UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE DEPUTY SECRETARY

June 19, 2012

Honorable De'Shawn A. Wright
Deputy Mayor for Education
Office of the Deputy Mayor for Education
District of Columbia
John A. Wilson Building
1350 Pennsylvania Avenue, NW, Suite 303
Washington, DC 20004

Dear Deputy Mayor Wright:

Enclosed are special conditions that the U.S. Department of Education (Department) is imposing on all grants awarded to the District of Columbia, Office of the State Superintendent of Education (DC OSSE) for Federal Fiscal Year (FFY) 2012. The special conditions will apply to all grants awarded by the Department to DC OSSE on or after the date of these special conditions. Additionally, the special conditions apply to all grant funds previously awarded by the Department to DC OSSE that are still available for obligation or liquidation on the date of these special conditions, including the Education Job Funds grant. Certain FFY 2012 grant awards will contain additional special conditions that are specific to the programmatic requirements of those grants.

The Department and DC OSSE continue to work cooperatively to address the longstanding financial and grants management and program compliance issues that confronted the DC Public Schools (DCPS), and now DC OSSE, with regard to the administration of Federal education grants. In 2009, DC OSSE put forth a comprehensive high-risk corrective action plan (HRCAP) that outlined a strategy and plan for reform to eliminate long -standing inefficiencies and build and support compliant and sustainable systems. DC OSSE has completed a significant portion of the action steps related to implementing these systemic reforms and correcting several program compliance deficiencies identified in the HRCAP. Examples of improvements DC OSSE reported in the HRCAP, and acknowledged by the Department in last year's June 15, 2011 special conditions letter, include: a finalized and fully implemented inventory management policy and process; a time distribution policy and a new single system of recording payroll expenditures and time and effort data; new cash management procedures fully implemented and in compliance with Cash Management Improvement Act requirements; a comprehensive financial policies and procedures manual; an improved grants allocations process; a uniform policy for sub-recipient monitoring and implementation of the new policy in each of the DC OSSE programs; and, progress in improving the timeliness and quality of grant data reporting internal and external to DC OSSE.

Additional improvements achieved since last year include: establishing a central records management system for monthly and semi-annual certifications, release of an agency standard operating procedures manual that includes updated procurement policies, a satisfactory rating received by the DC Office of Procurement Integrity and Compliance of DC OSSE's procurement

practices, and continuous show of improvement in cash management as demonstrated by a reduction of single audit findings in FY2010. Further, since October 2011, DC OSSE has reported on activities in its efforts to demonstrate how it is continuing to build on the capacities established under the HRCAP, and that its ongoing implementation of the corrective actions made to its financial, record-keeping and internal control systems and procedures are sufficient to address the longstanding financial and grants management and program compliance issues that led to the high risk designation.

However, DC OSSE has not yet fully implemented a process for calculating and charging indirect costs to Federal education programs that demonstrates sound internal controls and sustained improvement in the accurate accounting and recording of Federal grant expenditures. In prior single audits, the auditors found that DCPS repeatedly incorrectly calculated and charged indirect costs to Federal education programs and that DCPS' accounting system was not capable of calculating and recording indirect costs for Federal programs. The auditors further concluded that since DCPS applied a manual process to calculate and charge indirect costs, that DCPS personnel might have incorrectly calculated indirect costs on unallowable expenditures. For single audit periods 2005 and 2006, the auditors questioned costs in the total amount of $695,108. In the 2007 single audit, the auditors were unable to determine the amount of questioned costs because the calculation of indirect cost did not agree with the amount recorded in District of Columbia's accounting system of record and DCPS was unable to locate supporting documentation for the amounts used in the indirect cost calculations.

