

Financial Audit Division Report

**Minnesota Department of Education
and Metropolitan Educational
Cooperative Service Unit
Administration of Grant Funds**



Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

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- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

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OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Alice Seagren, Commissioner
Department of Education

Ms. Julie Frame-Hansen, Executive Director
Metropolitan Educational Cooperative Service Unit

We have conducted a special review of the Metropolitan Educational Cooperative Service Unit's financial management of the Project LEAD grant funded through the Department of Education for the period July 1, 2000, through October 3, 2003. Metropolitan Educational Cooperative Service Unit (Metro ECSU) is a service cooperative of the State of Minnesota which brings together school district personnel and county and city government leaders to share resources. For fiscal years 2001-2003, the Department of Education awarded Metro ECSU about \$8.5 million in federal and state funding, of which over \$2 million was for Project LEAD.

We conducted this review in response to concerns identified by the Department of Education. The department questioned Metro ECSU's financial management of grant funds, alleging improper use of funds by the agency and a potential conflict of interest on the part of Department of Education staff. Based on the preliminary information obtained from the organization, we decided to pursue the matter further and issue a special report. The following Report Summary highlights our objectives and conclusions. We discuss the issues more fully in the individual chapters of the report.

Pursuant to Minn. Stat. Section 3.975, we have referred this report to the Office of the Attorney General. The Office of the Attorney General has the responsibility to ensure the recovery of public funds and, in fulfilling that role, may negotiate the propriety of individual claims.

The report is intended for the information of the Legislative Audit Commission and the management of the Department of Education. This restriction is not intended to limit the distribution of this report, which was released as a public document on October 14, 2004.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

Report Signed On: October 11, 2004

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Marla Conroy, CPA, CISA	Director of Investigations
Sonya Johnson, CPA	Team Leader, Investigations
Carl Otto, CPA, CISA	Team Leader
Gena Hoffman	Senior Auditor

Exit Conference

The following representatives from the Department of Education and the Metropolitan Educational Cooperative Service Unit participated in the exit conferences held on September 28, 2004, and September 29, 2004:

Department of Education:

Alice Seagren	Commissioner
Chas Anderson	Deputy Commissioner
Tammy McGlone	Administrative Services Director

Metropolitan Educational Cooperative Service Unit:

Julie Frame-Hansen	Executive Director
Tom Baldwin	Executive Director (Retired)
Donald Krukow, Jr.	Project Director
Celine Horn	Accountant
Sandy Giancola	Executive Secretary

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Report Summary

Key Findings:

- The Minnesota Department of Education did not use a competitive process when awarding the Project LEAD grant. (Finding 1, page 5)
- Department of Education employees were inappropriately involved in Metro ECSU management decisions, including hiring staff and renting space. The department should work with Metro ECSU to resolve questioned costs and reimburse the federal grant account \$25,110 for inappropriate salary charges and \$16,539 for inappropriate rent charges. (Finding 2, page 5)
- Metro ECSU did not ensure fair and equitable access to contracting opportunities and did not adequately administer consulting services. Metro ECSU should repay the department \$7,000 in consultant service costs that were inappropriately charged to the Project LEAD grant. (Finding 3, page 7)

Audit Scope:

Audit Period:

July 1, 2000, through October 3, 2003

Programs Audited:

- Leadership Education and Development Project (Project LEAD)
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Background:

Metropolitan Educational Cooperative Service Unit (Metro ECSU) is a nonprofit organization that received a majority of its funding through state and federal grants from the Minnesota Department of Education. The department awarded approximately \$2 million in federal funds to Metro ECSU for Project LEAD.

The report contained a total of 3 findings relating to internal control and legal compliance.

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Chapter 1. Introduction

The Department of Education contacted us because of concerns about Metropolitan Educational Cooperative Service Unit's (Metro ECSU) administration of federal funds for the Leadership Education and Development Project (Project LEAD). The allegations included concerns about the grant award process and possible conflicts of interest involving Department of Education and Metro ECSU employees. Based on the preliminary information we obtained, we conducted a special review.

Metro ECSU is a nonprofit organization that received a majority of its funding from state and federal grants through the Minnesota Department of Education. Metro ECSU is a service cooperative that partners with schools, local governments, and nonprofit organizations to develop and offer a range of services in the Minneapolis/Saint Paul metropolitan area. Service cooperatives, established in state statute, allow for regional planning and delivery of common services, such as training. The statutes specify the governance structure and membership of these entities. Metro ECSU's board of directors, referred to as its Representative Assembly, consists of school board members from member school districts. The Representative Assembly elected a ten-member executive committee that met quarterly to oversee Metro ECSU's general business operations. The executive committee delegated the responsibility for day-to-day operations to Metro ECSU's executive director. Mr. Tom Baldwin served as the executive director during the time that Metro ECSU administered the Project LEAD grant.

