



Department of Development

Ohio Third Frontier Audit

Audit Period: July 1, 2010 through March 1, 2011



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Executive Summary

Background

The Ohio Third Frontier program is a commitment to create new technology-based products, companies, industries, and jobs within Ohio. The initiative supports competitive grants focused in the following areas: research and commercialization (five technology platforms are targeted: biomedical; advanced/alternative energy; instruments, controls, and electronics; advanced materials; and advanced propulsion), entrepreneurial assistance projects; pre-seed funds; fuel cell projects; advanced energy projects; technology-related internships; and technology-based industry attraction. Since its inception, more than 375 awards have been distributed throughout the state.

During fiscal year 2010, the total investments made in Ohio Third Frontier activities totaled more than \$93 million. The latest round of performance metrics were released, showing more than 55,000 jobs have been created or retained; more than 630 companies have been created, attracted, or capitalized; and Ohio Third Frontier leveraged more than \$4.7 billion dollars for the State of Ohio through targeted investments.

During the audit, OIA identified opportunities for the Department of Development (DOD) to strengthen internal controls and improve business operations. A summary, along with detailed observations, have been provided. OIA would like to thank Development's 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 Ohio Third Frontier Program. This work was completed between December 6, 2010 and March 1, 2011. The scope of this audit included the following areas:

- Grant application and awarding process
- Program administration and monitoring process
 - Communication of program requirements;
 - Disbursement of program funds;
 - Program oversight and monitoring
- Reporting process

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

Objective	Conclusion ¹
Evaluate the effectiveness of controls over the Ohio Third Frontier awarding process to grantees.	Well-controlled
Evaluate the effectiveness of controls over the communication of applicable state laws, regulations, responsibilities, and program requirements to the grantees.	Well-controlled
Evaluate the effectiveness of controls over the timeliness, accuracy, and completeness of disbursements.	Well-controlled
Evaluate the effectiveness of controls over grantee monitoring for the program.	Improvements Needed – See Observation 1
Evaluate the effectiveness of controls over the timeliness, accuracy, and completeness of reporting financial and non-financial information.	Improvements Needed – See Observation 2

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



Summary of Observations

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

No.	Observation	Risk ²
1.	Lack of Formal Monitoring Plan and Adequate Monitoring Procedures – Documentation did not include reviews of fiscal compliance and other funding requirements and conclusions were reached with insufficient supporting documentation. Also, DOD does not have formal policies and procedures for the monitoring process. Results of monitoring efforts at grantee site visits are not formally issued to the recipients and no formal process for remediation exists.	Moderate
2.	Reporting Requirements Not Met – Annual reporting was not completed for fiscal year 2010 and no timeline has been established to prepare the report. Additionally, the bi-annual report, which should detail research and development support awarded, was being compiled but did not leverage monitoring procedures to verify the accuracy of information provided by grantees.	Moderate

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 – Lack of Formal Monitoring Plan and Adequate Monitoring Procedures

The Department is required to conduct monitoring procedures on each research and development project that received support from the Third Frontier Commission under Ohio Revised Code Section 184.11.

DOD's documentation did not include significant topics that should be reviewed such as fiscal compliance and other funding requirements. Documentation that supports the conclusions reached is insufficient. Furthermore, the Department does not have formalized policies and procedures which stipulate management's expectations of how the monitoring process should be accomplished. DOD does notify grantees of issues resulting from on-site visits and works with the grantees to remedy the issues; however, it does not formally issue the results of its monitoring efforts to the recipients or have a formal process for remediation.

Without a planned, formalized, and structured methodology for monitoring, the Department may not have the information to manage the risks associated with fiscal accountability, operating progress, and desired outcomes.

Recommendation

Current monitoring policies and procedures should be updated and approved by management to address the risks with the requirements set forth in the grantee agreements. Prioritize monitoring activities by utilizing a risk based approach that establishes quantitatively weighted risk factors for the following:

- the nature of the project (complexity);
- prior grant recipient (history);
- prior review results;
- award amount; and
- project length.

