Audit Report

OFFICE OF THE INSPECTOR GENERAL

QUICK-REACTION REPORT ON ALLEGATIONS TO THE DEFENSE HOTLINE ON THE USE OF GRANT FUNDS FOR CONSTRUCTION OF SCHOOL FACILITIES ON FORT IRWIN, CALIFORNIA

Report No. 95-300 August 31, 1995

Department of Defense

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

August 31, 1995

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Quick-Reaction Report on Allegations to the Defense Hotline on the Use of Grant Funds for Construction of School Facilities on Fort Irwin, California (Report No. 95-300)

We are providing this audit report for review and comment. This is the first of two reports we will issue on the use of grant funds at Fort Irwin, California. This report responds to allegations to the Defense Hotline that grant funds are being wasted on the subject school construction projects. We are issuing this as a quick-reaction report to suspend $2 million of the remaining grant funds until the issues detailed in this report are resolved.

Army comments to a draft of this report were considered in preparing the final report. We revised portions of the report based on Army comments. The Army comments were nonresponsive to the recommendations. DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. We request comments to the final report by October 2, 1995.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Joseph P. Doyle, Audit Program Director, at (703) 604-9348 (DSN 664-9348) or Ms. Linda A. Pierce, Audit Project Manager, at (703) 604-9341 (DSN 664-9341). See Appendix F for the distribution of this report. The audit team members are listed inside the back cover.

David Steensma

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Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 95-300 **August 31, 1995**
(Project No. 5CK-8005)

Quick-Reaction Report on Allegations to the Defense Hotline on the Use of Grant Funds for Construction of School Facilities on Fort Irwin, California

Executive Summary

Introduction. This is the first of two reports we will issue on the use of grant funds for the construction of schools on Fort Irwin, California. We are issuing this quick-reaction report to suspend grant funds for the school construction projects until resolution of the issues discussed in this report. This report is in response to allegations to the Defense Hotline that the Silver Valley Unified School District wasted grant funds on the school construction projects. The complaint to the hotline alleged that the Silver Valley Unified School District was showing favoritism in contract awards and was wasting funds on a construction management company, an extravagant school design, and site surveys on land not owned by the Army. The complainant also alleged that the Army had not performed an internal audit of the grant.

Congress directed the Army to issue a $22 million grant to the Silver Valley Unified School District in Yermo, California, to construct schools on Fort Irwin (Public Law 102-172, "National Defense Appropriations Act for Fiscal Year 1992," November 26, 1991). The Silver Valley Unified School District needed the grant because high school students had a 1-and-½-hour bus ride and other students were in a deteriorating building augmented by portable trailers. The grant proposal specified building an elementary school and a high school and renovating a middle school with the $22 million. Construction began in July 1993.

Audit Objectives. The overall audit objective was to determine whether the Army properly executed and administered the grant. In addition, we reviewed the management control program at Fort Irwin and the applicable management controls for the administration of grants. This report does not constitute completion of our announced audit objectives. The objectives will be fully reported in an overall report to be issued at a later date.

Audit Results. The Army allowed the Silver Valley Unified School District to budget and spend grant funds for purposes not specified in the terms of the grant proposal and agreement. As a result, grant construction funds were used for unneeded expenses, contributing to cost overruns of at least $5.3 million on the elementary school and $7.6 million on the middle school, as well as $0.1 million of unnecessary expenditures for the canceled high school project.

The Army had not ensured compliance with the terms of the grant proposal and agreement on the following issues.

- The Silver Valley Unified School District purchased about $2 million of unauthorized computer equipment, furniture, television monitors, video equipment, and other equipment in Phase I, and planned to purchase about $500,000 more in Phases II and III of the school construction projects. The Silver Valley Unified School District ordered computers before a request for proposals was issued, and the bill for the computers was dated the same day as the bid closing.

• The Silver Valley Unified School District intended to stop renting and purchase and renovate portable classrooms with grant funds totaling about $966,000. The grant was not for that purpose.

• Phase III of the Fort Irwin school construction projects was planned to cost about $1.3 million that was not within the approved scope of the grant. All of Phase III will be addressed in a subsequent report.

• The Silver Valley Unified School District spent $18,700 on a trust account to manage the grant funds, an excessive fee for the services provided. The grant does not require segregation of funds and the use of a trust company is not common practice among the school districts.

• Property accountability was not adequate to ensure that property purchased with grant funds would be used at the Fort Irwin schools. We identified property purchased with grant funds at the Silver Valley Unified School District offices in Yermo, California.

See Part I for details of the above described issues.

Summary of Recommendations. We recommend that the Army suspend $2 million of the remaining grant funds until the issues detailed in this report are resolved. We also recommend that the Army prohibit the Silver Valley Unified School District from using grant funds for any nonconstruction purpose, including the purchase of equipment and the payment of trust account fees. We also recommend that the Army prohibit the purchase of existing rented portable classrooms.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) stated that the Army is unable to support the proposal to suspend grant funds because the Army has no legal basis for such a suspension. Headquarters, Forces Command, comments enclosed by the Assistant Secretary of the Army state that the Army nonconcurs with the recommendations. The Army stated that no material failure to comply with the grant existed. See Part I for a discussion of the Army comments. The complete text of Army comments are included in Part III of this report.

Audit Response. We disagree that no legal basis exists for suspending grant funds. The grant proposal and agreement state that if the grantee materially fails to comply with any terms of the grant, the Army may suspend or terminate the grant award. The Army allowed the Silver Valley Unified School District to materially violate the terms of the grant, resulting in as much as $13 million of cost overruns on the school construction projects. Proper fiduciary responsibility should require the Army to suspend the use of funds to preclude an adverse financial situation that will cause hardship on the Silver Valley Unified School District. See Part III for a detailed audit response to the Army comments. We consider the Army comments to the draft report nonresponsive and we request that the Army comment on this final report by October 2, 1995.

Table of Contents

Executive Summary i

Part I - Audit Results

Audit Background 2
Audit Objectives 2
Administration and Use of Grant Funds 4

Part II - Additional Information

Appendix A. Scope and Methodology
Scope 14
Methodology 14
Audit Period, Standards, and Locations 14
Management Control Program 15
Appendix B. Summary of Prior Audits and Other Reviews 16
Appendix C. Terms of the Grant: Laws, Regulations, Standards, and Agreements 18
Appendix D. Summary of Potential Benefits Resulting From Audit 20
Appendix E. Organizations Visited or Contacted 21
Appendix F. Report Distribution 23

Part III - Management Comments and Audit Response

Department of the Army Comments 26
Audit Response 42

Part I - Audit Results

Audit Background

This is the first of two reports we will issue on the use of grant funds for the construction of schools on Fort Irwin, California. We are issuing this quick-reaction report to suspend grant funds for the school construction projects until resolution of the issues discussed in this report. This report is in response to allegations to the Defense Hotline that the Silver Valley Unified School District (School District) wasted grant funds on the school construction projects at Fort Irwin. The complaint to the hotline alleged that the School District was showing favoritism in contract awards and was wasting funds on a construction management company, an extravagant school design, and site surveys on land not owned by the Army. The complainant also alleged that the Army had not performed an internal audit of the grant.

Establishment of the Grant. Congress directed the Army to issue a $22 million grant (Public Law 102-172, "National Defense Appropriations Act for Fiscal Year 1992," November 26, 1991) to the School District to support the construction of school structures on Fort Irwin. Fort Irwin needed the education facilities for military dependents because of the condition of the schools on Fort Irwin and the geographical size of the school district. The school structures for kindergarten through eighth grade were deteriorating and were augmented by portable classroom trailers. Students in grades 9 through 12 were bussed to the high school about an hour away from the installation. The Army and the School District established a grant agreement that incorporates the grant proposal and other criteria. See Appendix C for the terms of the grant agreement and other criteria. The Fort Irwin Deputy Director of Contracting is responsible for administering the grant. The School District employed the San Bernardino County Superintendent of Schools as the project manager, HMC Group as the architect, and K.L. Neff as the construction management company for the construction of the schools.

School Construction and Renovation Projects Specified by the Grant Proposal and Agreement. The grant proposal and agreement specified construction of a high school and an elementary school for kindergarten through third grade and renovations to a middle school. All the schools were to be located on Fort Irwin. We reviewed Phase I of the school construction projects, which included construction of the elementary school and an administrative addition to the middle school. We also reviewed plans for Phases II and III. Construction began in July 1993.

Audit Objectives

The overall audit objective was to determine whether the Army properly executed and administered the grant. In addition, we reviewed the management control program at Fort Irwin and the applicable management controls for the

administration of grants by the Directorate of Contracting at Fort Irwin. See Appendix A for a discussion of the audit scope and methodology and the management control program. See Appendix B for prior audits and reviews and Appendix D for potential benefits resulting from the audit. This report does not constitute completion of our announced audit objectives. The objectives will be fully reported in an overall report to be issued at a later date.

Administration and Use of Grant Funds

The Army allowed the Silver Valley Unified School District to budget and spend grant funds without regard to the terms of the grant proposal and agreement or to state regulations and standards. Compliance with the grant was not enforced because the Army had a "hands off" policy of grant administration. As a result, grant funds were wasted and used for extravagant, unallowable, or improper purposes that may not benefit the students or the education process. The elementary school had cost overruns of at least $5.3 million, and the middle school revised budget was $7.6 million more than its budget in the grant proposal. We estimate that of the $22 million grant, at least $2 million can still be put to better use.

Use of Grant Funds

The Army allowed the School District to spend grant funds without regard to the provisions of the grant proposal and agreement. Cost overruns have already occurred on the elementary school construction and will occur on the middle school renovation as well. The Army should intervene to minimize those overruns. The table below shows the budget and expenditures for the grant.

Grant Budget and Expenditures

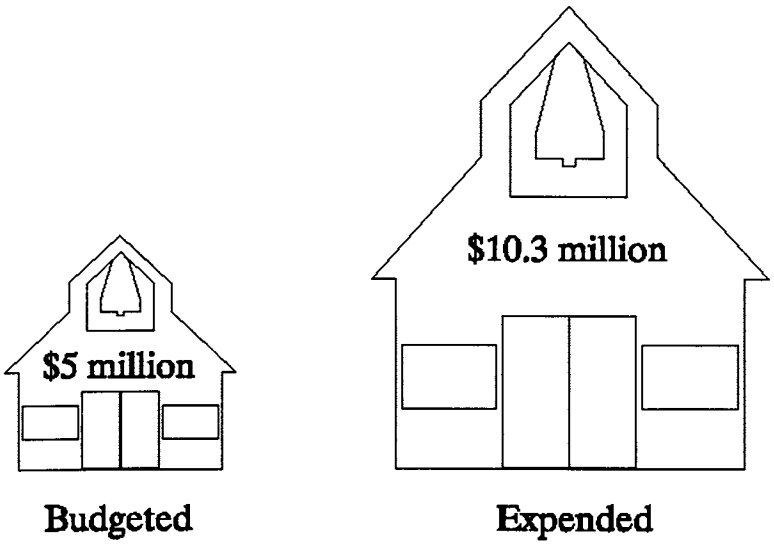
		Revised Budget	
School	Grant Budget	Actual[1] Expenditures	Planned Expenditures
Construct Elementary School	$ 5 Million	$10.3 Million	Completed
Renovate/Expand Middle School	4 Million	3.0 Million	$8.6 Million[2]
Construct a High School	13 Million	0.1 Million	Canceled
Total Grant Funds	**$ 22 Million**	**$13.4 Million**	**$8.6 Million**

Construction Costs:
[1]As of March 17, 1995
[2]Includes $1.3 million in proposed Phase III construction costs

Cancellation of the High School Project. The School District canceled the high school project after the grant proposal and agreement were in effect. The grant administrator (the Army) failed to request revised plans and budgets, as required by the grant proposal and agreement, when the School District changed the scope of the projects. The Army did not request the return of the $13 million in funding allocated in the grant for construction of the high school and did not modify the grant proposal or agreement. Instead, the School District Superintendent directed the architect to use materials of the "highest quality" and to increase the furniture and equipment allowance for the

elementary and middle schools. We believe that the Army should have withdrawn the $13 million allocated for the high school when the high school project was canceled. We will discuss the Army fiduciary responsibilities in a later audit report.