From July 2000 through June 2003, nearly 70 percent of Metro ECSU's funding was from the federal grants it received through the Department of Education. Table 1-1 shows the total funding that the organization received for fiscal years 2001-2003.

**Table 1-1
Metro ECSU
Source of Funds
July 1, 2000, through June 30, 2003**

Source of Funds	2001	2002	2003
Federal Grants	\$2,436,565	\$2,897,596	\$2,946,329
State Grants	199,290	81,094	10,963
Local Sources ⁽¹⁾	875,221	909,895	904,022
Membership Fees	228,875	198,386	189,533
Other Revenue ⁽²⁾	119,943	116,505	131,645
Total	\$3,859,894	\$4,203,476	\$4,182,492

Notes:

- (1) Local sources consist of special service and workshop fees and investment earnings.
- (2) Other revenue includes sales and other conversion of assets.

Source: Metro ECSU audited financial statements for fiscal years 2001-2003.

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Chapter 2. Project LEAD Grant Administration

Chapter Conclusions

The Department of Education did not use a competitive process when awarding the Project LEAD grant. In addition, department staff were inappropriately involved in Metro ECSU's management decisions, including hiring staff and renting space. In one instance, Metro ECSU charged an employee's compensation to the Project LEAD grant even though the employee did not work on the grant program. Department staff attended Project LEAD training events without paying the registration fees.

Metro ECSU did not ensure fair and equitable access to contracting opportunities and did not adequately administer consulting services.

Objective and Methodology

Our objective in conducting this special review was to answer the following questions:

- Did the Department of Education use an appropriate process when awarding the Project LEAD grant to Metro ECSU?
- Did Metro ECSU expend grant funds in accordance with legal requirements and grant contract provisions?

In conducting this special review, we examined the accounting records of Metro ECSU. We interviewed certain employees of Metro ECSU and the Department of Education. In addition, we reviewed relevant documents, including the grant agreements and reports related to Project LEAD, but did not conduct a full audit of Metro ECSU's financial records. In some cases, our interviews and review of documents did not provide sufficient evidence for us to determine the validity of specific allegations.

Project LEAD

The Minnesota Department of Education received grant funding from the U.S. Department of Education to implement the Individuals with Disabilities Education Act. The objective of one of these federal grants (CFDA # 84.027- Special Education Grants to States) was to ensure a free, appropriate education for all children with disabilities. Federal regulations gave the state discretion over the use of a portion of the grant. The department allocated the discretionary

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funds based on the priorities it identified through a self-assessment process. One of these priorities was to ensure the availability of qualified professional and paraprofessional staff for special education programs. To recruit, train, and retain special education leaders, the department developed the Leadership Education and Development Project (Project LEAD). The purpose of Project LEAD was to provide professional education to special education directors and other special education leaders. Department personnel involved in the project’s development stated that Project LEAD was not intended to be a permanent program. They anticipated that, within four to five years, some of the grant project’s training programs would be administered by a professional organization, such as the Minnesota Administrators of Special Education.

The department entered into a grant agreement with Metro ECSU to administer Project LEAD. The Department of Education’s grant agreement with Metro ECSU outlined the project’s primary components:

- to identify, recruit, and invite new candidates into the special education profession;
- to supplement candidate academic preparation;
- to support individuals currently in professional practice; and
- to provide ongoing leadership training for special education professionals.

Table 2-1 summarizes the Department of Education’s grant awards and actual amounts paid to Metro ECSU for Project LEAD for the grant periods listed.

**Table 2-1
Project LEAD
Funds Awarded and Disbursed to Metro ECSU
July 2000 through June 2004**

<u>Fiscal Year</u>	<u>Amount Awarded</u>	<u>Amount Disbursed</u>
2001	\$ 417,120	\$ 317,519
2002	1,265,048	865,492
2003 ⁽¹⁾	594,545	498,380
2004 ^{(1) (2)}	447,145	44,714
Total	<u>\$2,723,858</u>	<u>\$1,726,105</u>

Notes:

- (1) The Department of Education and Metro ECSU have not closed out the grant programs because of the pending issues discussed in this report.
- (2) The Department of Education’s only payment to Metro ECSU for fiscal year 2004 was the advance allowed by the grant agreement. The department cancelled the grant in October 2003.

Source: Minnesota Accounting and Procurement System (MAPS) and grant agreements.

We noted several areas where the Department of Education and Metro ECSU could improve their grant administration practices, as explained in the following findings.

