



**UNITED STATES DEPARTMENT OF EDUCATION**  
OFFICE OF INSPECTOR GENERAL

**Evaluation and Inspection Services**

March 9, 2012

Control Number  
ED-OIG/I13K0002

Anthony W. Miller  
Deputy Secretary  
U.S. Department of Education  
400 Maryland Avenue, S.W.  
Washington, DC 20202

Dear Mr. Miller:

This final inspection report presents the results of our review of the U.S. Department of Education's (Department's) process to identify and monitor high-risk grantees and the Department's response to the results.

The objectives of our inspection were to: (1) evaluate the Department's process for identifying and designating high-risk/at-risk grantees, and (2) evaluate the Department's process for monitoring and taking action as a result of the high-risk/at-risk designation. We did not identify any issues with the processes for managing the designation and monitoring of high-risk formula grantees; however, we found that these processes had not been formalized. During our inspection, the Department developed new processes for identifying and monitoring high-risk discretionary grantees. This process had not been fully implemented at the time of our review and as a result, we could not draw a conclusion on the effectiveness of this new process.

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## **BACKGROUND**

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Most of the grants awarded by the Department fall into two categories: formula grants, which are awarded based on statutorily defined formulas; and discretionary grants, which are competitively awarded. Formula grants are generally awarded to educational agencies in the 50 States and U.S. territories, collectively known as State Educational Agencies (SEAs). These SEAs, in turn, award subgrants to local educational agencies (LEAs), community-based organizations (CBOs), and other public and private entities. Discretionary grants are awarded to a broader range of

grantees including SEAs and LEAs as well as institutions of higher education and other non-profit organizations.

After award, the Department is responsible for monitoring and oversight. The Department tailors oversight activities based on the risk associated with grantees. Historically, the Department has designated grantees with known issues as “high-risk” or “at-risk.” During our inspection period, the Department discontinued the use of the term “at-risk” and began using the terms “Active Engagement” for formula grantees and “Evidence of Risk” for discretionary grantees. These designations denote a level of risk that does not meet the conditions of “high-risk” but still requires Department action.

According to Title 34 Code of Federal Regulations (C.F.R.) § 80.12, the Department may consider a grant to a State or local government to be “high-risk” if a grantee or subgrantee meets one or more of the following conditions:

- (1) Has a history of unsatisfactory performance,
- (2) Is not financially stable,
- (3) Has a management system which does not meet the management standards [required by Department regulations],<sup>1</sup>
- (4) Has not conformed to terms and conditions of previous awards, or
- (5) Is otherwise not responsible.

The regulation further states that if the awarding agency determines that an award will be made, special conditions and/or restrictions shall correspond to the high-risk condition and shall be included in the award.

The criteria under which the Department may impose special conditions on a grant to an institution of higher education, hospital, or other non-profit organization are at 34 C.F.R. § 74.14. The language used in this section is nearly identical to the five conditions listed for grants to State or local governments; however, this section of the regulations does not explicitly refer to a “high-risk” designation. Although 34 C.F.R. § 74.14 does not refer to a high-risk designation, the Department’s “Handbook for the Discretionary Grant Process” (Discretionary Grant Handbook) provides for its use as an internal designation in conjunction with special conditions.

According to the Department’s Formula Grant Bulletin: “Special Award Conditions, Other Special Actions, and High Risk Designations under Formula Grants” (Formula Grant Bulletin), 34 C.F.R. § 80.12 is the high-risk authority used for the Department’s formula grants. For discretionary grants, the Discretionary Grant Handbook references both 34 C.F.R. §§ 74.14 and 80.12 as high-risk authorities. Both the Discretionary Grant Handbook and the Formula Grant Bulletin state that it is the Department’s policy to designate a grant or grantee as high-risk whenever the regulatory standards for high-risk are met. Both documents also state that program offices may still impose special conditions without using the high-risk designation.

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<sup>1</sup> The management standards are set forth in 34 C.F.R. § 80.20 and include standards for financial reporting, accounting records, internal control, budget control, allowable cost, source documentation, and cash management.

The Department's Risk Management Service (RMS) was created in October 2007 to work with all Department components to ensure that each office has effective procedures in place to assess and mitigate risk among its grantees. RMS is responsible for coordinating and supporting consistent, quality management of formula and discretionary grants, including related program-funded activities, Department-wide. RMS is also responsible for developing and coordinating a Department-wide risk management strategy. RMS is composed of three components charged with specific duties in RMS' functional statement: the Management Improvement Team (MIT), the Program Risk Management and Monitoring Team (PRMMT), and the Grants Policy and Procedures Team. MIT is the component that has the primary responsibility for managing and coordinating office activities for the Department's select portfolio of grants and grantees that are determined to have high concentrations of risk. MIT is also responsible for coordinating cross-Department efforts to manage and mitigate risk associated with high-risk and at-risk grants and grantees.

