



Department of Development

State Energy ARRA Program Audit

Audit Period: March 1, 2010 to May 17, 2010



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Executive Summary

Background

The American Recovery and Reinvestment Act (ARRA), signed into law on February 17, 2009, includes the following statement of purposes:

- To preserve and create jobs and promote economic recovery.
- To assist those most impacted by the recession.
- To provide investments needed to increase economic efficiency by spurring technological advances in science and health.
- To invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits.
- To stabilize State and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive state and local tax increases.

The State of Ohio has applied for over 90 ARRA programs with expected total grant awards to exceed \$8 billion during the next two years. These applications have been initiated by 21 state agencies in the form of formula, competitive, and discretionary grants. The grant awards are distributed in the following four spending categories:

- Countercyclical Funds: The two largest components of the State's budget that are exposed during a recession, while state revenues decline, are health care and education. The State has been awarded two formula grants (Medicaid and State Fiscal Stabilization) to assist the State's budget. The State Fiscal Stabilization Fund is primarily for education.
- Appropriated Funds: These grants represent additional funding for existing programs such as transportation, labor, and justice programs which will assist in job creation.
- Safety Net Funds: These grants provide relief for lower-income families in the form of supplemental nutrition assistance, child care, and extension of unemployment benefits.
- Economic Growth Funds: These awards focus on new technologies such as alternative energy, health information technology, broadband, and research initiatives.



The Department of Development (DEV) has applied for approximately \$539 million in awards. This audit will focus on the State Energy ARRA Program which is a formula grant for approximately \$96 million. As of May 9, 2010, DEV has disbursed \$812,000 for this program.

The ARRA State Energy Program (SEP), CFDA #81.041, is divided into 5 major categories. Each category has one or more programs. The categories are: Deploying Renewable Energy, New Energy Financing, Targeting Industry Efficiency, Making Efficiency Work, and the Energy Gateway Fund. Programs for each of these categories primarily involves offering subsidies to both private and public entities for projects which promote the goals of the respective program.

During the audit, OIA identified opportunities for DEV to strengthen internal controls and improve business operations. Summary and detailed observations have been provided. OIA would like to thank DEV staff and management for their cooperation and time in support of this audit.

This report is solely intended for the information and use of agency management and the State Audit Committee. It is not intended for anyone other than these specified parties.



Scope and Objectives

OIA staff was engaged to perform assurance work related to the SEP ARRA Program. This work was completed between March 1, 2010 and May 17, 2010. The entire State Energy ARRA award was \$96 million. At the time of this audit, DEV was engaged in three projects totaling \$32 million titled: Deploying renewable Energy (\$14 million), Targeting Industry Efficiency (\$10 million) and Making Efficiency Work (\$8 million). Our audit focused on these active projects. The scope of this audit included the following areas:

- Program planning
 - Program risk assessment; and
 - Internal control process documentation
- Application process
 - Public award announcement; and
 - Applicant evaluation and award notification
- Program administration and monitoring
 - Communication of grant requirements; and
 - Program oversight and monitoring
- Reporting
 - Financial reporting; and
 - Non-financial statistical reporting

The following summarizes the objectives of the review along with a conclusion on the design of management’s internal controls.

Objective	Conclusion ¹
Evaluate the adequacy of the agency’s ARRA program risk assessment and internal control documentation based on guidance provided by State management.	Well-Controlled
Evaluate the adequacy of the awarding process for ARRA funds to subrecipients and vendors.	Well-Controlled
Evaluate the design and adequacy of communication related to program requirements, state guidance, and federal compliance requirements to grant recipients.	Well-Controlled



Objective	Conclusion ¹
Evaluate the design of controls over the timely, accurate, and completeness of ARRA disbursements.	Improvements Needed – See Observation 1
Evaluate the design of the controls over subrecipient and vendor monitoring process for the program.	Improvements Needed – See Observation 2
Evaluate the design of controls over complete, accurate, and timely reporting of financial and non-financial information.	Improvements Needed – See Observation 3

¹ Refer to [Appendix A](#) for classification of audit objective conclusions.



Summary of Observations and Recommendations

The Summary of Observations and Recommendations includes only those risks which were deemed high or moderate. There were no low risk observations and recommendations identified as part of this audit.