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Findings and Recommendations

1. The Department of Education did not use a competitive process when awarding the Project LEAD grant.

Department of Education personnel approached Metro ECSU about administering Project LEAD and hiring a department employee as the project director. The Department of Education awarded the Project LEAD grant to Metro ECSU without advertising the availability of grant funds or soliciting applications from other organizations. The department may have used the grant to Metro ECSU as a way to accomplish project objectives in a less restrictive environment, rather than administer it through the department, where it would be subject to state policies and procedures.

Metro ECSU then hired a Department of Education employee as the director of Project LEAD. The employee took a leave of absence from the department. While at the department, this individual had worked on the conceptual design of Project LEAD and had expressed to others in the department an interest in continuing his work on the project. Metro ECSU did not search for or interview any other candidates for the position. Metro ECSU's former executive director interviewed the department employee and said he offered him the position based on his qualifications; stating that he believed conducting a broader search would not have yielded a better candidate. The executive director also said he followed Metro ECSU's hiring practices and that he did not feel pressure from the department to hire this employee.

As administrators of federal and state funds, the department had the responsibility to ensure fair and equitable access to grant opportunities. The Department of Education's policies and procedures for grant contracts direct employees to prepare a notice of the project and the availability of funds and to coordinate an application process. Once Metro ECSU was awarded the funding, the grant administration should have been in its control, without direct involvement of the department.

Recommendation

- *The department should award state and federal grants using a competitive process to ensure fair and equitable access to grant funds. The department should document circumstances that preclude the use of a competitive grant award process.*

2. Department of Education employees were inappropriately involved in Metro ECSU management decisions.

The Department of Education inappropriately influenced management decisions made by Metro ECSU. The former executive director of Metro ECSU told us he complied with the department's

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requests without consulting the organization's executive committee, sometimes subjecting the organization to unnecessary financial risks.

- Metro ECSU's former executive director told us that a Department of Education supervisor asked Metro ECSU to hire a person that the department could not hire because of hiring restrictions. Metro ECSU employed this person from October 2001 through September 2002. The employee was responsible for coordinating the activities of the federal Self-Improvement Grant. The employee had office space at Metro ECSU, but often worked at the department. No one at Metro ECSU supervised her work. She reported to the Department of Education supervisor, who is now retired. When we spoke with him, he did not recall how she was hired by Metro ECSU or the nature of her duties or responsibilities there. Metro ECSU charged Project LEAD \$25,110 for the employee's compensation although she did not work on the project. In July 2002, the department and Metro ECSU entered into an interagency agreement that allowed Metro ECSU to bill the department for the employee's compensation. The department paid the subsequent interagency invoices from the appropriate federal funding source. The arrangement ended in September 2002, when the department hired the person as its own employee to do similar work.
- Metro ECSU's former executive director stated that a Department of Education employee, who had previously worked at Metro ECSU, asked him to lease additional space in its office building. The department subleased the space for department purposes for the period January 1, 2001, through July 31, 2003. In fiscal year 2002, Metro ECSU inappropriately charged Project LEAD \$16,539 for costs associated with the additional space. The department cancelled its sublease on October 31, 2002, leaving Metro ECSU financially responsible for the additional office space.
- The department did not pay the registration fees for employees that attended the Project LEAD's Special Education Leaders Fellowship training. Instead, the grant funded the cost of their attendance. The leadership training series included four sessions consisting of four days each. On average, there were 15 participants at each training session, of which 4 to 5 were department personnel, and the rest were school district employees. The registration fees ranged from \$500 to \$850 per session. The registration fees included the cost of meals and lodging as well as the facility and speaker fees. The project director and certain department supervisors supported the inclusion of department staff in the training to foster better relationships between department and school district special education personnel. Metro ECSU and Department of Education staff said there was confusion about whether department employees had to pay the registration fees or whether grant funds could be used. The director of Project LEAD stated the department provided different directions each year as to how Metro ECSU should handle the department employees' registration fees. Although the department may have been able to use the same federal program that funded Project LEAD, these costs should have been paid through the department and subject to state policies and procedures.

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- In the summer of 2003, the department told Metro ECSU that it could not hold its Project LEAD training conferences at resorts because of department restrictions. Metro ECSU had already made commitments to reserve conference space at resorts and lost nearly \$20,000 in cancellation fees when it cancelled the conferences. Metro ECSU's former executive director said department personnel had indicated Metro ECSU would not be reimbursed for costs incurred at resorts. Metro ECSU was not subject to department conference restrictions and should have been able to use its own judgment to determine conference locations.

Metro ECSU may have accommodated these requests to maintain a good relationship with the Department of Education, from which it received the majority of its funding.