MIT manages and coordinates Department activities for Department-wide high-risk formula grantees, while individual program offices are responsible for awarding and monitoring formula grants. Program offices have primary responsibility for managing the high-risk designation for discretionary grantees.

The Office of the Deputy Secretary (ODS) recently developed a discretionary grant monitoring tool, which was pilot tested during Fiscal Year (FY) 2011. The tool, which is supported by RMS' Decision Support System (DSS), is intended to make it easier for the Department to evaluate potential risk to grant funds for specific programs at the individual grant level. The data used in the DSS come from several sources: the Department's grants management systems, the Federal Audit Clearinghouse, the Adverse Accreditation Actions list distributed by the Office of Postsecondary Education (OPE), and Dun & Bradstreet.<sup>2</sup> The primary output of the tool is the Entity Risk Review report, a spreadsheet containing financial, administrative, and internal control information on all grant applicants. RMS provides these reports to program offices upon request for use in identifying and monitoring high-risk grantees, primarily during the initial award and continuation award periods. The Department informed us that RMS also provides the reports on formula grant recipients.

Before the Department's transition to its current grants management system ("G5") in 2010, the Grants Administration and Payments System (GAPS) High-Risk Module was the official central repository for all information related to grants or grantees that have been designated as high-risk. Now the G5 Risk Module is the official central repository, and it contains:

- a. Identifying information about the high-risk grant or grantee along with the name of a Department contact involved in the high-risk designation;
- b. The high-risk designation letter and all other correspondence from or to the grantee about the conditions; and
- c. The special conditions or actions imposed as part of the designation and identified in the Grant Award Notification (GAN).

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<sup>2</sup> Dun & Bradstreet is a corporation that supplies a variety of business information, services, and research. The Department has a contract with Dun & Bradstreet to include proprietary financial information on Department grantees in the DSS.

On November 19, 2009, GAO released a report titled “Grant Monitoring: Department of Education Could Improve Its Processes with Greater Focus on Assessing Risks, Acquiring Financial Skills, and Sharing Information.” GAO found that the Department had made uneven progress in implementing a Department-wide, risk-based approach to grant monitoring; had limited financial expertise and training, hindering effective monitoring of grantees’ compliance with financial requirements; and lacked a systematic means of sharing information on grantees and promising practices in grant monitoring throughout the Department. The report contained three recommendations for the Secretary related to developing guidance and tools for risk assessment, implementing a strategy to ensure that the Department has sufficient financial expertise, and developing an information sharing mechanism across program offices. The Department generally agreed with GAO’s recommendations and said that it was developing an enhanced risk-based approach to grant monitoring.

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## REVIEW RESULTS

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The objectives of our inspection were to: (1) evaluate the Department’s process for identifying and designating high-risk/at-risk grantees, and (2) evaluate the Department’s process for monitoring and taking action as a result of the high-risk/at-risk designation.

The category “at-risk” is no longer used by the Department. The “at-risk” designation was an informal designation used by RMS when MIT was actively engaged in addressing issues in a State or territory. This designation is now referred to as “Active Engagement” for formula grantees and “Evidence of Risk” for discretionary grantees.

At the start of our inspection, RMS, which is responsible for coordinating and supporting consistent, quality management of both formula and discretionary grants, focused on high-risk and “Active Engagement” formula grantees. We did not identify any issues with RMS’ processes for managing the designation and monitoring of high-risk formula grantees; however, we found that these processes had not been formalized.

During our inspection, the Department developed new processes for identifying and monitoring high-risk and “Evidence of Risk” discretionary grantees. In 2010, ODS developed a process designed to sensitize the Department’s program offices to risk and lead to more data- and information-based risk management. These recent ODS initiatives resulted in the development of a process for the identification and monitoring of high-risk and Evidence of Risk discretionary grantees, but they had not been fully implemented at the time of our review. As a result, we could not draw a conclusion on the effectiveness of this new process.