Based on the risk assigned to a project and/or grantee, program management could determine the frequency and scope of the monitoring efforts (i.e. if a desk audit would suffice or an on-site visit is more appropriate). The monitoring procedures developed should include, but not be limited to, steps to address how Development's Technology and Innovation Division will:

- ensure grantee fiscal accountability in accordance with the executed grant agreements;
- evaluate the projects' operating progress to ensure the projects are being properly managed to achieve the objectives and desired outcomes set forth in the grant agreements; and



- validate the desired outcomes, including job creation and economic impacts identified in the grantees' proposal, are achieved.

Additionally, program management should develop a formal remediation process that outlines how issues identified during monitoring will be communicated to the grantee and other vested parties. It should include a timeframe for issue resolution, and ultimately, a process for recouping grant awards for unresolved issues and/or non-compliance. Results of monitoring procedures should be adequately documented to support conclusions made and provide a history for future reference. The Ohio Third Frontier Commission and DOD senior management should be informed of the monitoring efforts and results at least annually.

Management Response

Development will establish a formal site visit outline that will be utilized by each Program Administrator during their site visits. Two different outlines will be created, one for Entrepreneurial Programs and one for all other Third Frontier Programs. Each outline will address the relevant monitoring issues for the respective program. Once a site visit is completed, the site visit outline will be attached to the site visit log in the online grant management system, TechLink, which will provide the grantee access to the outline. If there are specific issues that require remediation, the Program Administrator will contact the grantee via email with a correction plan and timeline. A hierarchy of risk will be assigned to the subprograms with a corresponding requirement of frequency of site visits. This monitoring process will be formalized and implemented within the next 60 days.

Grants that are found to be in violation of the terms of the grant agreement or become impracticable will enter the default process. Development has terminated several grants due to default, and those projects have been reported to the Third Frontier Commission. Fiscal accountability will continued to be monitored through the invoicing process already established within Development. Further, a formal audit can be performed if there is significant concern regarding expenditures claimed by the grantee.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Fiscal Officer, Technology and Innovation Division	May 2011



Observation 2 – Reporting Requirements Not Met

The Ohio Third Frontier Commission is required to publish an annual report of the Ohio Third Frontier program (Program) within ninety days of the previous fiscal year. The report is required to include details of grants, loans, and loan guarantees awarded under the biomedical and bioproduct development programs; the status of the projects funded; and the amount of grants or loans awarded and loan guarantees provided for projects in economically distressed areas. The Commission is required to publish a report twice each year detailing all support awarded for research and development projects, including the amount or type of support and the progress and performance metrics for the projects.

According to program management, annual reporting has not been completed for fiscal year 2010 due to recent changes in the administration and other priorities. No timeline has been established to prepare this report. Additionally, the bi-annual report, which should detail research and development support awarded, was being compiled but did not leverage monitoring procedures to verify the accuracy of metric information provided by grantees.

Failure to adequately validate the metrics data may result in incomplete and/or inaccurate information being reported, thereby decreasing the ability for the Governor, Legislature, and the public from making informed decisions regarding the Ohio Third Frontier program. Additionally, failure to submit required reports timely impedes the department and all other vested parties from monitoring the progress and achievements of the program.

Recommendation

Take immediate steps to prepare the required annual report for fiscal year 2010 while also establishing a timeline and other controls to ensure the reporting requirement is met in the coming years. Also incorporate information gathered through project monitoring to validate the metric information collected for the bi-annual reporting. This reconciliation process should be documented and maintained.

Management Response

Development is currently assembling the Ohio Third Frontier Fiscal Year 2010 Annual Report and will have it completed and delivered within the next 60 days. The fiscal year 2011 report will be delivered by September 30, 2011 in accordance with the ORC-defined schedule.

In addition, Development will be implementing a more comprehensive and standardized site visit monitoring process over the next 60 days. As part of the new monitoring process, metrics data will be addressed with the grantee during the site visit. The Program Administrator will weigh the reported metrics against grantee performance to ensure accurate accounting of success measures.

The bi-annual metrics report will continue to be delivered in accordance with ORC requirements. The process for Development approval of the biannual and the annual reports will be formalized and documented for future reports.



Risk	Remediation Owner	Estimated Completion Date
Moderate	Interim Director, Technology and Innovation Division	May 2011



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.