Elementary School Budget and Costs. The elementary school budget set in the grant proposal and agreement was $5 million. The actual costs came to more than double the budget at $10.3 million, a cost overrun from the grant proposal of $5.3 million. The design and equipment for the elementary school was so extravagant that it won architectural awards and was labeled a school of the 21st century. The School District intended to implement the "America 2000" concept, believing that President Bush would designate Fort Irwin as "the first America 2000 educational community in the nation." When the anticipated America 2000 designation failed to materialize, the Army and the School District carried on the concept under a program called "Fort Irwin 2000." The figure below illustrates the cost overrun on the elementary school.



The Elementary School Cost More Than Twice Its Grant Budget

Grant Costs Incurred and Planned. The grant proposal budget for the elementary school construction and the middle school renovation was $9 million. The Army allowed the School District to spend about $13.4 million on projects in Phase I, which included construction of the elementary school and an administration addition to the middle school and site surveys for the canceled high school. As of March 17, 1995, the School District had spent the entire $9 million plus a cost overrun of $4.4 million and had done nothing to improve the middle school classroom space. The middle school budget in the grant proposal was $4 million. The revised budget allocated $11.6 million to the middle school, almost three times the original budget amount. The cost overrun for the middle school will be about $7.6 million. The extravagant spending

pattern exhibited on the elementary school project could continue on the middle school unless the Army takes action to avoid further extravagant and wasteful spending on the Fort Irwin schools.

Revised Plans for Grant Funds. Revised plans called for spending the entire $22 million (including the $13 million high school budget) on the elementary and middle schools and on nonconstruction items. One revised budget that we reviewed included a Phase III construction plan costing $1.3 million. One line item in Phase III was called "district furniture and equipment" and was priced at the exact amount needed to bring the total cost of the school construction projects up to $22 million. The grant was to support the construction of schools on Fort Irwin, not to furnish and equip the School District offices. In the midst of those excesses, the Army has not made any attempt to curb spending by the School District or to return to the Government excess grant funds caused by the cancellation of the high school project. The $1.3 million for Phase III, not required for Phase I or Phase II construction, should be suspended.

Compliance With the Terms of the Grant

The grant agreement between the Army and the School District clearly states terms and conditions for the use of grant funds and incorporates applicable Federal and California laws, regulations, and standards. Nonconstruction items such as furniture, equipment, and computers are not specified in Public Law 102-172 or in the grant agreement and are therefore not allowable as construction costs. The use of portable classrooms was part of the justification to Congress for the need for new schools at Fort Irwin. The proposal to purchase those old portable classrooms now, after the grant has been received, is inconsistent with the previously defined need for new schools. We do not believe that the portable classrooms should be purchased with grant funds. See Appendix C for a list of the terms of the grant. The following paragraphs explain specific issues with the terms of the grant and the uses of grant funds.

Furniture, Equipment, and Computer Purchases. The Army allowed the School District to purchase about $2 million of furniture, equipment, and computers under the grant school construction projects. The "Applicant Handbook for State School Building Lease-Purchase Program," January 1992, provided for a furniture and equipment allowance of $5-per-square-foot. In the case of the Fort Irwin school construction projects, the state allowance equates to $418,250 for furniture and equipment (including computer equipment) (83,650 square feet x $5-per-square-foot). The furniture, equipment, and computer purchases exceeded the state funding allowance for a school by about $1.6 million. The School District also planned to purchase about $500,000 of additional furniture and equipment in Phases II and III of the school construction projects. A school district may use its own funds to spend more than the state allowance if the school district so desires. The state allowance does not limit the furniture and equipment (including computers) purchases, but rather limits the amount of state funds that can be used for such purchases. In this case, the Federal Government stepped into the shoes of California by

incorporating state standards in the grant proposal and agreement. According to the grant agreement, the rules governing state funds should be applied to the Federal grant funds. The Army should intervene and prevent any further purchases of furniture, equipment, and computers using grant funds.

Furniture and Equipment. Purchases of furniture and equipment are not considered construction under the grant proposal and agreement. The stated purpose of the grant was for the support of construction of school structures. The School District spent grant funds on furniture and equipment for Phase I of the construction projects. Included were $204,000 on furniture, $57,000 on television monitors and video equipment, and about $120,000 on other equipment. The School District planned to spend an additional $200,000 on furniture and equipment in Phase II. The money already spent on furniture and equipment was excessive. No additional furniture and equipment should be purchased under the grant, including the $200,000 of furniture and equipment planned in Phase II and $309,000 in Phase III.

Computer Equipment Purchases Under the Grant. The Army allowed the School District to purchase about $1.6 million of computer equipment in Phase I of the school construction projects. The computers, however, were not part of the construction of the schools and should not have been allowed under the terms of the grant agreement. That error was compounded by the way the computers were purchased. The School District did not solicit bids before the first computer purchase was made. A solicitation was done after the fact, and the invoice from the vendor requesting payment for the actual purchase had a due date the same date as the bid closing. The School District added the second computer purchase to another contract. The procurement process used in purchasing the computers did not support adequate competition and may not have resulted in the best price for the computers. Because the computer purchases were excessive, no additional computers should be purchased under the grant.

Portable Classrooms. The School District purchased 14 portable classrooms at a total cost of $217,000 and planned to execute renovations estimated to cost an additional $620,000. The School District has been leasing the portable classrooms at the Fort Irwin Middle School since the late 1980s. The justification to Congress for the school construction projects indicated that part of the need for the grant was based on the fact that the facility at Fort Irwin for kindergarten through eighth grade was deteriorating and was augmented by 32 trailers (portable classrooms). Therefore, the portable classrooms cannot be considered part of the new construction at the school. In addition, the purchase of the portable classrooms will not benefit the students or the education process at the Fort Irwin schools. The only benefit will be to the operating budget of the School District, because the School District would have to continue payments to lease the trailers if the grant does not buy them. The purpose of the grant was to construct schools on Fort Irwin, not to reduce the financial commitments of the School District. The Army should not allow the School District to spend an estimated $966,000 of grant funds on portable classrooms.

Trust Account Fees. The School District set up a trust account to manage the grant funds at a cost of $4,000 per year, plus set-up costs and legal fees. Although the grant agreement did not provide specifically for such fees, the grant agreement did provide that $100 of the interest earned per year was allowed to be used for administrative costs. Although the grant administrator initially disallowed the exorbitant trust account fees, the fees were deducted directly from the trust account, apparently without the knowledge of the grant administrator. A total of $18,700 has been spent on the trust account since its establishment in 1992, but none of that money benefited the school children or the education process. The Army should disallow payment of grant funds for any further trust account fees. A later report on this audit will discuss the recovery of trust account fees already expended.

Property Accountability. The Army did not ensure that all equipment purchased with grant funds was accounted for and installed at the Fort Irwin schools. Property records were inaccurate and incomplete, and did not correspond to the invoice information available. The School District was storing 242 computers, valued at $400,000, in a warehouse in Yermo, California. During the period of our audit, the computers were moved out of the warehouse, but the inventory records remained inadequate to provide proper accountability. We identified computer equipment at the Fort Irwin schools and at the School District's administrative offices in Yermo, California. The computers were purchased with grant funds for the Fort Irwin schools, not for the School District administration. The grant agreement requires effective controls and accountability for all property and assets purchased with grant funds. The lack of property controls is another reason that the Army should not allow the School District to acquire additional equipment. The management control weakness involving property accountability will be discussed in another report on this audit.

Grant Administration

The Army's grant administration was not adequate to ensure that the School District complied with the terms of the grant proposal and agreement and state regulations, resulting in cost overruns of $13 million. The Army's own internal review of the grant did not help to prevent the cost overruns or to correct the deficiencies of the grant administration. The National Training Center and Fort Irwin Internal Review and Audit Compliance Report Number 94-08, "Audit of the School Grant," November 3, 1994, indicated that the action plan centered on getting Fort Irwin out of the day-to-day administration of the grant. The Army, therefore, apparently does not intend to intervene to oversee the School District's use of the grant funds. A later report on this audit will discuss the overall grant administration problems.

Grant Administration Procedures and Assumptions. The overall approach by the Army to grant administration at Fort Irwin was "hands off." The grant administrator assumed that the School District was following state guidelines and thought that the state was monitoring the actions of the School District

regarding the construction projects. In fact, neither was the case. As a result, the School District was generally able to exceed the terms of the grant and the state guidelines without challenge. According to the grant agreement, the School District was to comply with applicable state laws and regulations. The Army approach to grant administration was inadequate to ensure the financial security of the grant funds or compliance with the terms of the grant.

Monitoring the Progress and Execution of the Grant. The grant administrator did not compare actual expenditures with budgeted amounts before signing the paperwork authorizing payment, as required by the grant agreement. In addition, audits were not performed to review costs for allowability and reasonableness until substantial expenditures had been made. As a result, cost overruns occurred on the elementary school, and items were purchased that were outside the stated purpose of the grant.

Conclusion

The cost overruns and the improper use of grant funds illustrate the lack of fiduciary stewardship of the Federal grant by the Army in this case. The grant agreement provides for unused funds to be returned to the Government. We believe that the $13 million budgeted for the high school that was canceled should have been returned. The grant proposal and agreement also state that if the grantee fails to comply with any terms of the grant, the Army may suspend or terminate the grant award. It is the opinion of the DoD, Office of Deputy General Counsel (Inspector General), that the terms of the grant have been violated. Because the Army did not perform proper grant administration, most of the $13 million that should have been recovered when the high school project was canceled has been spent or obligated on construction contracts for the elementary and middle schools or for improper purposes. Based on our review of budgets, plans, and costs, we estimate that at least $2 million can still be put to better use if the Army will begin to exercise proper fiduciary stewardship of this grant of Federal monies. The potential benefits and other benefits associated with this audit are explained in Appendix D.

Recommendations, Management Comments, and Audit Response

We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller):

1. Suspend $2 million of the remaining funds in the grant for the construction of schools on Fort Irwin.

2. Specifically prohibit the Fort Irwin grant administrator from:

a. Authorizing the use of grant funds to purchase furniture, equipment, computers, computer software, televisions and monitors, video equipment, supplies, and portable classrooms and from incurring any other nonconstruction type expense.

b. Authorizing the use of grant funds for renovating portable classrooms, and for paying fees for the trust account.

c. Authorizing the use of grant funds on Phase III and any additional phase of the Fort Irwin school projects.

The prohibitions should remain in effect until the issues discussed in this report are resolved.