## **Formula Grants**

RMS manages the designation and monitoring of Department-wide high-risk formula grantees through MIT. SEAs in the 50 States and 10 U.S. territories are assigned to MIT staff who serve as primary contacts for RMS's risk management activities for SEAs and program offices. As of December 15, 2011, RMS's most recent listing of grantee risk designations states that 20 of 60 SEAs are "Active Engagement Grantees" and four of these are identified as "Department-wide High-Risk Grantees." SEAs are formally notified of their risk designation status only if they are designated as high-risk.

MIT staff are also responsible for monitoring issues and conducting research on all of their assigned SEAs to identify risks and to determine whether a risk designation might be needed for those SEAs not already designated high-risk or Active Engagement. The primary sources of information used by MIT staff in their research to identify risks are Office of Management and Budget Single Audit findings, OIG audit findings, and business and financial data purchased from Dun & Bradstreet. Individual MIT staff members use these resources to varying degrees when performing research to identify risks. Currently, there is no written guidance on how this information is to be assessed or weighed to determine whether an Active Engagement designation is necessary.

For SEAs designated high-risk or Active Engagement, MIT helps to centralize the risk management process by working with program offices to coordinate site visits, write corrective action plans and special conditions, and work with SEAs toward compliance. MIT coordinates and involves program offices that administer grants to high-risk and Active Engagement SEAs and LEAs by placing grantees' reports and site visit summaries in a shared folder on the Department's intranet and by conducting weekly conference calls with program offices to discuss risk strategies and specific issues at SEAs and LEAs. RMS provided guidance to program officials regarding the establishment of special award conditions, other special actions, and high-risk designations for formula grantees through the release of the Formula Grant Bulletin in November 2010, but this bulletin does not address MIT's internal processes.

We did not identify any issues with MIT's internal processes described above; however, we found that these processes had not been formalized. Because MIT plays a role in centralizing the Department's interaction with high-risk formula grantees, it is in a position to document internal best practices for use in identifying and monitoring the Department's riskiest formula grantees. Formalization of MIT's internal processes would serve as a valuable knowledge management resource for the Department and ensure consistency in identifying and monitoring high-risk formula grantees.

## **Discretionary Grants**

Individual program offices are responsible for identifying and monitoring high-risk discretionary grantees. When we began our inspection, individual program offices did not have a common understanding of the use and management of the high-risk designation and special conditions for discretionary grantees. During our inspection, the Department developed processes for

identifying and monitoring high-risk and Evidence of Risk discretionary grantees and tracking special conditions, but those processes had not been fully implemented.

The primary way in which ODS has addressed the identification of discretionary grant risk is through the development of Entity Risk Review reports. These reports provide program offices with additional information related to grantee administrative capability, financial risk, and internal control risk. The information in these reports allows program offices to identify evidence of risk and, in consultation with RMS and OGC, determine the necessity of risk mitigation actions. Risk mitigation actions can include heightened project management (more frequent desk reviews or conference calls to discuss performance, fiscal management, or internal controls), on-site visits, special conditions, or designation as high-risk.

The Department also developed a policy that allows program offices to use Entity Risk Review reports in the grant award process. On May 16, 2011, RMS issued Grant Policy Bulletin 11-01 titled “Assessing Grant Applicant and Grant Recipient Risk Prior to Making New and Continuation Awards” (Grant Policy Bulletin). It provides guidance for assessing an entity’s risk prior to issuing a new or continuation award and for actions that may be taken when staff identifies evidence of risk. It also requires program offices to conduct a risk assessment prior to granting an award. The Grant Policy Bulletin states that prior to a new discretionary grant award or continuation award, program offices should review the grantee and identify evidence of risk which may include: the existence of past performance or financial issues, noncompliance with audit requirements or other administrative issues, or audit or monitoring findings. Program offices may use the Entity Risk Review reports to comply with this Grant Policy Bulletin requirement. The Grant Policy Bulletin also requires risk information to be recorded in slate memos, official files, and the G5 Risk Module when evidence of risk is identified.<sup>3</sup>

Before the issuance of the Grants Policy Bulletin and the transition from GAPS to G5, the Department did not have a policy or method for centrally collecting special conditions. Program offices were required to consult the GAPS High-Risk module when awarding discretionary grants, but the module collected special conditions for only grantees designated as high-risk. Program offices often impose special conditions on grantees without using the high-risk designation. As a result, prior to the Grants Policy Bulletin and transition to G5, there were significant interactions between the Department and grantees that were not being communicated to other program offices that award and monitor discretionary grants.

With the introduction of the G5 Risk Module, special conditions imposed on a grantee as a result of an Evidence of Risk designation are now centrally located. Program offices are required to review the information in the module, ask for updates from the principal office that entered the information, and determine whether a high-risk designation or any special conditions are necessary. This process had not been fully implemented at the time of our review. As a result, we could not draw a conclusion on the effectiveness of this new process.

