on or before April 2002, and copies will be sent immediately to your office and to the Clearinghouse*

No Written Financial Management Policies and Procedures

PRN did not have formal written policies and procedures governing its financial management system. PRN provided a seven-page document that it had given to its Single Auditor that identified some of the system's checks and balances. This document did not include the written procedures required by 34 C.F.R. Part 74.

Pursuant to 34 C.F.R. § 74.22(b)(1):

> Recipients are paid in advance, provided they maintain or demonstrate the willingness to maintain – (i) Written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient, and (ii) Financial management systems that meet the standards for fund control and accountability as established in § 74.21.

Written procedures are also required covering procurement standards that include (1) standards of conduct in 34 C.F.R. § 74.42, and (2) procurement standards in 34 C.F.R. § 74.44.

Since its inception in 1986, PRN has never had a formal accounting manual. Policies and procedures have been documented and notice given to employees through the on-going use of memorandums, written guidelines, and Board policies. These documents address such matters as payroll, expense reimbursement, reconciliation of bank statements with ledger, receipt of cash and other payments, deposits, travel policies, etc. A sample of those is enclosed in Attachment M. This situation has not been cited as a problem in any of our previous Single Audit reports. A relevant fact to note in this situation is that PRN has experienced overwhelming growth recent years. Before 1997, PRN had one project and a budget of $400,000. From October 97 to October 98, PRN gained three projects and doubled its budget. Obviously, PRN has reached a stage in its development where more formal systems are needed. Upon advisement of the OIG auditors, we began the process of developing a formal accounting manual. This manual will be completed by June 1, 2002. After Board approval, a copy will be sent to the OIG office.

Excess Cash

PRN maintained excess cash during a portion of our audit period. For example, during the first year of the PATH grant, PRN drew down $365,000 of its $400,000 annual award at the beginning of the grant year. PRN did not draw down the remaining $35,000 until almost the end of the year.

PRN made monthly draws during grant year 97-98. A log of the dates and amounts in enclosed in Attachment N. In addition, copies of PRN's bank statements for July 97 – June 98 are enclosed, Attachment O, showing the amount of electronic deposits from ***Education*** *each month of 97-98. During the first eleven months, the method for draw down was an 800 number and a P.I.N. A verification number was given at the end of each transaction. The verification numbers for each draw are indicated on the log in Attachment N. In June 98, the DOE switched to an*

on-line system for draw downs. In the conversion process, apparently the ***entire*** *amount for July 97 - May 98 was "batched" and posted for the month of July on the GAPS website, instead of throughout the year as the draw downs actually occurred.*

After the first year, PRN changed its practice and made more frequent draw downs (generally once a month). This practice still resulted in excess cash for short periods of time. For example, during a three-month period from February through April 2001, PRN made monthly draw downs of $35,000, $343,000, and $30,000. PRN took from five to nine days to expend the funds.

The regulations at 34 C.F.R. § 74.22(b) state

> (2) 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
> (3) 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

Prior to September 2001, PRN's practice was to make one draw per month and to expend the draw down by the 9th of the month. PRN's long term practice has been that of four dates for making payments each month: 1st – payroll, 3rd - accounts payable, 7th - late payroll, and 9th - expense vouchers. This practice was more relevant when draws were requested by telephone (prior to June 1998) because the number of days between a request and the actual deposit often varied, and sometimes checks had to be delayed until deposits could be verified. The GAPS on-line system for draw downs has significantly reduced that problem. This has been PRN's practice since 1986, and was not noted as a problem in any previous audit. However, upon advisement of the OIG auditors, at the very next opportunity (September 2001), we began making two or three draws per month, spacing them over a seven to ten day period and thus limiting the amount of funds we have on hand on any one date.

We calculated that $7,569 of imputed interest was incurred by the Federal Government as a result of PRN maintaining excess cash during the first year of the PATH grant (July 1, 1997, through June 30, 1998). This amount was calculated by multiplying the current value of funds rate of five percent published by the U.S. Department of Treasury by the monthly amounts of excess cash PRN maintained during the year.

Since an excess cash situation for 97-98 did not exist, as explained above and documented in Attachments N and O, no interest is due.

RECOMMENDATIONS

We recommend that the Assistant Secretary of OSERS require PRN to

1. Strengthen its management controls to ensure that all costs are adequately documented and allowable, required audits are completed and submitted timely, written policies and procedures are developed and followed, and draw downs are timed as close as possible to actual disbursements

2. Establish written standards of conduct governing the performance of employees engaged in the award and administration of contracts, including specific standards to prevent conflicts of interest

3. Follow the standards of conduct and terminate the existing consultant's contract, and discontinue contracting in the future with individuals and entities in which a real or apparent conflict of interest exists

4. Return to the Department of Education $17,220 of unallowable consultant costs identified during our audit and any additional payments made to the consultant since our audit that were charged to the SURE grant

5. Pay to the Department of Education the $7,569 of imputed interest on the excess cash maintained during the first year of the PATH grant.