Management Comments. The Assistant Secretary of the Army (Financial Management and Comptroller) stated that the Army is unable to support the proposal to suspend $2 million of the remaining grant funds because the Army has no legal basis for such a suspension. Headquarters, Forces Command, comments that were enclosed by the Assistant Secretary of the Army state that the Army nonconcurs with the recommendations and with the associated $2 million in estimated monetary benefits. According to Forces Command, "There were no material failures to comply with the terms of the grant, Federal law, state law, or regulation on the part of Fort Irwin or the District. Any variance from the grant terms was insubstantial and may be easily corrected at this time." Forces Command also states, "It should be the standing policy of the Army to award grants in a manner in which there will not be extensive oversight of the project by the Army." The Assistant Secretary of the Army requested postponement of further action until the Office of the Army General Counsel and the DoD, Office of Deputy General Counsel (Inspector General), conclude their discussions. A complete text of the Army comments is included in Part III.

Audit Response. We consider the Army comments to be nonresponsive to the recommendations. The Army comments contain inaccuracies for which we have documentation to show otherwise. In addition, differences in legal opinion between the Office of the Army General Counsel and the DoD, Office of Deputy General Counsel (Inspector General), regarding the issues in this report remain to be decided. We disagree with the Army position that no legal basis exists for suspending the $2 million of grant funds and we disagree that the Army did not fail significantly to comply with and enforce the terms of the grant. We do not consider a $13 million cost overrun to be an insubstantial variance from the grant. The grant agreement states that any material violation of the terms of the grant is cause to suspend or terminate grant funds. We believe that the School District violated the terms of the grant as discussed in the finding. Requiring a grantee to comply with the terms of the grant is not an excessive level of grant administration. The Army did not require the School District to follow the terms of the grant and the Army grant administrator did not perform the oversight tasks specified by the grant agreement. Issues on the grant administration policies and procedures will be discussed in a later report.

We discuss some of the problems with the grant administration in this report to show the importance of action by the Assistant Secretary of the Army (Financial Management and Comptroller) to suspend grant funds until the issues can be resolved.

The purpose of this report is to effect an immediate temporary suspension of the funds to allow time for final decisions to be made on the issues and the status of the $2 million of grant funds. The Army officials at Fort Irwin have made quite clear their intent to allow the School District to spend the full $22 million, regardless of what our report says. Suspending $2 million of grant funds now will not impede or stop ongoing construction and will not add to construction costs. After all of the grant funds are expended, however, it will be too late to achieve any savings or to recover funds for unauthorized expenditures without hardship to the School District. Therefore, time is of the essence in suspending the $2 million. We stand by the overall conclusions of our report and recommend the immediate suspension of $2 million of the remaining grant funds until the issues of reasonability and allowability discussed in this report are resolved.

A detailed audit response to the Forces Command comments is included in Part III of this report. We request that the Army reconsider its position and provide comments to this report by October 2, 1995.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

The Army issued a grant for $22 million to the School District for the construction of school structures on Fort Irwin. We reviewed Phases I, II, and III of the school construction projects. Phase I consisted of construction of a new elementary school and an administration addition to the Fort Irwin Middle School and was completed. Phase II consisted of construction of a science and technology building and a gym and the renovation of the existing buildings at the Fort Irwin Middle School. Phase II construction was ongoing. Phase III consisted of various items such as a parking lot, covered walkways, and additional furniture and equipment. Phase III was still in the planning stage.

Methodology

We performed audit steps to determine whether the allegations to the Defense Hotline were valid. We did not use statistical sampling methodology or computer-processed data to conduct this audit. We reviewed documentation from 1992, when the grant proposal was made, through 1995, when Phase II of the school construction project was getting underway. We reviewed the grant proposal and agreement documents, project plans and budget data, financial records of costs incurred, and other data available from Fort Irwin, the School District, and the contractors. Legal assistance was provided by the DoD, Office of Deputy General Counsel (Inspector General).

Audit Period, Standards, and Locations

This economy and efficiency audit was accomplished from January through May 1995. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Office of the Inspector General, DoD. We included a review of management controls considered necessary. The activities visited or contacted are in Appendix E.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls. The review of the Management Control Program will be discussed in a subsequent report.

Appendix B. Summary of Prior Audits and Other Reviews

Department of Defense

Inspector General, DoD, Audit Report No. 94-162, "Administration of Grants by Defense National Stockpile Center," June 30, 1994, states that the grant documents did not implement provisions of appropriations acts and that the grant recipients did not comply with Office of Management and Budget directives on charging expenditures to the grant. The report recommended amendments to grant agreements to bring them into compliance with appropriations acts and recommended recovery of $2,433,607 in unallowable costs charged to grants. The Defense Logistics Agency agreed to develop comprehensive grant procedures to address the responsibilities and functions of administering Federal grants. The Defense Logistics Agency also agreed to seek collection of unallowable costs charged against grants. As of August 18, 1995, the Defense Logistics Agency collected $57,100 for various questioned costs, was seeking collection of an additional $156,716, and was in the process of making a decision on the allowability of about $2,230,000.

Department of the Army

Department of the Army National Training Center and Fort Irwin Internal Review and Audit Compliance Report No. 94-08, "Audit of the School Grant," November 3, 1994, states that the Army ". . . took on more responsibilities than required . . . " and that the financial controls were good. One stated goal is to get out of day-to-day grant administration. Allowability of trust account fees and timely remittance of interest to the U.S. Treasury are cited as problems. Lack of documentation is mentioned, but no recommendations were made. Corrective actions were taken to obtain a legal opinion on the allowability of the trust account costs and to make quarterly payments of interest.

Certified Public Accountant

The Certified Public Accountant Firm of Vavrinek, Trine, Day & Company, Rancho Cucamonga, California, conducts audits of the School District's financial records. Vavrinek, Trine, Day & Company reviewed the school construction projects as a part of the overall audit of the School District's

financial statements. The report on the "Silver Valley Unified School District Annual Financial Report, June 30, 1994," September 16, 1994, states that the recommendation to improve documentation made in the 1992 through 1993 audit report had been implemented.

Vavrinek, Trine, Day & Company, Rancho Cucamonga, California, "Silver Valley Unified School District Annual Financial Report, June 30, 1993," November 19, 1993, states that the auditors were not able to audit the school construction projects. The report cited the lack of documentation and inadequate internal controls for the school construction projects as the reason that the projects were not audited. The report recommended improving the audit trail of the construction process and maintaining documentation at the School District offices.

Appendix C. Terms of the Grant: Laws, Regulations, Standards, and Agreements

The rules governing the grant are prescribed by Federal and California state laws, regulations, and standards, and by specific agreements between the Army and the School District as set forth in the grant proposal and agreement. The following paragraphs summarize the terms of the grant from all of those sources.

Federal Requirements

The Code of Federal Regulations, title 32, part 278, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments," March 11, 1988, was incorporated in the grant agreement and establishes criteria for grant administration. The Federal code specifies that:

- actual expenditures are to be compared with budgeted amounts during construction;

- prior written approval is required from the grant administrator for changes in scope, plans, and budgets;

- effective internal controls and accountability for all grant property and assets are to be maintained;

- site visits and audits to monitor the progress of the projects are authorized; and

- the School District is to comply with applicable state laws and regulations.

The grant agreement references Office of Management and Budget Circular No. A-87, "Cost Principles for State and Local Governments," January 28, 1981, which establishes principles and standards for determining costs applicable to grants, contracts, and other agreements with state and local governments. Circular No. A-87 requires documentation of approvals by the grantor Federal agency before incurring specific costs and establishes guidelines for the allowability of costs.

State Requirements

The state of California has established regulations and standards that apply to school construction projects. Under the grant agreement, the School District is required to comply with state and local guidelines. The applicable state guidelines include:

- State Allocation Board policy implemented in Education Code Section 17719.3, "Construction Project Management," based on Assembly Bill 303/88 (Leonard) (referred to in this report as Assembly Bill 303), June 28, 1989, requires meaningful negotiations of construction management fees;

- California Public Contract Code Section 20118, "Authorization of Public Corporation or Agency to Make Leases or Purchases," September 1990, which authorizes the governing board of any school district to lease or purchase items without advertising for bids, allowing "piggyback" procurements;

- Office of Local Assistance, State of California, Department of General Services, "Applicant Handbook for State School Building Lease-Purchase Program," January 1992, which specifies a $5-per-square-foot state allowance for furniture and equipment for school construction projects; and

- Office of Local Assistance, State of California, Department of General Services, "Applicant Handbook for State School Building Lease-Purchase Program," January 1992, Form SAB 533, "Client/Architect Agreement," June 1992, which requires that the districts act on behalf of the State in negotiating the best possible terms for the architectural services.

Grant Proposal and Agreement

The grant proposal and agreement specified terms and provisions that may or may not have been covered in the Federal and state laws and regulations. The grant proposal and agreement state that:

- segregation of grant funds is not required;

- interest of $100 per year is allowed to be retained for administrative expenses;

- grant funds are to be deposited in a bank supported by the Federal Deposit Insurance Corporation; and

- if the grantee materially fails to comply with any terms of the award, whether stated in the grant agreement or in Federal or state statute, regulation, or assurance, the Army may wholly or partly suspend or terminate the award (grant agreement Article XVII, "Enforcement, Suspension, or Termination").

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and Type of Benefit
1.	Economy and Efficiency. Suspends grant funds for Fort Irwin school construction projects until audit issues are resolved.	Nonmonetary.
2.	Economy and Efficiency. Prohibits spending grant funds for unallowable purposes.	$2 million in Operation and Maintenance funds put to better use.*

*The monetary benefit is an estimate based on plans and budget data reviewed.

Appendix E. Organizations Visited or Contacted

Office of the Secretary of Defense

Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education), Washington, DC

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller), Washington, DC
Army Forces Command, Fort McPherson, GA
National Training Center and Fort Irwin, CA
Inspector General, Department of the Army, Washington, DC

Non-Defense Federal Organizations and Individuals

General Accounting Office, Los Angeles, CA
Inspector General, Department of Education, Dallas, TX
Inspector General, Department of Health and Human Services, Kansas City, KS

California State Government Organizations

Office of the Comptroller, Sacramento, CA
Office of Local Assistance, Department of General Services, Ontario, CA
San Bernardino County Superintendent of Schools, Facilities Planning Division, San Bernardino, CA
Silver Valley Unified School District, Yermo, CA
Congressman Jerry Lewis Elementary School, Fort Irwin, CA
Daggett Middle School, Daggett, CA
Fort Irwin Middle School, Fort Irwin, CA
Newberry Elementary School, Newberry Springs, CA
Silver Valley High School, Yermo, CA
Yermo Elementary School, Yermo, CA

Non-Government Organizations

HMC Group, Ontario, CA
K.L. Neff Construction Company, Ontario, CA
Stewart's Business and Tax Service, Barstow, CA
U.S. Trust Company of California, Los Angeles, CA
Vavrinek, Trine, Day & Company, Rancho Cucamonga, CA

Appendix F. Report Distribution

Office of the Secretary of Defense

Assistant Secretary of Defense (Force Management Policy)
  Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education)
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Economic Security)
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Inspector General, Department of the Army
Commander, Army Forces Command
Commander, National Training Center and Fort Irwin

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations and Individual

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Honorable Jerry Lewis, U.S. House of Representatives

Part III - Management Comments and Audit Response

Department of the Army Comments

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
109 ARMY PENTAGON
WASHINGTON, DC 20310-0109

REPLY TO ATTENTION OF

July 25, 1995

MEMORANDUM FOR THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Quick-Reaction Report on Allegations to the Defense Hotline on the Use of Grant Funds for Construction of School Facilities on Fort Irwin, California (Project No. 5CK-8005)

We have reviewed the subject report. We are unable to support your proposal to suspend disbursement of $2 million of the remaining grant funds. The rationale for this position is outlined in the attached comments from the Staff Judge Advocates of Fort Irwin and Headquarters, U.S. Forces Command. In addition, the Office of the Army General Counsel reviewed the subject report and the comments thereon and concluded there is no legal basis for suspending disbursement of the remaining grant funds.