DC OSSE recognized the inconsistent application of indirect cost rates when it assumed SEA responsibilities in October 2007. DC OSSE committed in the HRCAP to address these audit deficiencies through a reassessment of agency policies and procedures for indirect cost calculation and reimbursement. During this period, DC OSSE informed the Department that effective FY 2008, DC OSSE would suspend the charging of indirect costs to Federal education grants. In the HRCAP, DC OSSE reported that it has engaged consultants to develop formal indirect cost rate proposals for FY 2008 through FY 2010 and has received Department approval. DC OSSE also reported that it has submitted a FY 2011 indirect cost rate proposal and is currently awaiting Department approval. Further, DC OSSE reported that it has taken steps to revisit policies and procedures for seeking reimbursements for indirect costs and is in the process of developing an LEA indirect cost rate proposal for submission to the Department. Upon the Department's approval, DC OSSE will begin negotiating indirect cost rates with all DC LEAs, including DCPS.

The Department awaits submission of the final indirect cost policies and procedures that provide assurances to the Department that DC OSSE's internal controls and methodology for calculating and charging indirect costs are based solely on allowable expenditures and that DC OSSE maintains supporting documentation for its indirect costs charges to Federal grants consistent with DC OSSE's applicable approved Indirect Cost Rate Agreements.

Accordingly, the designation of DCPS as a "high-risk" grantee in April 2006 under 34 CFR § 80.12 (transferred to DC OSSE effective October 1, 2007) remains in effect until such time as the Department is able to determine that DC OSSE has satisfied this objective and the Department is assured that the revised policy and processes for calculating and charging indirect costs demonstrate sound internal controls and sustained improvement in the accurate accounting and recording of Federal grant expenditures.

The Department will continue to assess the effectiveness of DC OSSE's corrective actions and looks forward to the continued work with DC OSSE and the DC Government to improve the

delivery of Federally-supported education services. We encourage you and other DC officials to continue to seek the advice and assistance of the Department in your continued work under the high risk reporting requirements and administration of Department grant programs.

Sincerely,

Philip A. Maestri, Director
Risk Management Service

Enclosure

cc: Honorable Hosanna Mahaley, DC OSSE State Superintendent

District of Columbia Office of the State Superintendent of Education
Special Conditions
Federal Fiscal Year (FFY) 2012

PREAMBLE: These special conditions are imposed on all Federal fiscal year (FFY) 2012 grants made available by the U.S. Department of Education (Department) to the District of Columbia Office of the State Superintendent of Education (DC OSSE) on or after the date of these special conditions and on all grants previously awarded by the Department to DC OSSE (or to its predecessor DC Public Schools) that are still available for obligation or liquidation on the date of these special conditions, including the Education Job Funds grant. These special conditions are applied in accordance with the Department's regulations governing "high-risk" grantees. *See* 34 CFR § 80.12. The special conditions are imposed to help ensure that Department funds granted to DC OSSE are expended in accordance with applicable legal requirements and the appropriate fiscal accountability measures and management practices and controls. They are also intended to help DC OSSE to improve its implementation of financial, record-keeping, and internal control systems and procedures sufficient to satisfy the applicable grant accountability requirements.

I. BACKGROUND:

A. In April 2006, the Department designated DC Public Schools (DCPS) a "high-risk" grantee under the authority in 34 CFR § 80.12 based on systemic problems identified through repeat findings of audits performed under the Single Audit Act for fiscal years 2003 through 2005, the fiscal year 2006 DC Government Consolidated Annual Financial Report audit, and unresolved findings of non-compliance from program reviews conducted in 2006. At that time, special conditions were placed on all Department grants awarded to DCPS. The Department concluded that DCPS had significant problems meeting some of the most fundamental program accountability requirements, including implementing appropriate financial, record-keeping, and internal control systems and procedures. The special conditions were intended to result in important improvements to Federal grants administration by DCPS so that the systemic problems identified by audits and reviews would not recur. On July 1, 2006, the Department imposed revised special conditions on all grants it awarded to DCPS for FFY 2006.