6. Provide documentation to support the accuracy of the $15,500 of unsupported salary costs charged to the PATH grant or return the charges to the Department

   1. *Four issues are addressed in this recommendation:*
      a. *Management controls regarding costs: As of August 2001, an individual was hired on an hourly basis to review bank statements, invoices, and payroll activities to ensure that all costs are adequately documented and allowable. This person has previous audit experience for a large union. His job is to verify that adequate documentation is present for all expenditures on a monthly basis, and he reports his findings to the Executive Director. Any needed subsequent action is taken on a monthly basis*

      b. *Audits: All work for the audits for 98-99 and 99-00 has been completed, and the written reports will be complete by the end of April 2002. Copies will be sent to your office and the Clearinghouse immediately.*

      c. *Written policies and procedures: A formal accounting manual of written policies and procedures to govern PRN's financial management system will be completed by June 1, 2002. A copy will be sent to your office immediately.*

      d. *Draw downs: As of September 2001, we began making two or three draw downs per month to avoid excess cash.*

2. *Standards of conduct governing the performance of employees engaged in the award and administration of contracts, including conflict of interest, will be part of the accounting manual mentioned above, to be completed June 1, 2002.*

3. *Upon advisement of the OIG auditors, the consultant's contract was discontinued as of September 2001, and no additional payments with SURE funds have been, or will be, made to the individual. A memo regarding avoidance of conflict of interest was issued in September 2001 (Attachment F). The written standards to be included in the accounting manual will ensure no such contracting in the future with individuals and entities in which a real or apparent conflict of interest exists.*

4. *This letter and its attachments provide irrefutable evidence that the $17,220 in consultant charges to the SURE grant over the three year period 98-99, 99-00, and 00-01are allowable costs. The contract was discontinued as stated above, and no additional payments were made to the consultant. The evidence we have presented is summarized as follows:*
   a. *Consultant Reports in Attachments B and D indicate that the consultant provided the services listed on the annual contracts to the extent possible. During the first year, the four deliverables not provided were due to DOE approval's of deletion of a specific objectiveaction, and the consultant then provided alternative services at the direction of the Executive Director. During the second year, he met all the deliverables of his contract. The report did not address the final status of the third year, and that status is stil pending, due to a no-cost extension of the SURE grant through September 2002.*

   b. *The expenditure in question ($5,760 per year for three years) was previously approved through the grant application process for services to be provided by the same individual named as consultant. As a consultant, the scope of his responsibilities was actually increased from those proposed in the original application.*

   c. *Time sheets in Attachment A present documentation of the consultant's time spent on the contracts. In most months, the number of hours exceeded the minimum called for in the contract.*

   d. *The consultant's annual reports (Attachments B and D) were brief, but however, did address the expected outcomes. Expectations of greater involvement and/or additional accomplishments are unrealistic for a position based only on three to four hours per week.*

5. *This letter and its attachments (See Excess Cash section) provide ample documentation that a draw down of $365,000 was not made in the beginning of 97-98, and thus, PRN does not owe $7,569 of imputed interest on excess cash.*

6. *Documentation to support the accuracy of $45,500 in salary costs charged to the PATH Project is enclosed in Attachment H.*

STATEMENT ON MANAGEMENT CONTROLS

As part of our review, we assessed PRN's management controls, policies, procedures, and practices applicable to the scope of the audit. We assessed the level of control risk for determining the nature, extent, and timing of our substantive tests. For the purposes of this report, we assessed and classified the significant management controls into the following categories: (1) use of grant funds, (2) documentation of grant charges, and (3) cash management.

Because of inherent limitations, a study and evaluation made for the limited purposes described above would not necessarily disclose all material weaknesses in management controls. However, our assessment disclosed weaknesses related to the use of grant funds, documentation of grant charges, and cash management. These weaknesses are discussed in the AUDIT RESULTS section of this report.

The weaknesses disclosed by the OIG audit were either: (1) corrected by PRN immediately upon the advisement of the auditors or (2) addressed in this letter and its attachments.

We appreciate the assistance provided us through this most insightful audit process. The experience was productive and has enhanced our ability to provide services to children and young adults with disabilities and their families in Texas.

Sincerely,

Janice S. Meyer
Executive Director

Martin T. Woodard
President, Board of Directors

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