Representatives of the Office of the Army General Counsel and your Office of General Counsel are currently discussing the appropriate actions to address the concerns surfaced by your report. Request you postpone further action on this matter until these offices have concluded their discussions.

Helen T. McCoy
Assistant Secretary of the Army
(Financial Management & Comptroller)

Enclosure

JUL 27 1995

DEPARTMENT OF THE ARMY
OFFICE OF THE GENERAL COUNSEL
104 ARMY PENTAGON
WASHINGTON DC 20310-0104

10 July 1995

MEMORANDUM FOR OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT & COMPTROLLER) (ATTN: SAFM-FOI)

SUBJECT: Quick-Reaction Report on Allegations to the Defense Hotline on the Use of Grant Funds for Construction of School Facilities on Fort Irwin, California (Project No. 5CK-8005)

This office has reviewed the above-referenced Draft Audit Report from the Office of the Inspector General, DoD, and the Forces Command comments on that report. We concur with Forces Command's conclusions regarding the report. In conjunction with the Office of the Staff Judge, Forces Command, and the Office of the Staff Judge Advocate, Fort Irwin, California, we will determine whether the Army should modify the terms of the subject grant agreement in view of the DoD IG's findings. However, in our opinion, there is no legal basis for suspending disbursement of the remaining $2 million of grant funds.

Matt Reres
Deputy General Counsel
(Ethics & Fiscal)

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DEPARTMENT OF THE ARMY
HEADQUARTERS, UNITED STATES ARMY FORCES COMMAND
FORT MCPHERSON, GEORGIA 30330-6000

REPLY TO ATTENTION OF

AFCG-IG (36-2)

MEMORANDUM FOR

Assistant Secretary of the Army (Financial Management and Comptroller), 109 Army Pentagon, Washington, DC 20310-0109
Deputy General Counsel (Ethics and Fiscal), Office of the General Counsel, 104 Army Pentagon, Washington, DC 20310-0104

SUBJECT: Forces Command Comments on DODIG Quick Reaction Report, Use of Grant Funds for School Facilities at Fort Irwin, CA

1. Reference U.S. Army Audit Agency memorandum, SAAG-PRF-E, subject: Quick-Reaction Report on Allegations to the Defense Hotline on the Use of Grant Funds for Construction of School Facilities on Fort Irwin, California (Project No. 5CK-8005), 13 June 1995.

2. Staffs at the National Training Center and Fort Irwin (NTC/Fort Irwin) and Headquarters, Forces Command (HQ FORSCOM) provide the enclosed comments in response to subject report. Overall, we disagree with the predominance of the findings, observations, conclusions, recommendations, and monetary benefits presented in the draft audit report. We addressed our objections to inaccuracies in the report to the Department of Defense, Inspector General (DODIG) during audit exit briefings, in a video teleconference, and in a memorandum to Ms. Linda Pierce, DODIG. However, the draft report remained essentially unchanged. Our specific exceptions and comments are keyed to the report text.

Encl

GEORGE A. FISHER, JR.
Lieutenant General, USA
Chief of Staff

Final Report Reference

FORCES COMMAND COMMENTS ON DODIG QUICK REACTION REPORT,
USE OF GRANT FUNDS FOR SCHOOL FACILITIES AT FORT IRWIN, CA
PROJECT 5CK-8005, JUNE 13 1995

1. Introduction. In 1991, Congress directed the Secretary of the Army to issue a $22 million grant to the Silver Valley Unified School District (SVUSD or the District) to support the construction of school facilities on Fort Irwin, California. The grant proposal included provisions for constructing an elementary school, renovating a middle school, and constructing a high school on the installation. In 1994, the Department of Defense (DOD) received a civilian complaint, via the DOD hotline, which alleged that grant money was being wasted. The National Training Center (NTC) conducted an audit of the grant administration and found it to be properly managed for the most part. DODIG subsequently conducted its own audit in early 1995 and found the District to be in substantial non-compliance. Based on its finding, DOD called for termination of the grant program with reimbursement of all unobligated funds. DOD has issued a Quick Action Alert to suspend funding of the project.

2. Executive Summary and Administration and Use of Grant Funds, pages i and 3: We nonconcur with the DODIG allegation that the Army allowed Silver Valley Unified School District (SVUSD) to budget and spend grant funds for purposes not specified in the terms of the grant proposal and agreement. All expenditures under the grant have been reviewed for allowability and reasonableness, in accordance with 32 CFR 278, Office of Management and Budget (OMB) Circulars, and the grant language, prior to release of funds. Questions regarding allowability of costs were forwarded for review and legal opinion to NTC Staff Judge Advocate (SJA), FORSCOM SJA, and Department of Army Office of General Counsel (OGC), prior to release of funds.

Executive Summary and page 4

3. Use of Grant Funds, page 3: We nonconcur that there have been cost overruns due to wasteful or extravagant spending.

Page 4

a. To date, SVUSD has not exceeded (in terms of budget or expenditure) the funding authorized in the grant. Plans and budgets have been revised for various reasons, all of which have been approved; first by the SVUSD School Board, and secondly by

1

Final Report Reference

the NTC on behalf of the Army, to include cancellation of the high school. An NTC-directed audit by NTC Internal Review pointed out that early plan and budget revision reviews and approvals were not executed in accordance with the terms of the grant. However, NTC initiated follow-on corrective actions and current procedures are in accordance with the terms of the grant. Inaccurate procedures did not result in the approval of plans or budgets, or the expenditure of funds, in violation of any provision of the grant.

b. The dollar estimates contained in the grant proposal to execute construction of a high school, an elementary school, and to remodel a middle school were never adequate to complete any of the individual efforts. The grant introduction states that the grant is entered into between the parties "...with the mutual goal of constructing, on military facilities, public school structures..." The grant, Article I -- General, states "...The twenty-two million dollars in federal grant funds are to be used solely for project costs associated with the construction of two schools on military facilities."

c. In addition, the grant, Article VIII -- Additional Funding, states "The Grant Proposal will propose school construction projects which can be completed using the $22,000,000 obligated by this grant agreement. It is understood by the parties that the $22,000,000 obligated by this grant may not be sufficient to construct the schools proposed in the Grant Proposal. In the event more funds are required, the District will use funds acquired by the District to complete the projects, unless further funds are made available by Congress."

Pages 4 and 5

4. Cancellation of the High School Project, pages 3-4: Original construction estimates, developed after the proposal, for the three projects drastically exceeded $22 million. Consequently, SVUSD, due to their lack of additional available funding, reduced the scope of all three projects in an effort to accomplish them within the $22 million provided. Their efforts were not successful as they were never able to get their estimate below $23 million, even after significant concept modifications, which included the elimination of facilities.

a. After the decision was made to revise the plans and budget to eliminate the high school, which was approved by the

2

Final Report Reference

NTC, SVUSD was able to restore the design of the elementary school and middle school to their original scope, adding back in facilities that were previously eliminated. In addition, SVUSD was able to make some quality improvements such as, but not limited to, additional furnishings and equipment and concrete versus asphalt playground areas. The allegation by DODIG that SVUSD Superintendent directed the use of material of the "highest quality" and the increase the furniture and equipment allowance is not factual and a misrepresentation of what occurred.

b. We also nonconcur with the DODIG allegation that the grant administrator failed to request revised plans and budgets from the district, as required by the grant proposal and agreement, when the high school project was canceled. The cancellation of the high school project did not involve a change in the previously specified purposes of the grant. On the grant application submitted by the District, the title and description of the project was categorized as "construction of school facilities". The proposal specifically included the goals of constructing a new elementary school and building out the middle school. In the proposal, SVUSD outlines three main projects, the high school being the last.

c. In Article IX of the grant agreement, Changes in Plans and Purposes, it is stated that the District will not "disburse any funds for plans and purposes other than those identified in the Grant Proposal, nor shall the District disburse grant funds other than in accordance with the disbursement schedule...without first having obtained the prior written approval of the Army Grant Official." **The plans and purposes as set out in the proposal were to construct school facilities at Fort Irwin.** That was the same purpose specified by Congress in the appropriations act. Although, there was no formal written approval, the Administrator was fully aware of the changes in plans.

d. The Grant Administrator, wholly cognizant of the change in the scope of the project, approved the Phase II project. By approving the Phase II project, the Administrator implicitly approved the Superintendent's direction to spend the grant funds on the elementary and middle school.

5. Elementary School Budget and Costs, page 4: We nonconcur with DODIG allegations that the actual costs for construction of

Page 5

3

Final Report Reference

the elementary school constituted a budget overrun and the design of the school was "extravagant."

a. Nowhere in the grant proposal or agreement is there a restriction that the facilities built must be marginally functional. The grant proposal states that the grant's implementation will be part of a plan to "ensure the best possible learning environment is provided for the students." The designs of the schools were not extravagant as indicated but rather representative of the goal of providing quality education.

b. The construction budgets that existed at the time the projects were put out to bid were all underestimated by approximately 20%, merely due to the location of Fort Irwin. The architect failed to recognize the impact associated with construction at a remote site, approximately 40 miles from the nearest town, in the midst of the Mojave Desert. The SVUSD, the NTC, and the Army should not be criticized for executing construction of public schools that will endure to the future, i.e., the 21st century.

Page 5

6. Grant Costs Incurred and Planned, page 4: We nonconcur with the DODIG allegation that the grant money channeled away from the high school project and into the elementary and middle school projects constituted a cost overrun. A cost overrun involves additional expenses above and beyond a previously allocated amount.

a. The amount allocated in this situation was $22 million. To date, the District has not used the full amount of the grant. The District's decision was a valid managerial diversion of funds from a defunct component of a project to viable ones. The budget included in the proposal was a general estimate. Before the grant project began, both parties contemplated the actual expenses incurred might cost more than the propsed estimates. In the grant agreement, no estimates of costs were included. Instead, Article VIII of the agreement states that both parties understand that the amount of the grant may not be sufficient to cover the cost of the intended construction as proposed in the grant proposal.

b. The audit report referenced the amount of money spent on site surveys for the high school project. At the time of the

Final Report Reference

grant agreement, both parties understood that the property in question was in the process of being acquired for the District. The construction/operation plan on page two of the grant proposal provided for acquiring the necessary site acquisition and approval studies. A necessary part of this acquisition was the geographical survey of the property. Funds were spent on architecture and engineering work in reasonable anticipation of purchase of the property. Fees for tortoise studies were also part of the survey costs. The grant agreement required studies, inspections, and monitoring to ensure the proposed high school site was in compliance with Clean Water and Air Acts, and all governmental environmental regulations. It was not until the overall costs of the high school project became unfeasible that the District canceled the project.