Recommendations

- *The department should limit its involvement in a grantee's operations to oversight of the grant agreement.*
- *The department should work with Metro ECSU to resolve the \$25,110 of inappropriate salary charges and the \$16,539 of inappropriate rent charges. The department needs to properly report project charges and resolve any federal funding discrepancies that these inaccuracies created.*
- *The department should not use the grant recipient's funding to pay for state employee training.*
- *The department should outline any grant-related restrictions or requirements in the grant contracts.*
- *Metro ECSU's Representative Assembly should establish proper oversight roles for the executive committee and the executive director.*

3. Metro ECSU did not ensure fair and equitable access to contracting opportunities and did not adequately administer consulting services.

During fiscal years 2001 through 2004, Metro ECSU charged \$238,349 to Project LEAD for consultant services, which was an approved budget line item for the grant. It was unclear how the project director selected consultants. As a recipient of public funds, Metro ECSU had the responsibility to ensure fair and equitable access to consulting opportunities. The project director did not specifically document his efforts to identify and select qualified consultants. He hired consultants based on interviews, qualifications, and past performance. In the following two cases, the project director hired relatives:

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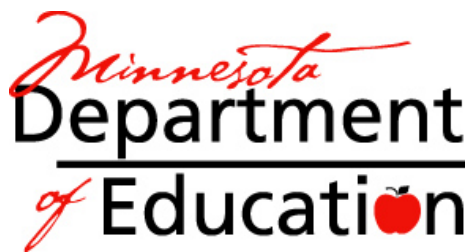
- The wife of Project LEAD's director was paid nearly \$8,250 for services she provided to establish a system to compile, analyze, and summarize confidential questionnaire data about Project LEAD's seminar participants.
- The son of Metro ECSU's former executive director was paid \$1,000 to conduct two training sessions.

Also, Metro ECSU often did not enter into a new contract when it hired a consultant it had previously used. Consultant service agreements did not exist for 18 of 25 tested consultant payments. A consultant services agreement would specify the service dates, the specific services required, and the amount to be paid for the services rendered.

Generally, where invoices existed, the services provided seemed related to Project LEAD. However, in one instance, Metro ECSU used Project LEAD funds to pay \$7,000 to a consultant where the services provided, as documented on the invoice, were clearly not related to Project LEAD. Also, vendor invoices did not support five payments, totaling \$8,740. Metro ECSU made one payment based on the consultant's estimate of time and costs. Although we determined that the vendors provided the services, an adequate internal control structure suggests payments only be made based on approved invoices.

Recommendations

- *Metro ECSU should develop a policy for consultant services. The policy should require valid service agreements for all consultants and establish a dollar threshold for when the organization needs to document its consultant selection process.*
- *Metro ECSU should only pay a consultant based on its review and approval of a detailed invoice.*
- *Metro ECSU should only charge a project for related costs.*
- *Metro ECSU should repay the department \$7,000 in consultant service costs that were inappropriately charged to the Project LEAD grant.*



October 6, 2004

James R. Nobles
Legislative Auditor
658 Cedar Street
Room 140 Centennial Office Building
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to respond to the special review of the Metropolitan Educational Cooperative Service Unit's (Metro ECSU) financial management of the Project LEAD grant funded through the Department of Education (MDE) for the period July 1, 2000 through October 3, 2003. As you are aware, since the Pawlenty administration took office in January 2003, we have requested your review of a number of items. This grant became a concern for the administration based on information provided to us. In October 2003, after review of the information, we requested a review by your office of the grant and canceled the grant agreement with Metro ECSU.

The MDE has policies and procedures in place to support the State of Minnesota standards for the management of grants. A policy was in place at the time this grant was issued to assure compliance with State rules on grants. Grants opportunities were required to be offered on competitive bases for services to a third party. In 2003, a review of another grant audit tightened up those policies and we met with staff to re-affirm the definitions and application of grants, the requirements for requests for proposals, the public notice of grant opportunities and what services would be considered grants and when a service would be considered a professional technical services contract. Employees have been notified that grant processes must be published and be competitive.

The current administration of MDE is committed to fiscal accountability. Since this administration has taken office, policies have been further defined to require all funds to be distributed on a competitive basis with clearly defined objectives and measurable outcomes. We will implement the recommendations of the report and make sure that we safeguard the public trust in the use and distribution of public funds. To the specific findings of this report, we will outline steps to implement the recommendations either already taken or to be accomplished in the following paragraphs.

Recommendation 1.1 *The department should award state and federal grants using a competitive process to ensure fair and equitable access to grant funds. The department*

should document circumstances that preclude the use of a competitive grant award process.