B. The core requirements of the FFY 2006 special conditions were that DCPS was required to (1) develop a comprehensive high-risk corrective action plan (HRCAP) to resolve applicable audit findings on all matters affecting funds under Department grant programs and unresolved program review findings, and (2) report every six months on the progress of the corrective actions in the HRCAP. Since the initial high-risk designation, the Department has worked with DC's State educational agency (SEA), DCPS (now DC OSSE), to support its development and refinement of the HRCAP. DCPS produced an HRCAP and made progress on some of the actions included therein. The HRCAP included actions to address weaknesses in financial management, procurement, and

property management; and areas of non-compliance with the requirements of the Elementary and Secondary Education Act of 1965, as amended (ESEA), the Individuals with Disabilities Education Act (IDEA), and the Perkins Career and Technical Education Act of 2006 (Perkins Act). The initial version of the HRCAP had a moderate likelihood of resolving most of the control weaknesses and incidences of non-compliance with applicable legal requirements. However, (1) DCPS had made changes to the plan and the revised version was delayed in reaching final form; (2) the timelines for action extended beyond one year; and (3) DCPS had not maintained sufficient progress on the planned actions to correct within one year the major deficiencies in its Federal programs.

C. On June 1, 2007, the President signed H.R. 2080 (P.L. 110-33) effectively permitting the Mayor and City Council of DC to assume responsibility for DC schools in accordance with the DC Public Education Reform Act of 2007 (DC Act 17-0038), approved by the City Council and signed into law by the Mayor on April 23, 2007. The legislation transferred authority to the Mayor's Office for the purpose of administering Federal grants, the functions of the SEA, the local educational agency (LEA), and the State agencies responsible for Adult Education and Literacy and the IDEA Part C Early Intervention Program. The transfer became effective October 1, 2007. The DC Government established DC OSSE as the SEA with an appropriate structure and sufficient grant and fiscal management capacity to carry out the State agency responsibilities of Department grants.

D. On July 1, 2007, the Department imposed revised special conditions on all of its grants awarded to DCPS for FFY 2007. The core elements of the special conditions required DCPS (the functions of which were transferred to DC OSSE, effective October 1, 2007) to maintain a current, comprehensive HRCAP, which would be the basis for tracking DCPS's progress in resolving its fiscal management deficiencies, grants management deficiencies, and program non-compliance. The HRCAP was to be sufficiently detailed to demonstrate that the corrective actions would adequately address the problems that have a high likelihood of preventing further lapses in internal controls, expenditures for unallowable costs, or failure to maintain proper documentation of expenditures. The HRCAP needed to include, at a minimum, corrective actions to correct the problems specified in all Single Audit program determination letters, program monitoring reports, and notifications of non-compliance with other provisions of law that are issued by the Department. If major changes to DCPS's financial management, procurement, payroll, human resources, or record-keeping systems or procedures were in progress or were necessary to achieve this, DCPS was required to incorporate these actions in the HRCAP. If any other audits, such as those conducted by the DC Inspector General or by independent auditors at the request of city agencies, contained findings regarding the administration of Department programs, DCPS was required to incorporate actions to address such findings in the HRCAP. The HRCAP was to be revised to address any new findings from audits and program and management reviews within 60 days of the issuance of such findings. DCPS was required to conduct an

annual, comprehensive review and update of the HRCAP and submit a revised HRCAP to the Department by May 30, 2008. If at any time during the review or implementation of the HRCAP, DCPS determined that implementation of the corrective actions necessary to come into compliance with applicable legal requirements would extend past July 1, 2008, DCPS was required to notify the Department that DCPS needed to enter into a compliance agreement, as authorized by section 457 of the General Education Provisions Act, 20 U.S.C. § 1234f.