No.	Observation	Recommendation	Risk ²
1.	Review of Expenditures – The process to review and approve disbursements does not include specific procedures or documented acknowledgements that expenditures comply with the restrictions stipulated in ARRA or OMB Circular A-87. In addition, department personnel involved in the review process did not demonstrate adequate knowledge or understanding of the OMB requirements.	DEV should provide guidance and training to Division and Program personnel regarding Federal requirements over allowable use of federal funds. DEV should also document adherence to these guidelines during the reviews as a component in the approval of the expenditure.	Moderate
2.	Subrecipient Monitoring –DEV has draft policies and procedures to monitor subrecipients for financial and program compliance. Draft policies and procedures mention Davis-Bacon and Buy American requirements; however, monitoring activities were insufficient to ensure compliance with those requirements.	DEV should develop a comprehensive, risk-based monitoring program that prioritizes monitoring activities according to risk factors. DEV should supplement draft monitoring policies and procedures to include provisions to document and validate subrecipient adherence to ARRA program requirements. DEV management should formally approve and finalize the draft policies and procedures.	Moderate



3.	ARRA Reporting – DEV has implemented effective procedures to collect and report required quarterly data. However, the information collected is required to be validated and DEV has no procedures established to validate the data reported.	DEV should continue to develop and implement formal procedures over the validation of financial and non-financial data. Additionally, DEV should implement procedures as they conduct onsite monitoring visits to validate the FTE data reported by its subrecipients.	Moderate
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Due to the limited nature of our audit, we have not fully assessed the cost-benefit relationship of implementing the observations and recommendations suggested above. However, these observations reflect our continuing desire to assist your department in achieving improvements in internal controls, compliance, and operational efficiencies.

² Refer to [Appendix A](#) for classification of audit observations.



Detailed Observations and Recommendations

Observation 1 – Review of Expenditures

The American Recovery and Reinvestment Act of 2009 and OMB Circular A-87 address costs that are allowable charges to ARRA programs. Federal agencies delegate the responsibility for ensuring ARRA funds are spent appropriately and in accordance with established laws and regulations. DEV has an obligation to develop policies and procedures to minimize the risk of expending ARRA funds for non-allowable costs.

Subrecipients are required to submit requests for reimbursement either at the end of a project or upon completion of project milestones. Technical Monitors review technical results achieved by the project and complete on-site monitoring visits during the project lifecycle. The Fiscal Officer verifies documentation is complete, accurate, and reasonable. The process to review and approve disbursements does not include specific procedures or documented acknowledgements that expenditures comply with the restrictions stipulated in the American Recovery and Reinvestment Act of 2009 or OMB Circular A-87. In addition, department personnel involved in the review process did not demonstrate adequate knowledge or understanding of the OMB requirements.

Inadequate review of subrecipient expenditure reports increases the risk of unallowable use of funds and noncompliance with federal regulations.

Recommendation

DEV should provide guidance and training to Division and Program personnel regarding Federal guidance governing the allowable use of federal funds. DEV should also document adherence to these guidelines during the reviews as a component in the approval of the expenditure.

Management Response

Ohio Energy Resources Division (OERD) staff will have training on OMB Circular A-87, including Attachments A and B, relative to subrecipients' expenditure reports to best ensure compliance with federal regulations concerning requests for reimbursements. OERD will also include a validation sheet within its processes to review and approve disbursements to indicate that reviewers and approvers of disbursements have reviewed the requests for disbursements by subrecipients relative to allowable costs as those requests relate to OMB Circular A-87.

Training will also be provided to staff regarding the distinctions in account coding that OERD uses for its programs within its division and relative to ARRA funds. When reviewing requests for reimbursements, OERD staff will document that they have reviewed the line of coding and that the coding complies with the setup within the Ohio Administrative Knowledge System for OERD grants that fall within funded ARRA programs.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Office Chief - Ohio Energy Division	September 30, 2010



Observation 2 – Subrecipient Monitoring

OMB Circular A-133, Subpart D, requires the department to monitor the activities of subrecipients to reasonably ensure that laws, grant agreements, and performance goals are achieved. Additionally, DEV signed an assurance statement indicating a risk-based subrecipient monitoring process would be in place to ensure achievement of the ARRA program and economic outcomes.