Procedures have been clarified to require all non-formula grant programs to be administered competitively. Sole source programs will have to follow the same process as identified for professional technical contracts with approval given by division director and assistant commissioner. Explanation will have to include all information to justify that there is no other vendor that can provide the service. The contract section of the administrative services division at MDE will also require copies of all public notices of requests for proposal and information regarding vendor responses to be submitted with grant agreements to assure compliance. Grant agreements will not be executed without the documentation of public notice and competition or approved sole source explanations.

Recommendation 2.1 *The department should limit its involvement in a grantee's operations to oversight of the grant agreement.*

MDE will not involve itself in operations of a grantee's organization beyond oversight of grants. Those oversight responsibilities will be defined in each grant agreement. The division directors and assistant commissioners will be responsible to assure that activities of staff administering grants in their divisions are appropriate to each circumstance.

Recommendation 2.2 *The department should work with Metro ECSU to resolve the \$25,110 of inappropriate salary charges and the \$16,539 of inappropriate rent charges. The department needs to properly report project charges and resolve any federal funding discrepancies that these inaccuracies created.*

The director of administrative services division will work with Metro ECSU to repay MDE the \$41,649.00 in costs that were inappropriately charged by Metro ECSU to the project lead grant and will direct staff in the Federal Financial Reporting section to properly adjust expenditure reports with the U.S. Department of Education for those grant periods.

Recommendation 2.3 *The department should not use the grant recipient's funding to pay for state employee training.*

The Department policy indicates employees will not receive services that are to their personal benefit from grantees, and this policy will be fully enforced.

Recommendation 2.4 *The department should outline any grant-related restrictions or requirements in the grant contracts.*

The contract section of administrative services division will ensure all grant documents reviewed identify restrictions or requirements for grants processed.

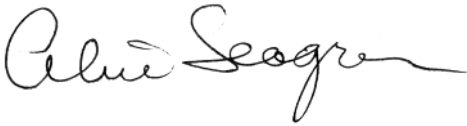
Recommendation 3.4 *Metro ECSU should repay the department \$7,000 in consultant service costs that were inappropriately charged to the Project Lead grant.*

MDE will collect these funds and provide for the proper reconciliation of federal funds as with recommendation 2.2.

Recommendations 2.5 and 3.1 through 3.3 apply to the operations of the Metro ECSU and response on implementation of these recommendations should come from them. However, MDE is in the process of developing standards for financial accountability to be included in grant documents for all grantees. MDE's administrative services contracts and internal auditing sections are working together as a result of a previous audit finding with Metro ECSU to identify criteria for grantees to make certain they have the ability to perform their fiduciary responsibilities with regard to the protection of public funds. All non-formula grant recipients of the MDE will have the same responsibilities.

If you have any questions regarding the MDE activities relating to the implementation of the audit findings, please feel free to contact Deputy Commissioner Chas Anderson, 651-582-8207 or Tammy McGlone at 651-582-8835.

Sincerely,

A handwritten signature in cursive script, appearing to read "Alice Seagren".

Alice Seagren
Commissioner

Date: October 5, 2004

To: James R. Nobles, Legislative Auditor

From: Julie Frame-Hansen, Executive Director Metro ECSU (/s/ JGH)

Re: Response to legislative audit pertaining to the Department of
Education's Project LEAD grant

This is in response to Key Finding #2 regarding \$25,110 for inappropriate salary charges and \$16,539 for inappropriate rent charges. These decisions were made solely by the Executive Director of Metro ECSU after negotiations between representatives of the Department who presented themselves as, and had evidence of, being authorized to conduct such negotiations on behalf of the Department, and the Executive Director of Metro ECSU (Tom Baldwin, former Executive Director). The primary concern of these negotiations from Metro ECSU's point was assuring the organization would not be at financial risk. In both matters the Executive Director was assured this concern would be met. The Executive Director of Metro ECSU did not feel responsible for ascertaining the Departments' source of funding. These would be matters of Department protocol that would rightfully be the responsibility of those representing the Department. Once both sides had concluded negotiations, Metro ECSU followed the direction of Department staff in determining which account codes would be liable for the negotiated rent and salary. As stated, the source of the funds were a matter of concern for the Department (the purchaser), not Metro ECSU (the vendor.)

These negotiations with the Department were done in good faith. Metro ECSU and the Department have had a good working relationship for many years. The Executive Director of Metro ECSU had no basis to believe these requests and negotiations with the Department were inaccurate or inappropriate. Therefore the Executive Director of Metro ECSU does not believe Metro ECSU should be held fiscally responsible for the charges in this finding.