E. On June 16, 2008, the Department imposed revised special conditions on all grants awarded to DC OSSE for FFY 2008. The core elements of the special conditions required DC OSSE to continue to maintain a current, comprehensive HRCAP, to be used as the basis for tracking DC OSSE's progress in resolving its fiscal management deficiencies, grants management deficiencies, and program non-compliance. The Department acknowledged the progress that DC OSSE had made in some areas of the HRCAP. However, DC OSSE had failed to provide sufficient evidence that it had taken all of the corrective actions necessary to demonstrate that it had successfully implemented financial, record-keeping, and internal control systems and procedures sufficient to satisfy the accountability requirements in administering grants issued by the Department. These accountability requirements included those relating to Office of Management and Budget (OMB) Circulars A-102 and A-110 governing procurement, and the cost principles in OMB Circular A-87, including those governing payroll costs charged to Federal programs. The Department further concluded that DC OSSE had not demonstrated full compliance with some major provisions of Department ESEA and IDEA programs.

F. On June 15, 2009, the Department imposed revised special conditions on all grants awarded for FFY 2009. The core elements of the special conditions required DC OSSE to continue to maintain a current, comprehensive HRCAP, to be used as the basis for tracking DC OSSE's progress in resolving its fiscal management deficiencies, grants management deficiencies, and program non-compliance. The Department acknowledged the progress that DC OSSE had made in some areas of the HRCAP. However, DC OSSE had not yet provided sufficient evidence that it had taken all of the corrective actions necessary to demonstrate that it had successfully implemented financial, record-keeping, and internal control systems and procedures sufficient to satisfy the accountability requirements in administering grants issued by the Department. These accountability requirements included those relating to Office of Management and Budget (OMB) Circulars A-102 and A-110 governing procurement, and the cost principles in OMB Circular A-87, including those governing payroll costs charged to Federal programs. The Department further concluded that DC OSSE had not demonstrated full compliance with some major provisions of Department ESEA, IDEA, Adult Education, and Perkins Act programs.

G. On June 15, 2010, the Department imposed revised special conditions on all grants awarded for FFY 2010. The core elements of the special conditions required DC OSSE to continue to maintain a current, comprehensive HRCAP, to be used as the basis for tracking DC OSSE's progress in resolving its fiscal management deficiencies, grants management deficiencies, and program non-compliance. The Department acknowledged the progress that DC OSSE had made during FFY 2010 on the implementation of systemic reforms and in resolving and closing individual correction actions, as detailed in the HRCAP quarterly reports, and as acknowledged by correspondence from program and other offices in the Department during the year. However, DC OSSE had not completed the reform efforts and corrective actions needed to demonstrate that it had fully implemented sustainable financial, record-keeping, and internal control systems and procedures sufficient to satisfy the accountability requirements in administering grants issued by the Department. These accountability requirements included those relating to Office of Management and Budget (OMB) Circulars A-102 and A-110 governing procurement, and the cost principles in OMB Circular A-87, including those governing payroll costs charged to Federal programs. The Department further concluded that DC OSSE had not demonstrated full compliance with some major provisions of Department ESEA, IDEA, and Perkins Act programs.

H. On June 15, 2011, the Department imposed revised special conditions on all grants awarded for FFY 2011. The core elements of the special conditions required DC OSSE to continue to maintain a current, comprehensive HRCAP, to be used as the basis for tracking DC OSSE's progress in resolving its fiscal management deficiencies, grants management deficiencies, and program non-compliance. DC OSSE had made significant progress in completing the action steps related to implementing systemic reforms and resolving and closing individual corrective actions as detailed in the HRCAP quarterly reports, and as acknowledged by correspondence from program offices in the Department. However, DC OSSE had not yet demonstrated that it has fully implemented sustainable financial, record-keeping, and internal control systems and procedures sufficient to satisfy the accountability requirements in administering grants issued by the Department. These accountability requirements included those relating to Office of Management and Budget (OMB) Circulars A-102 and A-110 governing procurement and property management, the cost principles in OMB Circular A-87, including those governing payroll costs charged to Federal programs, and other financial accountability requirements, including those relating to indirect costs and cash management. The Department further concluded that DC OSSE had not demonstrated full compliance with some major provisions of Department ESEA and IDEA programs.