DEV is responsible for monitoring the use of the ARRA State Energy Program grant funds for funded subrecipients. All reviews are performed by Division of State Energy Personnel and draft policies and procedures indicate Technical Monitors will perform two site visits for every project. DEV also has draft policies and procedures to monitor subrecipients for financial and program compliance. Draft policies and procedures mention Davis-Bacon and Buy American requirements; however, monitoring activities were insufficient to ensure compliance with those requirements.

The lack of a formalized risk-based monitoring process and insufficient documentation to evidence the monitoring efforts increases the risk of subrecipient noncompliance or questioned costs and exposes the department to increased oversight by federal agencies.

Recommendation

DEV should consider developing a coordinated effort between the monitoring performed by State Energy personnel and DEV's Audit office. A comprehensive, risk-based monitoring program should be developed that aligns controls with risks associated with disbursing ARRA funds to subrecipients. The program should prioritize monitoring activities considering the length of the project. The program should minimize risk to an acceptable level as established by DEV management. This risk-based approach should be reassessed annually through a combined effort with program and fiscal functions to communicate relevant issues and/or concerns with subrecipient activity that could impact the annual audit scope and schedule.

DEV should supplement draft monitoring policies and procedures and checklists to include provisions to adequately document and validate subrecipient adherence to ARRA program requirements. DEV management should formally approve and finalize the draft policies and procedures.

Management Response

OERD monitoring staff in conjunction with Development's Audit office will work to formulate a risk-based monitoring program that establishes controls relative to the risks associated with disbursing ARRA funds to subrecipients. Desktop monitoring by OERD technical monitors for small scale (e.g., quickly completed) and small dollar grant projects will primarily be the means of reviewing risks associated with requested reimbursements by subrecipients. Requests for



reimbursements concerning small scale/small dollar projects that do not appear to comply with federal guidelines and/or do not appear reasonable in light of the particular grant, may merit further inquiry by monitoring staff to clarify with the subrecipient that the request for reimbursement is supported by a reasonable explanation and/or further supporting documentation to be provided by subrecipient. Based on the dollar amount in issue and response or documentation provided by subrecipient, an on-site visit by an OERD monitor or Audit office staff member may be required before a request for reimbursement may be approved.

Projects of greater magnitude (e.g., ones requiring lengthier time frames to complete) and encompassing moderate to high dollar amounts may merit on-site visits by OERD’s monitoring staff and /or Development’s Audit office. To further mitigate risk, OERD will be assigned a specific auditor in mid Summer 2010 from Development’s Audit Office to assist with audit reviews of subrecipient projects and requests for reimbursements. Further, OERD is intending to hire 2 additional technical monitors in early Fall 2010 to assist with technical programs and reviews.

Additionally, the risk-based monitoring approach designed by OERD and Development’s Audit Office will be reassessed annually with input from technical monitoring staff, fiscal personnel, and audit staff to assess and redefine processes and monitoring as may be deemed necessary. Also, OERD staff and Development’s Audit Office expect to draft documents that adequately document and validate findings concerning subrecipient adherence to ARRA program requirements (e.g., Davis-Bacon, and Buy-American requirements). Said draft documents to be reviewed, commented-on, and subsequently finalized by Development’s management.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Office Chief - Ohio Energy Division	September 30, 2010



Observation 3 – ARRA Reporting

An effective reporting process includes documented procedures that define roles and responsibilities as well as detail the process steps to achieve the ARRA reporting objectives as described in OBM Guidance Memo #9, as well as federal Office of Management and Budget (OMB) Guidance M-09-21 and OMB Guidance M-10-18 which provided guidance to recipients on the 1512 reporting elements and requirements.

DEV is responsible for validating the quality of information of both the department and its subrecipients that is entered into the ARRA Hub. DEV has implemented effective procedures to collect and report required quarterly data. However, the information collected is required to be validated and DEV has yet to establish procedures that validate the data reported.

Failure to adequately validate ARRA data may result in incomplete and/or inaccurate information being reported to federal oversight agencies, thereby decreasing reliance to the public on whether the department will achieve the overall ARRA program objectives.

Recommendation

DEV should continue to develop and implement formalized procedures over the validation process that define:

- who validates the data;
- from where the data is obtained;
- how management ensures the subrecipients submit accurate, complete, and timely data; and
- how management ensures all reporting data as required by the American Recovery and Reinvestment Act, Section 1512 are included through the end of the proper reporting period.