7. Revised Plans for Grant Funds, page 5: The audit report recommends the suspension of Phase III funds for the grant project. We nonconcur. To date, SVUSD has not internally approved such a proposal nor submitted a Phase III proposal to NTC for review. Page 6

8. Compliance with the Terms of the Grant and Furniture and Equipment Purchases, pages 5-6: We nonconcur with the DODIG allegation that furniture and equipment purchases by the District exceeded the scope of the intended grant usage. Page 6 and 7

a. The language in the grant proposal and agreement specified that the grant would be used for constructing school facilities. As defined generally in legislation, "construction" of a facility encompasses the acquisition of the initial equipment needed for the functioning of such facility. Citations include 20 U.S.C. 2741 (Vocational Education Act); 29 U.S.C. 706 (Vocational Rehabilitation Act); 38 U.S.C. 8131 (Veteran's Benefits); 42 U.S.C. 2000e (Executive Order); and Public Law 103-382 (Improving America's Schools Act of 1994).

b. Prior to implementation of the grant, SVUSD made clear the fact that it had no money other than the grant funds to construct the school facilities. The parties contemplated that some portion of the funds would be spent on furnishings for the school. NTC requested an advance opinion in accordance with OMB Circular A-87 section C(3). This section allows costs for furniture and equipment when they are reasonably necessary to

5

carry out the purposes of the grant if prior approval is given. Expenditures for equipment and computers were reviewed by NTC SJA, FORSCOM SJA, and DA OGC and found to be allowable to the extent they were reasonably necessary for the functioning of the school facility.

c. OMB Circular A-87 section B(18) also allows costs of materials and supplies necessary to carry out the grant programs without prior approval. A building is not a school unless and until it contains certain equipment that creates the learning environment. In the twenty-first century, computers, visual monitors, televisions, etc. are all parts of the educational process and help develop students who can compete globally. Such equipment is necessary for the enhancement of the academic setting. The purchase of enough equipment to match the student population is reasonable in constructing a new school and was permissible under the grant and relevant OMB cost principles.

d. DODIG auditors also noted that the cost of the data processing equipment exceeded the amount specified by the California Office of Local Assistance in the "Applicant Handbook for State School Building Lease-Purchase Program." The amount spent by the District on equipment for the schools did not violate a provision of the State law because the State law applies only to distribution of State funds. The amount referred to is not a cap on the amount the district is allowed to spend but a limit on what the State will contribute for facility expenses in a school. If the cost of the equipment exceeds the State contribution, the excess must be paid through alternative sourcing. According to the San Bernadino County Cooperative for Adequate Schools (SANCOAST), the State actually encourages districts to seek alternative sources to fund facility equipment. The SVUSD sought alternative funding through the federal grant and used the funds to cover the additional costs of equipment. The grant money was not used to fund the District's other projects but to make the Fort Irwin schools sufficiently contemporary for the students' educational benefit.

e. Approximately $1.459 million has been spent on elementary school furnishings, equipment, and automated data processing equipment. Approximately $.5 million has been spent on middle school furnishings, equipment, and automated data processing

Final Report Reference

equipment. An additional $100,000 is in the budget for middle school furnishings and equipment.

f. DODIG's allegation that SVUSD plans to spend an additional $500,000 for additional furniture and equipment is not factual and, as such, has yet to be submitted by SVUSD to the NTC for review and approval/disapproval.

g. DODIG's allegation that SVUSD plans to spend an additional $200,000 for furnishings and equipment in Phase II construction is not factual as the approved budget for Phase II includes $100,000 for additional furnishings and equipment.

h. It should be noted that, on State funded projects, the State provides minimal funding allowances for school construction, to include furnishings and equipment, and that the funding allowances do not equate to an adequate level of funding. The State requires the school districts to utilize their own funds, or seek alternate avenues for obtaining additional funds to supplement those provided by the State. State funding allowances in no way should be interpreted as funding limits, nor as adequate funding levels for providing reasonable furnishings and equipment.

i. The purchase of furniture and equipment was determined reasonably necessary to construct a usable school facility by the SVUSD School Board and the NTC, and determined by the NTC, to be consistent with the intent of the grant.

9. Computer Equipment Purchases, page 6: We nonconcur with the DODIG allegation that SVUSD inappropriately purchased computers under an existing contract. The audit report cites California Code section 20118 as a prohibition to public agencies adding data-processing equipment on existing contracts unless the equipment is to be leased.

Page 7 Revised

a. For the most part, section 20118 states that, notwithstanding any law to the contrary, the board of a school district may: without advertising for bids...authorize by contract, lease, requisition, or purchase, any public corporation or agency...to lease data-processing equipment, purchase materials, supplies...for the district in the manner...authorized by law to make the leases or purchases. Upon receipt...the

Final Report Reference

school district may draw a warrant in favor of the public corporation...for the amount of the approved invoice, including reasonable costs to the public corporation...for furnishing the services incidental to the lease or purchase."

Revised

b. Section 20118.1 goes on to provide the governing board of a school district to contract with one of the three lowest responsible bidders for the procurement of electronic data processing equipment and supporting software "in any manner the board deems appropriate." The first computer procurement in question was acquired through a contract which piggy-backed a previous contract competitively awarded by SVUSD to the lowest responsible bidder. That former contract included provisions for the allowance of piggy-back orders.

c. We also nonconcur with the DOD allegation that as a result of the manner in which the computers were purchased there was a lack of adequate competition. This lack allegedly resulted in "probably" not receiving the best price for the computer equipment. There is no evidence, however, that the price of the computers was not the best price. Although, there was no quantity discount given, DOD has presented no information to show that the contract price was more than what would be reasonable for such equipment.

Page 7

10. Portable Classrooms, page 6: We nonconcur with the DODIG allegation that the purchase of these facilities is not construction as required under the enabling legislation and should not be allowed.

a. To economically complete construction, the overall school plan included leased modular buildings. These buildings are wholly integrated into the school facility and are permanent in nature, having concrete footings, in ground utility connections and sidewalks leading to the structures. The buildings will be renovated to insure settings are equal to classrooms in the rest of the school facilities and to insure adequate instructional conditions are obtained. This renovation and integration would not be possible with leased facilities. It was determined by SVUSD to be more cost effective to buy the leased buildings and renovate them than to return them and construct new ones. Therefore, the purchase of these facilities to provide public school structures is consistent with the intent of the grant.

8

Final Report Reference

b. The erection of modular buildings is considered construction. The Comptroller General considered the erection of temporary, portable buildings as construction on at least one prior occasion. (Reference 63 Comptroller General 422 (1984).) As defined in this opinion, construction includes any "acquisition, construction, installation and equipment of temporary or permanent works,...facilities and real property." This definition is the same as used in the Military Construction Appropriations Act of 1984 (Public Law 98-116, 1983).

c. In many other statutory and policy references, construction also includes the "acquisition, expansion, alteration, and renovation of existing facilities." (See, e.g., 20 U.S.C. 2471, 29 U.S.C. 706, Public Law 103-382 (1994).) Granting agencies have the right and will specifically regulate general implementation of a grant when they want to exclude traditional interpretations. For example, to avoid the general interpretation of the term "construction", the EPA specifically regulated certain grants under the Clean Water Act for construction of new facilities only and not for the acquisition of existing facilities. See Cole County Regional Sewer District v. United States, 22 CL. Ct. 551 (1991).

d. As Congress did not specifically exclude the acquisition of existing property in the grant appropriation, it is included under the general usage of the term. The term does not necessarily require erection of the physical structure of a building. The modular buildings are physically "attached" to the main school buildings and are an extension of the main buildings. The purchase of trailers or portable buildings is an accepted practice of "construction" for educational facilities nationwide.

11. Trust Account Fees, page 7: The District set up a trust account to manage the grant funds at a cost of about $4,000 per year plus set-up and legal fees. DODIG claimed that these fees were unallowable because separation of funds was not required and only $100 of administrative costs were authorized. Although the agreement did not require separation of funds, it did not prohibit separation either. OMB Circular A-87 allows the costs of fees incurred for accounting and other information systems required for the management of grant programs. SVUSD, a typical school district, was not equipped to readily manage a $22 million

Page 8

Final Report Reference

grant. It was reasonable to set up an outside account management system. Additionally, if the funds had not been separated, there may have been a potential question of impropriety in 1994. This year, for the first time, the District operated in the black and there may have been suspicion that the District would use grant money to supplement their budget.

a. Article VII of the grant agreement provides that any interest earned on advances of federal funds shall be remitted to the U.S. Treasury and mailed to the U.S. Army "except that the first $100 of interest per year earned on such advances may be retained to...for administrative expenses." This language does not specify the limit of administrative costs but rather the limit of interest earned which may be spent on administrative costs. We believe this item may have confused the DOD auditor. The "$100" refers to retained interest only.

b. The Department of Defense Grant Administration Regulation (DODGARS), DOD 3210.6-R, Interim Guidance, February 4, 1994, Part 34.2, paragraph (a)(5)(iii) states such interest may be retained "... to defray administrative expenses." In addition, the Trust Company did not act just as a repository of funds, they performed services to include, disbursement of funds to various contractors, tracking of funds to various contractors, and insurance of grant funds in excess of the $100,000 FDIC insures. The Trust Company insures all prompt payment discounts offered by vendors/contractors are taken and that SVUSD does not incur liabilities due to late payments. SVUSD's financial administration could not offer these cost saving benefits and additional staffing would have resulted in an expenditure of approximately $20,000 per year for the District. The NTC has contacted numerous financial firms, only one of which could perform services similar to those provided by the Trust Company, the cost of which would have exceeded $4,000 annually, as is charged by the Trust Company. The use of the Trust and the reasonable expenses associated therewith, in support of administering grant funds, are consistent with the intent of the grant.

Deleted

12. Consultant Fees Awarded, page 7: We nonconcur with the DODIG opinion that the expenditure of grant funds for the architect and construction management company fees are not in compliance with the terms of the grant proposal and agreement.

10

Final Report Reference

SVUSD awarded contracts to an architect and engineering firm (HMC) and a construction management firm (K.L. Neff) at rates in accordance with fee structures allowed by the State of California. The award of maximum fees is consistent with other contracts awarded to either of these firms. The NTC spoke with both firms and concluded that neither firm would consider negotiation of fees less than those awarded, and both are able to provide several examples of contracts awarded by other school districts at the same rates. The fees are determined to be allowable, allocable, and reasonable, and are therefore, consistent with the intent of the grant.

13. Property Accountability of Property, page 7: We nonconcur with DODIG conclusions that the District's storage of computers in a warehouse is inappropriate and a failure of property accountability on the Army's behalf. Page 8

a. The computers were stored at the warehouse pending completion of the middle school renovation. Temporary storage of the computers in a secure location was unavoidable and a proper security measure by the District. The Army's accountability for the property and assets acquired under the grant was proper. The intended role of the Army over the grant was not to oversee the daily operations but to approve disbursements of the grant money to ensure it was being used for the benefit of Fort Irwin schools. The Army carried out this duty. Involvement by the Grant Administrator beyond general oversight and review is inappropriate unless problems or questions arise. (32 CFR 278, OMB Circular A-102). There is no provision in the grant agreement that would require a greater degree of active participation from the Grant Administrator.

b. DODIG conducted an inventory of computers and found that the computers were accounted for. The equipment (4 computers and a file server) located at the District office were set up temporarily to execute training for Fort Irwin teachers. Once training and middle school renovation are complete, the equipment will be permanently installed at Fort Irwin. The NTC staff will conduct a complete property audit to ensure all equipment is properly installed in the school prior to releasing final payment to the contractor.

11

Final Report Reference

14. Grant Administration, page 8: We nonconcur with the DODIG opinion that the NTC Audit Compliance Report Number 94-08, November 3, 1994, did not help to prevent cost overruns or to correct the deficiencies of the grant administration. DODIG auditors based their opinion on the report's intent to get the Army out of the day-to-day administration of the grant. In accordance with 31 U.S.C. Section 6304, the U.S. Government enters into grant relationships when it is determined that there will be no substantial involvement between the Government and the grantee in carrying out the activity supported by the grant. By virtue of the fact that the Army chose a grant as the instrument to provide SVUSD with the $22 million authorized by Congress, the Army never intended to be substantially involved in carrying out the day-to-day activity supported by the grant.