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<sup>3</sup> A slate memo is a formal list of the grant applications recommended for funding and the recommended funding level for each application.

## Recommendations

We recommend that the Deputy Secretary ensure RMS:

- 1.1 - Formalizes MIT's formula grant processes to serve as a knowledge management resource and ensure consistency in identifying and monitoring high-risk formula grantees; and
- 1.2 - Monitors whether the new processes for identifying and monitoring high-risk and Evidence of Risk discretionary grantees are effective.

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## DEPARTMENT COMMENTS

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On January 19, 2012, we provided the Department with a copy of our draft inspection report for comment. We received the Department's comments to the report on February 22, 2012. The Department generally concurred with our results and recommendations and provided a description of the actions it is prepared to take consistent with our recommendations. The Department also provided technical comments which we have considered and incorporated into the final report, as applicable. The Department's response is attached in its entirety.

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## OBJECTIVE, SCOPE, AND METHODOLOGY

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The objectives of our inspection were to:

- (1) Evaluate the Department's process for identifying and designating high-risk/at-risk grantees; and
- (2) Evaluate the Department's process for monitoring and taking action as a result of the high-risk/at-risk designation.

We notified the Department of our inspection on February 25, 2010, and began our fieldwork on March 8, 2010. We conducted an exit conference on December 16, 2011.

We reviewed the Department's *Handbook for the Discretionary Grant Process*; the Department Bulletin: *Special Award Conditions, Other Special Actions, and High Risk Designations under Formula Grant*; the Department's Grant Policy Bulletin 11-01: *Assessing Grant Applicant and Grant Recipient Risk Prior to Making New and Continuation Awards*; individual program office monitoring plans; and documents related to ODS' Programmatic Risk Management Group's work. We interviewed ODS officials, OGC attorneys, Programmatic Risk Management Group members, RMS leadership, MIT staff, PRMMT staff, and the heads of RMS' policy and

customer service teams. We also interviewed relevant officials in the following grant-making offices: the Office of Innovation and Improvement, the Office of Postsecondary Education, the Office of Elementary and Secondary Education, the Office of Special Education and Rehabilitative Services, and the Institute of Education Sciences.

We also reviewed GAPS data including listings of: grants designated as high-risk, high-risk organizations by Data Universal Numbering System (DUNS) numbers, awards associated with those high-risk organizations, all formula and discretionary grants awarded in FY 2009, all grant transactions in FY 2009, and GAPS table descriptions.

Our inspection was performed in accordance with the *Quality Standards for Inspections, 2005*, as appropriate to the scope of the inspection described above. These standards were adopted by the Council of the Inspectors General on Integrity and Efficiency in 2009.

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## **ADMINISTRATIVE MATTERS**

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An electronic copy of this final inspection report has been provided to your Audit Liaison Officer. We received your comments, which generally concurred with our results and recommendations.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your offices will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). Department policy requires that you enter your final corrective action plan (CAP) for our review in the automated system within 30 days of the issuance of this report.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Respectfully,

/s/

Wanda A. Scott  
Assistant Inspector General  
Evaluation, Inspection, and Management Services

Electronic cc: Beverly Babers, Chief Administrative Officer, Office of the Deputy Secretary  
Phil Maestri, Director, Risk Management Service  
Heather Acord, Audit Liaison Officer, Office of the Deputy Secretary



UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

February 21, 2012

Ms. Wanda A. Scott  
Assistant Inspector General  
for Evaluation, Inspection, and Management Services  
Office of Inspector General  
U.S. Department of Education  
Washington, DC 20202

Dear Ms. Scott:

I am writing in response to the draft Office of Inspector General (OIG) inspection report on the Department's process for identifying and monitoring high-risk grantees (ED-OIG/I13K0002).

As the report describes, the Department's Office of the Deputy Secretary (ODS) Risk Management Service (RMS) leads, coordinates, and supports Department-wide efforts to assess and mitigate risk among the agency's grant recipients. RMS activities include developing policies and tools to identify and manage risk and leading oversight and technical assistance for a select portfolio of grant recipients that the Department has designated as high risk or selected for "active engagement." The development of the Decision Support System to mine data on grant recipients, the pilot-testing of Entity Risk Reviews to inform pre-award risk management, and the enhancements to the G5 grants management system are recent important initiatives that support the agency's management of risk among grant recipients.