II. SPECIAL CONDITIONS

During this past year, DC OSSE has completed a significant portion of the action steps related to implementing the systemic reforms and correcting program compliance deficiencies identified in the HRCAP. DC OSSE has reported a number of improvements, including an inventory management policy and process, a time distribution policy and a single system of recording payroll expenditures and time and effort data, new cash management procedures, a comprehensive financial policies and procedures manual, an improved grants allocations process, a uniform policy for subrecipient monitoring, improved timeliness and quality of grant data reporting, a central records management system for monthly and semi-annual certifications, updated procurement policies, and a reduction of single audit findings in FY 2010. Further, since October 2011, DC OSSE has reported on activities to demonstrate how it is continuing to build on the capacities established under the HRCAP and that its ongoing implementation of the corrective actions made to its financial, record-keeping and internal control systems and procedures are sufficient to address the longstanding financial and grants management and program compliance issues that led to the high-risk designation. The progress reported by DC OSSE is awaiting validation by the Department.

However, DC OSSE has not fully demonstrated sufficient improvement in the application of indirect costs to Federal education programs and, as such, has not yet fully demonstrated that it has implemented sustainable financial, record-keeping, and internal control systems and procedures to satisfy the accountability requirements in administering grants issued by the Department. These accountability requirements include the cost principles in OMB Circular A-87 relating to indirect costs. In particular, under the HRCAP, DC OSSE is still in the process of developing final indirect cost policies and procedures that will ensure that its methodology for calculating and charging indirect costs is based solely on allowable expenditures and that DC OSSE maintains supporting documentation for its indirect costs charges to Federal grants consistent with its applicable approved Indirect Cost Rate Agreement. The Department further concludes that although DC OSSE continues to demonstrate progress, DC OSSE has not demonstrated full compliance with some major provisions of the Department's IDEA, Part B program.

A. Corrective Action Plan

OSSE shall continue to maintain a current, comprehensive HRCAP, to be used as the basis for tracking DC OSSE's progress in implementing systemic reforms that fully demonstrate sustainable financial, record-keeping, and internal control systems and procedures sufficient to satisfy the accountability requirements in administering grants issued by the Department. The HRCAP must continue to reflect the progress that DC OSSE has previously reported, as described above,

as well as any updates, and must also include the steps that DC OSSE is taking to develop and implement final indirect cost policies and procedures that will ensure that it properly charges indirect costs to Federal education grants and maintains supporting documentation for indirect cost charges. The HRCAP shall also be used to track DC OSSE's continued efforts in resolving individual findings pertaining to fiscal management deficiencies, grants management deficiencies, and program non-compliance. The HRCAP shall be sufficiently detailed to demonstrate that the corrective actions will adequately address the problems and have a high likelihood of preventing such weaknesses as: further lapses in internal controls, expenditures for unallowable costs, or failure to maintain proper documentation of expenditures.

The HRCAP must continue to include, at a minimum, corrective actions needed to correct the problems specified in all Single Audit program determination letters, program monitoring reports, program-specific special conditions, and notifications of non-compliance with other provisions of law that are issued by the Department to date and during FFY 2012. If major changes to DC OSSE's financial management, procurement, payroll, human resources, or record-keeping systems or procedures are in progress or are necessary to correct these issues, DC OSSE shall incorporate these actions in the HRCAP. If any other audits, such as those conducted by the DC Inspector General or by independent auditors at the request of city agencies, contain findings regarding the administration of Department programs, DC OSSE shall incorporate actions to address such findings in the HRCAP.

DC OSSE shall revise the HRCAP to address any new findings from audits and program and management reviews within 60 days of the issuance of such findings, and shall submit these updates beginning with the next scheduled reporting period. DC OSSE shall conduct a quarterly, comprehensive review and update of the HRCAP. Each revised HRCAP shall include an analysis and justification of each change made from the previous version, and shall be submitted to the Department with each quarterly report beginning with the next scheduled reporting period.