15. Recommendations for Corrective Action, page 9: Based on our preceding comments and belief that the NTC and the Army acted appropriately in administering this grant, we nonconcur with DODIG's recommendations that disbursement of grant funds be suspended. We also nonconcur with the associated $2 million in estimated monetary benefit. The grounds for termination of the grant are outlined in Article XVII of the grant agreement. This provision allows suspension or termination of a grant by its federal sponsor for failure to comply with the conditions of the grant agreement. As specified in Article XVII, the Army may suspend or terminate the grant if "a grantee materially fails to comply" with the grant conditions. There were no material failures to comply with the terms of the grant, federal law, State law, or regulation on the part of Fort Irwin or the District. Any variance from the grant terms was insubstantial and may be easily corrected at this time.

Page 15 Deleted

16. Adequacy of Management Controls, page 13: We nonconcur with the allegation by DODIG that the management controls over the grant were inadequate to ensure proper execution of the grant terms. DODIG based this evaluation on the requirements of DOD Directive 5010.38, "Internal Management Control Program", April 14, 1987.

a. The DOD Directive requires each DOD component to implement comprehensive programs to provide assurance of proper DOD program operation. Implementation of the grant program at Fort Irwin was not a DOD operation, but a civilian operation

12

administered through a DOD component. The language of the grant agreement specifically stated that the school facilities to be constructed would be owned and operated by the District, not the government.

b. We also nonconcur with the allegation by DODIG that the Army did not supervise the School District in the proper manner, which led to extravagant expenditures of grant funds. It should be the standing policy of the Army to award grants in a manner in which there will not be extensive oversight of the project by the Army. This policy is consistent with the legislative definition of grants as agreements used when "substantial involvement is not expected" between the agency and the recipient. (31 U.S.C. § 6304.) An essential distinction between the different types of governmental funding agreements is the level of federal involvement. (GAO Redbook p.10-10.) The role of the Army in a grant relationship is to approve the original plans and monitor their implementation.

17. Conclusion. We nonconcur with the allegations and findings of the DODIG audit report. Grant administration by Fort Irwin and the District was executed in a proper manner pursuant to the grant provisions and relevant State and federal laws. Further, we request that grant funding not be suspended or terminated for the Fort Irwin project.

13

Audit Response

The following paragraphs are keyed to the format of the Army comments from Forces Command and address the specific issues in the report. Based on the Army comments, we revised portions of the report. Our overall finding, conclusions, and recommendations presented in this report remain consistent with the draft report. We request that the Army provide comments to the final report by October 2, 1995.

Army Comment: 1. Introduction. The Army comments state that a National Training Center internal audit of the grant administration found it to be ". . . properly managed for the most part." The Army further states that ". . . DoD called for termination of the grant program with reimbursement of all unobligated funds. DoD has issued a Quick Action Alert to suspend funding of the project."

Audit Response. Those comments misrepresent the facts in both the Army internal audit and our audit. The National Training Center audit was concluded in November 1994, two years after execution of the grant agreement, and after substantial expenditures had been made. The audit identified improper grant administration by the Army, including failure to require written approval before disbursing funds other than in accordance with the grant proposal, failure to require revised plans and budgets whenever the project changed, and failure to maintain written documentation (National Training Center internal audit report, Part III, paragraph 2.c.). The audit report states:

> Because we did not make the school district submit revised plans and budgets we placed ourselves into a reactive mode, trying to evaluate costs after they are invoiced. The smarter way would have been to evaluate estimated costs for allowability and reasonableness before the school district proceeded with their revised plans.

Everything we know about the Silver Valley Unified School District (School District) indicates that the School District would suffer hardship if invoices for obligations already incurred were disallowed. This does not absolve the Army from its fiduciary responsibility to enforce the terms of the grant. Failure to require revised plans and budgets when the scope of the project changed, and before incurring obligations for significant costs, was a major deviation from the terms of the grant agreement.

In our quick-reaction report, we recommend the temporary suspension of $2 million of grant funds to allow time for the resolution of the issues discussed in this report. At no time in our discussions with the Army or in our draft report did we recommend a termination of the project or a reimbursement of all unreimbursed grant funds. The Forces Command comments misrepresent the recommendations in our draft report.

Army Comment: 2. Executive Summary and Administration and Use of Grant Funds. The Army at Fort Irwin did not allow the School District to budget and spend grant funds for purposes not specified in the terms of the grant proposal and agreement. All expenditures were reviewed for allowability and reasonableness before release of funds, and questions were forwarded for review and legal opinion before release of funds.

Audit Response. We have considered the Army comments in preparing this report and have made some adjustments based on those comments. However, our position on the essential issues remains unchanged from the draft report. We contend that the costs questioned in this report were either not in conformance with the grant or were unreasonable under the circumstances. Specific issues are addressed in the following paragraphs.

Army Comment: 3. Use of Grant Funds. Cost overruns did not result from wasteful or extravagant spending.

Army Comment: a. Early plans and budget revisions were not done according to the terms of the grant, but the budget has not been exceeded, and the inaccurate procedures did not result in the approval of plans or budgets, or the expenditure of funds, in violation of any provision of the grant. In addition, all changes were approved by the School District School Board and the National Training Center on behalf of the Army.

Audit Response. We do not agree that funds were expended in accordance with the provisions of the grant. The grant agreement specified a budget for each school, including the high school. When the high school project was canceled, the Army did nothing to decrease the amount of the grant or to renegotiate the budget for the remaining schools, even though the high school was budgeted for $13 million, more than half the total grant amount. The grant agreement has never been modified and no documentation exists to demonstrate Army involvement in the review and approval of new budgets and plans. The grant administrator did not have copies of revised budgets or plans when we arrived to perform the audit in January 1995. Without the revised budgets or plans, the Army could not have given approval to the School District in advance.

Army Comment: b. and c. The estimates in the grant proposal to execute construction of a high school and elementary school and to renovate a middle school were never adequate to complete any of the individual projects. The Army quoted the grant agreement, stating that the ". . . grant funds are to be used solely for project costs associated with the construction of two schools on military facilities." The Army also quoted the provision of the grant agreement specifying that if more funds were required, the School District would use its own funds to complete the projects, unless Congress provided additional funds.

Audit Response. The grant proposal, dated August 26, 1992, incorporated by reference in the grant agreement, clearly contemplates three projects, complete with project costs and completion dates. The intentional submission of a grant proposal that could not under any circumstances be accomplished with prescribed funds would have been disingenuous at best. Documentation that we

reviewed indicated that all three projects could be accomplished for $22 million. A letter from the superintendent of schools to the National Training Center, dated September 11, 1992, spelled out the alternatives to bring the projects in under budget. That document also recognized the possibility that the School District would fund costs in excess of $22 million, as specified in the grant agreement at Article VIII. We did not find any mention of canceling any of the projects in order to limit expenditures to $22 million.

Army Comment: 4. Cancellation of the High School Project. Original construction estimates, *developed after the proposal,* [emphasis added] drastically exceeded $22 million. The District reduced the scope of the projects to try to get them within the $22 million provided, but were never able to get the estimates below $23 million.

Audit Response. The fact that construction estimates were developed after the proposal was submitted speaks volumes about the administration of this grant. The letter from the superintendent of schools to the National Training Center indicated that, including all the "bells and whistles," the total budget came to $25 million. That figure was reduced to $23,222,844, including $11,404,549 for the high school, $7,142,314 for the elementary school, and $4,300,981 for the middle school. The superintendent expressed in writing the hope that all three projects could be accomplished at the $22 million ceiling.

Army Comment: a. After the decision was made to eliminate the high school, the School District was able to restore the elementary school and middle school to their original scope and to make some quality improvements such as additional furnishings and equipment and concrete instead of asphalt playground areas. The Army also stated that the School District superintendent did not direct the use of material of the "highest quality" and did not increase the furniture and equipment allowance.

Audit Response. Assuming a $25-million-upper limit, with all "bells and whistles," and deducting $11.4 million for cancellation of the high school (at the reduced scope price), the maximum that the other two projects should have cost, using the School District's figures and with all amenities, would have been approximately $13.6 million. Before Congress awarded the $22 million, the School District had been independently processing a proposal with the Department of Education for construction aid to complete elementary and middle school projects, totaling $12 million, at Fort Irwin. Consideration of all of the facts indicates that a reasonable limit on expenses for the elementary and middle schools was between $12 million and $13.6 million. The remaining $8.4 million was not necessary to those two projects, even for construction and renovation at the original budget and scope.

We have evidence that the School District did not believe that spending the entire $22 million on the elementary school and middle school was necessary to achieve quality education, even after canceling the high school. According to a letter, dated February 10, 1994, from the School District architect and engineering firm to its construction management firm, the School District

intended to determine whether the grant could be rewritten to use the remaining funds to upgrade the existing Silver Valley High School (not located on Fort Irwin).

We have obtained written documentation that the School District superintendent directed the upgrade in quality of material and increases in furniture and equipment allowances, exactly as our report states. The architect confirmed that he was directed to use the highest quality material and increase the furniture and equipment allowance. The excessive construction costs incurred on the elementary school certainly seem to support the use of the highest quality and greater amounts of everything.

Army Comment: b. and c. The grant administrator did not need to request revised plans and budgets from the School District when the high school project was canceled because that cancellation did not involve a change in the previously specified purposes of the grant. The grant was for the construction of school structures and the high school was last in the list of three projects contained in the grant proposal. The Army agrees that the grant agreement prohibits disbursement of funds for plans and purposes other than those in the grant proposal, or other than in accordance with the disbursement schedule, without prior written approval (grant agreement, Article IX). The Army contends, however, that although the Army gave no formal written approval, the grant administrator was aware of the changes in plans.

Audit Response. The DoD, Office of Deputy General Counsel (Inspector General), opined that the purposes of the grant agreement cannot be so circumscribed. The Appropriations Act language was for support of construction of public school structures, to be located on military facilities (DoD Appropriations Act, 1992, Public Law 102-172, November 26, 1991). Congress was presented with a justification for this grant before its inclusion in the Appropriations Act. The House Committee on Appropriations, in considering the grant, stated:

> Fort Irwin has demonstrated its unique need for an education facility for dependents of active duty military personnel. The present facility for grades K-8 is deteriorating and augmented by thirty-two portable trailers. Grade 9-12 students are transported over one and one-half hours away to a high school. Accordingly, the Committee has agreed to provide a one-time appropriation for a new educational facility for these military dependents. A general provision has been added to allow $22,000,000 to be transferred to the State of California to build a new school complex . . . .
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> Language has been added to operation and maintenance, Army which transfers $22 million to the local educational authority at Fort Irwin, California, for the construction of an elementary and a high school at Fort Irwin.

In November 1994, Fort Irwin's own audit of grant administration, signed by the Deputy Commander and Chief of Staff, concluded that:

> Because we were inexperienced in grant administration we initially took on more responsibilities than required and then did not perform all we agreed to. Specifically, *when the school district changed the project,* we did not require the submission of a revised plan and budget to evaluate the allowability and reasonableness of the new costs. [emphasis added](At Part III, para 2.)
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> At the point we were required to take action we didn't. The agreement requires the administrator's written approval before the school district could disburse funds other than in accordance with the proposal. This means that *a revised plan and budget should have been required from the school district whenever the project changed. . . .* Because we did not make the school district submit revised plans and budgets we placed ourselves into a reactive mode, trying to evaluate costs after they are invoiced. The smarter way would have been to evaluate estimated costs for allowability and reasonableness before the school district proceeded with their revised plans. [emphasis added](At Part III, para 2.c.)