Additionally, DEV should consider implementing procedures as they conduct onsite monitoring visits to validate the FTE data reported by its subrecipients.

Management Response

OERD will develop formalized procedures addressing the validation process of information to be posted and validated by OERD into the ARRA-1512 Hub relative to OERD's subrecipients. More specifically, OERD will define in said procedures that subrecipients are to provide reporting data by the 1st of each month following the close of the prior reporting month, and that should this information not be provided by the 1st of the month by any subrecipient as identified on OERD's data reporting log, OERD staff will contact the subrecipient to inform him that the reporting data is due immediately; as reporting data is collected from the subrecipients, the data will be reviewed for content by both grant and technical monitors, as well as the technical monitoring manager, for completeness and reasonableness of data provided by subrecipients. After said information has been reviewed, OERD staff will compile each subrecipient's data into a master spreadsheet for the reporting period. The provided information will then be loaded into the ARRA-1512 HUB by OERD staff to be reviewed and validated by the OERD fiscal officer by the



7th of each month. The OERD fiscal officer is provided with OERD's own 'ARRA grant monthly report cover sheet' summarizing pertinent information as provided by each subrecipient for the reporting period. Each ARRA-1512 reporting cover sheet for the period is accompanied by the reporting data provided by each subrecipient and summary of review documentation prepared by OERD monitors. The data provided by subrecipients, reviewed by monitors, and loaded into the ARRA-1512 HUB by OERD staff is able to be validated for completeness and reasonableness by the OERD fiscal officer against the documentation provided by the subrecipients and review materials by the OERD monitoring staff.

Based on the review by OERD staff (from initial receipt of subrecipient monthly data, through review by OERD grant and technical monitoring staff and fiscal officer), should there be issues concerning completeness or reasonableness of data provided by subrecipients, further inquiry, including requests for supporting documentation as deemed necessary, may be made of the subrecipient by OERD.

Concerning the implementation of procedures by OERD during subrecipient on-site monitoring visits by OERD monitors and/or Development Audit office staff relative to validation of full time employee (FTE) data reported by subrecipients, OERD may incorporate into its existing procedures that onsite monitoring visits may include, where it is believed to be material and/or merited, inquires with subrecipients as to supporting documentation such as payroll records, payroll tax filings, W-4 forms, observation of employees during working hours and/or other similar information that would substantiate FTE claims by subrecipients.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Office Chief - Ohio Energy Division	September 30, 2010



Appendix A – Classification of Audit Objective Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Major Improvements Needed	Weaknesses are present that could potentially compromise achievement of its overall purpose. The impact of weaknesses on management of risks is widespread due to the number or nature of the weaknesses.
Improvements Needed	Weaknesses are present that compromise achievement of one or more control objectives but do not prevent the process from achieving its overall purpose. While important weaknesses exist, their impact is not widespread.
Well-Controlled with Improvements Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Well-Controlled	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	State Audit Committee, Senior Management, Department Management
Moderate	Observation has moderate impact to the agency. Exposure may be significant to unit within an agency, but not to the agency as a whole. Compensating controls may exist but are not operating as designed. Requires near-term agency attention.	State Audit Committee, Senior Management, Department Management
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Department Management, Senior Management (Optional), State Audit Committee (Not reported)



Appendix B – Audit Follow-up Procedures

OIA will periodically follow-up on management's plans to remediate high and moderate risk audit observations. Follow-up activities may generally be broken down into three categories:

Detailed Detailed follow-up is usually more time-consuming and can include substantial audit customer involvement. Verifying and testing procedures implemented as well as substantiating records are examples. The more critical audit observations usually require detailed follow-up.

Limited Limited follow-up typically involves more audit customer interaction. This may include actually verifying procedures or transactions and, in most cases, cannot be accomplished through memos or telephone conversations with the audit customer but requires onsite observation or testing.

Informal This is the most basic form of follow-up and may be satisfied by review of the audit customer's procedures or an informal telephone conversation. Memo correspondence may also be used. This is usually applicable to the less critical observations.

Low risk audit observations will not result in an OIA audit follow-up, although these observations will be factored into the continuous risk assessment process for future OIA engagements.