DC's Chief State School Officer (DC CSSO) is the individual responsible for the development and implementation of the HRCAP. In the event that a new DC CSSO is appointed or elected, DC shall provide timely notification to the Department of the identity of the authorized official. The new DC CSSO or other authorized official shall review the HRCAP and certify to the Secretary of Education that the plan is still valid or shall submit a revised plan for review by the Department. A revised plan or certification of the validity of the existing plan must be received by the Department within 60 days of a change in DC CSSO.

B. Required Adequate Progress in Implementing Corrective Action Plans and Related Reporting Requirements

It is essential that DC OSSE maintain steady progress in implementing its HRCAP in order for DC OSSE to build the capacity to responsibly manage its Federal grants. To ensure progress, and to enable the Department to assess progress, DC OSSE must continue to provide the Department with quarterly reports that include the HRCAP and any revisions thereto as required by section II.A above, beginning with the next quarterly report due within 30 days after the period ending September 30, 2012 (FFY 2012 1st quarterly report). The quarterly reporting schedule shall continue as follows:

FFY 2012 2nd Quarterly Report – period ending December 31, 2012. Due by no later than January 30, 2013.

FFY 2012 3rd Quarterly Report – period ending March 31, 2013. Due by no later than April 30, 2013.

FFY 2012 4th Quarterly Report – period ending June 30, 2013. Due by no later than July 30, 2013.

The parties may modify the schedule for the reports by mutual, written agreement.

In general, each quarterly report shall include (1) a complete and accurate description of the finding or deficiency that requires correction, (2) a description of activities and progress for each action during the reporting period, (3) the status of each action that is scheduled to be completed during the reporting period, (4) documentation of completion for those actions that are completed during the reporting period (including explanation of delays for all actions not completed that were scheduled to be completed during the period, and expected completion dates for all unimplemented actions), (5) documentation of measures of performance and results, and (6) other data or documentation as specified for each action, or as requested by the Department in order to verify action or assess the impact of the action.

The DC CSSO or other authorized official of DC OSSE shall certify to the completeness and accuracy of the reports.

C. Prompt Access to Records and Records Retention

DC OSSE shall promptly provide the Department or its representatives access to any requested staff, locations, records, and information associated with the affected grant funds. In addition to other applicable records retention requirements, DC OSSE must retain and maintain all records and information associated with all Department grants for the duration of the period of implementation of the HRCAP (including any revised version thereof).

D. Compliance with Program Requirements

In addition to the special conditions contained in this document, special conditions to address areas in which DC OSSE has not demonstrated compliance with program requirements, including specific requirements under IDEA, Part B, are specified in grant notification documents accompanying those awards for FFY 2012. The program-specific special conditions imposed on DC OSSE's FFY 2012 IDEA, Part B grant award are in addition to the enforcement action taken by the Department based on the Department's 2012 Determination under IDEA section 616(d). DC OSSE must continue to separately and directly report to the program office in the Department on its progress in meeting the program-specific special conditions in accordance with the reporting periods and timelines specified in the grant notification documents accompanying those awards for FFY 2012.

III. FAILURE TO COMPLY WITH SPECIAL CONDITIONS

If a plan, report or documentation required under Section II above is not provided by DC OSSE on a timely basis or is not considered acceptable to the Department (for example, does not show substantial promise of correcting the problems identified in audit and program review findings), it may be considered as a failure to comply with the special conditions.

IV. OTHER TERMS

A. Submission of Reports

All reports required to be submitted to the Department under these Department-wide special conditions should be sent electronically or hand-delivered to:

Cynthia Bond-Butler
Risk Management Service, Management Improvement Team
Office of the Deputy Secretary
U.S. Department of Education
550 12th Street, S.W., Room 11063
Washington, D.C. 20202
cynthia.bond@ed.gov

B. Reconsideration and Modifications

At any time, DC OSSE may request reconsideration of the above special conditions by contacting the Department and providing in writing the basis for DC OSSE's belief that particular conditions are no longer needed.

The Department may impose additional special conditions or modify these special conditions as appropriate. The Department will remove the special conditions at such time as DC OSSE meets, to the Department's satisfaction, the conditions set forth above.

Dated: June 19, 2012