Code of Federal Regulations, title 32, part 278, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments" (Uniform Rules), was incorporated by reference in the grant agreement at Article III. Those rules also require prior approval for changes (part 278.30, "Changes") as follows:

> (c)(2) Construction Projects. Grantees and subgrantees shall obtain prior written approval for any budget revision which would result in the need for additional funds.
>
> (d) Programmatic changes. Grantees or subgrantees must obtain the prior approval of the awarding agency whenever any of the following actions is anticipated: (1) Any revision of the scope or objectives of the project (regardless of whether there is an associated budget revision requiring prior approval).

Given the Fort Irwin audit conclusions, the grant agreement, and the Uniform Rules, advance approval should have been secured for the changes made to this grant. Just because construction of school structures would still take place on Fort Irwin after the cancellation of the high school project, it is not true that no change was made in the purpose of the grant. In addition, the fact that the high school is listed last in the grant proposal does not diminish its importance to the grant. The high school comprises more than half of the budgeted amount for the grant and was mentioned by Congress as one of the specific needs of Fort Irwin for which the grant money was being appropriated.

Army Comment: d. By approving the Phase II project, the grant administrator implicitly approved the superintendent's direction to spend the grant funds on the elementary and middle school.

Audit Response. The DoD, Office of Deputy General Counsel (Inspector General), opined that implicit approval is not the action required by the grant agreement or by the Uniform Rules. On the contrary, advance written approval is specifically required. In this case, the grant administrator did not approve Phase II until March 1995, after completion of the elementary school and the administrative addition to the middle school, after the scope of the project had been changed by the School District, and after substantial additional expenditures were incurred. The approval of Phase II was not in advance at all.

Army Comment: 5. Elementary School Budget and Costs. Costs for construction of the elementary school did not constitute an overrun and the design was not extravagant.

Army Comment: a. The grant does not restrict facilities to those that would be marginally functional, but provides for "the best possible learning environment." The school designs were not extravagant but represent the goal of the grant, to provide quality education.

Audit Response. We do not advocate facilities that are marginally functional; however, we also do not advocate excessive or extravagant facilities. As discussed in responses to numbers 3 and 4, the School District proposal with "bells and whistles" was budgeted at $13.6 million for the elementary school and middle school projects. Under that plan, about $8.4 million of grant funds would still be available after completion of the school construction. Under the latest plan we reviewed, no funds will be available for other uses. The School District increased allowances, changed construction materials, and attempted to build the two schools at Fort Irwin to be of the highest quality, aspiring to the canceled "America 2000" standard and using the entire $22 million.

Army Comment: b. Increased costs of the projects resulted from the architect's failure to recognize the impact of construction at a remote site, causing construction budgets to be underestimated by approximately 20 percent.

Audit Response. Using the $9 million budgeted in the grant proposal for the two projects as a starting point, a 20-percent increase would bring the total cost to $10.8 million. Budgeted costs in the latest plans that we reviewed have increased by over 100 percent. Using the "bells and whistles" proposal mentioned earlier ($13.6 million), a 20-percent increase would bring the total to about $16.3 million. In either case, the planned expenditure of the entire $22 million on the two schools represents a significant increase and is not justified.

Army Comment: 6. Grant Costs Incurred and Planned. Money taken from the canceled high school project and applied to the elementary and middle school projects does not constitute a cost overrun.

Army Comment: a. Costs are not overrun if the total amount allocated to the grant is not exceeded ($22 million). The Army states that the budget included in the grant proposal was a general estimate, that the grant agreement contained no cost estimates, and that the parties understood that the grant might not be sufficient to cover the cost of the construction as proposed in the grant proposal.

Audit Response. We disagree that the ceiling figure of $22 million must be exceeded for a cost overrun to exist. The grant proposal contained three projects, with budgets and timelines for each. Changes in the scope or objectives of the projects required prior approval. Required approvals were not secured in a timely manner and the grant proposal and agreement were not modified. Assuming that the grant proposal was submitted in good faith, that the request for grant funds was presented to Congress in good faith, and that increases in costs made completion of the three projects impossible within the $22 million allowed, then overruns have occurred. The fact that a $13 million budgeted project was scrapped because of cost increases to the other two projects signifies an overrun. To say otherwise ignores the facts. The Army also quoted the provision of the grant agreement specifying that if more funds were required, the School District would use its own funds to complete the projects, unless Congress provided additional funds. See the responses to items 3 through 5 for a discussion of program costs.

Army Comment: b. At the time of the high school site surveys, both parties understood that the property surveyed was in the process of being acquired for the School District. Funds spent for the survey and tortoise studies were therefore reasonably expended in anticipation of purchase of the property.

Audit Response. The grant proposal specified that the structures would be constructed on Fort Irwin. Without some advance indication that the Army could and would acquire new property, the DoD, Office of Deputy General Counsel (Inspector General), opined that the expenditure of grant funds to survey property that was known to be off the military installation was unreasonable. The acquisition of the land was not a certainty and no survey should have been done before the Army acquired the land.

Army Comment: 7. Revised Plans for Grant Funds. Grant funds should not be suspended for Phase III. The Army position indicates that a Phase III proposal has not been submitted for review.

Audit Response. If the Phase III proposal has not been submitted for review, we do not understand the Army objection to suspending the $1.3 million of grant funds that are uncommitted to the approved Phase I and II projects. We have seen the Phase III proposal and it contains items that we believe are not in compliance with the terms of the grant.

Army Comment: 8. Compliance With the Terms of the Grant and Furniture and Equipment Purchases. The purchase of furniture and equipment were within the scope of the grant.

Army Comment: a. "Construction" of a facility is defined generally in legislation to encompass acquiring the initial equipment needed for the functioning of such facility, citing United States Code, title 20, section 2741, "Vocational Education Act"; United States Code, title 29, section 706, "Vocational Rehabilitation Act"; United States Code, title 38, section 8131, "Veteran's Benefits"; United States Code, title 42, section 2000e, "Executive Order"; and Public Law 103-382, "Improving America's Schools Act of 1994."

Audit Response. Construction is defined in many different ways, depending upon the purposes of the legislation and the implementing regulations. Congress provided for DoD to administer this grant. The Appropriations Act provided that the funds were to support the construction of public school *structures,* to be located on military facilities [emphasis added]. Nowhere in the legislation or the legislative history was furniture or equipment identified as part of the project. Congress is capable of specifying what "construction of structures" means, and we believe that it did. In addition, the issue of furniture and equipment was not specifically addressed in the grant proposal or agreement.

In DoD, a military construction project is defined generally to include all military construction work necessary to produce a complete and usable facility or improvement to an existing facility (United States Code, title 10, section 2801[b]). A "facility" is defined as a building, structure, or other improvement to real property (United States Code, title 10, section 2801[c]). Construction work would include surveys and site preparation as well as acquisition and installation of equipment and appurtenances (United States Code, title 10, section 2802). Implementing regulations make it clear that the equipment covered in the definition means installed equipment (e.g. air conditioners, heating systems, etc.). The Army definition of construction and repair projects is similar, including installed equipment but not computer equipment or furniture (see, Army Regulation 415-15, paragraph 2-3, and Appendix H, paragraphs H-1 through H-3). The DoD, Office of General Counsel (Inspector General), opined that the fact that the grant is included in the DoD Appropriations Act for administration indicates that Congress intended normal DoD definitions and standards to apply.

Army Comment: b. Before implementation of the grant, the School District made clear the fact that the School District had no money other than the grant funds to construct the school facilities. Further, the parties contemplated some spending on furnishings, and the National Training Center requested an advance opinion in accordance with Office of Management and Budget Circular A-87, section C.3. The Army opinion found that the expenditures were allowable to the extent reasonably necessary for the functioning of the school facility.

Audit Response. Whether the School District had other funds available or not is not relevant to whether grant funds could be spent on furniture and equipment. In the letter from the superintendent to the Army at Fort Irwin in September 1992, the budget data specified a total furniture and equipment expenditure of $331,000 for the elementary and middle schools, far less than the approximately $1.6 million already expended. The $331,000 figure is close to the California standards incorporated in the grant agreement. That document also recognized the possibility that the School District would fund costs in excess of $22 million, as specified in the grant agreement at Article VIII. We did not find any mention of canceling any of the projects in order to limit expenditures to $22 million.

We identified only one "advance opinion" request from Fort Irwin. That request resulted from a decision of the National Training Center Chief, Project Management Branch, and a National Training Center Staff Judge Advocate

opinion dated September 19, 1994, that purchase of computer equipment was not part of construction and was not allowable. On October 14, 1994, the Forces Command Office of Staff Judge Advocate opined, based on input from the Army General Counsel, that computer equipment reasonably necessary for the functioning of the school facility could be purchased with grant funds. Office of Management and Budget Circular A-87 provides that the acquisition of computer equipment is allowed only with the specific prior approval of the grantor (Office of Management and Budget Circular A-87, Attachment B, section C.1). In this instance, documents reviewed indicate that invoices totaling approximately $570,000, dated June 14, 1994, were presented to the School District for payment for computer learning centers at the elementary and middle schools. Documents dated June 15, 1994, indicate that the vendor and the District entered into products and service agreements for the invoiced materials, with payment due on August 1, 1994. Further, the School District appears to have approved the acquisition of an additional $1,070,000 in computer equipment on June 27, 1994, and as early as September 14, 1994, deliveries of those additional computers were requested. The documents show that the School District had acquired nearly $1.6 million in computer equipment before any request for or receipt of an "advance opinion" regarding the allowability of such purchases under the grant.

Army Comment: c. Office of Management and Budget Circular A-87, section B(18) allows purchase of materials and supplies necessary to carry out the grant without prior approval. Such expenditures should include equipment sufficient to create the learning environment.

Audit Response. The DoD, Office of Deputy General Counsel (Inspector General), opined that the requirements for advance approval of the acquisition of furniture and equipment would apply. Section B(18), Attachment A, Office of Management and Budget Circular A-87, is a general provision. The requirements of Sections C.1 and C.3., Attachment B, are specific and related directly to the expenditures in question. The grant is not intended to provide a fully furnished school operation, including all of the high-tech equipment anticipated for the 21st century. The grant is for the construction of school structures.

Army Comment: d. California standards do not limit the amount that school districts can spend on equipment. The state merely limits the amount that the state will fund for such items. The state encourages the school districts to seek alternative sources to fund facility equipment. The School District sought alternate funding through the Federal grant.

Audit Response. We do not agree that grant funds were alternative funding for spending in excess of California guidelines; grant funds were the only funds used. In this case, the Federal Government stepped into the shoes of the state by incorporating state standards in the grant proposal and agreement. From that perspective, costs in excess of the state standards should be treated as the state would treat them and be funded with alternative, non-Federal sources. The grant agreement clearly states that the School District would use its own funds

or seek additional funds from Congress if costs exceeded $22 million. The grant does not provide for the cancellation of projects in order to free grant funds for other uses.

Army Comment: e., f., and g. The Army stated that the additional $500,000 for furniture and equipment is not factual and has yet to be submitted by the School District to the Army for review. The Army pointed out that the Phase II approved budget was for $100,000 rather than the $200,000 quoted in the audit report.