We recognize the importance of continuous improvement to ensure that the Department maximizes the effectiveness of the risk management process. To this end, the Department generally concurs with the draft OIG inspection results and recommendations. To ensure the accuracy of the information contained in this inspection report, technical comments are provided as an enclosure to this letter. To address the OIG recommendations, ODS proposes the actions described below.

**Recommendation 1.1:** Ensure RMS formalizes MIT's formula grant processes to serve as a knowledge management resource and ensure consistency in identifying and monitoring high-risk formula grantees.

**Response:** Consistent with the OIG recommendation, RMS will capture key risk assessment procedures successfully used to implement the standards for risk assessment, which are codified in 34 CFR §80.12. The Department will enhance its internal agency guidance on risk assessment to include these key procedures and provide program offices with additional risk mitigation strategies to address identified risk.

Consistent with the OIG recommendation, RMS will also document the standards and principles that it uses to identify and manage risk in formula grants to state agencies, recognizing that each agency has unique problems and challenges that require customized solutions. RMS will also capture information about practices for assisting recipients to improve their financial management and grant administration. RMS will synthesize the experiences into a set of principles that will guide future engagements. Assuming the necessary information technology resources are available, RMS will make this information available throughout the Department electronically. RMS expects to complete this work by December 31, 2012.

**Recommendation 1.2:** Ensure RMS monitors whether the new processes for identifying and monitoring high-risk and Evidence of Risk discretionary grantees are effective.

**Response:** The Department is committed to continuously improving its ability to analyze grant risk, share information about recipient risk across the agency, and promote risk-based monitoring. RMS's plans to improve and assess this work, as described below, are consistent with the OIG recommendations.

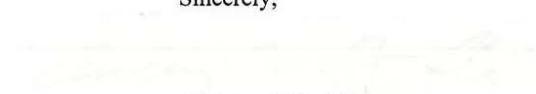
RMS's efforts to assess whether the new processes established to better identify and monitor high-risk and Evidence of Risk discretionary grantees build upon its work over the last year. In fiscal year 2011, RMS evaluated the impact of the processes and tools pilot-tested by collecting feedback from program officers that used ERRs in fiscal year 2011. This information was used to create an evaluation report and inform the development of the fiscal year 2012 version of the ERR. Throughout fiscal year 2012, RMS will continue to collect information about risk identification and mitigation practices for grants awarded in fiscal year 2012. RMS has embedded risk consultants in several program offices in order to facilitate the ongoing collection of feedback from program offices using the fiscal year 2012 version of the ERR. This data will be used to determine if the ERR is effective at meeting program officers' needs and to inform the design of new reports for programs. This data collection will also address how program officers have used ERR reports and risk data for grant slate development and clearance. In addition, RMS and the Policy and Program Studies Service in the Office of Planning, Evaluation, and Policy Development plan to procure a third-party evaluation of the effect of Entity Risk Review on the Department's grants administration. Proposed enhancements to G5 that facilitate the capture of risk-related information will also be assessed as part of the fiscal year 2012 evaluation of the ERR. These efforts should enable RMS to assess the effectiveness of the processes and tools. RMS expects to complete the evaluation of fiscal year 2012 ERR implementation by January 31, 2013.

Finally, we have included in the Organizational Performance Review framework, with which we assess each office's annual performance, an expectation that each principal office will create a risk-based approach to monitoring. RMS is providing technical assistance and advice to the program offices as they develop and refine their plans for fiscal year 2012.

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We appreciate the opportunity to discuss the Department's actions to strengthen the grant risk management process and trust that you will consider this response in the preparation of your final inspection report.

Sincerely,

  
Anthony W. Miller

Enclosure

### Technical Comments

1. Page 3, 2<sup>nd</sup> paragraph, 4<sup>th</sup> sentence: Delete *and the Customer Service Team*. The functions of the Customer Service Team have been delegated to the Management Improvement Team and the Program Risk Management and Monitoring Teams in RMS. There are no staff members on the Customer Service Team.
2. Page 3, 3<sup>rd</sup> paragraph, 1<sup>st</sup> sentence: Insert *Department-wide* before *high-risk formula grantees*. Grant recipients may be designated high risk for an individual grant.
3. Page 3, last paragraph: add at end, *RMS also provides the reports on the formula grant recipients to inform monitoring and oversight strategies*.
4. Page 5, **Formula Grants**, 1<sup>st</sup> paragraph, 1<sup>st</sup> sentence: Insert *Department-wide* before *high-risk formula grantees through MIT*.