Audit Response. The additional $500,000 for furniture and equipment is for Phases II and III of the construction project. The $500,000 is composed of $100,000 for Phase II furnishings and equipment; an estimated $90,000 for video equipment, which is included in the Fort Irwin Middle School electrical contract, also under Phase II; and a Phase III item described as "district furniture and equipment" for $309,000. Clearly, that the Army was not aware of the $90,000 of equipment included in the electrical contract. The Phase III outline that we obtained from the construction management company was apparently also not provided to the Army as of this report. If Phase III has not been approved, then the Army should not object to the suspension of the $1.3 million of grant funds not already committed to Phase I or II. We are concerned that a pattern has been established whereby the School District changes the plans and budgets without prior review and approval by the Army, leaving the Army to review and approve the expenditures after the fact. That process has occurred throughout Phase I and should not be allowed to continue through Phases II and III as well.

Army Comment: 9.a., b., and c. Computer Equipment Purchases. Computer equipment was purchased in accordance with California Code Section 20118. Competition on the computer purchase was adequate. DoD had no evidence to establish that the price charged was unreasonable.

Audit Response. We agree that the California Code Section 20118 allows so-called "piggyback" acquisitions of equipment by school districts if determined to be in the best interests of the district, but that does not mean that the acquisition was appropriate for the grant, or that the lowest price was obtained. The mechanism utilized by the School District to purchase the computers was not prohibited, even if the mechanism was not appropriate. We have revised this report and deleted our objections to the "piggyback" purchase.

The purchase of the $570,000 computer learning labs is a different story, however. The documentation in support of the purchase showed that the School District had contracted for the computer equipment on June 15, 1994, and only subsequently, on July 20, 1994, began running a "Notice to Bidders" in local newspapers, requesting proposals for the same equipment. The vendor submitted a bid on July 28, 1994, for the same amount that it had already invoiced in mid-June. No other bids were received and the purchase went forward. The Uniform Rules require the grantee to perform either a cost or price analysis in all procurements (Code of Federal Regulations, title 32, section 278.36[f], "Contract Cost and Price"). In the event that the costs charged to the grant were based on catalog or market prices, a price analysis

should have been conducted to determine the reasonableness of the proposed price (Code of Federal Regulations, title 32, section 278.36[f][1], "Contract Cost and Price.") We did not find evidence of a cost or price analysis in support of this purchase.

Army Comment: 10.a., b., c., and d. Portable Classrooms. The purchase (rather than lease) of modular buildings (trailers) is cost-effective and essential to renovating the trailers. The use of trailers is accepted construction practice for educational facilities, and is included in the general definition of construction used by the Comptroller General of the United States.

Audit Response. We agree that portable trailers used as classrooms may constitute "construction" for schools in California. However, we question the reasonableness of purchasing admittedly deteriorating trailers for renovation in this case. In the legislative history quoted in our response to item 4.b. and c., Congress indicated that part of the Fort Irwin need for the grant was based on the fact that the facility for kindergarten through eighth grade was deteriorating and was augmented by 32 portable classrooms. Congress provided funds to "build a new school complex." Purchasing the old portable classrooms will not improve the quality of life for the students or provide a learning environment consistent with the School District's goal of providing facilities that will endure into the 21st century.

According to the Army, the School District determined that the purchase of the leased portable classrooms would be more cost-effective than construction. Such a decision is suspect, however, when one considers that purchasing the portable classrooms will benefit the School District budget by eliminating the lease payments for those trailers. While the School District budget will get relief, the students will not benefit because they will still be attending classes in the portable classrooms that were part of the reason that Fort Irwin needed new school facilities. The purpose of the grant was not to solve the financial problems of the School District, but to improve the learning environment for the students at Fort Irwin.

Army Comment: 11.a. and b. Trust Account Fees. A trust account costing approximately $4,000 per year was reasonable given the size of the grant and the inability of the School District to manage such a program. The $100 amount in Article VII of the grant agreement applies only to the retention of accrued interest to defray administrative costs. Administrative costs are allowable under Office of Management and Budget Circular A-87, and the costs of the account for this grant were reasonable, given the services provided by the trust company.

Audit Response. We do not agree that the amount of the trust account fees is reasonable for the services provided. The trust company issues checks based on expenses compiled by the construction management company and submitted to the project manager for payment. The trust company prints the checks and returns them to the construction management company for distribution. The construction management company provides accounting services for the School District, not the trust company. Although the grant administrator initially disallowed the trust account fees, the fees were deducted directly from the

account, apparently without the knowledge of the grant administrator. The excessive fees did nothing to benefit the students or the education process. We do not believe that the School District would have chosen to use such an expensive service if the funds had been their own.

The grant agreement does not require or prohibit the segregation of the grant funds. Although we do not object to the segregation of the funds, we do object to the excessive cost of using the trust company. According to the accounting procedures that other school districts used on their construction projects, the use of a trust account is not common practice. The School District's reported sensitivity to potential perceptions of impropriety regarding the use of the funds does not justify the high-fee trust account. As evidenced by this report, even the use of the trust account did not prevent controversy over the use of the grant funds. Article VII of the grant agreement allows the School District to retain $100 of interest earned per year, to be used for administrative fees. It seems that the cost of maintaining a separate bank account for grant funds should be around the $100 amount, not the $4,000 amount charged by the trust company.

Army Comment: 12. Consultant Fees Awarded. Fees paid to the architect and engineering firm and construction management firm were in accordance with fee structures allowed by the State of California. The award of maximum fees was consistent with other contracts, and neither firm would work for less. The fees were allowable, allocable, and reasonable.

Audit Response. We only objected to the fact that the School District did not conduct negotiations for the fees to the architect and engineering firm or the construction management company. We concede that negotiating a lower rate at this juncture would be nearly impossible. The lack of negotiation of fees is just another example of the result of the lack of grant administration by the Army. We deleted the discussion of consultant fees from this report.

Army Comment: 13. Property Accountability. Storage of computers in a warehouse is not inappropriate and is not a failure of property accountability.

Army Comment: a. and b. Accountability for the property and assets acquired under the grant was proper, and involvement beyond general oversight is inappropriate. The Army acknowledged the presence of computers at the School District office and stated that the situation was temporary. The National Training Center staff will conduct a complete property audit before releasing final payment.

Audit Response. We disagree that accountability for the property and assets acquired under the grant was proper. When we began our audit, inventory records were inadequate. Storage of the computers in the warehouse would not have been a problem had proper inventory records been maintained. During the audit, inventory records were provided to us, but the records were inaccurate and incomplete and did not correspond to the limited invoice information available. Full accountability was not achieved before we departed the audit site. The grant agreement specifically requires accountability over property and assets.

We appreciate that the Army recognizes the need for an inventory of the property. The Army stated that an inventory will be conducted to ensure that all equipment is properly installed in the schools before releasing final payment. The problem is that the computers are already paid for. Property accountability should have been established at the time that the assets were delivered and before payment was made.

Because property accountability was not maintained from the time of purchase to installation, we believe that a reconciliation of the inventory to the grant fund disbursements is required to be sure that all items the Government paid for are physically present and accounted for. The Army should also establish procedures to verify the property inventory every two years in accordance with the Code of Federal Regulations, title 32, part 278, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments." Property accountability issues will be addressed in a later report.

Army Comment: 14. Grant Administration. The Government enters into grant relationships when the Government will not be involved substantially with the grantee in carrying out the activity supported by the grant. The Army cited United States Code, title 31, section 6304, to justify that position.

Audit Response. The Army seems to interpret the phrase "no substantial involvement" in the extreme, hence its "hands off" policy for grant administration. We do not recommend substantial involvement in day-to-day operations in administering the grant, but we do recommend that grant administration be sufficient to enforce the terms of the grant proposal and agreement. The Comptroller General has stated that a grant agreement involves the ". . . establishment of an ongoing relationship between Federal agency and recipient, with the precise terms of that relationship established by the agreement itself." The use of a grant instead of a contract does not exempt the Army from involvement with and oversight of the School District in this case. Grant administration should be sufficient to secure efficient program execution, effective program oversight, and proper stewardship of Federal funds.

Army Comment: 15. Recommendation for Corrective Action. The Army nonconcurs with the recommendations of the quick-reaction report, claiming that "There were no material failures to comply with the terms of the grant . . . on the part of Fort Irwin or the [School] District. Any variance from the grant terms was insubstantial . . . ."

Audit Response. Failure to submit revised plans and to secure prior written approval of major changes to the grant proposal were substantial variances from the requirements of the grant agreement. In particular, cost overruns of $13 million constitute a substantial variance from the grant. The issues discussed in this report identify other specific violations of the grant proposal and agreement. The DoD, Office of Deputy General Counsel (Inspector General), opined that the grant agreement contains ample authority in Article XVII to suspend grant payments, to disallow costs, to suspend or terminate the current award, or to take other legally available remedies. We identified $2 million designated for purposes that we believe are improper or

unreasonable under the grant. Suspension of the $2 million will not cause delays in primary construction efforts or cost additional money because the funds are not available.

Army Comment: 16. Adequacy of Management Controls. Management controls over the grant were adequate to ensure proper execution of the grant terms.

Army Comment: a. The DoD Internal Management Control Program does not apply in this instance because the grant administration was not a "DoD operation but a civilian operation administered through a DoD Component."

Audit Response. The DoD, Office of Deputy General Counsel (Inspector General), opined that grant administration must be responsive to DoD needs for efficient program execution, effective program oversight, and proper stewardship of Federal funds. Administration of grants and cooperative agreements within DoD Components is a DoD program and is subject to DoD policies and procedures.

Army Comment: b. The Army states, "It should be the standing policy of the Army to award grants in a manner in which there will not be extensive oversight of the project by the Army." The Army also states that such a policy is consistent with the legislative definition of grants, that a grant agreement is used when "substantial involvement is not expected" between the agency and the recipient (United States Code, title 31, section 6304). The Army further stated, "The role of the Army in a grant relationship is to approve the original plans and monitor their implementation."

Audit Response. The use of a grant agreement does not exempt the agency from involvement with and oversight of the grantee. The appropriating legislation in this case stated that "the Secretary may require such terms and conditions in connection with the grants authorized by this section as the Secretary considers appropriate." The grant agreement specified a number of procedural requirements and safeguards, and expecting those terms to be enforced by the grant administrator is not unreasonable. The grant agreement also incorporated the requirements of the Uniform Rule (Code of Federal Regulations, title 32, part 278, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments"), with its extensive provisions, and the cost standards of Office of Management and Budget Circular A-87. The agreement, and the referenced rules, provide extensive authority to the grant administrator and corresponding responsibilities that we do not believe are excessive.

The Comptroller General has stated that a grant agreement involves the "establishment of an ongoing relationship between Federal agency and recipient, with the precise terms of that relationship established by the agreement itself." Even in the absence of oversight authorization in grant legislation, the right to oversee the expenditure of funds and require an accounting for the use of grant monies is "implicit in the creation of the grantor-grantee relationship." Finally,

"the creation of a grantor-grantee relationship between the agency and the [grantee] would be meaningless if the grantor's role was limited to the ministerial function of disbursing funds at the grantee's request."

Army Comment: 17. Conclusion. The Army nonconcurs with the findings of the draft report, stating that grant administration by Fort Irwin and the School District was proper pursuant to the grant provisions and state and Federal laws. The Army requests that grant funding not be suspended or terminated for the Fort Irwin project.

Audit Response. We disagree that the Army properly administered the grant. The problems identified in our audit point to the need to change the Army approach to grant administration to properly protect Federal funds and achieve the real purpose of the grant. We appreciate the Army concerns over completion of the school construction projects, and we have tempered our recommendations accordingly. We recommend that $2 million of grant funds be suspended and that the questionable items that the School District would like to purchase be disallowed pending the final resolution of the issues we have raised in this report.

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